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Ofwat's emerging strategy

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About this document

Water companies' work supports every aspect of modern life for everybody, every day. Safe and reliable water and wastewater services are essential for public health and wellbeing. As a society, we expect water companies to provide resilient, affordable services for everyone and to plan and invest effectively for the long term.

We need to look after our environment to ensure sustainable access to water and so we and future generations can enjoy the nature around us. We look to water companies to sustain and improve the health of our rivers, lakes, coastal waters and ecosystems as they abstract and treat water and discharge treated waste back into the environment.

Ofwat's role is to enable, incentivise and hold companies to account for providing the very best for customers, society and the environment now and in the future. We also oversee the markets that exist in the water sector to make sure they are working for customers.

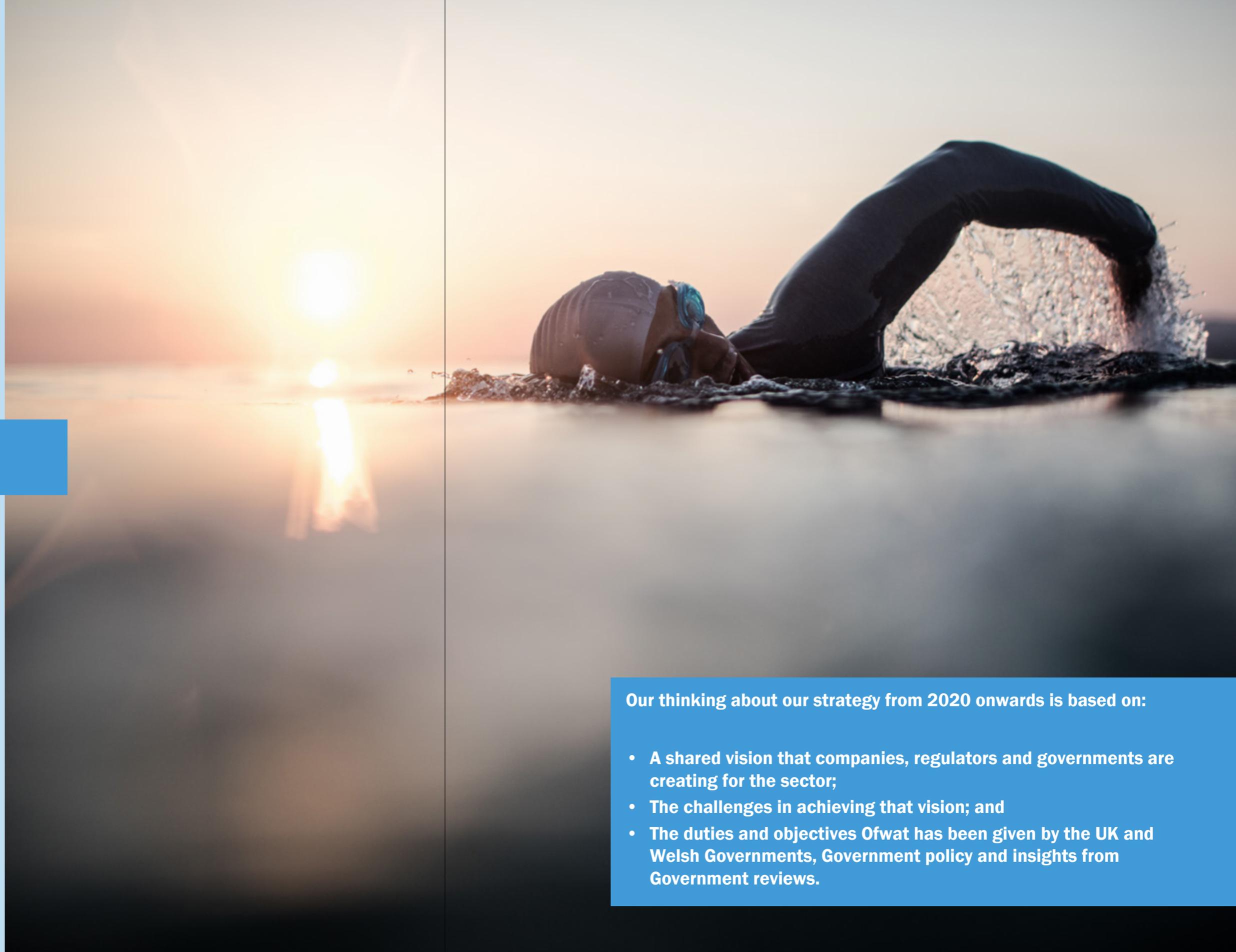
This document sets out emerging thinking about a new shared vision for the water sector and Ofwat's strategy for regulating the water and wastewater companies in England and Wales from 2020 onwards. We will publish the final version in the autumn.

