

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

Water 2020: our regulatory approach for water and wastewater services in England and Wales – overview



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Building trust in water

Our shared vision for the water sector in England and Wales is one where customers and wider society have trust and confidence in vital public water and wastewater services. Delivering this vision relies on everyone in the sector working together, listening to customers and tackling long-term challenges.

We are making changes to the way we regulate in future to play our part in building trust in water. Here, we summarise the main elements of our future regulatory approach for wholesale markets and the price review in 2019 (PR19) and beyond. We want to build on the successes of our previous price review (PR14) and go further, for the benefit of customers, the environment and wider society.

Alongside these changes, we are working with the sector to open the business retail market in England to competition from April 2017. We are also reviewing the costs and benefits of retail competition for residential customers for the UK Government.

Our regulatory approach

Outcomes focused: we focus on what matters to customers, the environment and society, now and in the future

Pro-market: we use our tools to align the interests of investors and companies with those of customers. We use market mechanisms to deliver benefits for everyone

Proportionate and targeted: we focus our regulatory work where it is most needed

Using all of our tools: we will use traditional and broader regulatory tools to shine a light on issues and provoke debate



Relationships focused: we want to see companies listen to and understand their customers and respond to their needs and requirements

What our new approach will deliver



Greater customer engagement and understanding

Transparency of information about how the sector is performing and for new entrants

More efficient use of scarce resources

A sustainable investment model and a fair balance of risk and reward

Effective challenge to companies' business plans and costs in PR19

Choice where possible, and ensuring markets are effective for customers

Essential services which are resilient and can recover from shocks

A focus on the long-term, targeted and risk-based

Support for sustainable improvements in the environment



Ensuring essential services remain affordable



Tackling challenges, delivering benefits

The water sector is facing some critical challenges. We need to address these challenges together to ensure that customer needs, priorities and concerns are heard and responded to, both now and in the future. Our new regulatory approach will help to secure a resilient future for water, for the benefit of customers, the environment and wider society.

The challenges

20% population rise over 20 years – much of it in drier areas

Risk of too much water being taken from rivers, causing environmental damage

Up to 20% predicted reduction in summer rainfall and increase in winter rainfall by 2050

One in five customers do not feel their bill is affordable, despite 5% drop in bills in real terms by 2020

210,000 new households per year, many in the South East and East of England

The benefits of our new regulatory approach

£800 million potential benefit and environmental protection from smarter water use through trading

£780 million potential benefit, and reduced carbon from creating power from waste

A better, more legitimate measure of inflation

New ways of tackling water scarcity and creating power from waste

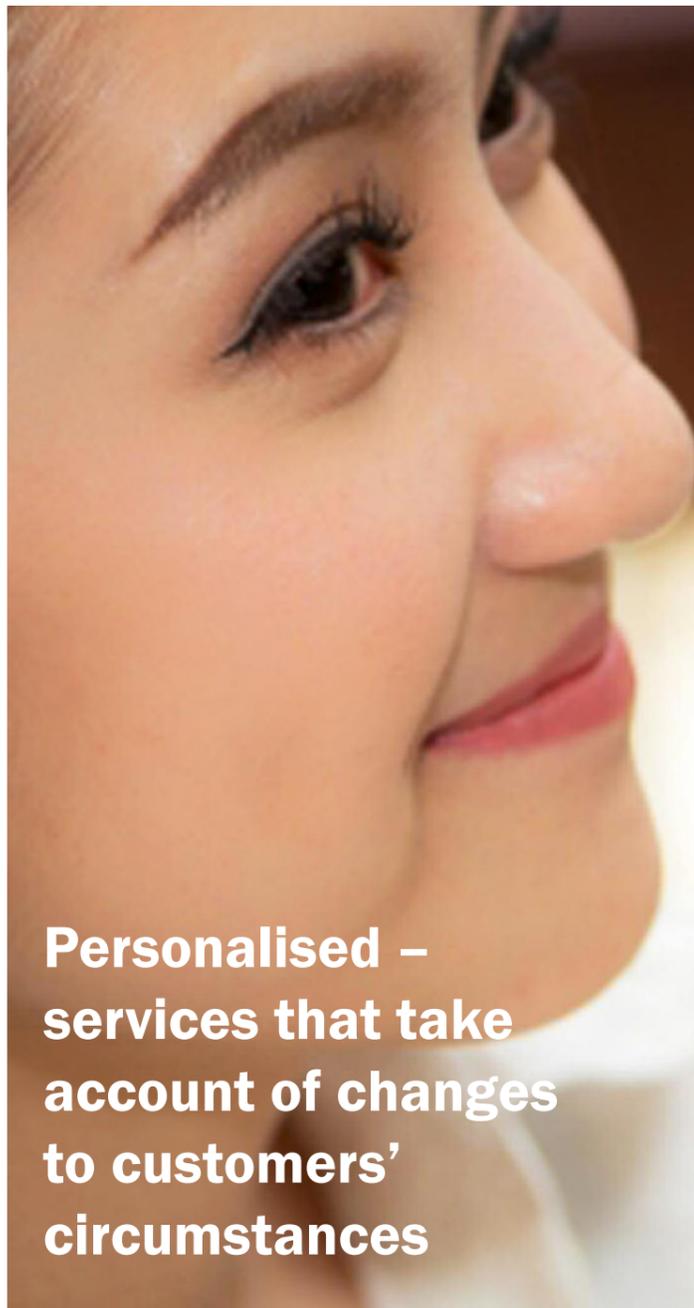
A long-term approach to meeting customers' needs, now and in the future

