Response Form – "Rules on Remuneration and Governance" consultation

Please send your responses to: RemunerationGovernanceRules@ofwat.gov.uk by 19 November 2024

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Sector: SF is a think tank and charity focused on practical solutions to deliver fairer and more sustainable energy and water sectors. We have extensive engagement expertise including in designing and delivering research and also as independent Chairs, Board members and members of consumer engagement groups.

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Rule: Performance related executive pay (PRP) prohibition
Question 1: Do you agree with our proposal in terms of which individuals the Rule would apply to? And what considerations do you think should be taken into account in designing the application of the Rule to different types of performance related pay?
Yes, we think applying this rule to performance related pay for those Director level (executive and non-executive) and above is appropriate. We agree that "Individuals at this senior level hold accountability for the companies' overall responsibility" and are therefore the most relevant for it to be applied to.
Question 2: Do you agree that PRP should be prohibited if a company has been fined by Ofwat for a breach of a principal duty? Are there any alternatives or additions you would suggest for the "consumer matters" standard?
We agree that it's reasonable for an executive director not to receive PRP if their company has failed to meet the principle duties outlined. We would welcome however further clarity on how that would be applied in practice and how that links to performance against ODI targets e.g. those related to reliability of supply.

As a general principle, from a public acceptability perspective, we don't think company directors should receive PRP for any area where they have not met performance targets especially where they have incurred penalties. That said, we appreciate that some companies may be on an improvement journey and a significant step change improvement in performance may warrant reward and PRP may help incentivise improvements. (Though arguably, PRP can still be applied at a 'Head of' operational level where much of the heavy lifting is done). In practice, Ofwat has to get the right balance between carrot and stick, so as to not totally disincentivise what appears to be an already demoralised industry.

We also wonder if there needs to be a little flexibility to allow for very exceptional circumstances that are beyond the company's control e.g. war, terrorist attack – where company leaders may go over and above expectations in extenuating circumstances to deliver their duties.

Easy wins

In terms of easy wins - if Ofwat genuinely wants to deliver culture change and build trust it should require companies to factor in customer satisfaction scores and stakeholder satisfaction scores into PRP staff performance assessments. Companies such as energy network UKPN, who have performed well under UK Customer Satisfaction Index, reportedly made this change with very positive results.

Consumer matters standard

As noted, the 1991 act defines consumer matters as those connected to the interests of the consumer in relation to the supply of water to consumer premises and the provision of sewerage services. We'd also like:

- Clarification this captures environmental and community impacts of water companies e.g. surface water flooding, delivery of road works, impact of infrastructure development; growth/local economies etc. We think these should be within the scope of what matters to consumers.
- Some specific consideration of compliance with requirements to support consumers in vulnerable situations – in particular access, communication and safety needs. This is especially important given our increasingly aging and disabled population, and as the harm caused by non-compliance can be more severe. Also there's evidence to suggest a link between fair treatment of vulnerable customers and trust in companies.

Question 3: Do you agree that PRP in any given year should be prohibited where the company has had a serious pollution incident in the previous calendar year? Are there any alternatives or additions you would suggest for the "environment" standard?

Yes, we agree that PRP should be prohibited where the company has had a serious pollution incident in the previous calendar year. However, we don't think this is sufficient as a metric or 'proxy' for a company's overall environmental performance, or indeed a company's impact on the environment.

Importantly, there's a risk that in setting such a low bar Ofwat would be out of step with public and wider stakeholder expectations in this area – thus undermining the aims of the legislative change and confidence and trust in Ofwat's regulations.

We'd prefer to see the PRP related to demonstrable overall environmental improvement. The Environmental Performance Assessment while it needs improving could be a clearer metric for PRP e.g. 2* and you lose the environmental component of PRP; 3* you get 50%; 4* you get 100%. We would be happy to discuss this further.

Question 5: Do you agree that this Rule standard should cover all criminal convictions? Please explain the reasons for your view.

Yes. We support Ofwat's proposal to require that PRP is prohibited if a company has been convicted of any criminal offence in the relevant financial year to which the PRP relates. As Ofwat notes, between the financial years of 2018-19 and 2022-23, all but two water and waste water companies were prosecuted for a total of 29 environmental criminal offences. On only two of those occasions did a company decide not to award the CEO an annual bonus. This will send a clear message as to what is and isn't acceptable.

However, we worry about unintended consequences of changes to PRP and wider measures. In particular Ofwat will need to be careful that it is not unwittingly encouraging companies to cover up transgressions and breaches rather than once they are identified, to quickly own up, share that information with the regulator, and take action to address them. Ofwat should ensure that there is sufficient incentive in place for companies to self-report breaches as well as explore strengthening whistle blowing arrangements.

Question 6: How can Ofwat best address the risk of the time lag between an incident and conviction?

