

Influencing Without Power

A review of Independent Challenge Groups
in the Water sector

For the Consumer Council for Water, February 2023

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Executive Summary

The task of the independent challenge group (ICG) is not an easy one. The ICGs provide scrutiny and challenge on behalf of customers to monopoly companies operating in a heavily regulated sector. Much of the expenditure incurred by the water companies, including the great majority of expenditure related to the environment, is determined by licence obligations and the associated regulation. This means that the discretion companies have to respond to customer needs and preferences is limited. In addition, the background to PR24 business planning is highly charged, with tension between the need for more infrastructure investment to serve the interests of customers now and in the future and other current demands on customers' budgets. Trade-offs that broadly satisfy most stakeholders and customers will be hard to find.

Ofwat decided not to mandate Customer Challenge Groups at PR24¹ and its expectation about customer challenge was as follows. *'Customers and their representatives must be able to challenge the companies' ongoing performance, business plans and long-term delivery strategies. The purpose of customer challenge is for companies to receive feedback on what issues matter to customers, what their views are on various aspects of companies' activities, and to enable customer comment on how well plans reflect their needs, priorities and preferences.'*²

Each company has decided an ICG (or in one case an independent challenge expert) has a role in meeting Ofwat's expectations for challenge.

Challenging a company is not difficult but challenge alone is unlikely to be effective, where 'effective' means challenge that leads to change in the company's approach and improves delivery for customers. The change may affect the company's decisions, strategies, culture and behaviours. Challenge can be carefully evidenced, well-reasoned and phrased constructively but unless it leads to action it achieves little. ICGs cannot compel the company to act on their challenges or recommendations, but they can present the case for doing so.

The findings of this review are set out in Sections 2 to 9 of this report and show that providing effective challenge, especially doing so consistently, depends on a combination of factors. We have summarised these in the 'Checklist for effective ICG challenge'. Some of the key factors are procedural, others are behavioural. They are not for the ICG alone, the actions of the company's leaders and staff play an essential role.

A third group of factors relates to governance. When Ofwat set its expectations for customer challenge³ a significant aspect was that company boards should be *'accountable for having in place*

¹ PR24 and beyond: Creating tomorrow, together – Ofwat, May 2021

² PR24 and beyond: Customer engagement policy – a position paper – Ofwat, February 2022, pages 8-10

³ ibid

a mechanism for, and listening to, customer challenge' and being 'able to demonstrate how business plans and wider decision-making take account of matters that are important to customers, including those highlighted through the customer challenge process'.

The evidence we obtained shows companies are at different stages of deciding how the board will discharge this accountability. That part relating to the ICG can be set out in the ICG's Terms of Reference and two ICGs have done this. Agreeing a formal process for how the ICG's scrutiny of business planning will interact with the board's sign off of the PR24 plan was underway in five companies and two had already agreed a process.

The review identified a range of approaches that ICGs and companies have found to contribute to effective scrutiny and challenge. Even apparently small measures can make a material contribution. The regular meetings of the ICG Chairs at the Challenge Coordination Group (COG) provide a forum the Chairs can use to share learning about approaches that enhance the quality of scrutiny and challenge.

As noted above, the proportion of expenditure over which the companies have discretion to respond to the needs and preferences of customers now and in future is limited and we understand that companies cite this as a reason for some things not being part of their plan. ICGs may wish to review company positions on this and, if necessary, seek clarity from the regulator. If there are instances where the ICG thinks an aspect of regulation is not working as well as it might to meet customer needs or preferences, it may wish to explore possible courses of action with the company. The COG could be a forum where matters of this kind and other matters relating to customer challenge could be discussed with the regulators.

A checklist for effective ICG challenge

In preparing this report we analysed material including ICG Terms of Reference and other documents and the results of in-depth interviews with ICG Chairs delivering challenge they hope will be effective and company representatives in a position to respond to that challenge.

Checks and balances have their part to play. Governance, processes and procedures contribute to creating circumstances where challenge is most likely to be effective. They are necessary but not sufficient. The behaviours of the ICG and of the company, particularly its leaders, are fundamental to whether the ICG's challenge is effective. Commissioning an ICG is intended to add value but there is a risk of adversarial interaction and challenge being rejected.

The review found that ICGs can be, and frequently are, a valued source of customer challenge and revealed insights into how to create the circumstances for this. The findings are set out in Sections 2 to 9, each of which has conclusions and recommendations. From these we have created a checklist of factors that can enhance an ICG's ability to challenge effectively. The checklist is at the end of this Summary. It is not exhaustive: the water companies are not homogeneous and what makes an ICG effective will vary, including over time.

The list starts with behaviours. In the cases where both the ICG Chair and their company counterpart said the ICG's challenge was consistently effective and added significant value, three types of behaviour were mentioned frequently.

- The first was that the company, from its leaders down, actively welcomed challenge and acknowledged that challenge will often feel uncomfortable.
- The second was that the ICG understood that its challenges were more likely to be taken on board if the ICG did not act solely as a critic but as a critical friend, interested in helping the company improve rather than seeing its job as issuing challenge and no more.
- The third was about both the company and the ICG, particularly the ICG Chair, being committed to having honest conversations, not just when the ICG was set up but throughout as circumstances evolved, barriers to effectiveness were identified and updated ways of working were needed. These conversations should include discussing what can go wrong and how the company and the ICG would handle such situations.

The second part of the list focuses on governance. Ofwat has said that the company board is accountable for *'having in place a mechanism for, and listening to, customer challenge'*⁴. The ICG Terms of Reference (ToR) should make clear how the Board will discharge this accountability, including the ICG's reporting line, the member of the Management Team responsible for the company's relationship with the ICG, the type and frequency of contact with the board, and how situations will be managed when the company and ICG disagree.

The ToR should set out the ICG's role and remit. Having a common, outcome-focused objective for both company and ICG, for example delivering a better business plan for customers, gives the ICG's challenge a clear purpose. This should be accompanied by a high-level view of what effective delivery looks like, for example the ICG holding the company to account for its promises to customers, so expectations are clear on both sides.

The final part of the checklist includes the operational building blocks on which the effectiveness of the ICG rests. The sections of the report containing the findings for each are signposted below:

- Having the right mix of members to deliver the ICG's remit is essential and should be considered in terms of the quality of challenge and constructive approach as well as subject expertise (Section 6).
- Maintaining independence requires a mix of behavioural mechanisms as well as processes (Section 3).
- The ICG is primarily reliant on the company for information, and determining the relevant scope and level will need active discussion, including sourcing comparative data and hearing wider perspectives, for example from EA and CCW representatives (Section 7).

⁴ ibid

- The final essential element is resourcing the ICG appropriately to deliver its remit. This includes ensuring the ICG has sufficient time to scrutinise topics, including preparatory time. Appropriate secretariat support is important, together with timely updating of online material. Sufficient engagement with the Group from the Management Team and technical experts is essential (Section 7).

Checklist for effective ICG challenge

Behaviours

- Company: welcoming 'uncomfortable' challenge
- ICG: acting as a critical friend, not just a critic
- Both: having honest conversations as issues arise

Governance

ICG Terms of Reference include

- A clear remit: set out a common objective for the company and the ICG that is outcome-focused and customer-centred
- The ICG's source of authority and role: set out the source of the ICG's authority to act, along with a high-level view of what effective delivery looks like
- Board accountability: make clear how the Board will discharge the ICG related part of its accountability for customer challenge

Operational

- Right mix of members
 - subject expertise
 - quality of challenge
 - constructive approach
- Independence guarded
 - processes and behaviours established
 - written down
- Providing relevant information
 - appropriate level
 - comparative data
 - wider perspectives
- Resourced appropriately
 - sufficient time to scrutinise
 - appropriate secretariat support and timely updating of online material
 - sufficient engagement from the Management Team and technical experts

Acknowledgement

CCW proposed that this review should be collaborative, noting in the Terms of Reference that 'it will require the support of ICG Chairs – and companies – to deliver the best outcome.'

That support has been forthcoming and we are grateful for the time that ICG Chairs, company representatives and independent non-executive directors (INEDs) have made available for interviews and, in the case of ICG Chairs, completing a questionnaire and providing relevant documentation. Additionally, a number of CCW and Environment Agency staff who attend different ICGs have provided submissions.

All contributors have been open and generous in providing in depth insights into how the ICGs are currently working and their views on how well the ICG-water company relationship is delivering against its potential.

This has enhanced the quality of information available to the review and made it possible to include a wide range of ideas and successful practices that the ICG Chairs and companies may find useful.

1 Introduction

This section covers the terms of reference for the review, the sector context, our approach to the review, the structure of the report, and the audiences who may find it of interest.

1.1 Terms of reference

The Consumer Council for Water's (CCW's) aim in commissioning this review was to assist Independent Challenge Groups (ICGs) and help to strengthen their challenge to the companies.

Ofwat's February 2022 position paper, *PR24 and beyond: Customer engagement policy*⁵, set out its expectations for customer challenge. This stated that '*The purpose of customer challenge is for companies to receive feedback on what issues matter to customers, what their views are on various aspects of companies' activities, and to enable customer comment on how well plans reflect their needs, priorities and preferences*'. Ofwat's expectations of how customer challenge would be evidenced were considered by CCW in developing the Terms of Reference for this review. Key topics included the ICGs' independence, their membership and expertise, resources, board access, constitution and clarity of role, and transparency. The subject of companies' responses to the removal of the mandate to have a Customer Challenge Group was also included. The Terms of Reference set by CCW can be found in Appendix A.

1.2 Sector context

Judgements about the role and effectiveness of ICG challenge should have regard to the complexities of the water sector and its current prominence in the spotlight of public attention.

Unsurprisingly, the seventeen water companies in England and Wales are not homogeneous. There are significant variations in size (customer numbers, lengths of main), geography and environment, water sources, population distribution, demographics and asset age. Additionally, there are differences between companies operating in England and those operating in Wales and between Water only Companies (WoCs) and those also responsible for managing wastewater, the Water and Sewerage Companies (WaSCs).

The background to PR24 business planning is highly charged, with tension between the need for more infrastructure investment to serve the interests of customers now and in future and other current demands on customers' budgets. It will be hard to make trade-offs that broadly satisfy most stakeholders and customers. Much of the expenditure incurred by the water companies, including the great majority of expenditure related to the environment, is

⁵ PR24 and beyond: Customer engagement policy – a position paper, February 2022. pages 8-10

determined by licence obligations and the associated regulation, administered by several statutory regulators. This means that the discretion the companies have to respond to customer needs and preferences is limited.

1.3 Approach to the review

Because of the context and the diversity of the ICG processes in the companies, we concluded that it would be inappropriate to adopt a single template of how an ICG should operate. Instead, we sought to understand how the ICGs are working, and how successful they are seen to be in delivering constructive, influential challenge to the company. From this, we distilled a view of the structural, governance and behavioural factors that allow an ICG to add value in ways that the company would not get from other sources and to identify barriers that can prevent this from happening. This is reflected in the recommendations at the end of each section and summed up in the Key Factors for Effective Challenge checklist on page 4.

The research approach included a questionnaire to the ICG Chairs; review of ICG documentation such as Terms of Reference, meeting minutes and reports; interviews with each ICG Chair and one or more representatives from each water company; and interviews with an independent non-executive director from several water companies. Interviewees being willing to speak openly was important for the quality of the evidence base, and the interviews were therefore conducted on the basis of anonymity. Rather than identifying individual companies or interviewees, the evidence is set out by theme and no direct quotes have been used. The research was qualitative; the results are presented as such.

We include, as examples, approaches that ICGs and companies have adopted to enhance the effectiveness of the scrutiny and challenge. While individually each of these will not be applicable to every company, they provide a bank of ideas that companies and ICGs can draw on and refine now and in future.

1.4 Structure of the report

The report is structured by the main topics in CCW's terms of reference for the review with subsections for each key questions. The findings related to each question are set out, including examples of approaches adopted by different ICGs. Conclusions and recommendations sections can be found at the end of each main topic area.

