

Risks

Risk management is a core component of our wider governance and internal control framework, which provides the overarching structure through which the company conducts its business.

We face a diverse range of risks and uncertainties. Those risks that have the potential to have a material impact on our company are our principal risks. We manage, monitor and report on the principal risks that can impact our ability to deliver our objectives. These risks are described on pages 126 to 139.

Managing risk

Southern Water's approach to risk management is designed to provide a clear and consistent framework for managing and reporting risks associated with our operations, to executive management and to the Southern Water Board. The framework seeks to promote better decision-making, avoid incidents and encourage the best outcome for the company and our customers by allowing us to:

- understand the risk environment, identify the specific risks and assess the potential exposure for Southern Water
- determine how best to manage identified risks to balance overall potential exposure
- take action to manage the risks we do not want to be exposed to, ensuring our resources are effectively and efficiently prioritised and used
- define our appetite for the range of risks and monitor and report risks against our desired risk appetite
- report up the management chain and to the Board on a periodic basis on how significant risks are being managed, monitored, assured and the improvements that are being made.

Risk management embedded in business processes

We want a risk management process that provides a consistent basis for measuring risk to:

- establish a common understanding of risks on a like-for-like basis, taking into account potential impact and likelihood
- report risks and their management to the appropriate levels of the company
- inform prioritisation of specific risk management activities and resource allocation.

All areas of the company review significant risks and business processes to help inform and enable risk-based decision-making. As part of Southern Water's annual planning process, the Executive Leadership Team and Board review the business' principal risks. These may be updated during the year in response to changes in internal and external circumstances.

Risk appetite

The Southern Water Board defines our risk appetite, enabling Southern Water, in both quantitative and qualitative terms, to judge the level of risk it is prepared to take in achieving its overall objectives.

We have aligned our risk appetite to our principal risks, and we have streamlined and simplified the process. This has included a review of our risk categories and our risk assessment criteria and is linked to wider improvements to our risk management framework.

➔ Read more on our operational performance on pages 74 to 99

The risk appetite for each of our principal risks underpins our governance and reporting framework and is reviewed regularly by the Board. The alignment of principal risk with risk appetite allows for an informed analysis and discussion of our risk position and has provided the Board with risk insight to inform key decisions.

As a company we are tolerating a level of risk which is outside our current risk appetite, and is reflected in the review of our principal risks on pages 126 to 139. This can result in more focus on short-term issues rather than longer-term resilience. The Board and the Risk Committee are actively engaged in reviewing and confirming our risk appetite as well as prioritising areas of focus to bring risks within appetite over the next few years.

COVID-19

The COVID-19 pandemic has brought a great amount of uncertainty. However, our role as a provider of vital water and wastewater services has not changed. What has become apparent is our need to be responsive and agile in our plans to protect public health as the pandemic continues to develop.

At the start of the pandemic, we moved in just one week from business as usual to a well-rehearsed Business Continuity Plan running against four simple priorities which have underpinned our COVID-19 response:

- Maintaining provision of essential services at all times.
- Protecting the health, safety and wellbeing of our employees, including our supply chain, and our customers.
- Providing the maximum practicable level of assistance to our vulnerable customers.
- Protecting the financial stability of our business.

The pandemic continues to impact our domestic customers, many of whom are facing uncertain futures and are struggling to pay their water bills. We have supported them in the short term, offering payment breaks and increased access to our support tariffs, while making sure that we monitor and prepare for the potential of increasing bad debt in the long term.

In addition to keeping customers informed, we created a dedicated COVID-19 area on our website, which included a letter from our CEO, Ian McAulay, and answers to common questions about the impact of the pandemic on our services,

changes to our ways of working, and the support available to them.

Our front line employees were identified by the Government as key workers, so we also published details of essential work that would carry on during the lockdown.

COVID-19 continues to challenge all parts of the business. The second lockdown in November 2020 and the third lockdown in January 2021 have stressed the importance of managing this element of risk to the business. All areas continue to monitor, review, and update their risks with reference to the pandemic as appropriate to reflect the latest view of COVID-19 impacts.

COVID-19 risks continue to be reviewed at a monthly risk session. As the pandemic evolves, and in light of government announcements of 22 February, 5 April and 14 June 2021, we are in preparation for the transition out of the national lockdown. We continue with COVID-19 adaptations where appropriate to mitigate continued risks, with regular monitoring and the ability to revert to business continuity mode as required. As the situation could change at any time, regular monitoring and risk assessment will remain in place.

There can be no assurance that the COVID-19 pandemic will not have a material adverse impact on the future of the company, should the situation change with future variants or waves of infection in the UK or other countries.

Brexit

As we moved towards the UK leaving the European Union at the end of December 2020, we undertook significant planning and preparations to ensure that the company was able to maintain its operations. Specific focus was given to our preparations for the supplies of chemicals, asset parts, and logistics. Additional work included preparations to confirm our operations in and around some of our coastal ports (Dover and Southampton) were not disrupted by any transport delays related to border crossings.

As we moved into January 2021, the risks we identified did not materialise and were relatively minor when compared to the scenarios for which we had planned and prepared. There was no significant financial impact.

Risks continued

Emerging risk

To reflect the requirements of the UK Corporate Governance Code, we have identified emerging risks facing Southern Water:

- **Drinking Water Inspectorate (DWI) enforcement regime** – during February and March 2021, the DWI has been consulting on a change to its method of regulatory enforcement. The DWI is considering a new approach to include a punitive financial penalty regime within its regulatory framework. Southern Water is currently subject to a number of DWI notices; this could lead to a risk of additional financial penalties.
- The potential introduction of a UK version of the Sarbanes Oxley Act will require close monitoring, reporting and understanding, to appropriately determine the impact on our business. These changes, which will impact the UK Corporate Governance Code, are not likely to impact until 2025. We are making preparations in this area by reviewing and making improvements to our system of internal control across both financial and non-financial aspects of the company.
- Further mutation and establishment of new variants of COVID-19 significantly impact the recovery of the UK economy or supply chain links in other countries. Additional and prolonged national lockdowns may also be required; this could give rise to increased customer and employee health and wellbeing issues that would need careful management.
- As COVID-19 continues to impact the economy, the potential for long-term solvency issues could see tighter bank lending standards that could impact on both our own ability to raise funds, but also our supply chain.
- As we begin to direct efforts to meet our net zero carbon obligations, there may be legislation and significant costs involved with market-based mechanisms designed to support the process. For example, carbon -offsetting may be cost prohibitive and limit our ability to meet targets.
- Environmental stakeholders are increasing pressure on water companies to limit their impact on the environment. This has emerged as a national debate on the future use of Combined Sewer Overflows and their impact on the environment.