More resilience through better informed decisions and more connected networks

The potential to deliver more for less, by incentivising efficiency

Benefits for customers, retailers and wholesalers

What our approach means for customers



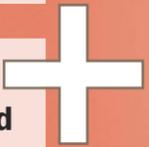
- Informed** – better access to services and information about company performance
- Engaged** – services based on companies understanding customer needs
- Involved** – customers playing a part in smarter use of water and helping make decisions about services
- Resilient services** – customers can have confidence in their water supply and in wastewater being taken away

Personalised – services that take account of changes to customers' circumstances

What our approach means for retailers

- Understanding:** greater expectations that companies will understand customers' needs, both now and long term 
- Tailored:** providing services that suit customers' different and changing circumstances 
- Choice:** for business customers in England from April 2017 
- Satisfaction:** listening to customers' feedback and taking action where needed 

What our approach means for wholesale service providers

- Evolution:** promotion of new markets in sludge and water resources
- Pluralistic:** alternative providers for sludge and water resources 
- Outcomes focused:** long-term, stretching service commitments driven by customer needs and requirements
- Resilient:** understanding and mitigating risks 

Innovation: new opportunities arising from technology, customer engagement and smarter water use

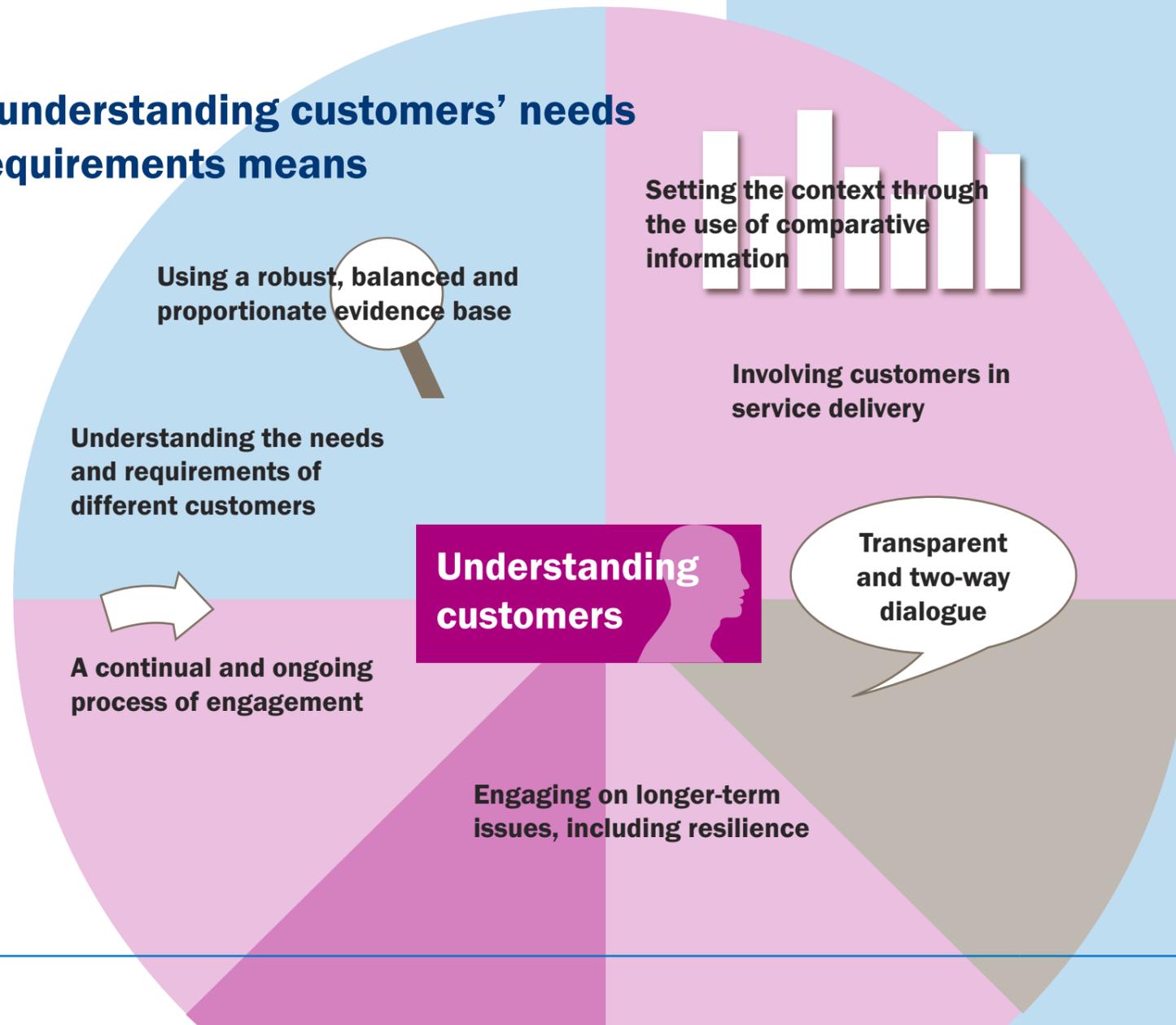
Focusing on current and future customers

PR14 was the biggest ever customer conversation in the water sector. Our new regulatory approach brings even greater expectations of companies understanding their customers and delivering outcomes over the long term. This means companies finding out what matters most to their customers and delivering this.

We expect companies to understand the needs of all their customers and any circumstances which might make their customers vulnerable. This requires more diverse approaches to understanding customers' priorities, needs, requirements and behaviours. This understanding should inform the development of performance commitments that drive delivery of resilient services now and in the longer term.

We are putting in place new principles for customer engagement, to help drive a focus on customers over the long term.

What understanding customers' needs and requirements means



What this will deliver

By raising the bar on customer understanding and engagement, we want customers to be more involved in helping shape water and wastewater services, both now and for the future.

Strengthening the role of Customer Challenge Groups

Customer Challenge Groups (CCGs) are independent local groups that play an important role in challenging companies to improve the quality of their customer engagement. In PR14, CCGs provided us with independent assurance that companies were engaging with their customers and that companies' business plans reflected a sound understanding and reasonable balance of customers' views. In PR19, we want to support and equip CCGs to challenge companies even further.

In PR19, we hope CCGs will continue to:

Challenge companies and assure us on the quality of companies' customer engagement and how this is reflected in business plans



