9. Risk, return and responsible behaviour

9.1 Key messages

- **Financeable plan on both actual and notional financial structure:** We are targeting credit ratings of Baa1/BBB+ for the notional company and A3/BBB+ for the actual company. The plan submission reflects Ofwat's early view CPIH real appointee WACC of 3.29%.
- **Efficiently financing the plan:** We expect that the WACC will be reviewed by Ofwat prior to the Final Determination, including updating previous estimates and taking account of market conditions. We are confident at the targeted ratings that efficient access to debt markets will be forthcoming and, subject to Ofwat reviewing and updating the risk-reward balance and allowed returns at the Final Determination, we will be able to attract £1.35 billion new equity from our listed parent to support our target capital structure for the actual company
- **Clear commitment to responsible policies on gearing, dividends, benefit sharing and executive pay:** Our approach reinforces trust and confidence in the company and its responsible treatment of all stakeholders. The plan reflects a resilient capital structure with actual company gearing below 65% and notional company gearing close to 55% throughout AMP8 and resilient to extensive stress testing.
- **Upfront commitment to customers of sharing outperformance:** CommUnity Share 2030 builds on our strong track record of sharing outperformance with customers and other stakeholders. Across 2010-2025 we have invested over £2 billion above our regulatory allowance in additional totex, pensions deficit repair contributions and support for customers in difficult financial circumstances. Shareholders contributed over £1.2 billion (60%) of this, representing shareholder funds that were reinvested in the business for the long term rather than distributed as dividends.
- **Fairness between current and future bill payers:** RCV run-off rates aligned with the natural rate and use of long-established CCD methodology delivers a fair sharing of bills between generations.
- **Notional company RoRE range of -6.3% to 4.4%, midpoint of -0.9%, on CPIH real basis:** Broadly aligned with Ofwat recommended range.
- **Notified item proposed recognising uncertainties in Bioresources requirements:** Risks to landbank availability and uncertainty on future regulatory obligations mean that an uncertainty mechanism for the Bioresources price control is justified in order to efficiently finance this activity.
- **UU continues to set a robust benchmark in terms of financial resilience:**

. - Gearing at 66% as at 31 March 2023;

- Robust credit ratings: A3 with Moody's, an Issuer Default Rating (IDR) of BBB+ and senior unsecured debt ratings of A- with Fitch, and BBB+ rating with Standard & Poor's (S&P) all on stable outlook;

- Prudent level of headroom and liquidity and our board has provided a high quality long-term 12 year viability statement out to 2035;

- Responsible approach to financial risk management and UK leading approach to pension risk management; and,

- Group parent is publicly listed providing robust market evidence for water sector beta and access to deeper and more liquid pools of equity capital versus privately owned peers.

9.2 Structure

In order to deliver excellent levels of customer service and environmental performance while restricting bill increases for customers to no more than is absolutely necessary, and which can be financed on a fair, efficient and sustainable basis, it is important to ensure that our business plan for 2025-30 and beyond strikes an appropriate balance of risk and return, delivered responsibly. This chapter explains how we have understood and assessed the risks in the business plan and provides evidence of the risk management measures we have in place. It demonstrates our sustainable, resilient and responsible approach to capital structure and financing.

Our business plan demonstrates a responsible capital structure, financial policies and corporate behaviour underpinned by our strong track record, which inspires trust in our long-term stewardship of the business for the benefit of all of our stakeholders.

This chapter is structured as follows;

- **Section 9.3** sets out the risk and return balance in our plan, including:
  - Our risk analysis and RoRE ranges by price control and for the business overall
  - How we will manage downside risk associated with the business plan
  - An overview of our benefit sharing, dividend and gearing policies. Further background information on our dividend policy is provided in supplementary document *UUW70 - Capital structure and dividend policy.*
  - Our updated CommUnity Share 2030 scheme, providing additional voluntary support and benefit sharing for customers.
- **Section 9.4** covers our approach to key financial elements of the plan including how we listened and acted early on Ofwat's "Putting the sector back in balance" publications[1] and subsequent licence changes as well our approach on WACC (with considerations in relation to the cost of capital being provided in supplementary document *UUW73 – Cost of Capital Considerations),* taxation, pensions and base dividend assumption.
- **Section 9.5** sets out details of our cost recovery rates. *UUW71 - RCV run-off rates* provides additional evidence for this section
- **Section 9.6** includes our approach to considering financeability. *UUW69 - Evidence of financeability* provides additional evidence underpinning this section as well as the third party reports in *UUW74 – Capital market assessments.*
- **Section 9.7** describes our frontier approach to financial resilience, providing robust stakeholder and servicd protection. *UUW 68 – Financial resilience* provides fuller analysis and the Board's long term viability statement.
- **Section 9.8** summarises our approach to executive performance pay, with additional evidence provided in supplementary document *UUW72 - Executive performance pay*.

9.3 Risk and return balance in our plan

A fair alignment of risk and return that works for all stakeholders is crucial to a successful business plan, placing risks where they are best able to be managed.

It is essential that equity investors are engaged with the incentive regime. Companies require shareholders to invest in them and shareholders substantially bear the risks and rewards, and volatility of returns, associated with good or poor performance. Where performance is poor, shareholders are required to fund the additional costs (e.g. ODI penalties; fines), as well as incurring the reputational impacts. Conversely, it is appropriate that there are incentives to improve performance and to supplement base returns with rewards for strong performance.

In this context, it is essential that investment returns are commensurate with the level of systematic risk. This helps to secure that, in an environment where there are many competing investment needs in global infrastructure (such as climate change mitigation and pathways to net zero), the UK water sector must be able to attract investment to keep the cost of financing the sector as low as possible, especially given the significant investment programmes that likely need to be delivered over AMP8.

[1] ofwat.gov.uk/consultation/putting-sector-back-balance-consultation-proposals-pr19-business-plans/

At the same time, customers expect to pay for a level of service and environmental performance that are calibrated at stretching levels, delivered at efficient cost, and would expect companies to be penalised where they fall short. If this balance is correctly struck and well communicated by companies, then this should inspire trust and confidence that the sector is working in the interests of all stakeholders.

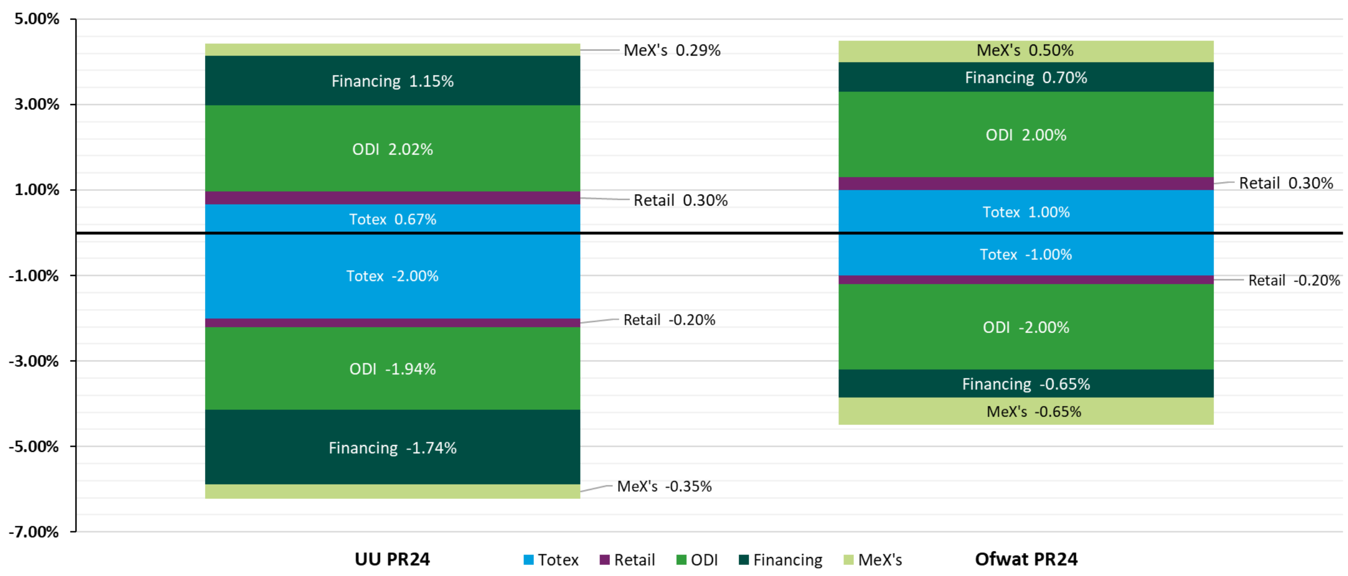
In putting forward our stretching and ambitious plan, we seek to directly satisfy these objectives.

Our business plan provides a fair risk and return balance to promote our efficient delivery of the significant service and environmental performance improvements expected by customers. Our ambitious package of Performance Commitments are calibrated to deliver excellent levels of service whilst delivering value for money. We recognise that we need to deliver all elements of our plan at the most efficient level of cost as possible, given the ongoing cost of living pressures on customers, and recognising the scale of delivery over AMP8 and beyond.

9.3.1 Our assessment of risk and RoRE ranges

We have set out our view of the RoRE ranges resulting from our plan in data table *RR30* and in Figure 9-1 below. This suggests an overall RoRE range of -6.28% to 4.43%. This demonstrates a broadly downward skewed risk profile, reflecting the stretching costs and performance targets that we have set in our plan, but with clear opportunities for rewards in the event of exceptional performance and clear (and significant) penalty consequences in the event of underperformance.

Figure 9-1 - Proposed PR24 UUW RoRE range



Source: Ofwat PR24 RoRE Chart tool 1.0 and submission data tables RR30.

We believe that this represents a reasonable balance of risk and return across our plan, and is also consistent (on a component basis) with Ofwat's guideline RoRE ranges that it expects to apply to each source of RoRE variation.

We note, however, that this analysis excludes the impact of Price Control Deliverables (PCDs), which apply an asymmetric downside risk to the RoRE range. Ofwat has insisted that PCDs should be applied asymmetrically, as a "penalty only" clawback mechanism, to compensate customers for non-delivery. However, the proposed design leads to companies being negatively impacted in all circumstances:

- If companies invest early to deliver early, in order to avoid the risk of PCD penalties, then they will incur additional (unfunded) financing and operating costs as a result of that early delivery; or
- If companies deliver late, then PCDs would likely compensate customers by more than the benefit to the company of any delay in expenditure.

Therefore, the only way that companies could avoid PCD related losses (and hence recover allowed returns) would be to deliver perfectly to the timetable assumed in the price control, for each and every enhancement (as it is not possible to trade off early delivery in one area against late delivery in another, given the asymmetric approach that Ofwat is expecting). This seems highly infeasible, and hence would result in an inherent downward skew in the ability of companies being able to recover allowed returns.

Ofwat should reconsider this aspect of its PCD approach to allow some (even if only limited) greater symmetry in each PCD mechanism, and/or the ability for a company to be able to trade early delivery off against late delivery, both within and between PCDs, even if the totality of the net value arising from PCDs is capped at zero.

9.3.2 Managing the downside risks

In delivering our AMP8 plan, the downside risk represents those severe scenarios in which events prevent us from delivering our commitments and results in a lower RoRE. In section 9.6 we quantify this downside risk in financial terms by representing a low case (P90) position.

Water companies can incur downside risk through a series of macro, company specific or exogenous factors. These can include physical or operating risks such as weather events or climate change or contractual and financial risks from counterparties such as the exposure to non-household retailers, Competitively Appointed Providers of large direct procurement schemes, as well as increased new inset appointments and variations with water companies usually acting as the default supplier of last resort. Downside risks have the potential to stretch beyond the P90 low case position, although we consider such an outcome to be extreme and therefore unlikely.

Here, we summarise the main ways in which we will manage the downside risk with a firm lens on long-term responsible stewardship, to ensure that customers and investors are best protected. In considering these options it is worth bearing in mind our past performance of effectively managing extreme scenarios, be it macro conditions (e.g. the pandemic) or weather related events, through our high levels of resilience, whilst continuing to deliver on our commitments to customers and generate returns for investors, and achieving this without resorting to many of the extreme mitigations available to us, described below.

The key levers that we employ to manage downside risk are as follows:

- **Risk management framework** – This well-established and best-practice process ensures we have a comprehensive understanding of the risks we face, that these are monitored and we have adequate and effective mitigations in place to reduce the likelihood of these risks taking place and the impact if risks do crystallise.
- **Alignment of pay with delivery for customers, communities and the environment** – Our remuneration arrangements provide strong incentives on employees and executive directors to effectively manage the downside risks in the best long term interests of customers.
- **Financial resilience** – Our robust levels of financial resilience, means we have the ability to effectively absorb and respond to extreme events providing further protection for customers.
- **Regulatory mechanisms** – There are various mechanisms in place to help manage the downside risks and influence the extent to which these impact customers and investors.

Regulatory mechanisms

The various cost sharing regulatory mechanisms are generally effective at enabling us to manage downside risks. For example, the totex sharing model allows us to share certain costs between customers and investors and provides the means of funding additional discretionary investment during the AMP to deliver even more improved outcomes where it is cost beneficial to do so. During AMP7, we reinvested £500 million of outperformance through this mechanism to help us improve environmental outcomes (including delivery of the pledges we set out in our Better Rivers plan) and to accelerate service improvements for customers.

In certain limited circumstances, water company licences allow the reopening of price limits subject to a materiality threshold. If, at the time of the price determination, uncertainty exists over the occurrence or impact of an event such that it is not included in the final determination, companies can raise these as notified items subject to Ofwat approval.

9.3.3 Notified item - uncertainty in future Bioresources requirements

The bioresources sector is undergoing significant and unpredictable change, including evolving (and tightening) regulation to meet Waste Framework Directive requirements (which also encapsulates IED regulations) and multiple regulatory and market drivers that constrain the use of the agricultural outlet for biosolids recycling – either by reducing the landbank available, or placing restrictions on the use of land (such as requiring reduced rates of spreading) such that more land would be required. This could drive a significant change (and likely a deficit) in the supply/demand balance in the agricultural landbank required for sludge recycling.