There are variations in the naming of the Independent Challenge Groups (ICGs). Some are ICGs, some are known as Customer Challenge Groups and other variations refer to Forum or Panel. For consistency, this report refers to them all as ICGs. Similarly, it refers to the group consisting of the company CEO and immediate team as the Management Team.

One company has appointed a single expert rather than an ICG to conduct its independent challenge for PR24. This person attends the ICG Chairs group (the Challenge Coordination Group known as the COG) and is considered with the ICG Chairs in this report. Therefore throughout the report 17 ICG Chairs are referred to but only 16 Independent Challenge Group (ICGs).

1.5 Audiences

CCW has shared this report with Ofwat and published it in the interests of transparency. Two primary audiences are CCW and the ICG Chairs. They are members of the Challenge Co-Ordination Group (COG), a forum for representatives of the ICGs. Another audience is the water companies and their boards. A clear finding from the review was the importance of the company's contribution to the delivery of effective, influential challenge by the ICG. Ofwat's expectations for customer challenge⁶ included board accountability for *'having in place a mechanism for, and listening to, customer challenge'* and being *'able to demonstrate how business plans and wider decision-making take account of matters that are important to customers, including those highlighted through the customer challenge process'*.

Others will be interested in the review, including the sector's regulatory bodies. The Environment Agency (EA), Natural Resources Wales, Natural England and the Drinking Water Inspectorate (DWI) are involved with the ICGs in various ways.

⁶ Ibid

2 Removal of the mandate to have a Customer Challenge Group

ToR - Assess companies' responses to the removal of the mandate from Ofwat to have Customer Challenge Groups as part of the price review process. Is the company still clearly committed to receiving and acting upon strong local challenge as part of its business planning process?

The water companies have responded in different ways to the removal of the mandate. The common factor from the company interviews was that all had thought carefully about whether to continue with an ICG and what its remit should be, often working with the ICG chair on this. The result was that all the companies decided to continue with a challenge group in some form. Some Groups continued seamlessly after submission of PR19 business plans, while others had a hiatus or were disbanded followed by a later decision to recruit a new group.

Ofwat's guidance on Customer Challenge for PR24⁷ said '*Companies are expected to put in place challenge and assurance solutions to meet their individual needs, ambitions and circumstances, while ensuring that they meet the standards we set out in this paper.*' Most interviewees were positive about the regulator's decision. For example, two INEDs said that Ofwat giving water companies the freedom to design their own customer challenge arrangements and judging them on the outcome is a sign of maturity in the sector.

Ultimately, all the companies have taken the freedom to scope the ICG's role in line with their needs as an opportunity. Some have taken an evolutionary approach, updating the role and membership of the ICG for the demands of PR24. Others had a hiatus, either deliberately or due to the Chair standing down or changes of ownership or management team at the company. They took time to consider what would be the most useful role for the ICG, in some cases waiting for Ofwat's final position before making their decision.

Some companies appeared more confident than others in their PR24 independent challenge arrangements. The most confident had either continued with an ICG throughout PR19, reviewing and updating the remit, or had completely rescoped their independent challenge arrangements to better meet their needs. Those who appeared less confident in their arrangements were more likely to have waited longer before deciding on their approach, either for Ofwat's decision on whether to mandate challenge groups or for further guidance following that decision. A few expressed a concern that without additional formal guidance there was a greater risk that Ofwat would judge arrangements to be inadequate.

⁷ Ibid

A number of the companies changed the model quite radically. For example, one WoC found the cost of resourcing a CCG disproportionate and instead recruited an individual policy and regulatory expert experienced in constructive challenge to focus on the quality of customer engagement and its use in business planning.

Another terminated its CCG and formed a new Group not to challenge on behalf of all customers, but to hear from groups in its communities whose voice might be unheard otherwise. An ICG that was formed after the original group was disbanded is focused on challenging on behalf of what they refer to as 'the silent majority', responding to the concern that subsets of 'noisy' customers can attract disproportionate shares of a water company's attention and time. Another has half its meetings in public, with customers invited to attend and challenge the company's Management Team directly. All companies acknowledged the importance of challenge that recognises the particular features and communities of their local area, but two different routes to achieving this are emerging. One continues to find value in an ICG predominantly or entirely made up of members who live or work in the company's operating area and together know it well. The other emphasises expert professional challenge that takes into account the company's local area but does not necessarily come from members who know it personally (see Section 6.2).

Different approaches have been taken to seeking challenge on the environment aspects of the companies' work. These include having one or more members with relevant expertise on the ICG, having an environment subgroup and having a separate independent group to scrutinise and challenge on environment matters. In this latter set there may be reciprocal attendance by the Chairs of the ICG and Environment groups at the other group. At least one company with this structure operates the ICG and Environment groups in parallel, both reporting to the CEO and Board and the Chairs providing strategic joint challenge as relevant.

The customer research assurance role that CCGs had at PR19 was felt by many companies and Chairs not to be appropriate. This was partly because of the very particular expertise required, as well as the workload and lengthy reporting involved which could limit the wider contribution of the Group. For PR24, few ICGs are providing formal assurance of the customer research programme. The others will scrutinise, but not assure, the company's customer engagement, with the breadth and depth of scrutiny varying. This scrutiny will centre on the quality of engagement and the use the company makes of the results in its business planning.

2.1 Conclusions and recommendations: removal of the mandate

The voluntary continuation with independent challenge arrangements, almost always in the form of a Group, demonstrates the value companies see for independent challenge in meeting Ofwat's expectations for customer challenge⁸. The companies appear to be committed to receiving and acting upon strong local challenge as part of their business planning. There was

⁸ Ibid

evidence that the PR19 customer challenge arrangements had been thoughtfully reviewed, and the opportunity taken to work out arrangements suited to today's circumstances.

To get the best from their independent challenge arrangements it is important that companies and ICG Chairs continue to take an active approach to evaluating their success, including in the run up to the submission of PR24 business plans. Signs of an ongoing conversation about the success of the current approach were common amongst those who were most confident that their arrangements will deliver the quality of scrutiny and challenge they are aiming for,

The ICG Chairs' Challenge Coordination Group (COG) convened by CCW provides an ongoing opportunity for sharing ideas and learning about what works well and not so well for different ICGs. In the short-term this may be particularly useful for newer Chairs, but all will be considering how to adapt their scrutiny as the sector evolves.

Where there is a separate group tasked with scrutinising the environment aspects of the company's work, there should be contact with the ICG. As a minimum, the two groups should have sight of each other's work programmes. Reciprocal attendance by the respective Chairs at the other group can enhance scrutiny, including facilitating potentially joint scrutiny of trade-offs the company is making, for example between affordability and environment interests.

Recommendations

- Active consideration by the company of what it wants from an ICG, and how it will facilitate challenge, is important. Companies, together with their ICG Chairs, should regularly evaluate the success of their independent challenge arrangements, evolving them as needed. This should include ensuring that there are appropriate links between environment and customer challenge arrangements where these are separate
- Particularly where new independent challenge arrangements are bedding in, companies may wish to review how well they think their arrangements are meeting Ofwat's expectations in *PR24 and beyond: Customer engagement policy*⁹. With company boards accountable for these arrangements, the Board or a board subcommittee may wish to be involved
- CCW and the ICG Chairs should regularly schedule time at the COG for discussing different aspects of independent challenge and the factors they find contribute to success or constitute barriers

⁹ PR24 and beyond: Customer engagement policy – a position paper, February 2022. Pages 8-10

3 Independence of the ICGs

ToR - Assess the degree to which the ICGs operate independently of their company's interests, including how well they are able to demonstrate this independence. How were members appointed, was this independently of the company?

There are some obvious tensions here. The water company pays for the ICG and the ICG relies on information provided by the company. 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.

Almost all the ICG Chairs said spontaneously that it was important to guard their independence and continuously prove it. A range of structural and behavioural approaches were mentioned as facilitating independence. These are discussed below.

3.1 Governance and working practices

There are a number of measures and processes that ICG Chairs have introduced to facilitate independent working and keep independence front of mind for members:

Group Name

While some groups and water companies have retained the 'Customer Challenge Group' (CCG) title or other longstanding name, others have taken the opportunity to rebrand to 'Independent Challenge Group'. They felt that 'CCG' risked being misleading as the group is not a customer representative forum, whereas Independent Challenge Group more accurately reflects that the group is there to provide independent challenge to the company.

Term limits

Many ICGs have limits to both Chair and members' terms. These are most commonly two price review terms, though some have members who have served for longer. One INED felt that two price reviews could be too long, questioning whether members could maintain their independence for longer than a single term. Other interviewees, however, had found having members with a mix of terms beneficial as more experienced members helped newer ones understand the company and wider sector. They had not found that the ICG's independence was compromised by the longer-serving members.

Independent Chair

All but one ICG has an independent Chair, and many company representatives emphasised how important having the right Chair is to the quality of the ICG's contribution and independence. The exception is chaired by the company's Chief Customer Officer. The interviewees associated with that group, including a group member, said they find that the

group is providing independent thinking. They took a pragmatic view that the arrangement could be changed in future if it was no longer working well.

Terms of Reference

Fifteen ICG Chairs were able to provide Terms of Reference (ToR) to this review. (One was being updated and one company does not have a ToR document for its group.) The ToRs emphasised the independence of the ICG. Two ICG Chairs referred to additional documented processes on independence. One Group has a Code of Conduct which requires members collectively to hold each other to account, and to declare any actual or potential conflicts of interest as soon as they become aware of them. The other has a process for members to raise concerns about independence.

Hospitality

Two ICG Chairs mentioned their approach to hospitality: one had a hospitality log and the other a 'no wine and dine' policy.

ICG-only sessions

Many have private, ICG members only sessions at the start or end of ICG meetings (or both) in order to facilitate open discussion with members feeling fully able to contribute independently.

Standing agenda items

Some ICGs have a standing agenda item for Declarations of Interest at the start of each meeting so that members' situations are clearly understood. One makes an independence statement at the start of each meeting reminding members that they are there in an independent capacity, not on behalf of any organisation they may work for. Another reminds members of the risk of 'capture' by company thinking. This Chair observed that capture can be inadvertent and that ICG members have an ongoing responsibility to test themselves on the independence of their scrutiny and challenge. One ICG has a questionnaire for members at the end of each meeting which includes a question about whether the member felt able to exercise their independence and give their honest views at the meeting.

Transparency

Transparency is another part of demonstrating the ICG is operating independently, and is discussed fully in Section 9. Almost all companies and ICGs choose to publish information about the ICG's work. The content of publications and the frequency varies but commonly includes the ICG's Terms of Reference, agendas, minutes, challenge and response logs, briefings and quarterly or annual reports.

3.2 Behaviours

Monitoring and promoting independence

A majority of company representatives emphasised unprompted how crucial the ICG Chair was to the group operating in a way that was genuinely independent. Most ICG Chairs monitor

their ICGs for signs that independence is maintained to guard against it slipping. Some require particular behaviours in this regard: for example always referring to the ICG and the water company separately, never as 'we', and ensuring the any one-to-one meetings with company representatives are documented.

Signals from the company's leaders

On the water company side, signals from the leadership are important. If the Board, CEO and Management Team are seen to emphasise the value of independent challenge and the ICG's role in providing it, this attitude will be much more likely to permeate through the management structure to individual team members who may be involved in preparing materials for the ICG and responding to their requests.

Some company representatives emphasised that the company had granted the ICG Chair freedom to have conversations across the company, for example being able to talk directly to non-executive directors or having a direct line to anyone in the company including the CEO. They saw this as more beneficial to the ICG's independent challenge role than 'gating' the group's work within ICG meetings only. One independent non-executive director who regularly observes ICG meetings emphasised the need to watch for the ICG developing empathy with the company as this would risk neutralising its challenge.

3.3 Information context and comparability

ICG Chairs are conscious that their groups rely on information from the company. They have members who have been recruited for relevant expertise, for example in customer research, or as local stakeholders, but who are not water industry experts.

