



Speech

Given by David Black, Chief Executive
Ofwat's Annual Non-Executive Director conference
Monday 11 April 2022

Challenges, opportunities, and customers

Good morning all and thank you for joining us for this year's non-executive director event. I hope you've all had a chance to say hello to the many faces in this room during lunch – but if you haven't, we will be having a break in between sessions for you to catch anyone you may have missed.

It has been two years since we've been able to see each other in person. For some it'll be our first-time meeting, so welcome. This is an important event for Ofwat – as non-executive directors of water companies you play an important role in the sector and the decisions that you make as part of company boards will shape companies' futures and the experience of customers in the years ahead. So, it is really important that we have the opportunity to speak directly to you and for Ofwat to hear and understand your views.

I want to open today by talking about challenges, opportunities, and customers.

I will look at the challenges that the sector has recently addressed, three challenges facing the sector right now, and look ahead at challenges to come, as well as some opportunities and what these might mean for companies' futures and the way we regulate. And I would like to talk about these through the lens of the customer.

Water companies exist to serve customers as they also pay the bills, so it is right that we look at everything we do through the eyes of customers. And we know that customers are interested in much more than just the price they pay. They need to be able to trust that companies are doing the right thing – both for customers now and in the long term. This includes adapting to the impact of climate change and the transition to net zero and that companies are responsible stewards of their environment. Customers also need to be confident that companies are earning a fair return and are financed for the long term with structures appropriate for monopoly providers.

Firstly - the challenges we've gone through

We've experienced an incredible amount of change in a brief period, and as that video has shown us, companies have lots of to be proud of over the past two years.

This was particularly noticeable as we navigated a period where many worried for the security of their families and their homes due to the pandemic. The need for reliable water supplies for hand washing and hygiene was evident, along with the desire to use water for recreational purposes, whether in their own backyard or in their local areas when travel was no longer an option. Water companies can be commended for maintaining water supplies throughout the pandemic, despite the impact of Covid on employees and the supply chain.

Three challenges we are facing now

But we now have new challenges facing customers and the sector.

The state of rivers

The state of our rivers has become a high-profile issue over the last 12 months, with widespread shock and anger from the public on the discharge of untreated sewage into our waterways. I think the intense debate is driven by at least two factors: a growing appreciation of nature and the importance of the local environment, contributed to by the experience of the pandemic. Secondly, the power of open data – the monitoring and publishing of data on the use of overflows was initiated in 2013 and has become available at scale in recent years.

I think this is the sign of changes to come – as more data is gathered on company activities and the state of the environment, we can expect to see much greater debate about water companies' environmental and social impacts. It has also been encouraging to see members of the public take a proactive role in this. Citizen science has begun to play a vital part in collecting and monitoring data. We will hear later in the session from Professor Chris Whitty on the public health impacts of sewage discharges.

This debate underlines the need for companies to own their impacts on the environment and take responsibility for mitigating them. The environmental regulators play an important role in setting standards, but water companies operating in the public interest ought to both know their impact and to mitigate the adverse impacts. There is more work to do to understand complex impacts on the environment and public health. And mitigation may be expensive and require prioritisation over time and place. But companies that wait to be told what to do may well find themselves on the wrong side of the debate and playing catch up.

I've also been pleased to see several companies including Anglian Water, United Utilities and Severn Trent, have already responded to my request for action, publishing tangible plans to help our water ways recover and to take immediate action. I look forward to seeing substantive action from the rest of the sector, with plans due to be published by the end of the month.

We also welcome the Environment Act 2021 and the Government's consultation on their draft storm overflows plan, which sets out ambitious long-term targets to reduce harm from sewage spills, which will help shape ambitions at PR24 and future price reviews.

Cost of living

Customers are facing a cost-of-living crisis. The Office for Budget Responsibility (OBR) forecasts real household disposable incomes per person would fall by 2.2% in 2022-23 as earnings from work fail to keep pace with soaring inflation. This fall would be the biggest in a single financial year since modern records began in 1956-57, and that it would take until 2024-25 for inflation-adjusted living standards to return to their pre-pandemic level. In the water sector, we could potentially see a devastating increase in the number of customers struggling to pay water bills increase from around 3 million to 9 million.

Companies will also be impacted. Rises in inflation will mean higher costs, on the other hand, companies will receive higher revenues and a rising RCV from indexation to inflation. Currently, around half of the RCV in the industry is still linked to RPI, which could hit double digits later this year.

In that context, it's even more important that we are mindful that expectations around company behaviour are met. We cannot see a situation where customers are struggling but shareholders are reaping unfair rewards. So, what's fair?

We have already stressed the importance of linking dividends and executive remuneration to operational performance and encouraged more transparency on these issues. It is vital that boards make responsible decisions on dividends and executive pay and we will be looking closely to see how companies deliver on their PR19 commitments on dividends and exec pay and on their licence obligations.

Companies will also need to consider their support for customers struggling to pay their bill and whether their proposals developed in PR19 need to be extended given the cost-of-living shocks facing customers.

