

## Severn Trent Water: Test area assessment

All company test area grades								
Engaging customers	Addressing affordability and vulnerability	Delivering outcomes for customers	Securing long-term resilience	Targeted controls markets and innovation	Securing cost efficiency	Aligning risk and return	Accounting for past delivery	Securing confidence and assurance
B	B	C	C	C	B	C	B	B

Severn Trent Water - test area results				
Test area	Overall test area grade	Overall test area summary assessment and rationale	TQ#	Test question grade
Engaging customers	B	<p>Overall the business plan demonstrates high quality with convincing evidence in the areas set out below, but it is not sufficiently ambitious or innovative to be considered exceptional.</p> <p>The company provides sufficient evidence of a high quality approach in the following areas:</p> <ul style="list-style-type: none"> <li>The effective use of a wide range of research techniques, including online community research, deliberative workshops, social media scraping, analysis of business as usual customer satisfaction surveys and a range of quantitative research techniques, in many cases meeting best practice, evidenced by independent assurance.</li> <li>The company's approach to adopting the four themes of customer participation as set out in the 'Tapped In' report, including co-creation and deliberative workshops with customers looking at future facing issues; water efficiency promotion campaigns; use of its employee community champions volunteering scheme targeting areas affected by company disruption; launch of a web self-service tool; and trialling of a leak locator system.</li> <li>The company uses a 'design your own plan' budget game to help understand the experience of customers who suffered service failures, with the survey design and results peer reviewed by an expert in the field.</li> </ul> <p>However, the business plan falls short of high quality with insufficient evidence, in the following areas:</p> <ul style="list-style-type: none"> <li>The company does not provide sufficient detail on the steps it has taken to ensure its customer valuation research was robustly designed and implemented (including the survey design used and extent of testing conducted).</li> <li>While the results of the company's engagement on customer priorities and preferences generally appear to be reflected in its performance commitments (PCs) the company provides insufficient evidence to justify adjustments made to its triangulated willingness to pay valuations such that its outcome delivery incentives (ODIs) do not appear to reflect the outcomes of its customer engagement for a number of PCs.</li> </ul>	EC1	B
			Addressing affordability and vulnerability	B
			AV2	C

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		<ul style="list-style-type: none"> <li>a high quality approach to vulnerability, suggesting a relatively strong increase in reach of its Priority Service Register to 5% of its customer base, and displaying a high quality approach to using data to identify and help customers in vulnerable situations.</li> </ul>	AV3	B
		<p>The business plan falls short of high quality in one area because:</p> <ul style="list-style-type: none"> <li>The company did not submit evidence on its bill profile for the 2025 to 2030 period through our financial model, although there is evidence to suggest it will be flat. It did not engage with customers sufficiently on bills or the bill profile for the 2025 to 2030 period.</li> </ul>	AV4	B
Delivering outcomes for customers	C	<p>Overall, across the outcomes test area the evidence Severn Trent Water provides falls short of high quality and the evidence is insufficient or unconvincing in some areas.</p> <p>The plan provides evidence of a high quality approach in some specific areas. Particularly, its approach for ODIs for asset health PCs and performance reporting structures.</p> <p>However, the plan provides insufficient evidence that the company has appropriate, well-evidenced and stretching PCs and service levels. In particular, The company has proposed insufficiently demanding forecast PC levels for supply interruptions. Additionally, the evidence supporting its package of ODIs is insufficient and it has provided unconvincing evidence that it has a sufficient focus on appropriate service delivery within its overall risk/return package.</p> <p>Key areas of concern where the business plan falls short of high quality are:</p> <ul style="list-style-type: none"> <li>The company proposes a deterioration in asset health measures by the level of mains repairs in the 2020-2025 period due to the expected increase in active leakage control, but provides insufficient evidence to support the proposed level.</li> <li>Although in general it has sufficient evidence for its willingness to pay evidence and triangulation for its ODI rates we have material concerns over its use of a top down adjustment for sewer flooding rates, which results in the highest outperformance rates across the industry.</li> <li>Its ODI package is skewed to the package of sewer flooding PCs, we have significant concerns that incentives are not balanced between water and wastewater.</li> <li>It has not set out protections for customers if outperformance payments are greater than expected despite a strong incentive package.</li> </ul>	OC1	C
			OC2	C
			OC3	C
Securing long-term resilience	C	<p>Overall, the plan falls short of high quality and the company does not provide sufficient and convincing evidence of securing long term resilience in certain areas.</p> <p>The company provides sufficient evidence of good customer engagement in terms of the risks to service delivery and risk mitigation options. The company outlines corporate mitigations to enhance cyber security and future skills gaps, which demonstrate its commitment to deliver improvements in these areas. The company provides convincing evidence that its proposal to maintain gearing within the range 57.5% to 67.5% in the period to 2025 combined with its target credit rating, and processes to manage and mitigate financial risks will allow it to maintain long term financial resilience. In addition, the plan incorporates uncertainty in its planning and subsequent development of efficient options through an adaptive pathways approach, which is welcomed.</p> <p>However, we consider that the company plan does not provide sufficient and convincing evidence of a commitment to resilience in the round in the following areas:</p> <ul style="list-style-type: none"> <li>There is insufficient evidence of an integrated and systems-based approach to resilience, where interdependencies or cascading impacts of one system to another should be considered.</li> <li>The company's plan does not present a convincing assessment of the resilience maturity of its systems and services, nor does it presents expected improvements for the future.</li> <li>The company presents mitigation options that generally align with the resilience risks identified. However, the risks and mitigations have not been prioritised and therefore there is insufficient evidence to demonstrate that the company's approach is robust. There is insufficient evidence that addressing multiple risks or integrating water and wastewater/drainage strategies have been used in developing options.</li> <li>Whilst the company provides sufficient evidence that financial risk mitigation approaches have been considered, the results of financial stress scenario tests are only presented as green/amber/red scores; and so there is insufficient evidence to determine the impacts of scenarios on key financial ratios relevant to the company's financial resilience. In addition, the company has not modelled financial stress tests for the period after 2025.</li> </ul>	LR1	C
			LR2	C