It can take years for judgments to be made on issues of fault so recovery is a challenge. In theory we'd like to see PRP restricted or 'clawed back' for all years that the breach has been found to have occurred, not just the year of conviction or one nominal year. In practice however we don't know how feasible it is for companies to

hold more than a year's PRP back (so it is paid 12 months after the end of year) nor the legalities involved in clawback.

Question 7: What type of arrangements (e.g. clawback) should companies be required to have to recover PRP payments when a Rule breach occurs?

The consultation document suggests that companies "should undertake best efforts to recover payment of PRP". We don't think this will be strong enough to deliver the outcome required. We encourage Ofwat to explore if the liability could rest more with the company shareholders. E.g. could they be required to donate the equivalent of the PRP to a charity/organisation linked to the breach that has occurred. There would then be a stronger incentive on the company to update the clawback clauses of their employment contracts and recover the monies. This redress funding could also help to address the harm caused (as works in the energy sector with the Energy Savings Trust redress fund)[1].

General comment on PRP

As a general point, Ofwat must be careful not to make the water sector even more risk averse than it is already with companies simply sticking to their duties rather than seeking to push the boundaries of what they do in a good way to improve service and delivery i.e. innovate.

Given that the failure rate of innovation is high (it is not failure but learning) and the water companies are increasingly expected to operate at the edge of technically achievable limits, it is perhaps inevitable that things will sometimes go wrong .

However good companies should always seek to operate in surplus (i.e. do more than expected of them) - to have something in the bank or protections in place when things go wrong. Current mechanisms don't recognise surplus or balance - only deficit.

Rule: Fitness and propriety

Question 9: Do you agree that the types of standards proposed above (under Standards for Consideration) could be suitable for the proposed fit and proper persons test? What other (if any) criteria should be considered?

We support the following:

- Criminal record checks

[1] About us | Energy Redress scheme

- Financial and credit checks – to ensure the individual has no history of insolvency, financial mismanagement, or significant unpaid debts that could impact their decision-making or integrity.
- Verification of appropriate qualifications, experience, managerial and technical competency – including ensuring up to date skills and knowledge.
- Has not been the subject of adverse findings of mismanagement in relation to a regulated activity.
- That a relevant individual must have adequate knowledge and understanding of the core duties under the relevant laws and licence conditions.

In addition:

- We would welcome a stronger focus on ethical conduct – checking for any sanctions, warnings, or disqualifications in professional bodies or regulatory authorities. Checking for any evidence of ethical breaches, such as discrimination, harassment, or misconduct.

We think Ofwat has to be a little be careful with the following proposed standards:

- Declarations of interest are critical. In particular the disclosure of any financial interests, affiliations, or relationships that might pose a conflict with the role. However in practice in the sector, senior leaders, given the experience needed to effectively perform a role and the complexity and relatively close nature of the sector, may have a few of these. What then becomes important is how these conflicts are managed in practice. Greater transparency and focus on that would be very welcome.
- 'Has not been the subject of any adverse finding or settlement in civil proceedings' – this should depend on the case. Some cases may be more relevant than others e.g. a dispute over the height of garden fence with a neighbour might not be a sufficient reason to rule out a candidate.
- 'Has not been the subject of a regulatory investigation' - just because someone is subject to an investigation, it does not mean they are guilty. Though multiple accusations can be cause for concern.
- The proposal not to include anyone who has been involved in the management of a business that has gone into insolvent liquidation or administration whilst in connection with that organisation, or within one year of that connection – whilst worth reviewing to see if there is a track record of incompetency or sharp practice, this would probably rule out some of the most successful global business people and entrepreneurs. Though arguably water as an essential service requires a safe pair of hands, there are important lessons to be learned from failure. What is more important is the overall track record of success of the individual, and the skills and competencies.

Question 10: Do you agree with the proposal that the fit and proper persons test should be applied at this stage to chief executives and other individuals who are appointed as directors to the board, including both executive directors and non-executive directors? If not, please explain why.

Yes. In terms of the competencies requirements, while non-executive directors (NEDs) cannot be expected to be experts in all areas, there may be a especial value in requiring they demonstrate an understanding of key relevant duties given that they are not always immersed in the sector in the same way as executive directors.

Experience is important but NEDs also need up to date knowledge and skills to effectively challenge the Exec team. We are surprised how few chairs regularly evaluate the performance of their non-executive Board members once appointed.

Those that have been in the sector for many years may be at greater risk of being captured or part of the cultural problem Ofwat sees within the sector, and could be less likely to provide effective challenge to the exec to improve. Greater scrutiny of NEDs' contribution (historic and going forward) as Board members may be useful.

Question 11: Do you agree with the approach that companies should as a minimum provide assurance to Ofwat through their annual reporting process? What other mechanisms of assurance and information provision could be considered for monitoring compliance of the rule?

Yes. This includes the 'alert system' proposed, whereby companies must proactively inform Ofwat when an individual fails to meet this test, rather than waiting for annual reporting. This would boost transparency and accountability to consumers and wider stakeholders, and should be part of the minimum expectation on water companies. In addition, information about relevant individuals being made available to Ofwat, such that an inspection could take place at any time.

