

November 2018

Trust in water

# **Call for inputs: Strengthening wholesaler performance and service in the business retail market**

## Executive Summary

In July this year we published [Open for Business](#), a report which assessed the state of the business retail market after its first year. In our report we identified a number of market frictions that have had a negative impact on customers' experiences during the first year of the market.

These included:

- Poor aggregate performance of wholesalers against Market and Operational performance standards;
- Poor interactions / communication between wholesalers and retailers; and
- Poor quality of data provided by wholesalers in the Central Market Operating System (CMOS) has resulted in problems for retailers.

We've been engaging with retailers and wholesalers to help us to identify some of the drivers behind these market frictions. The feedback we've received has highlighted a number of areas where wholesalers can improve to deliver better services to retailers and ultimately business customers.

There is a general consensus among retailers that there is a lack of effective reputational and financial incentives for wholesalers to deliver high quality services to the business retail market. Many retailers also point towards the problems and associated cost impact that they experience from dealing with a wide variety of wholesaler policy approaches.

We are aware that a number of industry led initiatives are planned or already in progress to improve interactions between wholesalers and retailers. But there is a concern that these initiatives may not deliver the improvements in performance and service at the pace of change that is needed.

In this Call for Inputs we look at the issues we believe are having the biggest impact upon wholesaler performance in the business retail market and the quality of service received by retailers. We consider where incentives already exist to improve performance and where industry is taking forward work which could potentially address issues. We also consider what more could be done by Ofwat and other parties where relevant.

## Why are we publishing this Call for Inputs?

We want to see trading parties take a lead on shaping the market themselves. We believe that the market codes can provide an effective route for stakeholders to develop a market framework that will encourage wholesalers to deliver high levels of performance and service. However, we also recognise that there may be times when we will need to be more directly involved in ensuring the conditions are in place to achieve these goals.

As part of this review we invite stakeholders to provide their views on how incentives can be strengthened or introduced to improve wholesaler performance. The information we receive may be used to help us work with industry to progress existing initiatives, contribute towards the development of the market codes, for example by raising a code modification ourselves, or potentially to inform the design of a PR19 based scheme.

Throughout this paper we have also set out some questions that we invite stakeholders to respond to. The information gathered from this exercise is intended to add to our evidence base and potentially assist us, or other parties, in addressing the issues that we've identified. For ease of reference, all questions are summarised in the [Annex](#) to this CFI.

## How is this document structured?

The remainder of this call for inputs is structured as follows:

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## 1. The role of wholesalers in the business retail market

Wholesalers play a fundamental role in the process of providing essential services to customers. They interact with retailers and ultimately end-customers through a number channels, such as through the delivery of network and water resources, the provision of market data and the agreement of credit terms.

As wholesalers hold a monopoly position on the delivery of these services, the Wholesale Retail Code (WRC) includes mechanisms to ensure they do not exploit this. Specifically, wholesalers are required to perform a number of tasks in line with industry obligations under the [Market Performance Framework](#) (MPF). This includes two sets of metrics – Market Performance Standards (MPS) and Operational Performance Standards (OPS). MPS also includes metrics relating to retailer performance. At present, these are the only established metrics available for measuring wholesaler performance in the market.

MPS relate to processes where underperformance is likely to have an adverse impact on the orderly operation of the market, such as notifications to the market operator of a new connection; declarations of temporary disconnections or reconnections and submission of meter reads. Charges are applied if a wholesaler (or retailer) misses an MPS target, with the level depending on how late the task gets completed. There is a cap on the total amount each wholesaler pays, and the charges collected get redistributed amongst retailers and wholesalers.

OPS isn't fully operational as an incentive yet, but it focuses more on bilateral processes between wholesalers and retailers which facilitate efficient market functioning, such as timescales for completing physical connections or meter replacements.

## 2. Review of our analysis and engagement

Engaging directly with retailers has helped us to understand what good and bad wholesaler performance looks like to them and how they see the impact it has on end customers. We've also held some face-to-face meetings with wholesalers to establish the causes and drivers behind underperformance. The information we have gathered suggests that those wholesalers who provide a good customer service to retailers generally perform strongly against MPS and OPS.

### **What supports good customer service for retailers?**

- Dedicated account or portfolio teams in place to manage their business as usual interactions with retailers
- Regular meetings / account reviews with named contacts at wholesalers
- User friendly online retailer portals (for initiating, tracking and completing bi-lateral processes)

### **What has a negative impact on a retailer's service experience?**

- Poor data
- Slow turnaround times
- Inconsistent approach to retailer portals
- Lack of wholesaler responsibility for service failures / customer complaints