We welcome views on all aspects, particularly whether the ideas and approaches in it will help us drive positive lasting change. You can keep track of the conversation, see how the vision is evolving and feed back your thoughts on our strategy by visiting our microsite at www.ofwat.gov.uk/vision-waterstories. You can also share your own vision for the future of water via Twitter or Instagram using the hashtag #waterstories.

We look forward to hearing from you.

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Context for Ofwat's strategy



Our thinking about our strategy from 2020 onwards is based on:

- A shared vision that companies, regulators and governments are creating for the sector;
- The challenges in achieving that vision; and
- The duties and objectives Ofwat has been given by the UK and Welsh Governments, Government policy and insights from Government reviews.

A shared vision for the sector

The water companies, Ofwat, the Environment Agency, the Drinking Water Inspectorate, Natural Resources Wales and the Governments in England and Wales are working together to create a shared vision for the water sector. Each of us has a different role to play. The vision will set out our collective aspirations for what the water sector should deliver for customers, communities and the environment in the coming years.

Work on the vision so far has been informed by discussions with customers and stakeholders, including over a million people the companies spoke to when forming their business plans up to 2025.

Three main aspirations are emerging.

Delivering everyday excellence

The standard of service is continually rising and customers' changing expectations are met.

Stewardship for the future

Companies share responsibility for thinking and planning for the long term. They look after the systems, relationships, investment and reputation to ensure a sustainable future. They protect and enhance the environment.

Value for individuals and for society

Water is affordable. Through delivering water and wastewater services, companies deliver value for customers, communities and the environment.

We are working together to shape and refine this vision for the future of water in England and Wales.



Challenges in achieving the vision

There are very significant challenges to our shared vision of excellence, stewardship and value. While regulators and the companies are already working to address them, the challenges require a refresh of Ofwat's strategy. The main challenges are:



Long-term water resources

A growing population and changing climate are making it harder to meet the demand for water in parts of England and Wales. Planning for a resilient and affordable water supply is not yet effective. Alongside this, our water consumption per head remains one of the highest in Europe. The way we use water needs to change.

Operational resilience

Company assets are not always resilient to extreme weather events, increased use or other shocks. During the freeze/thaw event in 2018 over 200,000 customers lost supply for more than four hours. Climate change and population growth will put these assets under further strain.

Pressures on the natural environment

Increased abstraction is putting the natural world under strain. Flooding and drought arising from climate change are becoming more common. As well as disrupting people's lives this is also placing further risk on ecosystems. The UK Government's 25 Year Plan for the Environment and the Welsh Government's approach to the sustainable management of natural resources raise the expectation that water companies play a larger part in improving the environment and mitigating the impact of climate change.

Customers' changing expectations

Customers' experience in other sectors is increasingly personalised, digitally enabled and based on sophisticated methods of anticipating and meeting their needs. Water companies are becoming better at this, but need to improve substantially.

Legitimacy

The industry's reputation has been damaged by some water companies historically being more focused on making money for their owners and managers than delivering for customers, society and the environment. Increasingly, people expect companies to act ethically and in the interests of the planet and society. Companies have and are continuing to take steps to restore the public's trust. Industry needs to keep ahead of society's expectations if it is to have a stable licence to operate.

Affordability

As an essential service, water needs to be affordable for all. Currently 3 million customers struggle to pay their water bills. We need to find ways of addressing the current challenges while making bills affordable.

Ofwat's role and policy context

Ofwat regulates the water and wastewater industry in England and Wales in line with duties set out in the Water Industry Act 1991. We must act in accordance with the strategic priorities and objective statements set out by the UK and Welsh Governments.

This statutory framework requires us to protect the interests of current and future customers. We are tasked with ensuring companies properly carry out their functions and that efficient companies can finance their business. We need to ensure there is long-term resilience, including through the sustainable management of natural resources. Both Governments ask us to encourage companies to seek solutions which deliver wider benefits to society and the environment as they carry out their business. We must ensure that water remains affordable and the needs of vulnerable customers are met.



