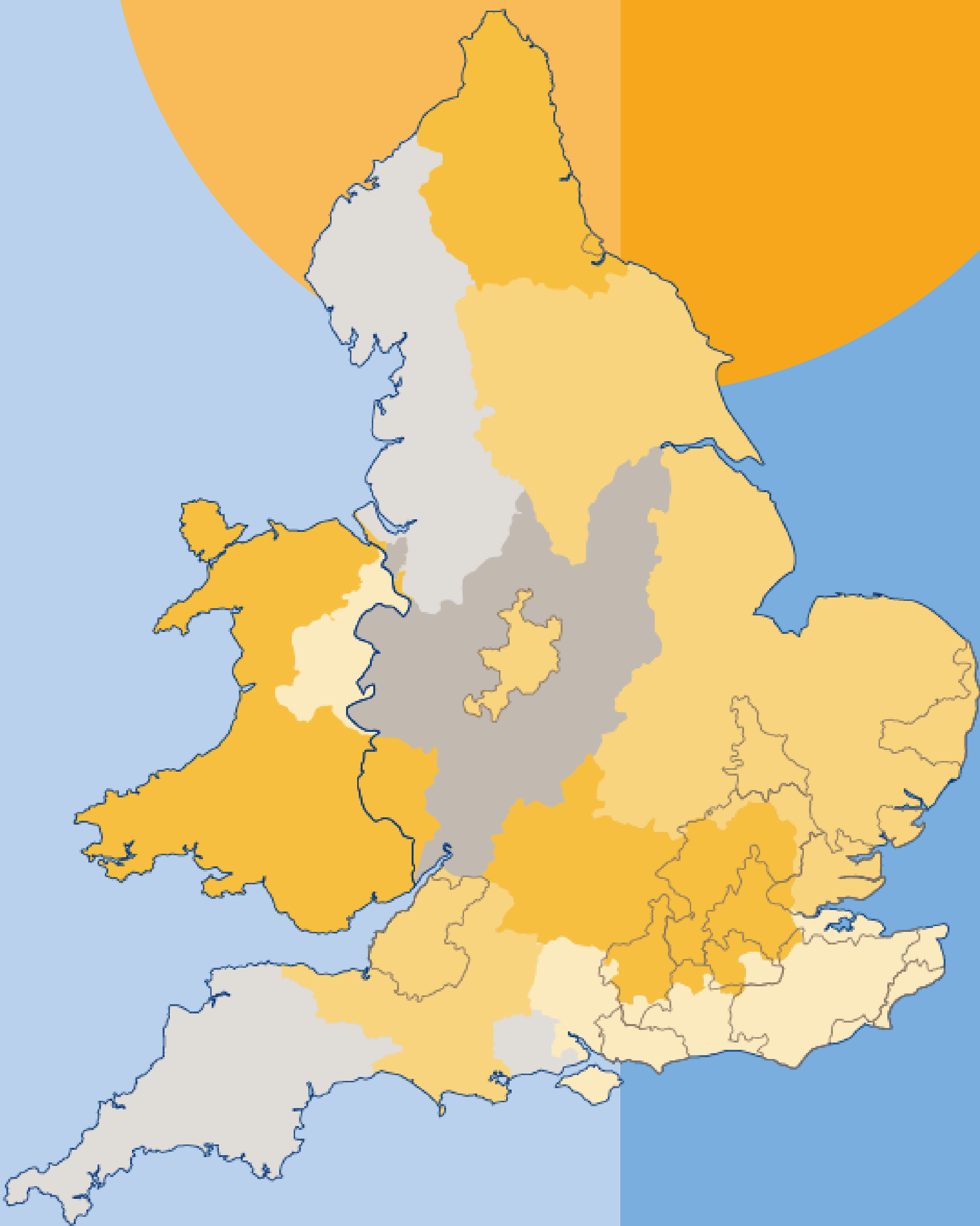
July 2019

Trust in water

PR19 draft determinations

Overview of companies' draft determinations



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Foreword

The challenges facing the water sector have never been greater. Customers expect their water and wastewater services to deliver more of what matters: high-quality, reliable and resilient services that are affordable for everyone. At the same time, water companies must also protect and enhance the environment, meet the needs of the communities they serve and plan for future generations. The 2019 price review has four priorities for water companies: affordable bills, great customer service, long-term resilience in the round and innovation.

Our draft determinations set out a new era in which water companies in England and Wales can meet these challenges. An era of better services for customers alongside environmental improvements, backed by increased investment and with lower bills. This new era means stretching targets for companies to achieve by 2025, with financial incentives for success. The targets include:

- 40% reduction in sewer flooding;
- 64% drop in supply interruptions;
- 17% reduction in leakage; and
- extra help for almost 2 million more vulnerable customers.

The draft determinations enable companies to improve the environment. We will provide the money for efficient delivery of the ambitious Water Industry National Environment Programme for England and National Environment Programme for Wales. By cutting leakage and helping customers to save water, companies can reduce the amount of water put into the public supply by at least 630 million litres per day. That is enough water to fill 3.3 million water butts. We will enable and promote nature-based solutions, such as sustainable drainage systems and catchment management, which can be both cheaper and greener.