Risk oversight and governance

To successfully embed risk management across Southern Water, the process is supported by a governance structure that defines roles and responsibilities at each level of the company.

The Board has overall responsibility for risk management but discharges this role through the Board Risk Committee. The formal Risk Committee report is included on pages 192 and 193. The committee meets three times a year and allows a detailed focus on risk factors to be discussed.

The Risk Committee advises the Board on the company's overall risk appetite, tolerance and strategy, taking into account the current and prospective regulatory, legal, political, macroeconomic and financial environment. The Board retains ownership and approval of the company's overall risk appetite, tolerance and strategy. The Southern Water Board also has ultimate accountability for risk management in Southern Water.

The Risk Committee oversees and advises the Board on the current risk exposure of the company and future risk strategy. It has a key role in risk assessment, including:

- reviewing the company's overall risk assessment processes that inform the Board's decision making, ensuring both qualitative and quantitative metrics are used
- reviewing regularly and approving the parameters used in these measures and the methodology adopted
- setting a standard for the accurate and timely monitoring of large exposures and certain risk types of critical importance.

In addition, the Risk Committee reviews the company's capability to identify and manage new risk types and reviews reports on any material breaches of risk limits and the adequacy of proposed action.

The Executive Leadership Team (ELT) is responsible for ensuring the corporate risk management system is effective and embedded in the business, and operates in accordance with the Southern Water's risk management approach.

➔ Read more about the Board's role in mitigating risks on pages 192 to 193

Key responsibilities include:

SWS Board	<p>The Board retains overall accountability for risk management in the company</p> <p>Attendees: SW Board members (including Executive, Non-Executive Directors)</p>	↑
SWS Board Risk Committee	<p>Responsible for oversight and challenge of the effectiveness of the risk management environment – meets three times a year</p> <p>Attendees: SW Board members (including Executive, Non-Executive Directors)</p>	↑
Executive Risk Committee	<p>Reviews enterprise risks, risk improvements, strategic risk review – meets quarterly</p> <p>Attendees: Executive committee (ExCom) of the Executive Leadership Team</p>	↑
Executive Leadership Team	<p>Receives monthly updates on operational risk dashboard</p> <p>Attendees: Executive Leadership Team</p>	↑
Enterprise Risk Management and Resilience Team (ERM)	<p>Provides support, guidance, training and management reporting</p> <p>Development, maintenance and embedding of the risk framework</p>	↑
Directorate Risk Forum	<p>Responsible for ensuring that effective risk management is in place and operating across all activities within their remit – meets at least quarterly</p> <p>Attendees: Senior Management team and Delegates</p>	↑

Our transformation

The Board continues to recognise the importance of effective risk and resilience management, champions its use within decision-making forums and is deeply committed to embedding risk management at every level of the organisation. As part of our transformation, we have recognised the need to improve our approach to risk and resilience management. Additional resource and expertise has been brought into the company to support the further development of risk management. A key aspect of this development is the implementation of a new business partnering model developed to ensure teams across the company are supported, facilitating risk-informed insight into day-to-day business activities.

Our Risk Management team has proactively engaged and collaborated with key stakeholders from across the business to identify improvements and enhancement to the existing risk management framework. Through extensive engagement with the Executive Leadership Team, Executive Risk Committee and wider company, a number of areas of improvement were identified.

Risks continued

Transforming our approach to risk management

Framework:

- Collaborating across the company to better understand the needs of the key stakeholders and identify any gaps and inconsistencies in the existing framework.
- Redefining the Enterprise Risk Management and Resilience framework, aligning it to industry best practice in the form of ISO 31000 – Risk Management.

Risk criteria:

- Through engagement with the Board and other key stakeholders, revised criteria for assessing material impact have been developed to be more reflective of our business operations.
- The downside areas of impact for each risk assessed have been refreshed and broadened to reflect our priorities and values.
- The impact descriptions are now more detailed and prescriptive to help teams across the business better understand the downside consequence of risk events.

Risk taxonomy:

- We have refreshed our taxonomy and aligned the structure to our principal risks.
- The new taxonomy allows for clear, enhanced identification and allocation of risk from both a top-down and bottom-up perspective.
- Risk tolerances have been added to each risk component within the risk taxonomy, allowing each element to be confirmed against the Board-approved risk appetite.

Risk appetite:

- The Board has refreshed its view of risk appetite, and it is underpinned by the updated risk taxonomy.
- A new simplified three-band approach to risk appetite has been implemented.
- The refreshed framework now supports the company in understanding where we should be reducing the impact of downside risk, versus those risks where we should or could be seeking risk if there is a possibility of upside opportunities.
- The new approach is being actively used to support decision-making, not least at Board level, where risk appetite is considered on key decisions, including the approval of the latest execution plan.

Roles and responsibilities:

- The Board has championed an approach to managing and owning risk in Southern Water.
- Each directorate's senior management team reviews and monitors its risks and has an established risk forum that meets at least quarterly.
- These forums are actively supported by the Enterprise Risk team, which supports as part of its business partnering approach and provides a forum for focused discussion on risk management, supporting and promoting a dialogue on risk and supporting decision-making.

Data cleanse:

- As part of the wider changes detailed above, a full review of the risk data in our systems was initiated.
- Working with teams across the company, a revised set of priority risks has been identified. The new risk profile has now been shared with senior management, the Executive Leadership Team, the Risk Committee and the Board.

