



Speech

Given by Aileen Armstrong
PR24 common reference scenarios workshop
Friday 1 October 2021

PR24 and beyond: Long-term delivery strategies and common reference scenarios

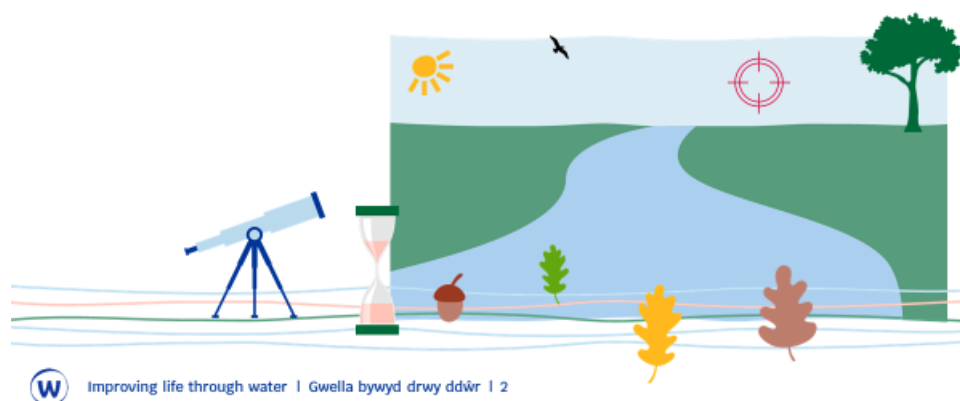
Good morning everyone, and thank you for coming along this morning.

As many of you will be aware, we set out in May that PR24 must support a greater focus on the long term. The challenges we face, whether it's achieving net zero, improving our environment or addressing affordability challenges, mean we need to look ahead to 2050 and work backwards from there. The focus needs to be on the long-term trajectory, and we need to use 5-year price reviews as staging posts along that path.

Focusing PR24 on the long term

The challenges we face require a long-term focus

- At PR24, we need to look ahead to 2050 and work backwards from there
- Long-term delivery strategies can provide a framework to do this
- We want to co-create our approach with the sector



When we consulted in May on our initial ideas for PR24, one of the ideas we set out was that companies need to pull together long-term delivery strategies. These strategies would set out

the long-term outcomes that companies are aiming to deliver and how they expect to achieve them: bringing together all the strategic planning frameworks and company plans for other areas into a coherent whole. And companies should then design their five-year business plans in the context of their long-term delivery strategies.

I was pleased to see that all companies and a number of wider stakeholders backed these proposals. They recognised that they could be a good way to focus attention on how we achieve long-term outcomes. But I also know that companies are keen to see further details as to how these will work in practice, so they can get on with developing their strategies with their customers and stakeholders.

We are keen, as far as possible, to co-create this next step in the process. Our thinking on this is very much developing. It's important that we are on the same page and that we're all invested in making these long-term strategies work. We don't want them to just be a regulatory exercise – our expectation is that a requirement to produce these strategies will help companies to focus on the long term.

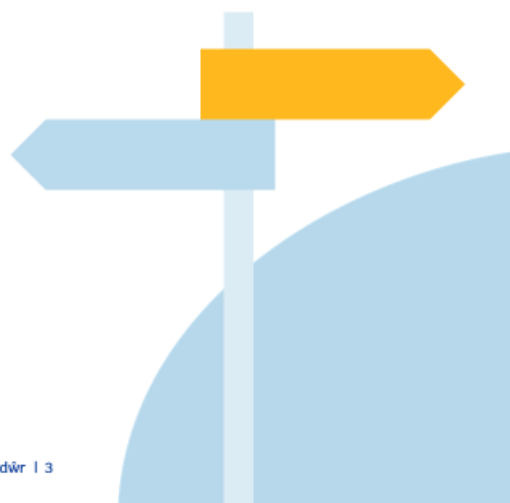
We will be publishing a consultation paper this November, setting out our expectations for long-term delivery strategies and the approach to scenario planning to support these strategies.

So let me set out what we are trying to achieve today, and going forward.

Planning for the future

The future is uncertain, so we need to plan ahead intelligently

- We need to assess what the right investments are to meet long term outcomes
- This requires us to consider uncertainties over the next 25 years
- Scenario planning helps us to judge the best-value interventions



We all know that meeting long-term targets and challenges will require a concerted effort. Ultimately, it will involve investment, but it also needs a change in mindset across the sector – including Ofwat.

But we also know that – looking out over the next thirty years – a number of factors are unclear. And that uncertainty means that it's difficult to say know what investments or interventions are the right ones to make. Obviously, many investments in the water sector are in assets that last a long time. So it's vitally important to try and reduce the risk of either underinvestment or stranded assets.