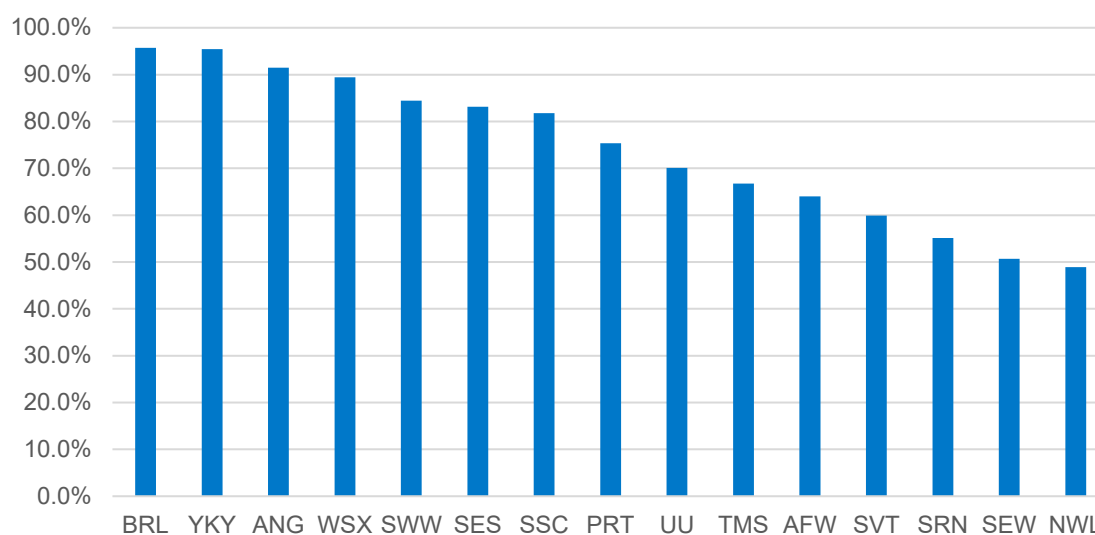
### 2.1 Performance against MPF metrics

A number of wholesalers reported to us that the bedding-in of new teams, processes and ways of working has contributed to OPS and MPS underperformance during year one of the market. Several wholesalers we engaged with said that they had identified issues with the corporate governance of their wholesaler service teams since the market opened and have subsequently carried out internal restructuring and system improvements to improve their service offering to retailers.

In Open for Business we noted that during the first year of the market wholesalers only completed two thirds of their MPS tasks on time. In April 2018 financial and reputational incentives came into effect to drive up wholesaler performance against MPS. While it's probably too early to determine whether the publication of MPS data and charging regime is encouraging improved performance, there are signs that wholesaler performance has improved against MPS since April 2018. From April to August 2018, 69,023 MPS tasks were completed by wholesalers, with 79% completed on time.

One issue that remains consistent since publishing Open for Business is the wide variance of performance across all wholesalers against MPS tasks. Looking at performance covering April to September 2018 the average rate for MPS tasks completed on time rate ranges from 96% to 49% across wholesalers<sup>1</sup>.

**Average MPS task completion rates across Wholesalers from April to September 2018**



As mentioned above, at present MPS data is the only publicly available measure of wholesaler performance. OPS data is currently self-reported by wholesalers but is not yet publicly available or subject to charges for underperformance. The first year of the market identified some inconsistencies in the way OPS is being measured and recorded. An OPS working group has been set up to establish consistent reporting measures. In Open for Business we set out our expectation that this work should be completed by autumn 2018 with charges in place by the end of the year.

In Open for Business we flagged our concern that the current system financial penalties under the MPF are relatively small when compared the possible detriment to customers. Other regulatory incentives which are based on customer detriment impose much higher fees. While the charging process for late completed OPS tasks has yet to be confirmed, it is envisaged that it will resemble what is in place for MPS.

Fees for MPS underperformance are subject to a monthly cap of 0.15% of each retailer's primary charges. Total capped MPS fees incurred by wholesalers from April to August 2018 stands at £0.44m. Looking at this in the context of total wholesaler revenues (about £11b per year) we are interested in stakeholder views on whether the publication of performance plus modest financial incentives can reasonably be expected to drive material improvements or not.

<sup>1</sup> For wholesalers that have completed at least 200 MPS tasks since April 2018. Data collated from [MOSL Wholesaler Market Performance Chart](#)

It is worth noting that each MPS task has different “time parameters” within which increasing levels of charges are applied for underperformance. For some MPS processes, if a wholesaler fails to meet the task requirements by the final time parameter a charge will be applied, but no further fees will be incurred for ongoing underperformance. This could potentially reduce the incentive for wholesalers to complete MPS tasks that are still outstanding beyond the final time parameter. The charging methodology is set out in more detail within [The Market Performance Framework](#).

In response to [Delivering Water 2020](#), the consultation on our methodology for PR19, several retailers expressed concern that our proposals did not include a robust incentive mechanism for services to the business retail market. Taking into account these concerns, we agreed in our [Final PR19 methodology](#) to continue to monitor the development of the business retail market and work with MOSL, retailers and wholesalers to ensure that wholesalers are encouraged to deliver good-quality customer service to retailers. We indicated that if we thought it appropriate to introduce an incentive mechanism, we would expect to do this in the draft determinations (by March 2019).

## **2.2 Poor interactions between wholesalers and retailers**

### Customer complaints

We asked retailers to consider where they have received complaints from customers that were in some way attributable to wholesaler underperformance or poor service. Of those retailers who provided data, most suggested that about a third of their complaints are in some way attributable to wholesaler underperformance. This is supported by [research published by the Consumer Council for Water](#)<sup>2</sup> in July this year, which identified that of all written complaints that retailers received up to March 2018, about 23.3% were deemed to be partly or fully a wholesale issue.

Retailers, and a recent review of WATRS (an alternative dispute resolution, ADR, scheme established by the sector), have also highlighted concerns about the means by which it can be ensured that wholesalers take ownership for addressing, and where needed, providing redress for complaints that are found to result from wholesale service underperformance, including complaints escalated to an ADR.

