
Institute of water 2016 – 2020 vision for the water industry

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Thank you to Martin both for his introduction and for inviting me here. I'm really pleased to be here as always. Much as I love talking it regulation directors and chief executives, it is great to get a chance to talk with a wider variety of people from across the sector.

How many of you were at last year's institute conference?

You could view what I am going to speak about today very much as the sequel to the session I did there...

I'm going to spend a little bit of time **recapping** on what I covered last year - so if you were at last year's conference and the first few slides feel a bit deja vu there will be a reason for that - though I will go quickly over them.

But then I want to talk about **what has moved on** from last year's conference. Both in the sector and in Ofwat. And I want to say more about where we - collectively - are going next... And what all that adds up to for the sector of 2020.

Challenges and opportunities



Challenges and opportunities

- Environment
- Changing demographics and a growing population
- Consumer expectations
- Technology
- Macroeconomic and financial market changes

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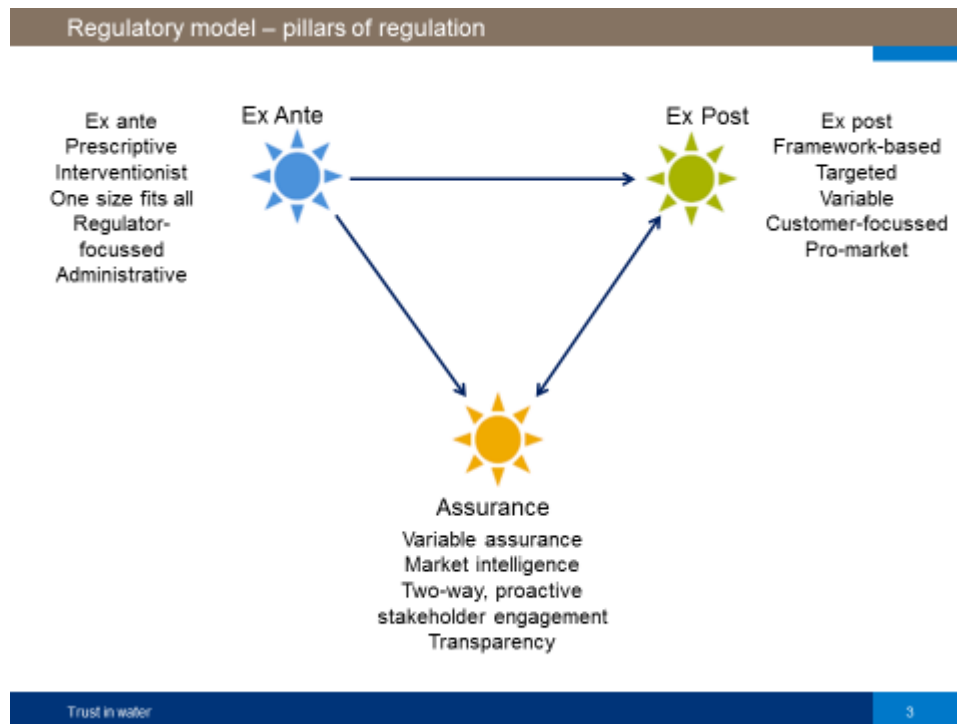
I remember opening what I said last year by talking about the challenges and opportunities the sector faces. And I remember coming after a really amazing opening session with a mock up news broadcast from 2020 that showed flooding and drought, graphically illustrating the potential **supply-demand balance issues** that the combination of **climate change** and **population change** could bring to the sector.

I also remember talking about the fact that in addition to these challenges, the sector would have to deal with those supply demand balance issues within a continuing **affordability constraint**. In particular given the fact that, for that constraint to ease, **real household incomes would have to rise at a faster rate than housing** costs - which could rise steeply as interest rates pick up. I'm conscious they haven't done yet, but I wouldn't want to bet on them staying as low as they are today until 2025, which is what they would have to do to ease the constraint at our next price control, which covers the period 2020-2025.

And I've said in various places that I think what all this adds up to is a **massive efficiency challenge** for the sector. A challenge to the sector to do more with less. A challenge which cannot be met simply by driving down the cost of doing what we have always done in the way we have always done it - top slicing, if you will. It requires us to think radically about how we make the best use of scarce resource and to find new and better ways of doing things.

All of which I think is **genuinely doable** - the slide references changes in **technology** which I think will be massively helpful here - but it requires different ways of thinking. Both in the sector and in the regulator.

Our regulatory model



... Which takes me on to our role.

Again, to recap briefly on what I said last year, one of the most important things we have to remember working in a regulator is that **we don't provide the services** that customers and society care about. That is what **you do**. But we do have an **important role to play in informing, enabling and incentivising** the companies we regulate to do the right thing.

And if the sector is facing bigger and more complex challenges than at any point since privatisation, we need to think about whether **regulation needs to change to help the sector meet those challenges**. And we think it does.

This slide shows how. Put simply, we see **three big changes** in the way that we regulate.

The first is that we need to move towards making **greater use of markets** in the sector. Not head to head competition, but rather the creation of **places where buyers meet sellers and where transactions can take place**. Markets that open

up options, create scope for companies to choose, for example, whether they do things themselves or contract with others who may be able to do things better, more innovatively, more efficiently.

