

COMPLIANCE OFFICER'S ACTIVITIES
ANNUAL REPORT ON BUSINESS SEPARATION 2019/20

1 Introduction

This report sets out Scottish Water's activities and the Compliance Officer's monitoring activity for the year 2019/20 pursuant to reporting requirements set out in the Water Services (Intra-Group Regulation) Directions 2006, as amended (the "Intra-Group Directions").

The Report also sets out the overall business procedures in operation during 2019/20 to mitigate against the risk of failure to comply with the requirements set out in the Intra-Group Directions and how these relate to the activities of the Compliance Officer.

It is Scottish Water's policy to comply with all regulatory and legislative requirements and Scottish Water has, during the year, reviewed the activity of market facing business functions to facilitate compliance with the obligations under the Intra-Group Directions and the Water Services etc. (Scotland) Act 2005 in relation to business separation.

2 Compliance responsibilities

This section sets out Scottish Water's compliance obligations in relation to the market. The activities under these headings are set out in Section 4, Key issues.

2.1 Compliance Officer

As set out in the Intra-Group Directions, the Compliance Officer responsibilities are as follows:

- (a) provide advice to Scottish Water on compliance;
- (b) monitor Scottish Water's compliance;
- (c) investigate any complaint or representation;
- (d) recommend and advice on remedial action; and
- (e) report to the Water Industry Commission for Scotland (the "Commission").

2.2 Compliance obligations

Scottish Water's compliance obligations are set out in detail in the Annex. These fall under four main headings:

- Intra-Group Directions, principally related to ring-fencing of Business Stream, confidentiality of information, and control of agreements between Scottish Water and Scottish Water Business Stream Limited ("Business Stream");
- Market documents, including the Operational Code, the Market Code, the Disconnections Document and Wholesale Service Agreements;
- The Governance Code, including oversight and financing of Business Stream by Scottish Water, and control of meetings between Scottish Water and Business Stream; and
- "No more or less favourable treatment" as required by the Water Services etc. (Scotland) Act 2005.

Full details of performance under these headings are given at Section 4, Key issues.

REPORT ON BUSINESS SEPARATION 2019/20

The separation between Scottish Water and Business Stream is now firmly established so the role of the Compliance Officer during the financial year 2019/20 has been mainly in relation to monitoring performance of specific outputs required under the market codes and documents, and investigating complaints or other compliance issues. With a larger number of market participants and larger numbers of customers switching Licensed Provider (“LP”), there is an increased potential for inadvertent errors.

3 Compliance arrangements

3.1 Outline

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.

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 the business 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 to ensure compliance requirements are acknowledged.

This Code of Conduct will be reviewed and refreshed in the first quarter of the 2020/21 financial year.

3.3 Assurance statements

Each relevant business area following the review has produced an Assurance Statement which sets out the specific obligations for that function. The statement confirms that the function is committed to fulfilling those obligations, is aware of the potential risks and issues relating to its performance, and has a plan to monitor and address these issues. As in previous years, the statements for 2019/20 include commitments in relation to wholesale data quality.

3.4 Risk management

Scottish Water has a risk register which is monitored regularly by the Executive Leadership Team of Scottish Water and reviewed on a quarterly basis by the Audit Committee and annually by the Board.

3.5 Training and communications

The Compliance function provides induction training 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. We are currently considering the need for an online training module to be developed and rolled out in 2020/21.

4 Key issues

4.1 Compliance Officer Responsibilities

During the period 2019/20, all obligations in relation to the Intra-Group Directions have been fulfilled. These obligations are audited annually by Scottish Water Internal Audit.

4.1.1 Advice to Scottish Water

The Compliance team provided advice to the business on specific areas including tailored training where required, and advice on processes and communications with LPs and customers, where required. The Compliance function also provided a central resource to respond to compliance enquiries from business functions and individual staff members. Detailed advice was provided on around 200 separate queries as they arose.

4.1.2 Monitor Scottish Water's compliance

The Compliance team monitors Scottish Water's compliance 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 given in Section 4.4.

The Compliance Officer has established arrangements for the investigation of any complaints received from the Commission or any other third party. Arrangements are in place to ensure any complaints which are received can be thoroughly and quickly investigated and a report issued.

4.1.3 Complaints

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

4.1.4 Issues

Three compliance issues were investigated out in the year, two raised by customers, and one raised internally by Scottish Water staff. In each case, the Compliance Function investigated the situation and recommended and, where appropriate, monitored remedial action to ensure no repeat of the non-compliance. These issues are set out below:

- Customer issues:
 - One issue was raised by a customer who had been incorrectly charged for services which his property was not in fact connected for. This complaint was the subject of an SPSO complaint. A report was prepared highlighting the causes of the complaint, and action was taken to ensure that no similar errors had been made in similar cases.
 - One further issue was raised by an LP on behalf of their customer which has had interactions with a large number of functional teams within Scottish Water. The customer felt that they had received conflicting advice from different parts of the business, which lead to increased expense on their part. On investigation no compliance issues were found. However, it became clear that Scottish Water could improve the customer experience by taking a more holistic approach to customers of this kind.
- One issue was identified internally by Scottish Water: A third party consultant was unhappy with the way in which Scottish Water processed a new connection. On investigation no issues were found.