### Poor turnaround times

We asked retailers to consider where wholesaler underperformance has the biggest impact on them delivering good customer outcomes. The vast majority of retailers advised us that the late completion of bi-laterals by wholesalers had a negative impact upon the service they provided to customers. The timely completion of OPS tasks (such as meter repair / verification, SPID deregistration and allowance requests) appear to be more important to retailers than MPS.

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<sup>2</sup> CCW “Non-household complaints to water retailers, companies in Wales, and Consumer Council for Water 1 April 2017 – 31 March 2018”

Six retailers we engaged with were able to provide us with comparable data on average turnaround times for OPS tasks across a range of wholesalers. This data suggested that retailers can experience anything from a 23 to 81 day wait for tasks to be completed, dependent on which wholesaler they engage with.

#### Monitoring the resolution of outstanding tasks

The information we received from retailers suggests that there are few processes in place to measure how wholesalers are addressing issues that they have created or have a responsibility for. This can result in retailers having to engage in protracted exchanges with wholesalers or needing to escalate matters to resolve an issue. Ultimately this engagement comes at an additional cost to a retailer and impacts on its ability to deliver a good service to customer. Some retailers also advised us that when certain bi-laterals are raised with wholesalers they put the customer account on hold so do not collect payments while still outstanding (e.g. dealing with leakage allowance requests, meter verifications, etc.). It is worth noting that where bi-laterals remain outstanding, retailers are required to continue paying wholesalers via the monthly settlement.

The issue of outstanding bi-laterals may touch upon a wider asymmetry in power between wholesalers and retailers. Some retailers have told us that they have limited routes available to formally raise and escalate concerns with wholesalers. Trading parties can raise a dispute if they think that another party in the market is operating incorrectly. But this dispute process should be a solution of last resort. The codes potentially could be updated to measure wholesaler performance for these type of interactions, though we haven't seen trading parties explore this opportunity to date.

#### Limited metrics covered under the Market Performance Framework

The feedback we received suggests that there are many bi-laterals or aspects of customer service that aren't currently captured or incentivised under the MPF, such as how well wholesalers communicate with retailers in the event of unplanned events. As our recent [freeze-thaw report](#) found, poor communication and information sharing between wholesalers and retailers left business customers confused about who to talk to.

#### Variance in Wholesaler Policy

Many retailers indicated that they have encountered difficulties in some circumstances where wholesalers employ different policy and service approaches. Several retailers suggested that more could be done to encourage the harmonisation of wholesaler policy. Many retailers referred to the problems that they experience due to a lack of consistent approach in the way that wholesalers receive and manage bi-laterals. At the time of receiving responses we understood that some wholesalers had online portals available for submitting bi-laterals, while others didn't - which adds to the administrative burden for retailers when interacting with them. Where wholesalers do have portals in place, retailers raised concern that



wholesalers had not adopted one common agreed approach for managing bi-laterals in the market.

## **2.3 Poor quality of data**

Most of the retailers who responded to our information request indicated that poor or absent data in CMOS creates problems when invoicing customers, raising correct bills and providing accurate quotes. A number of retailers were able to illustrate the considerable resource and financial impact that inaccurate or incomplete data is having on their operations. One retailer in particular was able to confirm that since the market opened it had identified issues with inaccurate or missing data that prevented or delayed it from billing 13,895 SPIDS, with an estimated value of £12.3m.

Some wholesalers advised us that legacy issues with their data sets such as wrongly assigned, missing, inaccurate or incorrectly migrated SPIDs have had a significant impact on their own performance during year one of the market.

It is worth noting that both wholesalers and retailers hold responsibility for the management and updating of data in CMOS. We therefore asked retailers to provide us with a view on how well wholesalers respond to data issues or queries that have been reported to them. In general, we noted that the best performing wholesalers in dealing with data issues generally aligned with those who provide good customer service to retailers and perform above average against MPS and OPS processes.

At the beginning of September MOSL began a market wide data improvement planning exercise with wholesalers and retailers and requested trading parties to submit data improvement plans. It is hoped that this work will help to address some of the issues identified during the first year and a half of the market and contribute towards improved trading party performance going forward.

### **Question for stakeholders**

- A. Do you have any additional evidence or views on current wholesaler performance?

### 3. Working groups and initiatives

As part of our information gathering we invited trading parties to advise us how they are contributing towards the overall improvement and development of the business retail market. Most wholesalers and retailers who responded to our information request confirmed that they attend workshops, industry working groups and committees with a view to improving the operation of the market.

We have summarised below some of the main groups and ongoing initiatives that we are aware of:

**The User Forum** – Enables trading parties to meet to identify, resolve and document market risk, challenge or required action as per the Market Arrangements Code and discuss issues arising in the market. The user forum also discusses Change Proposals, Charging Change Proposals or Market Arrangements Code Change Proposals.

**The Water Retail Council** – Also known as the Retail policy group, this forum acts as a network for retailers to discuss key policy concerns in the market and develop and share best practice.

**Wholesale Interface Group (WIG)** – The WIG is a network for wholesalers to discuss operational matters, work through areas of complexity and share and develop best practice on day to day operations.

