

Severn Trent Water Alternative Eligible Credit Support - Consultation Response Summary

March 2021

WONDERFUL ON TAP



About This document

Introduction

As part of Severn Trent's ongoing commitment to support and develop effective markets, in December 2020 we issued a consultation document to all retailers, wholesalers, MOSL and Ofwat, seeking views on proposed changes to our Alternative Eligible Credit support options. The consultation was open for nearly 4 weeks from 22nd December to 15th January 2021. A copy of the consultation can be found at Appendix B.

The consultation questions are listed below.

1	Please provide the name of your organisation
2	How do the Alternative Eligible Credit Support arrangements outlined in this document compare to others available in the market?
3	Which, if any, of the Objectives and Principles of the Wholesale Retail Codes do you think these proposals support? (https://www.mosl.co.uk/market-codes/codes)
4	Please provide comments on these draft proposals outlined in this document
5	Are the proposals clear and easy to understand and administer?
5	Are you interested in requesting a Tier 1 standard discount agreement?
6	Are you interested in requesting a Tier 2 alternative unsecured allowance agreement?

Thank you very much to all respondents for taking the time to provide feedback. We have fully considered all comments received and have found the feedback useful in adapting our approach.

1. Overview of responses

We received responses from 6 trading parties: 2 wholesalers, 3 Un-Associated retailers and 1 Associated retailer. Although the number of responses was relatively low in number, they highlighted a number of areas for consideration. The detailed responses are at Appendix A.

Feedback was generally very positive and said the proposals supported many of the Objectives and Principles of the Wholesale Retail Code. One retailer commented “... [Tier 1] *extended terms of renewal and Tier 2’s higher levels of unsecured credit would be on par only with United Utilities’ offering which we highly regard as the best practice option of choice*” whilst two respondents said the proposals support Ofwat’s project RISE. Another welcomed the evolution of the terms and another said “*Operating a two-tiered system improves the credit options available for all eligible Retailers and is a notable example of best practice and support for effective markets*”

2. Consideration of responses

There were several notable comments that we have summarised and considered below.

a. Credit Agency choice

Two respondents commented on the exclusive use of Dun and Bradstreet as a credit agency in the Tier 2 agreement, questioning if it was discriminatory and a potential barrier to entry, with one suggesting it should better align Schedule 2E and 2F (standard Unsecured Credit Allowances). We considered this issue carefully when developing the proposals and have reviewed again following the feedback.

We should clarify that by publishing and offering this Tier 2 option we are not seeking to preclude retailers from presenting alternative Schedule 3 proposals, that could include the use of alternative credit agencies with demonstrably comparable metrics, and we are happy to work with retailers to develop the Tier 2 approach on that basis.

When developing our proposals we opted for utilising D&B for several reasons:-

- To date, all retailer specific requests for this type of Schedule 3 arrangement have asked to be specifically linked to D&B metrics.
- The D&B platform is widely available to all, and the vast majority, if not all retailers will already have a D&B Rating, a Maximum Credit Recommendation and Overall Business Risk score (these are the three key criteria needed for the Tier 2 agreement) that can be assessed against the qualifying criteria. We are happy to provide a copy of the retailers specific report on request. Access to the system and the ability to view the relevant metrics is therefore not considered a barrier.
- D&B have some specific metrics definitions (D&B Rating, Maximum Credit Recommendation and Overall Business Risk) particular to their platform and in

combination we believe they can provide a robust measures/assessment of creditworthiness, net worth and future risk. That's not to say other agencies don't have equivalent, but that was not immediately evident from our research during the development stage. In any case, if an alternative agency were agreed, the agreement would need redrafting to include that agencies specific metric definitions (and that is still an option).

One retailer said the use of D&B was not in compliance with the Codes, as Schedule 1 (Objectives Principles and Definitions) has explicit references to Experian, Dun & Bradstreet and Equifax, as well as allowing for agreement to use other agencies. We disagree with this point for the following reasons : -

- The Schedule 1 references to Experian, Dun & Bradstreet and Equifax are specifically in relation to the Unsecured Credit Allowances provided under Schedule 2E and 2F, whereas the Tier 2 agreement is Alternative Eligible Credit governed by Schedule 3, which essentially says it needs to be agreed.
- Although the existing Schedule 2E and 2F seek to provide equivalence between D&B, Equifax and Experian for the purposes of a standard Unsecured Credit Allowance, there's no equivalence in the codes for the other metrics we intend to use to set the credit limit under the Tier 2 agreement (i.e. the Maximum Credit Recommendation and the Overall Business Risk metric), so if an alternative agency were agreed, the Agreement would need redrafting to include that agencies specific metric definitions (and that is still an option).

We believe our Tier 2 proposals are in line with Ofwat's position as stated in their "RISE" report – *"We want to emphasise that where different Retailers have different risk profiles, a Wholesaler is able to reflect this by offering these Retailers different or tailored terms, so long as the differences in terms objectively reflect the differences in risk."*

For the reasons given above we do not agree that the proposals are discriminatory, nor do they pose a barrier to entry.

b. Distorting the 60:40 risk allocation

One wholesaler questioned whether the proposals shifted more credit risk onto Wholesalers with the potential to start distorting the 60/40 risk allocation between Wholesalers/Retailers and questioned if this could lead to further issues in the market. Although we agree there may be some limited potential for this, we do not believe our proposals distort this to any significant degree, it's at a level that Severn Trent are prepared to accept and is allowed under the terms of a Schedule 3 agreement.

c. Termination provisions

One respondent sought clarification on whether termination triggers for late payment referred to Primary and / or Non Primary charges. We have reviewed the drafting of these provisions and will amend to clarify that it applies to Primary Charges.

One respondent asked for the single payment default trigger to be extended beyond 3 days to 5-7 days. We have considered this point by analysing retailer payment history, which is generally very good, and rarely exceeds 3 days, so we are comfortable to maintain it at 3 days to help maintain these high payment standards. We also believe that in all but the rarest of cases it should be possible for retailers to make an immediate payment, having been notified of a late payment.

One respondent questioned the need for separate termination clauses, the first covering 3 late payments not exceeding 3 days and the second covering one late payment exceeding 3 days, suggesting the latter could always be relied upon. We have reviewed these clauses and conclude that both could operate in isolation and should therefore be retained. The first clause (3 late payments of up to 3 days) provides a degree of clarity and flexibility for the retailer ensuring there's not a hair trigger default, whilst the second (one late payment exceeding 3 days) provides some protection to Severn Trent in the event of a potentially more serious payment issue.

d. Tier 1 credit limit increase

One respondent questioned if the Tier 1 unsecured limit of £125k was to increase. We have considered this by analysing the use of the existing Tier 1 agreement and conclude that many retailers, including the respondent, don't currently use the full £125k, so there is head room left to allow for immediate growth. As such we intend to maintain at £125k but will keep under review.

e. Tier 1 Mechanism

One respondent suggested the mechanisms for calculating the New Credit Support Amount should, for simplicity and clarity, be aligned between the two agreements. We think this is sensible, so we will amend the mechanism for the Tier 1 agreement, so rather than applying a £75k deduction to the P1 value, we will calculate the Credit Support Requirement in the standard way (e.g. ((P1 value/30 days) * 50 days credit) – 20% UCA), then apply the £125k Additional Unsecured Allowance (up to £125k). Retailers will now get the full £125k in addition to the standard UCA. See example below.