These changes have the potential to drive very significant new investment requirements. In contrast, changes in the past have been relatively small, when compared with the potential scale of investment required in future price control periods.

Our AMP8 business plan is focussed on low regret interventions, where we have high certainty in the scope and the investment needed to meet new service standards. We have taken a balanced view of the agricultural outlet risk by proposing enhancement investment to improve the resilience of the supply chain to agriculture in order to maintain the agricultural outlet for biosolids recycling.

However, despite industry efforts, the regulator has not provided a clear and consistent planning assumption for the future use of biosolids in agriculture. National landbank modelling, designed in collaboration with the EA, revealed the possibility of future changes leading to a significant deficit in the landbank available in plausible scenarios.

A reduction and/or deficit in the agricultural landbank could arise as a result of multiple external factors including; implementation of known regulations where requirements have not been confirmed, such as Farming Rules for Water (FRfW) (whereby the full impact of those regulations has not impacted on water companies, due to other factors such as the intervention by DEFRA through statutory guidance to curtail EA enforcement of regulation); the introduction of new regulations, such as the EA sludge strategy moving recycling to agriculture into Environmental Permitting Regulations. The response of third party land owners to changing regulatory requirements, or to an adverse public perception of using biosolids in agriculture and the subsequent negative impact that would have on the demand for biosolids. It is unclear which of the numerous potential triggers will be activated between now and 2030. The compounding effect that multiple changes may have is also unclear.

Scenario testing of our core pathway evaluates the impact that an adverse agricultural outlet scenario would have if it materialises in AMP8. If it did, this may require immediate costs (for UUW alone) of c.£300 million in AMP8 to divert biosolids away from agriculture alongside commencing and committing to a further £1 billion of investment in AMP8 and AMP9 to deliver a resilient and long term alternative outlet for biosolids.

These risks have not been addressable through the WINEP process. The industry presented to Ofwat, EA and DEFRA a view of scale of the risk and the investment needed to meet WINEP bioresources drivers, including a scenario where two thirds of the biosolids could not be recycled to agriculture. Most of this was rejected by the EA due to incompatibility with its interpretation of its WINEP drivers. It is important to recognise that this rejection by the EA was not a rejection of the potential investment need, but a rejection of its classification under that WINEP driver. Regardless of the WINEP outcome, if some of the more extensive outcomes arise (such that there is a significant deficit in available landbank), then significant investment will be required, regardless of whether or not the WINEP drivers align with those needs.

The timing of a significant change is also currently unclear, and unlikely to be clarified prior to PR24 final determinations. Industry discussions on defining the requirements for the implementation of Farming Rules for Water with the EA are continuing with no set date for a conclusion. The published EA sludge strategy has recently been updated specifically to remove a date of implementation. The published DEFRA statutory guidance on farming rules for water (which currently enables water companies to continue use of agricultural outlets, without risk of prosecution under FRfW) must be reviewed at the latest by September 2025. The outcome of that review cannot be known at present but it could be the trigger for a significant change to the agricultural outlet for biosolids recycling early in AMP8.

It is not acceptable for companies to carry the full risk of a significant reduction in the agricultural outlet. This concern is particularly acute for Bioresources, given that there is no customer sharing mechanism for the Bioresources costs. This leaves companies exposed to the full cost of the investment required to meet new service standards with no mechanism for recovering the efficient resources to meet these statutory obligations.

For the reasons set out above, our business plan for Bioresources (a) includes high certainty requirements that provide a clear scope and cost with low regrets investments (including our enhancement cases to improve biosolids quality and supply chain resilience to help maintain this outlet), and (b) includes the necessity of an uncertainty mechanism (this Notified Item) as a means of managing the uncertainty in future investment requirements. We believe this is the right approach to best protect the interests of customers – it is better than seeking to recover significant additional amounts up front from customers and then refund them in the event that those investments are not required.

We believe that the agricultural outlet risk should be recognised as a Notified Item, as defined under condition B of our instrument of appointment. We consider that it is sufficiently unclear as to whether any future change would qualify as a Relevant Change in Circumstance, given that (a) the precise route to the loss of landbank is currently unclear, and (b) whether or not the loss would arise directly as a change in legislation to water companies, or indirectly via restrictions placed onto the agricultural sector. What is clear is that it is the loss in available landbank itself that is the trigger to required investment, not the specific route (legislative or otherwise) by which that occurs. Therefore, a Notified Item is warranted in this case.

Furthermore, the precise investment needs will depend on the extent of the landbank restrictions and how this is best co-ordinated around the industry to manage it. It is important to recognise that a deficit in available landbank would be an industry–wide issue, not just a regional issue for UUW. Therefore co-ordination will be required (as we have previously flagged with Ofwat, to seek its support) to ensure that investment requirements across the sector are efficient. The IDoK process is best placed to give appropriate consideration to the specific investment needs identified.

We are aware that other companies have also identified the agricultural outlet as a risk and will likely be seeking similar or alternative forms of uncertainty mechanism. What is essential is (a) that Ofwat accepts the need for some form of uncertainty mechanism in AMP8 to manage the risk to landbank availability, and (b) that it is recognised that it is an industry issue, and therefore Ofwat applies a common and co-ordinated approach.

In addition to the landbank risk, the Bioresources sector is also facing further uncertainty in future changes to site base permits (or exemptions) under waste permitting regulations. For example, this would include a future change in IED guidance published by EA that leads to an IED permit variation, which specifies the improvement conditions (i.e. the additional investment we need to make) to meet those requirements. It is the conditions set out in the permit that establish the required new investment. During recent correspondence between UUW, EA and Ofwat, it has been stated that such permit changes may not qualify as a relevant change in circumstance under Condition B. If that is the case, then a further notified item is required to manage changes under waste permitting regulations that were not reflected within PR24 determinations. Alternatively, if Ofwat agrees that such permit variations are a relevant change in circumstance, then we would agree that this component of our proposed Notified Item would not be required.

The notified item that we are seeking is therefore for both:

- The immediate costs and future investment requirements arising from a significant change in the supply/demand for available landbank that is currently relied upon as an agricultural outlet for recycling of sewage sludge; and,
- The costs required to meet new improvement conditions arising within permits (or the requirements to meet exemption criteria). This could be either as a variation to an existing permit (or exemption), or from the creation of a new permit.

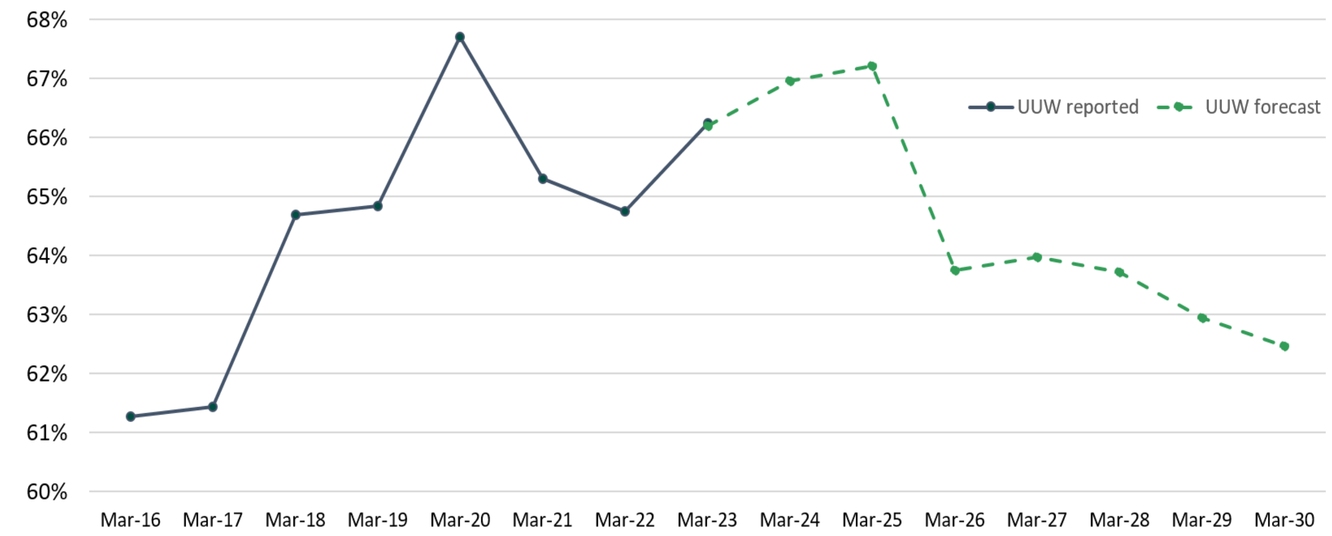
Considerably more information about our approach to Bioresources and the environment that is giving rise to our request for a Notified item is provided in supplementary document *UUW58 – Bioresources Business Plan.*

9.3.4 Strong track record of fair financing

We not only embody resilience in our approach to financing: we seek to demonstrate fairness to customers. As a responsibly financed company, we have eschewed opportunities to undertake financial engineering which would have exposed customers to high levels of gearing or which would have led to excessive dividend payments. This reflects our board's focus on long-term responsible financial stewardship rather than short-term financial engineering. We have also sought to share the benefits of outperformance between investors and customers where these have been realised – taking a broader view based on the long term social contract.

Gearing: We have always adopted a responsible approach to gearing with UUW having a long-track record of reporting gearing levels below the water sector average. This is expected to continue going forward, with UUW's gearing projected to remain below 65% throughout AMP8, as shown in Figure 9-2 below.

Figure 9-2 – UUW reported/projected RCV gearing



Source: Mar-16 to Mar-23 = APR data tables 1E; Mar-24 to Mar-30 = UUW business plan projections

Dividends: Across AMP7 UUW restricted its base dividend policy to only pay 4% of the equity portion of the RCV, broadly aligned with Ofwat's PR19 allowed cost of equity and down from 5% previously. Payments above the base dividend level are only made where there is demonstrable outperformance.

Benefit Sharing: UUW has a strong long term track record of sharing outperformance with customers and other stakeholders across 2010-25. This includes:

- Totex reinvestment of £1,170 million, with a shareholder contribution of £535 million
  - AMP5 spend (£240 million total; £70 million shareholder contributions) covering Future concept of operations; Private sewers and Spend to save initiatives;
  - AMP6 spend (£430 million total; £215 million shareholder contributions) covering expenditure to improve resilience, proactive drought mitigation and AMP7 flying start investment; and,
  - AMP7 planned spend (£500 million total; £250 million shareholder contributions) covering: £250 million to help us improve environmental outcomes, making an early start on implementation of the Government's new Environment Act including delivery of the pledges we set-out in our Better rivers plan; and £250 million to accelerate improvements in service for customers to drive ODI performance
- Company funded pension deficit repair contributions of £310 million (in excess of regulatory allowances) comprising £185 million in AMP5 and £125 million in AMP6; and,
- Support for customers in difficult financial circumstances of £565 million, with a shareholder contribution of c£380 million. This includes company funded support schemes across all AMPs: Payment matching (c£195 million); Support Tariff (c£80 million); Trust Fund (c£70 million) and Social Tariff (c£14 million) plus £20 million special customer discount in 2014/15, in addition to of customer funded schemes including Watersure, Back on Track support and help to pay social tariffs

In total, this represents over £2 billion of reinvestment over the period, of which £1,225 million was met through shareholder funds that were reinvested in the business for the long term rather than distributed as dividends.

9.3.5 Further cementing our responsible approach to gearing, dividends and benefit sharing in AMP8

We are continuing to refine our comprehensive approach to gearing, dividends and benefit sharing in AMP8 which builds on a track record of paying a reasonable and sustainable dividend, maintaining gearing in line with our responsible board policy and voluntary reinvestment of outperformance across AMP5-AMP7.

During AMP7, we established a dividend policy with robust and well-evidenced principles, which complies with or exceeds the updated licence condition P requirements and historic Ofwat guidance including "Putting the sector back in balance" publications. Our board remains committed to providing clear explanations of our approach and decision (including any change in dividend policy) as part of our Annual Performance Report. This was recognised with UUW being one of only four water companies who paid a dividend in 2021/22 to be assessed by Ofwat as:

"The company has generally met our current expectations on dividend policy and its application"[2].

For AMP8, we have revisited our principles with the aim to make them clearer to understand and offer more explicit alignment with the licence changes introduced by Ofwat. We expect that our approach to dividends, both in policy and practice, will exceed the requirements now embedded in the licence. We recognise the guidelines published by Ofwat in IN23/04 and the Board is committed to taking into account these guidelines to support its decision making when the Board makes its assessment of declaring or paying dividends. In particular:

- When declaring or paying a dividend, the Board will:
  - Take account of a full range of matters including service delivery for customers and the environment;
  - Consider company performance in the round and over time, encompassing all aspects of delivery against its licence, including delivery against performance commitments, investment plans, cost efficiency and other areas of its operations;
  - Give consideration to the company's current and future investment needs and financial resilience over the short and longer term; and,
  - Have due regard to whether the dividend rewards efficiency and the effective management of the business, including performance across a number of periods.
- The Board recognises that it has a responsibility to explain its decisions in relation to declaring and paying dividends and that customers and other stakeholders expect to understand how the Board has taken into account the full range of stakeholder interests and consideration of the external environment when making decisions about the dividend.
- Whilst the Board recognises that there is a strong presumption amongst investors in favour of dividend payments, and that this is a significant and legitimate part of the returns to equity that attracts necessary investment in the company, there may nevertheless be future circumstances where dividend payments need to be curtailed, deferred or suspended. Examples of such circumstances could include when payment of a dividend would be expected to materially impair the ability of the company to deliver services in future, materially impair the company's ability to finance the delivery of such services or would materially impair service recovery from an identified major incident which was known to be resulting in a service failure.
- The Board will set a base dividend that takes account of the price determination made by Ofwat and the company's anticipated level of performance against that determination. The Board also recognises that RCV growth is also a component of equity returns.