**The Retailer Wholesaler Group (RWG)** – The RWG brings together retailers and wholesalers to tackle the key market issues and make changes/share good practice to improve overall customer service in the market.

Some significant issues currently being considered by RWG working groups include:

- Reducing complexity in bi-lateral interactions.
- Looking at ways to measure good wholesaler service to retailers; and
- Planned events

The **Market Performance Committee (MPC)** has been established to provide oversight on market performance. It monitors overall market performance and has a role in the administration of the MPF. The MPC leads on periodic reviews of the package of standards in the MPF to ensure that they are effective in driving market behaviours and providing confidence to trading parties that their peers are complying with their obligations.

The **Operational Performance Standards Working Group** (“OPSWG”) was established in May 2018 comprising both wholesaler and retailer members to identify, and propose solutions, on a number of improvements felt needed to be introduced before, or simultaneously to, charging that will ensure all trading parties have confidence in the self-reporting of OPS by wholesalers.

The **Digital Strategy Committee** (DSC) provides governance over the technology components that support the obligations of the new retail market. The RWG bi-lateral process working group and the DSC are working hand-in-hand to look at ways to make the submission and processing of forms easier. The DSC is specifically focussing on the possibility of delivering a technology based solution and a single set of standards to govern bilateral communications.

**Data improvement plans** – In its June 2018 Market Improvement Strategy, MOSL indicated that it would coordinate improvements in data quality and work with wholesalers and retailers to interact in ways that best support effective market functioning. It is hoped that this initiative improves CMOS data completeness and accuracy. Early signs are that many wholesalers have already signed up to this initiative, with a number already having data improvement plans in place.

MOSL has also recently published its [Market Performance Operating Plan](#). Under the codes MOSL is required to produce these plans on an annual basis. As part of its 2018 - 20 plan MOSL intends to raise awareness of market issues collate and publish **market outcome dashboards** illustrating trading party performance against a range of metrics.

- **Settlement dashboard** - will include estimates of the financial impact of missing or poor-quality consumption information and supply point information
- **Level playing field dashboard** - will provide information on the regional variances in wholesaler performance and peer comparison information
- **Switching dashboard** - will provide information on the impact of supply point information on switching alongside Additional Performance Indicators on the use of estimated transfer reads.

MOSL indicates in its plan that, if appropriate, it may incentivise the resolution of market performance and data quality issues by making market outcome dashboards publicly available to create reputational incentives to drive the resolution of market issues.

<b>Question for stakeholders</b>
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- A. Above we have referred to a range of existing and planned work which may help to improve wholesaler service and performance. Do stakeholders think these initiatives will deliver sufficient outcomes within a reasonable timeframe? When responding please explain your answer.
- B. Have we missed out any other significant ongoing or scheduled work that could drive improvements in wholesaler performance?

## 4. Key issues impacting on wholesaler service and performance

Drawing upon our engagement with the market, and our analysis of market data, we think that the following issues are having the biggest impact upon wholesaler performance in the business retail market and the quality of service received by retailers:

- **Inadequate metrics to measure wholesaler performance and service**

The feedback we have received from retailers suggests that a number of bi-laterals and interactions aren't captured under the MPF. There may be a need for additional metrics to be developed that are focused on improving the retailer customer experience and encouraging quicker turnaround times for bi-laterals.

- **Weak reputational incentives**

Retailers have raised concern that there is a lack of a clear reputational incentives for wholesalers to deliver high quality services to the business retail market. At present the MPS data is the only publicly available measure of wholesaler performance.

- **Weak financial incentives**

In response to our May information request several retailers argued the case for strengthening the financial incentives for wholesalers to improve performance. Some retailers suggested that a wholesaler service incentive mechanism should be introduced as part of the price review (PR19). Others thought that updates to the codes would provide the most appropriate means to incentivise improved performance.

- **Wide variance in policy approaches**

In response to our questions, a number of retailers mentioned the problems and associated cost impact that they experience from dealing with a wide variety of wholesaler policy approaches throughout the different regions of England and Wales.

### Question for stakeholders

A. Do stakeholders agree that we have identified the key issues that need to be prioritised and addressed? Are there any other issues that should also be considered as part of our analysis?

In the following section we look at each of these issues in more detail and consider where incentives exist to improve performance or industry is taking forward work which could potentially address these issues. We then consider **what more could be done** by Ofwat, MOSL or trading parties.

## **4.1 Inadequate metrics to measure wholesaler performance and service**

Stakeholders have told us that the current scope of processes captured under MPS and OPS miss many key areas which are of high importance to retailers serving the business retail market. Retailers strongly indicated that the Codes could be updated to include metrics to measure how wholesalers perform against tasks such as dealing with data queries and complaint escalations (before a formal dispute is initiated).

Our engagement has also identified significant differences between the best and worst performing wholesalers in turnaround times for completing MPF tasks. A number of retailers suggested that the SLAs for all OPS and MPS processes should be reviewed to consider whether they truly reflect business and customer expectations.

### **Review of Market Performance Framework**

At present OPS and MPS are currently being reviewed and refined through various working groups and committees. The MPC is scheduled to do a further review of the MPF towards December 2018. This review also coincides with the ongoing work of the OPSWG. Several retailers have expressed concerns that the OPSWG is making slow progress and is lacking ambition as to what can be considered and included as part of its review. Concerns about limited MPF metrics have been apparent for some time and several retailers have suggested that widening the scope of OPS could help to address the situation.