		Current		New	
	No Sch 3 - standard code requirements	Tier 1 - Standard Sch 3 Discount		Tier 1 - Standard Sch 3 Discount	
D&B Rating	5A/1 or 5A/2	5A/1 or 5A/2		5A/1 or 5A/2	
P1 Aggregated settlement amount	£ 250,000	£ 250,000	£ 250,000	£ 250,000	£ 250,000
Current Tier 1 Sch 3 discount (£75k off P1)	N/A	£ 75,000	£ 75,000	N/A	N/A
Days in month	£ 30	£ 30	£ 30	£ 30	£ 30
Credit Support Requirement - 50 days	£ 416,667	£ 291,667	£ 291,667	£ 416,667	£ 416,667
Unsecured Credit Allowance - Sch 2E (20% for 5A/1 or 5A/2)	£ 83,333	£ 58,333	£ 58,333	£ 83,333	£ 83,333
Credit Support Amount (Credit Support Requirement less UCA)	£ 333,333	£ 233,333	£ 233,333	£ 333,333	£ 333,333
New Tier 1 - Additional Unsecured Allowance (£125k)	N/A	N/A	N/A	£ 125,000	£ 125,000
New Credit Support Amount	N/A	£ 233,333	£ 233,333	£ 208,333	£ 208,333
Reduction in Credit Support Amount	N/A	£ 100,000	£ 100,000	£ 125,000	£ 125,000
Notes	Without a Schedule 3 Agreement the retailer is required to provide £333k in Eligible/Alternative Eligible Credit Support	With the Tier 1 Schedule 3 Standard Discount, the amount of credit to be provided is reduced by £100k leaving £233k to be provided in Eligible/Alternative Eligible Credit Support	With the Tier 1 Schedule 3 Standard Discount, the amount of credit to be provided is reduced by £125k leaving £208k to be provided in Eligible/Alternative Eligible Credit Support	With the Tier 1 Schedule 3 Standard Discount, the amount of credit to be provided is reduced by £125k leaving £208k to be provided in Eligible/Alternative Eligible Credit Support	With the Tier 1 Schedule 3 Standard Discount, the amount of credit to be provided is reduced by £125k leaving £208k to be provided in Eligible/Alternative Eligible Credit Support

Next Steps

After review and consideration of the feedback received, we have chosen to implement the Tier 1 and Tier 2 options as set out in the consultation, with the following amendments :-

- Amend termination provisions to clarify late payment applies to Primary Charges
- Change mechanism in Tier 1 agreement (see above)

These changes will be implemented from March 2021.

We will contact all retailers with existing Tier 1 agreements expiring in March 2021 to discuss renewals and all retailers who've expressed an interest in a Tier 2 agreement.

Should you require further information, please contact your Account Manager.

Appendix A

Detailed Responses

2	How do the Alternative Eligible Credit Support arrangements outlined in this document compare to others available in the market?
	There is a good range of alternative credit arrangements across the market, STW's existing Schedule 3 AECS included, however the outlined arrangements' extended terms of renewal and Tier 2's higher levels of unsecured credit would be on par only with United Utilities' offering which we highly regard as the best practice option of choice.
	[Wholesaler] are in a similar position to STW and are currently doing a review of the AEC policies we offer to the market. We also recognise that the creditworthiness of retailers should be taken into consideration with the amount of unsecured credit made available. The % of the D&B maximum credit recommendation seems a logical solution.
	They are comparable in that they are risk based, both payment profile and risk of default. Subject to us meeting the criteria for Tier 2 we could see one of the higher value deductions.
	Given the requirement for all Alternative Eligible Credit Support arrangements to be made public by other wholesalers, we do not think it is appropriate for us to comment on the comparison of the proposed offering from Severn Trent to other offers. We would simply observe that the requirement to use only a credit scoring through one exclusive credit scoring agency is unusual.
3	Which, if any, of the Objectives and Principles of the Wholesale Retail Codes do you think these proposals support? (https://www.mosl.co.uk/market-codes/codes)
	This proposal supports the objectives of the Business Terms and the Principles listed below: (i) Efficiency – achieves the desired outcome of meeting the credit requirements of all different Retailer sub-sets (ii) Proportionality – provision of a fixed level of unsecured credit balanced with one linked to objective measures of individual Retailer creditworthiness and risk (iii) Transparency - clear eligibility criteria with an accessible methodology (iv) Simplicity, cost effectiveness and security – easy to understand, implement and monitor compliance (v) Barriers to entry – should reduce financial externalities (vi) Non-discrimination – improved credit options available to all retailers who fit the eligibility criteria (including new entrants, self-supply, and retailers of any size)
	Simplicity, cost effectiveness and security
	<ul style="list-style-type: none"> • Simplicity, cost effectiveness and security • Barriers to entry <p>Entering into the Schedule 3 agreements with retailers should reduce barriers to entry and reduce their cost of capital. Also by entering and agreeing schedule 3's it supports Ofwat's Project RISE.</p>

4	Please provide comments on these draft proposals outlined in this document
	We support this approach and welcome the continual evolution of these terms.
	The building blocks of both proposals are fundamentally sound and should serve to reduce/ or eliminate any barriers to entry for Retailers. The approaches do not only recognise the market’s maturation but acknowledge the differences in risk posed by different Retailers. We regard this a positive response to Ofwat’s RISE report highlighting the dearth of offerings tailored to reflect the characteristics of individual Retailers. Operating a two-tiered system improves the credit options available for all eligible Retailers and is a notable example of best practice and support for effective markets.
	<p>We would make the following specific comments:</p> <ul style="list-style-type: none"> • In relation to the Tier 2 proposal, we do not agree with the proposal that the relevant credit rating will be assessed by reference to Dun & Bradstreet only. We consider that this is unnecessarily restrictive and is not in compliance with the Codes. Schedule 1 (Objectives Principles and Definitions) explicitly references Experian, Dun & Bradstreet and Equifax as well as allowing for the agreement of the use of additional agencies. We consider that by restricting the availability of the Tier 2 option to only one of these agents is discriminatory against retailers and as such is contrary to the principles of the Codes. We also consider that restricting to one agency acts as a barrier to entry by not allowing all retailers the ability to access this additional benefit. We would suggest Severn Trent should reflect the flexibility in the Codes and make Tier 2 available to parties achieving appropriate scorings for at least each of the 3 agencies specified. • In both the Tier 1 and Tier 2 Agreements there an issue with the termination provisions. Clause 9 (c) and (d) in the Tier 1 Agreement and clauses 3.2.1.1.3 and 3.2.1.1.4 are the same provisions relating to the right for the Wholesaler to terminate the agreement for non-payment. However the drafting does not make sense. <p><i>3.2.1.1.3 by the Contracting Wholesaler immediately in the event of three (3) or more incidents of late payment, non-payment or late provision of Eligible Credit Support or Alternative Eligible Credit Support by the Contracting Retailer with each late event not exceeding 3 days under this Agreement or under the Wholesale Contract; or</i></p> <p><i>3.2.1.1.4 by the Contracting Wholesaler immediately in the event of a single incident of late payment, non-payment or late provision of Eligible or Alternative Eligible Credit Support by the Contracting Retailer exceeding three (3) days under this Agreement or under the Wholesale Contract;</i></p> <p>The first clause means that 3 incidences of payment being 3 days later than the due date allow termination. The second clause means that a single incident of</p>

	<p>late payment beyond 3 days from the due date allows termination. The second clause makes the first clause completely superfluous. The wholesaler does not need 3 incidences of late payment as it could always rely on the first. We presume that the inclusion of the 2 separate heads is deliberate and would suggest a de minimis threshold for each with a higher level on the second clause. This would mean a single non-payment of an appropriately large sum could allow termination. The alternative termination trigger would address persistent late payments of a smaller but important amount.</p>
	<p>Overall, we like the policy and the drafting just a couple of comments: The way in which the Credit Support Amount is calculated differs in Tier 1 and Tier 2. For ease / simplicity it may be easier for the retailers if the same methodology was used for both. Section 3: Termination Does the late payment refer to Primary and/or Non Primary invoices? Is there a need to differentiate? A question which we are considering in our policy review.</p>
	<p>Firstly, your proposal to extend the term of the current Tier 1 agreement appears to be sensible as it reduces administration for both STW and your Retailer customers. We are unsure of the proposal to introduce an additional termination provision and we would need further details on this to help our understanding. For your proposal to introduce a Tier 2 Schedule 3 offer we broadly agree with the general principles of having a mechanism to determine credit 'allowances' that is supported by the credit agencies, but we feel there are some areas of your proposal that may require further consideration. Please find below our specific observations.</p> <ul style="list-style-type: none"> • If the proposal shifts more credit risk onto Wholesalers does this have the potential to start distorting the 60/40 risk allocation between Wholesalers/Retailers and could this lead to further issues in the market? • Although you are proposing a Tier 1 and Tier 2 offer does the introduction of a single credit agency (Dun & Bradstreet) create a barrier for some Retailers to access the Tier 2 credit facility? • Although the credit agency reports are a useful source of information, we are uncertain if the D&B credit report would provide the appropriate level of robustness and consistency to be used in the way you are proposing, we also think this would not achieve an appropriate level of equivalence in the credit allowance calculation. • Although we agree with the mechanics of setting the level of credit available, we are uncertain if the calculation of the 1% or 2% credit value is appropriate and we are interested to know if this has been tested across a range of Retailer scenarios and can this be evidenced?
	<ul style="list-style-type: none"> • Are you planning to increase the discount unsecured credit limit to us for the next year at £125k? I take it that we were only offered £75k in our first year of trading, but I hope our stellar payment record so far will lead to an increased limit. • I think extending the agreements for periods up to 3 – 5 years is prudent – an annual contract means that you have to review the agreements each year which is unnecessary if the retailers maintain a good payment history.