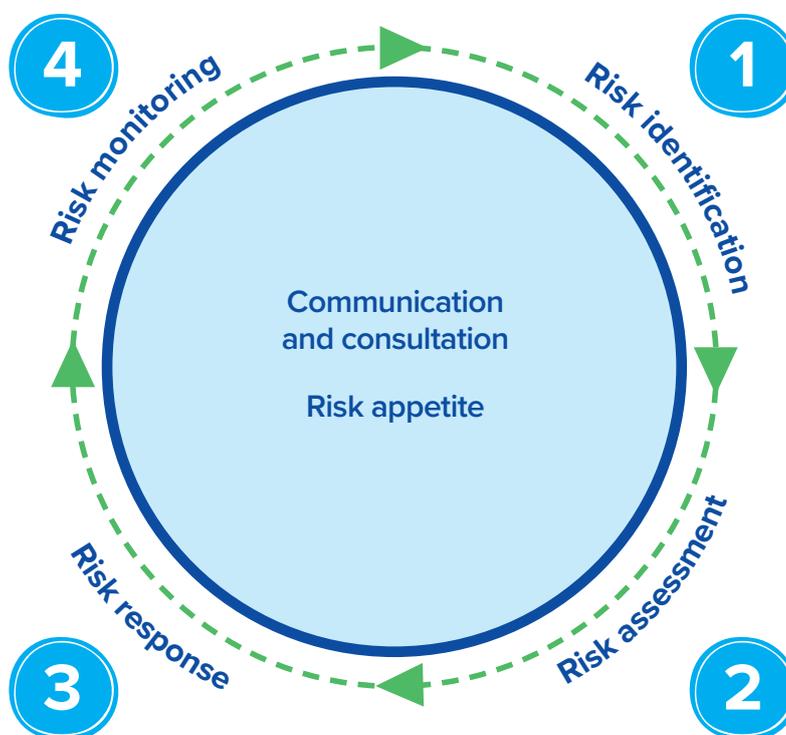
The next 12 months

The coming year will see continued embedding of our risk management approach; it is recognised that our journey is not complete and additional improvements have already been identified to further support risk-based decision-making across the company. This will see effort focused on maturing in a number of areas:

- Continued training with teams across the company, through the use of virtual and workshop sessions.
- To support our approach to risk management, and to deliver on commitments to Ofwat, we are implementing a Governance, Risk and Control (GRC) system. The project solution will provide a robust system to strengthen our risk management improvements and will also support assurance and control work across our Risk and Compliance teams.
- Enhancing our ability to report our risk position is a key focus and priority and will be achieved through the integration of enhanced reporting tools. The ability to extract and tailor assurance data will support the business in fully understanding the risk landscape and its relationship to our risk appetite, helping the company make better, risk-informed decisions.
- The improvements we are making to our risk management approach are setting the company up for future success. As we further embed these improvements, we will be able to demonstrate to our customers and external stakeholders that the decisions we make are considered, well thought through, and demonstrate a continued commitment to our values.

Risks continued

The purpose of our approach to risk management is to support better decisions through an improved understanding of risk.



The objectives of our risk management strategy relating to principal risks are to:

- 1 identify and understand all the principal risks that we face
- 2 select and proactively adopt strategies and plans to address, including seeking opportunities from those risks that deliver the right returns, and understanding their potential impact on the company
- 3 take action to mitigate our exposure to the principal risks, ensuring our resources are effectively and efficiently prioritised and used
- 4 use the analysis of our principal risks to inform our strategy and to monitor and report the risks we are taking against our desired strategic objectives.



Principal risks and uncertainties

Operational risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

1 Water

Description:

We must ensure we can supply enough good quality drinking water to cater for a growing population of more than 2.6 million people across Kent, Sussex, Hampshire and the Isle of Wight.

Should operational water treatment processes fail, the water supply become contaminated, or our water distribution network fail:

- there is a risk that water could be supplied to customers that is unfit for consumption
- large numbers of customers could find their water supply becomes cut off
- harmful chemicals could be released to the environment.

Executive accountability:

Director of Wholesale Water Services

Link to our values:

Doing the right thing / Succeeding together / Always improving

Forecasted business impact:

Long term

Areas impacted:

Customer experience, business disruption, brand and reputation, legal and regulatory, financial

Cross reference:

- ➔ Read more on our business model on pages 52 to 53
- ➔ Read more about how we deliver great service on pages 80 to 85

Risk climate: ●

Our risk profile has deteriorated following the introduction of challenging regulatory targets in the 2020–25 business plan; in particular, the amendment of regulatory limits on the amount of water that can be abstracted for water supply in our western region is proving challenging. Furthermore, increased demand from our customers, particularly within our Sussex North region, during the ongoing COVID-19 pandemic has placed additional stress on our asset infrastructure. In addition, we are now working to challenging performance targets, with respect to leakage, interruptions to supply and Compliance Risk Index (CRI) and Event Risk Index (ERI) and Security of Supply Index (SoSi).

Risk drivers:

- Levels of investment in maintenance and growth schemes to support asset capability and capacity.
- Ageing infrastructure increasing the frequency and severity of asset failure.
- Non-adherence to established processes and procedures when under pressure of operational incidents.
- Challenging regulatory targets from source to tap.
- Management of contracts for operational and maintenance services.
- Fluctuation and severity of weather events.

Mitigating strategy

- New bulk supply arrangement with SES Water and improvements to assets to support resilience in Sussex North.
- Portsmouth and Havant Thicket reservoir to provide additional long-term resilience.
- Water for Life Hampshire – significant capital and asset improvements providing long-term resilience in Western area.
- Introduction of a rolling 12-month strategy plan that identifies the needs of the business to meet its commitments.
- Water First – our improvement programme strengthening internal processes and asset performance.
- Water quality hazard review programme complete at our water production sites, with similar programmes being undertaken at network booster stations and treated water storage assets.
- Maintained ISO 9001 accreditation for continuous improvement.
- Robust and extensive regulatory monitoring programme of samples from source to tap.
- Incident and emergency planning system, process and procedures in place.
- Proactive leakage detection monitoring and reporting.
- Customer education programme supporting an improved understanding of the value of water – Target 100 water efficiency programme.