Our draft determinations set out a new era in which water companies in England and Wales can meet these challenges

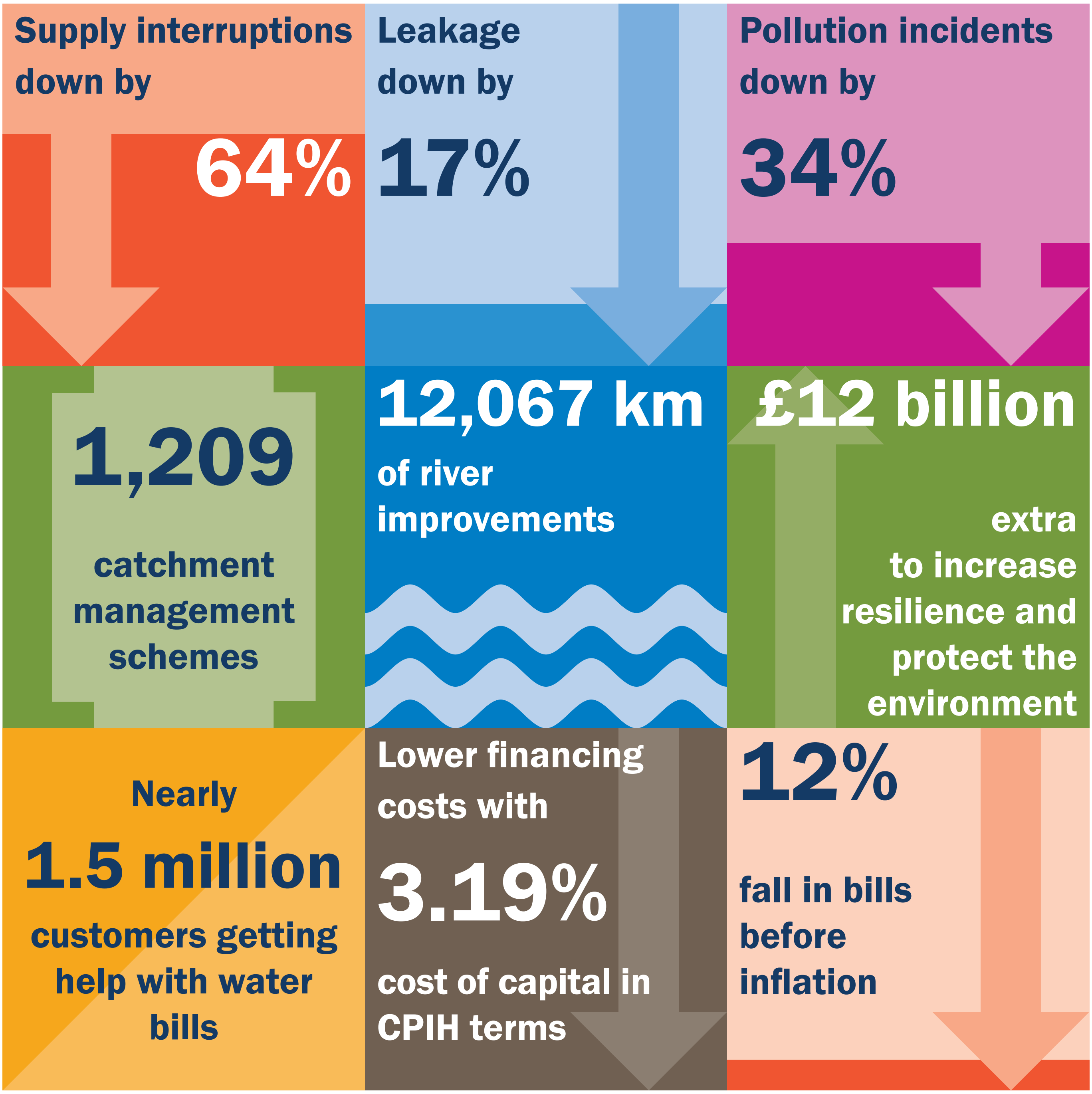
As well as day-to-day service improvements, the sector needs to invest in infrastructure. Population growth and climate change demand resilient supplies and services, and protection for rivers and waterways. Our draft determinations include £12 billion for new and improved services from water companies to meet these needs. This includes £2.3 billion to improve resilience and security of supply. We are funding up to £450 million for companies to collaborate on long-term strategic water resource solutions.

We scrutinised companies' proposals for the next five years. Our analysis – and comparison with the more efficient 'fast track' companies – shows that most water companies can be run more efficiently than their plans suggest. Greater efficiency and productivity, together with the fall in financing costs, are what will deliver this new era of service, innovation and environmental improvement. It also means that customers can benefit from water bills that are an average 12% lower before inflation.

Water companies now have a further opportunity to provide new evidence if they consider our draft determinations will prevent them from delivering for customers and the environment. We will consider carefully the responses we receive from all stakeholders before making our final determinations in December.

Our draft determinations at a glance

Water customers across England and Wales get more of what matters – we are challenging companies to deliver better and more resilient services, and bills that continue to fall before inflation.



What is a price review?

A price review is when water companies, together with their customers, create plans for the future that will deliver what customers want and need.

We set the framework for these plans, and scrutinise and challenge them to make sure they meet customers' needs and companies' obligations. Based on these plans and our interventions, we set each company's price, service and incentive package for the next five years. We call this the company's 'determination'.

Fast-track companies

Three companies – Severn Trent Water, South West Water and United Utilities – submitted plans that set a new standard for the sector. Other than some limited interventions, these plans were ready to implement, so we awarded these companies with 'fast track' status. They receive reputational and financial benefits, and we published their draft determinations early.

Affordable bills

Water and wastewater services must be affordable to customers. This means affordable overall, in the long term and for people struggling – or at risk of struggling – to pay.