We also work within the broader policy context set by the UK and Welsh Governments. These policies and Government commissioned and ongoing reviews are relevant as we consider our strategy from 2020 onwards:

- The UK Government's ['25 Year Environment Plan'](#), which sets out the UK Government's ambition for protecting and improving the environment;
- The Welsh Government's ['Water Strategy for Wales'](#), which sets out a series of long-term policy goals being pursued by the Welsh Government and Natural Resources Wales;
- The Welsh Government's ['Low Carbon Delivery Plan'](#), which outlines the approach to cut emissions and transition to a low carbon economy in a way which maximises wider benefits for Wales, ensuring a fairer, healthier and more equal society;
- The Welsh Government's ['Prosperity for All strategy for sustainable growth'](#);
- The recent consultation by HM Treasury and BEIS on [encouraging innovation in regulated utilities](#);
- The National Infrastructure Commission's (NIC) ['National Infrastructure Assessment'](#), which sets out recommendations to maintain and increase resilience to drought and flood;
- The NIC's [study of economic regulation](#), which will assess what changes might be necessary to the existing regulatory framework to facilitate future investment needs in infrastructure;
- The NAO's report on ['Regulating to Protect Consumers'](#), which recommends that regulators go further in defining, measuring, and reporting their success in delivering against customer-focused outcomes.
- The ['Industrial Strategy'](#) which sets out the UK Government's plan for boosting productivity, including the aim of supporting businesses with regulation that supports innovation; and
- The ['Modernising Consumer Markets' Green Paper](#), which sets out a range of areas for regulators to explore to respond to the challenge of modern consumer markets, including steps to create minimum standards and best practice for vulnerable customers.

Alongside the above, our future strategy must also consider how our regulation can contribute to the achievement of the Welsh Government's broader policies and strategies relating to the sector, such as those reflected in the Well-being of Future Generations (Wales) Act and the Environment Act (Wales).

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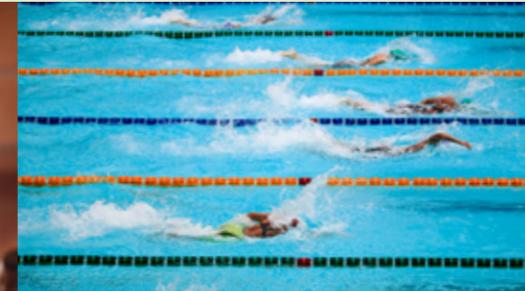
Overview of Ofwat's emerging strategy



We are looking afresh at how we can deliver our part of the shared vision. There is much that has worked in the past which we should retain and evolve. But the challenges mean we need to make important shifts in what we do and how we work.

Retain and evolve

Based on an initial assessment of what has worked well so far, we expect to retain and build on much of our policy framework including:



An allowed return on the assets of the regulated company

This approach to setting the price companies can charge gives investors certainty of revenue and a predictable return. It has successfully attracted low cost financing needed to clean up the environment and provide customers with reliable and safe water services. Over £4 billion each year has been invested in the water infrastructure since privatisation 30 years ago. Drinking water from the tap in England and Wales is at one of the highest standards in the world. Customers pay around £1 per day for drinking water, drainage and sewerage services.

Outcome based incentives, reset every five years

The five-yearly reset of revenue allowances, performance commitments and incentives allows us to drive continual improvement. We will reward companies that meet stretching performance commitments focused on things that customers care about and that deliver for society and the environment. Customer service and operational performance has improved over the last 30 years. We expect a step change in the period to 2025 in supply interruptions, customer satisfaction, leakage and sewer flooding, for example.

Financial resilience and board leadership

Financial resilience, a strong regulatory ring fence and responsible governance arrangements which consider the interests of customers and other stakeholders alongside those of investors are essential. An important part of this is recognising the role of Boards in leading water companies to deliver both public value and a return to shareholders. We have made substantial improvements in these areas in recent years through 'Back in Balance' and work on board leadership principles, and will continue to make further improvements.

Markets, trading and competition

This can drive further innovation to help the industry meet its challenges in a low cost way. They can also help strategically to:

- provide faster, low cost and water efficient connections to new homes;
- identify new sources for public water supply and innovative water saving products for businesses;
- and enable new uses for the waste produced in the industry.

The markets we have are still maturing and we will continue our focus on making them work better for customers and society. In developing our approach to the future use of market mechanisms, we will be mindful of the differing policies of the UK and Welsh governments.

Customer engagement

Companies should have customers at their heart. This involves them, not Ofwat, owning the relationship with customers. It involves them taking an inclusive approach to understanding the different customers they serve, engaging directly and regularly with them, and ensuring that their decision-making is well-informed by customer priorities, interests and changing expectations.