Ofwat could also:

- Require consumer panels or expert challenge groups to review and/or scrutinise the company's approach and the proposed annual statements.
- Chairs of consumer panels or challenge groups could also be involved in the recruitment process of new CEOs and board members to build confidence and legitimacy.
- Short-listed candidates could make presentations to consumer panels with the panels' reflections and thoughts feeding into the recruitment process. This could be insightful as any water company leader has to inspire confidence of the public.

Rule: Consumer involvement in decision-making

Question 12: Do you agree with the core principles proposed for effective consumer representation? Please explain the reasons for your view and tell us if you consider there are any other core principles that should be included.

Yes but we'd like Ofwat to go further. These principles appear to be weaker than the minimum high-quality engagement standards outlined in its 2022 PR24 customer engagement policy position paper[2]. Ofwat should build on its previous standards not lower the bar. Learning the lessons from engagement to date, we'd like to see:

- An explicit requirement for engagement to be **ongoing** - A few companies discontinued their challenge groups following PR19 which suggests more of a 'tick-box' approach to effective challenge and engagement rather than the embedding of consumer and expert views into business as usual decision-making.
- **Timely** included in the principles - Some of the biggest problems with water companies' engagement and causes of consumer backlashes to proposals, during the last two price controls have arisen as companies have not allowed sufficient time for consumers and wider stakeholders to input into the decision making process at an earlier enough stage to really influence and shape decisions. This is critical. Late engagement undermines trust (e.g. Thames Water's abstraction plan proposals in Teddington as a casing example) as companies look like they are just going through the motions and strength of opinion spirals and gathers its own momentum.
- **Transparent** – We welcome the requirement on companies to demonstrate clearly how relevant consumer representation has been taken into account in key decisions. Importantly this should be **proactively communicated** to 'interested and impacted' stakeholders – not quietly sitting in a corner of the water company's website only to be reviewed by a handful of people who know it is there. This should be accessible and tailored to different interests e.g. environmental issues proactively shared with environmental groups; updates and feedback on the consumer vulnerability strategy shared with poverty and disability groups; responsible business feedback shared with those stakeholders and consumers who have expressed an interest etc. This would require companies to genuinely map and communicate with interested and impacted stakeholders in their area – helping to build knowledge and understanding. This is something they say they all do, but few do well.

[2] PR24-customer-engagement-policy.pdf

- **Right to publish** - In particular consumer panels and expert groups should have the 'right to publish' views on performance in a timely way. Some CCGs' influence and ability to hold companies to account has been curtailed by companies not publishing their views on their performance when they don't like what was said, or not fact-checking reports in a timely way – effectively sitting on them until they are out of date. If Ofwat wants consumer panels and groups to be able to hold companies to account they should address this failing.
- **Feedback loops** – companies undertake a lot of engagement. Many aren't effective at providing timely accessible feedback on how consumer views have influenced decisions. E.g. emailing people to thank them and update them on how they made a difference. It's simple but often doesn't happen. This is a missed opportunity to build trust and should be embedded in a minimum standard.
- The need for consumer representation methods to be appropriately accessible - **inclusive and representative** - of either the company's whole customer base or the relevant segment (e.g. customers in vulnerable circumstances or a certain sub-region). In line with good practice, Ofwat should ensure the views of 'interested and impacted' stakeholders are heard on any given topic of relevance. This isn't though 'one-sized fits all'. The audience should be selected dependent on the question being asked.
- **Independent and comprehensive** - The need for consumer views to be gathered in a way that ensures sufficient independence from the company ***and any other party*** including CCW should they run panels. This includes in the provision of information and the design of engagement which must be **balanced and robust**. Too much engagement is poorly designed and skims across the surface of an issue with insufficient information provided to enable people to give informed views.
- **Board accountability** – In line with the current minimum engagement standards, the company board should continue to be accountable for having in place a mechanism for, and listening to, customer challenge and feedback. Company boards should be able to demonstrate how business plans, strategies and wider decision-making take account of matters that are important to customers, consumers and the communities in which they operate.

Question 13: Do you agree the consumer rule should require companies to take appropriate account of consumer views in these areas, or if any of them should be limited or otherwise defined? Please explain the reasons for your view and tell us if there are any other areas that should be included.

When this rule comes into force, companies will need to demonstrate tangibly that they have put in place arrangements for involving consumers in decisions that are likely to have a material impact on them.

This needs to consider both short and longer-term material impact and the impact not only on the individual household but also the community.

Some companies may immediately embrace the spirit of the Rule, engaging on changes that consumers will likely notice and areas they know matter to them. Others may focus on defining 'materiality' - a term that is often used in business, legal, and financial settings to describe outcomes or events that could substantially affect performance, results, or decisions. In this instance, given the outcomes intended, trust and confidence is arguably a key performance indicator that matters.

