

COMPLIANCE OFFICER'S ACTIVITIES
ANNUAL REPORT ON BUSINESS SEPARATION 2020/21

1 Introduction

This report sets out Scottish Water's activities and the Compliance Officer's monitoring activity for the year 2020-21 pursuant to reporting requirements set out in the Water Services (Intra-Group Regulation) Directions 2006, as amended (the "Intra-Group Directions").

2 Compliance responsibilities

The key responsibilities of the Compliance Officer are to provide advice to Scottish Water on compliance with the market Directions and to ensure the ring-fencing of Business Stream. These responsibilities are set out in full in the Compliance Statement.

As the separation between Scottish Water and Business Stream is now firmly established, the role of the Compliance Officer during the financial year 2020/21 has been mainly to monitor performance of specific outputs required under the market codes and documents, and investigate complaints or other compliance issues. With an increased number of market participants and greater numbers of customers switching Licensed Provider ("LP"), there is an increased potential for inadvertent errors.

The key elements of the compliance structure are set out in the Compliance Statement. This report summarises the activities within that structure. During 2020/21, Scottish Water Internal Audit reviewed the compliance structure and their recommendations are addressed within this report.

3 Compliance arrangements

3.1 Key elements

The principal elements of the compliance structure are:

- a Compliance Code of Conduct, which sets out Scottish Water's obligations;
- Assurance Statements for each functional business area which explains how these areas will comply with their obligations; and
- a risk-based approach to monitoring and responding to compliance risks.

In addition, in 2020/21 Scottish Water Internal Audit carried out a full review of the Compliance Officer's responsibilities. There were no major issues reported, and all actions for the 2020/21 financial year were completed to time.

3.2 Compliance Code of Conduct

The agreed compliance policy for Scottish Water's core business is set out in Scottish Water's Compliance Code of Conduct. This Code seeks to:

- promote a culture of compliance;
- empower compliance management throughout the organisation;
- reiterate that the responsibility for compliance sits with line management and the Compliance Officer is an advisory and monitoring function; and
- ensure that compliance is an integral part of the overall business planning process in order that compliance requirements are acknowledged.

REPORT ON BUSINESS SEPARATION 2019/20

The Compliance Code of Conduct was reviewed and refreshed in the first quarter of the 2020/21 financial year.

3.3 Assurance statements

Each relevant business area has produced an Assurance Statement which sets out the specific obligations for that function. The statement confirms that the function (i) is committed to fulfilling those obligations; (ii) is aware of the potential risks and issues relating to its performance; and (iii) has a plan to monitor and address these issues. As in previous years, the statements for 2020/21 include commitments in relation to wholesale data quality.

3.4 Risk management

The Scottish Water risk register is monitored regularly by the Executive Leadership Team and reviewed on a quarterly basis by the Audit Committee and annually by the Board. The Compliance risk register was reviewed as part of the wider Internal Audit of the Compliance Officer's responsibilities.

3.5 Training and communications

Induction training is provided by the Compliance Officer or the Compliance Manager where required to relevant staff taking up posts in the senior management structure and in key market areas of the business, including Revenue and Risk, the Wholesale Service Desk and other areas on request, or where a risk has been identified. Regular training sessions are held with all staff in market-facing areas where issues are identified, or on request. An online training module has been developed and will be rolled out in 2021/22.

4 Key issues

4.1 Compliance Officer Responsibilities

During the period 2020/21, all obligations in relation to the Intra-Group Directions have been fulfilled. These obligations are audited at a high level annually by Scottish Water Internal Audit as part of an oversight review of compliance with Scottish Government Directions and other legislation. In this regard, confirmation was provided that Scottish Water was in compliance with the eight relevant Directions issued by the Commission to date. In addition, as noted above, Internal Audit carried out a detailed audit of the Compliance Officer's responsibilities in 2020/21.

4.1.1 Advice to Scottish Water

The Compliance Officer and Compliance Manager provided advice to the business in relation to specific areas, including tailored training where required, and on issues such as processes and communications with LPs and customers, or other issues as they arose. Detailed advice was provided in relation to approximately 75 separate queries in the period.

4.1.2 Monitor Scottish Water's compliance

Scottish Water's compliance is monitored through analysis of Key Performance Indicator ("KPI") performance in relation to Operational Code, Market Code and Disconnections Document obligations. Issues are raised by exception at the Regulatory Management Group ("RMG"). Performance is also reported at summary level to the Board in a 'Performance at a glance' ("PAAG") table. Detailed comments on KPI performance are included in Section 4.4 of this report.

The Compliance Officer has established arrangements for the investigation of any complaints received from the Water Industry Commission for Scotland ("Commission") or any third party. Arrangements are in place to ensure complaints are investigated thoroughly, with a report issued timeously. The Compliance Complaints process was refreshed in early 2020/21.

4.1.3 Complaints

REPORT ON BUSINESS SEPARATION 2019/20

There were no formal complaints by LPs in relation to Scottish Water during the period.

