Code principle – Relations with shareholders

Introduction by Dr John McAdam

"During the year, along with the company secretary, I met with several investors and we discussed a number of topics, the details of which I shared with my board colleagues. Such face-to-face meetings are extremely useful in providing the board with a balanced understanding of the views of major shareholders."

The board as a whole accepts its responsibility for engaging with shareholders and is kept fully informed about information in the marketplace including:

- the investor relations adviser produces an annual survey of investors' views and perceptions about United Utilities, the results of which are presented to and discussed by the board;
- the board receives regular updates and feedback on activities within investor relations and reports from sector analysts to ensure that the board maintains an understanding of investors' priorities; and
- the executive and non-executive directors are available to meet with major shareholders and institutional investors – this is also one of the specific roles of the senior independent director.

During the year, the role of adviser providing investment research to the company was re-tendered due to the service being considered in accordance with the EU Audit Directive and Audit Regulation (see page 77) to be a prohibited non-audit service, with the incumbent, Makinson Cowell, being part of the KPMG organisation. Rothschild Investor Advisory were engaged to provide these services with effect from 1 April 2017.

Institutional investors

We are always keen to engage with our shareholders, hear their views and update them on developments in our business. As well as current investors, we engage actively with institutional investors who do not currently hold shares in United Utilities, as we are keen to ensure our business is well understood across the investment community, and to hear and discuss the views of all investors.

We have an active investor relations programme, which includes:

- a regular schedule of meetings between the CEO and CFO and representatives from our major shareholders, supplemented with meetings hosted by our investor relations team;
- presentations by the CEO and CFO to groups of institutional investors, both on an ad hoc basis and linked to our half and full year results announcements;
- the programme covers a range of major global financial centres, typically including the UK, Europe, North America and the Asia Pacific region;
- regular feedback is provided to the board on the views of our institutional investors following these meeting; and
- close contact is also maintained between the investor relations team and a range of City analysts that conduct research on United Utilities.

In 2016/17, through our investor relations programme, we met or offered to meet with 42 per cent, by value, of the overall shareholder base, which represents 74 per cent of the targetable institutional shareholder base (when adjusting for shareholders who do not typically meet with companies, such as indexed funds).

Frequent areas of common interest arising in meetings with investors include operational and environmental performance, customer service, capital investment, efficiency initiatives, regulatory performance and regulatory changes. Investors are always keen to observe financial stability and are interested in the level of gearing versus regulatory assumptions; cost of finance; our debt portfolio and debt maturity profile; future financing requirements; and dividends. The outcome of the price review, covering the 2015-20 period, remains a key area of interest, and investors are keen to understand how the company is performing relative to the price review allowances and targets each year, along with the potential implications of regulatory change and political risk.

Retail shareholders

Despite the privatisation process being over 25 years ago, we have retained a large number of individual shareholders with registered addresses in the North West of England – in fact over 50 per cent of registered shareholdings on the share register. We have historically always held our AGM in our region in Manchester, which enables our more local shareholders, many of whom are also our customers, to attend the meeting. We endeavour to hold the meeting at a venue which is both centrally located in the city (to enable shareholders to use public transport should they so wish) whilst being mindful of the costs.

There is a considerable amount of information on our website, including our online report which provides information on our key social and environmental impacts and performance during the year. Together with the annual and half-yearly results announcements, our annual report and financial statements are available on our website; these are the principal ways in which we communicate with our shareholders. Our company secretariat and investor relations teams, along with our registrar, Equiniti, are also on hand to help our retail shareholders with any queries. Information for shareholders can also be found on the inside back cover of this document, with a number of useful website addresses.

Outcome of 2016 AGM

At the 2016 AGM votes were cast in relation to approximately 61 per cent of the share capital. All 17 resolutions were passed by the required majority. Votes were cast in favour of the reappointment of the board directors as follows:

Dr John McAdam	**97.49%**	Brian May	**99.55%**
Stephen Carter	**99.62%**	Steve Mogford	**99.80%**
Mark Clare	**99.63%**	Russ Houlden	**99.46%**
Sara Weller	**99.62%**		

Alison Goligher and Paulette Rowe will stand for election by shareholders for the first time at the 2017 AGM.