The Board notes that Ofwat will review companies' approach to dividends paid or declared each year and that Ofwat may undertake enforcement action against companies that are in breach of the dividend licence condition. Given our commitment and ambition to delivering fair and balanced returns for all stakeholders, we would like to assure Ofwat and all stakeholders that were the company to be subject to any such action, this would be treated as a matter of serious concern. We consider that our approach in AMP7 has demonstrated the strength and depth

[2] Ofwat's Monitoring financial resilience report 2021/22 (published December 2022)

of our commitment to a considered, fair and balanced approach to dividend payments and we expect this to continue in AMP8.

The four key principles we expect to deliver against when we consider gearing, dividends, benefit sharing and our overall performance are set out below:

1 – Responsible stewardship

- Before declaring any dividend (including the base dividend) the company will take into account the full range of factors described above and whether a decision to declare or pay a dividend is consistent with the company's commitments and obligations under its licence.
- The Board will explain its decisions in the context of the company's performance and resilience and expect to be held to account for such decisions. Disclosures will be thorough and transparent and clearly communicated to stakeholders.

2 - A fair return to shareholders

- Assuming normal gearing levels (in the range 55-70% Net Debt/RCV[3]), and based on Ofwat's "early view" WACC, we would expect to set a base dividend of the allowed cost of equity minus 1%, reflecting equity reinvestment to fund an element of the expected real RCV growth. This equates to a dividend yield of approximately 3% using Ofwat's early view real cost of equity of 4.14%, and consistent with Ofwat's expectation for companies with real RCV growth and that perform in line with their determinations for 2025-30.
- If it performs well, then the company might also distribute additional dividends reflecting demonstrable current or past outperformance (usually derived through the delivery of cost efficiencies, strong ODI performance, financial outperformance or a combination of these) up to 3% above allowed base cost of equity.

3 - Commitment to sharing benefits with customers

- Based on our business plan submission, we propose to provide £200 million of contribution to financial assistance schemes over AMP8, funded entirely by the company. Contributions to these schemes would be made each year, before consideration of any dividend payment.
- In the event that the company adopts a high level of gearing (above 70%) then we are committed to sharing the financial benefits arising from gearing exceeding 65% equally with customers.
- Consistent with our AMP7 commitments, dividend distributions made above a proposed 3% of RoRE outperformance threshold above the base cost of equity will be matched 1:1 with customer benefits through discounted bills, targeted financial assistance or funding of community projects through CommUnity Share 2030. This means that if dividend distributions to shareholders were much higher than forecast in the business plan, customers would receive additional benefits through this matching.

4 - Dividends will support appropriate gearing

- The dividend policies above assume that the company's gearing (Net Debt/RCV) is within the normal range of 55% to 70%.
- Where gearing falls below the lower bound then the base dividend could be increased up to the greater of 100% of profit after tax or 100% of the nominal allowed equity return for AMP8, in order to manage the company's gearing position efficiently and align it with credit ratings targets for the actual company and/or the notional company structure. This would only apply up to the point at which gearing reached 55%.
- Where gearing rises above the upper bound of 70% then the Board would give explicit consideration to whether it should restrict the base dividend in order to lower gearing and explain its decision. In the event that the Board approved a base dividend which left gearing above 70% then it would explain to stakeholders what the company's forward looking plan was to manage gearing back to within the normal range.

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[3] Measured by net debt divided by adjusted RCV (adjusted for actual spend, timing differences and including full expected value of end-of-AMP ex-post adjustment mechanisms)

In truly exceptional and unforeseen circumstances, the board may have to deviate from these principles – for example to meet changing statutory requirements or during unexpected and exceptional events. However, if it were necessary to do so, the board would explain its reasoning to customers and stakeholders so that it could be judged on the extent to which it sought to meet these commitments and the reasons why a deviation was justified.

Modelling our AMP8 policy based on our AMP7 performance
We have modelled for illustrative purposes the impact of applying the AMP8 policy and benefit sharing arrangements in relation to our AMP7 performance, assuming that instead of the £500 million of totex reinvestment in environmental and customer service improvements that was made in AMP7, the board had chosen to distribute £500 million of additional dividends to shareholders. Under this scenario our modelling shows that our AMP8 dividend policy would give customers c£220 million of additional benefits through the CommUnity Share 2030 commitment.

Further details of our comprehensive approach to gearing, dividends and benefit sharing in AMP8 - including this modelled approach - are set out in supplementary document *UUW70 – Capital Structure and Dividend Policy*.

9.3.6 CommUnity Share 2030: additional support and benefit sharing for customers

In AMP7, we committed to providing £71 million of company funded financial support for customers as well as financial benefits for customers and communities if dividends or gearing were to rise significantly above thresholds set in our business plan. We propose to further improve this for AMP8 with our CommUnity Share 2030 commitment. This comprises three key sources of benefits for customers:

- **Shareholder funded financial support for customers:** Based on our submitted business plan we would propose to provide £200 million of company funded, customer support schemes within the base element of the commitment, targeting improved affordability. This funding is prioritised over dividend payments.
- **Gearing incentive:** In the event that gearing exceeds 70%, we guarantee to share half of the financial benefits arising from gearing exceeding 65%. This provides assurances to customers that they share any upside from higher levels of gearing.
- **CommUnity dividends:** In the event that we pay dividends that are in excess of 3% of RoRE above the base cost of equity we guarantee a 1:1 matching contribution for customer benefit on the excess.

This scheme is distinct from any voluntary reinvestment in services that the company might make, which would be inside the standard regulatory mechanisms.

Customer benefits arising under the gearing or dividend mechanisms could manifest as bill reductions, targeted customer support or other schemes that benefit customers and communities in the North West. We would consult with customers and stakeholders to determine the best use of such funds. Funds would not be used to displace or anticipate investment in services or assets that the company would expect to make in the normal course of business. In this way, customers would see clear, additional benefits in the event that gearing or dividends were much higher than expected in the business plan.

Taken together, these steps provide customers with an upfront assurance of protection in the event that significant outperformance is distributed as dividends and/or gearing is elevated to high levels. The effectiveness and impact of this is clearly demonstrated in our modelling as noted in 9.3.5 above (see “Modelling our AMP8 policy based on AMP7 performance” immediately above.)

This builds on our strong track record of sharing outperformance with customers and other stakeholders over the long term. Across 2010-2025 we have invested over £2 billion above our regulatory allowance in additional totex, pensions deficit repair contributions and support for customers in difficult financial circumstances. Shareholders contributed over £1.2 billion (60%) of this, representing shareholder funds that were reinvested in the business for the long term rather than distributed as dividends.

9.4 Components of a stretching and responsible plan

There are a number of key components that make a plan demonstrably stretching. At its core, it must embed stretching performance targets for services to customers. In Chapter 5 we set out our approach to setting these in a way that will require us to innovate in order to deliver and which exposes investors to out- and under-performance risks which are consistent with customer values. A stretching plan must deliver cost efficiency. Chapter 8 describes the steps we have taken to ensure that we will provide services at an efficient level of expenditure which minimises the demand for financing and ensures that customer bills are kept as low as possible, despite delivering a record investment programme.

This section considers the financial components of a stretching plan and describes how we intend to deliver our plan in a responsible manner which is responsive to a variety of stakeholder needs. We have demonstrated during AMP6 and AMP7 that we have listened and acted upon Ofwat's "Putting the sector back in balance" publications, our approach to delivering an appropriate financial structure, paying our fair share of tax and ensuring that pension promises made to employees are kept. We build on this approach for AMP8 taking account of Ofwat's recent licence changes and related guidance.

9.4.1 A responsible and industry leading finance structure

Low embedded financing costs and sound management of financial risks

Our robust financing structure supports the delivery of our business plan by ensuring we maintain appropriate credit ratings, can adequately manage financial risk and raise finance at efficient costs. We have delivered one of the sector leading financing costs which has not only benefited customers in our own region – including the sharing of outperformance in AMPs 5, 6 and 7 – but has also contributed to a lower industry average cost of debt, setting tougher benchmarks and thereby reducing bills for all customers in England and Wales. We have clearly articulated hedging policies to manage our exposure to inflation, interest rates and currency exchange rates.

Responsible financing structure enabling absorption of cost/performance shocks

Water companies provide a vital public service so it is in the best interests of customers and all stakeholders for water companies to be financially resilient and to avoid excessive levels of financial risk. Our capital structure has been set to ensure long-term financial resilience. As a conventionally financed company we have consistently operated with a responsible level of gearing over a long period, ensuring that we have a robust functioning equity buffer and are not subject to overly restrictive covenants.

Our capital structure is set with reference to long term, transparent and well communicated policies approved by the board. These include our listed parent having a longstanding debt to RCV gearing target range of 55 to 65% (consistent with Ofwat's notional company gearing assumptions across the applicable regulatory period) and an aim to retain an A3 rating with Moody's and an IDR of BBB+ (senior unsecured debt rating of A-) with Fitch. For S&P, both the notional and actual company key metrics are more stretched, being on the cusp of BBB/BBB+. However, updating the WACC and cost of equity to take account of more recent market data would likely improve S&P's primary credit metric – FFO to debt.

Our policies in these areas have proven robust and resilient over several AMPs. Our responsible track record and demonstration of high levels of financial resilience is detailed in section 9.7.

Our business plan maintains this stable and financially resilient profile, crucially by retaining a robust and functioning equity buffer to absorb cost/performance shocks.

9.4.2 Assessing the industry cost of capital

For AMP8 we have adopted Ofwat's early view WACC guidance provided in the final methodology for each of our wholesale price controls, along with the margin that underpins our residential retail price control. Our business plan assumes the same WACC and cost of equity for each price control.

It is widely acknowledged that the WACC for PR24 will be higher than at PR19, driven by the step-change in interest rates and the macro-economic environment observed since the start of 2022 that has continued during 2023, which inevitably results in a higher cost of capital for both debt and equity. Table 9-1 below shows the

Ofwat early view appointed and wholesale cost of capital on a nominal and CPIH real basis, along with the cost of equity.

The breakdown of the appointed cost of capital into its constituent parts is included in data table *RR25*, which mirrors the breakdown given by Ofwat in its 'early view' WACC. The wholesale cost of capital has been allocated into its constituent parts following Ofwat's guidance to allocate the retail margin deduction to the cost of equity through flexing the unlevered beta input assumption. The breakdown of the wholesale cost of capital into its constituent parts is included in data table *RR26*.

Table 9-1 Appointed and wholesale business cost of capital and retail margin for AMP8

AMP8	Nominal	CPIH stripped
Gearing	55%	55%
Cost of equity	6.22%	4.14%
Appointed vanilla WACC	5.36%	3.29%
Impact of 1% household retail margin	(0.06)%	(0.06)%
Wholesale vanilla WACC	**5.30%**	**3.23%**

Source: Ofwat's final methodology and UU calculations to inflate CPIH stripped rates by 2% to get nominal rates

We have adopted Ofwat's 'early view' WACC in our business plan submission for consistency and comparability purposes. We recognise that Ofwat's WACC is a spot position as published in December 2022 using a data cut-off of 30 September 2022. Due to subsequent significant changes in interest rates and other market derived data, and against a much changed macroeconomic environment, we do not consider the 'early view' WACC to be fully reflective of the cost of capital over AMP8. We expect Ofwat to update the WACC appropriately at its final determinations and we set out the broader considerations in relation to such update in supplementary *UUW73 - Cost of Capital Considerations.* This supplement also draws on evidence from independent reports on the Cost of Capital for PR24 by Frontier Economics.

When Ofwat makes its final determination on the WACC, we expect this will need to be a fair and balanced position reflecting not only quantitative matters as outlined in the supplement referenced above, but also considering the vital qualitative components. These include the significant capital investment needs for the sector and investor choices around deploying their capital in assessing a global opportunity set (with many competing demands such as the renewal of infrastructure in response to climate change and pathways to net zero). These challenges must be reflected within the assessment.

As part of our consideration of the proposed WACC guidance/methodology, we commissioned Frontier Economics to set out their view of the cost of capital using a 30 June 2022 data cut-off for an initial report and a 30 April 2023 cut-off for an update report. Frontier Economics' assessment is summarised in Table 9-2 below.

Table 9-2 Frontier cost of capital assessment for AMP8

AMP8	**30 June 22 CPIH stripped**	**30 June 22 CPIH stripped**	**30 April 23 CPIH stripped**	**30 April 23 CPIH stripped**
	Low	**High**	**Low**	**High**
Gearing	**60%**	**60%**	**60%**	**60%**
Cost of equity	**4.54%**	**5.54%**	**4.81%**	**5.71%**
Appointed vanilla WACC	**3.08%**	**3.67%**	**3.53%**	**3.96%**
Impact of 1% household retail margin	(0.07)%	(0.09)%	(0.07)%	(0.09)%
Wholesale vanilla WACC	**3.01%**	**3.58%**	**3.46%**	**3.87%**

Source: UUW73 Cost of Capital Considerations – Appendix: Frontier Economics Report

In light of the above and what we set out in *UUW73 Cost of Capital Considerations*, we consider that Ofwat's early view cost of equity of 4.14% is especially low. We appreciate that Ofwat recognises that equity has an important role to play in the sector, and there is an increasing need for equity investment. With a large planned investment spend which we anticipate will require new equity investment, we fully endorse this position.

Setting a WACC that provides a fair return to investors will necessarily impact final customer bills. We have conducted Affordability and Acceptability Testing (AAT) to understand how customers' views of future bills change as bills increase. In addition to testing average bills based on Ofwat's 'early view' WACC (see Chapter 3.6) we have tested a higher bill scenario, using the higher Frontier Economics WACC of 3.96%. Under this WACC, average household bills are projected to be £26 higher in real terms in 2030.

Levels of household acceptability under the higher bill scenario remain stable at 70% for both the 'early view' WACC bill and the Frontier WACC based bill. Overall the plan is still supported, with non-households, vulnerable customers and lower income customer groups all considering the plan acceptable. Levels of household bill affordability is slightly lower, moving from 15% to 14%, with householders saying they would find it hard to afford bills increasing from 48% to 50%.

Under a higher bill scenario we expect a need for higher levels of affordability support for low income households. Our proposed affordability support plan (see Chapter 4.6) does not exhaust the maximum contribution to social tariffs supported by customer engagement (see data tables *SUP15.11* and *SUP15.12*), meaning further affordability solutions could be extended under a higher bill scenario if needed.

