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Trust in water

Delivering Water 2020: consultation on PR19 methodology

Appendix 1: Addressing affordability and vulnerability

**Appendix to chapter 3:
Addressing affordability
and vulnerability**

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1. Introduction

This appendix sets out the issues that we want to address for both affordability and vulnerability, our proposed approach and the options we have considered and the reasons for our proposals. It supplements the information on affordability and vulnerability we set out in chapter 3 (addressing affordability and vulnerability) of our draft PR19 methodology consultation.

We want to see business plans that address:

- overall affordability – providing value for money;
- affordability in the long term; and
- affordability for those struggling, or at risk of struggling to pay.

We also want to see companies creating business plans that demonstrate how well companies **support customers who are in circumstances that make them vulnerable**. (This includes customers who may be about to be in circumstances that make them vulnerable).

We think it is more transparent to have two distinct sets of tests for affordability and vulnerability. Issues of affordability and vulnerability can overlap, but they can also be distinct as customers might be in circumstances that make them vulnerable but they can afford to pay their bill. We want to make sure our assessment of business plans covers both affordability and vulnerability.

- Section 2.1 summarises our proposals for affordability;
- Section 2.2 sets out our appraisal of the options we considered for addressing affordability;
- Section 3.1 summarises our proposals for how companies should address vulnerability; and
- Section 3.2 sets out our appraisal of the options we considered for addressing vulnerability.

2. Affordability

2.1 Summary of our proposals for affordability

What makes a bill affordable or unaffordable depends on household income, size of the water bill and a customer's individual circumstances. Affordability remains a

pressing issue and there are opportunities to improve affordability of bills in PR19 and scope for significant improvements to service resilience and quality.

Our thinking and proposals on affordability

We propose to assess three aspects of affordability:

- overall affordability – providing value for money;
- affordability in the long term; and
- affordability for those struggling, or at risk of struggling to pay.

We propose using these five principles, to assess the affordability of business plans:

- customer engagement;
- customer support;
- effectiveness;
- efficiency; and
- accessibility.

We propose that companies provide data to demonstrate the affordability of their plans. We will assess these when we make the initial assessment of business plans.

Our other price review assessments of costs, the cost of capital and outcomes will contribute to achieving affordable bills.

Reports from the Customer Challenge Groups (CCGs) will provide important evidence on companies' approaches to addressing affordability.

2.2 Appraisal of our proposals for addressing affordability

What issue are we seeking to address

It is important that all customers receive services that are affordable and give value for money both now and in the long term. Customers who are struggling or at risk of

struggling to pay their bills need easy access to assistance. Companies need to be more proactive both in getting this assistance to customers and in communicating to raise awareness of the support. The measures that companies propose to address affordability should be cost beneficial and effective, maximising customer benefits.

What options have been considered

Option 1: No change to PR14 approach

In this option we do not change our approach from the one we used in PR14 where we tested how well a company demonstrated that:

