
Preparing for market opening in the water industry

Speech by John Russell at Utility Week Consumer Debt Conference

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Introduction

Good morning everyone.

For those of you who don't know me, I am John Russell, the Senior Director of Strategy and Planning at Ofwat, the economic regulator for the water sector in England and Wales

Firstly, I want to say thank you to Utility Week for holding this event on such an important and timely subject and for inviting me here to speak on the issues of debt and affordability at a moment when the water sector is about to go through a profound change with the opening of the business retail market in England to competition at the beginning of April. It also great to be speaking on a platform with experts from other sectors as I'm sure there is a lot we can learn from each other's approaches to these issues.

We see affordability and debt issues as being a crucial part of our customer focus as a regulator. Our analysis has shown that the total level of revenue outstanding from customers' unpaid bills has increased from £1.9 billion to £2.2 billion in the four years between 2010-11 and 2014-15. And of course dealing with these issues has an impact on bills for all other customers. All this means that it is crucial that companies and Ofwat need to have a clear approach to tackling this now and into the future.

So today I want to talk about three issues that are on our minds as we head towards the periodic price review in 2019.

- First of all about what we see as the scale of the challenge.

- Then I'd like to talk about the work we have already undertaken with companies to tackle these issues and what we are planning to do going forward.
- And finally, I want to talk about how we are looking at these issues as they relate to the new business retail market.

Affordability and debt in the water sector

The economic climate that customers face right now is still as challenging as ever.

According to indicators, affordability risks emerge when a household spends more than 3% of their disposable income on water and sewerage bills. Nearly one quarter of households in England and Wales fall into this category. And we found that 11% of households spend more than 5% of their income on water.

And this is all in a context where the average amount of individual debt in the UK stands at just over 14 and a half thousand pounds. Since 2010 we have seen a 10% increase in the number of people who have contacted the National Debtline about their water bill arrears.

Recent research from the Consumer Council for Water (CCWater) found that one in five customers feel their charges are unaffordable, an increase from one in eight customers last year.

And, if we do see more turbulence in the economy, there are concerns that families may experience more pressure on their wallets.

No-one knows for sure what is going to happen in future but certainly at this point in time we don't foresee a lessening of the squeeze on customer finances and the number of customers who are struggling to pay their bills.

We do know this is a top priority of Government. The draft Strategic Policy Statements that we received from both the Welsh and UK Governments contain priorities and objectives for us around incentivising, challenging and driving improvements on affordability and vulnerability.

Affordability in the past and looking forward to PR19

It is important to say that issues of affordability are nothing new and we have always had a strong focus on them.

At PR14 our final determinations resulted in a 5% drop in bills in real terms. Our challenge to companies meant that customers will pay £3 billion less than proposed in

company business plans and by 2019-20, the average water and wastewater bill in England and Wales will be £376. Currently, it is £395, which works out about £1.08 a day.

However over time reductions to customer bills due to our efficiency challenge have fallen. The value of our challenge in PR09 was £39 on the average bill. By 2014/15 it was just £11. If companies have already exploited the “low hanging fruit” then any future challenge of achieving more for less is going to have to be met the hard way. Through innovation and finding new and better ways of doing things.

And in the last periodic price review in 2014 we set some good foundations to build on.

We moved to an outcomes-focused approach, driven by customer engagement and companies have already stepped up to more actively owning the relationship with their customers and doing more than ever before to put them at the heart of their plans.

This includes improved support to those who might struggle to pay their bills, and on this we have seen good progress.

All 17 water companies have now put in place social tariffs following customer engagement and with better engagement the number of customers accessing those tariffs is increasing. As of March 2016 around 130,000 customers were receiving financial help through social tariffs, compared to around 44,000 in 2014-15.

But more progress is needed. Last month the Consumer Council for Water reported that only around half of the households who stand to benefit from these schemes have so far signed up for help, meaning eligible customers are missing out on lower bills.

We've also done further work in this space publishing our Debt and Affordability Report in 2015 and building on that, our Vulnerability Focus Report last year. Both of these aimed to help water companies understand the pressures faced by customers and how best to respond to them. Tackling customer vulnerability is central to maintaining trust and confidence in water.

