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31 August 2021

Dear Ofwat,

**RE: Regulatory reporting requirements for new appointees in 2021-22**

I am writing to you on behalf of independent Water Networks Limited (“IWNL”), part of the BUUK Infrastructure Group of companies, in response to Ofwat’s July 2021 publication “Consultation on regulatory reporting requirements for new appointees in 2021-22”. In addition to the overarching comments in this letter, we have responded to Ofwat’s specific consultation questions in Appendix 1. I can confirm that this response is not confidential.

[REDACTED] proposals regarding reporting requirements for NAVs in line with the proposed timeline of plans to align NAV reporting with that of the industry. In addition, Ofwat’s proposals for NAV reporting are not as onerous as the current arrangements and welcome the adoption of a site-by-site approach to reporting, reflecting the respective level of risk that each operator poses to the market and ultimately to end customers. However, we note that it will be imperative for Ofwat to clarify that the small company threshold will be removed from 1<sup>st</sup> April 2022.

We also think that it will be important for Ofwat to carefully consider the way that NAV reporting requirements evolve into the future to ensure that these do not unduly disadvantage NAVs or impede effective growth of the market. In this respect, we think there would be merit in Ofwat giving further thought to the following issues.

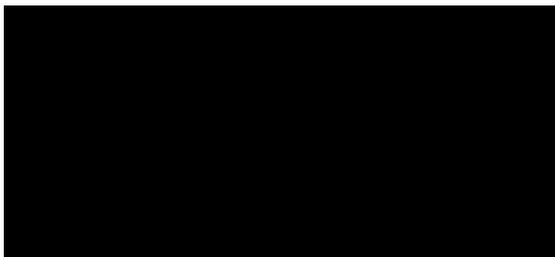
- **The requirement for NAVs to report performance on a site-by-site basis:** This approach subjects NAVs to a relatively more onerous administrative burden, which will only increase as NAV portfolios get larger. In effect, it also places NAV performance at individual sites under a microscope, by highlighting performance issues that would be

obscured if reporting were completed using a more aggregated approach. We consider this to be disproportionate when compared to the level of reporting required by incumbents and makes comparability of the data by third parties difficult.

- **The requirement to maintain a year's annual operating costs to supply projected connections in two years' time:** We understand the rationale for this requirement given its role in mitigating risks associated with potential failures in the NAV market. However, we think there would be merit in Ofwat reviewing the requirement given that NAV market risks will reduce over time as companies become more established. Retaining this relatively onerous monetary requirement could also act as a barrier to future growth.
- **Increases in annual reporting obligations:** We welcome the additional transparency that consistent reporting will provide in terms of understanding performance across NAVs and incumbent companies. However, the proposals will require a material increase in NAV reporting and we urge Ofwat to only mandate the submission of additional data where this will have material benefits. Ofwat should also carefully consider any future proposed increases in NAV reporting requirements and must be confident that the benefits of this will outweigh the costs.
- **Availability of data for reporting of 2021/22 performance:** Ofwat are proposing to implement the changes for the annual reporting cycle for 2021/22, the current regulatory year. Our proposal was that these additional data items be reported from the start of the new regulatory year, 2022/23. Following our internal review as part of this consultation response we believe that in this case all of the required additional information is available to IWNL. However, we require Ofwat's assurance that they would act proportionally if, when completing the return, IWNL discovered that some of these data items aren't available in the correct format for the current year.

I hope that these comments are helpful. Please do not hesitate to contact me if you have any questions about our response or would like to discuss these issues in more detail.

Yours Sincerely,



**Regulation Director (Heat, Fibre and Water)**

## **Appendix 1: Responses to specific consultation questions**

### **Q1: Do you have any comments on our proposed documentation approach?**

Ofwat's proposed approach aligns revised requirements for NAV regulatory reporting with existing arrangements established for incumbent water and wastewater companies; which we think is a sensible and pragmatic approach. Not only will this secure consistency in the way data is reported across the industry but, recognising the potential for significant NAV growth, it will also help to future-proof the regime.

We note that, in general, Ofwat's proposed regulatory reporting approach reflects the proportionate size of NAV companies and the potential impact they could have on the overall market as compared with their incumbent counterparts. In this respect, the proposals do not require the same level of detail to be provided by NAVs in their reporting. We welcome the recognition this gives to the relative market risk posed by the respective entities and the associated administrative burden they should be required to accept.