Operational risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

2 Wastewater

Description:

Our region benefits from a high-quality environment, both inland and coastal. We are fortunate to have some extremely rare habitats, as well as some of the best quality river fishing and coastline in the UK. Reliable wastewater services are essential to maintain public health and protect the environment

Should operational wastewater treatment processes fail, or our sewers and pumping stations become blocked or fail, our assets may discharge sewage, which is not of the required standard, to the environment. This may cause risks to the environment or public health from pollution and/or sewer flooding. There is also the potential to cause damage to the environment or distress to customers. This could lead to prosecution and fines by the Environment Agency and a reduction in stakeholder and customer confidence.

Executive accountability:

Director of Wastewater and Asset Management

Link to our values:

Doing the right thing / Always improving

Forecasted business impact:

Long term

Areas impacted:

Customer experience, business disruption, brand and reputation, legal and regulatory, financial

Cross reference:

- ➔ Read more on our business model on pages 52 to 53
- ➔ Read more about how we protect and improve the environment on pages 88 to 93

Risk climate: ●

The environment this risk relates to has deteriorated over the past 12 months; this is largely due to increased challenges, specifically in light of increased capacity demand, fluctuations in extreme weather events and challenging regulatory targets that are expected to be more onerous should newly-planned restrictive regulation be implemented. A national debate on the water companies' impact on the environment, and particularly the use of Combined Sewer Overflows has intensified over the last year. This could lead to additional regulatory scrutiny or intervention. We are working to increasingly challenging targets in the business plan period 2020–25, a number of which were not funded in the price review, with respect to wastewater treatment compliance and pollution.

Risk drivers:

- Asset capability performance due to ageing infrastructure.
- Increase in regional power outages.
- Investment requirements to support growth schemes for new housing developments.
- Levels of investment in maintenance and development schemes to support asset capability.
- Meeting the required standards of wastewater treatment and asset management to protect the environment and/or public health from pollution and/or sewer flooding.
- Non-adherence to established processes and procedures when under pressure of operational incidents.
- Drive to meet obligations on carbon neutrality (net zero).

Mitigating strategy

- Pollution Incident Reduction Plan (PIRP) delivery is ongoing and leading to improvements in underlying performance.
- Introduction of a rolling 12-month strategy plan that identifies the needs of the business to meet its commitments.
- Dedicated growth planning team established, tasked with developing plans and strategies that consider long-term resilience over the next 25 years.
- Generator maintenance programme in place with new contract process being embedded throughout 2021.
- Regular testing of power management systems and our back-up generator capacity to ensure continuity of services.
- High voltage equipment maintenance programme in place with external suppliers.
- Customer awareness/education programmes on avoiding blocked drains, targeted at catchments with blockage hotspots.
- Climate Adaptation Plan will be published by December 2021.
- Drainage Water Management Plans (DWMPs) are supporting work to improve drainage and environmental water quality.
- A culture transformation programme to develop a behavioural competency framework for our employees.

Principal risks and uncertainties continued

Operational risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

3 Customer

Description:

Providing an excellent customer experience is a key objective for us. We recognise the importance of prioritising our customers, and that accomplishing our strategic goals is contingent on providing the level of service expected by our customers and our regulators. We may not be able to provide the desired standard of service to our customers if there is inadequate capability in our people, process or systems.

Executive accountability:

Director of Customer Service

Link to our values:

Doing the right thing / Always improving

Forecasted business impact:

Medium term

Areas impacted:

Customer experience, brand and reputation, legal and regulatory, financial

Cross reference:

- ➔ Read more on our business model on pages 52 to 53
- ➔ Read more about how we deliver great service on pages 80 to 85

Risk climate: ●

The scale of the challenge is significant if the period 2020–25 business execution plan is to be delivered; the spend on Customer Service in 2015–20 is £95 million more than the allocation in the Final Determination (FD) for 2020–25, therefore the scale of improvement required to deliver the FD is significant. Our performance on key performance metrics is improving, although our performance is not where we would like it to be for both key performance metrics (C-MeX and D-MeX).

There has been no significant change in our risk profile during 2020–21. We continue to deliver improvements through our customer transformation plan (Velocity), and supported many of our customers impacted by the effects of the COVID-19 pandemic. Improvements to how we run our developer services channels have also been implemented, strengthening performance in this area.

Risk drivers:

- Customer and wholesale business impact on our C-MeX and D-MeX performance.
- New property builds requiring additional odour mitigation measures.
- Manual processes, which may lead to errors that require automating.
- Potential weakness of third-party customer service providers.
- Transformation project (Velocity) does not deliver in improvement of cost to serve.
- Increased number of growth schemes.

Mitigating strategy

- Our transformation project continues to develop the processes and technology underpinning our customer service.
- Contractual targets in place with key third-party suppliers providing customer service.
- Leadership team-led Operations Committee held monthly tasked with monitoring C-MeX and D-MeX performance.
- Cross-functional C-MeX group ensures appropriate accountability and management focus across the business.
- Dedicated team in place to proactively engage with local authorities and new-build developers to ensure the appropriateness of supply planning and connection.
- Specific incident management process and procedures for customers in the event of service impacts.
- Process in place to support vulnerable customers affected by an incident such as COVID-19 or water emergency.
- Customer insight work to better understand customer requirements.

Financial risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

4 Financial

Description:

Exposure to financial markets and other macroeconomic factors, impacting the ability to accurately forecast and ensure the continued ability to meet our short-term and long-term financial obligations. A failure to maintain certain credit ratings could lead to an increase in interest cost and reduced availability of finance. This could put pressure on our ability to finance our capital investment programme or refinance our existing debt maturities in the future. We only enter into treasury transactions to manage inherent risk and support prudent funding, not to speculate.

Executive accountability:

Chief Financial Officer

Link to our values:

Doing the right thing / Succeeding together

Forecasted business impact:

Medium term

Areas impacted:

Brand and reputation, legal and regulatory, financial

Cross reference:

- ➔ Read more on our business model on pages 52 to 53
- ➔ Read more on our financial performance on pages 102 to 111

Risk climate: ●

Our risk profile has deteriorated due to significant adverse financial impacts as a result of a challenging final determination, and managing the effects of the COVID-19 pandemic with revenue loss through an increase in bad debt and additional COVID-19 related costs.

