

Supporting the retail market during the pandemic

Roundtable discussion with Licensed
Providers and updates to the consultation

27 April 2021

www.watercommission.co.uk

Mindful of its statutory duties to promote the interests of customers, the Commission introduced measures to support non-household customers in light of the pandemic...

- In March 2020 the Commission announced the [temporary suspension](#) of wholesale prepayment requirement on Licensed Providers (LPs).
- The Commission later introduced a [deferral scheme](#) to support customers affected by the pandemic.
- LPs and Scottish Water have worked together to ensure that affected customers could benefit from a partial deferral of their water charges and extensions to their payment terms.
- In the absence of any evidence of LPs' financial resilience, however, these measures have increased the risk exposure to Scottish Water. The pandemic has, therefore, brought into focus the need to ensure that LPs are appropriately financially resilient – and can manage systematic risk for which they are remunerated through the allowed gross margin.
- As we now consider how to phase out current support measures, the Commission is mindful of its statutory duties to ensure an orderly functioning of the market and that there is no detriment to the wholesale business of Scottish Water. The Commission also wants to ensure that the unwinding of the current support measures is done in a measured and proportionate manner. To this end, in November 2020 the Commission published a [consultation](#) on steps to transition the market back to its normal operations.

It is important that the unwinding of current support and the introduction of new measures are consistent with the following principles...

1. Customers are, as far as possible, protected throughout this pandemic and can access appropriate support.
2. Measures are consistent with the Principles of Charging set out by Scottish Ministers.
3. Measures are consistent with our duties to make no detriment to the core business of Scottish Water.
4. The Commission can continue to facilitate an orderly participation of LPs in the retail market and use this pandemic to improve the market framework.



Ultimately, the unwinding of the current support and the introduction of future measures should be considered ‘a package deal’.

In line with the principles of Ethical Business Regulation, the Commission invited LPs to work collaboratively on developing proposals that support the retail market and allow to transition the market back to its normal operations...



- Following an industry-wide roundtable in December 2020, the Commission invited LPs to establish a Working Group (WG) to take ownership of the market framework and develop proposals that would address the issues set out by the Commission in its [consultation](#) issued in November 2020.
- LPs, thereafter, established a WG, chaired by Citizens Advice Scotland, and developed proposals to introduce a new deferral scheme and a new licence condition that would require LPs to demonstrate that they are financially resilient. The submissions from the WG to the Commission have been published on our [website](#).
- In April 2021, the Commission published a [consultation](#) setting out proposals to:
 1. Extend temporarily existing support measures to customers and LPs;
 2. Introduce a new voluntary licence which would be composed of two conditions:
 - a) A requirement on LPs to support affected customers by the pandemic through a new deferral scheme and
 - b) A commitment to demonstrate their financial resilience to Scottish Water and the Commission.LPs would be expected to notify the Commission by the end of May 2021 whether they are committed to signing up to a) both licence conditions b) only to the financial resilience licence condition or c) none of the new licence conditions.
 3. Take additional steps in the event that LPs do not make clear commitments to sign up to these additional licence requirements.
- The next slides summarise the proposals following engagement with Scottish Water and LPs. The presentation makes some revisions to some of the proposals set out in the April [consultation](#) document and provides more implementation details:
 - Maximum level of prepayment for LPs who sign up to the licence condition on financial resilience (slide 8);
 - The level of prepayment for LPs who do not sign up to the licence condition on financial resilience (slide 8);
 - Measures in support of a level playing field (slide 9); and
 - Implementation dates (slide 10 and 12).

The Commission expects all LPs to sign up to the new licence requirements. LPs who provide formal commitments on both financial resilience and customer support measures would ...

- Benefit from a more gradual unwinding of the support provided (e.g. wholesale prepayments).
- Have the flexibility to agree with Scottish Water tailored credit term arrangements that are consistent with the guidance set out by the Commission.
- Benefit from the relaxation of other regulatory provisions – for example lifting the cap on customer prepayments that LPs can collect from their customers (in light of the restrictions that the Commission is looking to introduce as part of the market review [changes](#)).
- Access the Market Health Check which could be used by LPs to improve their business and obtain a formal accreditation from an independent Market Health Checker.