Our assessment of an AMP9 WACC

As Ofwat did not give a view on an AMP9 WACC in its final methodology, we have used the 75th percentile cost of equity from the Frontier Economics' updated report in combination with the gearing and embedded/new costs of debt included in the Ofwat AMP8 'early view' WACC but using a new/embedded debt ratio of 49% (being a straight line extrapolation of the 17% average AMP8 new debt, being 0% at the start of AMP8 to 34% at the end of AMP8, with AMP9 assumed to start at 34% and end at 64%, giving an average of 49%) for this period.

9.4.3 Demonstrating adherence to financial resilience best practice and fully embracing the strengthened licence conditions

UUW has a strong track record of listening to and acting upon Ofwat's publications. This includes Ofwat's 'Putting the sector back in balance' publications dating back to 2018 covering dividend policy, executive remuneration, customer sharing arrangements and financial resilience. Our PR19 business plan set out a clear and transparent AMP7 dividend policy which included our approach and conditions for when we would pay base dividends and outperformance dividends and we committed to enhancing our APR disclosure narrative. On executive pay we have high standards of corporate governance and provide extensive transparency and disclosure within our annual remuneration report and other publications. And in 2020, we further increased the weighting of customer measures within our performance pay schemes, enhancing the extent to with performance pay outcomes relate to stretching delivery for customers. Our innovative CommUnity Share 2030 scheme provides guaranteed support for our most vulnerable customers, whilst offering protection against high gearing or excessive dividend distributions. Our PR19 financial resilience assessment was cited as an example of best practice as part of Ofwat's PR19 IAP assessments and we have continued to enhance our annual long-term viability assessments in line with Ofwat's annual feedback.

Table 9-3 below sets out how we ensure that we comply or exceed the requirements of some of the key points from relevant recent publications:

- "Decision under sections 13 and 12A of the Water Industry Act 1991 to modify the ring-fencing licence conditions of the largest undertakers" published in March 2023;
- "IN 23/04 Guidance on factors Ofwat considers in assessing dividends declared or paid" published in June 2023; and,
- "Protecting customer interest on performance related executive pay – recovery mechanism guidance issued June 2023" published in August 2023.

Table 9-3 Key points from Ofwat's recent publications

Area	Ofwat's ask	UUW response
Licence condition P32 - dividends	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	All dividend distributions are already subject to commitments and considerations including – amongst other matters – gearing, financial resilience, credit ratings, pension funding, delivery against the final determination and future investment needs to improve service performance. For AMP8 our dividend policy has been revisited to consolidate our principles to make them clearer to understand while further explicitly aligning to Ofwat's recent licence changes, including delivery for customers and the environment over the longer term. See section 9.3.5 for more details of our AMP8 dividend policy.
Licence condition P28 – financial resilience	The cash lock-up trigger increased to BBB/Baa2 with negative outlook (from BBB-/Baa3 with negative outlook), with effect from 1 April 2025.	Credit ratings above the new cash lock-up trigger threshold (current ratings A3 Moody's, BBB+ Standard & Poors and IDR BBB+ with Fitch), and for AMP8 continue to target A3/BBB+ for the actual company with two out of three ratings agencies.
Licence condition P26 – credit ratings	Maintain investment grade issuer credit ratings with at least two credit rating agencies	UUW maintains and for AMP8 continues to target investment grade issuer credit ratings with at least two credit rating agencies.
Dividend factors to consider	Companies to take account of the impact of paying out the dividend on the ability of the company to continue to finance its functions.	Prior to paying dividends, our board considers the company's future investment needs and financial resilience over the short and longer term resilience. See section 9.3.5.
Dividend factors to consider	Each company should consider its performance in the round and over time, encompassing all aspects of delivery against its licence including delivery against its performance commitments, investment plans, cost efficiency and other areas of its operations.	Prior to paying dividends, our board explicitly considers performance in the round and over time, encompassing all aspects of delivery against its licence including delivery against its performance commitments, investment plans, cost efficiency and other areas of its operations. See section 9.3.5.
Dividend factors to consider	Companies should consider withholding or restricting dividends where there are significant service failures to be addressed or there is a risk of regulatory fines, penalties or a need to take remedial actions.	Prior to paying dividends, our board recognises there may be circumstances where dividends need to be curtailed, deferred or suspended. Examples of such circumstances could include when payment of a dividend would be expected to materially impair the ability of the company to deliver services in future, materially impair the company's ability to finance the delivery of such services or would materially impair service recovery from an identified major incident which was known to be resulting in a service failure. See section 9.3.5.
Dividend factors to consider	We would not expect a company to consider future outperformance in determining the level of dividend for a particular period.	Our dividend policy only allows for distributions relating to past or present performance. See section 9.3.5 'A fair return for shareholders'.

Area	Ofwat's ask	UUW response
Executive pay	Companies should be transparent about how any performance related executive pay is aligned to the delivery of stretching performance for customers, and takes account of the underlying performance of the company. Both short- and long- term elements of performance related pay should demonstrate a substantial link to stretching delivery for customers and the environment. Performance pay decisions should take into account overall performance delivered for customers, communities and the environment including factors which are wider than the individual metrics used as part of PRP arrangements such as performance commitments, financial resilience, and compliance and reputational issues. Discretion should be considered and applied in relevant circumstances relating to the use of governance mechanisms such as deferral, malus, and clawback.	We will continue to provide extensive, high-quality disclosures about executive pay, and our executive performance pay approach will continue to: • reflect substantial alignment to delivery for customers and the environment, including at least 30 per cent of performance pay outcomes being related to environmental performance on activities such as those that are focused on reducing storm overflow activations; • use performance measures that reflect customer priorities, using stretching targets that reflect the context of those measures; • provide for other factors that may be relevant to overall performance to influence executive performance pay outcomes, alongside the specific individual performance related pay metrics selected by the remuneration committee; and • include the ability for the deferral of incentive outcomes, and the application of malus and clawback in appropriate and relevant circumstances. See section 9.8 'Executive pay'

9.4.4 Paying our fair share of tax

We are committed to acting in a responsible manner in relation to our tax affairs[4] and will continue to pay our fair share of tax in AMP8. Evidencing this, we were delighted to have retained the Fair Tax Mark independent certification in 2023 for the fifth consecutive year, see chapter 10.4.1 for further details. The company has a simple transparent corporate structure including no offshore financing arrangements. We are forecasting total corporation tax payments of around £130 million and a further c£900 million of other economic contributions in the form of business rates, employer national insurance contributions, environmental taxes and other regulatory fees.

The average cash tax rate is forecast to be below the headline rate of corporation tax of 25%, at around 5%. The benefit of this in-period tax saving passes immediately to customers reducing total bills by around £482 million across the AMP.

The above tax saving is mainly due to optimising available tax reliefs on the company's capital expenditure supported by a full tax deduction being available on all of the company's interest costs. As outlined elsewhere the capital expenditure programme in AMP8 is expected to be larger than in previous AMPs and as such is increasing the tax reliefs available overall - such available reliefs having been explicitly encouraged by successive governments. Our approach thereby ensures that we maximise the available benefit for customers while ensuring that we embody responsible corporate behaviour in relation to tax.

We remain supportive of the regulatory tax sharing mechanism first introduced for PR19. This reconciliation mechanism was introduced for PR19 and accounts for any changes to corporation tax or capital allowance rates after the final determination. This seeks to ensure that:

- Customers do not pay more than is needed if corporation tax rates fall.
- Companies are appropriately remunerated if rates rise

[4] See our tax policies and objectives on page 150-151 of UUW's Annual Report and Financial Statements 2023

We believe this achieves a good balance between continuing to incentivise us to act efficiently in relation to tax matters while allowing for the automatic sharing with customers of the most likely tax benefits or costs that are outside of our control.

As a responsible company, we note the following points in calculating corporation tax within our business plan:

- We have taken account of all available capital allowances and assumed no capital allowance disclaimers;
- We expect the company to generate taxable profits during AMP8. However, should it receive/surrender losses from/to a fellow group company, payment will always be made at the headline corporation tax rate;
- We commit to disclosing any group relief utilised within our annual accounts and UUW's annual performance report;
- We expect to obtain a full tax deduction for all interest payments, on the assumption that the 'Public Infrastructure Exemption' (PIE) will apply and that there will be no related party debt for these purposes; and,
- We have taken account of expected brought forward tax losses in calculating the AMP8 tax liability in line with current tax legislation.

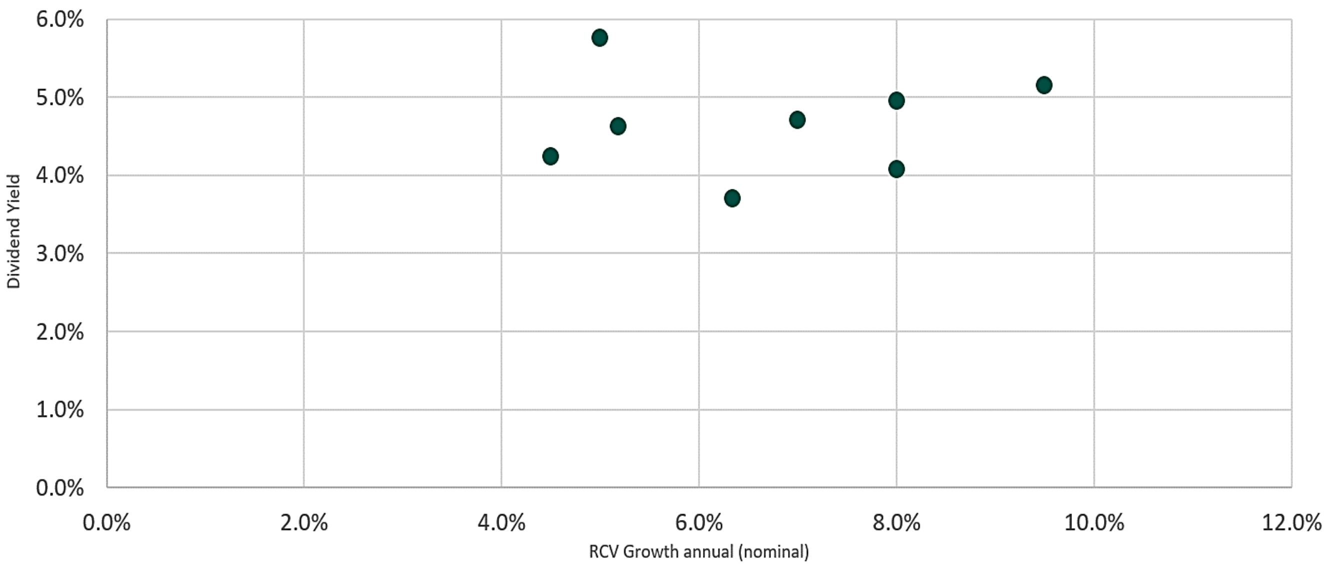
9.4.5 A responsible approach to pensions

We have the most robust and resilient funding position in respect of our defined benefit pension schemes in the industry and one of the strongest in the UK, resulting from our responsible approach to risk management and strong collaboration with the schemes' trustees. Our schemes are fully funded on a low dependency basis and significantly de-risked. This means that employees, customers and investors are protected from significant exposure to pension scheme deficits due to changes in life expectancy, interest rates and inflation.

9.4.6 Our AMP8 base dividends assumption

For AMP8, we have revisited our dividend principles again to make them clearer to understand while ensuring there is strong alignment between our approach to dividend and the delivery for customers and the environment over the longer term. We will also ensure our conduct and policy will comply with or exceed the requirements of Condition P of the licence. Furthermore, we have set out a clear and transparent AMP8 dividend policy which includes our approach and conditions for when we would pay base dividends as well as outperformance dividends. Full details are available in supplementary document *UUW70 Capital Structure and Dividend Policy.*

Figure 9-3 - European utilities RCV growth vs dividend yield



Source: Company published reports for asset base growth; Bloomberg for dividend yields

We recognise Ofwat's expectation[5] for companies with RCV growth and that perform in line with their determination and our AMP8 base dividend policy is reflective of this. We agree that it is prudent for a regulated business with high real RCV growth to retain an element of the real cost of equity allowance in addition to also retaining the inflation uplift to the RCV.

Under our base plan, AMP8 RCV growth is expected to be in the region of c7% real per annum. Whilst this is higher than historic water regulated asset growth (sector average of 1.6%[6] in AMP7 for instance), this growth level is comparable to other UK regulated utilities. Figure 9-3 above shows all regulated utility companies across UK, Germany and Italy, highlights that European utility companies with high RCV growth generally have dividend yields above 4%. It is important that we are able to provide listed equity investors with a reasonable and sufficient dividend, in order to maintain the health of our equity base and in order to fund substantial new investment. This equity base underpins our robust financial resilience and our ongoing ability to raise new debt and equity to fund our investment programme and do this at efficient cost.

Our base dividend policy is to apply Ofwat's allowed cost of equity less 1%. We are using Ofwat's early view of the allowed cost of equity of 4.14% real CPIH within our business plan submission. We retain c1% of the real return on equity, recognising expected real RCV growth and the need for retention of profits, we are deducting 1% from this to give an assumed base dividend of 3.14%. For simplicity, his has been rounded down to 3.0%, which aligns to Ofwat's financial model assumption.

In making decisions on both the base level of dividend and outperformance dividends, the board will consider the company's financial resilience, its performance against its statutory obligations and performance against the final determination for AMP8, all across a range of measures over time. Our board will also consider the impact that payment of the dividend would have on its ability to serve stakeholders and broader considerations that the board has committed to in AMP8 as part of its consolidated core four principles on gearing, dividends and benefit sharing. Our dividend policy and conduct will comply with or exceed the requirements of Ofwat's recently updated Condition P licence conditions.

9.5 Cost Recovery rates

9.5.1 Revenue assessment and limiting the impact on customer bills

Our business plan proposes significant, required investment to meet improved environmental standards and to deliver significant improvements in service to customers. Whilst delivering this significant proposed investment inevitably applies upwards pressure to customer bills, we have sought to make bills as affordable as possible for customers and plan to put in place an unprecedented £525 million of affordability support to those most in need if our plans are approved. Chapter 3 sets out the results of research on the acceptability of our plan, where engagement with customers and communities across the North West has actively informed and shaped the development of our business plan. Customers and communities support the proposed service improvements, long-term aspirations and strategies to adapt to new challenges in our plan. Customers feel the plan is reflective of their priorities and strongly support discretionary investment**.** This section sets out the price control "building blocks" components of our plan, and how this has resulted in our proposed bill profile over 2025-30.