### **What more could be done**

On the basis of the information we have received, it seems that there may be scope for improvements to be made in the way that wholesaler performance is measured under the Codes, such as:

- A review of the appropriateness of SLAs for all OPS and MPS processes;
- A measure for how well wholesalers respond to retailer-initiated data queries / correction requests;

- New processes to record how well wholesalers manage escalated queries and complaints from retailers; and
- A measure for how well a wholesaler engages with retailers for planned / unplanned events.

There may be some benefit in MOSL and trading parties exploring the feasibility of bringing in external technical support to assist with the ongoing development of the MPF. At present these conversations are mainly limited to market participants. A market fund could potentially be created to procure a consultant to assist with improvements to the MPF and provide an objective view on where metrics could be updated or created.

## **RWG**

As mentioned earlier, an RWG working group is currently looking at ways that wholesalers measure the quality of service that they provide and understand what works well, and not so well, from a retailer perspective. The working group is currently reviewing the ways each wholesaler surveys retailers with a view to developing a market wide agreed measure of retailer satisfaction. This work has come about partly due to retailers being asked to respond to numerous surveys issued by wholesalers. To date, each wholesaler has used a different method and set of questions when issuing surveys, which retailers say places a considerable burden on them and does not result in comparable data.

### **What more could be done**

The initial focus for this working group is developing a best practice framework for a retailer survey. We understand that the group is hoping to have something drafted towards the beginning of 2019. We recognise that there is still much work to be done to establish a format for surveying retailers and measuring their wholesaler service experience. Through this development process the working group might identify other ways that wholesalers can improve their service standards. It may be helpful if such observations and opportunities are captured by the group and shared with the wider RWG membership. This group could also consider the extent to which OPS and MPS already provide a good proxy for retailer customer satisfaction. As such, the group could potentially play a role in identifying metrics that could be considered as part of future reviews of the MPF.

## **Ofwat**

We want wholesalers and retailers to take the lead in making the market work. We are concerned that trading parties have not made full use of the channels available to them so far. It could also be the case that retailers have difficulty influencing existing working groups, such as the OPSWG. We will be closely following the progress of the OPSWG and next MPS review. We could also take further steps

directly if we consider that insufficient progress has been made in addressing the concerns

Under section 6.1.1 of the MAC, Ofwat can make a Change Proposal to the WRC. Ofwat would be able to submit a proposal as an 'Authority Timetabled Change Proposal', meaning that Ofwat could set out a proposed timetable for consideration by the Panel of the proposal. After the Panel has consulted and made its recommendation, it would be for Ofwat to make a final decision on whether or not to approve the change.

#### **Questions for stakeholders**

- A. We have suggested a number of ways that the MPF could be updated to improve the way that wholesaler performance is measured and incentivised. Which of these suggestions do stakeholders believe would be most effective and why?
- B. Are there other areas of performance and interaction that should be considered by the OPSWG or as part of the next MPS review?
- C. Aside from updates to the MPF, are there any other ways that the codes could be changed to better measure wholesaler performance?

## **4.2 Weak reputational incentives**

Comparing the performance of one firm against another can provide a powerful reputational incentive as companies typically care about how they compare to their competitors and peers. Bad performance may damage the value of a brand, bring greater regulatory scrutiny, and damage legitimacy.

### **Review of Market Performance Framework**

Feedback that we have received from retailers suggests that wholesaler performance against the OPS has a significant bearing on their day-to-day operations and the service that they provide to end customers. Most retailers suggest that good wholesaler performance against OPS processes is more important than MPS. They told us it was of key importance that Wholesaler performance against OPS measures is made publicly available and is comparable. However, all indications are that wholesaler performance data against OPS processes will not be published until 2019. MOSL's MPOP suggests that the work of the OPSWG may not be completed until April 2019.

While the MPS and OPS data we currently receive provides us with a view on tasks completed, it doesn't give a definitive view of how many tasks are outstanding with



wholesalers. In Open for Business we asked the MPC to see if there are ways to improve the visibility of all outstanding wholesaler tasks.

### **What more could be done**

The OPSWG could look at ways to accelerate its work programme to ensure that OPS wholesaler data can be made publicly available. As suggested earlier, the OPSWG could consider whether it would be beneficial to bring in external support to assist members in fast-tracking the full implementation of OPS measures.

## **MOSL**

As part of its MPOP MOSL will gather further data from trading parties and develop market outcome dashboards for measuring and monitoring market performance and data quality issues. This will include a “level playing-field dashboard” (LPF) providing information on variances in wholesaler performance and peer comparison information. MOSL has indicated that it is prepared to use these dashboards as a reputational incentive to address market issues or encourage improvements in performance.

### **What more could be done**

MOSL is the leading collector of performance data in the market. As such it is well placed to shine a light on how wholesalers compare in terms of performance and other aspects of wholesaler service delivery. In the first instance, there may be scope for MOSL to look at ways to improve the visibility of existing performance against MPS tasks and highlight the best and worst performing wholesalers in the market. This information is currently accessible in the [Market Performance](#) section of MOSL’s website, which mainly reaches an audience of market participants, rather than customers.