4.1.4 Issues

Four concerns were investigated within the year to determine whether they raised compliance issues:

- Three concerns were raised by customers or LPs:
 - One concern was treated as a compliance complaint and involved a customer whose site had been incorrectly billed at a wholesale level. This complaint related to actions from 2016/17. The customer has now been compensated and a “lessons learned” investigation completed.
 - One concern related to a customer who considered that Scottish Water had caused a burst on his property. This was investigated but did not appear to involve compliance issues. The customer has now raised a complaint with the Scottish Public Services Ombudsman (“SPSO”).
 - One further concern was raised by a major customer about the process of vesting pipework on their site. This did not appear to involve compliance issues and is being resolved in dialogue between the customer and the Developer Services function.
- One concern was identified within Scottish Water, relating to the behaviours of three LPs in relation to the wholesale deferral schemes. The issue was raised with the relevant LPs and reported to the Commission.

4.2 Data

There continues to be a focus on ensuring that market data is correct as this impacts on the quality of service Scottish Water is able to offer its customers, determines wholesale revenue and underpins Scottish Water’s reputation. The data quality strategy has been refreshed during the period, incorporating learnings from the English market.

4.2.1 Central Market Agency audit

The Central Market Agency (“CMA”) undertook an audit in May 2020. The audit took a risk-based approach to the review of market data quality and process transactions, with a narrower scope than in previous years due to resource constraints at the CMA. The level of mismatches between Scottish Water and the central market systems continues to remain at a low level which reflects the focus on ensuring that good quality data is transacted to the market and that errors are identified at an early stage through a system of data scorecards.

4.3 Intra-Group Directions

4.3.1 Ring fencing

The separation of Business Stream from Scottish Water took place on 1st November 2006 and Business Stream continues to be operationally independent of Scottish Water. Business Stream occupies its own offices and has transferred its IT services to its own supplier. None of Scottish Water’s or Business Stream’s operational systems were accessible to the other party in the period, with the exception of systems subject to Internal Audit, which are noted below.

4.3.2 Contracts with LPs

All agreements between Scottish Water and Business Stream have been approved by the Commission and are on arm’s length contractual terms. The table below sets out agreements that were in force in 2020/21 and indicates those which will continue into 2021/22. Very few services are now provided between the parties. There are no contracts in force with any other LP.

REPORT ON BUSINESS SEPARATION 2019/20

As part of the market response to the COVID-19 pandemic, the Wholesale Charges Deferral Scheme was established, and is open to all LPs. As a condition of its participation in the scheme, Business Stream has provided financial security to Scottish Water. This is governed by an agreement between the organisations, which has been approved by the Commission. The deferral scheme will continue into the early part of 2021/22 financial year and is due to be replaced by a further scheme with similar effect and conditions.

Table 1: Services in force in 2020/21 that will continue to 2021/22

Activity	Comment	Date of termination
Licensing agreement	Covers use by Business Stream of Scottish Water marque	No date currently agreed
Meter reading services for third party contract	The agreement has been extended for a further 3 years with Commission approval.	31 March 2024
Professional services: Internal Audit; insurance and tax advisory services		No date currently agreed
Escrow Agreement	This contract relates to the conditions for participation in the Wholesale Charges Deferral Scheme and may be replaced by a similar agreement when that Scheme is replaced or refreshed.	The contract continues until terminated by agreement between the parties

Table 2: Services which ended in 2020/21

Activity	Comment	Date of termination
None		

4.4 Compliance with the market codes and documents

4.4.1 Operational Code

Overall KPI performance for incoming service requests from LPs was 98.9% of tasks completed within target in 2020/21 (forecast year end) which is ahead of the corporate target of 95%. In the English market, data is reported on a slightly different basis but, by way of comparison, the best performing English wholesaler has a pass rate of 99.4% and the average performance is 95.5%.

4.4.2 Market Code

Market data transactions are monitored by the CMA and there are fines for some performance failures, capped on an annual basis. These charges have been suspended in 2020/21 due to the impact of COVID-19 restrictions upon field activities. Business users have a suite of exception reports produced from corporate systems which they can run on a regular basis to assist with the completion of CMA transactions. Performance at an aggregate level is reported to each Board meeting in PAAG.

The proportion of transactions that failed a CMA performance standard was 9.6% in 2020/21. The performance standards relate to a subset of transactions within the CMA, principally new connections, gap sites, disconnections and meter reads. It is not, therefore, comparable with the KPI performance reported through PAAG, which covers all steps in the operational processes, not just CMA transactions. English wholesalers report a similar transaction set, with a failure rate of 14.8% on average, with the best performing English wholesaler reporting a failure rate of 3.1%.

REPORT ON BUSINESS SEPARATION 2019/20

Whilst a proportion of Scottish Water's failures relate to transactions for new connections, performance is improving following implementation of the new IT system.

4.5 Governance Code

Scottish Water's obligations under the Governance Code reflect developments since the opening of the retail market and changes to the structure of Scottish Water's subsidiaries. A holding company, Scottish Water Horizons Holdings Limited, has Scottish Water Business Stream Holdings Limited ("SWBSH") as a subsidiary. These holding companies exercise Scottish Water's ownership functions and provide funding to Business Stream. The Compliance Officer is the company secretary of SWBSH, attends SWBSH board meetings and monitors its activities for compliance with the Governance Code.