Ofwat proposes the scope of materiality includes:

- the development of **company plans and strategies**. We welcome specific reference to the consumer vulnerability strategy. Ofwat should also include the engagement strategy (see below) and the responsible business strategy given the link between good performance in these areas and public trust. We'd also expect to see changes that would notably impact water quality/safety; reliability of supply, customer service, leakage, affordability and environmental impacts given their resonance with consumers. The scope will also need to capture proposals at a local level that impact communities. e.g. the building a reservoir or abstraction plant; even roadworks given the impact on the local economy and consumer satisfaction.
- retrospective reflection on **company performance.** We support this. However to be effective in driving positive change much more robust, transparent and timely reporting of views is needed than we currently have (see below). Ofwat also needs to be more involved in supporting consumer and expert panels to hold companies to account (by listening and receiving views and reviewing performance). Also supporting them to improve with the sharing of good practice. This shouldn't be outsourced to CCW. Doing so sends a message that it's not a priority for Ofwat.
- shorter term or **more reactive decision-making** which could reasonably be considered to have a material impact on consumers. We support this. There is a bit of chicken and egg to this however in that company decision-makers will need to have the wherewithal or understanding in the first place to recognise if an issue may have a material impact on consumers. Companies may want to include a 'material impact' section on their Board papers to ensure this is considered.

In addition:

- We think there is real merit in including key **communications and behaviour change programmes within the scope**. This is as effective and timely communication has been proven time and time again to be a key factor in consumer satisfaction and building trust. Changing behaviour e.g. not putting wet wipes down the toilet, or reducing water use, is of growing importance and ultimately will materially impact consumers short and longer-term. In our experience, consumer panels are well placed to provide feedback on communications and input on high level approaches – to give views on tone, jargon, messaging, general accessibility – which could help improve the impact of initiatives i.e. to improve water efficiency, increase social tariff uptake, reduce complaints - and increase trust. Many water companies continue to struggle with these basics and could benefit from direct consumer feedback.

Question 14: Do you agree with our proposal to take an outcomes-based approach to this element of this Rule? If not, please explain why.

In principle, we support an outcomes based approach, though we think Ofwat's outcomes need to be much better defined (see below) and the standards for minimum high-quality engagement improved as outlined above.

We recognise that companies need flexibility in how they engage and that engagement best practice dictates that companies select their engagement mechanisms and approaches dependent on the aims of the engagement, and the audience it intends to reach.

Most water companies already undertake ongoing consumer engagement and bespoke engagement including to inform the business plan development. They have a combination of consumer and stakeholder groups and panels.

The proposed mandating of engagement and improved accountability is very welcome and something Sustainability First has long-called for. Done well, it will help to bring up lagging companies who don't have appropriate consumer engagement mechanisms in place, to a basic standard, and strengthen the voice of consumers and stakeholders for those groups that already exist.

However, we are mindful that companies are at very different stages in their consumer engagement journeys[3]. The quality, breadth and depth of their engagement varies hugely. We are concerned that there will continue to be inconsistency in performance and therefore consumer representation.

[3] Realising the opportunity: Final Report Review of Independent Challenge Groups in the water sector For the Consumer Council for Water March 2024.

In addition, Ofwat isn't really addressing many of the barriers that exist to companies becoming more consumer-centric businesses. We are also worried that if the principles and aspirations in any Rules are set too low, the Rules could end up being counter-productive and we could see the quality of engagement slip back in some companies and a compliance mentality adopted.

Addressing the postcode lottery

To improve the engagement performance of *all* water companies we encourage Ofwat to therefore think about how it can use this opportunity to develop mechanisms that are not only focussed on compliance, but also shine a spotlight on good practice and give credit and praise where due.

We don't think sufficient recognition has been given to water companies who go above and beyond in engagement and innovate. We'd like to see more reputational regulation in this area and the sharing of good practice to support this Rule. This is important to motivate companies to go the extra mile and help raise the bar.

The uncomfortable truth is that culture change is also needed within Ofwat to support these Rules. Ofwat has seemingly provided very little transparency on how it has assessed engagement and applied its standards. This coupled with the regulator not engaging with or supporting customer challenge and stakeholder engagement groups undermined some companies' motivation to engage. This is in stark contrast to Ofgem during RIIO-2, where Ofgem board members had regular meetings with customer engagement group chairs and saw them as another tool in the regulatory toolbox – including to understand company cultures. This sent a clear message to the companies that engagement was important to the energy regulator. In addition, Ofgem has offered engagement innovation funds to energy network companies such as the Stakeholder Engagement and Consumer Vulnerability (SECV) Incentive which have catalysed improvements.