	<ul style="list-style-type: none"> I would urge you to extend the single payment default period to be clearly stated to 5-7 business days, but put in the termination clause that its at your discretion. The reason for doing so is that I think 3 days is too tight for smaller retailers with less resources like us, and so If for example there is a problem with the scheduled payment whilst I am away on holidays, then there is no real chance to rectify the missed payment within the 3 days.
5	Are the proposals clear and easy to understand and administer?
	Yes – seems easy and clear when we read through it.
	We believe so
	Yes, the core principles of the proposal are simple, easy to understand, implement and monitor

Appendix B

Consultation document

Severn Trent Water Alternative Eligible Credit Support Consultation

December 2020

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About This consultation

Introduction

The purpose of this consultation is to gather feedback on changes we're proposing to make to our Schedule 3 Alternative Eligible Credit Support arrangements available to Non Household Retailers. This follows an internal review and ongoing dialogue with our contracted Retailers. It includes changes to the existing Schedule 3 Alternative Eligible Credit Support option that's currently available to all Retailers (the existing "Tier 1" agreement) and the introduction of a new, "Tier 2" option, linked to retailer creditworthiness and risk.

When developing these credit support arrangements, we've tried to ensure they are easy to understand, straightforward to administer, transparent and with clear eligibility criteria. To help ensure these principles are met, we are inviting feedback from retailers and other market stakeholders on our proposals and the associated documentation contained herein.

We thank you in advance for your feedback.

Background to credit requirements

Wholesalers have exposure to Retailer default, so the Market Codes seek to provide a level of protection by requiring Retailers to provide a level of collateral linked to the level of financial exposure. The level of collateral, the Credit Support Requirement, is calculated to be 50 days worth of wholesale charges.

Schedule 2 of the Market Codes provide a menu of standard Eligible Credit Support options (e.g. bond, guarantee, letter of credit and cash), whilst Schedule 2E recognises that different Retailers present different levels of risk to Wholesalers, so it provides for a percentage reduction in the collateral requirement (an Unsecured Credit Allowance) based on improving credit score or rating.

Schedule 3 gives the option for parties to enter into more bespoke Alternative Eligible Credit Support arrangements, that can be more reflective of the individual Wholesaler's risk appetite, and of their ability to monitor and manage that risk, and based on the Retailers particular risk profile. Wholesalers should not discriminate between Retailers, but there is nothing to prevent Wholesalers agreeing alternative credit arrangements that are specific to the Retailer in question, providing that any difference can be objectively justified.

Severn Trent Water are keen to support Retailers and the market by offering further credit options under Schedule 3 agreements based on objective, transparent criteria. This consultation therefore relates to the Schedule 3 Alternative Eligible Credit Support agreements offered by Severn Trent Water.

It is recognised that Retailers will generally want to reduce the level of collateral provided, to minimise associated costs, while Wholesalers will generally seek protection for themselves and their other customers by maximising collateral levels. The Schedule 3 arrangements we have proposed in this document look to provide a balance between these two viewpoints; by providing a fixed level of unsecured credit to support all Retailers, irrespective of creditworthiness, and an additional level to those Retailers with a demonstrable lower risk profile, based on objective criteria.

Background to Severn Trent Water's Credit Support arrangements

Severn Trent Water currently offer a flat level of unsecured credit to all eligible Retailers of up to £125k, under the terms of a Schedule 3 Alternative Eligible Credit Support agreement (our "Tier 1" standard discount agreement). This was launched in April 2018 and has proved very popular, with 19 of our 25 active Retailers opting for this agreement. For the majority this meets their full credit requirement, avoiding the need to post any additional Eligible Credit Support, but for a handful of Retailers with larger portfolios, additional Credit Support needs to be provided. To date we have not entered into any other Schedule 3 agreements.

Severn Trent Water's Credit Support Proposals

We have developed two proposal for Alternative Eligible Credit support as set out below.

Tier 1 Schedule 3 Standard Discount

Description	Tier 1 Schedule 3 Standard Discount Agreement										
Qualifying Criteria	Available to all Retailers who maintain good payment and credit provision history										
What level of unsecured credit is available ?	<p>Up to £125k of unsecured credit for all eligible Retailers</p> <p>This is achieved by providing a discount of up to £75k from the P1 settlement value before calculation of the 50 day Credit Requirement, as illustrated in the example below.</p> <table border="1" data-bbox="549 759 1383 1245"> <thead> <tr> <th data-bbox="549 759 967 860">Credit Requirement <u>Without</u> the Tier 1 Sch 3 Discount</th> <th data-bbox="967 759 1383 860">Credit Requirement <u>With</u> the Tier 1 Sch 3 Discount</th> </tr> </thead> <tbody> <tr> <td data-bbox="549 860 967 922">P1 settlement value = £250k</td> <td data-bbox="967 860 1383 922">P1 settlement value = £250k</td> </tr> <tr> <td data-bbox="549 922 967 985">Days in month = 30</td> <td data-bbox="967 922 1383 985">Days in month = 30</td> </tr> <tr> <td data-bbox="549 985 967 1048">Credit discount = £0k</td> <td data-bbox="967 985 1383 1048">Credit discount = £75k</td> </tr> <tr> <td data-bbox="549 1048 967 1245">Credit Support Requirement = (£250k / 30) * 50 days = £417k (A)</td> <td data-bbox="967 1048 1383 1245">Credit Support Requirement = (£250k - £75k / 30) * 50 days = £292 k (B) A reduction of £125k (A – B)</td> </tr> </tbody> </table> <p>The Credit Support Requirement may be reduced further (by 10, 20 or 40%) if the Retailer is entitled to an Unsecured Credit Allowance under Schedule 2E</p>	Credit Requirement <u>Without</u> the Tier 1 Sch 3 Discount	Credit Requirement <u>With</u> the Tier 1 Sch 3 Discount	P1 settlement value = £250k	P1 settlement value = £250k	Days in month = 30	Days in month = 30	Credit discount = £0k	Credit discount = £75k	Credit Support Requirement = (£250k / 30) * 50 days = £417k (A)	Credit Support Requirement = (£250k - £75k / 30) * 50 days = £292 k (B) A reduction of £125k (A – B)
Credit Requirement <u>Without</u> the Tier 1 Sch 3 Discount	Credit Requirement <u>With</u> the Tier 1 Sch 3 Discount										
P1 settlement value = £250k	P1 settlement value = £250k										
Days in month = 30	Days in month = 30										
Credit discount = £0k	Credit discount = £75k										
Credit Support Requirement = (£250k / 30) * 50 days = £417k (A)	Credit Support Requirement = (£250k - £75k / 30) * 50 days = £292 k (B) A reduction of £125k (A – B)										
What's the proposed change?	<p>All existing agreements currently run for a maximum of 12 months and all expire on the 31st March each year, requiring agreements to be reissued and signed each year.</p> <p>We propose to extend the term of the agreement, giving the option to make it either rolling or a longer fixed term (e.g. 3 – 5 years), and to amend the termination provisions related to payment to apply to any rolling 12 month period and with clearer triggers. Also, to introduce an additional termination provision in the event of a single late payment default exceeding 3 days. We believe the extended term will provide more certainty for Retailers and reduce administration for both parties.</p>										
Where can I see more details?	See template document at Appendix A										
When do you propose to introduce this?	Subject to consultation feedback and Executive approval of final proposals, we plan to introduce this starting in April 2021.										