They find that representatives from the water regulatory and statutory bodies provide useful, often comparative, information about the sector which enables the ICG to be better informed in its scrutiny and challenge. CCW and the EA are the most common attendees. Natural England and the Drinking Water Inspectorate attend fewer of the ICGs and are more likely to be occasional attendees when specific topics are on the agenda. The role of these bodies is discussed in Section 6.3.

Several ICG Chairs mentioned that they value the role of the Challenge Co-ordination Group (COG) of ICG Chairs convened by CCW in providing and discussing comparative performance information for the water companies. In Wales, the ICG Chairs find the Wales PR24 Forum valuable with the range of voices in the room enabling comparison of views.

3.4 Recruitment and remuneration

When asked about capture, several interviewees said that independence starts at recruitment. One ICG Chair added that the calibre of members they recruit is such that they want to be on

the ICG on their own terms; they are not interested in being captured. Another emphasised that they look for both independence and diversity of views when recruiting.

Across the ICGs there is a range of approaches to recruitment. Of the sixteen independent ICG Chairs, thirteen were appointed through an open process via advertising or a recruitment agency or both. The others were appointed from among existing group members, who were invited by the company to step up.

When recruiting members, a majority, 9 out of 16, used open recruitment via advertising or a recruitment agency or both to find candidates. Five of these combined this with recommendations from the ICG Chair's network or contacts of the water company's staff, or both. Seven groups sourced candidates solely from the ICG Chair's and/or the water company's contact networks. As part of its commitment to independence, one ICG has a policy of the water company not suggesting potential members.

In 12 instances, the ICG Chair (or in one case the ICG's Nominations and Review Committee) is responsible for recruiting ICG members. In just under half of these (5), candidates are then put forward for water company sign off, with no further sign off for the rest. In the other four ICGs, the water company is responsible for recruitment, with the ICG Chair signing off recruitment in three of these. The last one does not have an independent chair.

The subject of remuneration of ICG Chairs and members is covered in Section 7.4. Regarding remuneration and independence specifically, two interviewees said that if ICG members are not paid by the water company this makes them more independent. All ICG independent chairs are paid by the water company for their work and of the 15 ICGs with independent members (i.e. those who do not represent an organisation) 11 pay their independent members. Two more make payments to a (often) local charitable or community organisation or initiative nominated by each member and the other two pay expenses only.

3.5 Conclusions and recommendations: independence of the ICGs

With Ofwat no longer mandating the existence and role of challenge groups, and company boards accountable for customer challenge arrangements, independence will only be achieved if both the water company and the ICG Chair make it a priority. This appears to be happening. Interviewees made clear that the independence of the ICG is important to those on the company side as well as ICG Chairs, and that there is agreement that it must be actively maintained.

The ICG Chairs cited a range of practices and behaviours that have been useful for maintaining independence. We note that even apparently small measures can make a material contribution. This is a potentially fruitful area for the Chairs to discuss at the COG.

ICGs are primarily reliant on information from the company about its performance. To properly understand this it is important that ICGs have access to wider contextual information, both

within and beyond the water sector. Where available, they should also have access to comparative datasets. Ideally, the access to such datasets should be consistent across ICGs.

As long as effective steps are being taken to maintain the ICG's independence, there does not seem to be a significant risk of capture in having members serve two price review terms. Some ICGs report that having members with varied lengths of service improves the functioning of the Group. These benefits should be considered when deciding term limits, and it may be that the company and ICG Chair decide that it is appropriate to make occasional exceptions to a two-term rule if a member's longer experience of price reviews is likely to add value to the Group.

Given the ICG Chair is responsible for ensuring that their ICG operates effectively, the approach to recruitment adopted in most ICGs makes sense, with the Chair having lead responsibility and the water company signing off. It reduces the risk of the company appointing, or being thought to have appointed, members who are less likely to disagree with their thinking or to act independently. The ICG Chair can take responsibility for forming a group suited to independent challenge, and the importance of the company's interest in having a group that can deliver what is needed is also acknowledged.

Recruiting solely via recommendation may be quicker and cheaper than running open recruitment but can mean a narrower pool of candidates and perspectives. If some or all of the recommendations are made by the company the risk of those members being thought to be less independent is raised. A well-managed open recruitment process that throws its net widely has the advantage of enabling a wide pool of candidates that can include those identified through the ICG Chair or company staff, with all candidates considered against the same criteria.

A 'no remuneration' policy for independent ICG members does not appear to guarantee greater independence of thought. It does appear to bring some risks to the quality of the ICG's work. There is a risk of increasing the likelihood of members being influenced by the agendas of organisations for which they work as an employee or in another paid capacity. Another risk is that members may be less committed to their ICG work, deprioritising it in favour of paid work especially if the policy is interpreted as a signal that the company does not particularly value the ICG's contribution. It may also make it more difficult to recruit members of the appropriate calibre and across the relevant areas of expertise (see Section 6.2).

Recommendations

- ICG Chairs to regularly review the processes and behaviours used to maintain independence

CCW and the ICG Chairs should:

- Consider whether a discussion of the processes and behaviours different ICG Chairs use to maintain independence would be fruitful
- Discuss the access that different ICGs have to wider contextual and comparative information about company performance, with the aim of developing a proposal for ICGs to

have access to consistent contextual and comparative information about company performance

Companies and their ICG Chairs should:

- Consider implementing a term limit for ICG members, including the option to consider circumstances in which exceptions could be made to allow longer service
- Where open recruitment for the ICG Chair or members is not used, review why not and consider whether it could be beneficial for some or all roles, for example in the context of the future needs of the ICG or the particular expertise needed
- Consider whether ICG recruitment responsibilities achieve an appropriate balance between the ICG Chair's responsibility to ensure the group will work effectively, and the need for the company to have confidence that the Group can deliver what is needed

4 The effectiveness of the ICGs' challenge

ToR - Look for evidence that an ICG is sufficiently empowered to challenge its company in a robust and constructive manner without censure. Consider the effectiveness of this challenge, including the response by companies.

Providing robust challenge of a 'Why isn't X, Y or Z better?' type is not difficult. Providing effective challenge to which the company listens and that influences decisions is more difficult. Effective challenge was seen as the purpose of the ICGs by both ICG Chairs and company interviewees. Some were confident that the ICG was delivering effective challenge that the company finds valuable. In several of these cases this was after changes to the approach and ways of working by both sides. Others said there was further to go to create the value adding and constructively challenging relationship they wanted to see.

Again, practices and behaviours can make important contributions to effective challenge. Approaches the ICGs and companies have found useful are discussed below.

4.1 Building trust

The interviews showed that many water companies and ICG Chairs see building a relationship of trust between the ICG and the company as fundamental to success. Some company representatives acknowledged that being challenged can be uncomfortable, and there is a risk that challenge can create defensiveness, which in turn can reduce the willingness to consider change. The risk is lower if there is trust between the company and the ICG. Interviewees emphasised the need for the ICG challenge to be constructive. This includes being well argued and well evidenced as well as being presented constructively. Some ICG chairs noted they had had to moderate input from some members for the group to develop constructive challenges. ICG Chairs said that the companies were more likely to listen when they felt supported as well as challenged. Equally, interviewees emphasised the need for companies to be willing to listen and respond.

The outcome most companies and ICG chairs are seeking is that trust is established and the ICG is seen as a 'critical friend', with equal emphasis on 'friend' and 'critical'. Some company interviewees who really value the contribution of their ICGs described the challenge as 'uncomfortable' and one said life would be easier without it. Even so, they acknowledged the value of the challenge. Another took the view that the water company should be open to challenge and said that respect for the opinions of others is in the company's culture.

A small minority of company representatives said that their ICGs had struck the balance too far towards 'critic' and that this had limited the willingness of company teams to engage with the ICG. One example was an ICG that saw its role as providing scrutiny and challenge and not going beyond this to providing ideas or other input. Another was an experience of a very

dominant ICG Chair with limited contributions from other members. The company found that despite requesting large volumes of materials that took considerable resources to produce, the Group's input has become predictable and was not adding value. These companies, in some cases working with the ICG Chair, had already, or were in the process of re-scoping the ICG's role or membership or both. This had included standing down members of the previous challenge group.

4.2 Governance

ICG Terms of Reference (ToRs) are used to set out the group's remit and the topics in its scope. Some ToRs are reviewed regularly and the majority have been updated to refer to the ICG's role in PR24. They provide a point of reference for the Group's work and can be useful if debate arises about where the ICG has licence to scrutinise and the type of challenge it is expected to provide.

Several ICG Chairs talked about active succession planning for roles in the ICG, with group members taking on greater responsibility so they are ready to step up. There may then be an open recruitment process so 'internal' ICG candidates are considered against a wide pool. Companies who had continued their ICGs following the submission of PR19 business plans valued a mix of continuing and new members, which gave a combination of expertise built up over time and new perspectives.

Several company interviewees said they had wanted to continue with their ICG post-PR19 business plans, regardless of whether Ofwat was going to mandate challenge groups. They experienced benefits from continuity, with the group able to scrutinise their delivery of PR19 commitments as well as building the knowledge over time to be ready to scrutinise the PR24 planning. This did not mean that the ICG had remained static. Reviews had been undertaken into the Groups' contribution at PR19 in order to help determine the role and remit of the ICG going forward. Terms of Reference had been updated and memberships had evolved.

Water company boards and individual board members are playing both formal and informal roles with respect to ICG challenge. Some INEDs talked about actively checking whether the ICG Chair finds that the group is getting what it needs from the company and whether it is being listened to. Some do this informally and others via a Board subcommittee. In some companies there is a route for the ICG to notify the Board or a subcommittee if the ICG does not agree that the company's response to a challenge has been sufficient.

There were signs that companies and INEDs were willing to act if they found the ICG arrangements were not delivering effective challenge. Two INEDs said that they thought their ICG was not challenging the company hard enough. They saw this as either due to particular members softening ICG views from what they would otherwise be or the ICG as a whole not pushing hard enough on the potential to improve delivery for customers, even if particular members were challenging strongly on certain topics.

Several company interviewees noted that their ICG had become less effective for a time. This was attributed either to a loss of focus on the ICG on the company's side due to changes in management or because the situation had evolved and the ICG was no longer delivering what the company felt was needed. All such companies said they had taken, or were in the process of taking, action to facilitate the ICG delivering effective challenge. Such reviews may involve the company's board.

4.3 Formulating effective challenges

ICG Chairs described approaches to providing challenge to their companies, with the number of challenges and level of detail varying across the Groups. Several had evolved their approach to deliver fewer but more substantial challenges as previous approaches of logging every challenge no matter how small had resulted in important issues being overlooked. Some ICGs now use an Action Log to track matters that the company has agreed to follow up, such as providing more information on a subject. The Challenge Log is then reserved for substantial challenges to the company's approach. If an item is on the Action Log for too long, the ICG may move it to the Challenge Log. One ICG Chair said they had a Recommendations Log organised by topic to facilitate checking how the company has responded when a subject is next reviewed.

The Challenge Log may be matched by a Response Log summarising the company's responses to the challenges. Some are published. One ICG Chair emphasised that the company is given the chance to respond before a challenge is published.

A minority of ICGs and companies have agreed explicitly an approach for disagreements and situations where the ICG does not think that the response is sufficient. Others have experienced such situations and worked through ways of dealing with them at that point. The rest have not considered working out a pre-agreed approach, in some cases because they have never experienced such a disagreement.

Many interviewees, both ICG Chairs and on the company side, stressed the importance of high-quality challenge. Several who greatly value their ICG's contribution characterised the level of challenge as being Board quality but specifically customer focused. Some company interviewees said that they did not find it helpful when the ICG focused mainly on details of regulatory performance metrics. They feel that the regulators provide sufficient scrutiny of these, and they want their ICG to provide additional, more rounded challenge from a customer perspective. Others saw a role for their ICGs in examining the company's performance on regulatory metrics, and it may be that this is done as part of broader reviews of those areas.