Getting the basics rights

We have just published joint research with CCW which shows that while the majority of customers are satisfied with their service, customer trust in water companies is low. And while it is positive that most customers are satisfied with service, there are areas for significant improvement.

We have also recently conducted research with CCW into customer experience with sewer flooding, which will be published in mid-May. Both Jonson and I sat in on a customer focus group with several customers who had experienced sewer flooding. The companies' response to sewer flooding was a story of basic failure of customer service. In far too many cases, customers were not treated with respect or even believed. The responses were poorly coordinated, slow, or just didn't happen. As the regulator of the sector, I felt appalled that service was so poor. While the sector has made good progress in reducing incidents of sewer flooding – falling by over 20% between 2015-20, the research shows that there is much to do in effectively responding to customers who experience this distressing issue.

CCW report nearly 100,000 customer complaints per year – and complaints have been rising for the last three years. If companies do not get the basics right, they are not going to be trusted to deliver against wider challenges.

Addressing the state of rivers, the cost-of-living crisis and getting the basics of customer service right will define how water companies are seen by customers, but companies also need to address future challenges.

The challenges that are still to come

If the experience of the last two years has taught us anything, it is that the future is uncertain. That said, I now want to focus on the challenges ahead.

These include:

- Improving resilience of water supplies and reducing over-abstraction including from chalk streams by developing major new infrastructure over the next decade alongside the delivery of ambitious demand and leakage reductions.
- Meeting the challenge of continuing to reduce and eliminate the adverse impact of companies on the environment and taking steps to enhance nature.
- Transition to net zero.

Addressing these challenges will mean that the water company of the future will look very different from today with:

- Smart networks/systems and open data – the digital revolution enables companies to optimise performance of the sector's assets to get much greater value from existing infrastructure.
- Green infrastructure – such as SuDS and nature-based solutions provide low carbon options to improve the environment and help prevent issues at source.
- Long term and adaptive approaches – the sector has a range of long-term plans but needs to ensure that decision making across their whole businesses including operation, maintenance, and investment decisions are made on a long-term basis. We will hear more later on the importance of a long-term approach for PR24.
- Effective collaboration and partnerships – meeting the water resource challenge will require regional and national decision making on transfers and new sources of supply.
- Development and use of markets – markets are emerging for ecological services such as carbon credits, biodiversity, phosphate, and ammonia reductions. Companies have opportunities both to develop markets and offer valuable ecological services as well using markets to procure environmental improvements such as nature-based solutions.
- Influencing customer behaviour - we need to see mass scale consumer behavioural shift to reduce water use from around 150l per day now to 110 l per day by 2050. 30 years ago, few recycled – but now it is second nature to all of us. Demand reduction requires companies to effectively influence customer behaviour, which is likely to be challenging while trust remains low.

Meeting the challenges of the future is also going to require companies to be financed on a sound long term basis, with structures that are able to finance new investment and with level of resilience to meet operational performance risks in a regulatory regime with strong and increasing levels of return linked to good operational performance. It's no secret to say that we and the rating agencies remain very concerned that some companies do not have adequate level of financial resilience – and are kicking the can down the road rather than facing up to the issue.

There is no good reason for regulated water monopolies to have a credit rating at the bottom end of investment grade ratings. We set out options to address the issue in a discussion paper last autumn and will consult on our proposed way forward this summer. Our concern remains that customers' interests are protected and not adversely impacted by the finances of companies.

So, what about Ofwat?

If the future challenges require changes in the ways that companies operate, what does this mean for Ofwat? Our regulatory framework needs to support, enable, and challenge companies to change. We have already made changes including:

- Moving to an outcomes and totex based approach - to allow companies much greater freedom to innovate to adopt nature-based solutions and take a whole life cost approach to decision making.
- The innovation fund – we've already awarded £43m to 33 projects which will improve the sector's capacity to innovate.
- RAPID – this partnership was built to ensure effective collaboration between ourselves, the Environment Agency, and Drinking Water Inspectorate to promote the development of major new water resources.
- A new approach to competitive procurement of large infrastructure projects – this was developed to open new sources of finance and providers to deliver new infrastructure.
- The Green recovery programme – it has enabled £2.8bn of new investment to improve the environment and to test at scale the development of SUDs at city scale, bathing rivers and low carbon water supplies.

Looking ahead, we have consulted on a range of proposals for PR24 and I look forward to discussion later in this session and hearing your views.

One final thought. As board members of water companies, you will be influencing, supporting, and challenging decision making that will shape and decide how companies meet these future challenges. It's vital that these decisions are driven by the customer and wider public interest and that they are made for the long term.

I am confident that the sector can rise to the challenges it faces and doing so will require strong board leadership. So, I am very grateful that you have made time to attend today and I am confident that today's discussion can build understanding and promote the actions needed to meet the challenges I have laid out.

We have a brilliant agenda set out for you all, hearing first from Professor Chris Whitty on the environment, river quality and public health, followed by a Q&A.

Then after a break, Aileen Armstrong who is our Senior Director of Company Performance and Price Reviews, will lead an interactive session on the 2024 price review.

To close today's agenda, we will hear from our Chair, Jonson Cox on reflections from his time as chair of Ofwat.