Our Vulnerability Focus Report noted that vulnerability is a complex area. The drivers are many and varied and above all, transient. Any one of us can become vulnerable and the circumstances that cause vulnerability are often temporary. Our report also set out our new approach to vulnerability. Rather than talking about ‘vulnerable customers’ we should be considering the circumstances that can lead to customers being vulnerable.

A year on from these reports, we have spoken to companies who are responding to our recommendations. Many companies are doing good work to improve the take-up on their support schemes and to identify customers who are in circumstances that could make them vulnerable or who may need help with their bills.

Some companies are also working with third parties, such as housing associations and credit reference agencies to achieve this.

For instance, South East Water have agreements in place with social housing providers, who provide information on their vulnerable customers (with their consent), which enables the water company to set customers up at the outset on the best possible tariff.'

Anglian Water have been developing a vulnerability scorecard with Experian which aims to help them differentiate between customers who can't pay and won't pay. United Utilities are running a pilot that uses face-to-face engagement with 'hard to reach' customers in order to improve awareness and take up of support schemes.

So there is real progress and evidence of companies owning their relationships with customers more strongly and targeting their engagement to support customers experiencing issue of affordability and vulnerability but there is further to go.

PR19

We are moving steadily now towards the next price review and our thinking around affordability for PR19 is already underway.

We expect to see companies continuing to put customers at the heart of everything they do. Customer vulnerability and affordability issues need to be integrated into a company's plans to deliver an inclusive and excellent customer service overall.

However, it is essential that we also recognise many customers will not be eligible for any targeted measures from companies. Yet they may have their own affordability concerns and will still be paying for those customers on social tariffs.

Therefore, affordability in PR19 is not just going to be about protection and support for those customers who are most struggling to pay their bills but will focus on affordable bills for all over the long-term.

We think there's real scope for companies to be more cost efficient at PR19 which will enable companies to set low bills for all their customers as well as improving resilience and the standard of service customers receive.

As part of tackling this efficiency challenge bad debt must be addressed. Customer bad debt is on the rise in the sector. Historically, this is an area where the sector has performed poorly. Our Affordability and Debt Report told us that bad debt has risen by 17% between 2010-14 to £ 2.2 billion. That's the equivalent of adding the hypothetical amount of £21 a year to the bill of every household customer in England and Wales.

Now we know that unlike other utilities (and for good reason) water companies cannot disconnect residential water customers but that should not be an excuse for not tackling this issue. After all, while disconnections do happen in energy, they are extremely rare. Last year Ofgem reported that in 2015, only 204 energy disconnections took place and 49 gas disconnections as a result of customer debt.

So in PR19 when companies submit their plans we will be looking for evidence that companies are considering efficient debt management practices and considering ways to reduce bad debt levels.

We will challenge companies' bad debt levels in our price setting process. We will do that by using evidence from within the sector as well as from other sectors.

And we expect companies to compare their performance not only against their peers, but also against approaches to revenue collection and management of bad debt levels in other sectors.

This brings me onto the subject of data.

Ofwat is currently working with companies to better understand how the sector approaches and utilises customer data. In June we will publish a report, *Unlocking the Value of Customer Data*, which will highlight good practice in the sector and make recommendations to serve as best practice guidelines to water and waste water companies.

We also want to widen companies' horizons about the opportunities available with respect to utilising data more effectively.

In our *Water2020* decision document we encouraged companies to develop strong relationships with their customers and an in-depth knowledge of their customer base to help them to identify outcomes that customers want. The effective use of customer data will play a key role in companies developing their understanding of their customer base. It also has a role to play in identifying those customers who are struggling to pay their bills, those who are experiencing vulnerable circumstances and help companies to facilitate an inclusive service for all. Data could also encourage innovation in products and services that benefit customers and drive efficiencies.

Both our *Affordability and Debt Report* and *Vulnerability Focus Report* said that collaborating with credit reference agencies would not only enable them to collect and manage data to the benefit of customers but also identify and support those customers whose circumstances make them vulnerable,

We have been talking to those companies who are sharing data and we are pleased to hear that this has enabled companies to improve their data quality, address bad debt and target their services.

For instance, Portsmouth and South East routinely use customer data shared with their overlapping wastewater companies to help ensure customers are in receipt of the most suitable tariffs.

We are also pleased that recent amendments to the Digital Economy Bill have added Water Companies as bodies that can disclose information to help target services for vulnerable customers.

Vulnerability and the new market

Finally I want to talk about how Ofwat intends to protect customers who may be in situations of vulnerability or experience affordability concerns when the new business retail market opens in two weeks.

For the first time, 1.2 million eligible businesses, charities and public sector customers in England - from the smallest corner shop or charity to the largest corporate - will be able to choose the water services retailer that best suits their needs. This will be the largest water retail market in the world.

This is the biggest shakeup in the sector since privatisation. For over 25 years, Ofwat has regulated a monopoly sector and most customers have been unable to switch their water provider or negotiate better deals. The introduction of choice for these customers will enable them to choose a service provider that best suits their needs and can act as a driver for those service providers to offer more customer-focussed, efficient and innovative services. We even expect to see the benefits of these market pressures spill over into services where customers, such as residential customers, do not currently have a choice in supplier. The growing choice of service offer that will become available to business customers will raise expectations of a better service for residential customers, driving improvements amongst remaining monopoly suppliers.

However, we still have a job to do to ensure vulnerability and affordability issues are considered. This is particularly for smaller business customers, such as home businesses and microbusiness which may have limited financial resilience and which in many respects behave like residential customers in terms of their time and ability to engage with the market.

We've developed our Customer Protection Code of Practice which sets out the minimum standards all retailers must abide by. Every retailer will be required to comply with this Code of practice as a condition of its licence. If they do not comply with the Code Ofwat will be able to take action against them, up to and including revoking their licence.

Our customer protection code of practice provides safeguards in a number of areas such as limits on back-billing and a cooling off period when contracts have been signed.

It also provides specific protection to micro-businesses – those organisations with ten employees or less who tend to have lower levels of buyer power than other larger customers. This is to provide additional protections to help ensure they have clear and complete information to understand the terms on which they choose to switch their retailer. Should there be a dispute between a customer and their supplier, the Code also requires every supplier to have a readily accessible and effective complaints handling process which is free to the customer.

Ofwat will monitor the market to test whether it is operating efficiently, that customers are aware of the market and that issues and complaints are dealt with effectively. We will report regularly on its effectiveness and carry out an in-depth review of the market as a whole every 3 to 5 years.

We've seen the benefits of competition in other regulated sectors, but we know there can be downsides too. We have learnt lessons from other markets and put protections in place to support the market. We've developed a strong market monitoring framework informed by these lessons and that will hopefully enable us to spot early on if similar issues are arising in our sector and if so where we need to intervene to protect customers.

Conclusion

So to conclude, Ofwat regulates a vital public service and customers are at the heart of everything we do.

We have a duty to protect all customers, with a particular mind to those customers who are in circumstances which could make them vulnerable or who are facing affordability pressures. It is clear that affordability, bad debt and vulnerability in utility sectors are subjects will continue to be political and social issues for many years to come.

It's been more than a year since we published our Affordability and Debt Report and our Vulnerability Focus Report. Our engagement shows that companies are embedding the recommendations in those report and we will continue to work with them on this as we look towards the next price review and beyond.

Through engagement and working with third parties, companies are getting to know all their customers, also enabling them to tailor services towards the most vulnerable and assist those struggling with their bills as well as tackling bad debt.

While Ofwat takes a direct interest in customers who are experiencing situations of vulnerability and affordability, we are also focused on protecting the interests of all

customers and expect overall efficiency improvements to drive down costs and bills for all. This is a key focus for us as we look towards PR19.

We believe that the opening of the business retail market will create new opportunities for innovation and efficiency to drive improvements in services and reductions in costs to customers. But we remain vigilant to problems and will step in if needed.

Tackling the subjects I have spoken about today is central to building and maintaining trust and confidence in the sector. Customers must be able to trust that water companies will provide the services on which they depend. And importantly, these must be delivered at a price they can afford and that they are willing to pay.