Encourage diverse membership, reflecting local needs and circumstances

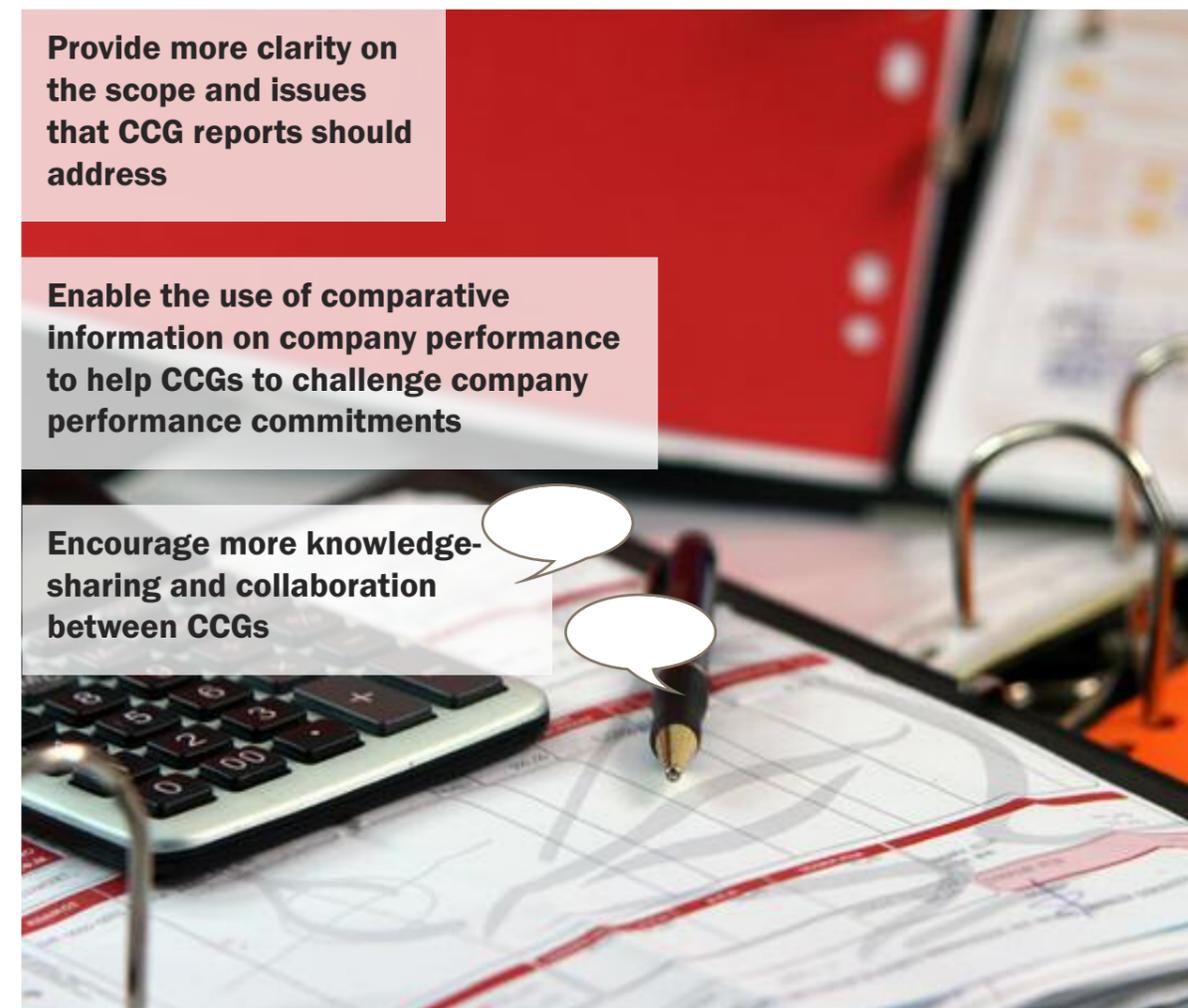
Submit an independent report at the same time that business plans are submitted

In addition, we will:

Provide more clarity on the scope and issues that CCG reports should address

Enable the use of comparative information on company performance to help CCGs to challenge company performance commitments

Encourage more knowledge-sharing and collaboration between CCGs



What this will deliver

Building on the success of PR14 these changes will empower CCGs to challenge companies' business plans even further, which should result in plans which better reflect the needs and requirements of customers and local communities.

Maintaining legitimacy

Our new regulatory approach emphasises the importance of trust and confidence in the water sector both now and in the future. Credible and legitimate indexation of customer bills is central to trust and confidence in the sector.

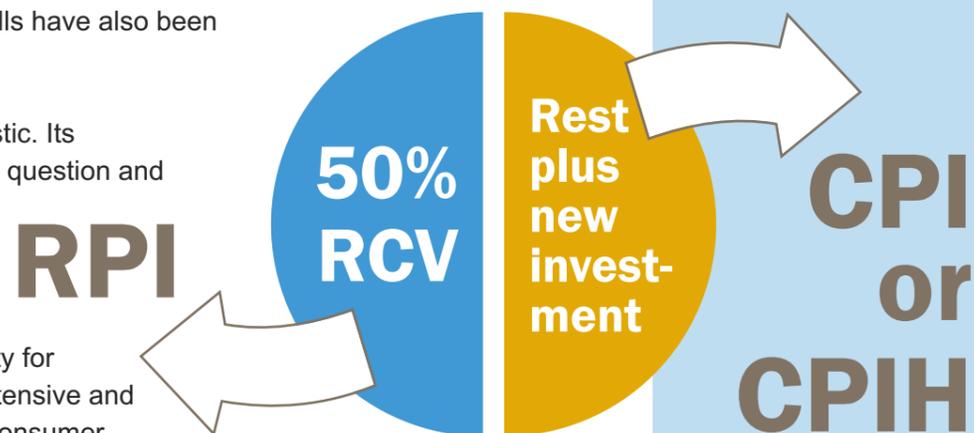
Previously, our price reviews have been linked to the Retail Price Index (RPI). This means that inflation changes in customer bills have also been linked to RPI.