Three shifts

There are three significant shifts we think we need to make in our approach to regulation. These are:

Creating a better future

We can bring a longer-term perspective to our approach by:

- setting long-term targets;
- planning for sustainable future water resources; and
- ensuring long-term operational resilience.

Driving transformational change

We can be more proactive in achieving resilience while keeping water affordable and improving the environment by:

- enabling adoption of innovative approaches;
- encouraging affordable solutions for the environment;
- maturing companies' relationships with their customers; and
- turning information into insight.

Encouraging private enterprises to deliver public value

We can give greater recognition to the public benefits companies can bring while keeping the sector financially and ensuring reliable services for customers by:

- looking to companies to own their public purpose;
- encouraging the delivery of social and environmental value; and
- ensuring value in the round for customers, communities and the environment.



How we work

To make these shifts and to achieve the aspirations in the vision, we expect to make a number of changes to how we work. These include:

Listening more to customers so we can drive change and enable water companies as they deliver value for customers, communities and society.

Collaborating and partnering more with other regulators, including through UKRN, for a more joined up and effective approach. We can also share expertise, insight and resources with the Consumer Council for Water and other consumer bodies and organisations specialising in customer service and business ethics.

Creating space for open discussion with water companies to keep abreast of the performance and other challenges across the industry and within individual companies. Work together in solving them where appropriate.

Carrying out more frequent reviews and evaluations of how effective our regulation is in driving the medium- and long-term changes and improvements needed in the sector.

Developing new skills and making better use of data so we are more effective and efficient in everything we do.



3

The shifts in Ofwat's strategy



The three key shifts we propose in our emerging strategy involve:

- creating a better future;
- driving transformational change; and
- encouraging private enterprises to deliver public value.

In this section we set out the rationale for these shifts and what Ofwat might do to achieve them. In closing we discuss some possible implications of this strategy for price controls from 2025 onwards.

Creating a better future

Rationale

The challenges facing the industry such as climate change and population growth involve long-term trends. Their full impact may not be felt in the next five to ten years, but if we do not take action to get ahead of these trends – for example by reducing water consumption or exploring new sources of water – we will run out of time to find sustainable and affordable solutions. We will not be able to achieve the excellence, stewardship or wider value that our shared vision describes.

Ofwat's approach to regulation centres around a five-year price review cycle. We ask companies to place their five-year business plans in the long-term context and to make 15-year indicative performance commitments. But we could do more to prepare for the longer term and ensure we are all focused on achieving sustained progress over decades.

What Ofwat could do

Explore how we can work with others to set a limited number of strategic **long-term expectations** for the industry

Follow through on the joint work already begun to improve the resilience of **long-term water supplies**

Consider how we can strengthen the industry's approach to achieving **long-term operational resilience** in its assets, especially in the face of climate change



Long-term expectations

Long-term expectations could help the industry as it decides where to target innovation, and could focus Ofwat and others on policy changes to enable progress. We could report periodically on progress against these expectations and review and update our regulatory approach accordingly.

We would work with governments, regulators, consumer bodies and others in the sector to ensure these expectations reflect the priorities and needs of customers and the environment. They need to be informed by company expertise and take account of different stakeholder views across England and Wales. We would look to ensure these expectations complement the long-term commitments the companies are making, including those set out in the recent [Water UK Public Interest Commitment](#) and in their business plans.

We have to consider the mix of firm targets versus aspirations and trends. We must also make sure any expectations are outcomes based and appropriate in both the English and Welsh contexts.

In carrying out this work we would have limited visibility of the cost of meeting long-term aspirations or how future technology change might affect our ambition. We would need to provide sufficient flexibility to account for this and other new evidence, without diluting the focus that clear expectations can provide.

Long-term water supplies

A new regulatory framework is required to deliver the water resources we will need in the long term at an affordable price while protecting and enhancing the environment. The need to develop new water supplies, increasing trading and demand side solutions, has been set out clearly by the National Infrastructure Commission in its recent report 'Preparing for a drier future – England's water infrastructure needs'.

Together with the EA and DWI we have set up a joint team (the Regulatory Alliance to Promote Infrastructure Development – RAPID) to develop a framework for the new infrastructure required for water security. We are liaising with water companies as they evaluate and investigate potential transfers and storage infrastructure for this purpose.

We are also working with the EA on the new National Framework for water resource management planning. This new framework will enhance the existing company-by-company Water Resource Planning approach to encourage strategic water resource planning across company boundaries.

