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Trust in water

# **Delivering Water 2020: Our final methodology for the 2019 price review**

## **Appendix 1: Addressing affordability and vulnerability**

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

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## 1. Summary

This appendix sets out our final methodology for our 2019 price review (PR19), with respect to addressing affordability and vulnerability. Our PR19 methodology has been informed by full consideration of the views expressed by respondents to our [draft methodology proposals](#), published in July of this year. There was also further engagement through a stakeholder workshop and two Customer Challenge Group (CCG) chairs meetings.

This appendix supplements the information on affordability and vulnerability we set out in [chapter 3 \(Addressing affordability and vulnerability\) of our methodology for the 2019 price review](#).

**Affordability** is the ability of a customer to pay their water bill. It is an important issue at PR19, as reflected by the fact that it is one of the four key themes of PR19. Customers must feel confident they are receiving affordable, value for money services, both now and in the long term.

**Vulnerability** relates to customers whose characteristics, situation or circumstances, mean that they may need sensitive, well-designed and flexible support and services. We are including vulnerability explicitly in a price review for the first time at PR19. If the sector is to build and maintain trust and confidence, it is essential that water companies thoroughly understand who their customers are and the specific needs of different types of customers. Companies can use this information to ensure that the vital services they provide are inclusive and accessible to those who need them.

### Applicability to England and Wales

Our PR19 final methodology for affordability and vulnerability **applies to both** companies whose areas are wholly or mainly in England and companies whose areas are wholly or mainly in Wales. Affordability is a key concern for water customers in England and Wales. According to research carried out by the [Consumer Council for Water](#), one in eight residential customers finds their water bill unaffordable across England and Wales. Some customers may be vulnerable over time and as much as half the population, irrespective of where they live, will find themselves at some point in temporary circumstances that may make them vulnerable. Both the [UK](#) and [Welsh](#) Governments' strategic policy statements for Ofwat recognise the need for fair and affordable bills and support for customers in circumstances that make them vulnerable.



The remainder of this appendix is structured as follows:

- section 2 sets out the links between affordability and vulnerability.
- section 3 sets out our approach and assessment on **affordability**.
- section 4 sets out our approach and assessment on **vulnerability**.

[Section 2 of appendix 15](#) outlines respondents' views to the four questions we posed on addressing affordability and vulnerability in our draft methodology proposals. In appendix 15, we provide (or reference) our response to the issues raised by respondents.

## 2. The links between affordability and vulnerability

We recognise that affordability and vulnerability are complex issues. Our work in this area has encouraged companies to work more collaboratively with each other, other utilities and with third sector organisations, including charities, to proactively share the development of ideas, knowledge and best practice.

For many customers, affordability and vulnerability issues can overlap. For example, those customers who struggle to access a companies' services might also struggle to pay their bills. Our initial assessment of business plan test covers affordability and vulnerability together, so that we consider companies' approaches to both issues, in a rounded way.

However, we think it is more transparent to separately emphasise affordability and vulnerability within the initial assessment of business plan test, so that companies have to consider their approaches to both issues, and make sure they are addressing both. This reflects the fact that, while the two issues overlap, they are distinct. For example, a customer in circumstances that makes them vulnerable might be able to afford to pay their bills, but might need a particular service to make a payment.

We also recognise that other organisations use the terms **affordability** and **vulnerability** in different ways. We are using the terms as we defined them on page 2 of this appendix.

This appendix considers each issue in turn, looking first at affordability.

## **3. Affordability**

### **3.1 Our approach to assessing affordability at PR19**

#### **The issue we are seeking to address**

It is important that all customers receive services that are affordable and provide value for money. Customers who are struggling to pay or who are at risk of struggling to pay their bills need easy access to assistance. Companies need to be proactive in raising awareness of the financial assistance that they offer, and in getting that assistance to the right customers. The measures that companies use should be effective and maximise customer benefits. We will expect to see strong evidence that customers are supportive of social tariffs that go beyond revenue neutral levels of assistance and that the assistance is provided in the most efficient way.