RPI is no longer an official statistic. Its robustness has been called into question and its use by Government and regulators has reduced. RPI is more volatile than other commonly used measures of inflation, risking more uncertainty for customer bills. We have had extensive and constructive engagement with consumer groups, companies and investors, about whether and how to change inflation measures within our price controls. Other regulators have also sought views on this issue.

We will be changing our indexation for customer bills and companies' assets to a more legitimate measure of inflation, the consumer price index (CPI) or CPIH. We will do this from PR19 onwards. This means that from 2020, inflation on customer bills will be linked to CPI or CPIH – helping to maintain customer trust and confidence, and potentially reducing bill volatility. We will confirm whether we are moving to CPI or CPIH in our methodology statement for PR19, which we will consult on in June or July 2017.

This means that 50% of the regulatory capital value (RCV) will be indexed to RPI from 2020-21. The rest, including all new investment, will be linked to CPI or CPIH. We have also set out our principles for how the transition is managed beyond 2025 to provide predictability and clarity in the longer term.

Start of PR19



From 2020-21, inflation on customer bills will be linked to CPI or CPIH



What this will deliver

Moving from RPI to CPI or CPIH will provide a more credible and stable method of inflation for customers. It will ensure the continued legitimacy of the regulatory approach over the long term.

Promoting new markets

To meet future challenges, we need to ensure that the water sector is resilient, efficient and taking a long-term approach. New markets – where buyers meet sellers – can benefit customers, the environment and wider society through choice, resilience, innovation, technology and information. Our new regulatory approach will promote markets in England and, where it aligns with Welsh Government policy, in Wales.

Choice

Markets provide choice to customers. More than a million businesses, charities and public sector organisations in England will be able to choose their water retailer from April 2017.

Retailers operating in a competitive environment are likely to drive more targeted and innovative approaches to water efficiency, metering and data management – creating value by meeting customers' needs with less water and lower costs.

We are also considering the potential benefits that could be gained from opening up the residential retail market in England and will report to the UK Government shortly.



Resilience

Markets can increase resilience by:

- responding swiftly and flexibly to changing demands and pressures;
- revealing information which allows for better planning to meet long-term trends and short-term shocks;
- creating diversity in the supply of services, reducing the risk of single points of failure;
- incentivising the sustainable use of resources; and
- increasing efficiency and freeing up resources for investment elsewhere.

Innovation

Markets provide opportunities for innovation, enabling companies to move away from capital-driven solutions and to deliver more for less, including through:

- engagement with customers;
- solutions to long-term challenges; and
- alternatives to traditional engineering approaches.

Technology

Markets encourage the development of technological advancements, such as apps and other digital aids. These can increase customer engagement and understanding and help meet environmental challenges through improved water use and recycling.



Information

Markets reveal and rely on information to be effective. New information revealed by markets enables companies to make better decisions and allows us and others to challenge that performance more effectively on behalf of customers. It also ensures new entrants in a market are treated fairly.



Promoting new markets for sludge and water resources

We are promoting the development of two new markets – sludge and water resources – where there is potential to unlock substantial benefits for customers, companies, investors and the environment. We will also encourage more competition in the financing and provision of new infrastructure by third parties.

Sludge

Sludge is a semi-solid product of the treatment of sewage. It has a value as fuel for energy production and as a fertiliser substitute. 90% of water and wastewater companies responding to our survey think the value of sludge will increase in the medium term, helped by new technology.

Promoting a market for trading in sludge will deliver efficiencies in treatment and usage and encourage technological innovation. This means:

- companies can trade with each other and use processing centres in adjacent company areas to improve efficiency in the short term;
- more efficient investment to make the most of sludge processing across company boundaries in the longer term; and
- better interaction and integration with the wider organic waste market, enabling efficient site and resource sharing.