Tier 2 Schedule 3 Alternative Unsecured Allowance

Severn Trent Water acknowledge that different Retailers pose different levels of risk to Wholesalers and to recognise this we propose to introduce a second tier Schedule 3 offer that could provide an additional level of unsecured credit linked to objective measures of credit worthiness available from Dun and Bradstreet. We have chosen the Dun and Bradstreet's reporting system because: -

- It's a long standing and widely accepted credit assessment system
- It's readily available and accessible
- It uses a broad range of business information and expert analysis to develop a perspective of risk
- In addition to an overall D&B Rating it provides an assessment of the Overall Business Risk, based on a broad combination of "live" metrics

Further details of the D&B Predictive Indicators are at Appendix D.

Description	Tier 2 Schedule 3 Alternative Unsecured Allowance	
Qualifying criteria	<ul style="list-style-type: none"> • Must hold a 5A/1 or 5A/2 Dun and Bradstreet “D&B Rating” (this includes a measure of company net worth based on last financial accounts) • Must hold a D&B “Overall Business Risk” score of “Low, Low/Moderate or Moderate” (this metric provides more of a forward assessment of risk using a combination of other risk metrics) • Maintaining good payment and credit provision history 	
What level of credit is available ?	<p>Where the “Overall Business Risk” score is “Low or Low/Moderate” the credit limit will be 2% of the “Maximum Credit Recommendation” (from D&B) up to £1m maximum</p> <p>Where the “Overall Business Risk” score is “Moderate” the credit limit will be 1% of the “Maximum Credit Recommendation” (from D&B) up to £0.5m maximum</p> <p>As illustrated in the example below.</p>	
	Tier 2 Sch 3 Alternative Unsecured Allowance – Low/Low Moderate Risk	Tier 2 Sch 3 Alternative Unsecured Allowance – Moderate Risk
D&B Rating	5A/1 or 5/A2	5A/1 or 5/A2
D&B Overall Business Risk	Low or Low/Moderate	Moderate
D&B Maximum Credit Recommendation	£30,000,000	£30,000,000
Alternative Unsecured Allowance	2% = £600k (max. £1m)	1% = £300k (max. £0.5m)
P1 Settlement	£250 k	£250 k
Credit Support Requirement (50 days)	£417 k	£417 k
Credit Support Amount	£0 k (the Alternative Unsecured Allowance of £600k exceeds the CRS of £417k, so no additional credit to be provided)	£117k (the Alternative Unsecured Allowance of £300 k covers part of the CSR of £417k, leaving £117 k of credit collateral to be provided as Eligible Credit Support.

What's changing ?	This is new
Where can I see more details?	<p>See template document at Appendix B and "A Guide to Dun and Bradstreet's Predictive Indicators" at Appendix D</p> <p>If you don't currently have access to D&B reports and would like to see scores for your company, please let us know.</p>
When do you propose to introduce this?	Subject to consultation feedback and Executive approval of final proposals, we plan to introduce this in February or March 2021

Examples of both Tier 1 and Tier 2 calculations are shown alongside each other at Appendix C for comparative purposes.

Consultation Questions

We are keen to obtain stakeholder feedback on the proposals set out in this document, and to help inform the development of our credit support arrangements.

The consultation questions are listed below.

1	Please provide the name of your organisation
2	How do the Alternative Eligible Credit Support arrangements outlined in this document compare to others available in the market?
3	Which, if any, of the Objectives and Principles of the Wholesale Retail Codes do you think these proposals support? (https://www.mosl.co.uk/market-codes/codes)
4	Please provide comments on these draft proposals outlined in this document
5	Are the proposals clear and easy to understand and administer?
5	Are you interested in requesting a Tier 1 standard discount agreement?
6	Are you interested in requesting a Tier 2 alternative unsecured allowance agreement?

We intend to publish a summary of responses and our consideration of any issues raised. Please advise if you wish your response to remain anonymous.

Timescales

The deadline for responding to this consultation is **Friday 15th January 2021**. Please email your responses to Andrew.lawson@severntrent.co.uk or to your Account Manager. If you would like further details on anything contained in the documents, please contact your Account Manager or Andrew Lawson on 07771 938 458.

We intend to review feedback, seek final Executive approval and implement any changes early 2021.

Appendix A

Tier 1 – Schedule 3 Standard Discount Agreement Template

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Dated:

(1) Severn Trent Water Limited

(2) **RETAILER NAME**

Alternative Eligible Credit Support Agreement made under Schedule 3 of the Business Terms within the Wholesale Contract

Standard Discount Agreement

THIS AGREEMENT is made on

BETWEEN

- (1) **Severn Trent Water Limited** of Severn Trent Centre, 2 St John's Street, Coventry CV1 2LZ (Company number **2366686**) ("the Wholesaler"); and
- (2) **RETAILER NAME AND ADDRESS** (Company number **XXXXXX**) ("the Retailer")

BACKGROUND

- (A) Pursuant to Schedule 3 of the Business Terms contained within the Wholesale Contract, a wholesaler and a retailer may agree to an Alternative Eligible Credit Support arrangement.
- (B) This Agreement is an Alternative Eligible Credit Support arrangement between the Wholesaler and the Retailer, the purpose of which is to reduce the Eligible Credit Support required to be provided by the Retailer in connection with its Wholesale Contract with the Wholesaler dated **XXXXXX** and made under section 66E or section 117E of the Water Industry Act 1991 ("the Contract")

OPERATIVE PROVISIONS

1. All defined terms in this Agreement have the same meaning as in the Contract, unless stated otherwise.
2. This Agreement commences on the date hereof, and continues until terminated in accordance with clause 9 of this Agreement.
3. Notwithstanding anything to the contrary in the Contract, with effect from the first Credit Support Notice issued by the Wholesaler to the Retailer following the commencement of and during the term of this Agreement, the Retailer shall be required to provide Eligible Credit Support each month on the Credit Support Requirement, as calculated subject to clause 4, 5 and 6.
4. The Credit Support Requirement shall be calculated by the Wholesaler by first discounting the amount specified in the P1 Aggregated Settlement Report issued to the Retailer and the Wholesaler by £75,000 ("the Discount") or such lesser sum such that the Credit Support Requirement for that month is never less than zero. The Wholesaler shall show the Discount on the Credit Support Notice.
5. This Agreement does not affect the Credit Support Requirement as calculated under the Contract.
6. Subject to clause 5 of this Agreement, if in any month the Primary Charges payable by the Retailer are less than the Discount then the Wholesaler shall treat the Credit Support Requirement for that month as zero.
7. This Agreement does not affect:
 - (a) any Unsecured Credit Allowance to which the Retailer is entitled; or
 - (b) the Retailer's discretion as to the manner in which it meets the Credit Support Requirement; or
 - (c) the Retailer's rights to have any Excess Eligible Credit Support Amount returned or to reduce the amount of Eligible Credit Support provided to match the Credit Support Requirement.

8. This Agreement will automatically terminate if the Contract terminates.
9. This Agreement may be terminated:
 - (a) by the Retailer on written notice to the Wholesaler; or
 - (b) by the Wholesaler on 30 days' written notice to the Retailer; or
 - (c) by the Wholesaler forthwith in the event of three or more incidents of late payment, non-payment or late provision of Eligible or Alternative Eligible Credit Support by the Retailer with each late event not exceeding 3 days under this Agreement or under the Contract; or
 - (d) by the Wholesaler forthwith in the event of a single incident of late payment, non-payment or late provision of Eligible or Alternative Eligible Credit Support by the Retailer exceeding 3 days under this Agreement or under the Contract; or
 - (e) by either Party in the event that replacement credit support arrangements take effect between the Parties.
10. On expiry or earlier termination of this Agreement the arrangements set out herein shall end and the provision of credit support by the Retailer shall be governed exclusively by the Contract and the Parties agree to co-operate with each other to the extent necessary to ensure compliance with the Contract.
11. The Retailer acknowledges and agrees:
 - (a) that it is entering into this Agreement as a means of obtaining Alternative Eligible Credit Support within the meaning of Schedule 3 of the Business Terms (forming part of the Contract); and
 - (b) that in order to comply with Schedule 3, the Wholesaler is required to publish this Agreement in full in a prominent place on its website.
12. No variation of this Agreement shall be effective unless it is in writing and signed by or on behalf of each Party.
13. In the event of any conflict between this Agreement and the Contract, the terms of the Contract shall take precedence, save as expressly specified otherwise in this Agreement.
14. The Parties do not intend any third party to have any right to enforce any provision of this Agreement under the Contracts (Rights of Third Parties) Act 1999 or otherwise.
15. Any notices under this Agreement shall be served in accordance with the provisions of the Contract.
16. Save for the Contract, this Agreement is the entire agreement between the Parties and replaces all previous written or oral agreements, representations, and understandings between them, relating to its subject matter.
17. This Agreement shall be governed by and construed in accordance with English law, and the English courts shall have exclusive jurisdiction to determine any dispute arising in connection with it (but subject to the powers of the Water Services Regulation Authority to determine disputes).