4.4 Conclusions and recommendations: effective challenge

It is essential that the ICG and the company take a clear-eyed view of their approach to and response to challenge, as well as its effectiveness. Either side can undermine effectiveness, often

inadvertently. For example, a company may be unwilling to listen to criticism or an ICG fail to formulate its challenge in a way that the company will find relevant. Having a common, outcome based, objective set out in the ToR, such as delivering a better business plan or improved in period performance, is a valuable reference point. Developing a critical friend relationship where the emphasis is on the 'friend' as much as the 'critical' is equally valuable.

As noted earlier (Section 2.1), to get the best from their independent challenge arrangements it is important that companies and ICG Chairs take an active approach to evaluating their success. Being willing to have what can be uncomfortable conversations about problems with the quality or focus of the ICG's challenge or the company's response to it, or simply acknowledging that a different approach is now needed, has paid dividends for those who have done so. Regular reviews, including INEDs who observe ICG meetings, that are built in to the agreed ways of working have the advantage of catching any emerging issues early and enabling the company and ICG to evolve their approach in line with changes in the sector.

It was notable that companies who said their ICG had consistently delivered effective challenge described it as consistently being 'uncomfortable' for the company. If the challenge from the ICG stops feeling uncomfortable this could be a sign that it is no longer effective.

Feeling uncomfortable is never pleasant, and therefore the signals from the Board and Management Team down through the management structure about the appropriate responses to ICG challenge are important. There is a risk that individuals or teams feel their personal performance is being criticised and look for ways to dismiss the ICG's challenge or avoid it in the first place. If the signals from the company's leaders are that the ICG's challenge is valued, and that it feeling uncomfortable is part of the process, the response is more likely be positive, with teams seeking ways to improve delivery rather than looking for reasons to dismiss the challenge. At the same time, the ICG should ensure that questions and challenges are phrased constructively to show why they are relevant to customer interests and to minimise the risk that they are interpreted as personal criticism.

A focus primarily on regulatory metrics risks the ICG missing the opportunity to consider other aspects of the company's performance in a subject area including considering 'What does good look like?' beyond the water sector. However, many ICGs and their companies find that including regulatory metrics in the ICG's scrutiny is useful, and it is important that companies do not give the impression of trying to avoid scrutiny. A useful benchmark is whether the ICG is delivering new challenge that the company would not otherwise have received.

Having a pre-agreed approach is worthwhile for situations where the company and the ICG do not agree that the company's response to a challenge is sufficient. This enables the company and ICG Chair to consider appropriate steps, tests and wider visibility without the position being clouded by the heat of an immediate disagreement. With challenge groups no longer mandated by Ofwat and the company board accountable for customer challenge, the potential role for the Board, perhaps via a subcommittee, merits consideration. Taking a role as arbiter appears less relevant, but a requirement to formally set out the situation can encourage all parties to consider whether they could go further to reach an agreement. Publication of the

impasse on the ICG's web pages is an additional way of providing transparency, but is not a good substitute for surfacing the matter at Board level given the Board's accountability for customer challenge.

ICGs are moving away from challenge logs comprising challenges of all sizes, which can run into the hundreds, including some that are really action points. There is value in having a formal record of ICG challenges, and it makes sense that these should be substantial, accompanied by a process such as an Action Log for dealing with practical, more micro-level issues that merit follow up. A Recommendations Log organised thematically may also be useful. Making the Challenge Log visible at Board level further emphasises the focus on matters of importance and fits the Board's accountability for customer challenge.

Recommendations

Companies and their ICG Chairs should:

- Build in regular reviews of the effectiveness of the company-ICG working relationship, evaluating in particular how effective the ICG's challenge is and what is contributing to that, and the extent to which the ICG is delivering challenge that the company would not otherwise have received
- Agree a process for working through disagreements between the ICG and the company, including surfacing at Board level any that reach an impasse
- Ensure there is a formal record of ICG questions and challenges which separates follow up actions such as committing to provide further information from substantial, evidence-based challenges to the company's approach

5 Constitution, role clarity and capacity

5.1 Formality of the constitution of the ICGs

ToR - Consider whether the ICGs are formally constituted with clear purpose, function and governance detailed in a Terms of Reference that has been agreed with both the Executive and Board of the Company.

Fifteen ICGs were able to provide Terms of Reference to this review, all but one of which had been agreed and the other scheduled for review. One was in the process of being updated, and one company does not have a ToR document for its group, instead using discussions and the letter of invitation to members to set their expectations about the role and working practices.

Nine ICGs have Terms of Reference (ToRs) that specifically cover the group's role in PR24 business planning. Five more are in the process of being drafted, and two further companies plan to have such ToRs.

For the 14 ToRs for PR24 business planning that are either complete or drafted, the most common approach was for the ICG Chair to draft them for agreement by the company, with seven taking this route. Four more were co-authored between the ICG Chair and the company, two were drafted by the company and agreed with the ICG or its Chair or both, and one ToR was drafted by the ICG Chair and agreed with the ICG.

Responsibility for signing off the ToRs varied. Two of the ToRs were signed off by the company's Board, three by the CEO and two more by another member of the Management Team. One was signed off by a senior manager at the company, one by the CEO and ICG jointly, and two more by the ICG or one of its committees. The remaining three are in the drafting process and responsibility for sign off has not yet been decided.

5.2 Clarity of ICGs' remit and capacity to deliver its workload

ToR - Determine how clear the remit of each ICG is and the extent to which the local challenge arrangements are set up to enable the groups to fulfil their stated functions. This will include reviewing the capacity of the ICG to deliver its workload.

The content and emphasis of the ToRs varies, though all stress the independence of the ICG and its role of 'challenge'. Our review examined whether each ToR included five elements that are important in enabling the ICG to provide effective challenge to the company.

The first was the inclusion of a common, outcome-focused objective for the company and the ICG that gives the ICG's challenge a clear purpose. ICGs have no power to compel the company

to act on their challenge so identifying the purpose of the Group's challenge can be a valuable reference point. For example, driving continuous improvement in the experience of the company's customers or delivering a better business plan for customers.

The second was the inclusion of a high-level view of what constitutes effective delivery, so that expectations are clear on both sides. This shows how the ICG is expected to perform its role, for example holding the company to account for its promises to customers.

The third was reference to the company board authorising the ICG to carry out its duties. This stems from Ofwat's decision that company boards are accountable for 'having in place a mechanism for, and listening to, customer challenge'¹⁰.

The fourth, mention of the ICG having the option to escalate issues to the board, was also linked to Ofwat's decision. Although commissioning an ICG is intended to add value, there is significant potential for an adversarial outcome, especially as the ICG has no power to compel the company to act on their challenge. The option to surface disagreements between the ICG and the company to the body accountable for the ICG's challenge can therefore play an important role.

The final element was about the ICG challenging 'constructively' or acting as a critical friend. The importance of this was clear from the interviews where both the ICG Chair and their company counterpart said the ICG's challenge is consistently effective. There is real value in the ICG understanding that the Group's challenges are more likely to be taken on board when the ICG does not act solely as a critic but a critical friend, interested in helping the company improve rather than seeing its job as stopping at delivering challenge.

No single ICG ToRs included all five elements. The number of ToRs including each element was as follows:

- A common, outcome-focused objective for both company and ICG: 5 out of 15
- A high-level view of what constitutes effective delivery (i.e. how the ICG is expected to perform its role): 6 out of 15
- Mention of the company board authorising the ICG to carry out its duties: 2 out of 15
- Mention of the ICG having the option to escalate issues to the board: 1 out of 15
- Mention of the ICG providing 'constructive challenge' or acting as a 'critical friend': 7 out of 15 (one of these ToRs includes both terms)

ICG sizes and structures

The average number of members an ICG has is 10, with the range being 1-21. Half the ICG Chairs said they planned to recruit between 1-5 additional members for the PR24 business

¹⁰ Ibid

planning period. One ICG Chair observed that they have a maximum group size of 12 as a larger group would be unmanageable.

Six ICGs have a Deputy Chair and another group has two. Another group has a subgroup consisting of the Chairs of the ICG's subcommittees. Half the ICGs do not have Deputy Chair arrangements.

Almost all the ICGs have at least one subgroup, with the larger groups tending to have more subgroups. The most common number of subgroups is two, and although one ICG has six, half of these are time limited. Only one ICG has no subgroups, with three others yet to determine their final subgroup arrangements.

The most common remits for subgroups are Customer Engagement (7), Affordability/Vulnerability/Social Contract (7) and Environment (6). Two ICGs have PR24 subgroups. The Environment subgroups may also cover other issues such as Resilience, Social Capital or Social and Community Issues, and some companies have Environment panels, separate from the ICG. Other remits for subgroups include Performance & Delivery, Capital Expenditure and Public Value Development.

5.3 Conclusions and recommendations: constitution, role clarity and capacity

Now that challenge groups are no longer mandated by the regulator, Terms of Reference take on greater importance in setting out the purpose of the ICG, the ways of working that are expected to lead to effective delivery, and the part the company will play in facilitating this. It is important that both the ICG Chair and the company are involved in agreeing the ToRs, particularly with the company board accountable for customer challenge.

With the ICG Chair accountable for the Group challenging effectively, drafting the ToRs for agreement with the company gives the Chair the opportunity to demonstrate how they are interpreting the role of the ICG and how they intend to deliver what the company is looking for. If the company leads on developing the ToRs it is important that the ICG Chair has the opportunity to provide input and agrees with what the company is looking for. The co-authored approach used by some may be the most effective approach as the ToRs are then seen to be jointly owned.

As the company board is now accountable for customer challenge, sign off of the ICG's ToRs at Board level is appropriate. In cases where the CEO or other member of the Management Team is responsible for signing off the ToRs it makes sense for this to be done after review at Board level. If responsibility for sign off lies below Management Team level there is a risk that this will be interpreted as a signal that the company views the ICG's challenge as not particularly important.

At present, only a third of companies and ICG Chairs have taken the opportunity to include a common, outcome-focused objective for both the company and the ICG in their ToRs. Instead, references to the purpose of the ICG are mainly about providing ‘challenge’. While an ICG should of course provide challenge, such descriptions stop short of identifying the purpose of the challenge, and therefore what its relevance, and ultimately the ICG’s effectiveness, should be judged against. Agreeing the purpose of the ICG’s challenge is particularly important in the new environment where it is not mandatory to have an ICG and companies have the freedom to set their ICG’s remit. As noted above, it can be a valuable reference point as ICGs have no power to compel the company to act on their challenge.

Just over a third of ToRs include a high-level view of what constitutes effective delivery by the ICG. This is another potentially valuable reference point in circumstances where ICGs cannot require the company to act and there is potential for an adversarial outcome. Agreeing a common view with the company reduces the risk of the ICG’s challenge being rejected or ignored, or in extremis disbanded if the company judges it to be ineffective.

Ofwat’s decision to place accountability for customer challenge with the company board is reflected in two out of 15 ICG ToRs. Reflecting this decision shows a coherent approach to this accountability. It can be relevant when considering how disagreements between the ICG and the company will be worked through. This may include the option to surface at board level any disagreements that have reached an impasse. However, casting the board in the role of arbiter may increase rather than reduce the risk of an adversarial relationship between the ICG and the company. A ‘for information’ approach may be more appropriate.

The way the ICG engages with the company and delivers its challenges can have a significant impact on how these challenges are received. As discussed above, and also in Section 4.1, acting as a critical friend, rather than simply a critic, enhances the likelihood of the ICG’s challenge being taken on board. Including the importance of constructive challenge and the ICG acting as a critical friend to the company in the ToRs demonstrates that the ICG has understood this and makes its importance clear to new ICG members from the start.

ICGs have adopted various structures and subgroups in order to deliver effective challenge on PR24 planning, and in many cases these appear to have been updated in order to deliver against an updated ICG remit in their ToRs. It is important that, like the ICG as a whole, any subgroups are formed with a clear purpose and have a specific set of questions to examine, reporting the findings to the wider ICG. The demands on individual ICG members of attending subgroups, particularly multiple subgroups, should be managed appropriately to avoid overload. There may be situations where a member’s expertise is relevant to more than one subgroup but they are not available to be full members of all of them. Prioritisation and finding alternative ways for members to contribute, such as providing written comments on particular papers, will enable the ICG to benefit fully from the member’s expertise.