Additional financial support arrangements were put in place by the Scottish Water Group during 2020 to provide Business Stream with temporary liquidity support to manage a range of potential financial impacts arising as a result of the COVID-19 restrictions. These arrangements were subject to the prior consent of the Commission and Scottish Ministers. Temporary modifications to the Governance Code have been agreed with the Commission to facilitate Stage 1 of the funding process. Any further modifications identified during the Stage 2 strategic review that will be undertaken by Scottish Water Business Stream Holdings Limited ("SWBSH") and Business Stream to consider the options for Business Stream's longer-term financial sustainability will be presented to the Commission for consideration following SWBSH review and approval.

4.5.1 Meetings with Business Stream

The Governance Code also requires Scottish Water to monitor meetings between Scottish Water and Business Stream. A register of meetings is in operation and meetings are attended by a Compliance representative where appropriate. This register is reconciled with data provided by the Compliance Manager at Business Stream to ensure that complete coverage of meetings is maintained. In 2020/21, 105 meetings were registered. As noted above, Scottish Water Internal Audit provides an audit function for Business Stream, which necessitates a number of meetings with Business Stream. However, Section 4.4 of the Governance Code strictly controls the information that can be provided to Scottish Water in relation to that activity, and it would not therefore be appropriate for those meetings to be included in this register. Specific training has been offered to the Internal Audit function to mitigate any residual risks.

4.5.2 Other Code obligations

The Code also requires Scottish Water to offer meetings between an executive director of Scottish Water and the CEO of any LP. In 2020/21, regular senior meetings were held with the largest LPs and offered to all active LPs. In addition, the Code sets out obligations in relation to Section 29E departures. During 2020/21, no section 29E opportunities were proposed by LPs or identified by Scottish Water.

4.6 "No more or less favourable" treatment

Scottish Water is obliged under the Water Services etc. (Scotland) Act 2005 to treat Business Stream no more or less favourably than it treats any other LP. KPI performance for different LPs and groups of LPs is periodically reviewed to monitor this obligation. Over this period, around three-quarters of tasks were carried out for Business Stream, reflecting the relative market shares of different LPs. At an aggregate level, other LPs as a group receive a slightly lower rate of KPI performance than does Business Stream. However, further analysis showed that the underlying performance for each business area was very similar, but that the Business Stream has a larger proportion of tasks in relatively higher performing areas. Taking this into account, it was concluded that there was no significant discrepancy in Scottish Water's performance.

REPORT ON BUSINESS SEPARATION 2019/20

As noted above, comparative data from the English market shows that Scottish Water's performance is above the average level for English wholesalers, and we will continue to monitor this in 2021/22.

5 Training

In addition to the training and communications strategy set out in Section 3.5, targeted training is provided in response to specific compliance issues. In the period, specific training was delivered to the Wholesale Service Desk. An online training package has been developed for rollout to the wider business in 2021/22 which will make it easier to deliver compliance messages while face-to-face training is restricted.

6 Conclusion

In the 2020/21 financial year, Scottish Water continued to operate robust separation and market-facing structures. Systems and processes in place monitor the level of Scottish Water's performance and there continues to be effective identification and remediation of potential and actual issues. The scrutiny of data quality has increased over the period and will continue into 2021/22. Going forward, Scottish Water is committed to ensuring that its separation and market obligations are achieved.

Emma Campbell
Compliance Officer

Annex: Scottish Water's compliance obligations

Intra-Group Regulation Directions

The Intra-Group Directions require Scottish Water to develop and operate ring-fencing to establish and maintain managerial and operational systems which would prevent any LP from accessing any confidential information held unless this would otherwise be in the public domain, its release is in accordance with the Operational Code or Wholesale Services Agreement or the information relates to a customer of the licensed provider. In addition, the Intra-Group Directions require any agreement between Scottish Water and Business Stream to be approved in advance and on arm's length terms.

Market codes and documents

Under directions from the Water Industry Commission for Scotland, Scottish Water is required to comply with the terms of the Market Code, the Operational Code, the Disconnections Document and any Wholesale Services Agreement to which it is party. The Market Code, Operational Code and Wholesale Services Agreements also have contractual effect.

Governance Code

The Governance Code requires Scottish Water to establish a holding company – Scottish Water Business Stream Holdings Limited ("SWBSH") – to exercise its ownership functions, and to provide funding to Business Stream. The Code sets out:

- governance arrangements whereby Scottish Water can fulfil its statutory obligations as owner of Business Stream without compromising the independence of Business Stream;
- the financial relationship between Scottish Water and Business Stream to ensure that this is transparent;
- there is appropriate scrutiny over meetings between Scottish Water and Business Stream; and
- a number of other obligations, principally in relation to the development of opportunities for Section 29E departures, and the offer of meetings at a senior level to all LPs.

"No more or less favourable" treatment

Section 13 of the Water Services etc. (Scotland) Act 2005 requires Scottish Water to treat Business Stream no more or less favourably than it treats any other LP.