SIGNED on behalf of the Wholesaler)

by **Name**
.....

) XXXXXXSIGNATUREXXXXXXXXXX

Position
.....

) Head of Customer Contact

SIGNED on behalf of the Retailer)

by **Name**
.....

) XXXXXXSIGNATUREXXXXXXXXXX

Position
.....

)

Appendix B

Tier 2 – Schedule 3 Alternative Unsecured Allowance Agreement Template



Dated:

(1) Severn Trent Water Limited

(2) **RETAILER NAME**

Alternative Eligible Credit Support Agreement made under Schedule 3 of the Business Terms within the Wholesale Contract

Alternative Unsecured Allowance Agreement

THIS AGREEMENT is made on

2021

BETWEEN

- (1) **Severn Trent Water Limited**, a company incorporated in England and Wales (No. **02366686**) whose registered office is at Severn Trent Centre, 2 St John's Street, Coventry, CV1 2LZ ("**Contracting Wholesaler**")
- (2) **RETAILER NAME** a company incorporated in England and Wales (No. **XXXXXXXX**) whose registered office is at **XXXXXXXXXXXXXXXXXX** ("**Contracting Retailer**"); and

WHEREAS:

- (A) Pursuant to Schedule 3 of the Business Terms contained within the Wholesale Contract, a wholesaler and a retailer may agree to an Alternative Eligible Credit Support arrangement.
- (B) This Agreement is an Alternative Eligible Credit Support arrangement between the Contracting Wholesaler and the Contracting Retailer, the purpose of which is to reduce the Eligible Credit Support required to be provided by the Contracting Retailer in connection with its wholesale contract with the Wholesaler dated **XXXXXX** and made under section 66E or section 117E of the Water Industry Act 1991 ("**the Wholesale Contract**").
- (C) The Business Terms require that an Unsecured Credit Allowance shall be available to the Contracting Retailer, where the Contracting Retailer holds a Current Credit Rating or Current Credit Score. In addition, the Contracting Retailer is required to ensure the remainder of the Credit Support Amount is met through additional Eligible Credit Support and/or Alternative Eligible Credit Support.
- (D) The Business Terms further state that the parties may agree Alternative Eligible Credit Support for all or part of the Credit Support Amount.
- (E) Accordingly, the Contracting Wholesaler and the Contracting Retailer agree to enter into this Alternative Eligible Credit Support Agreement (the "**Agreement**") to supplement the Wholesale Contract by enabling the Contracting Wholesaler to provide an Alternative Unsecured Allowance linked to the Maximum Credit Recommendation and Overall Business Risk as recommended by the Nominated Credit Scoring Agency.

1. DEFINITIONS AND INTERPRETATION

1.1. In this Agreement:

1.1.1. **Alternative Unsecured Allowance** means:

- an amount equal to 2% (two per cent) of the Maximum Credit Recommendation (save that the Alternative Unsecured Allowance shall not exceed £1 million pounds) if the Overall Business Risk is Low or Low/Moderate as detailed in the Nominated Credit Scoring Agency's Report; or
- an amount equal to 1% (one per cent) of the Maximum Credit Recommendation (save that the Alternative Unsecured Allowance shall not exceed £500,000 pounds) if the Overall Business Risk is Moderate as detailed in the Nominated Credit Scoring Agency's Report.

The Alternative Unsecured Allowance will be assessed each month and may change each month in accordance with any change in the Nominated Credit Scoring Agency's Report.

1.1.2. **Code** means the Wholesale-Retail Code issued by the Water Services Regulation Authority under sections 66DA and 117F of the Water Industry Act 1991;

1.1.3. **Maximum Credit Recommendation** means the figure set out in the Nominated Credit Scoring Agency's Report.

1.1.4. **Nominated Credit Scoring Agency** means Dun and Bradstreet Limited, company number 160043, with its registered office located at The Point, 37 North Wharf Road, London, W2 1AF.

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- 1.1.5. **Other Unsecured Arrangement** means any other arrangement for unsecured credit that the Contracting Wholesaler makes available to retailers and for which the Contracting Retailer meets the applicable eligibility criteria.
 - 1.1.6. **Overall Business Risk** means the risk assessment carried out by the Nominated Credit Scoring Agency's system as detailed in reports made available to customers, including the Contracting Wholesaler..
 - 1.1.7. **D&B Rating** means the credit rating given by the Nominated Credit Scoring Agency's system as detailed in reports made available to customers, including the Contracting Wholesaler.
 - 1.1.8. **Wholesale Contract** means the contract between the Contracting Wholesaler and the Contracting Retailer that constitutes:
 - (i) a Section 66D Agreement; or
 - (ii) a Section 117E Agreement; or
 - (iii) both a Section 66D Agreement and a Section 117E Agreement;and which, in each case, is in the form prescribed by the Wholesale-Retail Code;
- 1.2. Unless the context requires otherwise, terms not otherwise defined in this Agreement shall have the meaning ascribed to them in the Wholesale Contract or the Code.

1.2.1 **Interpretation:** Headings and titles are for convenience only and do not affect the interpretation of this Agreement. Unless otherwise described, references in this Agreement to sections are to sections of this Agreement.

2. ALTERNATIVE ELIGIBLE CREDIT SUPPORT AGREEMENT

2.1 The Contracting Wholesaler and the Contracting Retailer agree that for such period as this Agreement is in effect, the Contracting Retailer shall (as an alternative to the Unsecured Credit Allowance to which the Contracting Retailer is entitled to under the Business Terms and any Other Unsecured Arrangement from time to time) be entitled to elect to benefit from the Alternative Unsecured Allowance, subject to and on the conditions of this Agreement.

2.2 The Alternative Unsecured Allowance shall at all times be an alternative to the Unsecured Credit Allowance and any Other Unsecured Arrangement and may only be used independently of the Unsecured Credit Allowance and any Other Unsecured Arrangement from time to time. In no circumstances shall the Contracting Retailer be entitled to combine the Alternative Unsecured Allowance with the Unsecured Credit Allowance and/or any Other Unsecured Arrangement.

2.3 The entitlement of the Contracting Retailer to the Alternative Unsecured Allowance is subject to the following condition (which shall at all times be a pre-condition of the Contracting Retailer having any entitlement to any unsecured credit in excess of the existing Unsecured Credit Allowance):

2.3 (a) the Contracting Retailer shall at all times hold and maintain a D&B Rating of 5A/1 or 5A/2

2.4 The Contracting Wholesaler reserves the right to review, temporarily suspend, or remove the entitlement of the Contracting Retailer to Alternative Eligible Credit Support under this Agreement, if:

(a) the Contracting Retailer becomes a Defaulting Trading Party under the Wholesale Contract, and/or is otherwise in breach of the Wholesale Contract; and/or

(b) the Contracting Wholesaler otherwise has reasonable grounds to believe that the Contracting Retailer will default on its payment obligations under the Wholesale Contract, and in such circumstances the Contracting Wholesaler shall notify the Contracting Retailer in writing and the requirements of the Wholesale Contract relating to the provision of Eligible Credit Support shall continue as though this Agreement was not in force and effect from the date of the written notice.

2.5 The parties agree that nothing in this Agreement shall prejudice or otherwise undermine the obligation or other liability of the Contracting Retailer to pay any amount to the Contracting Wholesaler under the Wholesale Contract, and the rights and remedies of the Contracting Wholesaler in respect of such obligations and liabilities shall be unaffected.