During the year, we have remained at risk of downgrade in the credit ratings as a result of concern regarding perceived challenges facing the company in delivery of the business plan 2020–25, difficulties in meeting Ofwat Outcome Delivery Incentives (ODIs), and potential fines from the outstanding prosecution from the Environment Agency.

Our current credit ratings are provided on page 111.

Risk drivers:

- Accuracy of forecasts to meet long-term financial liabilities and obligations.
- Ability to access cost effective capital through maintaining an appropriate credit rating.
- Revenue impacts caused by counterparty defaults due to delayed Brexit or ongoing COVID-19 influences.

Mitigating strategy

- Liquidity testing and reporting is carried out on a regular basis, forming part of the going concern assessment.
- Sufficient cash and facilities are maintained to mitigate such risks as bond market closures.
- We ensure the aggregate nominal value of debt maturities does not exceed 40% of RCV in any single regulatory period (and 20% of RCV in any 24 months).
- Flexible dividend policy supports management of financial risk.
- Regular discussion with ratings agencies to evaluate financial health.
- We take each of the main credit agency ratios, relevant for our ratings, into account when setting the plan (one-year, five-year).
- Regular discussion with bank groups and lenders.
- We established a Sustainable ESG Framework during the year, and issued our first dual tranche sustainable bond in May 2020.
- Current borrowings are 'fixed rates' or 'index-linked' and we have no exposure to interest rate rises on our current borrowings.
- We ensure sufficient funds are available for our operational and capital investment programme.

Principal risks and uncertainties continued

Corporate risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

5 Compliance

Description:

We are a highly-regulated business with three main regulators: Ofwat, the Drinking Water Inspectorate (DWI) and the Environment Agency (EA).

Inadequate culture, structure, capability, governance and assurance could result in failure to meet these high standards consistently. The consequences can be regulatory enforcement, fines, legal action and, in the worst case, the loss of our appointment as a water and wastewater company. As with all companies, we are also required to comply with corporate legislation (for example Competition Law and the Bribery Act).

Existing and changing legal and regulatory requirements encourage the business to operate in an agile way to ensure continued compliance with our obligations.

Risk climate: ●

This risk remains high as a result of regulatory compliance issues, which have been raised by our regulators. We continue to be the subject of intense regulatory scrutiny. We are being prosecuted by the EA for wastewater permit breaches, we have pleaded guilty to charges in court and we are assisting the EA with its investigations into legacy issues relating to wastewater sampling compliance. Further detail on these and the Ofwat investigation can be found on pages 30 and 31 and in our Annual Performance Report.

The DWI and the EA continue to monitor our delivery of regulatory schemes (outputs) and this is likely to continue. Challenging performance on the Compliance Risk Index (CRI) from the DWI, and one-star performance on the EA's Environment Performance Assessment (EPA), is reflected in continued scrutiny from both regulators. Ofwat continues to focus on our ODI performance and compliance with Section 19 Undertakings.

Executive accountability:

Director of Risk and Compliance

Link to our values:

Doing the right thing / Always improving

Forecasted business impact:

Short term

Areas impacted:

Brand and reputation, legal and regulatory

Cross reference

- ➔ Read more about our regulators on page 30
- ➔ Read more on pages 186 to 193

Risk drivers:

- Failure to comply with the requirements of our Licence of Appointment with Ofwat (including our Section 19 undertakings).
- Failure to meet our obligations with the EA, as reflected in the Environmental Performance Assessment (EPA).
- Meeting our Water Quality obligations as reflected in key performance metrics (CRI and ERI) and DWI notices and enforcement.
- Failure in the ability to embed core controls over key processes, either financial or non-financial.
- Threat of a breach in our business ethics or Code of Conduct by an employee or contractor.
- Protection of data – GDPR.

Mitigating strategy

- Embedding of a robust three lines of defence compliance model and a dedicated Risk and Compliance function.
- Improved training, investment, internal business processes and controls via our transformation programmes.
- Company values linked to culture change programme and performance management, promoting ethical business practice.
- Subject matter experts and mandatory compliance-related training.
- Annual reporting is externally verified by financial and technical auditors to provide assurance on our compliance.
- Technical assurance of front line operations is supported by ISO 9000, ISO 17025 and ISO 14001 accreditation.
- A compliance framework with internal monitoring and assurance and an ethical business framework.
- Compliance with company procedures is reviewed through self-assessment every six months.
- Mandatory training courses are identified and communicated to all employees for completion.
- Contractors sign up to our Code of Conduct and supply evidence of operating within legal and regulatory environment.
- Enhancements delivered across the system of internal control, specifically within the assurance functions.

Corporate risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

6 Climate change

Description:

The impacts of climate change will continue to increase our related risks of water resources, drought, flooding, and extreme weather events. We supply drinking water to a growing population in areas already classified as under 'severe water stress'.

If we are unable to improve our resilience to the extreme weather events predicted by the physical impacts of climate change:

- we will find it increasingly difficult to supply sufficient water to meet the growing demands of our customers though scarcity of water resources, or contamination by saline intrusion of existing water reserves
- the assets on our sites, or our sewer system network, could more easily be overwhelmed by storm events, leading to flooding or pollution in our region
- our coastal sites may become inundated from rising sea levels or at risk of coastal erosion.

Risk climate: ●

Our risk profile has deteriorated due to continued worsening external climate change factors impacting the ability to supply sufficient water to meet the growing demands of our customers. Ongoing challenges with more stringent, revised abstraction licences in Hampshire, which limits our ability to access water in Hampshire and makes us more vulnerable to weather events. In addition, we have seen the emergence of supply issues in our Sussex North area.

Combating climate change is also about mitigating the causes of climate change. In terms of Southern Water's efforts to join the global response to climate change, we have made a Public Interest Commitment (PIC) to become a carbon neutral (net zero) company by 2030 (as part of the English water companies).