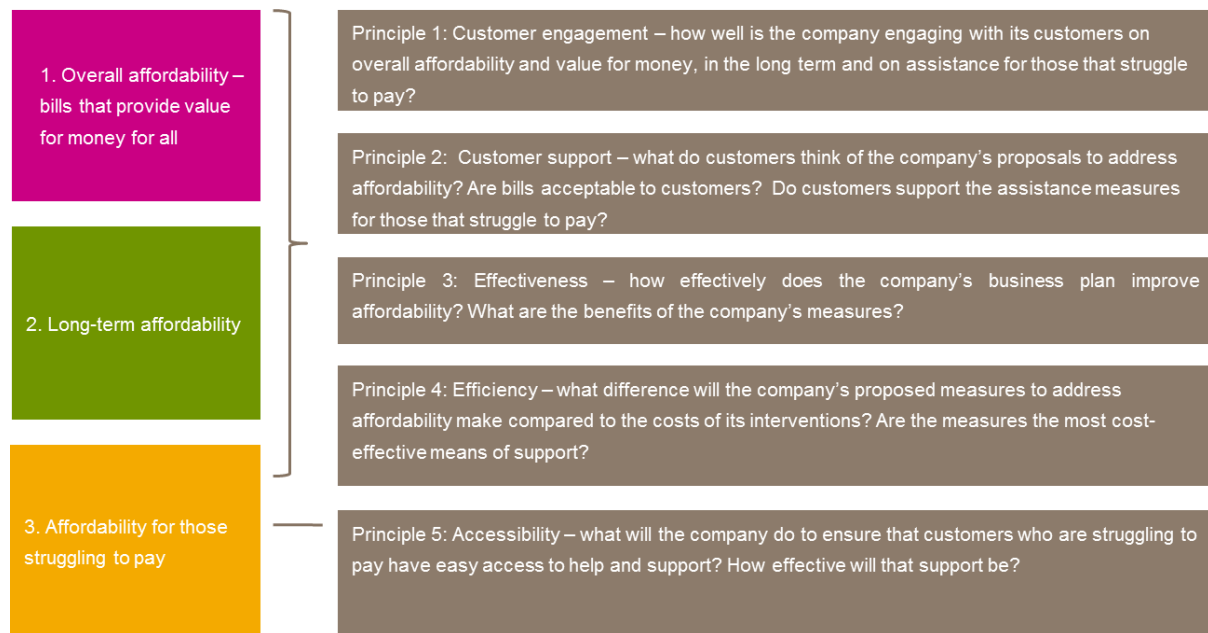
- it robustly tested its proposals with its customers for affordability;
- its customers found its proposals affordable; and
- it had explored all available means to make bills as affordable as possible for future customers as well as present ones.

Option 2: Using a principles-based approach to assess how companies are addressing affordability

The three areas of affordability that we have identified for PR19 when taken together encourage companies to think about all their customers by providing value for money for current and future customers as well as supporting those struggling or at risk of struggling to pay. Our engagement on the three areas revealed general support.

In this option we assess how companies are addressing the three areas of affordability against five principles, using both qualitative and quantitative evidence provided by companies. We developed these by looking at principles for the design of taxes and social benefits and water companies' existing measures relating to affordability and vulnerability. Figure 1 below shows the principles against the three areas.

Figure 1 Proposed principles to assess how companies will address affordability



Option 3: Using metrics for the principles-based approach to assess how companies are addressing affordability

In this option as well as using principles, like we do in option 2, we ask companies to provide data to demonstrate the affordability of their plans against the five principles. Some companies already measure how well they are performing against their performance commitments on affordability and we expect to see these become more innovative. Table 1 below illustrates the type of metrics companies already use to assess affordability, other measures we consider could be useful and other evidence we will look at to assess affordability.

Table 1 The information and metrics we could use to assess the three areas of affordability against our five principles

Principle to be applied	Sources of information for assessing affordability
<p>1. Customer engagement How well the company is engaging with its customers and third party organisations on addressing affordability.</p>	<p>Qualitative: Company evidence, in the CCG report and other organisations on the company’s customer engagement on affordability, long-term affordability and affordability for those struggling or at risk of struggling to pay. Of how well companies are engaging with their customers to understand the drivers of affordability issues; the extent of these issues among their customer base; how well they are engaging to</p>

Principle to be applied	Sources of information for assessing affordability
	<p>understand customer support for assistance for those with affordability issues, and in designing the most effective range of assistance measures.</p> <p>Quantitative: Number of customers engaged with on affordability in the company business plan.</p>
<p>2. Customer support What are customers' views on the company's proposals for addressing affordability?</p>	<p>Qualitative: Company evidence including research, and from the CCG report and other organisations on customer support for the company's approach to the three aspects of affordability - on the level of bills and the assistance for those who struggle or are at risk of struggling to pay.</p> <p>Quantitative: Percentage of customers finding bills acceptable (related to, but not the same as affordable). Percentage of customers who think their bill is affordable to them.</p>
<p>3. Effectiveness How well the company's proposed approach will improve affordability.</p>	<p>Qualitative: Company evidence and from the CCG report and other organisations, including how well the company understands the needs in its area for affordable bills and how its proposals address these needs.</p> <p>Quantitative: Benefits of applying affordability measures (for example, decrease in revenue outstanding). Average (mean) bill reduction from financial assistance measures.</p>
<p>4. Efficiency The difference the company's proposed approach will make compared with the costs of interventions.</p>	<p>Qualitative: Company evidence and the CCG report on the efficiency of the company's approach to addressing the three areas of affordability.</p> <p>Quantitative: Costs and benefits of applying affordability measures Debt management costs as a per cent of the average bill.</p>
<p>5. Accessibility What the company will do to improve accessibility and how effective will it be. (Applies only to the third area of affordability: those struggling or at risk of struggling to pay their bills).</p>	<p>Qualitative: Company evidence, evidence from the CCG report and CCWater research, and from other sources such as those organisations specialising in debt. Evidence of support available for those at risk of struggling to pay their bills and how proactively companies deploy such support in advance of problems arising.</p> <p>Quantitative: Number of customers receiving financial assistance.</p>