3 TERMINATION ON THIS AGREEMENT

3.1 This Agreement will automatically terminate if the Wholesale Contract terminates.

3.2 This Agreement may be terminated:

3.2.1.1.1 by the Contracting Retailer on written notice to the Contracting Wholesaler at any time; or

3.2.1.1.2 by the Contracting Wholesaler on thirty (30) days' written notice to the Contracting Retailer; or

3.2.1.1.3 by the Contracting Wholesaler immediately in the event of three (3) or more incidents of late payment, non-payment or late provision of Eligible Credit Support or Alternative Eligible Credit Support by the Contracting Retailer with each late event not exceeding 3 days under this Agreement or under the Wholesale Contract; or

3.2.1.1.4 by the Contracting Wholesaler immediately in the event of a single incident of late payment, non-payment or late provision of Eligible or Alternative Eligible Credit Support by the Contracting Retailer exceeding three (3) days under this Agreement or under the Wholesale Contract;

3.2.1.1.5 by the Contracting Wholesaler in the event that the Contracting Retailer fails to maintain the required D&B Rating as specified at clause 3.3(a); or

3.2.1.1.6 by either Party in the event that replacement credit support arrangements take effect between the Parties.

3.3 On expiry or earlier termination of this Agreement the arrangements set out herein shall end and the provision of the Credit Support Amount by the Contracting Retailer shall be governed exclusively by the Wholesale Contract and the Parties agree to co-operate with each other to the extent necessary to ensure compliance with the Wholesale Contract.

4 GENERAL

- 4.1 No variation of this Agreement shall be effective unless it is in writing and signed by or on behalf of each Party.
- 4.2 In the event of any conflict between this Agreement and the Wholesale Contract, the terms of the Wholesale Contract shall take precedence, save as expressly specified otherwise in this Agreement.
- 4.3 The Parties do not intend any third party to have any right to enforce any provision of this Agreement under the Contracts (Rights of Third Parties) Act 1999 or otherwise.
- 4.4 Any notices under this Agreement shall be served in accordance with the provisions of the Wholesale Contract.
- 4.5 Save for the Wholesale Contract, this Agreement is the entire agreement between the Parties and replaces all previous written or oral agreements, representations, and understandings between them, relating to its subject matter.
- 4.6 This Agreement shall be governed by and construed in accordance with English law, and the English courts shall have exclusive jurisdiction to determine any dispute arising in connection with it (but subject to the powers of the Water Services Regulation Authority to determine disputes).

SIGNED on behalf of the Contracting Wholesaler)

by **Name**) **XXXXXXXXSIGNATUREXXXXXXXXXX**
.....)
Position) **Head of Customer Contact**
.....)

SIGNED on behalf of the Contracting Retailer)

by **Name**) **XXXXXXXXSIGNATUREXXXXXXXXXX**
.....)
Position)
.....)

Appendix C – Examples (assuming £250k P1 Aggregated Settlement value)

	No Sch 3 - standard code requirements	Tier 1 - Standard Sch 3 Discount	Tier 2 - Alternative Unsecured allowance 1% (Overall business Risk = Moderate)	Tier 2 - Alt Unsecured Allowance 2% (Overall business Risk = Low / Low-Moderate risk)
D&B Credit Score	5A/1 or 5A/2	5A/1 or 5A/2	5A/1 or 5A/2	5A/1 or 5A/2
D&B Maximum Credit Recommendation			£ 30,000,000	£ 30,000,000
Overall Business Risk	N/A	N/A	Moderate	Low or Low - Moderate
%age of Maximum Credit Recommendation			1%	2%
P1 Aggregated settlement amount	£ 250,000	£ 250,000	£ 250,000	£ 250,000
Tier 1 Sch 3 discount	N/A	£ 75,000	N/A	N/A
Days in month	£ 30	£ 30	£ 30	£ 30
Credit Support Requirement - 50 days	£ 416,667	£ 291,667	£ 416,667	£ 416,667
Unsecured Credit Allowance - Sch 2E (20% for 5A/1 or 5A/2)	£ 83,333	£ 58,333	N/A	N/A
Credit Support Amount (Credit Support Requirement less UCA)	£ 333,333	£ 233,333	£ 416,667	£ 416,667
Tier 2 - Alternative Unsecured Allowance (%age of Max Credit Recommendation)	N/A	N/A	£ 300,000	£ 600,000
New Credit Support Amount	£ 333,333	£ 233,333	£ 116,667	-
Reduction in Credit Support Amount		£ 100,000	£ 216,667	£ 333,333
Notes	Without a Schedule 3 Agreement the retailer is required to provide £333k in Eligible/Alternative Eligible Credit Support	With the Tier 1 Schedule 3 Standard Discount, the amount of credit to be provided is reduced by £100k leaving £233k to be provided in Eligible/Alternative Eligible Credit Support	With the Tier 2 Schedule 3 Alternative Discount, and a "Moderate" Overall Business Risk" the amount of credit to be provided is reduced by circa £217k, leaving £117k to be provided in Eligible/Alternative Eligible Credit Support	With the Tier 2 Schedule 3 Discount, and a "Low or Low-Moderate" Overall Business Risk" the amount of credit to be provided is reduced by circa £417k, leaving £0k to be provided in Eligible/Alternative Eligible Credit Support

Appendix D

A Guide to Dun and Bradstreet's Predictive Indicators

A Guide to Dun & Bradstreet's Predictive Indicators

UK & Ireland



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Dun & Bradstreet Risk Assessment Explained

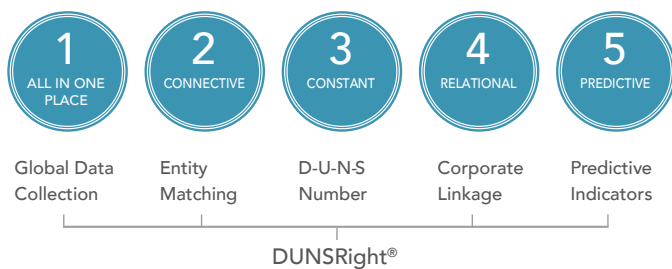
Decide With Confidence

Understanding and minimising risk is fundamental to your organisation. Staying informed of any changes is key to enabling you to profitably grow your customer portfolio without increasing risk exposure. Knowing a customer's or prospect's long-term commercial sustainability is critical to your organisation and a commercial imperative.

To evaluate risks objectively and consistently, you need to combine a multitude of business information sources with expert analysis to develop an Informed Perspective. By choosing Dun & Bradstreet (D&B) you can be assured of accurate, up-to-date and quality assured insight supporting your decision making.



The DUNSRight process includes separate automated and manual checks to ensure D&B data meets the high quality standards demanded by our customers."



DUNSRight And What It Means For Your Organisation

All D&B data and insight has been quality assured via our patented DUNSRight process. In this process we collect, aggregate, verify and enhance data from thousands of sources daily so customers can use our information and assessments with the confidence to make profitable decisions. The DUNSRight process includes separate automated and manual checks to ensure D&B data meets the high quality standards demanded by our customers.

The DUNSRight process has 5 Quality Drivers and works in this way:

1. Global Data Collection brings together information from a variety of sources worldwide, delivering more robust and accurate information.
2. D&B integrate the data into our database through our patented Entity Matching, which produces a single, accurate picture of each business.
3. We apply the D-U-N-S® Number as a unique means of identifying and tracking a business globally through every step in the life and activity of that business.
4. We use Corporate Linkage to enable our customers to view their total risk or opportunity across related businesses.

The first 4 DUNSRight drivers provide the platform to produce the final driver – the Predictive Indicators.

5. Our Predictive Indicators use statistical analysis and expert rules to indicate how an organisation is likely to perform in the future and make the information actionable.

What Are Predictive Indicators?

D&B's Predictive Indicators are tools that are designed to provide customers with insight into how an organisation is likely to behave in the future.