Corporate governance report

Relations with other providers of capital

Running a water and wastewater business, by its very nature, requires a long-term outlook. Our regulatory cycle is based on five-year periods, and we raise associated funding in order to build and improve our water and wastewater treatment works and associated network of pipes for each five-year cycle. We are heavily reliant on successfully acquiring long-term funding from banks and the debt capital markets to fund our capital investment programme and refinance upcoming debt maturities.

This requires long-term support from our credit investors who invest in the company by making term funding available in return for receiving interest on their investment and repayment of principal on maturity of the loans or bonds. We arrange term debt finance in the bond markets (with maturities typically ranging from seven years to up to 50 years at issue). Debt finance is raised via the group's London listed multi-issuer Euro Medium Term Note Programme, which gives us access to the sterling and euro public bond markets and privately arranged note issues. Committed credit facilities are arranged with our relationship banks on a bilateral basis. Additionally, the European Investment Bank (EIB), which is the financing arm of the European Union (EU), is our single biggest lender, currently providing around £2 billion of debt and undrawn facilities to support our capital investment programmes (past and present). Following the 2016 referendum regarding the UK exiting the EU (Brexit), it is likely that the EIB will significantly curtail new lending into the UK once Brexit has been effected. We therefore expect that post-Brexit, further loans from the EIB will not be available and our existing loan portfolio with the EIB will enter into 'run-off' in line with the scheduled maturities of each loan. The group is therefore likely to access the debt capital markets on a more regular basis post-Brexit. The group currently has gross borrowings of circa £7,384 million.

Given the importance of debt funding to our group, we have an active credit investor programme coordinated by our group treasury team, which provides a first point of contact for credit investors' queries and maintains a dedicated area of the company's website. One-to-one meetings are held with credit investors through a programme aimed at the major European fund managers known to invest in corporate bonds that may be existing holders of the group's debt or potential holders. Regular mailings of company information are sent in order to keep credit investors informed of significant events. The treasury team has regular dialogue with the group's relationship banks and the EIB and the credit rating agencies. More information can be found on our website at: **corporate.unitedutilities.com/93**

Code principle – Accountability

Introduction by Dr John McAdam

"One of the actions that was highlighted by our internal investigation into the Lancashire water quality incident in August 2015 was providing increased focus on reputational and operational risks. Accordingly, the information received by the board on the risk profile of the group has been broadened considerably."

Board's approach to risk management and internal control

The board is responsible for determining the nature and extent of the risks that it is willing to take to achieve its strategic objectives. The board is also responsible for ensuring that the company's risk management and internal control systems are effectively managed across the business and that they receive an appropriate level of scrutiny and board time. The group's risks predominantly reflect those of all regulated water and wastewater companies. These generally relate to the failing of regulatory performance targets or failing to fulfil our obligations in any five-year planning cycle, potentially leading to the imposition of fines and penalties in addition to reputational damage.

During the year, the board reviewed the effectiveness of the risk management systems, including financial, operational and compliance controls and the progress made to address the key recommendations of the investigation undertaken by Mark Clare, senior independent director, relating to the Lancashire water quality incident in 2015. This investigation identified that the risk management framework was robust whilst identifying a number of improvement opportunities, namely: better coordination of drinking water safety plans within wholesale; improved application by business units of the risk management process; further embedding existing risk management processes within wholesale; and improving system integration. All the actions have either been completed or were on target to be completed by their forecast completion date.

The board, following the review by the audit committee, concluded that it was appropriate to adopt the going concern basis of accounting (see page 131). Similarly, in accordance with the principles of the Code, the board concluded, following the recommendation from the audit committee, that it was appropriate to provide the long-term viability statement (see page 73). Assurance supporting these statements was provided by the review of: the group's key financial measures and contingent liabilities; the key credit financial ratios; the group's liquidity and ongoing ability to meet its financial covenants. As part of the assurance process, the board also took into account the principal risks and uncertainties facing the company, and the actions taken to mitigate those risks. These principal risks and uncertainties are detailed on pages 48 to 49, as are the risk management processes and structures used to monitor and manage them. Biannually, the board receives a report detailing management's assessment of the most significant risks facing the company. The report gives an indication of the level of exposure, subject to the mitigating controls in place, for the risk profile of the group. This now provides the board with information in two categories – group-wide business risks and wholesale operational risks. The board also receives information during the year from the treasury committee (to which the board has delegated matters of a treasury nature – see the structure diagram on page 59) including such matters as liquidity policy, the group's capital funding requirements and interest rate management.

