



LICENSED PROVIDER DEFERRAL CAP, CREDIT SECURITY AND FINANCIAL RESILIENCE POLICY

1. Background and Purpose

Following proposals from the LP Working Group and consultation by WICS, new deferral arrangements replace the Wholesale Charges Deferral Scheme (WCDS) from May 2021, enabling Licensed Providers to extend payment terms to business customers and to benefit from corresponding deferral of wholesale charges. This forms part of a package of new market measures to support customers impacted by COVID and to improve the financial resilience of the market against future external shocks.

The purpose of this document is to set out Scottish Water's approach to the following three elements of the new measures:

- a) **Deferral Cap:** The scheme includes a cap on wholesale charge deferrals and this policy sets out Scottish Water's approach to determining the level of deferral cap which would apply equally to each Licensed Provider (section 2 below).
- b) **Security for alternative Credit Terms:** Licensed Providers signing up to all relevant new licence conditions will have the flexibility to agree with Scottish Water tailored credit arrangements as an alternative to prepayment. This policy sets out Scottish Water's approach to agreeing alternative credit security (section 3 below).
- c) **Financial Resilience:** The new market measures enable Licensed Providers to sign up to new licence conditions relating to increased financial resilience as an alternative to moving to 3.5 months prepayment of wholesale charges. This policy sets out WICS and Scottish Water's proposed approach to assessing increased financial resilience (section 4 below).

The policy is defined to ensure no detriment to the exercise of Scottish Water's core functions by minimising any bad debt risk associated with deferred wholesale charges in the event of Licensed Provider insolvency and mitigating the risk of additional financial support being required by the market in the event of future external shocks.

2. Cap on Deferrals

2.1. Default Cap on Deferrals

Scottish Water will cap the value of wholesale charges which can be deferred at 10% of a Licensed Provider's eligible charges in any given settlement report.

Eligible charges are the primary charges associated with all Supply Points registered to the Licensed Provider which would be eligible for deferral under the terms of the scheme (i.e. ≤ 25 mm metered, unmetered or surface drainage only Supply Points).

2.2. Credit security on increased cap

If a Licensed Provider wishes to apply for cap on deferrals higher than the default level set out in section 2 above, additional credit security would be required. To ensure no detriment to Scottish Water, the value of the credit security would need to cover 100% of the incremental value of the cap above the default level.



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The forms of credit security could include cash security account, guarantee, letter of credit and surety bond from a party with an Investment Grade credit rating, on terms acceptable to SW.

3. Security for alternative Credit Terms

The duration of prepayment required from Licensed Providers will vary from April 2022 as set out in section 4 below. Where a Licensed Provider has signed up to the relevant licence conditions they will be able to agree alternative credit terms with Scottish Water.

Agreement of alternative credit terms would be subject to acceptable credit security being in place. The credit security would need to provide the same value of credit cover as would otherwise be provided by prepayment under the terms of section 4 below i.e. for a Licensed Provider on two months prepayment under the terms of section 4 below, credit security for the value of two months wholesale primary charges would be required.

The forms of credit security could include cash security account, guarantee, letter of credit and surety bond from a party with an Investment Grade credit rating, on terms acceptable to Scottish Water.

4. Financial Resilience

In order to protect the market from future external shocks, **the Commission has indicated that from April 2022 3.5 months of wholesale prepayments is a reasonable level of liquidity that should be required by any retailer**, in the absence of any evidence or clear commitments to demonstrating its financial resilience.

From April 2022 the level of prepayment required from Licensed Providers who have signed up to the licence condition on financial resilience will be varied based on an assessment of their financial resilience. Where a Licensed Provider has also signed up to the licence condition on customer support, credit security to the same value may be provided as an alternative to prepayment (as set out in section 3 above).

By default, the level of prepayment or credit security required from Licensed Providers **could be** determined based on the Licensed Provider's credit score or credit rating as set out in Table 1 below.

Alternatively, Licensed Providers may also be able to apply for an individual assessment of their financial resilience by Scottish Water based on financial ratios. This would require the provision of full audited and more recent interim financial information by the Licensed Provider and would be subject to approval by the Commission.



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Table 1 – Financial Resilience Levels

Risk level	Credit Rating or Score	Licensed Provider signed up to Financial Resilience and Customer Support licence conditions	Licensed Provider signed up to Financial Resilience licence condition only	Licensed Provider signed up to neither Financial Resilience nor Customer Support licence conditions
1	Credit Score Assessment of [8, 9 or 10] (see Table 2 below)	6 weeks prepayment or credit security for 6 weeks wholesale charges	6 weeks prepayment	3.5 months prepayment
2	Credit Score Assessment of [5,6 or 7] (see Table 2 below)	2 months prepayment or credit security for 2 months wholesale charges	2 months prepayment	
3	Credit Score Assessment of <5 (see Table 2 below)	3 months prepayment or credit security for 3 months wholesale charges	3 months prepayment	

Table 2 – Equivalence of Credit Assessment Scores

Credit Assessment Score	Dunn & Bradstreet Comprehensive Report	Equifax	Experian Bronze, Silver or Gold Report	Credit Rating from Moody's, Standard & Poor's or Fitch
10	5A1/	A+	95-100	Investment Grade
9	5A2/4A1	A/A-	90-94	
8	5A3/4A2/3A1	B+	80-89	
7	4A3/3A2/2A1	B/B-	70-79	
6	3A3/2A2/1A1	C+	60-69	
5	2A3/1A2/A1	C/C-	50-59	
4	1A3/A2/B1	D+	40-49	
3	A3/B2/C1	D/D-	30-39	
2	B3/C2/D1	E+	20-29	
1	C3/D2/E1	E/E-	10-19	
0	Below E1	Below E-	Below 10	