Utilising the insight provided by D&B's Predictive Indicators helps customers to quickly identify the organisations that are likely to fail, pay late or purchase their goods/ services, helping to drive growth, mitigate risk and increase profitability by:

- Allowing automated decisions for increased efficiency, freeing up valuable resources to focus on more important decisions.
- Enabling more consistent decisions across the entire organisation.
- Applying scores across an entire portfolio to segment risk and opportunity.
- Allowing faster processing of large volumes of transactions.



Utilising the insight provided by D&B's Predictive Indicators helps customers to quickly identify the organisations that are likely to fail, pay late or purchase their goods/services."

D&B Solutions

Risk Management Solutions identify prospects, customers or suppliers that are likely to fail owing money or who will pay invoices slowly:

- *D&B Failure Score* – Likelihood that an organisation will fail in the next 12 months.
- *D&B Delinquency Score* – Likelihood that an organisation will pay its suppliers in a severely delinquent manner in the next 12 months.

D&B models are predictors based on statistical probability and are not guarantees of a particular event. They are designed as a tool to help customers make their own decisions and should be used as part of a balanced and complete assessment relying on the knowledge and expertise of the reader, and where appropriate on other information sources.

Overall Business Risk

Dun & Bradstreet delivers an Overall Business Risk in our D&B Credit solution that uses the best available scores, ratings, and indices to provide a high-level assessment for each company. The overarching Low- to High-Risk Levels are based on the combination of individual risk levels for scores, ratings, and indices that have been assessed for the specific company.

Whilst each market globally will have their own risk scores and ratings, the Overall Business Risk uses data that is available locally to create a globally consistent view that can be used to compare businesses in different countries to one another.

Scores, ratings, and indices that give a perspective on business discontinuation or failure:

- Failure Score
- Portfolio Comparison from the Viability Rating
- Risk Indicator from the D&B Rating

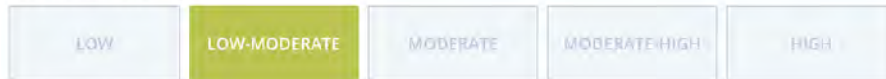
Scores, ratings, and indices that give a perspective on payment behaviour:

- Delinquency Score
- PAYDEX®
- Triple-A Rating
- 1-2 Trade Experiences
- Financial Strength from the D&B Rating



The overarching Low- to High-Risk Levels are based on the combination of individual risk levels for scores, ratings, and indices that have been assessed for the specific company.”

Overall Business Risk



Dun & Bradstreet Thinks...

- Overall assessment of this organization over the next 12 months: **STABLE CONDITION**
- Based on the predicted risk of failure: **STRONG LIKELIHOOD OF CONTINUED OPERATIONS**
- Based on the predicted risk of severely delinquent payments: **MODERATE POTENTIAL FOR SEVERELY DELINQUENT PAYMENTS**

D&B Failure Score

Identify Risk & Opportunity

The D&B Failure Score predicts the likelihood that an organisation will obtain legal relief from its creditors or cease operations over the next 12 month period. The Failure scorecard also looks for events signalling the onset of failure, such as a meeting of creditors, administrator appointed, bankruptcy, receiver appointed and petition for winding-up.

The Failure Score makes risks visible, allowing our customers to reduce their bad debt and identify profitable opportunities – it also improves objectivity and consistency.



Factual information is analysed using advanced statistical modelling techniques (including Logistic Regression, Discriminant and Segmentation Analysis)."

Transforming Information Into Insight

How is the D&B Failure Score calculated?

Factual information is analysed using advanced statistical modelling techniques (including Logistic Regression, Discriminant and Segmentation Analysis) and commercial expertise to identify data characteristics that are common to and most predictive of organisational failure. These characteristics are then weighted by significance to form rules for our scorecards that differentiate between organisations with a high risk of failure to those with a low risk.



How is the D&B Failure Score calculated?

The areas of information used in the D&B Failure Score include:

- *Demographics* – Including business age, location (local or national trading) and line of business incorporating the Economic Index which reflects the risk to different industries when the economy changes.
- *Corporate Linkage* – The size, strength and risk of a group of businesses as a whole is taken into consideration when calculating the Score for an individual business.
- *Principals* – The Principal's experience and performance of associated businesses.
- *Financial* – Ratios and trends taken from financial accounts. Factors assessed include liquidity, solvency, profitability, debt, late filing and detrimental notes.
- *Trade Experiences collected through the D&B Trade Programme* – D&B customers regularly provide their experiences of the payment habits of businesses they are trading with. Payment trends and percentages of prompt or late payments will affect Scores in addition to comparison with industry payment averages.

- *Public detrimental information* – Such as County Court Judgements (CCJs), mortgages / charges and the legal pre-failure events (administration, receivership, bankruptcy, etc.)

Expert rules (sometimes referred to as overrides) including the following are also used to calculate the Failure Score:

- *Minimum Data* – To identify trading activity and provide substance for the Score.
- *High Risk Parent* – The high risk of a domestic ultimate parent cascades down through the corporate family tree so that subsidiaries are also marked as high risk.
- *Detrimental Legal Events* – In addition to failure events (for example; meeting of creditors, administrator appointed, bankruptcy, etc.). Detrimental Auditors Reports will also automatically mark the subject organisation as high risk.
- *Possible Fraudulent Activity* – Our Critical Intelligence team identify potential and actual fraudulent businesses and individuals to help protect our customers.
- *Manual Overrides* – Predictive Indicators can be adjusted by authorised experts to reflect non statistical /catastrophic events. For example, news reports from trustworthy sources that indicate a material change to risk can be investigated and changes made where appropriate.



The D&B Failure Score is dynamic, meaning that it is recalculated every time we collect a new piece of information about an organisation, or when information changes.”

The information used may vary from market to market as D&B scorecards are tailored to local data and legal procedures.

The D&B Failure Score is dynamic, meaning that it is recalculated every time we collect a new piece of information about an organisation, or when information changes. For example, as the age of an organisation increases its risk typically decreases and our Failure Scores will change to reflect this.

Interpreting The D&B Failure Score

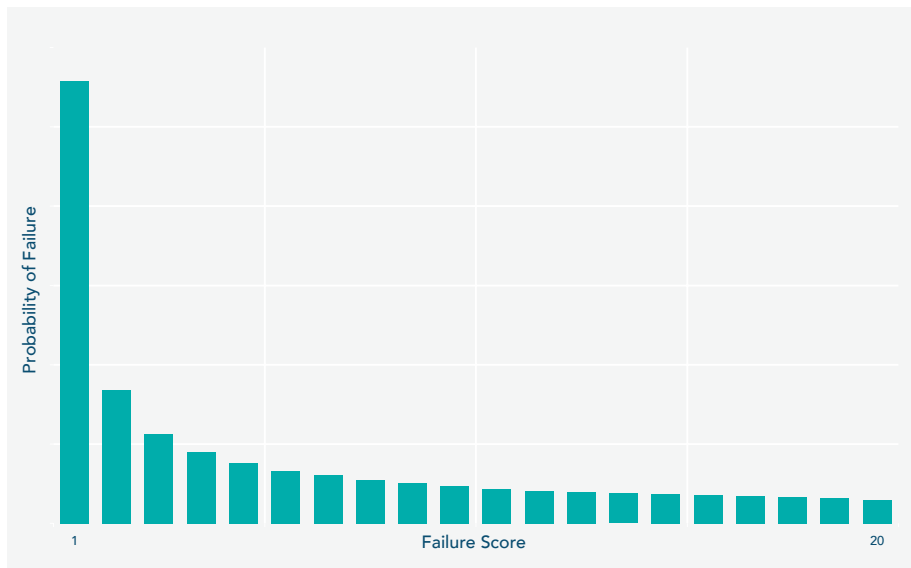
The D&B Failure Score is a relative measure of risk, whereby 1 represents organisations that have the highest probability of failure and 100 the lowest. It shows how an organisation’s risk of failure compares to other organisations within a country.



Probability of Failure

Behind each Failure Score is an associated probability of failure, which rises rapidly at the low end of the Failure Score range (1-10).

The probability of failure allows our customers to set cut-offs for decisions based on their own credit policy and attitude to risk. It can be used to show the expected level of ‘bad’ applications / accounts for each Failure Score and therefore allow our customers to balance the opportunity of increased sales against the risk of bad debt.