Operational resilience

The industry needs to develop continually its approach to managing assets if it is to meet the resilience challenges arising from population growth and climate change in an affordable way. By understanding their assets, companies can target and be more efficient in their maintenance and replacement activity, be proactive in mitigating the impact of climate change and reduce service failure risks to customers.

Not all companies have a sufficient understanding of the condition and resilience of their assets, or how this is likely to evolve over the longer term. We will seek further information from companies in this area so we can devise an approach for driving improvements.



Driving transform- ational change

Rationale

The immediate and long-term challenges facing the industry are significant, and our vision of excellence, stewardship and value is ambitious. We are confident we can continue to make progress through the financial incentives we place on companies. But we have other tools we can also use to speed up change. We had success recently in bringing about changes by: setting principles, such as on Board Leadership; reporting on good and poor practice, such as on operational resilience during freeze/thaw; and engaging with individual companies on particular risks, including relating to financial resilience. We are currently looking at changing company licences to set consistent standards around financial ring fencing.

What Ofwat could do

The pace of innovation

New techniques, technologies and business models are essential to increase productivity and meet strategic challenges in the most cost-effective way. The sector has been slow to adopt new tools and techniques at scale and there is much duplication of effort and expenditure in this area.

Protecting and enhancing the natural environment

More sustainable management of our natural resources – including changing how we use water – is essential if we are to deliver the ambitions set out by both Governments, ensure we are able to meet long-term resource challenges, and address the pressures of climate change and population growth.

Customer relationships

Continuing to build a mature relationship with customers is essential if water companies are to meet their expectations, and deliver value for customers and communities, including those who are vulnerable or struggling to pay.

Creating insight

To be more effective in driving change for customers and the environment Ofwat could do more to turn the data we have into insight and take a fresh approach to how we report on company and the industry's performance overall.





Innovation

Companies are stepping up their focus and collaboration on innovation. We welcome the launch of the World Water Innovation Fund involving Severn Trent Water and United Utilities partnering with water services providers around the world to fund, develop, and accelerate new technologies.

Ofwat could do more to facilitate the adoption of new tools and techniques. We could include ring-fenced funding in our upcoming regulatory settlement to reward companies who have rolled out innovative approaches. Or we could establish a centre of excellence to drive more co-ordination in trialling and rolling out new technologies and ways of working by water companies.

We will consider options for how we could provide speedy and effective guidance and advice on regulatory treatment of innovative approaches. We will continue our work to improve the way the new business retail and other markets work. They provide an important vehicle for bringing new ideas and disruptive approaches to the sector as a whole.

We could examine the role of data in promoting innovation and consider whether further action is needed to make water company data openly available to allow insight and new services and products to be developed.

The natural environment

There is an opportunity for regulators and Governments to work together to ensure our ecosystems and natural resources are managed sustainably and our shared ambitions and responsibilities for stewardship are met, while keeping water affordable.

As discussed above, this might begin by jointly setting long- and medium-term targets to give a stronger focus on the natural world. These might include ambitions to radically reduce water use, minimise pollution from sewer overflow and restore natural environments to good ecological status.

We can work together to remove barriers, inconsistencies and gaps in regulation which might hinder companies meeting our shared ambitions in a low-cost way. We could work together to review the evidence available to consider whether current standards have properly accounted for cost savings arising from new techniques and the broader value and natural capital that is created when the environment is improved. Ofwat may need to be more joined up with regulators in other sectors to create a regulatory framework and identify opportunities to encourage water companies to explore circular economy approaches.

Customer relationships

Companies engaged with around 1.5 million customers as they developed their PR19 business plans, in a process which was subject to independent challenge and assurance from Customer Challenge Groups.

There is more we could do to drive continual improvement within the next regulatory period. We could partner with experts on how to use the customer voice in company decision making. There is scope for us to ensure the entire sector is building on best practice and learning from new opportunities that are being opened up by social media and digital technologies.

We could work with CCWater and other sectoral regulators to improve how the industry serves the most vulnerable in society. This might involve calling out those companies who are falling behind and considering new high-level licence obligations to clarify the expectations on companies in this area.

Overall, if we build up our own understanding, this might equip us to drive companies to build the relationships they need with their customers. As part of this we could make better use of publicly available research and use social media and information technology to listen and learn more about customers and their needs.