Recommendations

Companies and their ICG Chairs should

- Where not already present, consider including in ToRs
 - a common, outcome-focused objective for both company and ICG
 - a high-level view of what constitutes effective delivery (i.e. how the ICG is expected to perform its role)
 - mention of the company board authorising the ICG to carry out its duties
 - a description of the approach that will be taken to resolving disagreements between the ICG and the company, including the option of surfacing at board level any that reach an impasse
 - the responsibility of the ICG to challenge constructively and act as a critical friend to the company.
- Ensure all subgroups have a clear purpose and remit, reporting back regularly to the wider ICG
- Ensure members selected for subgroups have sufficient time available to contribute fully
 - where a member's expertise is relevant to more subgroups than they can commit to, find ways to enable them to participate on topics where their expertise adds particular value, for example through written contributions
- Regularly review whether each subgroup is still needed, and whether its purpose, remit or membership should be updated. This is particularly relevant at the start and end of the ICG's scrutiny of the company's preparation of its business plan for a new regulatory period such as PR24

6 Membership and expertise

6.1 Level of expertise and skillsets among ICG Chairs and members

ToR - Consider the level of expertise among the Chairs and members of each ICG. This will be linked to the stated remit of the groups - is the ICG adequately resourced, in terms of the skillset among its members, to undertake the tasks it is anticipating?

Level of expertise among the Chairs and members of each ICG

The ICG Chairs are generally highly valued by companies and feel well regarded. A few mentioned areas of frustration centring on the Chair being too controlling and/or inflexible, but these had either been dealt with or this was underway.

There was a view from some companies that their ICGs' scrutiny provides significant quantities of high quality, expert input that helps the company identify ways of improving delivery for customers. This was seen to be due to the quality of the ICG Chairs and members, and the quality of discussion that stems from the cross-disciplinary makeup of the groups. Interviewees noted that this could mean the company could avoid the need to commission consultancy support which might otherwise have been required.

ICG 'constructive challenge' skillset

On the whole, both ICG Chairs and their company counterparts thought that the skillsets and expertise of the members enables the ICG to fulfil its remit effectively. A small number had had issues with members saying or contributing little, and some had introduced informal or formal processes to review members' performance and give them the opportunity to address any concerns.

A very small minority raised two other sources of frustration. One was about stakeholder organisation members taking little interest in issues beyond those of interest to their organisation. The other was about independent members who are also customers of the water company pushing personal agendas rather than weighing up the pros and cons for the whole customer base. For example, opposition to universal installation of water meters appearing to be because they personally were concerned that they would pay more.

Areas of subject expertise

In terms of subject expertise, the 16 ICGs constituted as groups had an average of 13 areas represented from the list of 24 possibilities, with coverage between 5 and 19 areas. The subjects listed were potential (rather than recommended) areas in which ICGs may have sought expertise to fulfil their remit.

Number of ICGs with each area of expertise (from prompted list)					
Debt and Affordability	16	Diversity and Inclusion	10	Utilities	6
Vulnerability	15	Board Governance	9	Engineering	5
Environment	15	Customer Service	9	Behavioural Economics	5
Consumer/customer representation	15	Strategic Communications	9	Innovation	4
Community Engagement	14	Market Research	9	Data & Digital	3
Stakeholder Engagement	12	Leadership/Senior Management	8	Finance	3
Policy Development	10	Farming	8	Human Resources	2
Local Government	10	Regulation	7	Supply Chain & Procurement	1
Added by one or more ICG Chairs: Sustainability (2), Responsible Business (1), Purpose (1)					

It was clear from the interviews that the twin concerns of Affordability and Environment, and the trade-offs that will need to be made, are front of mind for both ICGs and water companies for PR24. ICGs have recruited accordingly with all or almost all groups having expertise in Debt and Affordability, Vulnerability and Environment. Expertise in engagement has also been prioritised, with experts in Consumer/Customer Representation, Community Engagement and on almost all and Stakeholder Engagement on most groups. Specific expertise in Market Research is less of a priority, with just over half the ICGs having an expert in this.

Water companies are increasingly considering the need for customers to reduce their water usage. In line with this, five ICGs have recruited a behavioural economics expert and two more said they are or will be seeking this expertise. The water industry is also confronting the need for substantial, long-term investment and innovation along with supply chain and workforce challenges. ICGs were less likely to have recruited for related areas of expertise, with Innovation, Data and Digital, Finance, HR and Supply Chain and Procurement experts on a quarter or fewer of the ICGs. The situation is subject to change, with eight ICGs expecting to recruit new members for the PR24 business planning period and three others yet to decide.

6.2 The mix of expert and stakeholder representation on ICGs

ToR - Are ICG's members experts in a particular field or stakeholder representatives representing a particular organisation?

There are two predominant approaches here. Almost half (7) of the ICGs have only independent expert members. Eight have a mix of independent members and representatives from companies, trade bodies or other organisations. One has only members from companies, trade bodies or other organisations. The most commonly represented types of organisations are local government and advice, particularly Citizens Advice. Business, Environment and Farming groups are often included, though there is plenty of variation with members including housing associations, a disability partnership and the NHS.

The importance of the ICG being able to bring challenge rooted in an in depth understanding of the area the water company operates in was emphasised by several company representatives and ICG Chairs. This incorporated both societal and geographic aspects. The contributions from local councillors and senior representatives from local Citizens Advice, business organisations and trade bodies were often particularly valued here. Others continue to see the importance of challenge that is specific to the area the water company is operating in but take the view that this can be done by a group bringing high quality expertise across the disciplines represented along with experience in providing expert challenge. They may live in the water company's area, but this is not essential. For some Chairs this view was informed by previous experience of stakeholders on the group who had only been interested in topics related to their organisation's work, reducing the quality of the cross-discipline debate and insight an ICG can provide. The view was also raised that stakeholders have other opportunities to provide input whereas getting informed input that has properly considered the impact on customers and is centred on their interests is much more difficult.

ICG Chairs are also looking beyond subject expertise and local knowledge. For example, one ICG Chair said that they look to recruit members who are motivated to make a difference for their community. Several company representatives emphasised how much they value the blend of different perspectives and expertise that the ICG has, and the often demanding work the group does to come to an ICG position rather than polarising into, for example, 'customer' vs 'environment' camps. The companies find that this is unusual, and even unique, among the many and varied sources of input that they have.

The demographic diversity of the ICGs was raised by several interviewees. While acknowledging that it is impossible to represent every group in their communities, some ICG Chairs and companies expressed concern that their groups had an over-representation of older, white members. They are working to make the ICGs more diverse and increase the range of perspectives. This concern was combined with a view that the ICG was not always considering the impact of plans and decisions across the whole customer base.

Several ICG Chairs made the point that paying members in line with the commitment and expertise required to perform well in the role enables the participation of members who would otherwise be unable to afford to join an ICG, as well as those who feel that private companies should not ask members to provide their time in return for token payments or on a voluntary basis. They noted the risk in the latter situation that membership is restricted to those who can participate for limited or no remuneration. One ICG Chair said that since the company had increased the day rate for ICG members, the quality of candidates had improved and new members with impressive expertise had been recruited, resulting in the Group having the skills to add more value.

6.3 Contribution of regulatory and statutory bodies to ICGs

ToR - To what extent do CCW, Environment Agency, Natural Resources Wales and DWI contribute to the ICG?

The extent of the contribution to ICGs by the various relevant regulatory and statutory bodies varies, with resource constraints driving lower levels of representation or attendance. CCW are represented on all the ICGs, and the Environment Agency (EA) on 13 out of the 16 groups, with occasional topic-specific attendance at two more. Some CCW and EA representatives cover more than one ICG. Natural England is represented on six, with occasional topic-specific attendance at two others. The DWI attends a minority of ICGs on an occasional, topic-specific basis. In Wales, CCW, the DWI and Natural Resources Wales all attend the PR24 Forum, giving the ICG Chairs in Wales access to their expertise.

ICG Chairs and companies were generally very positive about the contributions of these bodies to the ICGs, particularly CCW and the EA who participate in more groups. There was concern that resourcing constraints are limiting the participation of the DWI in particular, but also Natural England and the Environment Agency. The EA has wide representation on ICGs but regular attendance had declined at some groups. Some ICGs are addressing these issues by targeting invitations towards meetings when specific topics relevant to that body's work are on the agenda.

The contributions of these bodies are valued because they have greater sector knowledge than many ICG members. They can provide the groups with technical, specialist information in the form of independent research, data and views, including raising concerns. They also help the ICGs understand regulatory programmes and requirements and provide comparative data on subjects including customer satisfaction and complaints. One EA representative was praised for successfully bringing a regional as well as national perspective. EA and CCW representatives agreed that they play these roles and added that they provide clarification should information from the company be incorrect or unclear.

Interviewees acknowledged that the EA has its regulatory regime and CCW has policies that it is advancing, for example a national social tariff. The dominant view was that their representatives do not treat the ICGs as a place to advance their agendas, and if they did start to dominate then the situation could be managed. Instead they were more often seen to bring a sense of balance to a situation where otherwise the ICG would only hear the company's view. One company representative characterised their role as stopping the ICG being misled, misinformed or misunderstanding. At times, when water companies disagreed with an EA or CCW position they had discussed the issue with the relevant representative at an ICG meeting, and ICGs had found it useful to hear both perspectives and the dialogue between the two.

EA and CCW representatives say they can balance the tensions that can arise in their role at ICG meetings as representatives of statutory bodies. They provided examples of how they handle these in practice. This includes asking for appropriate caveats to be added to ICG reports where

the Group's position is one the statutory body would not agree with. Similarly, if the representative believes a conflict of interest has arisen they declare this and ensure it is noted in the minutes.

A small number of company representatives and INEDs expressed a view that the company could not be fully open with the ICG on certain subjects with a regulator in the room. EA representatives' description of how they handle tensions around their role acknowledged this concern, saying that they have withdrawn from meetings or discussions which have posed a specific conflict of interest or in which it was not appropriate for them to be involved.

Situations arise where what is in the interests of the environment may not be in the interests of customers (and vice versa). Representatives have managed this by acknowledging the concern openly, along with declaring their position. They find that ICG members understand that this is connected with their role as, for example, an EA representative. There have been situations when a representative has been challenged strongly by company attendees who feel that statutory requirements conflict with opportunities for innovation. These have been addressed by maintaining that statutory requirements must be met, but that this should not prevent innovation.

In most ICGs the regular attendees from the regulatory and statutory bodies are full members of the ICG. However, some ICGs have experienced issues in the past with members of these bodies being unwilling to sign off ICG reports or challenges to the company when they found that elements conflicted with the aims of their organisations. They valued the information and water industry technical expertise that these bodies bring to ICGs and so solutions have been found to enable their continuing attendance. They are no longer full members of the ICG so are not required to sign off ICG reports and challenges. Instead they attend in an advisory capacity.

6.4 Conclusions and recommendations: membership and expertise

The ICG's role is an unusual one, and delivering effective challenge is not straightforward. ICG Chairs building in regular performance reviews for members, even 'light touch' ones, enables emerging issues to be identified and dealt with early and reduces the chance of them affecting the quality of the ICG's scrutiny. For these reviews ICG Chairs should seek contributions from the main company representatives and INEDs who see the Group's work.

In terms of ICG members' areas of subject expertise, the ICGs appear to have recruited well against the current major concerns of Affordability and Environment. As all ICGs have a role in scrutinising customer research, albeit at varying levels, it was surprising that only just over half the ICGs had recruited expertise in market research. Relevant expertise can be gained through other routes, and this may be present in ICGs without a market research expert and be sufficient for the scrutiny the ICG will be undertaking on the company's customer research programme.

The water industry is confronting the need for substantial, long-term investment and innovation along with supply chain and workforce challenges. There is also a need to encourage customers to change their behaviour with respect to water use. ICGs were less likely to have recruited related areas of expertise and may wish to consider this if they are undertaking further recruitment for their PR24 scrutiny or in the medium term.