Mitigating strategy

- Public Interest Commitment to become a carbon neutral (net zero) company by 2030.
- Board-approved net zero plan.
- 50-year Water Resources Management Plan, to provide resilience against drought and climate change.
- Drought Plan containing measures to conserve water, operate our sources and secure additional resources.
- In excess of £400 million was invested in the existing water and wastewater infrastructure through 2015–20.
- Established climate change working group.
- Customer campaigns supporting an understanding of the value of water – Target 100 water efficiency programme.
- Investment in new infrastructure, including the Havant Thicket Reservoir.
- Drainage Water Management Plans (DWMPs) supporting work to improve drainage and environmental water quality.
- RAPID process will lead to new investment in the Western Area as part of Water For Life – Hampshire.

Executive accountability:

Director of Environment & Corporate Affairs

Link to our values:

Doing the right thing / Succeeding together / Always improving

Forecasted business Impact:

Long term

Areas impacted:

Customer experience, business disruption, brand and reputation, legal and regulatory, financial

Cross reference

- ➔ Read more on sustainability on pages 63 to 73
- ➔ Read more on environmental disclosures on pages 70 to 73

Risk drivers:

- Failure to adapt to the long-term effects of climate change.
- Challenging regulatory targets.
- Unless there is unprecedented investment, there is an inability to meet the demands of a significantly-increased customer base.
- Onerous and challenging targets to mitigate the effects of our carbon footprint.
- Fluctuation and severity of weather events.

Principal risks and uncertainties continued

Corporate risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

7 Delivery

Description:

We have a planned investment programme of £2.1 billion between 2020 and 2025. We have plans in place to ensure we will deliver this and we are working hard to ensure our focus is maintained to complete all works on time.

If we are unable to deliver significant parts of the programme on schedule, our ability to provide an excellent service to our customers could be compromised. Any failure to deliver would also prevent us from fulfilling the promises that we have made in our business plan with regard to performance measured by our outcome delivery incentive measures, along with commitments to our regulators.

Executive accountability:

Director of Engineering and Construction

Link to our values:

Succeeding together / Doing the right thing / Always improving

Forecasted business impact:

Medium term

Areas impacted:

Customer experience, brand and reputation, financial, people

Cross reference:

➔ Read more on about how we are getting fit for the future on pages 96 to 99

Risk climate: ●

The scale of the requirements of the capital investment delivery programme, combined with a tight financial settlement in the period 2020–25, has increased risk in this area.

Our risk profile has deteriorated due to the size and scale of the requirements of the capital investment delivery programme, during the unprecedented time of managing the effects of the ongoing COVID-19 pandemic. The financial pressure on the capital programme, plus stringent requirements from regulators to deliver extensive programmes of work, has seen an increase in risk in this area. Key recent focus has been on delivery of our WINEP obligations and on key notices from the DWI.

Risk drivers:

- A tight Financial Determination from Ofwat has put pressure on capital delivery budgets.
- Delivery delays as a result of on-site restriction and COVID-19.
- Supply chain restrictions as a result of Brexit.
- Challenging delivery efficiencies that are required to deliver value for the wider business.

Mitigating strategy

- We have brought significant investment capability in-house including:
 - an embedded engineering and capital delivery function
 - an established long-term delivery partner supply chain.
- Enhanced management information procedures ensure the delivery of the business plan is given the greatest level of focus.
- Risk and value are considered at each step of the investment cycle to provide best value for money to our customers.
- Enhancing and continuously developing our asset planning systems, processes and capabilities.
- Monitoring the delivery of our final determination obligations, continually assessing our financing status.

Corporate risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

8 Information Technology (IT)

Description:

If we do not maintain the resilience of our operational and enterprise IT systems, their failure could have a significant impact on our business reputation, ability to operate, and the resilience of our operational assets.

Additionally, we hold and process personal and payment data about our customers and employees, so it is important that we treat this information with respect and in accordance with the requirements of information governance.

Failure to properly protect the data we hold could lead to reputational damage and loss of confidence from our customers, as well as significant fines under Data Protection (GDPR) and the Network and Information Systems (NIS) Directive.

Executive accountability:

Managing Director

Link to our values:

Doing the right thing / Always improving / Driving results

Forecasted business impact:

Long term

Areas impacted:

Customer experience, business disruption, brand and reputation, legal and regulatory, financial

Cross reference:

➔ Read more on our business model on pages 52 to 53

Risk climate: ●

There has been no significant change in the risk climate, notwithstanding managing the effects of the COVID-19 pandemic by providing additional IT infrastructure, hardware, and other key equipment to support remote working. Although, there is a heightened risk of cyber attack that could disrupt our key systems.

We continue to rebuild our IT capability. This transformation has been ongoing for the past four years and has featured in-sourcing of our IT capability and seen an improvement in our IT estate.

Risk drivers:

- Lack of cyber security controls and monitoring in place for business systems.
- Technology failure through the use of, and dependency on, legacy systems.
- Appropriate business continuity processes to reduce any impact on our IT systems.
- Mishandling or deliberate sabotage of employee or customer data.
- Non-compliance with NIS directive requirements.
- Inability to monitor and manage operational functions (telemetry and control) or to provide IT-supported customer services, including billing or new service provision.
- Weakness in the security of our telemetry network, where physical access to the network can be obtained.
- Malicious attacks from sabotaged plant activity or the loss of control of major site systems.

Mitigating strategy

- We have implemented two new data centres – these are focused on resilience and protecting our core services.
- Active programme for migration of services off heritage infrastructure and onto new fully-managed infrastructure.
- Migration of existing critical and core service solutions to the new data centres which are focused on resilience, protecting core services and preventing issues before they occur.
- Enhanced suite of IT general controls identified following alignment to the Network and Information System – Cyber Assessment Framework.
- Mandatory business-wide cyber security and data protection training provided to all employees.
- Information Governance Council with the responsibility of oversight and governance of our GDPR and NIS compliance.
- Continued investment in cyber threat mitigation strategies in response to the ever-changing risk landscape.
- Cyber-security investment to implement new tools and processes.
- New end-user Windows 10 and virtualised desktop roll-out.

Principal risks and uncertainties continued

Corporate risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

9 Resources

Description:

The nature of our business model includes the use of long-term contracts for the provision of critical goods, services and works, as well as some outsourced activities. Some of our most critical resources include the supply of chemicals, fuel and spare parts to ensure continuity of service, as well as the energy required to power our operational equipment on a continuous basis, at a commercially viable price.