Barriers to company culture change

Before finalising these Rules we'd encourage Ofwat to gain a better understanding of the barriers to culture change and the weaknesses in current engagement approaches as there are no doubt opportunities to address these. We recommend:

- Speaking to CCG Chairs who regularly review water companies engagement. In particular seek their views on where culture change is needed and how they think the Rules can deliver the aims required. This could be done relatively simply via the challenge group Chairs meeting facilitated by CCW.
- Reflect the findings of Indepen's 'Realising the Opportunity' report for CCW which while only related to the independent challenge groups still have relevance.
- Share Ofwat's own learning from having reviewed the companies' engagement for PR24.

In our experience there are a handful of key barriers to the culture change needed that Ofwat could address as part of these Rules:

- Employees lacking the skills, knowledge, time and confidence to engage. Also, teams who think they engage well, but don't really understand what good engagement looks like. Both of the latter could be addressed by companies rolling out effective engagement training and the sharing of engagement best practice.
- Teams or individuals within the business who don't not really understand the value of engagement – how it can improve delivery, trust and confidence. They don't see engagement as for them – rather it's something the engagement or communications teams do. This includes at a senior level. A shift could be incentivised via customer and stakeholder satisfaction scores and feedback being part of employees performance review assessments.
- Challenge mindset – linked to above, our experience is that more confident and higher performing employees and companies often have a culture of actively seeking feedback and views. They want to get ahead of problems and concerns and exceed expectations. They acknowledge that challenge and scrutiny can be uncomfortable, but welcome and respond to insight and constructive challenge. This culture is often set by the team leaders, but permeates from the top in the stories and narratives companies tell themselves about their own performance and the value of engagement.
- Lack of a strategic joined-up approach to engagement across the business – this adds cost and inefficiency and means companies are less likely to carry out the 'right engagement at the right time to deliver the right outcome'. Ofwat could require water companies to have an engagement strategy.
- Many companies undertake a lot of engagement, but seem to struggle to turn all the data into meaningful insight as they don't have the resource or structures in place to do so. This means they aren't able to pull on the insight when they need it to inform decisions. This could be addressed in an engagement strategy.

<u>Ofwat's outcomes based approach</u>

While we support an outcomes based approach, we encourage Ofwat to better articulate the outcomes it is looking for, in particular being explicit about the culture and behaviour change it wants to see. This is not clear.

Given that a key aim appears to be to build trust in the sector, Ofwat should also clarify how it sees its new Rules on engagement improving trust and delivering the wider outcomes. There is no insight provided in the response regarding what Ofwat sees as the drivers of trust and how better engagement can support these. Done badly poor engagement can deplete trust. We would be happy to help with this. There may be simple opportunities here to shift the dial. We recommend Ofwat does further research on this before finalising the scope and design of its engagement Rules. For example in no particular order:

- Co-development of proposals e.g. nature based solutions, by consumers, community and companies helps to build trust and can result in champions for initiatives and active engagement to support delivery.
- South East Water's responsible business engagement indicates that knowing the company is taking action to support customers in vulnerable situations can have a positive impact on wider perceptions of the company including levels of trust. A focus on vulnerability may then have particular value, given the aims.
- There's a large body of evidence that suggests well-designed and timely communications build trust especially during incidents and following complaints. As noted, consumers could particularly add value in this area.
- Building understanding can increase trust and support e.g. better understanding the water system, and challenges to delivering water reliability. This arguably lends itself to more deliberative processes which are well documented and communicated to the wider public.
- Academic research indicates that knowing the company is playing its part to tackle challenges such as water scarcity, and affordability, also improves trust, as does increased transparency around decision-making and open communications. Admitting mistakes, feedback loops following engagement, supporting communities, all mater.
- Critically consistent quality of performance, and providing excellent customer service are both big trust promoters. All of which could in theory could be areas of focus.

A greater focus on some of these areas may help to shift the dial on trust relative to today.

Question 15: Are there any other mechanisms or channels for the consumer voice that should be considered? Please explain the reasons for your view and tell us whether there are any consumers under our definition who may need a different type of approach

<u>Definition of consumer</u>

Company engagement should capture the following interests:

- Customers –those who pay for using water i.e. bill payers.
- Consumers – those who use water but may not directly pay for the water they benefit from e.g. non-bill payers in a household.
- Communities – geographic areas that are impacted directly or indirectly by a company's activities e.g. via road works, development of infrastructure, due to surface water flooding, or its activity as a local employer.
- Civil society groups and wider stakeholders - e.g. environmental groups, trade unions, poverty campaigners who are interested and impacted by a company's decisions.

- The Public interest – collectively citizen and community interests reflect the 'public interest' e.g. supporting growth, in line with Ofwat's new duty, reducing carbon emissions, minimising pollution, ensuring affordability which can have wider public benefits such as improving health and social well-being. This is consistent with Ofwat's historic focus on water companies having a public purpose.

Mechanisms and channels for the consumer voice

In its guidance to water companies Ofwat should be explicit that its list of engagement mechanisms and channels is illustrative only, and not exhaustive. There are many other potential sources of insight and as Ofwat mentions, it is important to encourage innovation.