#### **Our proposed position as set out in our draft methodology proposals**

We want to see business plans that address three areas:

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

We proposed using five principles to assess business plans against these three areas:

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

We said that our assessment will be supported by:

- evidence provided by companies;
- the independent reports from CCGs; and
- evidence from other expert organisations.

As well as qualitative evidence, we also proposed that companies provide data, including on a short list of common metrics, to help us assess the affordability of their plans.

Our cost efficiency challenge, our approach to the cost of capital and our financeability test, will also promote affordability in PR19 and provide scope for lower bills (as explained in [chapter 3 of the PR19 final methodology](#)).

## **Responses to our draft methodology proposals**

There was agreement (some strong) with our proposals to consider the three areas of affordability, and to use the five principles to assess business plans against those areas. One respondent suggested that we focus more on assessing how companies support customers who struggle to pay their bills (our third area of affordability). Two respondents suggested we include additional principles. The first was on how well companies understand customers at a segmented level, and the second on how companies contribute to the funding of affordability support.

There were mixed views on our proposals to collect common quantitative metrics through the business plan tables, to assess how companies are addressing affordability. Some respondents considered that affordability was too complex and dynamic to capture in the individual metrics that we proposed.

Some respondents said they preferred companies to use bespoke metrics (metrics that companies design to measure how they are addressing affordability as opposed to common metrics that we ask companies to use) and some thought that it should be left for companies to decide what evidence they provide, to show how they are addressing affordability in their business plans.

Some respondents thought that if common metrics are used they should be easily comparable and the benefits of the comparison should be clear. They recommended that we work with stakeholders to develop common metrics, which incentivise the right company behaviour. A number of alternative metrics were suggested.

Some stakeholders suggested that we require companies to have common performance commitments on affordability, to reflect the importance of the issue.

## Our final position on assessing companies' approaches to affordability

We will test companies on the three areas of affordability and use the five principles, as set out above, to assess how companies are addressing the three areas in their business plans.

Companies should provide qualitative and quantitative evidence for us to carry out our assessment, including information on common metrics of affordability. We will collect this information through the business plan tables.

We will consider the common metrics alongside the quantitative and qualitative evidence provided by companies, and information from the independent CCG reports, when making our assessment **in the round**.

The table below illustrates the type of qualitative information we could use to assess companies' approaches to affordability, as well as the common metrics that we will use to assess companies' approaches to affordability, having considered responses to our draft methodology proposals and further engagement with our stakeholders. Companies can and should provide information in addition to the example qualitative information and the required common metrics in the table. This will allow companies to reflect the different challenges they face in relation to affordability, and the different approaches they can take, in the evidence they provide to us.

For the common metrics we are requiring companies to provide information for the 2017-18 financial year, and for future years (2018-19 to 2024-25). We have asked for historical information where it is available.

**Table 1 Our proposed approach on how affordability could be assessed**

Principle to be applied	Sources of information for assessing affordability
<p><b>1. Customer engagement</b>                      How well the company is engaging with its customers and third party organisations on addressing affordability.</p>	<p><b>Qualitative:</b>                      Company evidence, the independent CCG report and information from 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.                      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 understand customer support for assistance for those who struggle or who are at risk of struggling to pay,</p>