Diversity of membership is a concern for some ICG Chairs, linked to the importance of the ICG being capable of considering the impact of plans and decisions across the whole customer base. As noted by several Chairs, remuneration levels are a relevant consideration in enabling wider participation of members with a range of perspectives and appropriate levels of expertise.

Different approaches are taken to the mix of independent experts and stakeholder representatives on the ICGs, as well as subject expertise. There are various ways to constitute an effective ICG, the outcome is what's important: is the Group bringing high quality scrutiny and challenge, with all members full involved in considering the impact of plans and decisions on customers? Is the group able to weigh up competing needs, particularly regarding affordability and the environment, and come to a well-reasoned view that all members can sign up to?

ICG Chairs and company representatives alike emphasised the importance of ICG challenge that takes into account the particular make up of the water company's area, geographically and in terms of its communities. Whichever approach to the make-up of the ICG is chosen, this should remain front of mind.

Attendance at ICGs by representatives of the water industry statutory and regulatory bodies is valued by ICG Chairs and companies. The few tensions about their presence on an independent group appear to be manageable and outweighed by the benefits of their contributions.

Where company concerns that they cannot be fully open with the ICG with a regulator in the room remain, it is important that they are discussed openly between the company and the ICG Chair. Such discussions should be held with a view to finding a way forward that enables the ICG to continue to benefit from the technical expertise of the regulatory body's representative without the company's openness being compromised. For example, the representative of the regulatory body could brief the ICG on a topic area but not be involved in evaluating the company's proposals on it.

Resources are stretched at these bodies and finding ways to enable their attendance, even if only occasional and for particular items on the agenda seems beneficial for those ICGs who manage it. Online attendance via Teams or Zoom may be appropriate. Some representatives from the EA and CCW cover more than one ICG. Meetings may clash and they can find that they do not have time to attend every meeting, especially when an ICG has several subgroups. Taking an active approach to agreeing priorities for the time the representative has available, and dealing with meeting clashes, will ensure their value to the Group is maximised. This can include identifying any meetings or agenda items where their presence would not be appropriate.

Recommendations

ICG Chairs should:

- Conduct regular ICG member performance reviews
- Ensure the ICG's challenge considers the particular make up of the water company's area, geographically and in terms of its communities

Companies and their ICG Chairs should:

- Actively consider whether particular expertise needs to be added to the ICG given the challenges the Water industry is facing and the ICG's particular PR24 remit
- Explore ways of facilitating occasional, topic-specific attendance from the regulatory and statutory bodies who do not currently attend the ICG

ICG Chairs, together with their company counterparts and the regulatory and statutory body representatives, should:

- Agree priorities for the representatives' attendance and input
- Find approaches for deciding what to do in situations where there is a concern that the presence of one or more of the representatives may not be appropriate.

7 Resourcing and remuneration

7.1 Sharing of information by the water company

ToR - Consider how transparent the company is in its sharing of information with the ICG.

Partial vs rounded perspectives

Some ICGs had been on, and some still are on, a journey to stop their companies presenting only the positives instead of giving a rounded view and helping the ICG understand the challenges they are experiencing. These Chairs generally feel that this journey has been, or will be, successful. In several cases, the conversation between the ICG Chair and the company about the type and depth of information the ICG needs in order to provide effective scrutiny is ongoing, with the level needed varying by topic (see Section 7.2).

ICG latitude to select topics

The ICG Chairs were generally positive about the access to information that the ICG has, and the quality of information the company provides. Almost all ICG Chairs and their company counterparts said that ICG has considerable latitude to choose topics for scrutiny, and many companies facilitate effective scrutiny of the information by scheduling subjects for review in line with relevant data becoming available. ICG Chairs said that they found comparative data on performance particularly helpful, and as discussed in Section 3.3 the impartial contributions from CCW and the EA are also valued.

There were occasional signs of tension around what an ICG wanted to scrutinise, and what the company thought were the boundaries of the ICG's role. For example, one INED said that there are some topics the ICG should not be involved in. A company representative raised a concern that their ICG thinks the company has more leeway to respond to challenge than it actually does. In general, company representatives and ICG Chairs appeared to be able to come to an agreement when such tensions arose. One company said that they had never refused an ICG request to look at an aspect of the business, but when relevant they did explain to the ICG why they thought scrutiny in a particular area would not provide useful outcomes. They had found that this enabled the ICG to reconsider the request in an informed way.

Relevant company attendees at ICG meetings

All the ICG Chairs said that the company makes the relevant people available to attend the ICG, and they engage fully with the group. When matters require follow up further responses are provided. One ICG Chair had concerns that company attendees spend too long talking about each topic, making it difficult to complete the meeting agenda, and another commented that this is a common tactic in the water sector to get things past a challenge group. However, almost all ICG Chairs appeared happy with how company staff engage with the Group, and many company representatives emphasised the value the company finds it gets from the ICG.

Regular attendees include members of the Management Team and in most ICGs the CEO attends at least once a year, more frequently in most cases. For some, there is also contact with members of the Management Team between meetings. One company representative said the ICG Chair has a 'direct line' to anyone in the company, including the CEO.

Only one company representative said that they had experienced problems with staff being unwilling to attend the challenge group, not wanting to 'explain themselves' to a group who were asking questions at the level of 'interested amateurs' and not adding value. However, these problems largely seemed to have been addressed over time through the ICG and company working together. The ICG is now perceived throughout the company, from the CEO down, to add a lot of value even if attending its meetings is not always a 'comfortable' experience.

Willingness to discuss media coverage

Although some companies appear more frequently than others, the water sector as a whole is experiencing a period of hitting the headlines for various reasons. ICG Chairs were asked whether and to what extent the ICG considers customer concerns resulting from or influenced by media stories about water company behaviour, and their company counterparts were asked whether they thought this was something their ICG should consider. Both groups agreed that this is a relevant area for ICG scrutiny, and some said that such concerns are coming through in the company's customer research. Several company representatives said that they found it useful to discuss such matters with the ICG as the discussion with an informed, customer-focused group helped shape the company's public response.

7.2 Timely provision of appropriate information

ToR - Is the information provided to the ICG by the company in relation to its activities and business planning shared in a timely manner and with adequate context in relation to company performance (both historically and in relation to the rest of the sector)?

Many ICG Chairs and company representatives are conscious of ensuring that ICG meeting time is used well. 'Death by PowerPoint' was mentioned several times as a hindrance to the ICG's scrutiny, and most ICGs have moved away from company representatives giving lengthy presentations in the meetings. Instead, materials are circulated in advance, commonly about a week ahead, and ICG members are expected to read them in advance so the meeting can be question focused. A few groups have gone a step further with materials circulated further ahead and members asked to provide questions to the company. This reduces the risk of company representatives feeling blindsided by a question or not having the relevant information to hand and is felt to enhance the quality of discussion at ICG meetings, where members may ask further questions. Another ICG submits their questions in advance, the company then prepares advance materials answering them, and the topic is discussed at the ICG meeting following a short presentation of key points by the company.

Companies have sought ways to avoid the preparation of information for their ICGs becoming overly onerous for the teams involved. A small number of interviewees said that in the past this had become 'an industry' that wasn't seen to be worthwhile and had made teams unwilling to engage with the ICG. Interviewees also noted it is important that the company gives the ICG sufficient time, attention and resources if the group is to be able to scrutinise effectively. Approaches that different companies had found to be useful included providing the ICG with the same information as the Board (with confidential elements removed) or using other existing documents, edited as relevant. One had found that if they use accessible language in the ICG materials they can also be used for staff communications.

Several ICG Chairs had worked with their companies over time to get the quantity and level of information provided to the ICG to a point where the ICG gets the level of detail it needs without being swamped, and teams are not overwhelmed in providing it. Some now discuss the level of detail needed on each topic in advance with the company.

A few ICG Chairs said that receiving timely information continued to be an occasional or regular issue, but for most the agreed systems are working.

7.3 Resourcing

ToR - Consider whether the ICG is sufficiently resourced to carry out its stated functions.

We have considered the issue of resourcing from the perspective of the ICGs' PR24 scrutiny: the topics they expect to cover, their training needs and the scheduling and time allocated for this scrutiny. Section 5.2 covers the considerable variation in the size and structure of ICGs, and there is no simple answer to the question of whether the ICG is the 'right' size or has 'enough' time for its scrutiny, especially as each company now sets the remit for its ICG.

Planned scrutiny of PR24 business planning

In response to a prompted list of 30 items in the questionnaire, the ICG Chairs said that their ICGs would be covering an average of 23 areas in their PR24 scrutiny. The extent of the scrutiny will inevitably vary across topics, and some ICG Chairs said in their interviews that their scrutiny would be influenced by the findings of research and engagement programmes regarding customer and stakeholder concerns.

The range of topics being scrutinised varied across the ICGs, but there were many common topics. At least three-quarters of the ICGs expected to scrutinise 19 of the 30 topics listed. By contrast, fewer than half expected to consider Digital and Data, Finance, Workforce Resilience or Supply Chain.

Number of ICGs expecting to scrutinise each topic					
Customer Engagement and/or Research	17	Customer Service	14	Value for Money	12
Affordability	16	Drought	14	CSOs	11
Community Engagement	16	Company-specific Enhancement Schemes	13	Innovation	11
Environmental Improvements	16	Delivery against Ofwat's Expectations	13	Investment	10
Resilience	16	Social Value	13	Corporate Responsibility	10
Stakeholder Engagement and/or Research	16	Water Usage	13	Local Government Engagement	9
Delivery in Customers Interests	15	Net Zero	13	Digital and Data	7
Long-term Considerations	15	Pollution	13	Finance	6
Leakage	15	Reliability	13	Workforce Resilience	5
Vulnerability	15	Diversity & Inclusion	12	Supply Chain	4

Training ICG members on water sector issues

Companies value the ICG's external perspective, often particularly appreciating that the group's views are not steeped in water industry lore and members bring insights from other sectors. However, both ICG Chairs and company representatives observed that ICGs who had gained knowledge over time were adding significant value. Conversely, some more recently formed ICGs felt they were struggling to get up speed. One Chair had found that the company provided an induction but not (up to that point) sufficient training on issues in the water sector to enable the group to provide scrutiny and challenge at the level it is aiming for. Others have established processes in place. One ICG Chair mentioned Ofwat running training sessions for new ICG members, and another highlighted the training packs and videos they have developed.

Starting dates for ICG work on PR24 business planning

ICGs that continued to scrutinise their companies during the implementation of PR19 are more likely to feel confident about being able to scrutinise PR24 planning, and to feel that the focus on PR24 started at the right time – usually earlier and borne in mind for some time before that. Nine of the seventeen ICGs started work on PR24 in 2022, all but one of these in Quarter 2 or 3. These ICG chairs, and some company counterparts, were more likely to say they thought this had been too late. The concerns centred on feeling that by this point the ICG had lost the opportunity to influence the company's thinking, including the possibility of the company doing some 'blue sky thinking' with the ICG. Instead, the ICG's role became more limited, reacting to the company's thinking in more of a 'show and tell' process. Some attributed their start dates, wholly or partly, to the timing of Ofwat's release of relevant documents, guidance and/or the draft PR24 methodology. However, all water companies are subject to the same Ofwat release dates, and some started work with their ICGs earlier.

Where the ICG had started work on PR24 during 2021 or earlier, ICG Chairs and their company counterparts were more likely to feel the timing had been about right. They were also more likely to describe a continuous process, with the ICG's work continuing after PR19 business planning with scrutiny of in period performance and the company taking more of a 'rolling' approach to business planning. One company representative described a process of keeping the ICG up to date with regulatory developments as they happened. They explained the PR24 landscape to the ICG, briefing them on the key elements and making clear that it would be a significant part of their work. The company presented their initial thinking to the ICG and provided open access to the customer research programme as it developed.