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Targeted controls, markets and Innovation	C	<p>Overall, despite some areas of high quality, Severn Trent Water's plan falls short of high quality across the Targeted Controls, Markets and Innovation test area and evidence is insufficient and/or unconvincing in some areas.</p> <p>The company's plan provides sufficient and convincing evidence that it has the right capabilities and culture to deliver results for customers and the environment from innovation. Initiatives such as 'The Challenge Cup', its internal crowd sourcing platform #BrightSparks, and its 'Open Innovation' ideas inbox are ambitious and sector leading. There is strong evidence of the use of markets across water network plus, with a variety of innovative examples demonstrating a long-term catchment-based approach. On water resources, the company has a strong approach to engagement with third party providers to deliver a twin track approach. They have put forward an innovative mechanism to support the water transfer from the North West to the South East. For RCV Allocation the evidence was complete.</p> <p>The plan falls short of providing sufficient evidence that resourcing and recognition of innovation is ambitious and innovative. The company demonstrates a commitment to using market led solutions in certain aspects of its plan, although there are certain aspects where the plan falls short of high quality. The company's plan provides limited consideration of the impact of the bilateral market. The plan is less convincing about the approach to wastewater, with insufficient evidence in the Drainage and Wastewater Management Plan (DWMP) that sustainable approaches or market based approaches have been adequately considered. The evidence is unconvincing that the proposed long term risk sharing arrangement will strike an appropriate balance of risk between customers and shareholders. On bioresources, the plan lacks the evidence to be high quality. Specifically, the evidence is insufficient and/or unconvincing to support their volume forecasts or justify incremental changes in costs and revenues with volumes; and lacks sufficient evidence about third party engagement for sludge treatment services. The company has produced a bid assessment framework for water resources that falls significantly short of demonstrating the key principles of transparency, non-discrimination and proportionality. The bid assessment framework lacks sufficient detail to enable a third party to be confident that bids will be assessed appropriately. The company provides evidence that it considered DPC and provided third party assurance. However, the company does not provide a complete list of schemes consider nor their whole life totex that would be sufficient to confirm that the company has identified all relevant schemes for DPC. The level of information and evidence provided is not sufficient to convince us that the technical and value for money assessment assessments are robust.</p>	CMI1	B
			CMI2	B
			CMI3	B
			CMI4	C
			CMI5	B
			CMI6	D
			CMI7	C
Securing cost efficiency	B	<p>Overall, Severn Trent Water's projected costs for the AMP7 period are relatively efficient. At the company level its costs are about 3% above our view of efficient costs. Its base costs in wastewater and retail are efficient at about 7% and 6% respectively below our view. However, its proposed costs in wholesale water services are about 12% above our view of efficient costs. This is driven by its enhancement proposals in this area. On base costs the company is below our efficient baselines.</p> <p>The company proposes a large number of cost adjustment claims, most of which are not of high quality. This gives the company a grade of D on our cost adjustment claim test.</p>	CE1	C
			CE2	B
			CE3	A
			CE4	D
Aligning risk and return	C	<p>Despite some aspects of Severn Trent Water's plan which are high quality, shortcomings in other aspects mean that it overall falls short of providing convincing and high quality evidence to support its approach in the area of aligning risk and return.</p> <p>The following areas of the plan are high quality:</p> <ul style="list-style-type: none"> <li>It is based on our Final Methodology 'early view' cost of capital and retail margins.</li> <li>It contains a clear board statement that the plan is financeable under its actual and the notional financial structure, with appropriate evidence to support this.</li> <li>There is convincing evidence to support the company's choice of PAYG rates.</li> </ul> <p>There are three main areas where the plan falls short of high quality. It does not provide sufficient and convincing evidence:</p> <ul style="list-style-type: none"> <li>to support the starting point for RCV run-off rates;</li> <li>to support the adjustment to RCV run-off rates for bills that reflect a full transition to CPIH. The company has provided insufficient evidence for the level of the adjustment and that this is in line with customer preferences; and</li> <li>the company has provided insufficient evidence of risk mitigation measures in its RoRE analysis for the notional company and evidence is unconvincing in respect of one element of its proposed uncertainty mechanism.</li> </ul>	RR1	B
			RR2	C
			RR3	B
			RR4	C