Our assessment of the potential options

Our preferred option is option 3. This furthers the consumer objective, but it goes further than Options 1 and 2 because it requires companies to provide more robust evidence in their business plans on how their approaches have and will help deliver the affordability of bills.

The common metrics in option 3 enable customers and other stakeholders to understand the nature of affordability issues, understand the variations between companies and provide the sector with better information to identify ways of improving approaches to affordability in the future.

Option 3 encourages companies to think even more about how long-term resilience can be delivered with the support of customers, following good-quality customer engagement and. Option 3 promotes efficiency by encouraging companies to have approaches that are efficient and effective.

Table 2 Options assessment for our approach to affordability

	Option 1 Do nothing (PR14 approach)	Option 2 Principles applied to three areas	Option 3 Using metrics (Preferred option)
Achieving our objectives	Helps us to meet our duty to further the consumer interest. But it does not go far enough to meet the challenges we have identified or to incentivise companies to improve how they address affordability. ✓	Helps us to meet our duty to further the consumer interest. But it does not go far enough in incentivising companies to demonstrate how they are improving on addressing affordability and the efficiency of their approaches. ✓	Helps us to meet our duty to further the consumer objective by incentivising companies to improve how they address affordability along with robust evidence of how efficient and effective their proposals are. ✓✓
How our objectives are achieved	Not sufficiently focussed on efficient approaches nor does it provide a sufficient incentive in respect of company ownership or accountability. Does not encourage companies to improve enough. ✗	Focuses on efficiency and incentivises companies to improve their approaches to affordability and to provide robust evidence. ✓	Encourages more focus on customer impact and incentivises efficiency and effectiveness. Incentivises companies to own and drive improvement through producing data on metrics. Metrics can be more comparable and provide more transparency. ✓✓
Practicality	Less evidence for companies to provide but might be harder for us to compare and assess plans and for other stakeholders to compare progress. ✓	More evidence for companies to provide but could lead to a more subjective assessment than option 3 and it might be harder to make comparisons. ✓	More evidence for companies to provide, and more assessment work for us. But will provide more robust evidence and more comparable data. More transparency. ✓

3. Vulnerability

3.1 Summary of our proposals for how companies should address vulnerability

Vulnerability relates to customers whose characteristics, situation or circumstances mean that they may need sensitive, well-designed and flexible support and services. We know that people can move in and out of positions of vulnerability over time and that a mixture of personal circumstances, characteristics and situations can trigger vulnerability. We think that our proposed approach for PR19 will enable companies to demonstrate, and provide more transparency on, how well their plan will support customers in circumstances that make them vulnerable.

Our thinking and proposals on vulnerability

We propose to use qualitative information to assess how companies' business plans support customers in circumstances that make them vulnerable. This is based on the challenges we set in our 2016 Vulnerability focus report. We will assess:

- how well companies use good-quality available data to understand their customers and identify those in circumstances that make them vulnerable.
- how well companies engage with other utilities and third-party organisations to identify vulnerability and best support those who are in vulnerable circumstances; and
- how targeted, efficient and effective companies' measures to address vulnerability are.

Reports from the CCGs will provide an independent assessment to us on the quality of companies' planned support for customers who are in circumstances that make them vulnerable, and the quality of the engagement that supports their plan on vulnerability.

We propose to require companies to include bespoke performance commitments for addressing vulnerability in their business plans after engagement with customers and challenge from their CCGs. We propose to require companies to develop common measures for addressing vulnerability, and to report on the data they gather.