Allocation of time for ICG scrutiny

ICG meeting frequencies and lengths expected in the run up to the submission of PR24 business plans ranged from monthly meetings for a full day to quarterly meetings for half a day. Some groups expected to increase their meeting frequency and/or 'deep dive' scrutiny of individual topics during this phase. Some ICGs also have subgroups operating, and there will also be variations in preparatory time. The concerns that were expressed about scrutinising the company's PR24 planning seemed to be attributed to the date the ICG was able to start work on it rather than the amount of meeting time scheduled.

Attendance at ICG meetings is good, with all or almost all members attending every meeting at 13 of the groups, and most members attending every meeting of the other three ICGs.

Scheduling the ICG's work

Most companies see planning effectively as key to using the ICG's limited time well. They are working with their ICG Chairs to schedule topics up to a year ahead, in line with data becoming available. This can include discussing a topic in stages. ICG Chairs are keen that the ICG reviews topics at a point where their scrutiny can influence the company's thinking rather than commenting on approaches that are close to being fully formed. For some, this is still a work in progress. Several company representatives mentioned that they have gone through a learning process regarding the best time to involve the ICG and have become more proactive in sharing early thinking. One commented that getting the right balance is challenging as their ICG expects a lot of information so there is a risk of taking subjects too early.

7.4 Remuneration of ICG members

ToR - This [consideration of resourcing] will include the remuneration budget, whether this covers only the Chair or includes other remunerated expert members.

All the ICG Chairs are paid. Fourteen receive an annual, fixed amount, two have a day rate for a limited number of days per year and one has a day rate without a maximum number of days applied. The amounts of time that Chairs are contracted for varied quite widely, and several commented that they work significantly more hours than their contracts allow for.

Independent ICG members are paid on two thirds of ICGs, usually with a day rate. Two of these have a maximum number of days applied while six do not. Three companies pay independent ICG members a fixed annual amount. Two other companies do not pay their independent members directly but make payments to an (often) local charitable or community organisation or initiative nominated by each member. On two ICGs independent members are not paid although expenses are covered. The Chairs of both those ICGs reported difficulties recruiting ICG members. Other Chairs did not report such difficulties.

A small number of company representatives said that they thought customers would not think paying for an ICG was a good use of the company's budget. These views did not appear to be drawn from customer research. Other interviewees, from both the ICG Chair and company sides, said that remuneration is important and makes it easier to hold ICG members to account for the quality of their work. Several companies had gone through formal benchmarking processes as part of deciding remuneration levels. One interviewee questioned the value of an unpaid person treating the ICG as a 'passion project', citing a risk that they would focus on things they personally cared about rather than in the interests of the wider customer base. As previously mentioned in Section 3.4, two interviewees said that if ICG members are not paid by the water company this makes them more independent

ICG members from a commercial, trade body or other organisation are generally not paid. In a few cases there is a donation to their organisation, which may or may not be taken up. Representatives from CCW and the Environment Agency are not paid.

7.5 Administrative Support for the ICG

ToR - Is adequate independent administrative support available to the ICG or is the group reliant on company support?

Six ICGs have independent administrative support that is funded by the water company. Nine have administrative support provided by their water company and one ICG Chair covers the administration needed. Those where the water company provides the administrative support are more likely to report encountering issues with the person's time and focus, with other aspects of their role taking priority. Those with independent administrative support are most likely to think the arrangement is working well. A minority of ICGs have retained a report writer, who may also provide some administrative support such as preparing meeting minutes.

7.6 Conclusions and recommendations: resourcing and remuneration

ICG's cannot provide effective scrutiny of the company's performance without the company providing suitable information. ICG Chairs were generally positive about the quality of information the company provides and issues with quality or timeliness had largely been overcome.

While it is understandable that a company will think there are areas of the business where ICG scrutiny is not relevant, it is equally understandable that an ICG may challenge this. One test would be whether issues in an area are contributing to suboptimal outcomes for customers. If so, it may be an area where ICG scrutiny would be valid. The approach taken by one company is potentially useful: never refusing an ICG request but always explaining why scrutiny may be of less relevance than the ICG thinks.

It is understandable that a company may not want their ICG to scrutinise areas where a regulator mandates what the company is to do, and the company does not feel that it has any latitude to do things differently. However, in some cases it may be worth considering the longer-term potential for change if there is evidence that the current regulation is delivering outcomes that work against customers' interests in some way. For example, it may be that circumstances have moved on, and regulatory metrics that were originally fit for purpose would benefit from being updated. It is possible that a company and its ICG could decide that the situation merits making a case to the relevant regulator for updating a particular element of regulation. The COG could be a forum for identifying patterns across companies, with a group of ICG Chairs then engaging with the appropriate regulator.

ICG Chairs have indicated that their ICG will scrutinise a wide range of aspects of the company's PR24 business planning. This will be demanding, and some Chairs and companies think that the start dates for this scrutiny have been later than ideal. In addition, some Chairs feel that their ICGs have not had the level of training on water sector issues that they need in order to be able to provide the most effective challenge. This suggests risks for some companies that the scrutiny and challenge from their ICG may not be as effective as it could be. Where there is concern, on either the ICG or company's side, about the time available for scrutiny this should be discussed and a practical way forward agreed. This could include increasing the amount of time the ICG will spend on scrutiny and/or reducing the number of areas which the ICG will scrutinise.

The risks to ICG scrutiny identified above increase the importance of companies working with their ICG Chairs and members to ensure that the information provided to the ICG is of the appropriate level and quality to facilitate rigorous scrutiny. The practices adopted by a few where the ICG provides questions in advance of the preparation of materials or before the ICG meeting have the potential to be particularly useful, particularly as they can also reduce the risk of unnecessary work by company staff. Considered scheduling of ICG scrutiny can also make a difference, aligning it with relevant data becoming available and ensuring that it is early enough for the ICG's input to influence the company's thinking. Engagement with the ICG by expert members of company staff, including members of the Management Team, is another important factor and it was positive to hear that almost all ICG Chairs are very happy with how company staff engage with the Group.

Viewing the ICG as a cost that customers would not want to pay for risks undervaluing the ICG's contribution and missing opportunities to make the most of its expertise. As noted in Section 6.1, some companies say that their ICGs provide high quality, expert input through their 'scrutinise and challenge' role that can enable the company to avoid consultancy costs that

it would otherwise have incurred. Additionally, payment has been found to be a lever to hold members to account for the quality of their contributions, and the benchmarking that some companies undertake can help provide reassurance that remuneration is appropriate rather than excessive. As previously discussed in Section 3.5, a 'no remuneration' policy for independent ICG members does not appear to guarantee greater independence of thought but appears to bring some risks to the quality of the ICG's work.

The value of effective administrative support for groups such as ICGs can be overlooked. Having agendas and minutes produced in a timely manner is important for the smooth functioning of the Group, including the company completing its follow up actions. Good record keeping also facilitates time efficient reporting on the Group's activities which is an important aspect of Transparency (see Section 9). Where the ICG finds that they are encountering issues with the time and focus of the company employee providing administrative support, a review including the option of the water company funding independent administrative support may be merited. The review should bear in mind that the water company providing administrative support is not a cost-free option as the person will be salaried and could be spending their time on other tasks.

Reporting is now agreed with the company rather than mandated by Ofwat, and more than half the ICGs produce regular reports (see Section 9) on their scrutiny and challenge of the company's performance. Some companies and ICGs find that a role for a report writer remains merited, and this should be reviewed as appropriate in light of the ICG's reporting needs.

Recommendations

Companies and their ICG Chairs should:

- Consider whether the ICG has sufficient time available to complete, at an appropriate level of quality, the scrutiny the company is expecting of its PR 24 plan. Where this is no longer practical, priorities should be jointly agreed
- Ensure that their processes for developing materials for the ICG's review produce information that facilitates rigorous scrutiny early enough to influence the company's thinking, particularly in the time pressured run up to PR24 business plans submission
- Agree how ICG requests to scrutinise areas outside the usual workstreams will be handled, ensuring that the potential relevance, including in the longer term, is properly considered
- Ensure there is an effective process to get new ICG members up to speed with what they need to know about the company and wider water sector to challenge effectively. This is particularly important where there is limited continuity of membership or none
- Where the administrative support arrangements for the ICG are not working well, consider other options, including independent administrative support
- Consider whether the reporting requirements of the ICG merit the support of a report writer
- CCW and the ICG Chairs should agree whether the subject of regulatory outcomes that may be in conflict with customers' interests merits inclusion on COG agendas

8 Board Access

8.1 Visibility and importance of the work of the ICG

ToR - Consider the visibility of and importance given to the work of the ICG by the company Board. Does the ICG have unmediated access to the company Board, with regular attendance by company Board members at ICG meetings and vice-versa?

Board accountability for customer challenge

For PR24 Ofwat has said that *'The company board is accountable for having in place a mechanism for, and listening to, customer challenge. Company boards should be able to demonstrate how business plans and wider decision-making take account of matters that are important to customers, including those highlighted through the customer challenge process.'*¹¹

This marks a shift in emphasis from PR19 when Customer Challenge Groups were mandatory and had a very clear role: *'This is to provide independent challenge to companies and independent assurance to us [Ofwat] on:*

- *the quality of a company's customer engagement; and*
- *the extent to which the results of this engagement are driving the company's decision making and being reflected in the company's business plan'*¹²

Companies are no longer required to have a Customer Challenge Group as part of their customer challenge arrangements. In fact, all companies have chosen to have some form of independent customer challenge for PR24, almost all via a 'group'. With water company boards now accountable for the company's mechanism for, and use of, customer challenge, boards may choose to increase or alter their contact with the ICG.

Arrangements for reporting on the ICG's work to the Board

Of the 16 independent Chairs, 13 attend a Board meeting at least once a year to provide an update on the ICG's work, with five of these also observing part of the Board meeting. Attendance was commonly once a year, but several companies anticipated that this would be more frequent in the run up to PR24. In addition to attending a Board meeting at least once a year, a few ICG Chairs have more regular contact with a Board subgroup, either in person or via regular written updates. The specific subgroup varied with examples including PR24, Environmental, Social and Governance (ESG), Corporate Social Responsibility (CSR) and Audit.

Where ICG Chairs attend a Board meeting at least annually, company representatives had found that the Board appreciated hearing directly from an independent voice, and the ICG's

¹¹ Ibid

¹² Aide Memoire for Customer Challenge Groups, Ofwat, March 2018. Page 1

views carried weight at a level comparable to that of other key stakeholders. One INED observed that if the Board was not going to take the ICG's views seriously they should have pushed back on the whole process.

There was also a view that attendance at the Board cements the ICG's impartiality and gives the Board the opportunity to check how good the company's engagement is with the ICG. One company where the ICG had recently been formed had found it useful for the ICG Chair to explain the ICG's role regarding PR24 to the Board, not all of whom were familiar with such challenge groups.

Twelve of the ICGs have an independent non-executive director (INED) attending an ICG meeting at least once a year (often more frequently), observing all or part of the meeting and in seven cases also giving an update on the Board's work. Three others have not yet decided whether there will be INED attendance. One ICG Chair is against regular INED attendance at private ICG member only sessions as it would feel like the group's independence was being compromised. A Q&A session with INEDs would, however, be acceptable.

One ICG Chair does not attend any Board meetings but an INED regularly attends ICG meetings, providing an update on the Board's work and observing part of the meeting. In the remaining two ICGs a decision has not yet been taken on whether the ICG Chair will attend any Board meetings or an INED attend any ICG meetings. An INED does observe the meetings of the ICG which does not have an independent Chair.

8.2 Influence of the ICG's work on Board sign off

ToR - Is there a clear process outlining how the work of the ICG will influence the Board's sign-off of the business plan and long-term strategy?

At the time of the interviews (November and December 2022) two companies had a formal process agreed with their ICG setting out how the work of the ICG will interact with the Board's sign-off of the PR24 business plan. One of these ICGs will do a formal report to the Board which will be submitted to Ofwat along with the company's business plan. The ICG Chair anticipates that the Group's points will be reflected in the business plan. The other company will have an ICG representative at each meeting of its Board level subgroup that is examining progress on the business plan. They have also timetabled ICG meetings to tie in with meetings of this subgroup and those of the full Board so the Board can be aware of the ICG's views ahead of the formal consideration stage.