Water resources

Water resources are sources of water that are used for agriculture, industry, the public sector, residential, recreational and environmental activities.

Promoting a water resources market will deliver efficiency savings and greater long-term resilience. This means:

- efficient decision making on procurement of new resources for resilient services and environmental improvements;
- the value of water being reflected across the value chain better; and
- links to the UK and Welsh Government’s proposed reform of water abstraction rights to facilitate abstraction trading.



£2.5 billion
proposed new investment in water resources capacity over 25 years in water resource management plans

We will set the conditions to enable both the sludge and water resources markets to develop. We will:

- introduce separate binding price controls in PR19;
- allocate companies’ assets to the controls to encourage transparency and market entry;
- protect efficiently incurred investment up to 2020 to provide investor certainty; and
- develop information platforms to enable potential new entrants to see opportunities in the market.

In addition, we will set access pricing for the water resources market to facilitate third party access to the existing water network.

Competition in infrastructure financing and provision

Our new regulatory approach incentivises companies to use direct procurement for customers (DPC) for high-value infrastructure projects.

DPC takes place when a water company procures services, particularly infrastructure projects, on behalf of customers, including the project’s financing. It promotes the use of markets for projects which would otherwise be provided by the water company.

DPC can generate savings from project costs and cheaper financing. It can also encourage companies to take a long-term view of projects, bringing long-term savings.

We will evaluate companies’ proposals for DPC as part of our risk-based review of company business plans at PR19. We will expect companies to use DPC for projects valued at more than £100 million.

What this will deliver

Promoting new markets will help tackle some of the long-term challenges for water, providing resilience and choice for customers now and in the future.

Environmental benefits

Our new regulatory approach focuses on long-term ways to ensure resilience in the environment and in the supply of water and the taking away of wastewater.

At PR14, we asked companies to focus on total expenditure (rather than separating capital and operational expenditure) and outcomes that matter to customers. This created greater incentives for companies to innovate and take sustainable, flexible and partnership approaches to delivering services for customers.

We will support sustainable improvements in the environment through a long-term view of investment and risk management that encourages companies to plan over multiple price review periods rather than one. This helps companies develop whole-of-life solutions and use the most effective mechanisms to deliver environmental outcomes such as payment for ecoservices.

In particular, the development of new markets for sludge and water resources will bring environmental benefits, by promoting smarter use of water and waste. These benefits include the following.

Greater resilience for the natural environment and our water supply – incentivising more sustainable use of resources

Making it easier to move water around to where it is needed from where it can be spared, especially in the South East where water is already scarce

Protecting our rivers – and the species which depend on their ecosystems – from having excessive water taken from them

Technological innovation – encouraging smarter water use and recycling

Revealing information to show where water companies could work with others to maximise the benefits of energy from waste

-C Saving energy and carbon by reducing the need for transportation and using more renewable energy

Releasing energy from waste

Incentivising sustainable solutions where water is a scarce resource



What this will deliver

These changes will bring benefits both now and for future generations, by helping tackle environmental challenges such as water scarcity and by generating energy from waste.

Next steps

The decisions summarised here set out our future regulatory approach for our price review in 2019 and beyond, building on the successes of PR14. Together, the changes will deliver an approach that helps secure a resilient future for water, for the benefit of customers, the environment and wider society.

Some of our decisions, such as our decision to move from RPI to CPI or CPIH and separate controls for sludge and water resources, require changes to water company licences. We want to make all the changes to companies' licences as a package, to make sure they are implemented consistently for everyone.

We will engage with companies well ahead of any formal process to make licence changes. But in developing detailed proposals we see benefit from working particularly closely with companies that feel able to broadly support the package of changes.

We will engage with companies well ahead of any formal process to make licence changes



Looking ahead to 2020

December 2014

Our price review means customers will get more for less over the next five years, with bills falling by 5% in real terms and service improvements

December 2015

Our December consultation set out proposals for long-term changes to our regulatory approach for wholesale market and PR19

May 2016

Our decisions on our regulatory approach to benefit customers, promote efficient markets and ensure targeted and proportionate regulation

October/November 2016

Consultation on customer engagement and outcomes and further design issues

June/July 2017

Methodology consultation for PR19

December 2017

Methodology statement for PR19

September 2018

Companies submit business plans and CCGs submit independent reports to Ofwat for PR19