### **Q2: Do you have any comments on the issues raised in our May / June 2021 consultations on the main RAGs?**

Recognising that Ofwat does not consider there to be substantive overlaps between this consultation and its May / June 2021 consultations on the main RAGs, we do not have any specific comments to make in response to this question.

### **Q3: Do you agree with our proposals for which parts of the existing RAGs should apply to NAVs, our proposed adjustments and the drafting in Annex A1?**

In general, we are supportive of the proposals that Ofwat presents in the consultation regarding the application of existing RAG provisions to NAVs. Attaining consistency in the regulatory reporting approach for incumbent water and wastewater companies as well as for NAVs is important; and this principle guides our proposals put forward.

[REDACTED] We have some more specific observations about the key elements of the individual RAG documents and these are included in the following.

- **RAG 1:** In line with existing reporting arrangements, RAG 1 requirements are already applicable to NAVs and these will continue to have effect under Ofwat's proposed approach. Recognising the currently applicability of these provisions, we have incorporated the relevant provisions into our current regulatory reporting approach. However, we note the requirements under IFRS 15 which state that water companies should adopt assets for zero payment but, the differing regulatory arrangements in place for NAVs means that, this is not the case for IWNL.
- **RAG 2:** The provisions contained within RAG 2 are not currently included in IWNL reporting, but we could extend our reporting to comply with these requirements for 2021-22. This would specifically involve an assessment of the allocation of costs

between (a) retail HH and NHH and (b) wholesale water and waste as well as any other cost allocations that may be required.

- **RAG 3:** The provisions contained within RAG 3 are not currently included in IWNL reporting, but we could extend our reporting to comply with these requirements for 2021-22. This would specifically require us to provide (a) a board statement on the accuracy and completeness of data and information, (b) information on transactions with associates and (c) an accounting methodology statement.
- **Annex A1:** The provisions contained within Annex A1 are not currently included in IWNL reporting, but we could extend our reporting to comply with these requirements for 2021-22. This would include an extension of our reporting to cover financial security and a potential extension of the analysis we complete to inform our company-based assessment in order to fully explain any variances between the expanded F1 table and the company-based assessment.

**Q4: Do you agree with our proposed approach for NAVs to produce an accounting policy and methodology note and the draft text in Annex A2?**

Given the existing requirement on incumbent water and wastewater companies to produce an accounting policy and methodology note, we agree that it is appropriate for a similar requirement to be placed on NAVs. We welcome the pragmatic approach that Ofwat is proposing, whereby NAVs would be required to specify how costs are allocated appropriately between retail / wholesale services and appointed / non-appointed activities; without providing the same level of detail as incumbents. We think that this strikes the right balance in terms of securing a consistent industry approach while recognising the respective size of individual players and proposing requirements that are proportionate to the potential impact NAVs could have on the overall market.

While we do not currently report on this, we could extend our reporting to comply with these requirements for 2021-22. This would require the inclusion of explanatory notes on [REDACTED] 2, as well as commentary on any changes to our [REDACTED] developing the accounting policy and methodology [REDACTED] specified in RAG 2. As outlined above, in our [REDACTED] allocate costs between (a) retail HH and [REDACTED] (as well as any other cost allocations that may [REDACTED] details on the allocation methods that we used.

**Q5: Do you agree with our proposed approach for allocating regulatory costs?**

Ofwat's proposals around allocating regulatory costs appear to be prudent. The approach is based on similar principles used to derive allocations for incumbent water and wastewater companies and reflects the differences in the scope of the value chain for which the respective players have responsibility. While in principle we do not oppose the proposed cost allocation of 1/3 to retail, 1/3 to wholesale water and 1/3 to wholesale wastewater services, we think there would be merit in recognising that in practice the split of costs would comprise four elements: retail water, wholesale water, retail wastewater and wholesale wastewater. Acknowledging this split would also allow us to reflect the

difference in respective end customer numbers that we have across water and wastewater; for both the wholesale and retail cost elements.

While we do not currently report on this, we could extend our reporting to comply with these requirements for 2021-22. To allow us to report accurately and in line with Ofwat expectations, we would welcome clarification from Ofwat on their definition of 'regulatory costs' and what this specifically includes.

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**Q6: Do you have any comments on the format / draft line definitions of the financial reporting tables for NAVs?**

Ofwat's proposed approach is to replace current reporting requirements contained in table S1 with an expanded set of items contained in tables F1–F5. Although we do not currently report in all of these areas, we could extend our reporting to comply with these requirements for 2021-22. We also note that the definitions specified for tables F1–F5 appear to be sensible and appropriate.