9.5.2 The building blocks of our revenue requirement

Our revenue calculations reflect the costs of delivering the plans (as set out in Chapter 8), along with assumed WACC, PAYG ratios, RCV run-off rates and average asset lives.

We have calculated the revenue requirement for each of the price controls using Ofwat's financial model and these are presented in Table 9-4 below. For more information on the calculation of our revenue requirement please see our data tables *RR10* and *RR15*. We have also provided Ofwat's financial model and an associated commentary alongside our business plan submission in *UUW94 – Ofwat Financial Model* and *UUW95 – Financial Model Commentary*.

[5] Ofwat final methodology December 2022.

[6] Source: Ofwat PR19 FD Aligning-risk-and-return-technical-appendix

Table 9-4 Revenue requirement AMP8

Revenue requirement AMP8 £million (2022/23 CPIH prices)	Water resources	Water network plus	Wastewater network plus	Bio-resources	Household Retail	Total
PAYG – operating costs	583	1,859	1,707	360	-	**4,509**
RCV run-off	105	1,032	1,794	357	-	**3,288**
Return on capital	122	636	1,723	104	-	**2,585**
Revenue adjustments for PR19 reconciliations[7]	-16	284	90	-1	63	**420**
Quality and ambition assessment (QAA) reward / penalty	-	-	-	-	-	**-**
Taxation	-	101	-	14	-	**115**
Grants & contributions (price control)	-	198	229	-	-	**427**
Other income (non-price control)	-9	3	8	7	-	**9**
Innovation Fund	-	-	-	-	-	**-**
Residential retail costs	-	-	-	-	585	**588**
Retail margin (1%)[8]	-	-	-	-	84	**81**
Re-profiling	-	-	-	-	-	**-**
Revenue requirement	**785**	**4,114**	**5,551**	**841**	**733**	**12,023**
Grants & contributions (non price control)	-	142	18	-	-	161
Total direct procurement from customers	-	67	4	-	-	71
Total revenues	**785**	**4,323**	**5,573**	**841**	**733**	**12,254**

Source: PR24 data table RR10, RR2, RR6, RR9 & Ofwat financial model 'residential retail' tab (row 564/552)

9.5.3 Maintaining affordable bills whilst delivering significant improvements in the levels of service

Our business plan will deliver services that customers value and we have taken robust action to ensure the lowest possible bills for customers. However, given the anticipated material bill increases, our customer engagement shows that many customers are understandably concerned about affordability challenges. To address this, our proposed plan reflects an unprecedented £525 million of affordability support to those in need, including making direct financial contributions worth £200 million. Building upon our current industry leading range of support schemes through tariff innovation and the introduction of a new capped annual discount for income deprived households will ensure the widest possible range of customers can access help appropriate to their circumstances. We also plan to further develop our industry leading Priority Services scheme increasing positive outcomes for consumers in vulnerable situations who require extra help accessing services. Further details are set out in Chapter 4. Despite financeability constraints, we are not proposing to advance any revenue, either through RCV run-off (which we have aligned with natural rates) or PAYG and are apportioning our carry forward adjustments between RCV and revenues in line with Ofwat's proposed PR19 reconciliation mechanisms, which bolsters financeability on an actual company basis.

The average 2029-30 residential bill of £556.17 consists of the four wholesale service elements and retail. We have used Ofwat's financial model to calculate expected bill levels, which are summarised in the data table *RR14* and broken out further in Table 9-5 below.

[7] Presented on a post tax-adjustment basis, as applied to revenues. Note that this is different to presentation in Ofwat's PR19 reconciliation models which is presented prior to the application of tax-adjustments

[8] Includes retail margin on revenue adjustments for PR19 reconciliations as well as retail costs

Table 9-5 - Household customer bills

Household customer Bills (2022/23 prices)	2025-26	2026-27	2027-28	2028-29	2029-30
Wholesale revenues (£m)	1,965.34	2,096.16	2,168.09	2,267.57	2,410.08
Retail apportionment[9]	70.88%	70.93%	70.80%	70.64%	70.59%
Household customers ('000s)[10]	3,195	3,220	3,251	3,285	3,315
Average wholesale bill (£)	435.97	461.69	472.08	487.65	513.21
Average retail bill (£)	45.14	44.60	43.73	43.31	42.96
Average household bill (£)	**481.11**	**506.29**	**515.81**	**530.96**	**556.17**
Average household bill, 2024/25 (£)	446.71	-	-	-	-
Change in bills, 2024/25 to 2029/30	**24.5%**	**-**	**-**	**-**	**-**

Source: Data table RR14; Ofwat financial model, 'Bill module' tab rows 233-240 & 'Summary calcs' rows 474-516

The average household bill across the five year period includes £3.17 related to the recovery from customers of the Competitively Appointed Provider (CAP) payments in 2025/26-2029/30, predominantly relating to the DPC Haweswater Aqueduct Resilience Project (HARP).

9.5.4 RCV run-off rates

We consider current cost depreciation (CCD) to be the most appropriate methodology to use for estimating RCV run-off, since it corresponds to the purpose of run-off i.e. reflecting recovery of past investment and resources to maintain capability. It also reflects the modern value of assets and is a well understood method, consistent with regulatory methodology since privatisation.

We apply our derived natural CCD rates to estimate RCV run-off for each price control. Whilst our natural RCV run-off rates are well below Ofwat's proposed upper limits within the water resources (2.7% vs 3.26% cap) and wastewater network plus (3.3% vs 4.35% cap) price controls, the rates are slightly higher in water network plus (5.0% vs 4.5% cap) and bioresources (10.3% vs 8.0% cap).

However, we believe applying our natural CCD rate best aligns to Ofwat's framework on intertemporal fairness, striking the right balance to ensure that customer are paying their fair share of past investments but without exerting excessive pressure on customer bills, recognising affordability for customers. Using natural rates also aligns well with maintaining financeability over the longer term. As such, we believe applying the 'natural rate' of RCV run-off is appropriate and do not seen any reason to deviate from this approach.

Further supporting details of the basis of our proposed natural rates as well as details on our reductions in rates compared to both PR19 and historic levels and methodological considerations are provided in the supplementary document *UUW71 - RCV run-off rates*.

9.5.5 PAYG ratio

Consistent with Ofwat's view of the most appropriate starting point[11], for AMP8 we have applied PAYG rates consistent with operating costs (which includes infrastructure maintenance expenditure) as a proportion of totex for each price control. We see no reason to deviate from this approach. More specific values for the PAYG rates applicable to each price control are set out in the relevant table commentaries to data table *RR1*.

9.5.6 Opening RCV/midnight adjustments

Our strong expected ODI performance over the last two years of the current AMP, alongside additional reinvestment and accelerated environmental spend to drive further environmental and customer benefits, we are expecting a carried forward value of £1,041.1 million as at March 2025. This has been split out between RCV

[9] Taking weighted average of all individual price control retail apportionments

[10] Taking average of total water and total wastewater customers

[11] PR24 final methodology Appendix 10 Aligning risk and return, section 7.3.1

(£603.4 million) and revenues (£436.7 million) (pre tax-adjustments) in accordance with Ofwat's regulatory true-up mechanisms and is broken down in the Table 9-6 below.

Table 9-6 Carried forward value - RCV or Revenues (2022-23 FYA) (£m)

Carried forward value - RCV or Revenues (2022-23 FYA) (£million)	RCV	Revenues	Total carried forward
Totex (customer share)	148.4	227.1	**375.6**
Defra accelerated programme	201.4		**201.4**
Additional Tax allowance		(156.7)	**(156.7)**
ODI rewards		134.4	**134.4**
Transitional Investment	104.2		**104.2**
Developer connections true up		96.9	**96.9**
WINEP / NEP adjustments	91.9		**91.9**
RPI/CPI wedge true-up		61.6	**61.6**
Debt Indexation Mechanism (DIM)		57.2	**57.2**
PR14 Blind year adjustments	43.7	(0.3)	**43.4**
Green Recovery adjustments	24.0	0.8	**24.8**
Retail revenue reconciliation		14.9	**14.9**
Strategic regional water resources	(2.2)	(6.9)	**(9.0)**
Land Sales	(8.1)		**(8.1)**
C-Mex		5.2	**5.2**
D-Mex		2.5	**2.5**
Total	**603.4**	**436.7**	**1,040.1**

Source FD model 'inp_FD19' down to row 440

The RCV true-ups of £603.4 million are split £(2.4)million water resources; £105.3 million water network plus, £499.5 million wastewater network plus and £1.1 million bioresources

Revenue adjustments of £436.7 million are split £(20.7)million water resources; £313.2 million water network plus; £91.3 million wastewater network plus; £(4.3)million bioresources and £57.2 million Household retail. All revenue adjustments are spread equally in real terms across the five years 2025/26 to 2029/30, smoothing customer bill impacts.

9.5.7 Demonstrating bills are affordable post 2030

Chapter 4 sets out our long-term forecast for average residential bills and our assessment of affordability post 2030. This explains the main factors driving future bill changes, including a continued focus on enhancement requirements (including investment to reduce spill frequency at CSOs and long term river quality drivers) extending out into AMP9 and beyond. It also demonstrated that our proposed approach of spreading investment, and recovering revenues on a gradual but continual basis over multiple AMPs is supported by the majority of customer.

It is important to recognise that, since we are not proposing any financeability adjustments and are setting a responsible dividend policy, we are doing nothing that would actively tend to make bills less affordable post 2030. This should ensure problems are not stored up for future AMPs, and that future generations of customers pay no more than would be their fair share of the future investment plans that are legislated or approved.

9.6 Our financeability assessment

This section demonstrates that our plan is financeable on both a notional and actual company basis and sets out the methodology used and the evidence that supports our assessment. The high level detail is included here with more detailed evidence included in our supplementary document *UUW69 - Evidence of financeability*.

9.6.1 Our plan is assured as financeable by our board.

Our business plan as set out in this document is financeable on both a notional and actual company basis. Our board has provided a clear statement of assurance on this, with appropriate supporting evidence, in its assurance statement provided in document *UUW11 – Board Assurance Statement* stating:

*"**The board can confirm that the plan is financeable on both the notional and actual capital structures**. This is subject to raising the necessary debt and equity financing and the board anticipate that the final determination will set a WACC at a sufficient level to facilitate this…*

The Board has assessed the financeability of the business plan under both the notional and actual capital structures and has reviewed the supporting independent assurance undertaken.

Specific reviews have been undertaken of a number of aspects of the financeability of the plan including by Deutsche Bank and JP Morgan and Deloitte for the long term viability statement (LTVS)."

The Board's financeability assessment has been supported by the evidence in this chapter, and as further assessed in the related supplementary documents *UUW68 - Financial Resilience*, *UUW69 - Evidence of Financeability* and *UUW74 – Capital Market Assessments*.

9.6.2 Our financeability assessment approach

Our financeability approach is set out in more detail in supplementary document *UUW69 - Evidence of Financeability*.

Our plan for PR24 represents a step-change in the level of investment for AMP8 compared with previous AMPs, requiring significant amounts of financing. Effectively, UUW will be competing to attract the necessary investment not just domestically but internationally. This is set against a macro-economic environment that has changed since PR19, with increasing evidence that the post-global financial crisis era of ultra-low interest rates and central bank Quantitative Easing has given way to higher interest rates and more elevated risk premia.

Therefore, it will be essential for the PR24 risk and return framework to be appropriately calibrated to attract the necessary investment to successfully deliver our plan, including the setting of an appropriate allowed return at the Final Determinations (FD). We expect that up-to-date market based evidence will be taken into account in setting the final PR24 WACC.

We see benefits for customers in setting an overall package with the right balance of incentives and returns that secures financeability on a sustainable basis for an efficient company. This should take account of higher risk associated with the delivery of significantly bigger investment programmes and avoid downside bias in performance incentives or in the setting too low of a cost of capital such that it would exacerbate associated cost and delivery risks.

Our financeability assessment follows Ofwat's guidance, including providing board assurance, completing the PR24 financial model, using the early view WACC, adopting the required notional company capital structure assumptions, adopting dividend assumptions in line with Ofwat's expectations, proposing AMP8 PAYG and RCV run-off rates in line with natural rates, targeting credit ratings at least two notches above the minimum investment grade, considering ratios before the impact of PR19 reconciliation adjustments for the notional company and assessing financial ratios in our financeability assessments 'in the round', taking account of a range of factors.

9.6.3 What a financeable company looks like

There are two main attributes of a financeable water company:

- The company has good prospects for accessing equity finance and can attract sufficient levels of investment in a competitive market where international investors have a choice of where to invest; and
- The company has resilient access to debt capital market financing in a range of market conditions at an efficient cost.

Successfully accessing equity finance requires companies to be able to earn adequate returns that are at least in line with the cost of equity of the company and to be able to distribute a sufficient and stable return to investors.

When allocating capital, equity investors will consider the risk-reward on offer in light of rising political and regulatory risks, how this risk-reward balance compares to similar regimes in related sectors, the stability of company financial strength, along with an assessment of financial resilience.

The step-change in investment required by the UK water sector makes equity financeability considerations even more important. From an equity viewpoint a financeable plan will require a competitive dividend yield, strong dividend coverage and a ROCE at least in-line with WACC.

Resilient access to debt capital market financing in a range of market conditions requires companies to hold strong investment grade credit ratings. As is discussed in more detail in supplementary document *UUW69*, our plan targets credit rating at least two notches above the minimum investment grade ratings with 2 out of the 3 ratings agencies, being Baa1/BBB+[12] and A3/BBB+ for the notional and actual company respectively. We assess this as giving a reasonable level of headroom against minimum licence conditions and allowing UUW to cope with most cost shocks. The Moody's targeted rating is one notch higher for the actual company as the actual company benefits from its higher proportion of index linked debt and below sector average cost of embedded debt. Our actual company assessment also reflects the benefit of AMP7 reconciliation adjustments.