Our draft determinations show average bills across England and Wales falling overall by 12% before inflation. Continuing to keep water bills low for everyone will help make sure that more customers can afford to pay their bills.

Three million customers say that they struggle to pay their water bills, so we asked water companies to provide financial support so more people can afford their bills. Overall, companies rose to this challenge in their business plans; but in some cases, we thought they could be more ambitious and specific about their plans. Our interventions mean that more customers will benefit from more support to help pay their bills.

In our initial assessment of companies' business plans, we were concerned that some companies did not adequately show that customers supported their plans, and had not engaged sufficiently with customers about long-term bill levels and profiles. In some cases, companies provided better evidence, reassuring us that changes to bills will be more in line with customers' preferences. In other cases, we are stepping in to improve the affordability of their customers' bills. We continue to expect companies to satisfy themselves that they have genuine customer support for their proposals.

12% fall in bills before inflation

Nearly 1.5 million customers getting help with water bills through social tariffs and WaterSure

At least 70,000 customers helped to get out of debt through payment matching

20,000 customers getting help from hardship funds

Extra help for customers struggling to pay

Southern Water and Hafren Dyfrdwy are putting new measures in place to help them understand what kinds of affordability support work best for customers, and to tailor their support according to people's needs.

Five companies (South West Water, Wessex Water, Thames Water, Northumbrian Water and South East Water) will double the number of customers they provide with financial support through social tariffs and WaterSure. Four companies pledge to partly self-fund their social tariff schemes using shareholder money: South West Water, United Utilities, Welsh Water and Yorkshire Water.

Efficiency challenge

We expect companies to make a step change in efficiency, and to pass those savings on to customers through lower bills. To assess companies' efficiency, we compare the proposals in their business plans to our view of efficient costs. Our view is based on evidence about best practice in the water sector, efficiency gains from our framework, and productivity gains in the wider economy.

Some companies show they are stepping up to our challenge, while others have some distance to go. We are particularly concerned that four companies (Anglian Water, Thames Water, Yorkshire Water and SES Water) propose much higher spending than we consider efficient, so far without justification, particularly on 'business as usual' services.

Our draft determinations allow companies £49 billion for both 'business as usual' services and new investment, so that they can deliver what customers want and need.

Slow-track and significant scrutiny companies' average bills for 2020-25 before inflation

Company		2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	% change
Water and sewerage companies	Anglian	421	370	370	370	370	370	-12%
	Dŵr Cymru	439	378	378	378	378	378	-14%
	Hafren Dyfrdwy	293	286	286	286	286	286	-2%
	Northum-brian	429	319	319	319	319	319	-26%
	Southern	422	362	362	362	362	362	-14%
	Thames	382	333	342	344	344	344	-10%
	Wessex	457	390	390	390	390	390	-15%
	Yorkshire	380	342	342	342	342	342	-10%
Water only companies	Affinity	173	150	150	151	151	151	-12%
	Bristol	183	155	155	155	155	155	-16%
	Portsmouth	102	90	90	90	90	90	-12%
	SES	190	161	161	161	161	161	-15%
	South East	205	185	185	185	185	185	-10%
	South Staffs	140	125	122	120	118	116	-17%

Bills shown in 2017-18 prices

Inflation

Inflation is the rate at which the price of goods and services changes. It is measured by the Office for National Statistics. We do not include an allowance for inflation when we set price controls. This means that inflation will also affect the amount customers pay but we expect this to be smaller than the average bill reduction.

Great customer service

We are challenging water companies more than ever before to deliver great customer service.

For companies, getting customer service right starts with an in-depth understanding of customers' preferences and priorities. Through our price review process, most companies have shown they can engage meaningfully with their customers, and they are increasingly involving customers in the development of their plans and decisions about day-to-day priorities.

We expected each company to:

- use these priorities to set themselves stretching performance commitments in 13 areas such as supply interruptions and sewer flooding – all identified as important for customers of any water company; and
- put forward their own bespoke performance commitments in areas that are important to their specific customers.

In our draft determinations, we are stepping in to make sure that the commitments they make for the next five years can really deliver the great customer service their customers want and need. Where companies exceed these commitments and set new standards for the sector, they can receive payments reflecting the improvements they achieve. If companies fall short, customers will get money back through lower bills.

Customers' expectations are set by their experiences across the board. As other sectors offer more personalised and digital offerings, and make better use of customer insight and participation to anticipate and meet customers' needs, water companies will need to innovate to keep up. So from 2020, we will be comparing customers' satisfaction with their water company to their satisfaction with other services.

Helping vulnerable customers

Great customer service means that companies really know and understand their customers, and can provide more effective support to customers who are in circumstances that make them vulnerable.

Some customers need extra help in order to access services. We are asking water companies to step up and do more to identify these customers so they can meet their needs. Priority services registers list customers who need extra help, and the kind of extra help they need. By 2025, we require at least 7% of each company's customers to be on their register, 2 million more than are registered now. To make sure their registers are up to date, companies will also need to try to contact at least 90% of the people on the register every two years, to check their information is current. They will need to make actual contact and validate their records for at least 50%.

Nine companies (Affinity Water, Bristol Water, Northumbrian Water, SES Water, South East Water, Southern Water, Thames Water, Yorkshire Water and South West Water) are committing to maintaining high customer satisfaction among their most vulnerable customers.

