

**MYNERS REVIEW OF THE GOVERNANCE OF LIFE MUTUALS:
CONSULTATION DOCUMENT**

RESPONSE BY GLAS CYMRU CYF.

Glas Cymru Cyfyngedig (Glas Cymru) is a Company Limited by Guarantee, substantially debt financed, the sole purpose of which is to own Dwr Cymru Welsh Water (Welsh Water). Welsh Water itself is a regulated water and wastewater utility providing services to some three million people in most of Wales and in some adjoining parts of England. Neither Welsh Water nor Glas Cymru carries out any other significant business.

Glas Cymru's articles of association ensure that its purpose is always to act solely in the best interests of its customers. As such, it share some similarities with the principles underlying "mutual" institutions. However, the customers of Glas Cymru do not "own" the company and do not provide its capital, which comes instead from private investors.

Glas Cymru has been invited to provide views to the Myners Review. The terms of reference for the Myners Review, include the request,

"where appropriate, the review may also develop general governance principles for other types of mutual (taking into account the particular characteristics of other parts of the mutual sector)" (page 7).

The consultation document also states that the Review will consider the corporate form of a Company Limited by Guarantee to be a "mutual" for the purposes of its review (footnote 4, page 5).

Prior to its inception, substantial consideration was given to the appropriate corporate governance arrangements for Glas Cymru, as it was (and still remains) the only Company Limited by Guarantee operating in the UK privatised utility sector. As such, the experience of Glas Cymru may provide some evidence of how the corporate governance of a non-shareholder company can be effectively adapted to the particular circumstances of its business environment. However, it should be stressed from the outset that the business environment in which Glas Cymru operates is demonstrably very different from that of life mutuals and so any parallels with the issues facing that sector will be quite limited.

In particular, the Review may wish to be aware of how Glas Cymru has approached key corporate governance issues, including:

- Compliance with the Combined Code
- Membership and expertise of the non-executive Directors of the Board
- Board committee structure
- Process of appointment of Directors
- The role of the industry regulator (Ofwat)
- The role of investors and other financial stakeholders

- The role of members and the information made available to them, both by the company and by external bodies.

Glas Cymru's view is that diversity of corporate form and ownership structure are beneficial for the water sector in the UK, within which it operates. Competition with shareholder owned water and wastewater Plcs is of great importance to the long-term efficiency and success of Glas Cymru. In turn, the presence of Glas Cymru may act as a competitive pressure on the rest of the sector over time.

Each of the questions raised in the Consultation document is addressed in turn below, in those cases where the experience of Glas Cymru may be of some relevance to the Myners Review.

Q. 1&2. Corporate governance guidance

From its inception, Glas Cymru gave a commitment to comply fully with the Combined Code. This was later enshrined in a Licence Condition for its regulated subsidiary, Welsh Water. Glas Cymru considers that heightened transparency is very important for a company that is not listed on the Stock Exchange, to give confidence to investors and other stakeholders that they will always be aware of the true financial and operating position of the company. A voluntary adherence to the requirements of the Combined Code is a good way to give this confidence. (Glas Cymru also complies with the Luxembourg listing requirements resulting from the bonds issued by a subsidiary company.)

For Glas Cymru, the "comply or explain" principle of the code is effective, because any such disclosure of non compliance would be subject to scrutiny by stakeholders which actively monitor the company's announcements, including bondholders, Financial Guarantor and rating agencies (see below), as well as the industry regulator Ofwat.

Glas Cymru holds an annual investors' meeting and two meetings a year for Members (including an AGM), at which such issues could be raised and the company's position on any matter subjected to challenge. The company also has an structured programme of dialogue with key financial stakeholders (bondholders, banks, rating agencies and financial guarantor) and regulators.

Q. 3,4, 5 & 6 Board effectiveness

The composition of the Board of Glas Cymru is particularly important because, in effect, the non-executive directors carry a heightened responsibility to be seen to hold the executive to account, in the absence of the role of shareholders. In addition, certain aspects of the business are technically complex, such as issues involving water quality science and environmental science.

Particular relevant features of the Glas Cymru Board include:

- The articles of association require there to be a majority of independent non-executive Directors – at present, there are 6 independent non-executives (including the Chairman) and 3 executive directors on the Board

- Directors have been given a formal induction programme to help them gain an initial understanding of the business.
- The Directors were chosen to have a range of relevant specialist experience – for example, one non-executive director has a strong background in public health, because this is a key feature of a public water supply business. Other directors have particular experience in corporate finance, corporate governance, business outsourcing and stakeholder management.
- Non-executive Directors are encouraged to take a particular interest in operational aspects of the business which are particularly relevant to their specialist expertise (e.g. outsourcing, regulation and government, PR and external communications).
- In particular, specialist committees of the board review operational performance on an ongoing basis. For example, the Quality and Environment Committee, which is chaired by a non-executive director, meets monthly to review in detail water quality, environmental performance and other technical issues.
- Whenever appropriate, non-executive directors have access to regular advice from independent, specialist advisers. For example, the Quality and Environment Committee is advised at each meeting by independent advisors with expertise in water quality and environmental science.
- The audit committee of the Board has always had regard to the importance of auditor independence and external advice, as recommended in the Smith Report. The audit committee of three non-executive directors has direct access both to the external auditor and to the independent internal audit function, which is provided by a second independent and specialist service provider.