In supplementary document *UUW69* we set out the relevant financial ratios and thresholds that are required to meet these targeted credit ratings, noting that business risk factors such as scale and complexity of investment programmes are also relevant. We also set out some key differences in calculations between the rating agency versions of the financial ratios and those included in the financial model, along with accordingly adjusted thresholds for the financial model version of the financial ratios.

9.6.4 Financeability constraints and levers

Financeability constraints

As is set out in more detail in our supplementary document *UUW69*, we have considered financial ratio output before the application of financeability levers to identify our financeability constraints with regard to target ratings ratio thresholds, which for both the notional and the actual company are impacted by the size of our proposed investment programme, as the natural equity retention is relatively modest compared to our AMP8 investment requirements.

For the notional company, even though gearing increases, this metric remains in line with the target ratings over AMP8. However, the opening gearing assumption of 55% is a key driver in enabling various interest cover metrics to be met and once gearing increases to a more normal (for the sector) level, the financeability constraint is then felt on those interest cover metrics.

For the actual company, it is gearing that initially act as a financeability constraint but is swiftly followed by various interest cover metrics, as notwithstanding the actual company's higher proportion of index-linked debt and below sector cost of debt, this is not enough to offset the additional interest costs associated with financing the proposed investment programme.

[12] For water companies Fitch apply a one notch differential between the issuer default rating (IDR) and the senior unsecured debt ratings. The target credit rating set out here is the IDR, which equates to an A- senior unsecured debt rating.

Financeability levers

In our supplementary document *UUW69* we considered a full range of possible financeability levers, whilst keeping in mind that equity issuance or retention would likely be the key lever to solve financeability constraints. To resolve our financeability constraints we have included the following financeability levers in our plan:

- Assumed £2.25 billion of equity issuance for the notional and £1.35 billion for the actual company to ensure that our large investment programme is funded by an appropriate mix of debt and equity;
- Reduced cash dividend pay-out amounts by adopting a policy of a base distribution of the allowed cost of equity less 100bps (using a dividend yield of 3% derived from Ofwat's early view cost of equity of 4.14% less 100bps and rounded down) for both the notional and actual company to further bolster equity retention; and
- For the actual company only we have also utilised positive AMP7 reconciliation adjustments due to be received in AMP8 as an alternative choice to additional equity issuance or dividend restriction and to ensure that customers do not bear the costs of resolving actual company financeability constraints.

These financeability levers should enable the notional and actual companies to maintain strong credit ratings enabling efficient access to debt funding and to attract equity investment to support our planned investment, which should benefit customers over the long term.

9.6.5 Financial metrics

A full list of our forecast AMP8 financeability financial ratios after financeability levers for the notional and actual companies are set out in our supplementary document *UUW69*, but selected key financeability ratios are shown below in Table 9-7 and Table 9-8. Green indicates that a required threshold is met, amber indicates a near miss that should be acceptable in the round and red indicates that a required threshold is not met.

Table 9-7 Selected financeability metrics after financeability levers (notional company)

Ratio	Thresholds Baa1/BBB+	FY26	FY27	FY28	FY29	FY30	AMP8
Moody's: Gearing	≤72%	55.22%	56.30%	55.91%	54.86%	54.93%	55.41%
Moody's: Adjusted interest cover	≥1.6	1.64	1.61	1.60	1.62	1.65	1.62
S&P: FFO to debt	≥9.2%	9.04%	8.39%	7.99%	8.16%	8.56%	8.40%
S&P: Debt to EBITDA	≤9.0x	7.38	7.51	7.86	7.83	7.50	7.62
Fitch: Gearing	≤67%	55.22%	56.30%	55.91%	54.86%	54.93%	55.41%
Fitch: Cash PMICR	≥1.6	1.62	1.59	1.58	1.61	1.63	1.61
Fitch: Nominal PMICR	≥1.8	2.10	2.06	2.03	2.05	2.09	2.06
Ofwat: Dividend yield	N/A	3.00%	3.00%	3.00%	3.00%	3.00%	3.16%
Ofwat: Dividend cover	N/A	0.65	1.42	1.09	1.02	1.19	1.09

Source: Table RR16

Table 9-8 Selected financeability metrics after financeability levers (actual company)

Ratio	Thresholds A3/BBB+	FY26	FY27	FY28	FY29	FY30	AMP8
Moody's: Gearing	≤65%	63.75%	63.99%	63.74%	62.98%	62.50%	63.33%
Moody's: Adjusted interest cover	≥1.7	2.27	2.04	1.85	1.77	1.69	1.88
S&P: FFO to debt	≥9.0%	8.57%	7.87%	7.21%	7.17%	7.39%	7.58%
S&P: Debt to EBITDA	≤9.0	8.03	7.99	8.38	8.43	8.08	8.19
Fitch: Gearing	≤67%	63.75%	63.99%	63.74%	62.98%	62.50%	63.33%
Fitch: Cash PMICR	≥1.6	2.34	2.11	1.91	1.82	1.72	1.93

Ratio	Thresholds A3/BBB+	FY26	FY27	FY28	FY29	FY30	AMP8
Fitch: Nominal PMICR	≥1.8	2.37	2.21	2.07	2.03	1.95	2.10
Ofwat: Dividend yield	N/A	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Ofwat: Dividend cover	N/A	1.99	2.00	1.65	1.52	1.50	1.70

Source: Table RR16

9.6.6 Debt financeability assessment

The key financial ratios used by Moody's and Fitch (gearing, adjusted interest cover, cash PMICR and nominal PMICR) meet the required thresholds (or are an acceptable near miss in one or two years) for the targeted credit ratings over AMP8. On that basis the targeted ratings with Moody's and Fitch are demonstrably met for both the notional and actual company.

The S&P metrics are more challenging: S&P's primary metric, FFO to debt, and secondary metric, Debt to EBITDA, are respectively outside and within the required thresholds for the targeted credit rating over AMP8. On this basis we assess that both the notional and the actual companies are expected to be on the cusp of BBB+/BBB flat after financeability levers. There are limited levers available to improve FFO/debt, which reacts much more strongly to increases in revenue than equity issuance, so any potential increase in WACC from Ofwat's early view used in our plan should increase revenues and so improve financeability with reference to S&P's key credit metrics.

On the basis that the notional and actual companies should achieve target credit ratings with at least 2 of the ratings agencies, we consider that both the actual and notional companies are financeable from a debt perspective after our proposed application of financeability levers.

Finally whilst our debt financeability assessment necessarily focuses on credit ratings and the associated relevant financial ratios and thresholds, business risk is also important. In addition a well-functioning equity buffer remains critical to debt investors, with an adequate cost of equity being important to all providers of finance, in maintaining broad-based investor confidence.

9.6.7 Equity financeability assessment

To fund investment and growth, companies need to be able to attract equity investment. For UUW, as a regulated utility facing a step change in investment, it will be necessary to demonstrate that we are an attractive investment proposition for equity. Here, the regulatory framework, the overall PR24 risk and return package, and the level of allowed returns are all likely to be material factors in determining equity financeability.

Dividend yield
Equity financeability is primarily assessed with reference to the level of dividend yield, with UU's shareholders primarily investing for income purposes and confirming that dividend was an important part of their investment decision. Competing with domestic and international firms to secure equity investment of our proposed investment programme will require an attractive dividend.

In supplementary document *UUW69 – Evidence of Financeability*, we set out dividend yields for UK utilities, European utilities and FTSE100. This chart demonstrates that other dividend yields are higher than 3%. A higher growth rate could compensate investors for a lower yield, however, UUW's AMP8 growth rate of c.7% (real, CPIH) is comparable to peers.

Supplementary document *UUW73 - Cost of Capital Considerations* highlights that a lot has changed in financial markets since the 'early view' WACC was published that has informed our dividend yield. The updated report uses a cut-off date of 30 April 2023 and sets out its cost of capital estimate range of 4.81% to 5.71% (at 60% gearing). Assuming c.100bps retained for reinvestment, this implies a base dividend of around 4.0%, which is closer to the European peers, helping us to compete for capital and improving financeability.

Dividend cover
Dividend cover is also a metric that is used to assess dividend sustainability, although some caveats should be placed on this metric, given that metrics derived from regulated utility income statements might not fully capture

the true underlying economics. The dividend cover ratios for both the notional and actual company are deemed to be adequate for the level of dividend assumed in the plan.

Sources of new equity capital for UUW
As outlined in section 9.6.4, our plan includes a £1.35 billion equity injection on an actual company basis. As UUW is the principal operating subsidiary of its listed parent United Utilities Group PLC (UUG), UUW would make a call on UUG to consider putting in an appropriate amount of capital at the required time.

Subject to the board of UUG being satisfied as to the overall PR24 risk and return package and the level of allowed return, as a listed company with access to a deep and liquid pool of investors, UUG is expected to be well placed to fulfil such equity calls from UUW, and is likely to consider one or more of the following sources of capital: injection of group cash, issuance of debt higher up the group capital structure or UUG equity issuance. It would be for the board of UUG to determine the most appropriate way of making any equity injections into UUW at the appropriate time.

9.6.8 Overall assessment of financeability of our plan

Taking account of the above factors, and on the assumption that the overall PR24 risk and return package and the level of allowed return are set at an appropriate level at the FD, we are confident that our plan is financeable from a debt and equity perspective on both a notional company basis and an actual company basis.

9.7 Assessing and demonstrating financial resilience

9.7.1 A frontier company built on strong foundations

We welcome Ofwat's focus in recent years on the sector improving its financial resilience, in particular the measures taken to reduce gearing and to improve transparency of reporting. We have a long track record of maintaining robust financial resilience underpinned by two key factors: i) our long term and responsible approach to financial risk management; and ii) applying rigorous governance and disclosure standards associated with being a publicly listed company. These support our position as a benchmark frontier company in terms of financial resilience.

Responsible approach to paying dividends
We have demonstrated a cautious approach to paying dividends, as evidenced during the onset of the Covid pandemic. During 2020/21 the board took the difficult decision to defer paying any dividends due to the heightened uncertainty at that time. Whilst under our rigorous dividend assessments we could have made a case for paying a dividend, our board made the responsible decision to defer any payments to reinforce our financial resilience at that time of heightened uncertainty. Further details of our dividend policy is set-out in sections 9.3.5 and 9.4.6 and in supplementary document *UUW70 - Capital Structure and Dividend Policy*.

Maintaining an appropriate level of gearing
UUW has consistently reported below sector average gearing as noted in section 9.3.4 and supplementary document *UUW70 - Capital Structure and Dividend Policy.* Low relative gearing allows us to maintain robust investment grade credit ratings. Our current credit ratings are: Moody's A3, Fitch IDR BBB+ and senior unsecured debt rating A-, and S&P BBB+, all on stable outlook, which places UUW as one of the best rated companies in the sector. This supports a low cost of financing and UUW has maintained one of the lowest cost of debt in the sector, whilst having a capital structure that is unencumbered by securitised debt or overly restrictive covenants.

A prudent level of headroom and liquidity
Headroom and liquidity is about having enough cash or readily available committed facilities to draw on to meet the funding requirements of the business on an ongoing basis. We have a longstanding board policy of maintaining between 15 and 24 months of financial headroom on a rolling basis, which provides a substantial level of liquidity to meet any short-term cash flow impacts that may arise. At 31 July 2023, the company had over £1,533 million[13] of available liquidity at its disposal, comprising £938 million of cash and short-term deposits and £595 million of undrawn committed loan facilities. In addition, we manage our debt maturity profile to avoid any

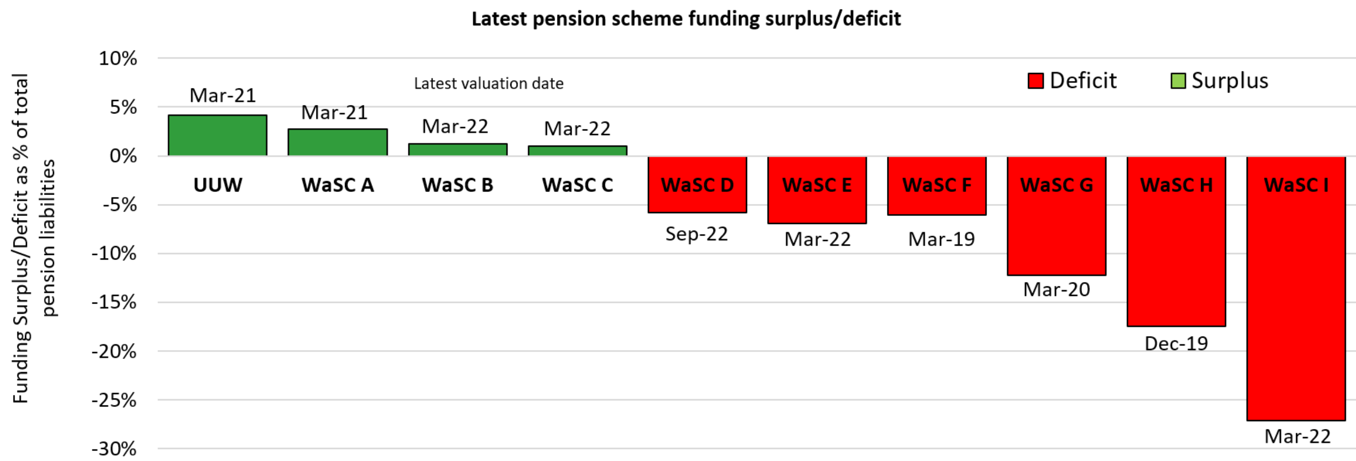
[13] United Utilities Water July month-end management information liquidity

undue refinancing risks. At March 2023, our debt portfolio had an average term to maturity of 17 years. In addition, we manage our debt maturity profile to avoid any undue concentration of refinancing risks.

A responsible approach to financial risk management
We take a responsible approach to financial risk management including the use of hedging in a cost effective manner against interest rate, inflation, foreign currency and electricity prices in line with clearly articulated treasury policies. By not speculating on these costs, we help protect financial resilience and investor confidence by mitigating the impact of these risks. To help protect stakeholders further from the impact of certain extreme events, we also have a carefully constructed portfolio of insurance in place to cover many high impact, low frequency insurable events.