In addition, a small number of e-mails relating to customers or LPs were inadvertently sent to the incorrect LP. The LPs involved were informed and asked to delete the relevant information, and the people involved were reminded of their confidentiality obligations.

REPORT ON BUSINESS SEPARATION 2019/20

A number of other customer concerns were investigated by the compliance function, but following analysis were treated as escalated complaints as they did not raise compliance concerns.

4.1.5 Training and communications

Over 2019/20, the number of LPs with wholesale service agreements has continued to increase and now stands at 30. Following consolidation in the English market, a number of LPs are moving to merge their Scottish operations, though no licences have yet been surrendered. At the same time, the number of customers who have switched has also increased, albeit the rate of switching has lessened. This has led to an increased potential for non-compliance, for example by increasing the potential for confusion amongst Scottish Water staff as to which LP serves a customer, or by increasing the potential for different LPs to receive a different service in some dimension. With the English market maturing, we have taken the opportunity to learn from the experience of wholesalers and retailers in England.

In 2019/20, the compliance function continued the normal sequence of training market facing areas and giving induction briefing to new staff in key areas.

4.2 Data

There continues to be a focus on ensuring that market data is correct as this impacts on the quality of service we are able to offer our customers, determines our wholesale revenue and underpins our reputation. The move to the use of live RV for charging purposes has required a link to the Scottish Assessor's data set, which has the added benefit of flagging splits and mergers in property configuration.

4.2.1 CMA audit

CMA undertook an audit in May 2019. The audit took a risk based approach to the review of market data quality and process transactions.

In relation to the process audit, there were modest improvements from previous years in most areas. The aggregate level of performance charges payable to the CMA continues to fall. The CMA is currently reviewing the operation of performance charges, though this is focussing on LP behaviours. The English market has now introduced performance charges for operational failures as well as market transactions, though this is not currently under consideration in Scotland.

In relation to the data audit, the level of mismatches identified also continues to fall, particularly in relation to revenue-affecting data. This reflects improvements in the quality of data entered into the market and the increasing use of dashboards and scorecards to correct issues on a continuing basis.

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 under the arrangements set out in the next section.

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

REPORT ON BUSINESS SEPARATION 2019/20

were in force in 2019/20 and indicates those which will continue into 2020/21. Very few services are now provided between the parties. There are no contracts in force with any other LP.

Table 1: Services in force in 2019/20 that will continue to 2020/21

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 approved by the Commission allowed for a two year extension beyond the original term, and Scottish Water has decided to use this extension.	31 March 2021
Professional services: Internal Audit; insurance and tax advisory services		No date currently agreed

Table 2: Services which ended in 2019/20

Activity	Comment	Date of termination
Consultancy service	Scottish Water International has a consultancy contract with Business Stream to support their HR activity in the English market. Two current Scottish Water employees worked with Business Stream from June 2018.	30 June 2019

4.4 Compliance with the market codes and documents

4.4.1 Operational Code

Overall KPI performance for incoming service requests from LPs was 98.1% of tasks completed within target in 2019/20 (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 98.3%; two other wholesalers have a performance level above 95%, and the average market performance is 86.2%.

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. The 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 is also reviewed at the Product Forum and at the RMG. Performance at an aggregate level is reported to each Board meeting in PAAG.

The proportion of transactions that failed a CMA performance standard was 8.5% in 2019/20, which maintains the high level in 2018/19. 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 13.9%, with three undertakers performing above Scottish Water's level.

REPORT ON BUSINESS SEPARATION 2019/20

A proportion of Scottish Water's failures relate to transactions for new connections, with others relating to data project work, for example the remaining properties from the SAA project and proactive work to align the market data with ongoing changes in the SAA database. Where data is corrected, there will continue to be a level of performance failures due to the historic effect of some transactions.

4.5 Governance Code

Scottish Water's obligations under the Governance Code reflect developments since the opening of the retail market and to 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.

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 member of the Compliance team 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 2019/20, just over 200 meetings were registered.

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 2019/20, 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 2019/20, 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. The Compliance team periodically reviews the KPI performance between LPs to monitor this obligation. At an aggregate level, other LPs as a group receive a slightly higher 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 other LPs have a larger proportion of tasks in relatively higher performing areas. Taking this into account it was concluded that there was no significant discrepancy in our performance. It therefore appears that, on this measure, we treat Business Stream no more or less favourably than we treat other LPs.

As noted above, we have also used comparative data from the English market which shows Scottish Water's performance to be on a par with the best performing English wholesalers, and we will continue to monitor this in 2020/21.

5 Training

In addition to the updated training and communications strategy set out in Section 4.1.5, deployment of a targeted training programme is provided in response to specific compliance issues. In the period, specific training was given to the Wholesale Service Desk and to all new staff in the Wholesale area. Each new LP also received training from the Compliance Manager as part of their induction sessions.

REPORT ON BUSINESS SEPARATION 2019/20

The importance of compliance is reflected within Scottish Water's values as a key part of employees' day to day functions, together with the consequences to Scottish Water and employees of non-compliance.

6 Conclusion

In the 2019/20 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 on data quality has increased over the period and will continue into 2020/21. 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.