Principle to be applied	Sources of information for assessing affordability
	and in designing the most effective range of assistance measures.
<p><b>2. Customer support</b></p> <p>What are customers' views on the company's proposals for addressing affordability?</p>	<p><b>Qualitative:</b></p> <p>Company evidence, including: research, the independent CCG report and information from other organisations on customer support for the company's approach to the three areas of affordability - on the level of bills and the assistance for those who struggle or are at risk of struggling to pay.</p> <p><b>Quantitative:</b></p> <p>Percentage of customers finding the level of their bills affordable.</p> <p>Percentage of customers finding their bills acceptable.</p>
<p><b>3. Effectiveness</b></p> <p>How well the company's proposed approach will improve affordability.</p>	<p><b>Qualitative:</b></p> <p>Company evidence, the independent CCG report and information from 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><b>Quantitative:</b></p> <p>Percentage of customers who are in debt and who have a repayment plan.</p> <p>Percentage of customers who have a repayment plan and who are continuing to pay.</p>
<p><b>4. Efficiency</b></p> <p>The difference the company's proposed approach will make, compared with the costs of interventions.</p>	<p><b>Qualitative:</b></p> <p>Company evidence and the independent CCG report on the efficiency of the company's approach to addressing the three areas of affordability for PR19.</p> <p><b>Quantitative:</b></p> <p>Benefits (in £m) of applying affordability assistance measures.</p> <p>Costs (in £m) of applying affordability assistance measures.</p>
<p><b>5. Accessibility</b></p> <p>What the company will do to improve accessibility and how effective it will be. (Applies only to the third area of affordability: those struggling or at risk of struggling to pay their bills).</p>	<p><b>Qualitative:</b></p> <p>Company evidence, the independent CCG report and CCWater research, and information from other sources, such as those organisations specialising in debt management.</p> <p>Evidence on the support available for those at risk of struggling to pay their bills and how proactively companies deploy support in advance of problems arising.</p> <p><b>Quantitative:</b></p> <p>Percentage of customers aware of affordability assistance measures.</p>

We have revised the common metrics on affordability, following responses to our draft methodology proposals, a stakeholder workshop and discussion at two CCG chairs meetings. At the workshop we asked for stakeholders' views on a list of alternative metrics suggested in responses to our draft methodology proposals. We then received comments from CCG chairs on a revised list, which we considered before deciding on our final list.

We confirm that we are considering common metrics in the round alongside other qualitative and quantitative information provided by companies. We have decided on collecting common metrics because it gives us a small amount of common evidence across companies. This helps us to evaluate approaches to assessing affordability, as well as taking account of company-specific information.

Our approach allows and encourages companies to supplement the information in the common metrics with their own company-specific information. This addresses the concerns of those respondents who said they would prefer companies to decide what evidence they provide, to show how they are addressing affordability in their business plans.

We have not changed the balance between the three areas of affordability. We consider that all three areas are equally important. We consider overall affordability and long-term affordability to be as important for us to assess at PR19 as companies' support for customers who struggle to pay their bills.

We have not changed the five principles we are using to assess companies' approaches to affordability. We consider that how well companies understand customers at a segmented level forms part of our first principle on customer engagement. We consider that how companies contribute to the funding of affordability support is covered by our assessment of the third area of affordability: those struggling or at risk of struggling to pay their bills.

We will not require companies to have a common performance commitment for affordability because we recognise that no single measure reflects the complexity and dynamism of affordability and that the challenges vary across companies. Companies can propose bespoke performance commitments on affordability that reflect their specific challenges. We are requiring companies to provide data on a number of common metrics of affordability to help us to better understand the nature of affordability issues and the variations between companies, but we are not requiring companies to set commitments on these common metrics. We consider our strong emphasis on affordability at PR19 will sufficiently incentivise companies to address these issues effectively in their business plans. We will build on experience

in PR19 and reconsider common performance commitments for affordability at PR24.

## **3.2 Our assessment of proposed options: affordability**

This section contains our assessment of the options in our draft methodology proposals on our approach to affordability. We consulted on three options.

### **Option 1: No change to PR14 approach**

In this option we proposed not to 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**

We proposed three areas of affordability that, when taken together, encourage companies to think about all their customers. They do this by providing value for money for current and future customers, as well as supporting those struggling or at risk of struggling to pay.

In this option we proposed to assess how companies are addressing the three areas of affordability against five principles, using both qualitative and quantitative evidence provided by companies.

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

In addition to the proposals set out under option 2, in this option we proposed to ask companies to provide data to demonstrate the affordability of their plans against our principles. We set out the type of metrics companies already use to assess affordability, other measures we consider could be useful, and other evidence we would look at to assess affordability.

## **Responses to our draft methodology proposals**

Respondents did not comment specifically on the numbered options, although there was agreement to base our assessment of business plans on our three areas and five principles (option 2). There was also general support for companies providing data as part of their evidence to show how their plans address affordability. We consider, therefore, that there was general support for option 3, acknowledging the mixed views on the use of common metrics.