Ofwat's approach to insight and reporting

We collect a significant amount of data from water companies on all aspects of their performance. To be more effective in driving improvements in performance overall, we could combine our data with other pieces of intelligence and do more to turn it into insight. We could explore how we work with other regulators so that we can create cross sectoral insights and comparisons to help us drive further change in the water industry.

With this insight we could provide richer reports on the progress the industry is making in delivering for customers and the environment. We could be swifter in picking up on cross cutting trends or identifying performance issues specific to a particular company. A fresh approach should help us keep the effectiveness of our regulatory framework under review.

Encouraging private enterprises to deliver public value



Rationale

The core function of water companies is to deliver water and wastewater services for current and future customers. In delivering these services, water companies provide important public value – public health and cleaner beaches for example. Many working in the industry have a strong public service ethos. The joint vision sets an aspiration that companies deliver considerably more value for the environment and communities as they carry out their core functions.

Examples of how water companies can (and some do) deliver more for society and the environment include:

- using catchment management, rather than traditional approaches to water and wastewater treatment. These improve river quality, improve the wellbeing of local communities and can drive down costs over the long term;
- partnering with local energy companies to use recycled water, and create and use renewable energy. This reduces costs for customers, is good for the environment and creates local wealth; and
- assisting local economic growth in deprived communities through company job and training opportunities while providing a talent stream for the company.

If water companies make it their mission to deliver the best public value they can through their core business activities, they will be joining private enterprises across a range of sectors in responding to growing expectations about what business delivers for society.

Through a stronger focus on delivering value for communities and the environment, the water industry can rebuild trust. Companies' range of financing options may broaden, including through accessing Environmental Social and Governance funds. It might make it easier for water companies to attract skills and enlist the support of customers and other partners in tackling the challenges associated with climate change and population growth.