The Commission expects all LPs to sign up to the new licence requirements. LPs who provide formal commitments on the financial resilience licence requirement but not on customer support measures would ...

- Benefit from a more gradual unwinding of the support provided (e.g. wholesale prepayments). The two month prepayment would be reintroduced earlier than what it would otherwise be if the LP had also committed to the licence condition on customer support measures.
- Have the flexibility to agree with Scottish Water tailored credit term arrangements that are consistent with the guidance set out by the Commission.
- Benefit from the relaxation of other regulatory provisions – for example lifting the cap on customer prepayments that LPs can collect from their customers (in light of the restrictions that the Commission is looking to introduce as part of the market review [changes](#)).
- Access the Market Health Check which could be used by LPs to improve their business and obtain a formal accreditation from an independent Market Health Checker.

The Commission expects all LPs to sign up to the new licence requirements. LPs who do not make any formal commitments on both the financial resilience and customer support measures licence requirements would ...

- Observe a faster reintroduction of the wholesale prepayments.
- Have no flexibility to agree with Scottish Water tailored credit term arrangements and be required to prepay a higher proportion of wholesale charges compared to LPs who do sign up to the licence condition on financial resilience .
- Be banned from collecting any prepayments from their customers (in light of the restrictions that the Commission is looking to introduce as part of the market review [changes](#)).
- Have no access to the Market Health Check. The Commission would kitemark the LP as a ‘high risk provider’ on its website and on Scotland on Tap. The Commission would also continue to monitor LPs’ compliance with regulatory provisions.

The pandemic has highlighted the importance of ensuring that LPs are robustly capitalised and can manage systematic risk...

- The Commission has reviewed market evidence from other re-financing arrangements and has observed that four months of wholesale prepayments appears to be an appropriate level of liquidity to withstand a similar shock to the current pandemic. Given the exceptional nature of the current pandemic, the Commission believes that 12 weeks of wholesale prepayments is a sufficient level of liquidity for any LP who has committed to demonstrate its financial resilience.
- LPs who can evidence an appropriate level of financial strength may be able to reduce that prepayment requirement by negotiating revised payment arrangements with Scottish Water. LPs who sign up to this condition but fail to meet the criteria set out by Scottish Water would pay a maximum of 12 weeks of wholesale prepayments.
- The Commission believes that 6 weeks of wholesale prepayments is the lowest level of prepayments that would be consistent with its no detriment duty to Scottish Water.
- LPs who **sign up** to the new licence condition on financial resilience would, therefore, be able to negotiate tailored credit term arrangements with a level between 6 to 12 weeks of wholesale prepayments based on Scottish Water's creditworthiness assessment. Any new entrant would also be required to sign up to this additional licence requirement.
- LPs who **do not sign up** to the new licence condition would be required to prepay 14 weeks of wholesale charges.



Credit term arrangements that are negotiated between Scottish Water and its licensed providers would, therefore, need to be consistent with the cap and collar on prepayment set by the Commission.

The Commission will ensure that the measures are consistent with a level playing field...

- To ensure transparency, Scottish Water would publish a framework setting out the criteria that would be taken into account in its assessment of LPs' creditworthiness, which will affect the amount of wholesale prepayment that would be required.
- Scottish Water would also review LPs' ongoing financial position - the Market Health Check could be used for monitoring purposes. As LPs' financial position may change overtime, the level of prepayment may also change consistent with the framework set out by Scottish Water.
- In order to support a level playing field, the Commission is proposing to implement additional requirements for LPs with more than 30% of market share (based on the value of wholesale charges). In this case, LPs would also have to explain how the arrangements are consistent with a level playing field and seek the approval of the Commission. The arrangements would then be published. In light of this, the Commission will likely have to amend Business Stream's Governance Code to support these proposed measures.
- Whilst we would not anticipate to change these arrangements in the foreseeable future, we would continue to keep them under review, having regard of changes in the perceived risk of the overall market and taking into account LPs' individual circumstances. Changes to the arrangements would always be subject to public consultation.