And as markets become more prevalent, **we can regulate in a different way**. This is the second big change. We may be able to deregulate. **Relying more heavily on companies** to get on with things, with us intervening only where things go wrong. We will certainly be able to **use the information that markets generate** to regulate both more effectively and less intrusively.

And more generally **where we need to continue to regulate**, even in an ex ante way that involves us 'setting the rules' upfront, we should do so in ways that focus on what really matters, that is **outcomes**, and create both the **ability and the incentive for companies to deliver those outcomes in the most efficient ways** possible.

This is really what that movement along the **axis at the top of the slide** is all about. Greater use of markets, coupled with a more proportionate, more targeted, less one size fits all approach to regulation.

But it is also important to stress a **third change** in the way we regulate. Which is about a greater emphasis on **market monitoring, regulatory reporting and assurance**. Because it would be wrong to create markets and then back off entirely. We have an important role to play in ensuring that customers and society, and those who represent them have **assurance** that markets are working well and delivering what customers and society expect. And so we need to collect **information** on this. Information that enables **us to provide that assurance, and to take action where we need to**. And crucially information that enables **others** to provide that assurance and act where they need to as well.

Virtuous spiral

Virtuous spiral



Trust in water

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And - the final element of my recap - all adds up to a big change. But that the **size of the prize here is huge**.

Not just in terms of short term delivery but in **building the capability and confidence of the sector** to meet the challenges it faces. By putting the **responsibility** on companies, but encouraging them to **step up**, what we are looking for is for companies to **take the initiative**, to do the right thing, to try things, to **learn** from what they have done and from what others have done, and to **develop new skills, new knowledge**.

None of that has changed from last year. We have the same vision for the sector, the same vision for regulation, the same model and the same conviction that this is absolutely the right thing for us all to be doing if the sector is going to rise to the challenge and keep delivering the water and waste water services that customers and society expect.

So... How are we doing?

Progressive developments in regulation



To cut a long story short, I think we have - all of us - come an incredibly long way in the last twelve months. I think we have made huge progress.

I'm perhaps inevitably going to focus on things that Ofwat has been leading on, but I want to touch on some other stuff as well.

At Ofwat we feel as though we can really see our strategy, which I have always said we can't deliver on our own, becoming a reality. In particular we can really see changes coming through in the way that we regulate, changes in the relationship with have with companies, and we can see the changes in companies too.

The infographic up on the slide relates to one of our programmes, Water2020 which has been taking forward some of the biggest changes. The programme is all about how we can make better use of markets in the sector. Again, I repeat, not to create head to head competition, but to create those places where buyers can meet sellers and where transactions can take place. To reveal a wider set of choices and enable companies to make those choices in ways that deliver new efficiency frontiers. This programme is all about that, and the changes we need to make to regulation to deliver it.

Last summer our thinking was at an early stage of development. It has now moved on...

We know that we would like to see markets emerge for new water resources. So that companies are able to identify make use of the most efficient new water resources - which may include resources freed up through demand management, and may include resources from outside that company's area. And we have a pretty clear idea of how we need to regulate to enable and encourage this, with separate price controls, visible prices for water resources based on incremental cost, and access pricing that reflects the costs of treatment and transportation.

We know that we would like to see more vibrant markets for sludge treatment and disposal. Markets that enable companies - maybe existing water companies maybe not - to develop sludge to energy facilities alongside other bio-waste to energy facilities. Markets that enable companies to choose whether to invest in new technologies within their own areas to serve their own customers, or contract with another company to do this, possibly in a bigger plant that serves customers from a number of companies. And again, we know what we need to do to enable and encourage this. Again, with separate price controls and clearer, cost reflective, prices for these services.

And in line with all of this, we can see scope for different ways of new infrastructure being provided. We see scope for new kit to be built, owned and operated by water companies of course. But we also see that it could be sensible for it to be built and/or owned and/or operated by others. Possibly other water companies, possibly JVs, possibly third parties. Where this happens, where the market is tested in this way, we will could get useful information about the costs of enhancing networks that could complement our cost modelling, and possibly take the weight off that comparative economic modelling approach we have generally taken to this type of expenditure. We are thinking about what we need to do to enable all this to happen.

So... We are well on our way from that ex ante, administrative, one size fits all approach to an approach that is much more market-based, and enabling of a more proportionate and targeted approach.

And it is worth noting how the way we have been working on water2020 illustrates that change in relationship between us and the companies we regulate, that I spoke about earlier. We started the programme and opened up a 'market place for ideas' where we asked companies like and indeed others, to help us define the problem we are trying to solve here and - crucially - help us to come up with what we needed to do to help solve it. And that has been a great success. People across the sector have really stepped up and we have seen some great contributions there, which have really shaped our thinking and flowed directly through into what we are doing.

But of course water2020 isn't the only show in town. And we have moved a long way elsewhere too.

