

Speech from David Black: Developing a customer focused asset management strategy at PR19

WWT Water industry Asset Management conference, Birmingham, Thursday 2 May 2019

Introduction

Thank you for the opportunity to speak today. It's great to be at asset management event. Like many in the room, I care about the service that customers get and in an asset intensive sector like water, good asset management is key to delivering for customers.

What do customers have to do with asset management strategies?



You may be thinking what do customers have to do with asset management strategies – customers don't know the conditions of your assets or the cost of various options to maintain and enhance assets. However, the purpose of asset management strategies is ultimately about best serving the customers now and in the long term. And unless you understand what they expect, what they would like and what they don't, then it is unlikely an asset management strategy will deliver. Furthermore failures to manage asset appropriately may result in damaging loss of service to customers, so they have interest in good asset management. Customers sit at the centre of the water and wastewater value chain and the way they use water and what they put down sinks and loos impact on asset health. So good asset management requires working with customers.

I am going to focus on how we are promoting asset health in PR19 and what we learned from our assessment of operational resilience and asset health in the initial assessment of business plans.

But before I do, it's worth **recapping where we are in PR19**.

Throughout our 2019 price review, we aim to enable, incentivise and challenge water companies, so customers get more of what really matters to them. And asset management has a part to play in this.

We started our journey to PR19 with engagement on the challenges facing the sector. For example:

- Climate change
- A changing and growing population
- Rising customer expectations:

From that work we identified four key themes which companies and other stakeholders considered vital to address.

These are:

- Great customer service
- Resilience in the round: They expect water and wastewater services to be resilient to both short-term shocks and long-term challenges and resilience is has operational, corporate and financial dimensions
- Affordable: customers and society expect those services to be affordable for all, including those struggling to pay

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- Innovation: to deliver the above themes, requires the sector to innovate, as never before.



The first phase of the delivery of the price review was our initial assessment of plans, which covers the breadth of companies' plans across nine test areas. The results of our IAP was to grade companies into four categories:

- Exceptional and fast-track categories, which receive reputational, procedural and financial benefits for;
- Slow-track companies
- Significant scrutiny companies

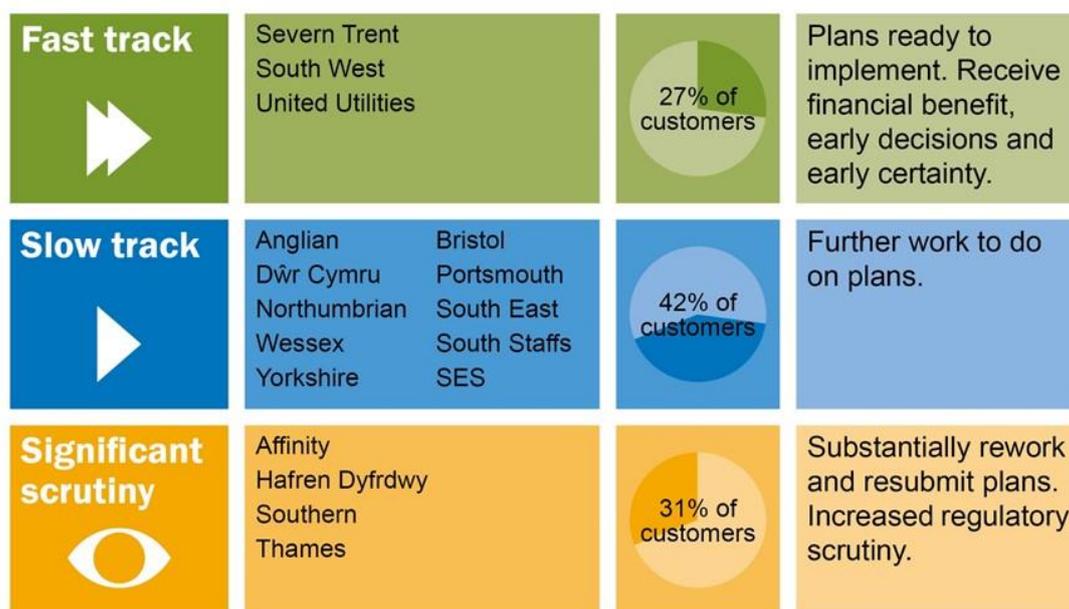
We were really pleased to see three companies: United Utilities, Severn Trent and South West Water meet the high bar for fast track and submit business plans that move the dial for customers. And we recently published the draft determinations for those companies.

For the rest of the sector, they have had the opportunity to revise plans, taking account of our specific feedback on areas of concern and where we think they have not gone far enough for customers.