As a Company Limited by Guarantee, the Directors of Glas Cymru are subject to reappointment by members on a rotating basis. New appointments are made following input from external advisers, to aid the independence of the process.

Q. 7&8 Policy holder voice

A crucial difference between Glas Cymru and a life mutual is that the capital for the business is provided by the capital markets and not by members. Therefore, corporate financial investors acting in their own self-interest provide a powerful source of scrutiny of the performance of the company, in a similar manner to the role played by shareholders in other companies.

The members of Glas Cymru also play an important role in scrutinising the standards of corporate governance of the company and the effectiveness of its performance over time. To aid this process, the company has an AGM each summer and also a review meeting with members each winter. Consistently, over 70% of members have attended each meeting. There is also a process for ongoing dialogue between the Company Secretary and members on issues that they wish to raise, and members are kept informed about performance generally and other topical issues through the issue of a monthly Members Bulletin

In order to maximise the independence and effectiveness of member scrutiny, the size of the membership has been limited to around 50, with members being appointed at

the recommendation of an independent membership appointment panel, which operates according to Nolan principles. The membership appointment panel has a published term of reference, which requires it to seek to maintain an overall balance of stakeholder interests and expertise among the membership, which reflects the activities of the business itself. Membership is personal and is unpaid.

To date, the interaction of the company with the membership has worked very effectively. Possibly due to the status and importance of Welsh Water in Wales, the company has been extremely pleased with the degree of interest and input from members.

Q. 9&10 Regulation

An important feature of Welsh Water is that all its operations are subject to a very high degree of independent regulatory scrutiny by bodies including the Director General of Water Services (Ofwat), Environment Agency, Drinking Water Inspectorate, Health and Safety Executive, Countryside Council for Wales and the National Assembly Government.

Ofwat, in particular, is an important source of competitive pressure on the business, as it sets five-yearly price caps, service standards and investment requirements (see below). However, all regulators are crucial in terms of the provision of comprehensive independent information about the relative performance of Welsh Water, which is of great benefit to those who scrutinise the performance of the company. Comparative information from annual reports by regulators are of particular use to non-executive directors, customers and members in assessing the effectiveness of Welsh Water.

Q. 11 Market Discipline

Welsh Water has to operate in competition with other water and sewerage companies, which are generally shareholder owned. This competition takes the form of comparative competition, as promoted by the industry regulator Ofwat through company specific efficiency targets and other means. The Board of Glas Cymru and other stakeholders are able to assess the competitive position of Welsh Water relative to the rest of the sector, in particular through the comparative information published by the regulators on relative levels of service, cost efficiency and so on.

Although Glas Cymru does not have shareholders, it does have over £2,200 million of “at risk capital”, which has been raised over the last three years in the capital markets. In particular, there are a number of institutions with a substantial, long-term exposure to Glas Cymru credit risk, which therefore monitor closely the performance of the company, in a way not dissimilar to the activities of large institutional shareholders. Indeed, many holders of Glas Cymru bonds are also owners of shares in other water companies.

Financial institutions which provide particular oversight of Glas Cymru’s activities include its financial guarantor MBIA, which has guaranteed £1,000 million of Glas Cymru bonds for up to 30 years, the credit rating agencies, which provide credit

ratings on public bonds of some £2,000 million, and of course the banks and bondholders themselves.

In the event of poor financial or regulatory performance by Welsh Water, there are certain “trigger events” which would result in additional powers being given to its creditors to help them achieve a turnaround in performance. These powers include, in particular circumstances, the right to appoint additional Directors to the Board, the ability to have an independent technical review of the company carried out, and the ability to “trap cash” in the business by precluding any distributions to its customers. Again, in these circumstances, Glas Cymru’s financial creditors could exercise at least as much influence over the business as the institutional shareholders of a Plc.

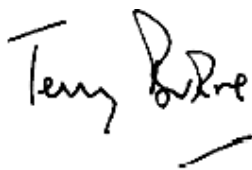
Q. 14 General governance principles for financial mutuals

The review’s terms of reference give it the task of considering what general governance principles might be applied to other types of mutual.

In carrying out this consideration, the review should have particular regard to the very different circumstances and the very different markets in which various mutuals operate. For example, as discussed above, Glas Cymru operates in a very different environment to life mutuals and other financial mutuals. It operates in a competitive market, which is subject to extensive sector specific regulation.

Also, in particular, Glas Cymru is operated for the benefit of its customers but does not raise its capital from its customers. Rather, it raises its capital from the capital markets and maintains a prudent balance of “reserves”, in the form of cash balances and undrawn borrowing capacity, which provide a buffer against financial or other shocks to the company. Thus, the division of interest between the customers of the business and its providers of capital are present in the case of Glas Cymru, albeit in a different form to that for a Plc with public shareholders.

If the review would like further information in respect of Glas Cymru it should please contact our company secretary (<mailto:richard.curtis@dwrcymru.com>)

A handwritten signature in black ink that reads "Terry Byrne". The signature is written in a cursive style with a horizontal line underneath the name.