UK leading approach to pension scheme risk management
We have the most robust and resilient defined benefit pension scheme in the industry and one of the strongest in the UK, with both schemes being fully funded on a low dependency basis and significantly de-risked. In July 2023 around two-thirds of our pension liabilities were hedged through buy-ins with Legal & General and the remaining one-third of liabilities are fully hedged for changes in interest rates and inflation. We continued to report the highest IAS19 surplus of any WASC at 31 March 2023. In addition, enhanced 2022/23 APR reporting now allows sector comparison on a funding basis, more aligned to the true cash position. On this basis (as presented in Figure 9-4, UUW is the strongest in the sector with a reported funding surplus position of £119 million, equating to 4% of its technical provision, with the majority of the sector in a funding deficit position.

Figure 9-4 UUW WaSC with the highest pension scheme funding position



Source: APR data

Financial resilience benefits from highest governance and disclosure standards of being a public listed company
Publicly listed companies must adhere to the highest levels of governance and accountability, carefully balancing the interests of all stakeholders and working in their long-term interests. Publicly listed equity finance provides the broadest degree of shareholder ownership[14] and a viable source for further equity investment through access to a deep and liquid market. Furthermore, our listed parent's share price provides a 'real-time' investor confidence measure of our resilience and longer-term prospects.

It also provides the highest degree of disclosure and transparency for customers and other stakeholders to understand our simple ownership and financial structure. As well, it is helpful in providing real world evidence to Ofwat to derive equity betas for water companies. In summary, we consider that being listed provides the best framework within which to operate and maximise benefits for customers.

As our regulated activities comprise substantially all (98%) of the total assets of the UUG group, the financial resources and interests of the regulated business are robustly ring-fenced and protected, with negligible risks

[14] At 31 March 2023, we had over 63,000 equity investors, the largest of which held a c8% stake.

from our non-regulated activities. The gearing of UUG group is currently c6% lower than UUW[15], which provides a further degree of resilience as additional liquidity within the group can be made available to the company.

9.7.2 Demonstrating our financial resilience

High quality 12 year viability statement

As part of our business plan submission the board has provided a viability statement out to March 2035[16] (further details provided in supplementary document *UUW68: Financial Resilience*) having satisfied itself that our plan will support the financial resilience of the company over at least this period, with sufficient headroom to enable it to continue to deliver its commitments under a range of stressed conditions. This assessment is underpinned by the fundamental assumption that the current regulatory framework, or interpretation thereof, does not substantively change and continues to appropriately fund and incentivise well managed companies. To further underpin the robustness of our assessment, Deloitte has provided assurance to the board that the financial resilience assessment[17] provides a considered and appropriate basis upon which to base the viability statement. This should reinforce trust for customers that we have the financial resilience to cope with disruptions or to turn around poor performance without further costs falling on them.

Scenarios modelled (including thresholds used)

Our assessment, set out in detail in supplementary document *UUW68 - Financial Resilience*, performs stress testing against baseline (actual capital structure) forecasts based on severe but plausible company specific scenarios, Ofwat prescribed scenarios and combined scenarios. Stress testing is set primarily against the key credit rating agency metric thresholds with Moody's, Standard & Poor's and Fitch, including gearing, FFO:debt and interest cover metrics, as set-out in the financial resilience assessment, appendix I. This has a particular focus on maintaining the minimum required lowest investment grade credit rating, aligned with UUW's licence requirements. UUW's financial covenant ratios are also considered. The results of stress testing against all modelled scenarios is presented in Table 9-9 below.

Table 9-9 Stress tests modelled

		Test	Pre-mitigation
1	Ofwat	Totex underperformance (10% of totex) FY26-30	Pass
2	Ofwat	Additional ODI penalty of 3% RoRE FY27	Pass
3	Ofwat	CPIH inflation -2.0% vs baseline plan for FY26-30	Pass
4	Ofwat	Deflation -1% FY26 & FY27	Pass
5	Ofwat	High inflation FY26-28	Pass
6	Ofwat	Bad debt 20% increase FY27, FY28	Pass
7	Ofwat	New debt financed at 2% above forward projections	Pass
8	Ofwat	Financial penalty of 6% turnover in FY27	Pass
9	UUW	Largest severe but plausible scenario - £406 million one-off opex impact in FY25	Pass
10	UUW	Largest two severe but plausible scenarios combined - £882 million one-off opex impact in FY25	Pass
11	UUW	Estimated value of top 10 risks – spread FY24-FY35	Pass
12	UUW	Combined scenario – 50% of scenarios 1,2,3,6,7,8	Pass
13	UUW	FD revenue and cost allowance differentials	Pass
14	UUW	HARP DPC going back in-house	Pass

Source: UUW modelled results of stress testing

[15] Measured on a like-for-like basis as at March 2023 e.g. net debt divided by adjusted RCV (adjusted for actual spend, timing differences and including full expected value of end-of-AMP ex-post adjustment mechanisms) was 58% for UUG and 64% for UUW

[16] Provided in supplementary report *UUW68 financial resilience*, appendix A

[17] Financial resilience assessment supplementary report *UUW68*

As shown in Table 9-9 above, under all scenarios modelled the company would reasonably expect, on a standalone basis, to be able to maintain investment grade credit ratings and have no projected breaches of financial debt covenants without having to consider mitigating actions. In the most extreme scenarios the credit ratings could reduce further to BBB- (both for Fitch and S&P) without any mitigating actions, which we consider unlikely given that mitigating actions would be likely given the prospect of UUW cash lock-up being triggered at this level under Ofwat's updated licence conditions. As such, under such circumstances our board is likely to consider mitigating actions to restore the ratings to a sufficiently adequate level.

The most extreme scenarios result in a temporary c5% increase in debt to RCV gearing[18] to c72% in FY25 (UUW specific scenario 10); a persisting average c0.4x reduction in adjusted interest cover[19] to c1.5x across AMP8 (UUW combined scenario 12); a persisting average c0.5x reduction in Post maintenance interest cover (nominal)[20] to c1.6x across AMP8 (Ofwat low inflation scenario 3) and a persisting average 1.3% reduction in FFO:debt[21] to 6.3% across AMP8 (Ofwat totex scenario 1). Given our strong capital base and robust liquidity policy, we believe that we would be relatively well positioned to manage through such extreme scenarios.

Reverse stress testing

In addition to our scenarios modelled, reverse stress testing of two extreme theoretical scenarios focusing on totex overspend and persisting low inflation have been performed to understand the extent to which the group could further absorb financial stress before it reaches a sub-investment grade credit rating. This reverse stress testing demonstrated that these extreme conditions would have to be significantly outside what would be considered 'severe but plausible' scenarios before UUW's long-term viability would be at risk.

Key management mitigations available in extreme circumstances

We consider that we are the leading company in relation to financial resilience and as such are in a robust position to effectively absorb and respond to extreme events if they were to arise. In the event that adverse factors result in an impact on the business beyond what cannot be naturally absorbed, there are a number of mitigating options available to management to improve its capital solvency and/or liquidity position to ensure the ongoing viability of the company. These are set out in detail in supplementary document *UUW68: Financial Resilience* and are summarised below:

- **Refinancing of maturing borrowings and raising of additional new finance** – Given that UUW is targeting A3/BBB+ credit ratings on an actual company basis, has a reported c66% debt to RCV ratio providing it with c£4.5 billion of regulatory equity, and has a good track record of successfully negotiating new financing including around £2.6 billion raised across AMP7 to date, access to finance is expected to continue;
- **Close out of derivative asset positions** – The group could realise at least £380 million based on the value of 'in-the-money' swap contracts at March 2023;
- **Sale and leaseback of fleet and property assets** – The sale and leaseback of Head office and Estate property or Fleet vehicles (of total value >£100 million) could generate sale proceeds to improve liquidity;
- **Further injection of equity or loan capital from the group parent** – The baseline plan already assumes £1.35 billion of equity issuance across AMP8 and a further £1.0 billion across AMP9, on the assumption that sufficient equity investment can be attracted. As a public listed company, UUG, could, in theory, raise further equity in the market which could be utilised by UUW as required;
- **Access to additional equity (including hybrid debt issuance) –** The UUG group has history of raising equity, including a £1 billion 2-stage rights issue in 2003-2005, and further equity raising could support the companies' viability;

[18] Debt to RCV gearing is calculated based on the company's shadow RCV, based on the methodology published by Moody's

[19] Adjusted interest cover calculated based on the methodology published by Moody's and also consistent with Fitch's Post maintenance interest cover methodology

[20] Post maintenance interest cover (nominal) calculated based on the methodology published by Fitch

[21] FFO: Debt calculated based on the methodology published by S&P

- **Deferral/suspension/cessation of dividends** - If extreme circumstances merited it then the company could restrict dividend payments in order to conserve cash and maintain gearing at an appropriate level. This could generate up to £3.1 billion across the 12 year viability period representing c23% of the March 2023 RCV;
- **Capital programme deferral** – We plan to invest c£2.0 billion per annum across the first three years of AMP8. Whilst this would have notably adverse performance and delivery impacts, we could temporarily pause and defer some programme spend to later in the AMP whilst considering other mitigating actions; and
- **Reduction of discretionary totex spend** – Similarly, planned discretionary spend above our AMP7 final determination totex allowance of £500 million included within FY24-25 baseline position, could also be suspended into AMP8. Discretionary opex (e.g. bonus, pay awards) could also be reduced across the whole 12 year assessment period;

It should be noted that any equity issuance, including that set-out in the baseline position, is on the underlying assumption that equity can be raised via our listed UUG group parent. This assumes a sufficient equity return is provided to attract future equity financing at an economic cost, with the appropriate risk and return balance.

Through our PR24 financeability assessment, we have fully tested our business plan to ensure we can maintain efficient access to debt and equity markets whose on-going trust and confidence we rely on in order to retain or attract capital on the most economic terms.

9.8 Meeting Ofwat's expectations on performance related executive pay

We are confident that our executive pay policy and approach in AMP8 will meet and or exceed Ofwat's expectations of performance related executive pay. The Board is committed to further demonstrating to stakeholders that our performance pay outcomes are well-aligned with delivering value for customers, communities and the environment, based on stretching targets. The Board will continue to take into account overall performance, rather than a formulaic approach. This includes governance mechanisms such as malus, clawback and deferral of rewards. The Board has demonstrated its willingness to use such mechanisms in the past, and it will do so again if necessary.

Our intended AMP8 pay policy and approach is set out in below and in considerably more detail in supplementary document *UUW72 – Executive Pay*, but it is relevant to first summarise the context and components of our current approach, as our AMP8 approach will maintain and build on its already high-quality features.

Supplementary document *UUW72 – Executive Pay* also provides details about how the executive pay commitments we made in PR19 were met during AMP7, to demonstrate our track record for delivery.

9.8.1 High standards of transparency and governance in our approach to executive pay

We understand why there is a high level of scrutiny and concern amongst stakeholders around water company performance, and the corresponding focus on executive pay. We believe that legitimacy is strengthened when sound corporate governance processes are operated and visible, and when disclosures about executive pay are clear and transparent. Customers and other stakeholders can gain confidence that we are operating responsibly when executive performance pay is aligned with their experience. Table 9-10 below summarises our existing high standards of governance and transparency.

Table 9-10 - High standards of governance and transparency in our current executive pay policy and approach

Category	Feature of our policy and approach
External context	• We recognise our responsibilities as a monopoly provider of an essential public service and, in the context of United Utilities Group plc, as a FTSE100 listed company on the London Stock Exchange • We consider compliance with key corporate governance standards to be crucial to demonstrate legitimacy. In this respect, the remuneration committee's independent adviser (Ellason LLP) monitors and assures our remuneration approach and external reporting to confirm compliance with key governance standards, including: The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013, the FCA Listing Rules, and the requirements of the Financial Reporting Council in the UK Corporate Governance Code and its Guidance on Board Effectiveness. Figure 1 in Supplementary document *UUW72 – Executive Pay* summarises our compliance with these and other relevant regulations and standards, and Ellason's formal assurance statement in relation to the 2023 UUG PLC remuneration report is available on our corporate website[22] • Shareholders have a binding vote on our directors' remuneration policy (policy) at least every three years, and are consulted when changes to policy are proposed. The current policy was approved at the UUG PLC AGM in July 2022, and is publicly available to view in the 2022 and 2023 UUG PLC Annual Reports on our corporate website[23]
Remuneration committee oversight	• Our executive pay policies and practices are governed by the Board's remuneration committee (committee) in line with its terms of reference, which are published on our website[24], along with our long-term incentive plan rules • A minimum of three independent non-executive directors make up the committee, recognising the potential conflict of interest of executives/management being directly involved in decision-making relating to their own pay • The terms of reference require the committee to ensure that "performance elements of executive pay are transparent, stretching and rigorously applied" and the committee's effectiveness is externally and independently evaluated at least every three years • At every meeting the committee receives a report from its independent external adviser covering trends, evolving best practice and emerging issues in the field of executive remuneration, so it can continually review its approach to pay policy and incentives in view of the perspectives of key relevant stakeholder groups, including regulators and customers. The committee's ongoing considerations also include taking account of relevant research undertaken by the company with customers
Transparency and disclosure	• We consider that there is robust and observable evidence which points to UU being amongst the leaders in the water sector in the development, application and clarity of our approach to executive pay. We provide extensive transparency and disclosure on our approach, including our performance pay schemes and outcomes, in our APR and in the UUW statutory accounts • These documents also provide a clear reference to the full executive pay disclosure provided in the UUG PLC annual report[25], which includes transparency about the link between pay and performance (taking account of overall performance, alongside specific incentive measures), alignment to business strategy, and disclosure of annual bonus and long-term incentive measures, targets and outcomes • Our pay disclosures align with the expectations set out in Ofwat's Board leadership, transparency and governance principles

[22] unitedutilities.com/globalassets/z_corporate-site/responsibility-pdfs/assurance-statement-for-2022-23-remuneration-report.pdf

[23] unitedutilities.com/corporate/investors/results-and-presentations/annual-reports/

[24] unitedutilities.com/globalassets/documents/pdf/remco-tor---approved-22.11.pdf/download

[25] The 2022/23 directors' remuneration report commences on page 170 of the UUG PLC annual report available at unitedutilities.annualreport2023.com/media/lqrjgtx5/31404-united-utilities-ar-2023-fully-linked-spreads.pdf. Reports for previous years are also available on our corporate website or on request.