Five more companies were working on a process. Feeding in to relevant Board subgroups and decisions about publishing the ICG's final report were mentioned by some as active considerations, as was the Board asking for ICG input on particular decisions that it will be making. One company said that they were also working out how to position the ICG's

contribution. While valued, it is different from a conventional 'assurance' role, and the company appreciated the freedom to decide the most relevant approach.

A further seven companies expected to agree a process but had not yet started work on it. One ICG Chair from this set said that they were waiting to see Ofwat's final methodology for PR24.

Two other companies had not yet agreed a formal process but expected the ICG's work to feed into that of a PR24 assurance team that would report to the Board. The final company does not have a process though it was intending that the ICG would provide feedback to the Board on its work.

One company representative identified the ICG's work on PR24 as an opportunity for the ICG to shine with the Board. They noted that the risk of giving too much detail needed to be managed, and that the Board would only be interested in areas where things were not working.

One INED did not appear to see great relevance in the ICG providing input to the Board on PR24, viewing the relationship with the Management Team as the primary one.

8.3 Conclusions and recommendations: board access

Companies are taking various different approaches to their ICGs' interaction with the Board, including one or more of attendance at meetings of the full Board, regular contact with a Board subcommittee and observation of ICG meetings by INEDs. With the Board accountable for customer challenge, the chosen approach should ensure that the Board has sufficient information about the work of the ICG and the company's facilitation of this work to understand whether the ICG is delivering effective scrutiny and challenge of the company's performance as set out in the Terms of Reference.

The arrangements for ICG's interaction with the Board should be designed in the context of Ofwat assigning accountability for customer challenge at PR24 to the company board. ICG Chairs are likely to find that the decision as to how the ICG's work will interact with the Board's sign off of the PR24 business plan has a material impact on their work and how they report on it. It was notable that fewer than half the companies had started looking at this, with a formal process agreed by only two companies and their ICGs. A process should be put in place as soon as possible at every water company.

Recommendations

- Companies, Boards and ICG Chairs should ensure that arrangements for the ICG's contact with the Board will enable the Board to understand how successfully the ICG is delivering against the remit set out in its Terms of Reference
- Companies, with input from their ICG Chair, should prioritise deciding how the ICG's work will interact with the Board's sign off of the PR24 business plan

9 Visibility of the ICG's work

9.1 Visibility of the ICG's work to interested stakeholders

Consider how transparent and visible the work of the ICG is to interested stakeholders. Are details of the work of the ICG easily available? Are agendas, minutes and a record of both challenges and company responses to these challenges published on a dedicated ICG website/page? Is this information updated regularly and in a timely manner?

The ICG Chairs generally thought that publishing information about the ICG's work is important. Many said that they see this as being about transparency and the voice of the customer, holding themselves and the company to account for delivering relevant, effective challenge and responding to this challenge appropriately.

Thirteen of the ICGs either have a section on the company's website or their own website, and three more said one will be forthcoming. There are no plans for the final one to have an online presence. There is considerable variation in what is published for each ICG, and the frequency with which the web pages are updated. Nine include the ICG's Terms of Reference, with one group going further with a Governance section that also includes a Declaration of Interests policy, a Register of Interests and published costs of the ICG.

Five ICGs produce Annual Reports about the ICG's scrutiny of the company's performance, challenges and responses, and two more do shorter annual statements. One ICG publishes a quarterly update on its work, and two do ad hoc reports on company performance in key areas. One ICG Chair moved from publishing an annual report, having found it was not read, to publishing periodic ICG Viewpoint pieces on company progress and performance in particular areas as well as blogs. These pieces are also circulated to relevant stakeholders, including via LinkedIn.

Twelve of the 13 sites publish ICG minutes, most of which appeared to be regularly updated. This includes one ICG that has moved to publishing Feedback Notes which set out the ICG's views and recommendations on the topics discussed at each ICG meeting, along with action points. Three include their Challenge Logs with company responses, although two of these no longer appear to be being updated. Two ICGs publish their Engagement Observation Logs.

All sites list the ICG members, and most also include photos and biographies. Only one orients these biographies towards why the member wanted to join the ICG and what they bring to it.

Some ICGs and companies appear to have thought harder than others about what they would like to communicate to visitors to their ICG pages, and what visitors might want to know. Some provided clear, accessible summaries of the ICG's purpose and work prominently on their web pages, rather than solely in downloadable documents, and had gone out of their way to provide

content in non-technical consumer-friendly language. One ICG invites emailed questions for the ICG. The page points out that the Group does not handle any customer issues or complaints but provides a link to the company's 'Contact us' page.

Company representatives agreed that publishing information about their ICG's work was part of being transparent with customers and stakeholders. However, several pointed out that visitor numbers to the ICG web pages are very low, and one said that they did not want to put resources into the ICG's web section because 'no one will read it'. A few ICG Chairs had experienced delays to the pages being updated by the relevant company team.

9.2 Conclusions and recommendations: visibility of the ICG's work

Publishing information about the ICG and its work is important for transparency. The ICG's priority is to be effective rather than promoting itself but having an online presence which provides such information plays a role in holding both the ICG and the company to account for effective challenge of the company's performance. However, readership of the ICG's web pages will inevitably be limited so it is important to find time efficient ways of publishing relevant elements of the Group's work, in particular about areas it has scrutinised and company responses to the ICG's challenges. This need not be full agendas, minutes, challenge logs and each company response, and in fact the existing ICG web pages suggest that companies and ICGs often experience challenges in keeping such materials up to date. Instead, summaries of the ICG's areas of scrutiny, its conclusions and the company's responses to any challenges could be made available. ICG Chairs could use the COG to share what has worked well.

Most ICG web pages set out the Group's purpose. Making the full Terms of Reference available is a straightforward way of providing for those who want full details of its role and remit. It is worth considering what visitors are likely to want to know and what they will find useful. For example, most include member biographies but few communicate each member's role on the Group and what they will bring to it. New members could provide this when they join the ICG.

Recommendations

Companies and their ICG Chairs should:

- Work out efficient approaches of producing information for online publication about the ICG, its work and effectiveness that can be kept up to date easily
- Consider what visitors to the ICG's web pages are likely to want to know and what they will find useful, and present this information clearly on pages that are easy to navigate
- Decide whether the ICG will respond to questions from customers, stakeholders or the media, and if so what types of question and how. Set out the policy clearly online, including a link to the ways of contacting the company's customer services department
- Seek time efficient ways of making ICG's work accessible to customers and visible to stakeholders, for example circulating relevant pieces via LinkedIn
- Keep published content up to date

Appendix A – Terms of Reference

Background: Aim of the review

CCW organises and runs the COG meetings and we are members of each of the challenge groups set up (or retained) by companies to scrutinise their plans during the PR24 process. There is a potential conflict of interest in CCW carrying out this assessment itself, which could hinder our ability to press ICGs and companies to accept the recommendations it delivers. We would expect the successful consultant appointed to deliver the work to bring experience of working within similar challenge group arrangements, whether in water or other sectors.

The ultimate aim of the review is to assist ICGs and help to strengthen the challenge to their companies. This should be a collaborative review and it will require the support of ICG Chairs – and companies – to deliver the best outcome. This suggestion has been received positively and we have looked to incorporate the views of ICG Chairs, along with those provided by CCW and Ofwat, in designing the process.

The review will identify the differing strengths and weaknesses of the ICGs as they are currently implemented, producing a report which identifies the reasoning behind this decision with recommendations for any suggested remedial action, or sharing of best practice.

Objectives for review

We expect the review to consider the following aspects of each ICG. CCW has developed these areas with input from the ICGs through the COG meetings. They also consider Ofwat's standards for challenge, published in its position paper on Customer Engagement Policy for PR24.¹³

Independence

The review will assess the degree to which the ICGs operate independently of the company's interests, including how well they are able to demonstrate this independence. The review will look for evidence that an ICG is sufficiently empowered to challenge its company in a robust and constructive manner without censure. It will also consider the effectiveness of this challenge, including the response by companies.

This part of the review will assess companies' response to the removal of the mandate from Ofwat to have Customer Challenge Groups as part of the price review process. Is the company still clearly committed to receiving and acting upon strong local challenge as part of its business planning process?

Membership and Expertise

The review will consider the level of expertise among the Chairs and members of each ICG. This will be linked to the stated remit of the groups – is the ICG adequately resourced, in terms of the skillset among its members, to undertake the tasks it is anticipating.

- How were members appointed, was this independently of the company?
- Are ICG's members experts in a particular field or stakeholder representatives representing a particular organisation?
- To what extent do CCW, Environment Agency, Natural Resources Wales and DWI contribute to the ICG?

¹³ Ofwat: PR24 and beyond: customer engagement policy – a position paper. February 2022

Resources

The review will consider if the ICG is sufficiently resourced to carry out its stated functions. This will include the remuneration budget, whether this covers only the Chair or includes other remunerated expert members. Is adequate independent administrative support available to the ICG or is the group reliant on company support?

Board Access

The review will consider the visibility of and importance given to the work of the ICG by the company Board.

- Does the ICG have unmediated access to the company Board, with regular attendance by company Board members at ICG meetings and vice-versa?
- Is there a clear process outlining how the work of the ICG will influence the Boards sign-off of the business plan and long-term strategy?

Constitution and Clarity of Role

The review will consider if the ICGs are formally constituted with clear purpose, function and governance detailed in a Terms of Reference that has been agreed with both the Executive and Board of the Company. The review will determine how clear the remit of each ICG is and the extent to which the local challenge arrangements are set up to enable the groups to fulfil their stated functions. This will include reviewing the capacity of the ICG to deliver its workload, which may include the following aspects:

- Delivery of existing commitments to customers
- Quality of ongoing operational learning from customers and implementation of these learnings
- Quality of engagement & research for the purposes of forward planning
- Translation of learnings from all elements of citizen engagement & research into future strategy including how well this links into the PR24 Business Plan

Transparency

The review will consider both how transparent the company is in its sharing of information with the ICG and how transparent and visible the work of the ICG is to interested stakeholders.

- Is the information provided to the ICG by the company in relation to its activities and business planning shared in a timely manner and with adequate context in relation to company performance (both historically and in relation to the rest of the sector)?
- Are details of the work of the ICG easily available? Are agendas, minutes and a record of both challenges and company responses to these challenges published on a dedicated ICG website/page? Is this information updated regularly and in a timely manner?

Appendix B - Research process

We did the research between October and December 2022. It had three elements

- review of documentation and ICG websites
- questionnaire to ICG Chairs
- one-to-one interviews with the ICG Chairs, company representatives most directly involved with the ICG and independent non-executive directors of the companies (INEDs).

Review of documentation and ICG websites

ICG Chairs provided, where available

- ICG ToRs for the PR24 business planning period, and the previous version if different
- Agendas and Minutes for 2022 meetings up to October
- ICG challenge log and company responses
- ICG publications in 2021 or 2022 and link to the ICG website or page(s)

Questionnaire to ICG Chairs

The questionnaire covered the

- Size, structure and areas of expertise of the ICG
- Recruitment approaches
- Meeting frequency, length and attendance
- Plans for PR24 scrutiny and start date
- Responsibility for Terms of Reference
- Contact with the company board
- Publications

All independent ICG Chairs (16) completed the questionnaire. For the Group chaired by the company CCO, two were completed in order to enable all questions to be answered - by an ICG member and a company representative directly involved with the ICG.

One-to-one interviews

The interviews were to understand the nuances of how ICGs operate in practice and the reasons behind the decisions that have been made about the way the ICG performs its role. Interviewees spoken on a confidential basis. All ICG Chairs and at least one representative from each company were interviewed (at some companies more than one staff member attended the call), and INEDs from nine companies.

In addition, representatives from the EA (covering 9 ICGs) and CCW (covering 7 ICGs) provided written feedback on their work with the ICGs.