## **Our decision on the preferred option**

We have decided on option 3. It requires companies to provide robust evidence in their business plans on how their approaches have, and will, deliver affordability for current customers, future customers, and those struggling, or at risk of struggling, to pay. It also requires companies to provide evidence on the customer engagement they have carried out on their approaches, how well the company understands what affordability looks like for its customers, and the customer support for the approach they have taken. Companies will have to provide evidence on the effectiveness and efficiency of their approaches to addressing affordability, and how accessible their support schemes are for customers.

## 4. Vulnerability

### 4.1 Our approach to assessing vulnerability at PR19

#### The issue we are seeking to address

We want to see companies demonstrating in their business plans how they provide sensitive, well-designed and flexible support and services for customers in circumstances that make them vulnerable. This includes customers who are at risk of being in circumstances that make them vulnerable. We set out the challenges facing companies in our [2016 vulnerability focus report](#) (see below). We want to build on our work on vulnerability, including our vulnerability focus report, by requiring companies to provide evidence in their business plans of how they are addressing vulnerability.

#### Our proposed position as set out in our draft methodology proposals

We proposed to use evidence 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 proposed to 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 circumstances that make them vulnerable; and
- how targeted, efficient and effective companies' measures to address vulnerability are.

In the focus report, we stated that we would encourage CCGs to use the report as a base on which to challenge companies and their business plans when considering both customer service excellence and their companies' approaches to addressing vulnerability. We explained that the CCGs have an important role in providing independent assurance to us on the quality of companies' customer engagement and the extent to which companies have taken the customer engagement into account in their plans.

In addition to our customer engagement tests and our qualitative vulnerability tests, we proposed going further in our assessment of how companies address vulnerability issues, by requiring companies to:

- propose **at least one bespoke performance commitment** in their business plans for addressing vulnerability, after engaging with customers and taking on board challenges from their CCGs; and
- **report to us publicly on how they are addressing vulnerability**, including using common metrics. We said that we would work with the companies and other stakeholders to develop common metrics to assess business plans in PR19. We will reconsider common performance commitments for PR24.

We proposed three common metrics of vulnerability:

1. Proportion of eligible customers receiving support through vulnerability assistance option(s).
2. The number of customers contacted by the company about eligibility for vulnerability assistance options.
3. The percentage of customers receiving vulnerability assistance option(s) who are satisfied with the assistance.

## **Responses to our draft methodology proposals**

There was support for us using evidence from companies and the views of CCGs to assess how companies' plans support customers in circumstances that make them vulnerable, based on the challenges we set out in our 2016 vulnerability focus report.

There was strong support for companies having a bespoke, rather than a common, performance commitment on vulnerability, to reflect local circumstances, and because this is the first time we are testing companies' approaches to vulnerability explicitly in a price review. Some respondents accepted that our approach might be a precursor for a common performance commitment on addressing vulnerability at PR24.

There were mixed views on our proposal to collect common quantitative metrics through the business plan tables to assess how companies are addressing vulnerability. Similarly to common metrics of affordability, some respondents considered that vulnerability was too complex and dynamic to capture in individual metrics, and that the focus should be on company behaviours, not metrics. Some respondents disagreed with the particular metrics we proposed. In contrast, some

stakeholders suggested that we require companies to have common performance commitments on vulnerability, to reflect the importance of this issue.

A small number of respondents suggested using CCGs and independent verification to help assess companies' performance in addressing vulnerability.

## **Our final position on assessing vulnerability**

We will assess how companies plan to support customers in circumstances that make them vulnerable, based on the challenges set out in our [2016 vulnerability focus report](#). We will assess:

- how well companies use good-quality available data to understand their customers and identify those that are 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 circumstances that make them vulnerable; and
- how targeted, efficient and effective companies' approaches to address vulnerability are.