For example, in line with good practice:

- third party research and insight (so as not to duplicate research and engagement – we too often see duplication of research due to poor gap analysis and horizon scanning, resulting in inefficient use of consumer money);
- BAU insight and learning e.g. from consumer complaints and contacts, social media scraping, customer satisfaction surveys;
- insight from companies own staff especially operational staff in call centres and who visit peoples' homes;
- one-to-one meetings with politicians and councils at a local and regional level and:
- a whole host of potential bespoke engagement, from surveys to more deliberative engagement such as citizens juries. This is alongside a range of different types of consumer, stakeholder group and expert panels alluded to.

As Ofwat suggests, good practice dictates that the engagement methods, mechanisms and channels used by companies should and will vary depending on the aims of engagement and the audience being engaged with.

CCW's proposed panels

Re the CCW proposed panels. On the surface these seem attractive, however we have some reservations based on experience and dependent on the detail of the model proposed.

If the Panels are going to be like the 'Your Water Your Say' sessions – one-off, ad-hoc or short-lived opportunities for the public to share their views and quiz the companies - then we support CCW running them. They could help to ensure that attendance is more representative than the YWYS sessions; and that there's a good balance of robust independent information and the right issues are discussed at the right time. Though ahead of setting them up we'd recommend CCW consult on their approach.

However, if these consumer panels are expected to be standing panels, to be used to inform BAU company decision making, we don't think CCW is best placed to chair and run them (though it still has a very important facilitation role to play). This is for practical, governance and effectiveness reasons. In particular:

- **Independence** - Panels should be able to take a different view from CCW, and from other consumer panels. If they work well, they will be a source of consumer insight for CCW, Ofwat and companies, but they won't be the only insight or evidence under consideration when decisions are made and there may be times when the views of a consumer panel differ from that of community and environmental groups in an area and the final official position of CCW. This could create a tension and undermine trust in the process and CCW as an independent consumer watchdog.

  It is worth remembering that originally when the customer challenge groups were set up, CCW wanted to chair them all. It became clear however that this hindered their role as an independent statutory consumer watchdog i.e. they couldn't be an advocate for consumers and also be an independent chair, facilitating the sometimes divergent views of others. There was consequently a move to appoint independent consumer chairs, separate from CCW. CCW has remained on all the challenge groups and provides an invaluable source of challenge and information.

  This separation of responsibilities between CCW and panels and challenge groups is healthy, providing effective checks and balances on the activity of each other. For example, challenge group chairs have provided feedback on CCW's and Ofwat's acceptability and affordability testing – highlighting where improvements can be made for PR29. CCW has also reviewed the role and effectiveness of the challenge groups. In this instance, if CCW were to run the groups, they wouldn't be able to do that, as they would be marking their own homework. i.e. who would monitor that the panels are effective?

- **Culture change** – If Ofwat wants to see culture change – companies becoming more consumer centric and better aligned with consumer priorities and values - it needs companies to take ownership of their engagement and embrace and see the value of consumer panels. If CCW runs them, they risk not being embedded into company decision-making.

- **Resource** – on a practical level providing secretariat for all the water companies' standing panels would be a massive undertaking. Liaising with the different teams within the companies to get the information needed for meetings is time consuming, especially for someone who sits outside of the company. Generally, running consumer panels well – replenishing them when people drop out or to ensure perspectives are both fresh but informed; providing appropriate incentives to ensure representation, is not straight forward and highly resource intensive. A light-touch approach by contrast

risks being the worst of all worlds. We encourage Ofwat to speak with Ofgem and learn the lessons for example from their consumer panel.

- **Favouritism** – If CCW runs panels for some companies and not others there may be perceptions of favouritism. Again the watchdog could be left effectively marking their own homework and unable to take an independent view on the quality of energy companies approaches when they clearly champion one particular mechanism.

Role of CCW

If companies set up consumer panels or equivalent stakeholder or expert groups, there is nonetheless a really important facilitation and monitoring role for CCW to play which also helps to support independence:

- Helping with recruitment of an independent panel Chair – including sitting on the recruitment panel.
- Vetting the plans for the panels/groups, including to ensure they are representative and inclusive.
- Provision of an independent induction for members of the panels e.g. on the company and the water sector – it is a complex area that will need to be explained simply and without bias.
- Provision of robust independent information e.g. on company performance.
- Monitoring the effectiveness of groups – how well they are run and listened to.
- Convening Chairs of groups and panels to share good practice, insight and learning. In more recent years CCW has facilitated meetings of the challenge group chairs, provided independent information and insight and sought the Chairs' views. This has been very well received and effective. It helps to ensure challenge group Chairs have independent and up to date information, and it facilitates the flow of information between the Chairs and from the Chairs to CCW, sharing good practice and strengthening the consumer watchdogs insight as well as the effectiveness of challenge groups.

Question 16: What are the most effective ways for ensuring these mechanisms or channels are sufficiently independent from the company?