**Q7: Do you have any comments on the format / draft line definitions of the NAV performance reporting tables?**

We note that a number of the proposed elements of the NAV performance reporting tables are aligned to the equivalent reporting requirements that Ofwat specified for NAVs in the 2020-21 regulatory reporting year. In this respect, under the current proposals, NAVs will still be required to submit regulatory reporting data in the following areas.

- **A customer-focused performance study:** We welcome retention of this element given its alignment to the overarching IWNL ethos of seeking to secure the delivery of outcomes that effectively meet the needs of our customers. As outlined in our 2020-21 submission, we intend to increase our activity in this area in coming years.

**Requirement of sufficient financial security:** We understand the requirement and note the role that it plays in helping to mitigate potential failures in the NAV market. However, we are reviewing the specifics of the requirement given that it may evolve over time as companies become more established and the requirement could act as a barrier to growth in the future.

**Expectations around future profitability and predicted growth:** We recognise the links between this and the maintenance of financial security and note the insights that this information could also provide with respect to the growth of the NAV market.

In addition to the specific benefits of reporting information in the areas outlined above, we note that requiring companies to report on consistent information between years will allow the evolution of the NAV market to be monitored and progress to be observed. This comparative analysis will also enable Ofwat, and the industry more generally, to identify areas where additional research, review and / or policy focus may be needed.

We agree that there is a need for NAVs to consider how best to report against tables P1 to P4 to realise the full value of the process. Recognising that this market is in a period of

substantial growth and evolution, with increasing performance reporting requirements being placed on market participants, we think there may be benefit in an Ofwat review of NAV / incumbent documentation and subsequent publication of a best practice report. This would help guide NAVs on the best way to report performance from the outset.

A review of Annex 3 suggests that there will be a material increase in the information that NAVs are required to report on for 2021-22 as compared with 2020-21 including:

- disaggregated water / wastewater data and void properties (P1: Columns 6 to 20);
- metering data (P1: Columns 21 and 22).
- length of mains / sewers (P1: Columns 27 and 28).
- data on social / watersure tariffs and reduced charges (P2: Columns 7 to 9).
- data regarding properties on the priority service register (P2: Column 10).
- disaggregation of per capita consumption (PCC) data (P3: Columns 5 to 11)
- interruptions data (P3: Columns 12 to 14)
- mains repair data (P3: Column 15)
- compliance risk index (CRI) data (P3: Column 16)
- internal / external sewer flooding and sewer collapses (P4: Columns 4 to 6); and
- pollution incidents and treatment works compliance data (P4: Columns 7 and 8)

We note that IWNL provided much of this data within our 2020-21 annual report and we welcome the additional transparency that consistent reporting on these elements across the industry will provide. However, we would also note that these proposals represent a significant increase in reporting requirements and would urge Ofwat to ensure that it only requires the submission of additional data where this will have material benefits; either in terms of better understanding the industry or informing future policy decisions. In a similar vein, it will be important that Ofwat carefully considers any future proposed increases in NAV reporting requirements and has confidence that the benefits of this reporting will outweigh the costs, in terms of additional administrative burden, that NAVs will face.

#### **approach to unique identifiers?**

ers will facilitate consistency of reporting over time  
ed from this reporting are accurately inferred.  
with requirement for NAVs to report performance on  
a site by site basis. Not only does this represent a disproportionate administrative burden for NAVs but it also effectively places our performance at each individual site under a microscope; magnifying the impact of individual events on overall NAV performance.

A more proportionate approach that would allow NAVs to be assessed on an equivalent footing to incumbents, would be to either require reporting at a national level (aligned to respective incumbent requirements) or at a regional level (providing greater transparency on in-area performance). While the latter option would still require NAVs to report to a greater degree of granularity than their incumbent counterparts, it would help to ensure that local operating conditions were considered in any subsequent analysis completed.

**Q9: Should we introduce further granularity in reporting against the GSS in the performance reporting tables?**

We welcome Ofwat's proposed approach to the reporting of GSS payments. While the existing format provides transparency on the payments made to customers over the course of a reporting year, we think that an overview of GSS payments within the associated customer narrative would help to put the figures into context and provide a fuller picture of NAV performance. In addition, where NAVs have greater discretion to determine which indicators they report on, this will provide the flexibility to allow them to flag the key figures / trends that are of most relevance to the regulator.

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