

Senedd Climate Change, Environment and Infrastructure Committee – evidence from Ofwat

Who we are and how we regulate.

Ofwat is a non-ministerial government department. We regulate water and wastewater companies in Wales and England. In Wales our regulation principally applies to Dŵr Cymru Welsh Water and Hafren Dyfrdwy. Our work ensures that monopoly water companies deliver high quality, affordable, resilient, and environmentally sustainable services to their customers.

Through setting clear and stretching objectives, we incentivise companies to provide the very best service for customers, protect and enhance the environment, and make the investments needed for the future. We have the power to take enforcement action, including imposing financial penalties, where companies fail to meet certain statutory and licence obligations. We use all our regulatory tools to align the interests of customers, management, and owners, and to encourage companies to build strong relationships with their customers and other stakeholders.

Through its strategic priorities and objectives statement for Ofwat, Welsh Government expects Ofwat to develop and implement a regulatory framework that is applicable to Wales, relevant in a Welsh context and that accounts for the specific circumstances of Wales. Our ability and commitment to operating effectively in this context is reflected by the steps we've taken over recent years to strengthen our presence in Wales, including establishing a Director Wales role to lead the regulatory process in Wales. We take account, where appropriate, of current and future differences in both policy and law between the Welsh and UK governments including where new obligations on water companies in Wales emerge. For example, we regulate for a different approach to competition in Wales than in England. Our approach in Wales takes account of goals and ways of working set out in the Well-being of Future Generations (Wales) Act 2015.

How we monitor performance

Every year we scrutinise the performance of water and wastewater companies using data we require companies to publish in annual performance reports (APRs). These reports show company performance against a set of key performance commitments and expenditure metrics. The APR informs two annual pieces of work: the Water Company Performance Report (WCPR) and the assessment of companies on Performance Commitments, known as 'in-period determinations'.

The WCPR categorises companies' performance as 'leading' 'average' or 'lagging behind', against a set of common metrics including pollution incidents, customer service and leakage. This year, no company has been shown to be in the top 'leading' category, compared with three last year. Seven companies are categorised as 'lagging behind', including Dŵr Cymru.

Most of the companies' performance commitments have associated rewards and consequences known as 'outcome delivery incentives' (ODIs). The majority of these ODIs are financial.

- If a company performs better than the performance commitment level, it may get a financial reward (known as an 'outperformance payment')
- If a company performs below the performance commitment level, it may pay a financial penalty (known as an 'underperformance payment')

In 2022 & 2023, under-performance by the majority of water and wastewater companies in England and Wales, will mean that in aggregate companies will have their revenue allowance reduced by £114m and reflected in customers' bills from April 2024, with £24.6M relating to customers in Wales.

We published our draft in-period ODI determinations for consultation on 26 September 2023. Our final determination will be published in November 2023.

We also monitor the financial resilience of companies. This year's Monitoring Financial Resilience (MFR) report covers the year ending 31 March 2023, prior to new licence conditions being introduced regarding credit ratings and dividend payments. New powers were introduced in May 2023 that will see Ofwat able to take enforcement action if the payment of dividends doesn't take account of water company performance or financial resilience over the long term.

This year's report shows that the water sector has attracted £4.6bn in additional money from shareholders since 2020, helping to improve the financial resilience of water companies and help fund increased investment for the 2024 price review.

It is only the second year we have used categorisation (Standard, Elevated Concern and Action Required) in the MFR. This year, eight companies were categorised as standard, four marked as elevated concern and four companies as requiring action. We categorised both DC and HDD as 'standard', which means no specific concerns with the financial resilience of the company that we are aware of at this time and no specific company action expected to be required at this time.

PR24

Water and wastewater companies submitted their business plans for the price review period 2025–2030 (PR24) on the second of October 2023. The need for substantial improvement in the sector is clear, and PR24 will drive water companies to step up and deliver improvements for customers and the environment.

The key elements of the PR24 framework include:

- New common environmental performance commitments for companies including on the use of storm overflows, improving biodiversity, improving bathing water quality and reducing greenhouse gas emissions.
- Steps to drive companies to deliver excellent customer service, and to maintain and improve the health of their assets, so that customers have consistently good service, every day.
- Clear expectations for companies to address the long-term challenge of ensuring we have sufficient water resources, including through steps to reduce leakage and water consumption and increase water supply, with a new fund of up to £100 million to stimulate new approaches to water efficiency.
- Setting clear requirements for companies' dividend and executive pay policies, with the prospect of additional measures on performance-related pay to ensure customers do not pay where expectations are not met.
- Putting the views of customers at the heart of the process, with each company conducting robust customer research and holding two public meetings in 2023
- Incentives for companies to be more efficient and innovative, including through a £300 million Innovation Fund to support further sector-changing ideas.
- Greater use of markets where they can deliver better value for customers by driving down costs while maintaining quality, including in how major investment projects are procured, and in the operation of the markets for developer services and bioresources.

We have established a collaborative approach to PR24 in Wales, which means that the Wales PR24 Forum of key stakeholders has provided views on the high level outcomes and priorities for the water sector in Wales.

We have published key facts from companies' business plans, including information on proposed increases in investment and customer bills [Key facts and data from water company plans - Ofwat](#). Ofwat is currently scrutinising the companies' plans, including looking at their ambition for customers and the environment and the affordability of plans for customers. We have also, with CCW, required all companies to hold public meetings this Autumn, so their plans face local scrutiny.

We have been very clear with companies that companies need to act now to deliver improvements ahead of the next price review taking effect. Ofwat is calling on water companies to use the next 12 months to prove to customers that they can deliver better service and improve the environment. The latest Water Company Performance Report showed that after three years of the 2020-25 period, 13 out of the 17 water and wastewater companies had not spent their forecast enhancement allowance.