We make the following recommendations:

- Recruitment - We welcome the proposal for independent selection process for appointments. All appointments should be competitive open recruitment – not 'tap on the shoulder'. This is key. CCW as the independent watchdog could be involved and oversea this process.
- Chairs' appointment – Strong independent chairs are important. They set the culture of the group. In the energy sector, Ofgem for the RIIO-2 price control vetted all Chairs of the customer engagement groups and vetoed those proposed by the company where they thought they were too closely linked to the company or not sufficiently consumer focussed (there were a number

vetoed!). This is arguably especially important for Ofwat as they have in the past implied that some CCGs were captured. This could perhaps give the regulator confidence in the process. Ofgem also required energy network companies to notify them if they dismissed a chair and to provide the reasons for that to ensure that dismissals weren't because they groups were in disagreement with the company. Ofgem also now attends engagement group meetings on request which allows them to see the groups in action, as well as share useful insight. Ofgem says it also learns a lot from the meetings which helps make it a better regulator. We'd like to see Ofwat do the same.

- Ensure provision of independent evidence and insight - Groups should have access to information from sources other than the company. E.g. outside perspectives to ensure a diversity of voices are heard. For example, performance information from CCW, Ofwat, Environment Agency and the Drinking Water Inspectorate and different environmental groups such as Blueprint for Water and Citizens Advice.
- Independent chairs should control the meeting agendas – the agenda for meetings should be set by the panel/groups in liaison with the companies, not controlled by companies.
- Term limits - regularly refresh membership and add new members to minimise risk of capture and ensure fresh perspectives.
- Funding - to ensure inclusivity/accessibility and/or expert challenge, good practice supports paying members and Chairs for their participation. E.g. consumer members may need to be compensated for loss of income. Ideally it would be best for this money to be routed via a third party e.g. CCW, rather than via the company. Groups shouldn't be in a position where they are at risk of 'biting the hand that feeds them'.
- Code of conduct for members and the company - Members sign a code of conduct. Ensure members hold each other to account to ensure independence. In the words of Indepen's report – "Independence cannot be guaranteed by the structure of the group or its processes but comes down to attitudes and behaviours. There must be a genuine commitment to independence by every member of the ICG and everyone dealing with the group on the company side; without this the ICG's independence is at risk." While recruiting the right people is a key contributor to the latter, a code of conduct can act as a useful reminder as can an independence statement at the beginning of each meeting.
- Conflicts of interest - Have, publish and keep up to date, a Conflicts of Interest Policy and Register. Ensure conflicts of interest are understood, especially by lay members and declared at each meeting.

- Transparency – Capture, record and publish where any direct advice, feedback or recommendations are given to the Company and any meetings between members of the panel outside of the formal proceedings.
- Hospitality Log – beyond any attendance allowance, keep a log of any payments made by the company to individual members or benefits in kind.
- Private sessions – operate private sessions to discuss issues openly when the company is not present.
- Monitoring – CCW could play a valuable role in monitoring performance and give views on independence and governance structures. As noted Ofwat should also support panels/groups where needed. This should be mutually beneficial.

Question 17: Do you agree that the Rule should provide options for water companies in terms of how they establish appropriate arrangements? And do you agree with these proposed mechanisms? If not, please explain why and if are there alternative mechanisms that should be considered.

No, if it's important to do, Ofwat should mandate a minimum approach to ensure consistency. This also enables comparability and provides clarity for the companies.

We've worked with companies with a nominated non-executive director as consumer champion at Board level. This can be effective, helping to raise the profile of consumer issues at senior level. However, how effective it is depends on the competency of the Board member and the wider culture of the board. All too often under this approach consumer issues, or engagement aren't seen as the collective responsibility of the board (rather something that person x (the consumer rep) deals with) and it doesn't result in the full engagement of the Board and therefore the genuine culture change that Ofwat and government appear to want to drive. On some boards, usually those most in need of a shift in values, trying to drive change as the sole consumer champion, can be harder to achieve.

We recommend as a minimum Ofwat:

- Establishes the principle that consumer engagement is the collective responsibility of the Board. In the case of the water challenge groups, Indepen's review recommended that "The company board is accountable for enabling, and listening to, the ICG's challenge".
- Requires all Board members to attend consumer panels, listen to views and respond to questions. All should be accountable from shareholder members, to independent NEDs, as well as directors. Some companies have a rota of attendance at groups. It is important that those with ultimate responsibility for the company's actions hear directly from customer representatives, so that consumers can have confidence that their input is not being sanitised or misinterpreted before it reaches those most senior within the company. It also enables consumers to ask questions directly to those in charge, helping to hold them to account.