3.2 Appraisal of our proposals for how companies should address vulnerability

What issue are we seeking to address

We want to see companies demonstrating in their plans how they provide sensitive, well-designed and flexible support and services for customers in circumstances that make them vulnerable. We already stated in our [2016 Vulnerability Focus report](#) that we will encourage CCGs to use that document as a base on which to challenge companies and their business plans when considering both customer service excellence and their company's approach to addressing vulnerability. The CCGs have an important role in providing independent assurance to us on the quality of that engagement and the extent to which companies have taken it into account in their plans.

We want to build on this at PR19 by requiring companies to provide compelling evidence in their business plans of the beneficial impact of their approaches on addressing vulnerability. We want to see how targeted, efficient and effective company measures to address vulnerability will be.

What options have been considered

Option 1: Do nothing

In this scenario we would not have a distinct test for vulnerability.

Option 2: Qualitative measures, bespoke performance commitments and commons metrics

Our qualitative customer engagement tests will assess how well companies have engaged with all customers, including customers in circumstances which make them vulnerable, and how well they have reflected their views in their plans.

In addition to the tests we will apply the following qualitative vulnerability tests at PR19. These are based on our recommendations in our 2016 Vulnerability Focus Report:

- how well companies have made use of good-quality data to understand their customers and identify those in or about to be in situations of vulnerability;

- how well companies have engaged with other utilities and third-party organisations on vulnerability issues; and
- how targeted, efficient and effective companies' measures to address vulnerability have been.

The CCG's challenges, based on the results of the company's engagement, and the CCG's expertise will provide important evidence on how the company is addressing the three issues.

In addition, this option requires companies to propose **bespoke performance commitments** relating to vulnerability in their business plans, following engagement with customers and challenge from their CCGs.

Option 2 also proposes requiring companies to report to us publicly against common metrics of vulnerability. For example, companies would provide:

- proportion of eligible customers receiving support through vulnerability assistance option(s);
- the number of customers contacted by the company about eligibility for vulnerability assistance options; and
- the percentage of customers receiving vulnerability assistance option(s) who are satisfied with the assistance.

This option also proposes us working with the companies and other stakeholders to develop common metrics of vulnerability which could evolve into common performance commitments in future price reviews.

Option 3: Qualitative measures plus common performance commitments

This option requires that all companies have the same common performance commitment on vulnerability with a common definition. We would develop the common performance commitments with the companies and other stakeholders ahead of our final PR19 methodology statement.

Option 3 also involves us setting the same performance level (normalised for company size) for the companies' common performance commitment on vulnerability, based on a form of comparative assessment of all companies' past and projected performance.

Our assessment of the potential options

Our preferred option is 2, which is to apply qualitative tests together with the requirement for companies to propose bespoke performance commitments on vulnerability and report against common metrics of vulnerability.

The qualitative tests will ensure we are testing companies against the three key areas set out in the Vulnerability Focus Report.

The bespoke performance commitment at PR19 will require all companies to engage with their customers and CCGs on their future commitments in relation to vulnerability, which only some companies did at PR14. The common metrics will enable customers and other stakeholders to understand more fully the nature of vulnerability issues, understand variations between companies and provide the sector with better information to identify ways of improving approaches to vulnerability in the future.

We do not yet consider the data currently available on vulnerability is mature enough for a common performance commitment because its definition would have to stay fixed for a five-year price control period, whereas we could evolve the definition of common metrics in option 2.

Table 3 Options assessment for our approach to vulnerability

	Option 1 No test	Option 2 Base case and bespoke PCs and common metrics Preferred option	Option 3 Base case plus common PCs
Achieving our objectives	Does not further the consumer objective or drive improvement in how companies address vulnerability. ✘	Furtheres the consumer objective and protects customers by including addressing vulnerability into the price review. ✓✓	Furtheres the consumer objective and protects customers by including addressing vulnerability into the price review. ✓✓
How our objectives are achieved	Customer impact not visible. ✘	Incentivises companies to own and be accountable for improving their approaches to addressing vulnerability. ✓✓	Incentivises companies to own and be accountable for, improving their approaches to addressing vulnerability. ✓✓
Practicality	No evidence/data for companies to provide for PR19. ✓✓	Companies would have to provide more data and work with us to agree common metrics. But this will be more transparent. ✓	Not practical at this stage. The data on vulnerability is not mature enough for a common performance commitment. ✘