The table below summarises the measures depending on whether LPs sign up or not to the additional licence requirements...

Measures	LP signs up to the customer protection and financial resilience licence condition	LP signs up to the financial resilience licence condition but not the customer protection licence condition	None
Wholesale prepayments	<ul style="list-style-type: none"> • 4 weeks prepayment in July 2021 • 8 weeks prepayment in December 2021 • Between 6 and 12 weeks prepayment in May 2022 based on Scottish Water's assessment of LPs creditworthiness 	<ul style="list-style-type: none"> • 4 weeks prepayment in July 2021 • 8 weeks prepayment in October 2021 • Between 6 and 12 weeks prepayment in May 2022 based on Scottish Water's assessment of LPs creditworthiness 	<ul style="list-style-type: none"> • 4 weeks prepayment in July 2021 • 8 weeks prepayment in September 2021 • 12 weeks prepayment in January 2022 • 14 weeks prepayment in April 2022
Wholesale payment terms	Flexibility to negotiate tailored agreement	Flexibility to negotiate tailored agreement	Fixed 14 weeks of prepayment of wholesale charges
Customer prepayments	No cap – full flexibility to offer tailored arrangements	No cap - full flexibility to offer tailored arrangements	Ban on customer prepayments
Market Health Check (MHC)	Access to MHC	Access to MHC	LP is kitemarked by WICS as 'high risk provider' on its website and Scotland on Tap.

The Commission is also consulting on the introduction of a new deferral scheme...

- The scheme would target small and medium customers (≤ 25 mm meter, unmetered and surface drainage only customers).
- LPs who opt in the licence condition on customer support measures would be able to offer tailored support to their customers through deferrals of charges and extensions to their payment terms. LPs offering support to their customers would be able to access a deferral of wholesale charges. Scottish Water would charge an annual interest of 3.5% on any deferred charges.
- To ensure there is no detriment to its core business, Scottish Water is proposing to cap the value of each LP's deferrable charges. The cap should be consistent with ensuring that Scottish Water's cash exposure is managed prudently throughout the current financial year. Any value above the cap could be accessed by offering Scottish Water security covering the full value of that incremental deferral.
- The repayment of the deferral charges would be done gradually – all deferred wholesale charges would however be repaid by April 2023. Customers who wish to repay deferred amounts quicker or end the current deferral would be able to come off the scheme at any point in time.
- LPs would be able to auto enrol customers on the scheme and target customers in greater need. Any customer who is seeking a full deferral of charges from their LP but cannot access it would be able to switch to a new LP.

Timescales for implementation...

- The Commission is inviting stakeholders to send their comments on the outlined proposals to competitionteam@watercommission.co.uk by 7 May 2021.
- The Commission will then review all responses to the consultation and publish a final decision on the proposals set out in this consultation document, including any revised licence condition, by 17 May 2021.
- The table below sets out indicative implementation timescales:

Date	Milestone
7 May 2021	Stakeholders provide responses to the consultation
7 May 2021	Scottish Water publishes its final approach to assessing LPs' creditworthiness
By 17 May 2021	Final decision published by the Commission on measures
End of May 2021	LPs notify the Commission whether they are signing up to the new licence requirements
May/June 2021	New Deferral Scheme is introduced
June 2021	Scope for Market Health Check
July 2021	Procurement for appointment of Market Health Checker
October 2021	Market Health Checker appointed
December 2021	First Market Health Check
April 2022	Interim review of progress on financial resilience arrangements
November 2022	Second Market Health Check
By April 2023	All deferred wholesale charges are repaid



Water Industry Commission for Scotland
First Floor, Moray House, Forthside Way, Stirling FK8 1QZ

E: enquiries@watercommission.co.uk

T: +44(0) 1786 430200

www.watercommission.co.uk

www.scotlandontap.gov.uk

@WICScotland