Review of the effectiveness of the risk management and internal control systems

Taking into account the information on principal risks and uncertainties provided on pages 48 to 49, and the ongoing work of the audit committee in monitoring the risk management and internal control systems on behalf of the board (and for whom the committee provides regular updates, see pages 80 to 81), the board:

- is satisfied that it has carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity; and
- has reviewed the effectiveness of the risk management and internal control systems including all material financial, operational and compliance controls (including those relating to the financial

reporting process) and no significant failings or weaknesses were identified. After review, it was concluded that through a combination of the work of the board, the audit committee and the UUW board (with specific responsibility for operational and compliance controls), the company's risk management and internal controls were indeed effectively monitored throughout the year.

In the review of the effectiveness of risk management and internal controls systems the board also took into account:

› the biannual review of significant risks;

› the oversight of treasury matters;

› reviewing and assessing the activities and effectiveness of internal audit;

› reviewing management's internal control self-assessment;

› reviewing reports from the group audit and risk board;

› reviewing the outcome of the biannual business unit risk assessment process; and

› reviewing the business risk management framework supported by the work of the independent reviewer (see page 81).

Long-term viability statement

The directors have assessed the viability of the group, taking account of the group's current position, the potential impact of the principal risks facing the business in severe but reasonable scenarios, and the effectiveness of any mitigating actions. Based on this assessment, the directors have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the five-year period to March 2022.

The long-term planning detailed on pages 26 to 29 assesses the group's prospects and establishes its strategy over a long-term time horizon, proving a framework for the group's strategic planning process. The viability statement has been based on the group's strategic planning process which is aligned to the price control period, the group's liquidity position providing headroom to cover its projected financing needs through until mid-2018 and the group's robust capital solvency position with a debt to RCV ratio of around 60 per cent, providing considerable headroom within which to increase medium-term liquidity if required.

The group has a proven track record of being able to raise new forms of finance in most market conditions, and expects to continue to do so into the future. In addition, the board has considered the protections which exist from the regulatory and economic environment within which it operates. From an economic perspective, given the nature of water and wastewater services, threats to the group's viability from risks such as reduced market share, substitution of services and reduced demand are low compared to those faced by many other industries. From a regulatory perspective the group benefits from a rolling 25-year licence which, coupled with the price control set by Ofwat, provides a high degree of certainty of cash flows during the current price control period (which runs to March 2020), while between price control periods there exists additional protection afforded by Ofwat's primary legal duty to ensure that water and wastewater companies are able to finance their functions. For these reasons the board considers it appropriate to provide a medium-term viability statement of five years.

The directors have assessed the group's viability considering the principal risks as set out on pages 48 to 49, and its ability to absorb a number of severe but reasonable scenarios. These include political and regulatory risks, as well as the potential for a restriction to the availability of financing resulting from a global capital markets crisis. The viability assessment has considered the potential impacts of these risks on the group's business model, future performance, solvency and liquidity over the period. As well as the protections which exist from the regulatory environment within which it operates, a number of mitigating actions are available in the extreme scenarios considered, including the raising of new finance, capital programme deferral, the close-out of derivative asset positions and the restriction of dividend payments. These actions provide the group with significant scope to improve its liquidity and capital position to further absorb such threats.

The directors also considered it appropriate to prepare the financial statements on the going concern basis, as explained in the basis of preparation paragraph in the accounting policies section of the accounts.

Read the **Principal risks and uncertainties** on pages 48 to 49

Code principle – Remuneration

Introduction by Dr John McAdam

"Our remuneration policy has been designed in order to promote the long-term success of the company and delivery of the business strategy, with a significant proportion of senior executives' pay being performance related."

Read the **Remuneration committee report** on pages 86 to 109