- Requires companies to have a consumer and stakeholder engagement strategy in place and report on progress against that. This simple document could be really powerful. Many companies lack a genuinely strategic whole business approach that understands the value of engagement to cost effective delivery, consumer satisfaction and trust. We are happy to discuss this further with Ofwat.
- A requirement for employees to be trained in good practice engagement and ensuring the company has mechanisms in place to capture data and turn data into meaningful insight. We've yet to see a well-functioning meaningful insight hub with timely insight summaries.
- Importantly, the Board should also be required to assure that they have seen and reviewed any consumer feedback, challenge and recommendations log or reports on at least an annual basis. We recommend this, as all too often consumer groups can provide feedback and recommendations which are ignored by poor performing teams in a company with some challenges left open for many years. This focus would ensure that all recommendations were considered and responded to in a more timely way. The Board would have visibility of teams who aren't as responsive. It would also help hold the companies to account in a way that current approaches can fail.

Re Ofwat's other proposals. We support:

- Updating relevant board and committee terms of reference to acknowledge the importance of understanding consumer interests, and to identify how and where in decision-making this will be considered. From a governance and assurance perspective this may have value.
- The setting up of a consumer advisory board sub-committee. To work this needs to include a number of Board executive and non-executive representatives including the Board Chair and be a cross-company committee. Too often engagement is seen as the responsibility of the communications or customer service teams and the nominated lonely consumer NED and gets siloed.

Question 18: Do you agree with the proposed assurance mechanisms described? Do you have any other suggestions on assurance mechanisms for monitoring compliance?

We support the assurance proposals outlined. The public reporting to Ofwat is particularly important to strengthen the voice of consumers. To improve the consumer culture of companies we'd also like the assurance statement from the Board to confirm:

- That the company has an engagement strategy.
- That it has in place 'engagement' training. This recognises that many employees lack the skills, knowledge and confidence to engage well.

This would be an easy win to drive positive culture change and address a gap in many companies.

- That it has in place mechanisms to capture and record data and research and turn that into insight e.g. insight hubs, insight bulletins. In our experience this is a real weakness and barrier to consumer views influencing decision making in a timely way.
- That it has in place mechanisms to encourage a consumer centric culture e.g. PRP linked to customer satisfaction and stakeholder satisfaction engagement scores.
- That the company has met Ofwat's high-quality PR24 engagement and challenge standards as well as wider engagement requirements.
- That the Board has reviewed the feedback, recommendations and challenges from consumer and wider stakeholder panels, and can confirm that the company has taken steps to address the feedback provided and close any open challenges. Evidence could be provided in the form of a recommendations or challenge log or a 'You said, we did type' document. Such logs will give Ofwat insight into the breadth, depth, and quality of challenge. Also the quality of responses may indicate the quality of engagement from companies.

In addition, there is value in a very short statement from any panel/consumer groups' chair that the company has met any relevant engagement standards. For example, Ofgem requires independent scrutiny groups to do a general statement to confirm that the company has adhered constructively and positively to all aspects of their Enhanced Engagement Framework in Ofgem's Business Plan Guidance. This covers things like appropriate resourcing of the group; the provision of timely high-quality information; views on whether the engagement has been meaningful on the issues that matter to consumers; confirmation of transparency and openness and that the company has made best efforts to listen to and respond to views.

Question 19: Do you agree with the proposed means of raising concerns on behalf of consumers who do not consider the Rule is being adequately followed?

We'd welcome consumer groups/panels being able to engage at least annually with the company board, Ofwat and CCW on the process and their view on the effectiveness of the company's arrangements under this Rule.

We encourage these three organisations to provide a named contact for panels/group chairs so that if issues arise throughout the year they have place to go.

As mentioned, if these Rules are to achieve the intended outcomes, Ofwat needs to play a bigger and better role on engagement than it has done to date.

Responding to this consultation

We intend to publish responses to this consultation on our website at www.ofwat.gov.uk. Subject to the following, by providing a response to this consultation you are deemed to consent to its publication.

If you think that any of the information in your response should not be disclosed (for example, because you consider it to be commercially sensitive), an automatic or generalised confidentiality disclaimer will not, of itself, be regarded as sufficient. You should identify specific information and explain in each case why it should not be disclosed and provide a redacted version of your response, which we will consider when deciding what information to publish. At a minimum, we would expect to publish the name of all organisations that provide a written response, even where there are legitimate reasons why the contents of those written responses remain confidential.

In relation to personal data, you have the right to object to our publication of the personal information that you disclose to us in submitting your response (for example, your name or contact details). If you do not want us to publish specific personal information that would enable you to be identified, our privacy policy explains the basis on which you can object to its processing and provides further information on how we process personal data.

In addition to our ability to disclose information pursuant to the Water Industry Act 1991, information provided in response to this consultation, including personal data, may be published or disclosed in accordance with legislation on access to information – primarily the Freedom of Information Act 2000 (FoIA), the Environmental Information Regulations 2004 (EIR) and applicable data protection laws.

Please be aware that, under the FoIA and the EIR, there are statutory Codes of Practice which deal, among other things, with obligations of confidence. If we receive a request for disclosure of information which you have asked us not to disclose, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances.