



Water UK city conference - keynote speech

Jonson Cox,
Chairman, Water Services Regulation Authority
9 March 2017

In short, we've made a lot of progress in recent years:

- We now have a healthy mix of respect and challenge
- Successfully, and without fanfare, implemented licence changes
- Better lines of communications
- Clarity of our position and approach

All of which is good for customers. But also for companies, investors and Ofwat

- Will open on time in three weeks
- Herculean effort from all involved
- Companies making interesting strategic decisions – and some profound shifts in thinking
- We'll see more strategic developments yet
- Companies will have to innovate - and customers' demands will drive that
- We will see a move to dynamic efficiencies

Residential retail review – the findings

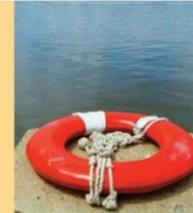
No one can accurately predict the future. In our cost benefit assessment we have identified a number of illustrative possible scenarios modelled over a 30-year period, which reflect how key features of a competitive residential retail market could develop. Of course, there are no guarantees of how successful competition would be, but the evidence suggests that a net positive outcome is more likely than not.

Here we summarise our view on the prospects for a successful market opening.

It would be a competitive market, not an unregulated market. Appropriate assistance would need to be in place for vulnerable customers and those struggling to pay their bills.



Reductions in customer bills could be limited, especially in the short term.



Some customers will secure better deals than others. Safeguards may be needed to protect especially vulnerable customers, from this risk.

£2.9 billion
potential benefits over 30 years

In financial terms, the benefits of opening the market should exceed the costs over the 30-year period we have modelled. There are significant potential benefits worth around £2.9 billion over 30 years.



Competition could cut bad debt costs as retailers improve debt management



There will be some significant set-up costs to open a new market which companies and customers will have to meet.



Competition could deliver substantial benefits that are difficult to quantify, such as the power for customers to take their business elsewhere if their provider falls short.

Competition could lead to widespread and ongoing innovation in customer service.



There will be significant ongoing costs for retailers who compete in the market, including to gain and retain customers.

Photos © DWP, Lumix2004, Hortongrou, Brian Norcross, Adriana Herbut, Getty Images

- We expect the government formally to respond on the residential retail review in the near future
- Some companies are already seeing this as a ‘when’ not ‘if’ question
- Review shone a light on how slow and passive companies have been on customer service
- Some companies have become far too comfortable
- Whatever the outcome of the government’s decision, clear we need frontier shift on service and innovation
- With PR19 on the horizon – take note of new frontiers!

2017

- **July** - PR19 methodology consultation
- **December** – PR19 final methodology document

2018

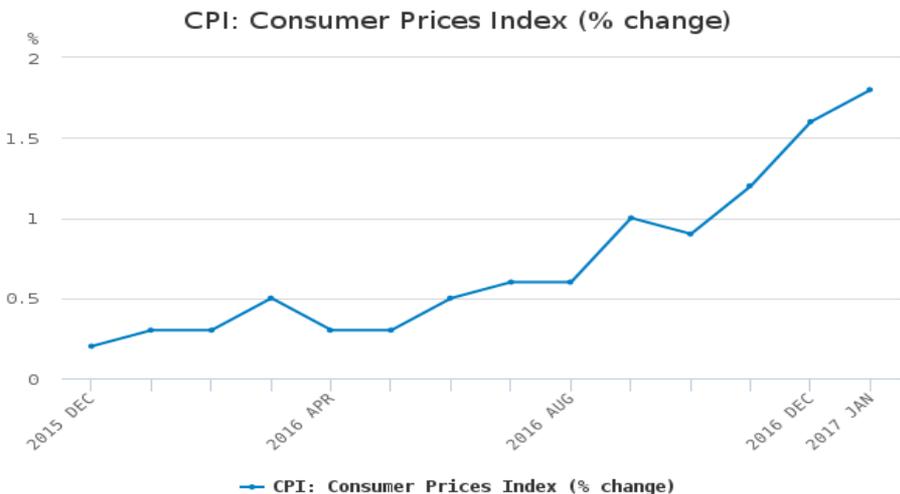
- Business plans submitted

2019

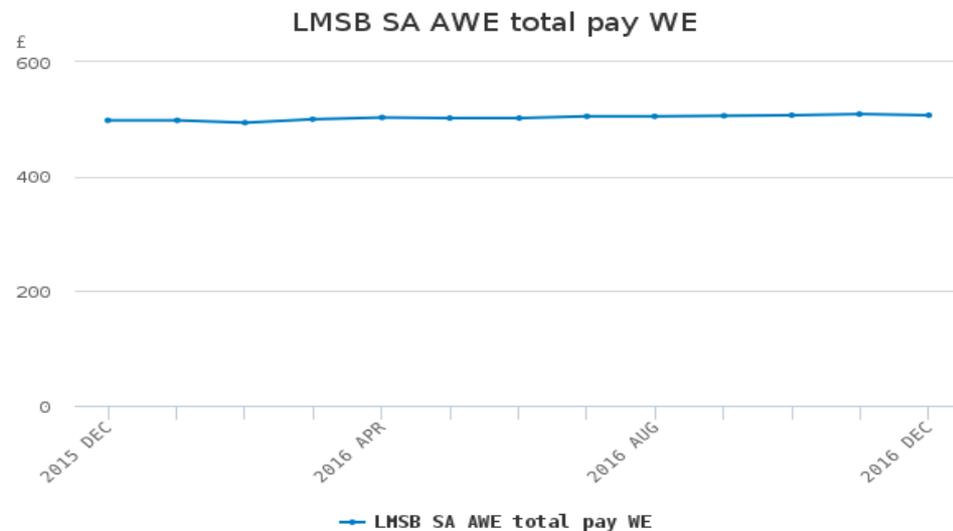
- **March** – draft determinations for enhanced companies
- **July** – draft determinations for other companies
- **December** – final determinations for all companies

What are customers experiencing?

- Challenging environment for customers – inflation rising, wages are not and the big unknown of life outside the EU
- What does it mean for vulnerable customers and the help they need?
- What does this mean for affordability?
- Affordability is not just about social tariffs - keeping prices down for ordinary people



Source:

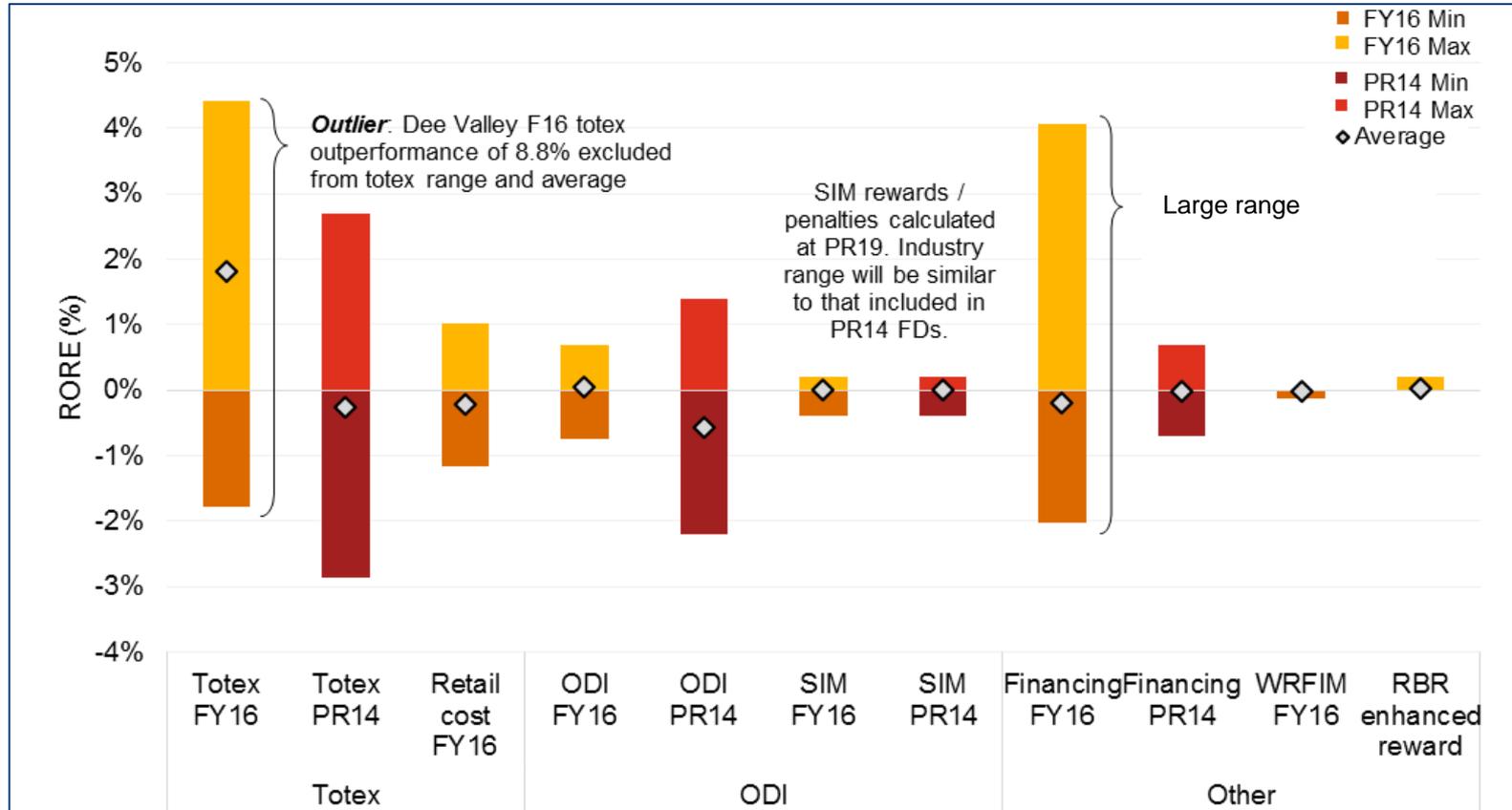


Source:

- We are thinking about asset management – are companies maintaining the health of their assets as they should have? And effectively?
- Asset intensive sector and we expect hard evidence that assets are maintained in line with licence obligations and performance commitments
- Some attitudes on this worry me. It is companies' responsibility to maintain assets and they should remember who pays: it's customers' money.
- Companies trying to attribute underspending to Ofwat won't wash – it's the company's responsibility to maintain assets.



Introduction of TOTEX



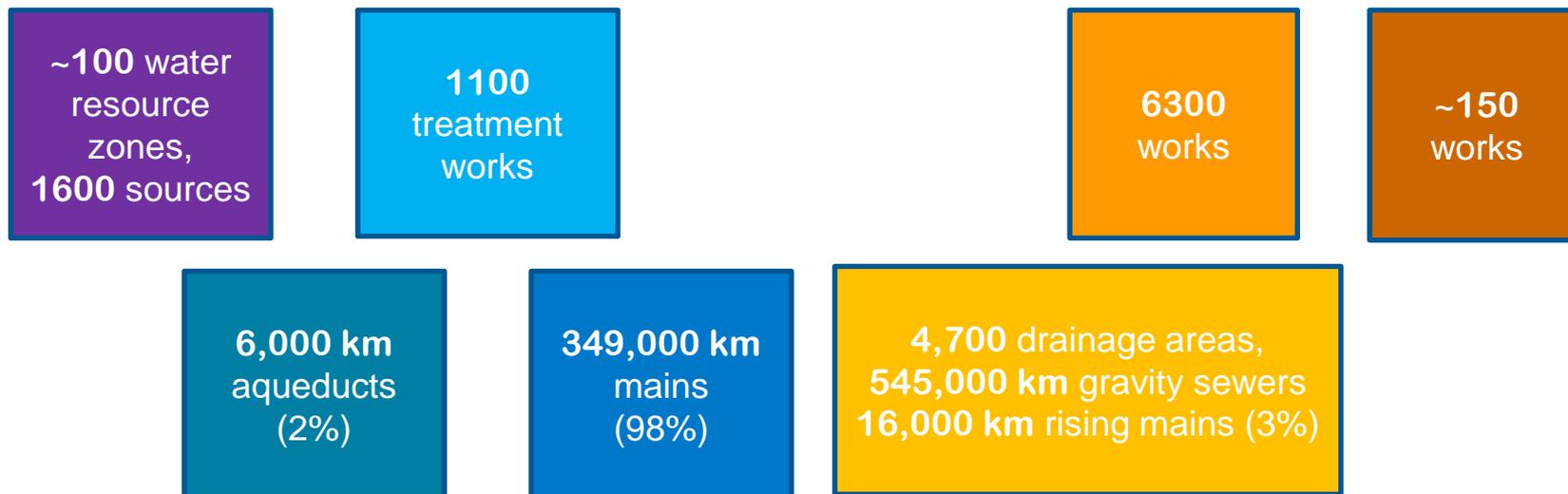
Dynamic efficiencies through markets, including bioresources and water resources