Category	Feature of our policy and approach
Relevant and stretching targets	• A substantial proportion of the remuneration that executives are eligible for each year is performance related (69%) and long-term (52%). This balance towards recognises the importance of focusing on aspects of performance that will improve outcomes for customers, communities and the environment for the long-term. The performance pay measures selected reflect customer priorities as identified by research in to what matters most to them • Of the performance related pay that executives are eligible for each year, currently 75% of annual bonus and at least 50% of long-term incentives are directly linked to delivery for customers. Overall, this amounts to nearly 63% of all performance pay • The stretching nature of the targets set for performance related pay is evidenced by the fact that they are not always achieved, and so executives therefore do not receive elements of the remuneration that they were eligible for • Even measures and targets which are not directly linked to delivery for customers have the potential to be reflective of customer outcomes. For example, the significant freeze/thaw event that affected our customers in Winter 2022 required a response that resulted in material additional costs to the company, and therefore had a detrimental effect on the outcome of the profit measure in the annual bonus. Additionally, return on regulated equity performance could be materially impacted by customer service delivery failure and have a detrimental effect on the long-term incentive outcome.
Taking account of overall performance, applying discretion, judgement and using underpins	• It is central to our remuneration approach that overall performance for customers, communities and the environment influence executive performance pay outcomes • Our pay policy enables the committee to override formulaic incentive outcomes by exercising discretion on outcomes if deemed necessary, and all assessments of performance are ultimately subject to the committee's judgement • Our long-term incentive plan contains a specific underpin whereby overall vesting is subject to the committee being satisfied that the company's achievements on its measures is consistent with underlying business performance • When determining the outcomes for executives at the end of an incentive's performance period, the committee considers the extent to which the formulaic outcomes are aligned with the experience of customers, communities and the environment, amongst other stakeholders • Clear disclosure is provided in our remuneration report of performance against the targets set and the other lenses through which the committee has considered the performance outturn, including the rationale for the eventual outcomes and the impact of any discretion used (if applicable) • The committee has a track record of rigorously applying these governance mechanisms. It exercised and disclosed the use of discretion in recent years by applying downward adjustments to the executive directors' bonuses on two occasions, recognising performance issues that became apparent during the year. For example, in 2016 the committee reduced executive directors' bonuses to reflect the impact on customers caused by a prolonged water quality incident in Lancashire in 2015 ("Franklaw") • In May 2023 the executive directors voluntarily waived around 21% of their incentive outcomes in respect of 2022/23, in recognition of their personal commitment to a reset across the water sector in relation to environmental performance. The committee and Board supported their decision, and also took action to make sure that customers did not pay for any performance-related executive pay outcomes in respect of 2022/23, with the costs being paid by a group holding company rather than the regulated company. This is a further illustration that the committee, Board, and indeed the executives themselves, behave responsibly in regard to executive pay and are sensitive to the external context within which it operates

Category	Feature of our policy and approach
Our long-term stewardship responsibilities are facilitated by best practice governance mechanisms	• Our incentive plan rules include comprehensive and legally enforceable malus and clawback provisions that enable the committee to withhold or recover payments in a number of circumstances, which are shown in Table 2 of Supplementary document *UUW72.* Any use of the provisions would be disclosed in our remuneration reports along with a clear rationale for their use • Executive directors are required to defer at least 50% of any bonus received into shares and these only become available after a period of three years • Long-term incentive outcomes for executive directors are assessed over a three-year performance period, followed by an additional holding period so that in total at least five years must elapse before any shares are due • These deferral and holding mechanisms provide the committee with time to consider and respond appropriately to any matters that were not known at the end of the relevant performance period but become apparent during the holding or deferral period, and this could include the use of the malus and clawback provisions referred to above • Executive directors are required to build to and retain a material personal shareholding in the company within five years of their appointment, of at least 200% of their salary • Combined with the deferral and holding periods this means their interests are strongly aligned with the long-term performance of the company, not only during employment but also for at least two years after departure, so any performance or reputational issues arising could have an effect on the value of their shareholding both whilst still employed and after leaving

9.8.2 Our executive pay policy and approach for AMP8

Our current policy was approved by shareholders in July 2022 and would therefore normally be due for renewal at the 2025 UUG AGM. However, the committee has accelerated the process for reviewing the policy, including performance pay criteria, to make sure that as set out above, when AMP8 begins in April 2025 our executive remuneration approach is well-aligned with Ofwat's expectations.

As a listed company there is a legislative requirement for shareholders to approve our pay policy, and so it will be put to shareholders at the 2024 UUG AGM. Our summary timeline for this process is summarised in Table 9-11 below. Given the support previously expressed by shareholders for our current approach we are confident that the policy and approach outlined above will be approved, and will be in place ready for the start of AMP8. By law, a policy can only apply for up to three years before requiring renewal by shareholders, and whilst we can commit our intention for ongoing alignment with Ofwat's expectations during AMP8 we note that flexibility in this respect is retained.

Table 9-11 - Summary timetable for the development and approval of our next pay policy

March-November 23	November 23-March 24	March-April 24	May 24	July 24
Develop proposals for new policy, including taking account of Ofwat's assessment of executive pay outcomes for 2022/23 (if available)	Consult with shareholders Update Ofwat and other stakeholders on progress	Consider feedback from consultation phase Update Ofwat and other stakeholders on progress	Finalise proposed policy *Also in May 24:* Agree performance pay outcomes for 23/24, again taking account of Ofwat's assessment of executive pay outcomes for 2022/23 (if available)	Seek shareholder approval of new policy at the 2024 UUG AGM

Further detail of our AMP8 approach is provided in *UUW72 – Executive Pay,* but Table 9-12 below summarises the key features of our intended pay policy and how it will meet Ofwat's expectations.

Table 9-12 - meeting Ofwat's expectations for executive performance pay in AMP8

Ofwat's AMP8 expectation	How our policy and approach will meet the expectation
Alignment to delivery for customers and the environment – policies should demonstrate that the criteria for awarding both the short- and long-term elements of performance related executive pay demonstrate a substantial link to stretching delivery for customers. This includes delivering on environmental commitments and obligations.	✓ Short and long-term performance-related pay will remain substantially linked to stretching delivery for customers, communities and the environment ✓ At least 75% of annual bonus outcomes will be linked to customer performance measures, influenced by the identified priorities of customers and regulators. Examples of customer measures used in AMP7 include: reducing storm overflow activations; delivering our Better Rivers commitments; achieving our ODIs; improving water quality so that fewer customers contact us about its appearance; and performing well in the regulatory customer service measure (C-MeX) rankings ✓ 50% of long-term incentive outcomes will be linked to customer performance measures, again influenced by customer and regulator priorities. Examples of measures used in AMP7 include: reducing/mitigating pollution incidents; supporting vulnerable customers; reducing leakage; performing well against the Environment Agency's Environmental Performance Assessment; and delivering carbon-reduction initiatives such as woodland creation ✓ The remaining 50% will be based on RoRE performance, noting that the totex and ODI components of RoRE also relate to delivery for customers ✓ At least 30% of overall executive performance-related pay schemes will be based on environmental measures ✓ Overall, when combining annual bonus and long-term incentives at least 62.5% of performance pay outcomes for executives will be linked to the delivery of stretching performance for customers, communities and the environment. Based on information available to us from other water companies' 2022/23 pay disclosures we are currently one of the sector leaders in regard to linking performance pay with delivery for customers (see section 4 of Supplementary document *UUW72* for further details) ✓ We will undertake research with customers to understand their priorities and the committee will take account of the findings when selecting performance pay measures
Stretching targets – policies should demonstrate that stretching targets are used for criteria which are related to delivery for customers and the environment. Companies will need to consider what is stretching in the context of the metrics being used.	✓ The committee's terms of reference will continue to require that "*performance elements of executive pay are transparent, stretching and rigorously applied*" ✓ The performance targets used to determine performance-related executive pay outcomes will be stretching by reference to our business plan, sector performance and regulatory requirements and determinations. The level of stretch applied will take account of the context of the specific performance metric/s selected ✓ Clear disclosure will be provided in our remuneration report of the targets used and performance achieved, so stakeholders can readily assess the extent to which they are stretching

Ofwat's AMP8 expectation	How our policy and approach will meet the expectation
Overall performance – policies should explain how remuneration committees will take into account overall performance delivered for customers, communities and the environment as well as performance against specific metrics when deciding on what, if any, award to make. Policies should set out what factors committees will take into account when considering overall performance, including poor performance. They should also be clear that poor performance overall will not be rewarded and clearly justify and explain any exceptions, for example to reflect stretching longer-term turnaround targets.	✓ The committee will be able to override formulaic incentive outcomes by exercising discretion on outcomes if deemed necessary ✓ Our long-term incentive plan will retain the specific underpin whereby overall vesting is subject to the committee being satisfied that the company's achievements on its measures is consistent with underlying business performance ✓ When determining performance pay outcomes for executives, in addition to reviewing performance against the specified measures the committee will consider other factors, including: the extent to which the formulaic outcomes are aligned with the wider experience of customers, communities and the environment; the experience of other stakeholders including colleagues and shareholders; significant events impacting customers and/or the environment in the course of the year; serious reputational issues; financial resilience; compliance issues, including actual or potential enforcement action or litigation; and Ofwat's assessment of performance pay outcomes from the prior year ✓ We will disclose clearly the factors considered and the lenses through which the committee has considered performance outcomes, the rationale for any pay-out received, the impact of any discretion used, and where necessary confirm that any identified poor performance has not been rewarded
Underpins, malus and clawback – policies should set out the approach to any underpinning arrangements, for example, by reference to overall performance, and any malus and clawback provisions and how and when these would be used. Recognising the limitations of intervention after the event, we also expect policies to set out how remuneration committees will take account of the existence of any enforcement activity, actual or pending, including through the use of deferral, or binding malus and clawback arrangements.	✓ Comprehensive and legally enforceable malus and clawback provisions will continue to apply with the potential triggers remaining at least as extensive as they have been in AMP7 (as shown in Table 2 of Supplementary document UUW72), and any use of the provisions will be clearly disclosed ✓ Executive directors will be required to defer at least 50% of any bonus received into shares which will only become available after a period of three years. The committee has the discretion to set the deferral level where it deems appropriate each year, and could choose to set it at a higher level in response to uncertainty, such as in recognition of actual or pending enforcement activity ✓ Long-term incentive outcomes for executive directors will be assessed over a three-year performance period, followed by an additional holding period so that in total at least five years must elapse before any shares are due ✓ These deferral and holding mechanisms will provide the committee with time to consider and respond appropriately to any matters that were not known at the end of the relevant performance period but become apparent during the deferral or holding period, which could include the use of the malus and clawback provisions referred to above ✓ Executive directors will remain required to build to and retain a material personal shareholding of at least 200% of salary in the company within five years of their appointment, strongly aligning their interests with the long-term performance of the company, not only during employment but also for at least two years after departure

Ofwat's AMP8 expectation	How our policy and approach will meet the expectation
Companies should commit to transparent and accessible reporting of policies and any changes to them and, where there are changes, the reasons for these. There should also be transparent reporting of the application of the policy in each year to include clarity on how overall performance has been assessed; and in relation to individual metrics being used, the targets set for those metrics, performance against each of them and the resulting award, if any, for each metric.	✓ We will continue to provide extensive, high-quality disclosures about our executive pay via traditional channels, such as our remuneration reports, recognising the importance of providing robust, clear and accessible explanations to stakeholders about performance-related executive pay, and in particular how it relates to performance for customers, communities and the environment ✓ As stated above, we will clearly disclose the factors considered and the lenses through which the committee has considered performance outcomes, the rationale for performance pay outcomes, the impact of any discretion used, and where applicable confirm that identified poor performance has not been rewarded ✓ We are also committed to improving the accessibility and visibility of important messages about our performance and the link to our executive pay approach and outcomes. We will consider how we might supplement our existing communication methods and with succinct explanatory messages using other media formats and channels, so that these new types of interaction points can be opportunities to prompt dialogue. We may seek input from relevant stakeholders, such as the CCW, on these new communication methods as we develop our approach.

Additionally, and going beyond the stated expectations of Ofwat, during AMP8:

- The committee will regularly take account of developments in the external climate, including those of a regulatory nature and issues affecting other stakeholders, to maintain an awareness of emerging and relevant matters so that any potential impact on the executive pay approach can be considered;
- Our remuneration approach will be reviewed and updated to appropriately reflect changes arising from the FRC's consultation on enhancing the UK Corporate Governance Code's effectiveness in promoting good corporate governance, expected to take effect in 2025; and,
- We will commission an annual independent assessment of our compliance with relevant reporting and governance standards (similar to those outlined in supplementary document *UUW72 – Executive Pay*).

9.8.3 Ofwat's performance pay guidance and recovery mechanism

The committee has noted that Ofwat has published guidance on its expectations regarding the approach to performance related pay. The committee will use Ofwat's guidance to help support its decision making throughout AMP8, and is already applying it in AMP7.

The committee has further noted that Ofwat will review companies' approach to executive performance pay and publish its findings each year. The committee will take account of these findings from across the sector and the potential relevance that these findings might have to our own future decisions and what we might learn as a result.

The committee also recognises that Ofwat intends to take action where it considers that customers should be protected from company decisions about performance related pay. This can include use of a recovery mechanism if a company is unable to demonstrate that it has met Ofwat's expectations. Given the committee's commitment to delivering performance pay outcomes that are transparent, well aligned with delivering value for customers, communities and the environment, and based on stretching targets, we would like to assure Ofwat and all stakeholders that were the company to be subject to such action this would be treated as a matter of serious concern. We consider that our approach in AMP7 has demonstrated the strength and depth of our commitment to a high quality and transparent approach to executive pay which is capable of winning the trust and confidence of stakeholders and we are committed to further developing this approach in AMP8.