
Speech from Cathryn Ross - CCWater Customer Matters event, 19 September 2017

Thanks Alan and Tony for inviting me to this excellent 'Customer Matters' event.

What matters to customers is the heart of everything we do as a regulator.

Indeed, customers go to the heart of why we exist as a regulator. You often hear it said that economic regulators exist because there is monopoly power. And of course there is truth in that. But, however, much monopoly power existed in the water sector Parliament would not have created Ofwat if water and waste water services didn't matter to customers, if customers didn't depend on those services.

So, as far as Ofwat is concerned, customers, and the delivery of what matters to customers is existential. Indeed, it is no accident that our strapline for the next price review is 'More of what matters'.

I'll come on and talk a bit later about the review.

But before I do, I think it is worth standing back and reflecting on the context in which this event is taking place today.

You'd have to have been on Mars for the last 12 months or so, not to have noticed that the basis of provision of some of our essential public services is coming under scrutiny to a deeper extent than I recall in the last 30 years or so. The Labour manifesto for the last election included the water industry in a list of industries that the party planned to renationalize.

Now, clearly the choice of what model underpins the ownership, funding and financing of the sector is ultimately a 'big P' political one. And you wouldn't expect me to comment on that.

But it seems to me that a lot of the noise we are hearing right now isn't about 'big P' political issues. It is about whether the system we have is actually delivering for customers in the way it was intended to.

We all know how much this sector has delivered since privatization. We

know that two thirds of our beaches are today classed as excellent (up from a quarter twenty five years ago), and that we now have more than 100 blue flag beaches. We know that leakage is down 40% on its 1995 peak, customers are 5 times less likely to suffer from supply interruptions, 8 times less likely to suffer from sewer flooding, and 100 times less likely to have low pressure. And we know that all this has been delivered for, on average, less than a penny per litre of water delivered, and waste water taken away, treated and returned safely to the environment. And with bills a third lower than they would have been without Ofwat's efficiency challenge
That is a great story. It really is. But it just isn't enough.

If you ever sit in on a focus group of water customers, I pretty much guarantee you than within half an hour somebody around the table will say something like '... but water just falls from the sky; I don't understand why we pay for it at all!'

Now, customers aren't daft. They know perfectly well that treating and transporting water has a cost. So why do they say this? Well, I think that statement is telling us something quite profound. I think it is telling us that just how differently people think about water, as compared to other things like consumer goods or even energy. They think of it as a human right. Instinctively, they think of water more in the same way as they think of education or healthcare.

And when you look at it through that lens, the questions we are facing today about the model of funding, financing and ownership in the sector seem a lot less surprising.

The very fundamental challenge facing the sector today is one of legitimacy. It is not a new challenge, but as we approach PR19, we need to recognize that the sector's legitimacy is under a brighter spotlight than ever.

I said I would talk a bit about the review, and I will. The good news is that I think PR19 provides fantastic opportunity for the sector to demonstrate and enhance its legitimacy, especially when coupled with some of the other reforms we've been making to regulation in the sector.

But if we are going to seize that opportunity, we need to recognize complex drivers of legitimacy. The fact that it is fundamentally a package deal. In a number of different dimensions.

First, as I implied earlier, legitimacy is about both the 'what' and about the 'how'. I want to talk about each of these things in turn.

In terms of the 'what' customers expect a reliable, supply of safe, wholesome drinking water to be supplied to their taps, and their waste water taken away, treated and returned safely to the environment. That's the base expectation. Companies have improved on the basics here enormously since privatization and I gave you some of the statistics earlier. But as is the way with these things, what used to be aspirational levels of performance are now the baseline. Which is why we need our economic incentives to keep stretching and encouraging companies to go further. It is why we are so pleased to see companies setting new frontiers on customer outcomes, that will shift the benchmark for PR19.

To give you some examples, we have seen Anglian reducing category three pollution incidents by 47% so far in this period, Welsh Water has reduced supply interruptions by 75% and Severn Trent has reduced external sewer flooding by 25%. This is why we are keen both to see more money at risk for companies through ODIs and a stronger challenge to set performance benchmarks at the upper quartile level. In our view this strike the right balance between incentivizing most companies to improve, in order to avoid financial downside, while putting a decent upside on the table for those companies who will go for that to keep that frontier moving forwards. I also think that the new CMex measure, with its emphasis on customer satisfaction across the customer base, will help to drive improvements in some of the 'softer' aspects of the customer experience, which matter so much and where expectations are moving rapidly.

We mustn't forget that customers expect all of this to be provided on the basis of bills that are both affordable and good value. I've talked a lot about the step change in efficiency that I expect we will see in PR19 as those companies who are really taking advantage of the move to outcomes and totex to change how they operate are setting new frontiers. And we are expecting to take a more forward looking approach in our efficiency challenge too – so the benchmark will no longer just be based on the best available historical data at the time of the review – which is is two years' out of date by the beginning of the control period – but on our view of what is achievable in future. This, coupled with the lower financing costs we expect to see in PR19, give considerable 'headroom'. On average – and I know individual companies' circumstances differ – we think significant improvements in customer service, and in resilience are possible together with lower bills.