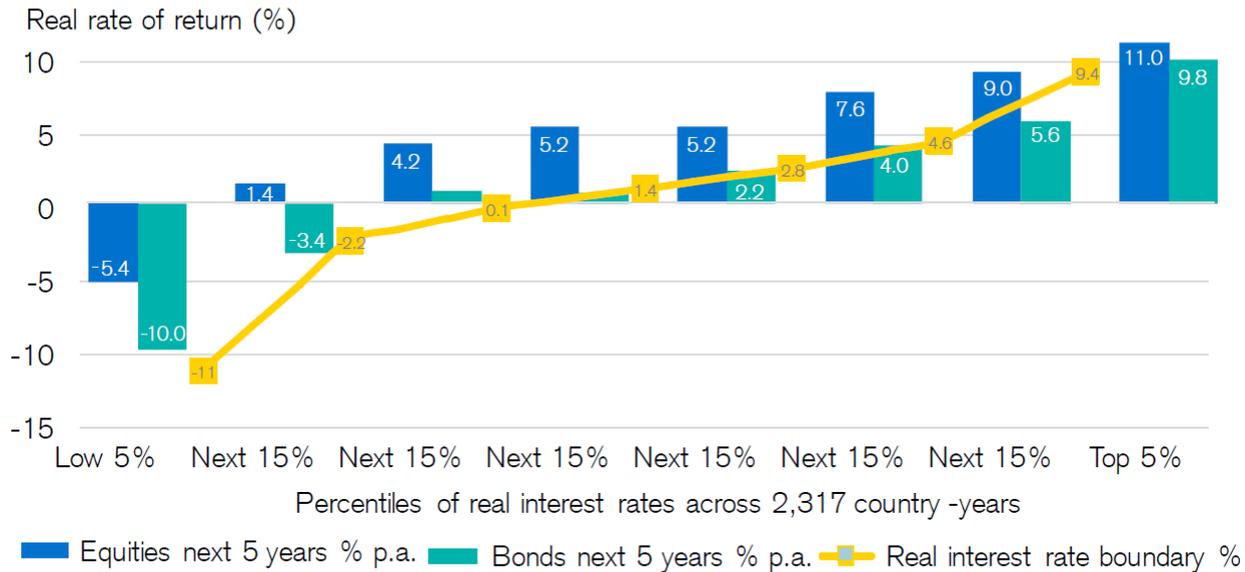
% of total expenditure



Asset types and numbers included in each part of the value chain



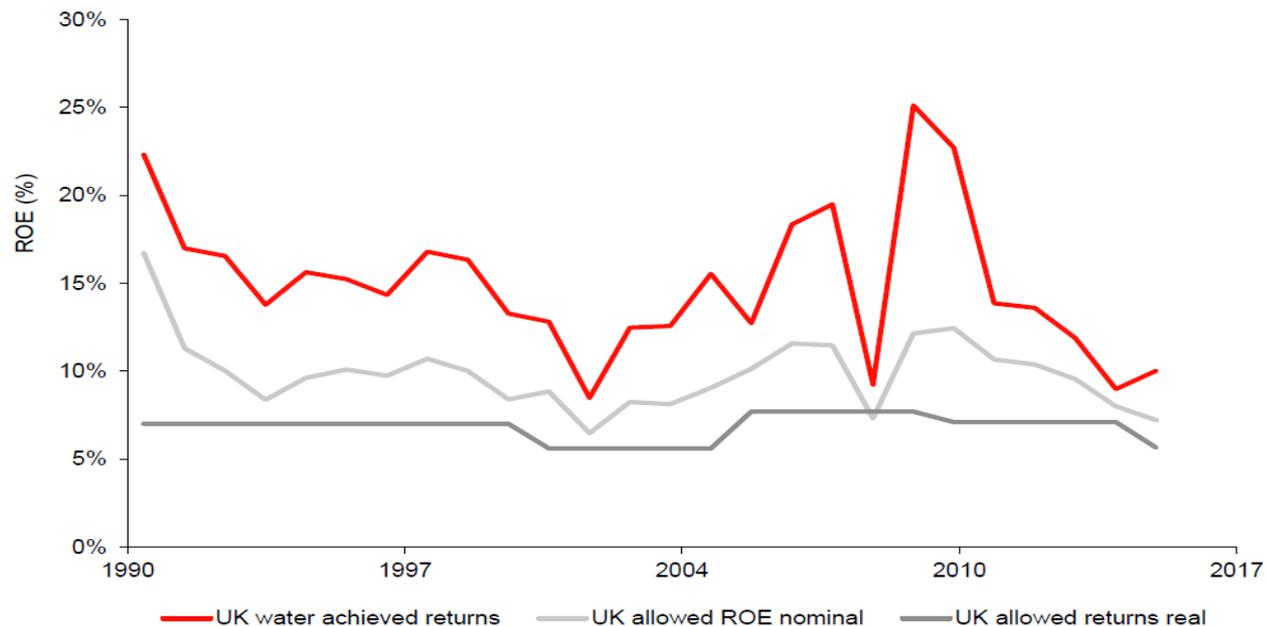
Low real interest rates means a low return world



Real interest rates impact subsequent real equity and bond returns

- Overestimated debt costs in the past – something we will consider again in PR19
- Moody's recently forecast a wholesale WACC of around 2.5% for PR19%

Fig 77 Water companies have outperformed the regulatory contract every year since privatisation with an average of 400bps



Source: Ofwat, Company data, Macquarie Research, January 2017



- Expenditure on resilience is not new – each price review has improved funding for operational resilience
- Customers are at the heart of resilience and the time frame for implementing resilience
- We will take a balanced approach
- We will set out our expectations at a May 4th event

In PR19 we want companies to show more ambition than ever to deliver:

- **Great customer service**
- Long-term **resilience**. And that means resilience in the round, building on our resilience framework
- Affordable **bills** that offer value for money – looking at scope for reducing bills
- **Innovation** and new ways of doing things

All underpinned by 'enhanced' being the 'new normal'