The probability of failure allows our customers to set cut-offs for decisions based on their own credit policy and attitude to risk.”

The D&B Risk Indicator Table

There is a direct correlation between the Failure Score and Risk Indicator:

Please note regarding “Undetermined” or “—” Risk Indicators; this means D&B have been unable to collect or verify certain key data elements, including some that confirm that an organisation exists or is still trading. Another reason this Indicator may be assigned is when D&B learns of an event that has not yet been published through the official channels but will affect the risk assessment for an organisation. For example a business may advise they have ceased trading but not have filed the appropriate documents yet.

Therefore, when an organisation is assigned an “Undetermined” or “-” Rating we recommend that our customers conduct further analysis and investigation before making a decision. Customers can contact D&B to understand the reason for the dash rating, why it was assigned and use that insight to influence their decision.

Failure Score	Risk Indicator	Probability of Failure
86 – 100	1	Minimum Risk
51 – 85	2	Lower than average risk
11 – 50	3	Higher than average risk
1 – 10	4	High risk
--		Insufficient information

The D&B Financial Strength Indicator

The Financial Strength Indicator is determined by the Tangible Net Worth from the latest financial accounts and provides an indication of the strength of the organisation to cope with adverse trading periods or exploit investment opportunities.

Tangible Net Worth is defined as shareholder funds minus any Intangible Assets.



The Financial Strength Indicator is determined by the Tangible Net Worth from the latest financial accounts and provides an indication of the strength of the organisation to cope with adverse trading periods.”

Financial Strength Indicator	Tangible Net Worth (in £ for UK and € for Ireland)	
	From	To
Net Worth		
5A	35,000,000	And above
4A	15,000,000	34,999,999
3A	7,000,000	14,999,999
2A	1,500,000	6,999,999
1A	700,000	1,499,999
A	350,000	699,999
B	200,000	349,999
C	100,000	199,999
D	70,000	99,999
E	35,000	69,999
F	20,000	34,999
G	8,000	19,999
H	0	7,999
Alternate Symbols Used		
N	Negative net worth	
O	Net worth undetermined (accounts unavailable or older than 2 years)	

The D&B Rating

Identify Credit-Worthiness Quickly

The D&B Rating provides an indication of credit-worthiness. The rating is made up of two parts:

- *Financial Strength* – Based on Tangible Net Worth from the latest financial accounts.
- *Risk Indicator* – Derived from the D&B Failure Score.

D&B Maximum Credit

Agree Appropriate Terms & Limits

The D&B Maximum Credit shows the total value of goods and / or services the ‘average’ creditor should have outstanding at any one time with an organisation. It is not necessarily the maximum the organisation can afford and helps our customers to agree appropriate terms and limits when extending credit.

The areas of information used to calculate the Maximum Credit are:

- *Organisation Size* – Based on financial information including Turnover and Total Assets when available or demographic information such as the number of employees.
- *Industry* – Based on the Standard Industrial Classification (SIC) code.
- *Risk Factor* – Banded segments of the D&B Failure Score linked to the risk of failure.

2A

Financial Strength

4

Risk Indicator

- The Financial Strength indicator is determined by the latest Tangible Net Worth.
- Based on latest filed annual accounts.
- Linked directly to the failure score.
- Dynamically kept up-to-date.

D&B Delinquency Score

Manage Your Cash Flow

The D&B Delinquency Score predicts the likelihood that an organisation will pay its bills in a severely delinquent manner over the next 12 months.

The Delinquency Score identifies organisations that are likely to pay late and helps customers manage their cash flow. Having the cash or liquid resources available to meet daily working capital requirements is fundamental to the survival of all organisations.

How is the D&B Delinquency Score Calculated?

Similar to the D&B Failure Score, factual information is analysed using advanced statistical modelling techniques (including Logistic Regression, Discriminant and Segmentation Analysis) and commercial expertise to identify data characteristics that are common to and most predictive of delinquency. These characteristics are then weighted by significance to form rules for our scorecards that differentiate between organisations with a high risk of delinquency to those with a low risk.

The main difference between the calculation of the D&B Failure and Delinquency Scores is that we use different data elements and weightings because we are predicting a different result.



The D&B Delinquency Score predicts the likelihood that an organisation will pay its bills in a severely delinquent manner over the next 12 months."

What Information is Used to Calculate the D&B Delinquency Score?

The areas of information used in the D&B Delinquency Score include:

- *Trade Experiences collected through the D&B Trade Programme* – D&B customers regularly provide their experiences of the payment habits of businesses they are trading with. Payment trends and volatility will affect Scores in addition to percentages of prompt or late payments.
- *Public detrimental information* – Such as County Court Judgements (CCJs), mortgages / charges and the legal pre-failure events (administration, receivership, bankruptcy, etc.).
- *Demographics* – Including business age, location, line of business and corporate linkage (especially when there is risk within the group).
- *Corporate Linkage* – The size, strength and risk of a group of businesses as a whole is taken into consideration when calculating the Score for an individual business.
- *Financial* – Ratios and trends taken from annual and interim accounts. Factors assessed include liquidity, solvency, profitability, debt, late filing and detrimental notes.

The D&B Delinquency Score is also dynamic just like the Failure Score. Whenever we collect a new piece of information or information changes the Delinquency Score is recalculated.

Interpreting the D&B Delinquency Score

The D&B Delinquency Score is a relative measure of risk, whereby 1 represents organisations that have the highest probability of delinquency and 100 the lowest. It shows an organisation's relative rank against other organisations within a country by ordering and segmenting that country's database into 100 equal percentiles. Each Delinquency Score represents 1% of organisations within that country with the same risk of delinquency.



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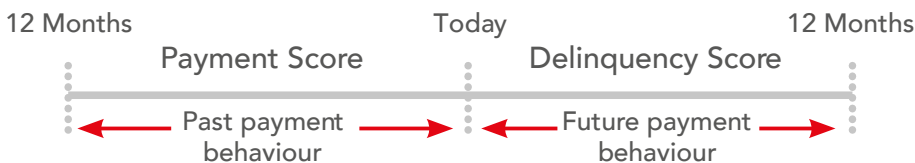
D&B Payment Scores (Paydex)

The D&B Payment Score (or Paydex) is a score that evaluates an organisation's payment history based on trade experiences collected through D&B's Trade Programme i.e. how the organisation has been paying its bills.

A Paydex Score of 80 indicates prompt payments, less than 80 (down to 1) indicates slow payments, and greater than 80 (up to 100) indicates payment before due.



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How Do Our Customers Use D&B's Predictive Indicators?

Monitoring our Predictive Indicators for key changes can provide our customers with critical early warning signs of increasing risk or opportunity. D&B experience shows:

- Over 90% of organisational failures exhibit deteriorations or fluctuations in payment behaviour 3 – 6 months before bankruptcy.
- Organisations with cash flow pressures are likely to pay less important suppliers slower or not at all, so if you are a key supplier you may be one of the last to know of impending financial stress.

However, by proactively monitoring these early warning signs, corrective action can be taken before it's too late.

Combining the power of the Failure Score and the Delinquency Score allows our customers to segment their credit risk profile and focus sales teams, credit management and collections resources where they will be most effective, for example:



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	LOW RISK OF FAILURE	HIGH RISK OF FAILURE
HIGH RISK OF DELINQUENCY	Cash Vultures <ul style="list-style-type: none"> - Offer discount for prompt payment - Improve relationship with client to induce prompt payment - Charge interest on late payments - Reset payment terms accordingly 	Let Your Competitors Have Them <ul style="list-style-type: none"> - Increase prices to cover risks/ costs - Reduce exposure – stop orders until paid - Take guarantees - Monitor vigorously - Avoid new clients with this profile - Up-front payments
LOW RISK OF DELINQUENCY	Ideal Customers – Cultivate <ul style="list-style-type: none"> - Push for more sales - Improve relationship with client - Find more like this 	Monitor Closely <ul style="list-style-type: none"> - Reduce exposure – minimise outstanding balances - Monitor vigorously - Take guarantees

To learn more about D&B's Predictive Analytics and how you can make better credit decisions for your business, call:

(0800) 001234 or visit www.dnb.co.uk.



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ABOUT DUN & BRADSTREET

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