We are also see a more pro-market approach rolled out with the introduction of competition in the retail market for business customers in England. This time last year, Ofwat has just taken on the responsibility for programme management from Open Water Markets Ltd. Well we now have in place a really solid and successful set of programme governance arrangements, with clear leadership from the management group - Me, Sarah Hendry from DEFRA and Ben Jeffs the CEO of MOSL.

We are well on with delivering the stuff Ofwat needs to deliver - the codes, including the customer protection code, the licences and the licensing process. And indeed we are receiving applications for licences from retailers now.

MOSL is well on with the delivery of the switching and settlement systems too. Not without stress and some anxiety. But nevertheless on track.

And of course there has been and is still a lot of hard work going on in companies. Not only on data and systems. But we can already see evidence of some companies making big strategic choices about how they will play in the new market. Water Plus, the UU-SVT JV is a good example of this. As is Portsmouth's arrangement with Castle Water.

And of course last October Ofwat was asked by the UK Government to look at the costs and benefits of extending competition to the household part of the market in England.

Beyond Water2020 and Retail Market Opening we have also been developing that third limb of our regulatory model - reporting, market monitoring and assurance.

We have our company performance reporting framework in place. And we are starting now to develop our thinking on how we monitor resilience - which is all about the risks associated with those outcomes, now and over the long term and how companies and others in the sector are managing those. We have the work on of the resilience task and finish group that goes a long way to helping us with this! And we have already asked companies to do and share with us some financial stress testing. But there is a lot more to come on this...

And in parallel with this Companies are of course reporting to their customers on their performance commitments, making use of their customer challenge groups too. And I really welcome the progress that is being made through WaterUK on the sector dashboard, which will really help with this.

And this is just the stuff that Ofwat is leading on, or has been really instrumental in.

There is a lot of other stuff besides...

Things have changed a lot in the government space since the election.

We have the creation of the National Infrastructure Commission. Water isn't one of the three areas it has been asked to do deep dives on, but maybe it will... And a lot of its work is inextricably linked with housing, which of course has a big impact on the sector.

We have increasing devolution. New law-making powers for the Welsh Government...

And, obviously less powerful but still significant, we also have the creation of mayors across England and a push towards more localism here.

We have a changing policy environment too....

We have a new policy framework in Wales - we now have the Welsh Government's Environment bill and the Wales Water Strategy. No Strategic Policy Steer yet for Ofwat from Welsh Government but a clear direction of travel.

We are soon to get sight of Defra's 25 year environment plan, and a new SPS for us on the back of that.

All this against the backdrop of one thing that hasn't changed in the government space, and that's the squeeze on the public purse. Which almost certainly means a continuing debate with water companies about where they might legitimately help to deliver some of the outcomes that customers and society care about, but which might in a different world have been delivered by the public sector.

So I have talked about changes at Ofwat and changes in the government space. Things are changing with companies too...

I can see very clearly a step change both in the breadth and depth of thinking in the sector about what are the outcomes that customers and society care about, about how those outcomes should best be provided, about where water companies might have a role, and what that role might be.

I see companies thinking really seriously and making choices about what they want to do themselves, and where they want to work with others, and crucially developing the tool kit they need to work with others successfully - from new forms of alliancing with the supply chain to 'catchment coordinators'. And developing the use of what Richard Flint calls 'the convening power' companies have - to bring different people

together across communities and regions. And we can already see some of the fruits of thinking.

We can see it in how companies are delivering their performance commitments, in a world of outcomes and totex... with more activities focussed on local communities and behaviour change. We can see it in the increasing use of new technology and social media.

We can see it in the discussions we have with the new customer challenge group chairs.

We can see it as companies prepare for retail market opening in England. And in some cases we can see it translate into structural changes, with companies joining forces for example through the UU-SVT Water Plus joint venture, or deciding that others may be best placed to serve business customers in a competitive market, as in the arrangement Portsmouth Water has reached with Castle Water.

So, when asked to think about the vision for the industry in 2020, we don't have to think very far! 2020 isn't only pretty close in that it is only 4 years away, the seeds of the differences between the sector we will see then and what we see now have already been sown. We don't have to speculate on 2020 any more, it is almost a reality.

Trust in water



Which is **great news**. Because it is these changes we are all relying on to deliver that step change in efficiency, that ability to do more with less, that is essential if the sector is going to continue to deliver for customers and society in the face of those challenges we discussed at the beginning ... challenges which include a continuing affordability constraint.

From where I stand right now, it really does look at those we have taken those **critical early steps onto that virtuous circle**, of companies stepping up, taking responsibility, trying new things, learning... growing capability and confidence. We have a lot more to do, that is certainly true. But early indications are really positive.

But of course - as you would expect - part of our role as the regulator is to think ahead, so can continue to challenge and provoke...

Every price control looks back to the previous one. It reaps the rewards for customers - passing the benefits of the efficiencies achieved on to them. And **every price control looks forward** to the next one, creating the framework that will inform, enable and incentivise further efficiencies that can then be passed on.

So, as we get closer to PR19 and what we will all need from the sector in 2020... We **starting to think seriously about PR24** and the demands on the sector in 2025... Which is a conversation I look forward to having with you in the - not too distant - future!

Thank you.