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Accounting for past delivery	B	<p>Overall, Severn Trent Water's business plan demonstrates high quality accounting for past delivery.</p> <p>In the round, we do not have concerns with the evidence for deliverability for the 2020-25 plan.</p> <p>The plan is high quality for deliverability in the following areas.</p> <ul style="list-style-type: none"> <li>The company has delivered or is forecast to deliver 78% of PCs with financial ODIs in 2015-20. Overall the company has not proposed stretching PCs on areas where it is performing less well, such as water quality complaints, or on areas where it is performing well, and so although it provides insufficient evidence on how it will improve performance, we do not have concerns with the evidence for deliverability for outcomes.</li> <li>The company is forecast to underspend against its cost allowance for 2015-20. The company provides sufficient evidence on lessons learnt and measures to give confidence in the deliverability of the planned costs.</li> <li>While the company had four major incidents, and was required to provide an externally assured action plan following the 2018 freeze and thaw, the company provides sufficient evidence that it has measures in place to improve performance in relation to incidents.</li> </ul> <p>The plan falls short of high quality for deliverability in the following areas.</p> <ul style="list-style-type: none"> <li>The company is already meeting CCWater's 2020 household customer complaints target of resolving 95% of customer complaints at stage one, but the proportion is falling. The company has an above average, but falling number of customer complaints. The company provided insufficient evidence it understood the drivers of its performance and learnt lessons. The plan provides insufficient evidence that it includes appropriate measures to improve its performance. We therefore have some concerns with the evidence for deliverability of customer complaints handling performance.</li> </ul> <p>There is sufficient and convincing evidence for three out of the eight PR14 reconciliation areas and insufficient evidence for land sales, ODI, residential retail, service incentive mechanism and totex. However, there is only a marginal difference (0.1% of 2019-20 revenue) between expected and proposed reconciliations. In the round we do not consider that this should result in a lower accounting for past delivery test area score.</p>	PD1	C
		<p>Overall, Severn Trent Water's business plan provides sufficient evidence to demonstrate high quality in the securing confidence and assurance test area.</p> <p>The company's Board provides statements of assurance in the vast majority of areas to demonstrate that all the elements of its business plan add up to a plan that is high quality and deliverable. Most are supported by sufficient evidence of the Board's challenge and assurance process. This supports our overall confidence in the assurance of the plan and demonstrates Board ownership.</p> <p>The company's Board also provides a compliant statement of assurance with sufficient supporting evidence to demonstrate that the business plan will deliver – and that the Board will monitor delivery of – its outcomes.</p> <p>Additionally, the company's business plan provides sufficient and convincing evidence that overall, its business plan tables and the assurance and commentary provided are consistent, accurate and assured.</p> <p>However, the plan falls short of high quality in the following areas:</p> <p>The company's Board provides a compliant statement of assurance to demonstrate that its governance and assurance processes will deliver operational, financial and corporate resilience over the next control period and the long term. However, the company provides insufficient evidence to support this statement.</p> <p>On providing evidence of a fair balance between customers and investors:</p>	CA1	B
Securing confidence and assurance	B		CA2	C
			CA3	C

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	B	<ul style="list-style-type: none"> <li>While gearing is forecast to be below 70% in 2020-25 and the company does commit to sharing benefits with customers if gearing exceeds 70%, it does not explicitly commit to our default mechanism.</li> <li>The company is proposing a bespoke voluntary benefits sharing mechanism to donate 1% of profits as a community dividend and to spend £10m on a technical academy, which we assess could have a value of £4.5m per year. The company is also proposing donations to social tariffs and hardship funds which we assess could have a value of £3.5m per year. The company's proposals for voluntary benefits sharing are high quality.</li> <li>On dividend policy, there is insufficient evidence of the company's intention to meet the expectations set out in the 'Putting the sector in balance' position statement. There is insufficient evidence that the dividend policy covers all of the required elements and insufficient evidence of how the dividend policy in 2020-25 takes account of obligations and commitments to customers when determining dividends. Also there is insufficient evidence of a clear Board commitment to publish detail on dividend policies annually and to signal changes to stakeholders.</li> <li>On executive pay, the company demonstrates insufficient evidence of its intention to meet the expectations set out in the 'Putting the sector in balance' position statement. There is insufficient evidence of how the targets will be stretching and aligned with delivery to customers. Also, there is no reference to the policy for 2020-25 and how it will be rigorously applied and monitored or evidence as to how changes will be signalled to customers.</li> <li>The Board provides only a partially-compliant statement of assurance that its plan will enable customers' confidence through high levels of engagement on its corporate and financial structures.</li> <li>Additionally there is insufficient evidence of transparency on its corporate and financial structures and how these relate to its long term resilience.</li> </ul> <p>In our assessment of the company in the 2018 Company Monitoring Framework (not including the elements related to the PR19 business plans) while the company meets expectations in 7 areas, it has minor concerns in 2 areas.</p>	CA4	B
			CA5	C
			CA6	B