If the mark of a civilized society is how it treats its less fortunate members, so the sector's approach to customers in vulnerable circumstances is an acid test of its legitimacy. Recognising that we all now have a better, more nuanced understanding of vulnerability today, we have said we expect

companies to set out in their plans their strategies for identifying and providing support to customers in vulnerable circumstances.

This may include financial support – and we've seen some great strides here, I know, especially where companies are using home visits to help customers improve their financial position overall and I really welcome what companies like UU are doing to make it easier for people to access social tariffs even when they might have different water and sewerage providers. And it also includes non-financial support, such as help for those with learning difficulties to understand their bills, or better identifying those who should be on a priority services register.

So I have talked about the opportunities water companies have to do more on the 'what', but I think PR19 will also bring improvements in the 'how' too. Critical to this is maintaining that connection between companies and the customers who depend on their services. Customer engagement is key to this. We have said for a while now that we want to see companies going beyond the sort of willingness to pay research we saw in plans for PR14, and making good use of all the many and various insights they have into customers' preferences and priorities. I'm delighted to see so many companies doing this right now, using social media communities, randomized control trials, and even just capturing more effectively the feedback from their customer contact people. I'm very much hoping we will see some companies, on some issues, go even further and into the world of customer participation, co-creating a vision of the future with customers and supporting them in helping to co-deliver it.

But of course the 'how' goes broader than customer engagement. The public expects private providers of essential public services to be exemplary corporate citizens. They expect the public interest purpose of these companies to flow through right the way through everything they do. They expect the highest standards of board leadership, transparency and governance. We put in place some principles a few years ago that have driven significant improvements in this area, especially for the non-listed companies. And as you might have picked up from Jonson's recent piece in Utility Week, we are pursuing these further with companies at the moment, especially to push forward greater transparency on financial flows. And we are giving all of this work some real teeth through PR19, with a requirement (again as we did at PR14) for board assurance of plans, and by pulling our views on companies' assurance more generally through into our assessment of business plans, which will feed through directly to how favourable a balance of risk and reward they receive.

So, I have talked about legitimacy being not only about the 'what' but also about the 'how'. We also need to realise that legitimacy is about today and about the long term.

Customers want to be confident that they will get the services they expect when they want them. Now, it simply isn't possible to provide a cast iron guarantee of that while maintaining costs at a level that everyone can afford to pay. But we do need to recognize that expectations of the resilience of services are rising and people's tolerance of failure is, I'd suggest, getting lower. I do (just about) remember standpipes in the street in 1976, and we just wouldn't stand for that today.

From what I can see in the sector right now there is some great work going on that will really improve resilience. In the Water Resource Management Planning process, companies are working more closely than before to make the best use of water across their region, rather than simply optimizing within company boundaries. The 21st Century Drainage board is pushing for a more joined up approach to waste water planning, which is great to see. And it is good to see customers increasingly integrated into thinking on resilience, through work on water efficiency and leakage but also in terms of improving response and recovery. This is the kind of thing where a regulatory approach based on outcomes and totex (rather than outputs and capex) helps deliver resilience more efficiently. As I said earlier, the best companies are really taking advantage of this now.

Beyond this, customers also want to be confident that the water and waste water services they enjoy today do not come at the expense of future generations. We have been consistently clear with companies that we expect them to engage with their customers not only about service provision today but into the future, and on the trade offs that might be made between today and tomorrow. Difficult, yes. But quite possible – just look at what South West Water did in its PR14 plan, or what Welsh Water has been doing in relation to the distribution of its outperformance.

So, if we need to recognize that legitimacy is about the what and the how, and about today and tomorrow, we also, finally, need to recognize that it is not only about what each individual company does but also about how the sector as a whole is perceived.

And this is a real challenge. Because each individual company's performance could be improving over time - and that is the case - but if people are reading this month about a boil water notice, next month about a pollution incident and the month after about a mains burst, the impression

that is created is one of a sector that is falling short. The impact of incidents like these on the sector's legitimacy over the long term is far greater than the immediate impact on any individual company's reputation in the short term. And when you think about this looping back on my earlier point about the importance of the how, the challenge is greater still. Not only does the sector as a whole have to deliver reliable water and waste water services, the sector as a whole has to demonstrate unfailing alignment with its public purpose in everything it does.

Our regulation does help here. It helps because the sector wide information we have, especially in conjunction with the sector-wide view from others like CCWater and the other water regulators, means we provide a challenge across the sector that improves performance, efficiency and accountability across the piece.

But it does more than this. And this is the point I want to leave you with... One of the things we have consciously done at Ofwat over the last few years has been to improve the quality and transparency of information that is available both on what companies across the sector are delivering for customers and society, and on how they are delivering it. Why? Because we have always recognized that that vision of trust and confidence in water and waste water services that sits at the heart of our strategy and which underpins the legitimacy of the sector, is not something we can deliver alone.

Of course, it relies on the companies we regulate. But more than that it relies on all sorts of other organisations who touch the sector – many represented in this room - challenging those companies, holding them to account, supporting them, working with them and enabling them to do better.

So, as we approach PR19, I'd urge everyone in this room, everyone who touches the sector, to do so in the fullest understanding of the opportunity we all have to address the starkest challenge to the sector's legitimacy since privatization. And the imperative that we do so successfully if we are going to see the sector continue to succeed for customers.

Thank you.