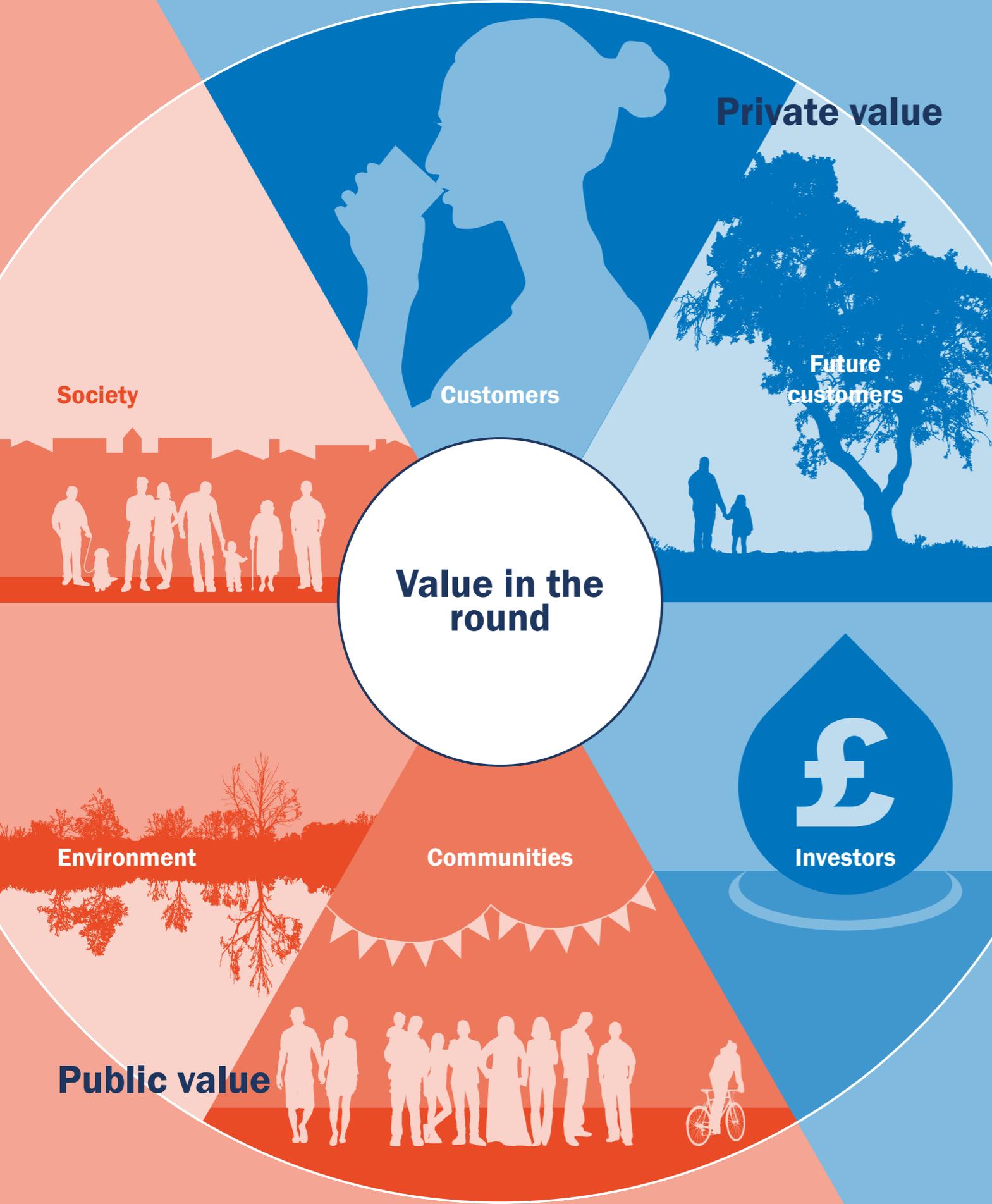


Evolution of our approach

Ofwat has traditionally focused its regulation on delivering value for money for customers, with considerations of broader social value limited to allowing companies to recover the efficient cost associated with meeting environmental or public health standards set by other regulators or government.

With PR19 we have begun to engage with wider public value considerations, for example, by inviting companies to set environmental and social performance commitments which customers support, such as for cleaning up rivers or supporting those in debt. New objectives we have recently introduced require company boards to set a purpose which recognises the interests of all the company's stakeholders.

We could further evolve our approach in light of the untapped opportunities and the renewed importance delivering public value could play in the future of the industry. As we must also ensure customers receive reliable services and the sector can continue to attract finance.



What Ofwat could do

Look to companies to own the aspiration of creating more public value as they carry out their role in delivering water and wastewater services. This should underpin and be embedded in the purpose and culture of the water companies.

Some companies in the sector are already developing and formalising their public service role to build customer trust. We also welcome Water UK's recent publication of a public interest commitment which encourages companies to enshrine public interest within their business purpose and sets a number of industry public value aspirations for 2030. We will watch how this develops over the next 12 months and consider what steps, if any, we need to take.

Encourage water companies to deliver greater social and environmental value. We might report on and measure their progress in delivering for society – potentially partnering with accreditation bodies already set up for this purpose. We could also consider in future price reviews what process, reputational or financial incentives we might give to companies which are effective in delivering in the interests of society and the environment.

Secure value for customers, communities and the environment. There is ample untapped opportunity for companies to add more public value without incurring additional costs to owners or to customers, while supporting, not compromising, the delivery of core services. These opportunities are enhanced when companies partner with organisations that bring complementary expertise and new sources of funding. We will monitor carefully to ensure that customers do not lose out and the sector can continue to attract investment.

There may be different views on what role companies should play in society and for the environment and about whether customers should pay for wider benefits that the companies provide. While some decisions may be for Government to make, we will engage constructively in these debates and provide analysis to show ways to deliver enhanced public value while keeping services reliable and affordable and ensuring an efficient industry remains able to attract investment.

Evolving our approach to price controls

Price reviews enable us to challenge companies and reset demands on companies taking account of changes in wider society. They will remain an important tool for delivering value for customers, communities and the environment and for holding companies to account.

We will build on and learn lessons from the 2014 and 2019 price reviews to shape our approach in 2024 and beyond. We also see opportunity to reshape the role of price reviews, taking account of the vision and emerging strategy and direction of travel set out in PR19.

Scope of the review

We will consider how the greater role of markets in the wholesale value chain enables the price review to be redesigned. We will also consider the scope of the price review in light of developments elsewhere in the strategy. We note that PR19 included a broad scope of activities such as on companies' approach to vulnerability, corporate, financial and operational resilience and innovation and we will consider the extent to which these might be more effectively pursued outside the price review process.

Customer engagement

We could use insight to improve the ability of customers and stakeholders to shape the companies' business plans, which may reduce the need for Ofwat intervention. There may be a case for national surveys or other work to improve the robustness of willingness to pay analysis especially for new commitments that could have a significant impact on customers' bills.