There is a risk that a failure to have the required external market capability and capacity would lead to Southern Water being unable to deliver its committed obligations, required efficiencies in our business plan, and a return for our shareholders. There is a risk that a failure to have an effective resilient energy model in place will lead to power interruption at our sites and subsequent operational interruption, and cost inefficiencies.

Executive accountability:

Managing Director

Link to our values:

Doing the right thing / Always improving

Forecasted business impact:

Short term

Areas impacted:

Business disruption, brand and reputation, financial

Cross reference:

➔ Read more about our COVID-19 response on page 15

Risk climate: ●

In light of the COVID-19 pandemic and conclusion of Brexit, there has been no significant change in the risk climate.

Risk drivers:

- Failure to effectively manage third-party suppliers and contracts to ensure availability of critical chemicals and services.
- Ineffective assessment of supplier criticality and resulting vendor management plan thereafter.
- Lack of central monitoring of supplier base and related performance versus contractual terms and service levels. Failures in due diligence process when tendering or on-boarding new suppliers.
- Cost inefficiencies through the use of multiple suppliers contracted to deliver similar or the same products and services.
- Failures through non-compliance with internal policy when procuring goods and services from suppliers.
- Lack of a swift reconciliation of projects following closure, leading to financial claims by suppliers.
- Failure to have an effective resilient energy model in place would lead to power interruption at our sites, subsequent operational interruption, and cost inefficiencies.

Mitigating strategy

- Supplier procurement framework in place that mandates the processes required to be completed, including management approval and sign-off in line with authority levels.
- Processes in place to identify key suppliers with additional alerts and monitoring processes in operation.
- A reconciliation hub for completed projects has been implemented to ensure accounts are completed.
- Working group established to review alternative key sourcing options.
- Key working groups established and operational to manage the effects of Brexit and COVID-19.
- Each business function has a continuity plan in place in the event that the supply of critical resources from our suppliers is interrupted. The plans will include identification of alternative suppliers or stockpiling of necessary resources (e.g. chemicals) supported by our dedicated contract and supplier managers.
- We created a new centralised Contract and Supplier Management capability.
- The Supplier Relationship Management framework is in place, which covers principles to drive the right collaborative relationships with our key supply chain partners.

Operational risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

10 Health, Safety, Security and Wellbeing

Description:

The health, safety, security and wellbeing of our employees and the public while we provide our services is of the highest priority. The nature of our work requires that our employees and contractors undertake activities or use equipment which, if uncontrolled, have the potential to cause significant harm.

Failure to comply with our Health and Safety Management System and associated procedures could result in death, serious injury or adverse health effects. We could be liable for prosecution under the Health and Safety at Work and Corporate Manslaughter Acts, civil claims and employers' liability and professional liability.

Executive accountability:

Chief Executive Officer

Link to our values:

Doing the right thing / Always improving

Forecasted business impact:

Short term

Areas impacted:

Business disruption, brand and reputation, legal and regulatory, financial

Cross reference:

➔ Read more on pages 57 to 58

Risk climate: ●

There has been no significant change in our risk profile during 2020–21.

We have seen an increase in reported instances this year; however, this reflects improvements in our reporting of incidents which is giving us a much more accurate view of our level of risk.

Risk drivers:

- Incidents as a result of deteriorating assets, trips and hazards.
- Lack of training and controls to prevent incidents through poor behaviours and the handling of hazardous materials.
- Environmental from damage, disturbance and nuisance as a result of business activities.
- Integrity of dams and reservoirs.
- Threats to asset security and personal safety due to unexpected incidents.

Mitigating strategy

- Clearly defined strategy, safety protocols and standards are set to help prevent injury and occupational ill health to our employees and contractors, and are continuously reviewed and changed in line with legislation and industry best practice.
- Site safety inspections and audits to assess working practices and equipment.
- Supplier and delivery partner performance is monitored to ensure they meet our standards and expectations for health safety and wellbeing.
- Mechanism for reporting near misses and lost-time incidents, with follow-up investigation process, established.
- Health, safety and wellbeing performance and compliance is monitored and reported monthly to the Executive Leadership Team and the Board.
- Mandatory health, safety and wellbeing training for all employees, including mental health awareness training.
- Employees have access to a digital mental health platform 'Unmind' and Mental Health First Aiders.

Principal risks and uncertainties continued

Corporate risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

11 Corporate affairs

Description:

During recent years, there has been a significant focus on the water industry at a political and regulatory level. Failure to effectively monitor and adapt to any changes in our regulatory frameworks, or a failure to influence change to the political or regulatory landscape, may lead to potential unforecasted increases in administrative costs, reduced revenue, and ultimately non-compliance. Our current business plan and approved pricing structure runs until 2025. The Final Determination has stringent financial constraints, performance incentives and targets, making longer-term resilience more challenging.

There is a risk that changes in the political landscape (e.g. Brexit) may cause costly consequential impacts on the water sector to which we will have to adapt.

Risk climate: ●

Risk maintained following Ofwat's Final Determination and potential changes in future regulatory environment and future price reviews. There has been no significant change in our risk profile during 2020–21.

Executive accountability:

Director of Regulation

Link to our values:

Doing the right thing / Always improving

Forecasted business impact:

Long term

Areas impacted:

Customer experience, brand and reputation, legal and regulatory

Cross reference:

➔ Read more on page 50

Risk drivers:

- Inability to meet assumed performance as reflected in Operational Delivery Incentive (ODI) performance.
- Ineffective regulatory change horizon scanning.
- Lack of influence in shaping the outcomes of change.
- Ability to adapt and transform the business to meet the changing environments in which we operate.
- Inability to influence the perception of the business, following past events.