We are encouraged by the plans set out in the MPOP to develop market outcome dashboards and understand that MOSL intends to use these dashboards to drive the resolution of market issues and make data public should it be required. It may be helpful if MOSL could explore whether some of the data used in these dashboards could be made publicly available as standard to improve the general visibility of trading party performance in the market.

## **RWG**

We previously mentioned that there is a RWG working group which is looking at improving the wholesaler approach to surveying retailers. The working group is still in the early stages of developing a market-wide agreed method to gather feedback from retailers on their wholesaler service experience. This work has the potential to develop a method to benchmark wholesaler service quality in the business retail market. But we also acknowledge that it might take some time for something to be

developed, piloted and implemented before eventually having an influence on wholesaler service quality.

### **What more could be done**

We recognise that the RWG will face some challenges in its effort to develop a market wide measure for retailer satisfaction. Firstly, the RWG will need to ensure that it gets buy-in from trading parties to make it a credible measure of service. Secondly, and most importantly regarding the effectiveness of any survey that is developed, the group will need to identify ways to make the results of the survey accessible and visible to a wide range of stakeholders. The work may have greatest impact if the RWG can adopt an approach that maximises transparency and ensures that wholesaler performance is communicated to a wide audience.

### **Ofwat**

We are closely monitoring the progress of the above initiatives and working groups. But we could also take further steps directly if we consider that insufficient progress has been made.

Ofwat has previously gathered feedback from retailers to understand their wholesaler service experience. There is the potential for Ofwat to develop this survey further and issue it to retailers on an annual basis. The data gathered could be consolidated in a league table form which would be made publicly available. For example, data could be presented through the Open Water website or in our annual state of the market reports. This would then provide a useful yardstick for wholesalers to see how they measure against their peers in terms of the quality of service that they provide to retailers.

#### **Questions for stakeholders**

- A. Do you believe that sufficient progress is being made in reviewing and updating the MPF? If not, what more do you think should be done in the in the short and long term?
- B. We invite views from stakeholders on how Ofwat, MOSL or any other parties could use performance data to strengthen reputational incentives for wholesalers to improve performance.

## **4.3 Weak financial incentives**

Direct financial incentives arise when a company can gain a financial reward or avoid a financial penalty from certain behaviours. Most businesses are incentivised to maximise profit and hence respond to reward and penalty incentives, providing that

they are sufficiently material relative to the costs of responding to them. If, however, the operational costs of changing behaviour to respond to the incentives are too great then firms may be prepared to forego a reward or incur a penalty. An optimal reward or penalty may reflect the value that customers put on a change in performance. In such cases if it is more expensive for a wholesaler to provide the improvement than customers' value, it is optimal for them not to do so.

## **Review of Market Performance Framework**

As part of the wider review of the MPF we understand that it is in the remit of the panel to review the suitability of the charges that are levied on wholesalers for underperformance against MPS and OPS processes.

The panel can also consider the method in which surplus cash from charges is redistributed. In Open for Business we indicated that we believe that the existing method of redistribution of surplus cash from MPS charges does not effectively incentivise trading parties to improve performance against the MPS. Given the asymmetry in the level of activities and charging between retailers and wholesalers in the current method there appear to be weak incentives on wholesalers.

[In May](#) we asked the Codes panel to consider alternative approaches of using surplus cash from MPS charges. The Panel has recently submitted a proposal recommending that we approve a code change that refines the existing method of redistributing surplus cash from MPS charges. We will consider the evidence provided to support this proposal when deciding whether to approve.

## **What more could be done**

### Implement charging for OPS

Retailers think that it is important that charges can be applied for underperformance as soon as possible. The feedback we have received from retailers suggests that wholesaler underperformance against OPS tasks has a direct detrimental impact on the service that they provide to customers, more so than MPS underperformance. Retailers expressed frustration that a year and a half after market opening no charges are applicable to wholesalers who fail to meet these measures.

### Form of redistribution

As part of its ongoing work, the OPSWG is also considering how surplus OPS charges will be redistributed. Where they land on the point of redistribution will have a significant bearing on the overall strength of OPS as an incentive.

There are a number of options that could benefit the wider functioning of the market or help to incentivise improvements in wholesaler performance. One approach the panel could consider would be to use surplus OPS charges to help fund market

improvement initiatives. An alternative could be to redistribute some surplus charges in a way that better incentivises good performance.

#### Review of charging process, levels and caps

More consideration could be given to the level of charges that wholesalers are subject to for MPS, and eventually OPS, underperformance. While there is a difference in the levels of MPS charges applied to retailers, retailers have argued that the charges don't really reflect the very different levels of size and scale when comparing wholesalers to retailers. The MPF could potentially be strengthened to ensure that there are ongoing incentives for trading parties to complete MPS (and OPS) tasks that remain outstanding beyond the final time parameter for completion.

If the MPF metrics are updated and expanded to include more processes and attract higher charges for underperformance then the level of the cap for wholesalers may need to be considered again as part of the ongoing review of the MPF.

#### **Ofwat**

In our final PR19 methodology we indicated that if we thought it appropriate to introduce an incentive mechanism for improving wholesaler performance, we would expect to do this by the draft determinations.

We have considered what a wholesaler performance incentive mechanism could look like as part of PR19 and believe that the scheme could draw upon aspects of what we have outlined for D-MeX and C-MeX. The scheme could have service level metrics, based on performance against MPS and OPS, which could be combined with retailer satisfaction metrics. We could rank companies based on their overall score and publish results annually.