Process rewards and streamlining

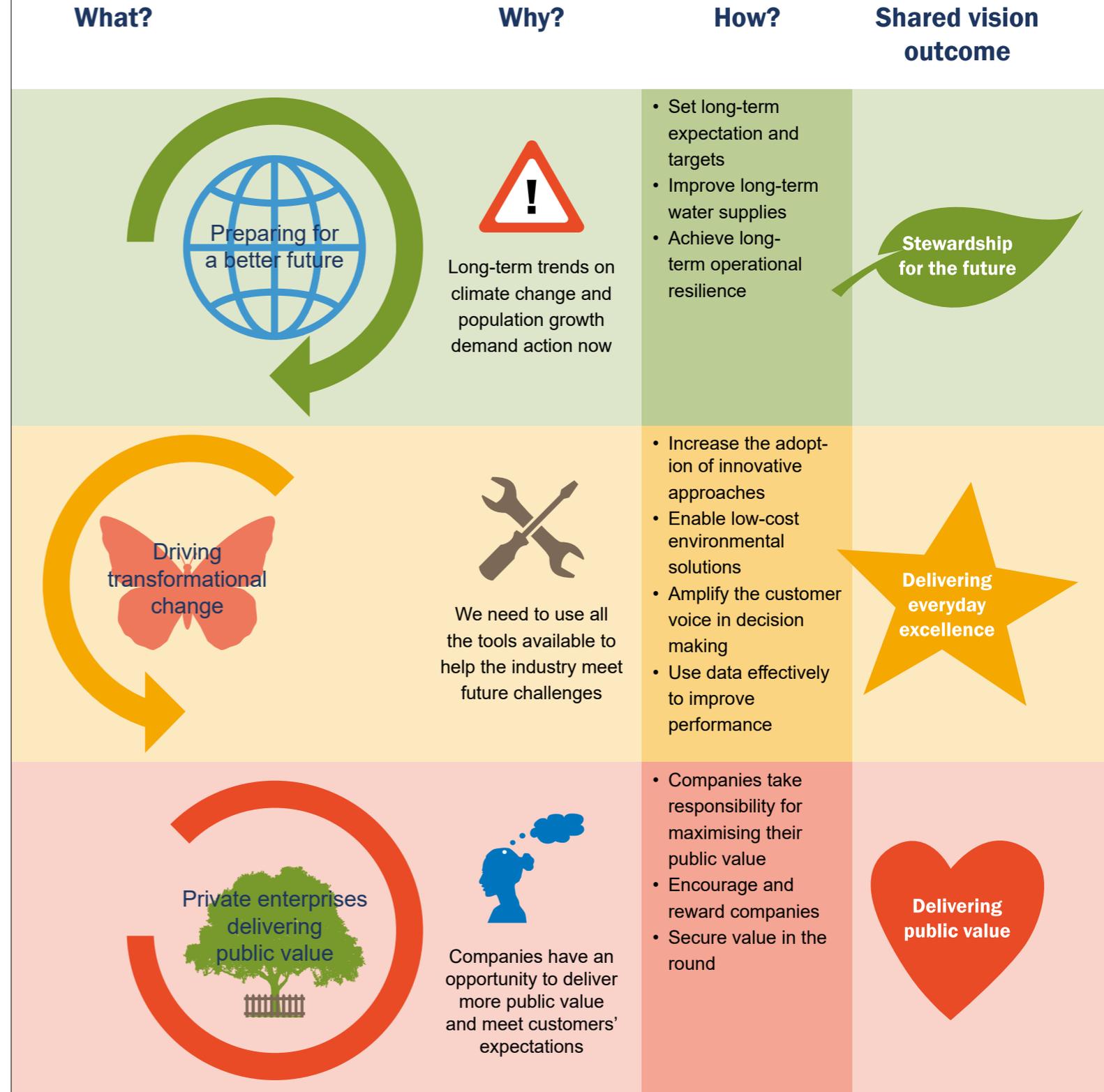
If companies challenge themselves and step up to effectively deliver for customers, environment and communities, then they could benefit from reputational, procedural and financial benefits in subsequent reviews. We may look to evolve the current fast track approach to differentiate further between the process for companies with a strong track record in living up to the aspirations in the vision and those that are falling behind.

Performance standards

We introduced indicative outcome performance commitments to 2035 in PR19 and we will consider how the five-year price review aligns to delivery of long-medium term aspirations.

Going further, we will consider what new performance standards might be appropriate in the light of the joint vision, especially best practice in protecting and enhancing the environment and delivering for society. We may need to improve our ability to assess the natural capital accounting methods which companies use in their business plans to calibrate incentives.

Strategy on a page



Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales.

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