However, although many companies need to improve their plans in some areas, it is also important to say that the sector has taken a major step forward – with a major step up in customer engagement and improvements in performance set out in business plans such as:

- Help for 1.5 million customers struggling to pay
- 40% reduction in supply interruptions
- 25% reduction in sewer flooding
- 37% reduction in pollution incidents

Our IAP decisions at a glance



A key challenge facing the sector is asset management and maintenance.

We know the water sector is asset intensive, relying on tens of thousands of kilometres of underground pipes, often installed more than 50 years ago to deliver service. Understanding the condition of both above and underground assets is critical both to developing an effective asset maintenance programme and ensuring that asset replacement is targeted at the right place and the right time. In contrast to

other utilities, the water sector is highly dependent on reactive maintenance or fixing problems when they appear.

I was at an event recently where a smart ball probe was displayed. It can be used to detect whether the pipe needs replacing, refurbishing or no work at all.

I'm not in the business of picking winners. I don't know whether that probe is the best way forward. But it shows the power of technology – innovation – to be more targeted and efficient. New data on asset health may highlight new problems or it might make maintenance costs more efficient and probably both. Innovation can enable both better asset health and more efficient asset maintenance – improving both resilience and efficiency.

A key element of our PR19 methodology is the development of a comprehensive set of stretching outcome performance commitments and associated outcome delivery incentives to drive service delivery for customers.

There are two key types of outcome performance commitments:

- Common performance commitments – where we have worked with industry to develop common definitions and reporting of measures and where we set expectations of the level of service. These were set out in PR19 methodology in December 2017
- Bespoke performance commitments – to be developed by companies to reflect their customers needs and preferences

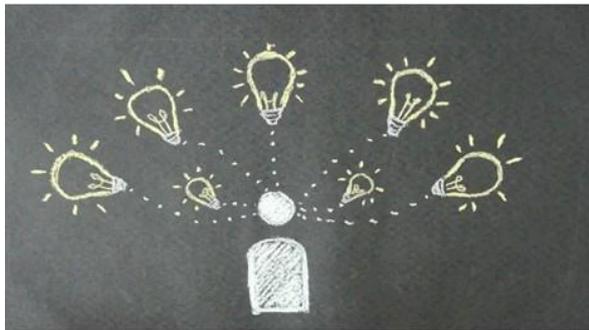
For both common and bespoke performance commitments, we asked companies to propose outcome delivery incentives reflecting the value of delivering on these commitments or consequences to customers for failing to do so. We set expectations of forward looking upper quartile performance for three common performance commitments and for companies to challenge themselves to reduce leakage by 15%.

As part of our assessment of business plans, we assess the stretch of proposed performance commitments, coverage of commitments and whether outcome delivery incentives are aligned to customer interest and based on robust customer engagement and research.

At the centre of our approach to asset health in PR19, are the four common asset health PCs that we have introduced so that performance of companies' on asset health can be more easily compared. The four mandatory common PCs for asset health are mains repairs (bursts), unplanned outage, sewer collapses and sewage treatment works compliance.

We have a further list of optional asset health PCs with common definitions from which companies are able to select bespoke performance commitments, ranging from low pressure to water quality contacts, from sewer blockages to external sewer flooding. Companies are also to develop their own bespoke performance commitments.

A key challenge facing the sector is asset management and maintenance



Innovation can enable both better asset health and more efficient asset maintenance – improving both resilience and efficiency

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PR19:

Outcome performance commitments (PCs) + outcome delivery incentives (ODIs) = drive service delivery for customers

Four common asset health PCs

PLUS bespoke asset health PCs

Bespoke performance commitments to reflect customers' preferences and their own specific circumstances

For the first time: allowed asset health outperformance payments or rewards alongside underperformance payments or penalties

We expect companies to use their bespoke performance commitments to reflect customers' preferences and their own specific circumstances such as particular resilience or asset health challenges, or specific issues not covered by common performance commitments.

Alongside the performance commitments, we require companies to propose outcome delivery incentives to hold companies to account for delivery of their asset health performance commitments. For the first time at a price review, we have allowed companies to propose asset health outperformance payments or rewards, alongside underperformance payments or penalties, that are were required on asset health performance commitments or their equivalent in previous reviews.

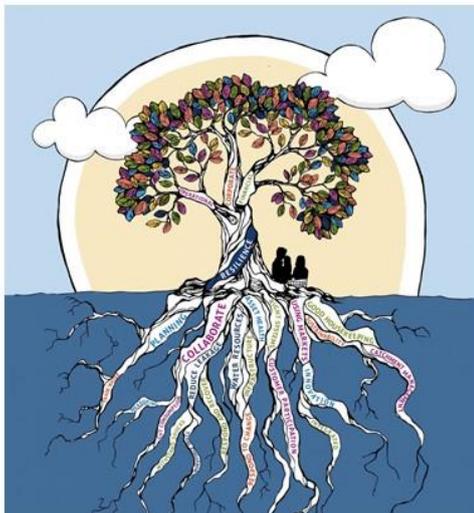
Resilience is a key theme of PR19 and was an important element of our initial assessment of business plans. As part of our assessment, we considered

operational resilience and how well companies assessed and prioritised risks to the delivery of the services over the next five years and over the longer term.