Similar to the system in place for C-Mex, each year:

- Top performers could receive a performance payment (in C-Mex this is 1.2% of residential retail revenues);
- The poorest performers could receive a penalty (in C-Mex this is up to 2.4% of residential retail revenues annually); and
- Company data used to compile the metrics would be incorporated as part of our Annual Performance reporting requirements for wholesalers.

We recognise that there are several areas we would need to consider further as part of any scheme:

- The performance payment and penalty levels need to be considered.

- If Ofwat included a retailer service metric as part of a scheme, we could develop our own measure or draw upon existing initiatives in the market (e.g. the RWG “retailer survey” working group referred to earlier);
- The weightings of OPS/MPS performance (and retailer service metrics) within the overall calculation would need to be considered; and
- Methodological issues (such as timings, piloting and other technical elements of the scheme).

PR19 sets the outcomes framework, of which this would form a part, for five years. This means that we would not have flexibility to change the shape of the scheme or financial incentives during those five years. This is a significant tension because, as the market is young, our collective understanding of metrics is improving fast and will develop further over the next few years. It is therefore likely that the suite of metrics that we specify in our PR19 determination would not cover all key aspects of wholesaler performance.

We are also mindful that the codes have been designed to address problems in the market and incentivise efficient and effective interactions between trading parties. Price control mechanisms should therefore only be used as an alternative approach if it isn't possible to promptly address these issues through the codes. PR19 does however, have an advantage in that it could provide a way to regulate the quality of the data used to underpin OPS and MPS performance, giving greater confidence and assurance in companies' stated performance against those metrics.

As discussed throughout this paper, OPSWG work on definition and data for OPS metrics is ongoing, but we believe this should be completed to fulfil our timings for a scheme to be implemented in 2020.

#### **Questions for stakeholders**

- A. How can the process for redistributing surplus charges be improved to incentivise good wholesaler performance?
- B. Can the charging structure, as set out under the MPF, be improved? For example, are the charges for underperformance appropriate and is the cap set correctly? What can be done to incentivise the ongoing completion of tasks that remain outstanding beyond the final time parameter?
- C. We have outlined what a PR19 wholesaler performance incentive mechanism could look like:
  - I. Do stakeholders agree with the metrics that we have identified to include in a potential scheme?

- II. If an incentive mechanism were introduced, are there any other data sets that could be considered as part of our assessment of wholesaler performance?
- III. We have suggested that, should a scheme be introduced, performance payments and penalties would only be applicable to the best and poorest performers respectively? Do stakeholders agree?
- IV. We welcome views from stakeholders on where the revenue levels for performance payments and penalties should be set if a PR19 scheme was implemented.

## 4.4 Variance in wholesaler policy

We are aware that where significant differences in wholesaler policy and ways of working exist this can contribute towards market complexity, add cost to retailers and have an impact on their ability to serve customers. This is especially pertinent for retailers serving customers with sites located across a range of different wholesale regions.

### **RWG**

Since the market opened the RWG has delivered outcomes which will hopefully improve trading party experiences across a number of key areas. We are aware that best practice / guidance has now been developed for:

- Carrying out disconnection for non-payment;
- Dealing with unplanned events; and
- Establishing where a leakage allowance is applicable

Looking further ahead a working group is looking at ways to improve or standardise the processes involved in retailers submitting bi-laterals to wholesalers.

At present the adoption of any best practice / guidance is optional for retailers and wholesalers. We understand that where best practice or guidance is developed it goes through an initial pilot phase where it is tested in practice and then reviewed to see if it needs to be revised.

### **What more could be done**

We acknowledge that the RWG can play an important role in supporting the resolution of market issues. However, experience suggests that overall engagement with the group varies, with smaller retailers under-represented. There may be scope to make the RWG and its working groups more inclusive and accessible.

There may also be scope to get more coverage for its work. Best practice is currently made publicly available on the MOSL website but there may be scope to use other forums and digital platforms to help encourage trading party engagement and participation with its work.

At present adoption of any best practice or guidance that is developed by the RWG working groups is not compulsory. To reduce market complexity, the RWG could explore if the codes can be updated to encourage trading parties to adopt guidance or best practice once it has gone through a post-implementation review with no significant changes or updates.

## **MOSL**

We mentioned earlier that in its MPOP MOSL indicated that it will develop a level playing field dashboard which will provide information on the regional variances in wholesaler performance and peer comparison information. The User Forum will support raising awareness, the promotion of best practice and the development of industry solutions.

The MPOP also indicates that MOSL is exploring the possibility of delivering a centralised solution for addressing bi-laterals, with the Digital Strategy Committee (DSC) having a key role to play. We understand that the DSC is co-ordinating its work with the RWG bi-laterals working group (mentioned above) and seeking proposals for solutions to reduce the complexity of bilateral interactions between trading parties. We understand that solution development is planned up until March 2020.

### **What more could be done**

If the User Forum is intending to engage with the RWG (and other forums) to try to address market issues, there may be the potential to gather and share intelligence to identify areas of significant policy variance among wholesalers. This information could better inform its dashboard and highlight key differences in wholesaler policy. The dashboards could then shine a light on areas of best practice, which may contribute towards reducing market complexity for retailers.