Eight companies (Affinity Water, Anglian Water, Northumbrian Water, South West Water, United Utilities, Thames Water, Wessex Water and South East Water) are committing to adopt the British Standards Institute (BSI) standard for accessible services.

Measuring customer experience

We are introducing a new customer experience measure, C-MeX, to replace the service incentive mechanism (SIM). C-Mex compares water customers' experience with customers of other water companies, and also with customers of companies in other sectors. It covers the satisfaction of all water company customers, not only those who have contacted their company. We have also assessed companies' track record in addressing customer complaints and learning from experience with previous service incidents to improve future service.

For the first time, we are also setting an explicit incentive to improve experiences for new connections customers. This involves another new measure, D-MeX, encompassing a developer satisfaction survey and performance on key service metrics.

Customer engagement

Since the last price review, the water sector's independent customer challenge groups have had an increasingly positive impact on the quality of each company's customer engagement. We expect the relationship between companies and their customers to continue maturing as companies increase customers' participation in their business delivery and planning. We will consider how best to promote strong customer and citizen voices as we look past the 2019 price review toward our emerging strategy.

2 million

more customers registered for the extra help they need by 2025

Internal sewer flooding down by

40%

Supply interruptions down by

64%

Resilience in the round

Customers expect reliable water and wastewater services that can avoid, cope with and recover from disruption, as well as protect the natural environment. This means water companies need the right information, systems, processes, governance, capabilities and finances to make decisions about their operations, maintenance and investment in the short and long term. They need operational, financial and corporate resilience – 'resilience in the round'.

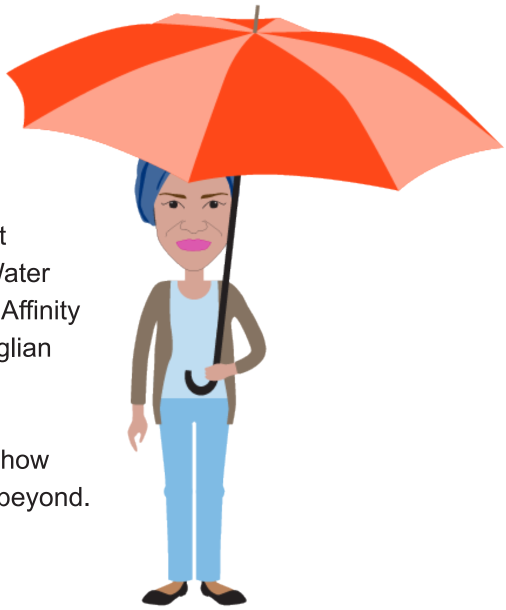
Where companies have shown that their proposals reduce the impact or likelihood of risks, provide real improvements to resilience, and offer value for money, we are allowing funding for them in our draft determinations. This means that customers will benefit from for example, £2.3 billion of investment specifically to help protect them from the risks of extreme weather conditions (such as drought and floods) and critical asset failures.

Where companies have not shown that their proposals adequately improve resilience for customers or the environment, we are protecting customers and not allowing funding for them in our draft determinations. Where companies propose measures they should be implementing anyway as part of their day-to-day operations, we are stepping in so that customers do not pay extra for them. At the same time, we are strengthening companies' outcome performance commitments and associated financial incentives so that customers do benefit from better day-to-day services and improved asset health, with for example fewer mains bursts or sewer collapses.

In our initial assessment of companies' business plans, we saw good work on individual aspects of resilience – but more needs to be done to embed 'resilience in the round' across the whole of each water company's business. We are asking companies to develop action plans for implementing systems-based approaches to resilience by 22 August 2019. These should address our company-specific concerns, particularly in relation to clarifying the line of sight between the risks that water companies face, how this influences business decisions, and the outcomes delivered for customers and the environment.

Financial resilience

Companies and their investors are responsible for ensuring the long-term resilience of their financial structures.



We are pleased that a number of companies are proposing to improve financial resilience in their revised plans, such as by reducing their debt levels. Among the companies with high levels of debt financing, SES Water has announced it has already reduced its debt levels; Yorkshire Water, Affinity Water and South East Water propose to reduce gearing levels; and Anglian Water and Thames Water propose small reductions in debt levels.

In our draft determinations, we are asking several companies to clarify how they will maintain their financial resilience over the next five years and beyond.

Investment in resilience

We are stepping in to provide funding of up to £450 million to help companies identify the right projects to solve the drought resilience challenges in south-east England. The funding will allow companies to work together to investigate and develop strategic water resource solutions to address these challenges. These solutions include potential major new water resources, including reservoirs, in south and south-east England; and national transfers of water from north-west to south-east England.

We are also providing a total of £312 million of funding for Anglian Water, Southern Water, South East Water and Dŵr Cymru to connect more of their own network together, so that water in their regions can be moved to where it is needed more easily.

And we are providing £780 million of funding to reduce the impact on customers and the environment if water supply and wastewater treatment infrastructure should fail.

£2.3 billion of investment to protect against extreme weather and critical asset failures

Sewer collapses down by 19%

Mains bursts down by 18%

Looking after assets

We are encouraging all companies to improve and maintain the health of their assets – that is, to keep things like pipes, pumps and plants in better working order – over the next five years and beyond.

The worst performers will need to go further to close the gap between them and the rest. These companies will face higher penalties for underperformance if they fail to catch up.

We are also ensuring that companies work together to develop forward-looking asset health metrics. This will improve their understanding of asset health and the risks affecting it. Companies can then target investment to have the greatest positive impact on services for customers and the environment.