We have revised the small number of common metrics on vulnerability following responses to our draft methodology proposals, a stakeholder workshop, and discussion at two CCG chairs meetings. At the workshop we asked for stakeholders' views on a list of alternative metrics suggested in responses to our draft methodology proposals. We then received comments from CCG chairs on a revised list, which we considered before deciding on our final list.

Following the responses to our draft methodology proposals and further engagement with stakeholders, we consider that there is benefit from us collecting a set of common metrics of vulnerability to provide comparative information and transparency for customers and other stakeholders. We will consider the common metrics alongside the quantitative and qualitative evidence provided by companies, and information from the independent CCG reports, when making our assessment **in the round**.

Our revised list of common metrics of vulnerability, following responses to our draft methodology proposals and engagement with stakeholders are set out below. For the common metrics we are requiring companies to provide information for the 2017-18 financial year, and for future years (2018-19 to 2024-25). We have asked for historical information where it is available.

1. Percentage of customers aware of the non-financial vulnerability assistance measures offered.
2. Number of customers on special assistance register / priority service register (SAR/PSR).
3. Percentage of customers on SAR/PSR.
4. Number of customers receiving the following services through the SAR/PSR:
  - a) Support with communication;
  - b) Support with mobility and access restrictions;
  - c) Support with supply interruption;
  - d) Support with security; and
  - e) Support with 'other needs'.
5. Percentage of customers satisfied that the services provided by their company are easy to access.
6. Percentage of customers on SAR/PSR contacted over the past two years to ensure they are still receiving the right support.

We will not require companies to have a common performance commitment for vulnerability because we recognise that no single measure reflects the complexity and dynamism of vulnerability, and the extent to which the challenges vary across companies. We are requiring companies to provide data on a number of common metrics of vulnerability to help us to better understand the nature of vulnerability issues and the variations between companies, but we are not requiring companies to set commitments on these common metrics. We consider that our strong emphasis on vulnerability in PR19 will sufficiently incentivise companies to address these issues effectively in their business plans. We will build on experience in PR19 and reconsider common performance commitments for vulnerability at PR24.

We are requiring companies to include at least one **bespoke performance commitment for addressing vulnerability** that reflects their specific challenges in their business plans, after engaging with customers and taking on board challenges from their CCGs. The bespoke performance commitments will require companies to engage with their customers and CCGs on their future commitments to addressing vulnerability.

We are also considering the use of a **third party expert panel** and the **further development of common metrics** to assess and advise companies' approaches to vulnerability across all companies during 2020-25. We will discuss this with the sector after the PR19 final determinations.

## **4.2 Our assessment of proposed options: vulnerability**

This section contains our assessment of the options in our draft methodology proposals on our approach to vulnerability. We consulted on three options.

### **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**

Option 2 was our preferred option, as we have described above. In brief, in this option we would apply qualitative vulnerability tests, based on the recommendations in our 2016 vulnerability focus report and drawing on evidence from the CCGs. We would also require companies to propose bespoke performance commitments relating to vulnerability in their business plans. Option 2 also involved companies including information on three common metrics of vulnerability in their business plans.

### **Option 3: Qualitative measures plus common performance commitments**

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

Option 3 also involves us setting the same performance commitment 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.

## **Responses to our draft methodology proposals**

There was general support for option 2. Most respondents preferred that companies have bespoke, rather than common, performance commitments with companies proposing the bespoke commitments following engagement with their customers. The reasons in support for bespoke performance commitments included that this is the first time vulnerability is being tested within the price review, it will allow companies to align bespoke performance commitments to location issues, and it will facilitate the co-creation of the bespoke commitment with customers.

As mentioned above, there were mixed views on us using common metrics to assess how companies address vulnerability in their business plans and on the particular metrics we proposed. Some respondents asked for us to work with stakeholders further to improve these metrics.

### **Our decision on the preferred option**

Our final approach is option 2, which is for us to apply qualitative tests, together with the requirement for companies to propose bespoke performance commitments on vulnerability, and to provide information on common metrics of vulnerability, in their business plans. We have explained above in the section 'our final position on assessing vulnerability' why we have decided upon option 2.