Mitigating strategy

- Closely monitor developments in the requirements from all of our regulators on key issues.
- Maintain close dialogue with the Government, Ofwat and other regulators on key issues.
- Work with our customers to understand their perception of our delivery, and future ambitions.
- Continue to engage constructively with all of our regulators in regards to the water scarcity challenges we face in the South East of England.
- Assessing the outputs of the appeals to the Competition and Markets Authority by four companies in the sector against their final determinations, and their implications for the next price review.
- Work with our regulators on how we better understand and address our customers' needs to enable successful outcomes in the next price review period 2025–30.
- Meeting new environmental priorities such as carbon net zero.

Corporate risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

12 Transformation

Description:

The business is committed to delivering the level of service our varied stakeholders expect and deserve. Our ongoing transformation programme, and the degree of change it brings, can lead to risk and opportunities, which we will closely monitor.

The business is delivering a significant volume of change required to transform the business over the 2020–25 period. There is a risk that these business changes will not lead to delivery of efficiencies, improve our general performance, and support our incentive performance.

Due to financial constraints, and the impacts caused by the COVID-19 pandemic, our ability to conclude and sustain the volume of change could be impacted due to further restraints in capacity or capability. As a result, we may not be able to effectively coordinate the required changes, which might result in the possible failure to deliver some customer promises, including financial targets and incentives.

Executive accountability:

Managing Director

Link to our values:

Doing the right thing / Always improving

Forecasted business impact:

Medium term

Areas impacted:

Customer experience, business disruption, legal and regulatory, people, financial

Cross reference:

- ➔ Read more on our progress on pages 26 to 27
- ➔ Read more on sustainability on pages 63 to 73

Risk climate: ●

There has been a deterioration in our risk profile during 2020–21 – our execution plans are comprehensive but also challenging, and the financial pressure on the company as a whole will be substantial. This is notwithstanding managing the effects of the COVID-19 pandemic, ensuring that our employees and contractors are able to carry out their work safely.

Risk drivers:

- Failure to deliver transformation and realise strategic benefits.
- A lack of governance in the management and delivery of business-wide transformation programmes.
- Negative impact on employee morale and fatigue through continued change.
- Ability to attract and retain the right skills to get optimum value from our people.
- Failure to appropriately train and develop employees to retain key capability.

Mitigating strategy

- Several strategic projects have been initiated to support the delivery of efficiencies.
- Comprehensive approach to the development of our execution plan that includes a range of activity to support the realisation of strategic benefits.
- A high-level strategic talent review has been completed across the organisation.
- Workforce planning analysis that has captured external market trends and labour statistics has been completed across the business.
- Control Transformation Project underway which includes People Plan.
- Annual workforce planning process to be implemented, which will review existing workforce, obtain market insight on industry needs and identify critical data feeds.
- Talent review board to be put in place to provide insight to senior management of the future business capability and capacity needs.
- Plan to develop People Plans for each directorate and functions to identify skills for the future that will feed into the overarching HR People Strategy.
- Transformation portfolio, office, and governance forums established.
- All business initiatives are developed with standard processes, ranked in order of priority, resources and wider business impacts.
- Annual engagement surveys are used to assess our employee satisfaction, with action plans developed to identify and improve any areas of concern in the business.

Principal risks and uncertainties continued

Corporate risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

13 COVID-19

Description:

The COVID-19 pandemic has put unprecedented pressure on the overall operation of the organisation. This has impacted all areas.

However, we have moved quickly to ensure we maintain service levels to our customers and are ensuring that our employees and contractors are able to carry out their work safely. We have provided payment breaks to support customers during challenging financial circumstances. The move to home working for a large proportion of our employees has impacted the way we work. If uncontrolled, COVID-19 would have potential to cause significant harm to our ability to carry out our essential services and put our colleagues at risk of becoming ill.

Risk climate: ●

Coming on top of a very tight Final Determination, the COVID-19 pandemic has impacted the way we carry out our business and has presented significant challenges to our finances, our ability to provide our essential services to customers and meet regulatory targets and expectations. In addition, the risk has led to us transforming the way we do our business with increased remote working and additional processes to enable safe field-team working.

Executive accountability:

Chief Executive Officer

Link to our values:

Doing the right thing / Always improving / Succeeding together

Forecasted business impact:

Short term

Areas impacted:

Customer experience, business disruption, legal and regulatory, people, financial

Cross reference:

➔ Read more about our COVID-19 response on page 15

Risk drivers:

Failure to manage this risk could lead to the realisation of a number of issues including:

- Colleagues could be at risk of COVID-19, anxiety or other health and wellbeing issues.
- Our supply chain could not meet our needs, with the consequential impact upon our services.
- Operational failures due to resource gaps, chemical supplies/parts restrictions and customer demand increases/behaviour change could impact our essential services to customers of water supply, wastewater collection and customer contact.
- Managing concurrent events (e.g. asset failure, heat wave, property flooding) during COVID-19 will be more challenging due to additional social distancing and/or the increased number of vulnerable customers that will need additional support.
- Operational performance or regulatory duty issues linked to COVID-19 could result in challenges associated with regulatory penalties (ODIs) or other regulatory action such as enforcement or prosecution.
- Adverse financial impact due to revenue loss, increased bad debt and additional COVID-19 costs.

Corporate risk

13 COVID-19 continued

Mitigating strategy

We have developed a COVID-19 continuity plan, which is reviewed and adjusted as appropriate. All decisions and changes implemented as a result of COVID-19 are managed through existing governance processes.

At the start of the pandemic, we moved in just one week from business as usual to a well-rehearsed Business Continuity Plan running against four simple priorities which have informed our COVID-19 response:

- Maintaining provision of essential services at all times
- Protecting the health, safety and wellbeing of our employees, including our supply chain, and our customers
- Providing the maximum practicable level of assistance to our vulnerable customers
- Protecting the financial stability of our business.

In terms of our domestic customers, many are facing uncertain futures and are struggling to pay their water bills. This means we supported them in the short term, offering payment breaks and increased access to our support tariffs, while making sure that we monitor and prepare for the potential of increasing bad debt in the long term.

To keep customers informed, we created a dedicated COVID-19 area on our website, which included a letter from our CEO, Ian McAulay, and answers to common questions about the impact of pandemic on our services, changes to our ways of working, and the support available to them. Our front line employees were identified by the Government as key workers, so we also published details of essential work that would carry on during the lockdown.