We also examined whether companies consider a full range of options for mitigating risks and how these align with the risks the company has identified and assessed. We expect companies to systematically consider options that enhance the reliability, resistance, redundancy, response and recovery of systems and services.

These mitigations need to be aligned with customers' views and supported by resilience outcome performance commitments that reflect each company's challenges, strategy and ambitions.

Resilience was an important element of our initial assessment of business plans



Companies which did well are those that focused on service performance, put forward stretching asset health performance commitments and provided a well-balanced and evidenced ODI package

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Concern: most business plans lacked a clear line of sight between: risks, mitigations and performance commitments.

So what did we find in the IAP assessment of operational resilience?

Disappointingly, most business plans lacked a clear line of sight between the risks to resilience identified by the company, the proposed mitigations presented in the plan to tackle these risks, and how these mitigation plans are reflected in performance commitments.

In particular, bespoke resilience performance commitments often did not reflect companies' approaches to resilience or their asset management strategies. For example, bespoke resilience performance commitments (such as, the percentage of population supplied by single supply system) could be used to complement common asset health commitments (which relate to asset reliability). This would mean that redundancy (for example, alternative sources of supply), resistance, and response and recovery mitigations could also be supported and monitored by performance commitments as part of companies' resilience strategies. But bespoke resilience performance commitments were rarely used in this way.

At the corporate level, while business plans usually describe well established systems and processes to identify and assess risks to resilience, these are not fully integrated into the companies' decision making. For example, companies generally have some form of asset management system in place, but the effective use of such systems to inform asset health improvements in the context of resilience risks is not clearly demonstrated in their plans. As a consequence, there is insufficient evidence that the identification, assessment and mitigation of risks to resilience are embedded in companies' decision making and oversight.

Companies which did well are those company's which focused on service performance and put forward stretching asset health performance commitments and provide a well-balanced and evidenced ODI package. They meet our asset health expectations by putting forward strong incentives against poor service delivery and recognised their asset health challenges.

Where companies have fallen short in the IAP, we have set out a detailed set of actions for companies to address, either for revised business plans submitted on the 1 April or for the company to develop actions plans to address. We have also asked companies to review and address our concerns around the stretch of their asset health performance commitment and level of outcome delivery incentives.

PR24 challenges and next steps

So what happens next?

Well, there's still some way further to go.

Next steps

	Next steps	Date
Fast-track companies	Companies must submit information, including: <ul style="list-style-type: none"> • completed business plan tables; and, • an actions tracker. 	11 February 2019
	Draft determinations	11 April 2019
	Respond to draft determinations	24 May 2019
Slow-track and significant scrutiny companies	Companies must submit information, including: <ul style="list-style-type: none"> • a revised business plan; • completed business plan tables; • a completed Ofwat financial model; and, • an actions tracker. 	1 April 2019
	Draft determinations	18 July 2019
	Respond to draft determinations	30 August 2019
All companies	Final determinations	11 December 2019

We are currently reviewing companies revised business plans and we will be publishing our draft determinations for the slow track and significant scrutiny companies in July. We will then make our final determinations in December of this year.

While the results of the initial of business plans reveal some weaknesses in the approach to asset management and that further work is required to walk the talk on resilience, the results also highlight that in most areas, some companies are already at good practice. I am confident that with further work companies approach to resilience and asset management can address the challenges the sector faces. The asset health performance commitment and wider focus on service improvement such as the 15% reduction in leakage and upper quartile performance will make good customer focused asset management a must have for success at PR19.

One issue emerging from PR19 is the dependence on backward looking measures of asset health and raises the question of whether we could develop more forward looking metrics. We have set out two new forward looking measures for operational resilience as part of our common performance commitments. I am conscious that

developing robust new measures takes time, particularly, if shared measures are to be developed across companies, so an early start on this will be required for PR24.

Thinking further about life beyond PR19, over recent months, in collaboration with people across the sector, we have been thinking about setting a new vision for the water sector. On 2 May we published some emerging themes for a vision. This builds on the substantial work we have done over the last few months to listen to stakeholders, including the public through our 'Water Stories' campaign.

Over the weeks and months that follow we'd like others to join us in telling their story about the vision of the sector, which we'll host on a dedicated microsite. You can also join the debate about the shared vision for the sector by talking to us, attending our events or through social media using the hashtag #waterstories.

The shared vision will help us develop our own strategy for the world beyond PR19 – including building towards the next price review

So get involved.

Thank you.