The DSC is still at a relatively early stage in terms of solution development and it isn't clear at this stage what the focus of the group will be. We recognise that many wholesalers already have portals in place. The focus may be on developing a front-end interface that will enable retailer access to these existing portals. Alternatively, the DSC could look to develop one portal for all trading parties to interact through. An early view on the scope of this work should help to inform business planning for wholesalers and retailers alike.

## **Ofwat**

We recognise that Ofwat can also play a role in smoothing interactions between trading parties by issuing guidance or engaging directly with companies that we have concerns with. For example, during the first year of the market concerns were raised by a number of retailers about the availability and quality of meter reading services in the business retail market. In September we [wrote to all wholesalers and retailers](#) making recommendations to improve meter reading services.

**Question for stakeholders**

- A. Throughout section 4 we explore a number of ways that Ofwat or other parties could take action to incentivise improvements in wholesaler performance. We welcome feedback from stakeholders on these actions and any other potential actions we may not have considered.



## 5. Next steps and responding to this CFI

As mentioned earlier in this paper, we want to ensure that the intelligence that we gather as part of this review aligns with and, where possible, complements existing initiatives. We are aware that the work contributing towards the improvement of the MPF is ongoing. We believe that the intelligence that we gather as part of this CFI will be received at time where it can feed into this review and the work of the RWG.

Who	What	When
RWG	Retailer survey review / Best practice development	Retailer survey working group findings are due to be drawn together in early 2019
Review of the MPF	Development of OPS and MPS metrics	Review scheduled to continue up until end of March 2019
Ofwat	Consideration of PR19 based incentive mechanism	Potentially consult and finalise scheme details in time for draft determinations (March 2019).
Ofwat	Consideration of code modifications	We will review proposed updates to the MPF towards April 2019 to determine whether there is a need to consult on code modifications.

The Call for Inputs period will be open for 4 weeks, closing at **9:30am on 10 December 2018**. Earlier responses, where evidence is already available, will be very helpful for our analysis.

By email (preferred): If you would like to submit your response by email please send a copy to [Wholesaler.CFI@ofwat.gsi.gov.uk](mailto:Wholesaler.CFI@ofwat.gsi.gov.uk)

By post: If you would like to submit your response by post, please send to:

**Ofwat – Wholesaler Performance CFI**  
**7 Hill St**  
**Birmingham**  
**B5 4UA**

Responses may be published on our website and shared with the UK and Welsh Governments. Therefore, if there is any information which is commercially sensitive or confidential please make this clear in your submission in a covering note. We will take these representations into account when considering whether information should be redacted.

## **Annex – Summary of questions for stakeholders**

### **Section 2 - Review of our analysis and engagement**

- A. Do you have any additional evidence or views on current wholesaler performance?

### **Section 3 – Working groups and initiatives**

- A. We have referred to a range of existing and planned work which may help to improve wholesaler service and performance. Do stakeholders think these initiatives will deliver sufficient outcomes within a reasonable timeframe? When responding please explain your answer.
- B. Have we missed out any other significant ongoing or scheduled work that could drive improvements in wholesaler performance?

### **Section 4 – Key issues impacting on wholesaler service and performance**

- A. Do stakeholders agree that we have identified the key issues that need to be prioritised and addressed? Are there any other issues that should also be considered as part of our analysis?

#### **Section 4.1 – Inadequate metrics to measure wholesaler performance and service**

- A. We have suggested a number of ways that the MPF could be updated to improve the way that wholesaler performance is measured and incentivised. Which of these suggestions do stakeholders believe would be most effective and why?
- B. Are there other areas of performance and interaction that should be considered by the OPSWG or as part of the next MPS review?
- C. Aside from updates to the MPF, are there any other ways that the codes could be changed to better measure wholesaler performance?

#### **Section 4.2 – Weak reputational incentives**

- A. Do you believe that sufficient progress is being made in reviewing and updating the MPF? If not, what more do you think should be done in the short and long term?

- B. We invite views from stakeholders on how Ofwat, MOSL or any other parties could use performance data to strengthen reputational incentives for wholesalers to improve performance.

### **Section 4.3 – Weak financial incentives**

- A. How can the process for redistributing surplus charges be improved to incentivise good wholesaler performance?
- B. Can the charging structure, as set out under the MPF, be improved? For example, are the charges for underperformance appropriate and is the cap set correctly? What can be done to incentivise the ongoing completion of tasks that remain outstanding beyond the final time parameter?
- C. We have outlined what a PR19 wholesaler performance incentive mechanism could look like:
  - I. Do stakeholders agree with the metrics that we have identified to include in a potential scheme?
  - II. If an incentive mechanism were introduced, are there any other data sets that could be considered as part of our assessment of wholesaler performance?
  - III. We have suggested that, should a scheme be introduced, performance payments and penalties would only be applicable to the best and poorest performers respectively? Do stakeholders agree?
  - IV. We welcome views from stakeholders on where the revenue levels for performance payments and penalties should be set if a PR19 scheme was implemented.

### **Section 4.4 – Variance in wholesaler policy**

- A. Throughout section 4 we explore a number of ways that Ofwat or other parties could take action to incentivise improvements in wholesaler performance. We welcome feedback from stakeholders on these actions and any other potential actions we may not have considered.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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