So, thinking through an example – the journey to net zero probably means we will need to see an increase in nature-based solutions instead of traditional infrastructure, along with a greater emphasis on demand-side and collaborative interventions. But it is also the case that low-emission building technologies are likely to improve over time, bringing down both the financial and carbon costs of potential solutions. So it would be prudent to think about what technological developments might lie ahead before we plan out how we best tackle the issue. And the impacts of climate change are unclear – partly because we don't know exactly what the effects on the sector and society will be, and partly because the severity of these effects depends on the preventative action taken at a global level.

Over the next 25 years and beyond, projections for demand and growth are no more than educated guesses – when we get there, it's entirely possible that the future will look very different to the one we had anticipated.

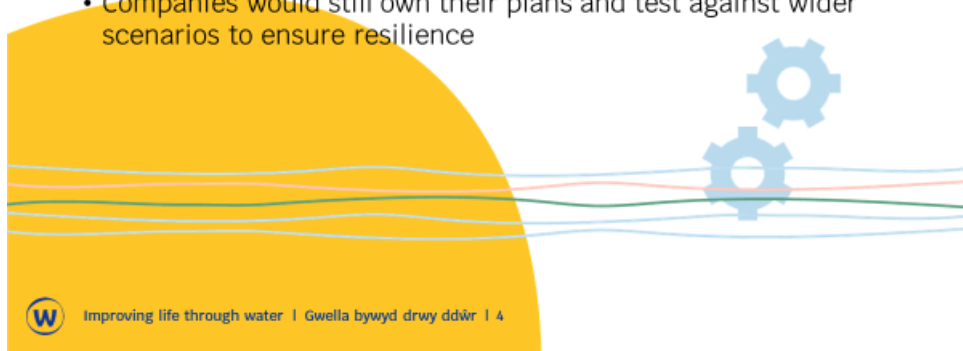
Using scenario planning can help us to judge what the best value investments are likely to be, on the balance of risks, given what we know and what we don't know.

In particular, we consider there is value in setting out a small number of common reference scenarios, that all companies will use to present their long-term delivery strategies, and therefore their five-year business plans.

Using common reference scenarios

Common scenarios can inform the conversations we need to have

- Their main purpose would be to help test how far proposed investments enable the adaptive plan
- They would help us decide whether to go forward with investments now, or buy time to decide later
- Companies would still own their plans and test against wider scenarios to ensure resilience



The aim of these common scenarios is to create a platform for an informed conversation about how likely it is that the long-term strategy is the right one, and – in turn – to what extent the proposed business plan investments are the right ones to start off that trajectory. It's in all of our interests for the PR24 process to get a handle on this – we mustn't simply focus on what fixes are needed in the short term.

We will expect companies to explain clearly how and why their long-term strategies are appropriate in a range of future scenarios. And that means that strategies need to be adaptive, allowing investment plans to adjust to new information and experience over time, and marking out the points at which new or alternative solutions would need to be adopted.

We will expect the enhancement investments allowed at PR24 to enable the adaptive plan. And there are a number of options for how we do so.

In some cases, if long-term outcomes are to be reached, investments or activities will clearly be needed as soon as possible. In others, it may be better to wait a while until the right time to decide – and to do what it takes to keep options open until that point.

Alternatively, we might open up new options through pilots, exploratory or investigatory activities, or allow partial solutions where necessary. The context provided by the long-term strategies will allow us to have the nuanced conversation that we need to have.

I also want to be clear about what we expect these scenarios to do. The common reference scenarios that we set will serve a different purpose to the large-scale scenario modelling that

companies undertake within the existing strategic planning frameworks, or within their own options development processes. The common reference scenarios are intended to provide a clearer way of checking that the proposed investments are the right ones at the right times to meet long-term outcomes.

They wouldn't replace any requirement to test against wider scenarios, such as localised or company-specific factors that wouldn't be captured in common requirements. Companies would still have ownership of their plans and would still be expected to provide assurance as to their resilience.

I expect PR24 to represent a huge step towards a future of long-term adaptive planning. In its draft strategic policy statement, Defra calls on water companies to enable best-value solutions by moving towards adaptive planning. This shift aligns with the ongoing work to develop the first round of DWMPs, the first regional water resource plans, and a more long-term, outcomes-focused approach to the WINEP – not to mention the important work going on in RAPID to enable long-term solutions.

Moving in the same direction

The water sector is shifting to a world of long-term planning

- Strategic planning frameworks are embracing adaptive planning
- Ongoing work to reform the WINEP and in RAPID to enable long-term solutions
- We now want to work constructively to continue that progress through the price review



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I'm also encouraged by the collaborative effort that has gone into the sector's Vision for 2050.

It feels like we are moving in the same direction. I hope we can work constructively to continue that progress.