Innovation

Innovation must be at the core of every water company if they are to successfully address the challenges facing the sector, deliver long-term resilience, and provide great customer service at affordable prices.

Our outcomes and total expenditure approach facilitate this innovation, by giving companies the flexibility and freedom to adopt innovative means of delivering services. We promote innovation by setting water companies stretching outcome performance commitments, such as a 17% reduction in leakage, and by setting other performance commitments and the cost efficiency challenge according to the performance of the leading companies.

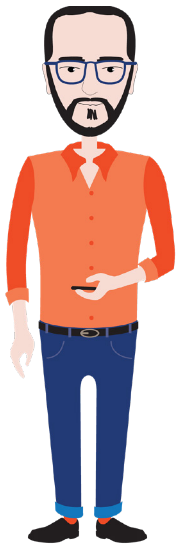
Our outcome delivery incentives approach means that companies have to return money to customers where they fall short, but it also gives companies the opportunity to earn additional financial payments if they successfully improve performance and deliver for customers above and beyond the level expected of most companies. This encourages companies to look for innovative ways of delivering better services to customers and improving the environment.

Seven companies have enhanced outcome delivery incentive rates on performance commitments such as supply interruptions, internal sewer flooding, pollution incidents, leakage, and water use per person. This means these companies will receive enhanced payments if they:

- successfully innovate and deliver beyond the current best performance in the sector; and
- share how they innovated with other water companies, to push the sector as a whole forward and benefit all customers.

As well as our existing package of measures, which encourages companies to innovate individually, we are considering how we can stimulate innovation more widely within the sector. We are currently consulting on a competitive funding mechanism to support collaborative innovation initiatives and provide long-term benefits to customers. The level of funding is yet to be determined but would be in addition to the allowances in these draft determinations. Companies would return this to customers if it were not spent on innovation. We will take account of this consultation in our final determinations.

Markets



New markets offer water companies scope for greater innovation and more effective co-operation with third parties, so they can deliver more effectively for customers. There are opportunities in new markets for water resources, bioresources and eco-services, as well as direct procurement for customers on large infrastructure projects.

In March 2019, we set out our expectations about how companies should use and facilitate markets. We expect companies to maintain their focus on taking a market-based approach now and in the future.

Direct procurement for customers

Direct procurement for customers is when water companies open up the financing, design, construction and operation of large projects to competition. This allows new participants to bring fresh ideas and approaches to the water sector, which encourages innovation and resilience.

We want to encourage water companies to use direct procurement for customers where it is likely to deliver better value for customers.

In our draft determinations, we have endorsed one United Utilities project to be delivered through direct procurement for customers. We are also stepping in to propose the use of direct procurement for customers in one Dŵr Cymru project in Wales and one Anglian Water project in England. There is also scope for further projects for Southern Water and Thames Water during 2020-25.

We want to encourage water companies to use direct procurement for customers where it is likely to deliver better value for customers

Water resources

We want to see companies making more efficient use of water resources. They can achieve this goal by engaging and collaborating with third parties, and by using market mechanisms to influence the behaviour of companies and third parties, for example. For the first time, we are setting a separate price control for water resources. This will help to shine a light on companies' water resources costs and so place a value on water resources. This in turn will support the development of markets and more commercial behaviour.

We are proposing a new 10-year price control allowing £120 million for a new reservoir at Havant Thicket. This will enable Portsmouth Water to supply Southern Water, benefiting customers across the south of England.

Bioresources

Bioresources services include transporting, treating and recycling the byproducts of wastewater services. These services can provide significant value for wastewater companies and their customers, so we want companies to manage these resources effectively. For the first time, we are setting a separate price control for bioresources services and challenging companies to consider market solutions than spend extra on in-house facilities. This will help to shine a light on companies' bioresources costs and so place a value on bioresources. This in turn will support the development of markets and more commercial behaviour.

Environment

For this price review, our ambition for the environment is higher than ever. Both the UK Government's and the Welsh Government's strategic priorities include sustainably managed natural resources and a resilient ecosystem. We have a role to play in this, working with others like the Environment Agency, Natural Resources Wales and Natural England.

Our draft determinations support this agenda. We allow water companies the £4.6 billion costs they need to efficiently deliver the ambitious Water Industry National Environment Programme (WINEP) for England and National Environment Programme for Wales. These programmes include schemes to prevent sewage spills, restore habitats and protect species such as eels. Our draft determinations also include stretching performance commitments that push companies to go even further on important environmental outcomes, such as reducing pollution, leakage and water use. Investment to increase resilience to drought (page 9) will mean that less water is removed from environmentally sensitive sites. Water companies also have bespoke commitments relating to climate change such as Yorkshire Water's 15% increase in its biogas renewable energy generation, and South East Water's 68% reduction in carbon.

We continue to encourage companies to use efficiently delivered nature-based (or 'green') solutions instead of capital (or 'grey') solutions, as long as the green solutions are suited to the situation. Our approach, which will continue to evolve for future price reviews, enables and encourages companies to deliver more nature-based solutions by 2025 and we will challenge companies to consider nature based solutions where they fail to so do. We are pleased to see catchment management becoming a mainstream activity but still think there is huge scope for wider and more efficient use of nature-based solutions.

Our strong focus on the environment continues beyond this price review. In our emerging strategy, we consider how regulators and the Government can work together to ensure our ecosystems and natural resources are managed sustainably and our shared ambitions and responsibilities for stewardship are met.

Leakage challenge

We challenged companies to reduce leakage by at least 15%. We asked them to do this without putting extra costs on customers. Where companies perform much worse than average on leakage, we are stepping in to set them tougher performance commitments so that they will catch up with the rest of the sector. This means that we expect leakage to fall by 17% between 2020 and 2025. This will save water equivalent to the needs of everyone in Manchester, Leeds, Leicester and Cardiff.

Encouraging customers to use less water

Water companies are committing to help customers use up to 13% less water per person by 2025. We are stepping in to require eight companies to adopt more stretching targets for 2020-25. Alongside improving information about water usage and running educational campaigns, companies will install two million new smart water meters. Smart meters help customers understand the amount of water they use and the impact of any changes they make. They can also help find leaks in customers' pipes.

Keeping water in the environment

Our draft determinations mean companies will invest in installing meters and fixing leaks, as well as encouraging customers to use less water. This means the amount of water that companies need to put into their networks will fall by at least 630 million litres a day, meaning that more water can stay in the environment.

English water companies are also committing to reduce the amount of water they take from environmentally sensitive sites during times of low flow. This is needed to help adapt to the impacts of climate change.

1,209
catchment management schemes

Leakage down by
17%

Pollution incidents down by
34%

12,067 km
of river improvements

Water use down to an average
131 litres
per person per day

£4.6 billion
investment in environmental improvements

Nature-based solutions

We have seen a range of innovative nature-based solutions being considered and explored in companies' plans, and we expect to see a far greater shift in future. Catchment management approaches are becoming standard practice and over 1,200 will be delivered between 2020 and 2025.

For example, through a partnership with the Norfolk River Trust, Anglian Water has successfully created a natural treatment plant in the wetlands at Ingoldisthorpe. Millions of litres a day of used but treated water is further filtered and cleaned by the wetland plants before it is returned to the River Ingol. Anglian Water is now exploring the potential for 34 more such schemes between 2020 and 2027 as part of the company's WINEP activity.

Dŵr Cymru is looking to substantially extend its RainScape programme for sustainable urban drainage solutions, covering priority catchments and reducing sewer flooding. In central Llanelli, 20% of the urban drainage area has been diverted away from combined sewers and into natural watercourses using a network of new storm water pipes, storage systems and the innovative use of green infrastructure such as roadside planters, trees, larger basins and swales.

We are challenging other companies to make sure they have fully considered the possibilities of catchment management in choosing how to deliver WINEP enhancements.

Highlights across England and Wales

Hafren Dyfrdwy

2% £

- Pollution incidents down by 39%
- 74% reduction in supply interruptions

South Staffs Water

17% £

- 23% reduction in leakage
- Supply interruptions down 57%

Dŵr Cymru

14% £

- Replacing five times as many lead pipes
- £59 million to improve water quality
- 30% reduction in internal sewer flooding incidents

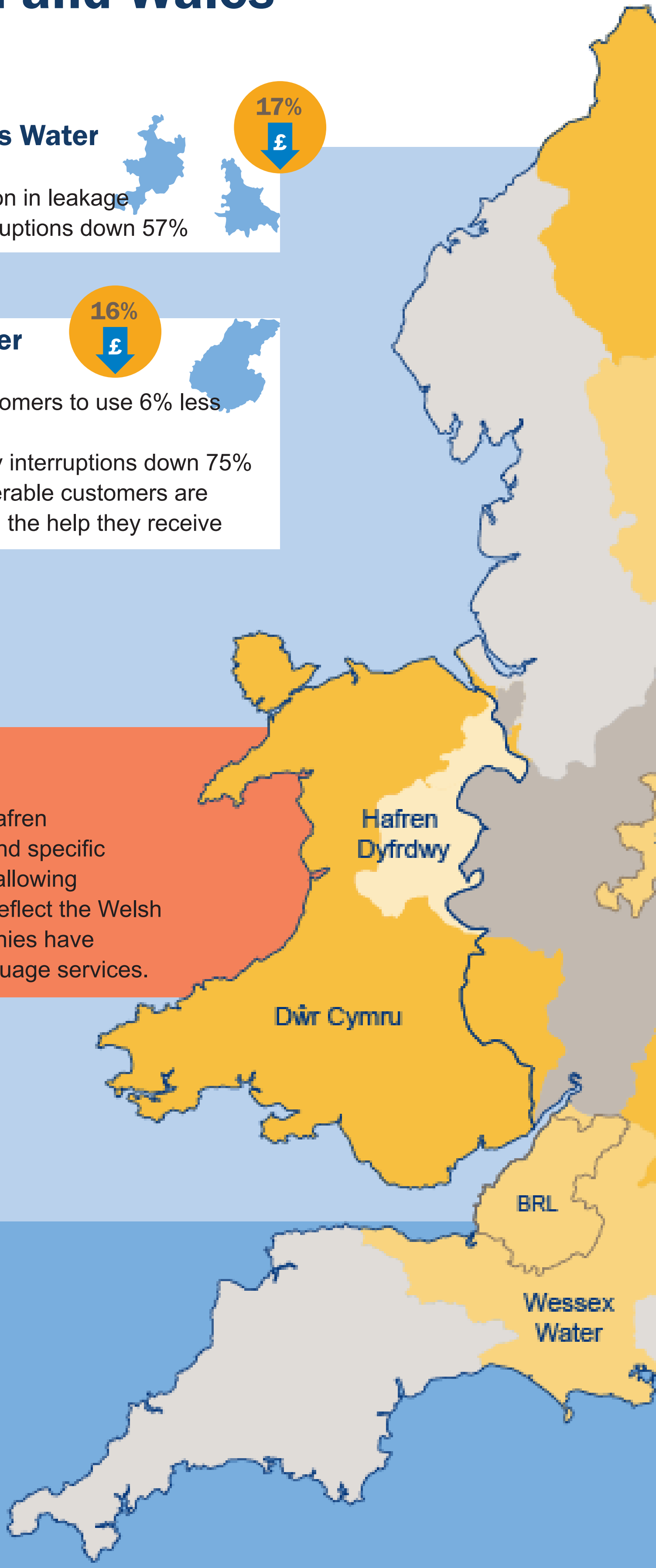
Bristol Water

16% £

- Help for customers to use 6% less water
- Water supply interruptions down 75%
- 85% of vulnerable customers are satisfied with the help they receive

Wales

Our draft determinations for Dŵr Cymru and Hafren Dyfrdwy take into account the Welsh context and specific circumstances in Wales. For example, we are allowing increased funding for removing lead piping to reflect the Welsh Government's priorities, and the Welsh companies have performance commitments on their Welsh language services.



Wessex Water

15% £

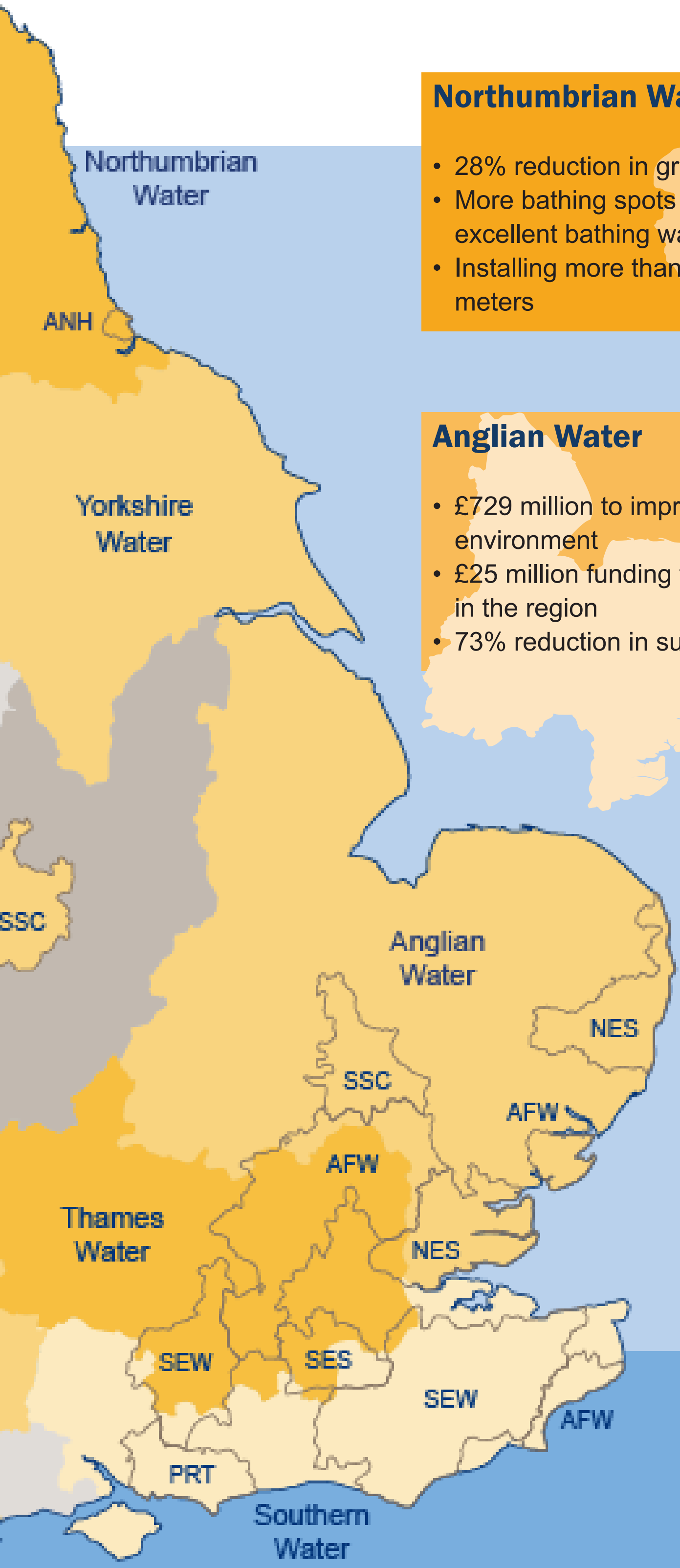
- £463 million investment in improving service, resilience and the environment
- 76% reduction in supply interruptions

Portsmouth Water

12% £

- Funding over 10 years to build a new reservoir at Havant Thicket
- Leakage down by 20%
- 74% reduction in customers with low pressure

The percentage figure shows reduction in bills before inflation between 2020 and 2025



Northumbrian Water

26%

- 28% reduction in greenhouse gases
- More bathing spots with good or excellent bathing water quality
- Installing more than 450,000 smart meters

Yorkshire Water

10%

- 767 km of river improvements
- 50% increase in customers receiving social tariffs and WaterSure
- Pollution incidents down by 41%

Anglian Water

12%

- £729 million to improve the environment
- £25 million funding to help share water in the region
- 73% reduction in supply interruptions

Affinity Water

12%

- Leakage down by 20%
- Water use down 13% – the biggest drop in England and Wales
- Supply interruptions fall by 50%

Thames Water

10%

- Leakage down 25%
- 72% reduction in supply interruptions
- £448 million to improve the environment

SES Water

15%

- Helping customers reduce their water use by 7%
- £1.7 million to replace lead pipes

South East Water

10%

- £67 million to improve the environment
- Helping customers reduce their consumption by 8%
- Supply interruptions down 70%

Southern Water

14%

- Halving water supply interruptions
- £257 million funding to make sure there is enough water where it is needed
- 41% reduction in pollution incidents

Ensuring a fair balance between risk and return

Water companies have to take on a range of risks to deliver services to customers, such as unexpected incidents, or cost overruns. In exchange for this, our draft determinations allow efficient companies to earn a reasonable return.

Our approach to ensuing a fair balance between the risk companies bear and the return they earn, now and in the long term, supports the key themes of this price review: great customer service, long-term resilience in the round, affordable bills, and innovation.

We achieve this by making sure companies' returns are closely aligned to the delivery of efficient services to their customers. Where companies underperform for customers, their returns will be reduced; if they outperform, they will earn additional returns.

Cost of capital

Our allowed cost of capital is intended to provide a reasonable return on investment that reflects the risk inherent in the water sector. Too high an allowance may result in customers overpaying, while too low an allowance may mean efficiently-run companies could struggle to finance themselves. Companies will invest £12 billion to enhance services over the next five years, and will need to access capital markets to finance this investment.

Companies will invest £12 billion to enhance services over the next five years

We are proposing the lowest allowed cost of capital since the privatisation of the water sector. This reflects benign capital market conditions, including falling interest rates and lower returns.

In December 2017 we provided all the companies with an early view of the likely allowed cost of capital, on which to base their business plans. At the time, we placed the figure at 3.40% in CPIH terms. Based on recent market evidence, we now estimate that required returns in 2020-25 will be lower than our early view. Our draft determinations use revised figures of 3.19% (for the whole business) and 3.08% (for wholesale controls).

Current market evidence suggests the cost of capital may be even lower when we update our assessment for our final determinations.

Financeability

Water companies and their investors should bear the risk of capital structure decisions, not customers. So when we assess the financeability of companies' business plans (that is, whether the company can earn enough to finance all its proposed activities), we base our assessments on a standardised, notional capital structure, rather than companies' actual capital structures.

We require companies to show, and provide assurance, that their plans are financeable on both a notional and an actual basis. We are asking companies to update this assurance in their responses to our draft determinations.

Companies can adjust the costs they recover from customers over time to adjust their cash flow. By doing so, they can address any constraints on their financeability relating to the notional capital structure we use in our assessment. We step in to make sure these adjustments are in the customers' best interests, and are not being used to support highly geared capital structures or inefficient costs.

We are intervening in companies' business plans where we have concerns about financeability, to make sure all the companies are financeable on a notional basis. We provide more information about notional and actual financeability in each company's draft determination.

Putting the sector in balance

In 'Putting the sector in balance', we encouraged companies to take greater account of customers' interests – and to transparently demonstrate that they are doing so in the way they finance themselves, pay dividends to their shareholders, and set executive pay. We stated our expectations that:

- companies will share the benefits of high gearing with their customers;
- companies should consider voluntarily sharing the benefits of outperformance with customers; and
- companies will align their policies on dividends and performance-related executive pay with the need to deliver efficient services for their customers.

Gearing outperformance sharing

A highly geared company is one that uses higher than usual levels of debt to finance its activities. In 'Putting the sector in balance', we set out a mechanism for sharing benefits of high gearing with customers. Most companies have committed to apply this mechanism. Several companies which were highly geared have plans to reduce gearing, improving their financial resilience.

For Thames Water and South Staffs Water, we are stepping in to protect customers' interests by imposing our default mechanism.

Performance-related executive pay

We expect water companies' policies on executive pay to align with their responsibilities to deliver services for customers.

All of the slow track and significant scrutiny companies have taken steps to demonstrate their commitment to meet these expectations, including providing evidence that their service delivery targets will be stretching.

However, some companies have not yet fully addressed our expectations about performance-related pay. We expect each company to demonstrate that its policy on performance-related pay is substantially linked to stretching service delivery for customers, and to report transparently on the application of that policy throughout the next five years.

Dividend policy

We expect each company to be transparent about how its dividend policy in 2020-25 takes account of its obligations and commitments to customers.

While companies have taken steps to demonstrate that they intend to meet our expectations, many have more to do in this area. We expect companies to respond to our challenges in their responses to our draft determinations.

Voluntary benefits sharing

We have encouraged companies to propose voluntary schemes for sharing the benefits of financial outperformance with their customers.

Two companies, Wessex Water and Dŵr Cymru, propose to share outperformance payments (earned for delivering above and beyond their commitments to customers) with their customers and local communities.

We summarise each company's proposed scheme in its draft determination.

Next steps

Next steps	Date
Representations on slow-track and significant-scrutiny companies draft determinations from companies and stakeholders	10 am on 30 August 2019
Ofwat publishes final determinations	7 am on 11 December 2019
Companies wishing to appeal their determination to the Competition and Markets Authority must notify Ofwat	11 February 2020
Revised price limits apply	1 April 2020

We intend to publish all the written responses we receive on our website once our final determinations are made.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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