National Audit Office

Report
by the Comptroller
and Auditor General

Ofwat, Ofgem, Ofcom and the Financial Conduct Authority

Regulating to protect consumers in utilities, communications and financial services markets

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Key facts

4

number of regulators covered in this report – covering water, energy, telecoms and retail financial services

£140bn

total amount that UK consumers spent on bills in water, energy and telecoms, and fees and charges in financial services, in 2017

£855m

total running costs in 2017-18 of Ofwat, Ofgem, Ofcom and the Financial Conduct Authority, which vary substantially in size

It is important for regulators to measure and report transparently their performance to highlight what progress they are making in protecting consumers' interests.

92%	reduction in the total number of electricity and gas disconnections for people in debt between 2016 and 2017
28%–37%	real-terms increase in average gas and electricity prices between 2007 and 2018
94%	proportion of UK premises in 2018 able to access superfast broadband, up from 91% in 2017
15%	proportion of broadband customers in 2018 who had reason to complain, the most common issue being connection problems
£150 million per year	estimated saving for borrowers as a result of the introduction of the Financial Conduct Authority's price cap on short-term high-cost credit in 2015
70%	increased likelihood of consumers in deprived areas of the UK using unarranged overdrafts, which are twice as expensive as arranged overdrafts, than those in less deprived areas
43%	proportion of water customers in England and Wales in 2017 who were aware of special non-financial assistance that water companies can provide, up from 29% in 2009
36,000	number of homes in England and Wales left without water for more than a day following the cold weather in early 2018

Summary

1 UK households spend a total of around £140 billion a year in bills on water, energy and telecommunications, and fees and charges in financial services. These sectors provide services that are critical for security, well-being and social participation, which consumers purchase directly mostly from private companies. Each sector is overseen by a regulator to ensure that services are provided in a way that meets public policy objectives, including that markets work well for consumers.

2 The four main regulators of these sectors – Ofwat, Ofgem, Ofcom and the Financial Conduct Authority (FCA) respectively – were set up to be directly accountable to Parliament, independently of government. Their long-term high-level objectives are set out in statute, including a primary statutory duty to protect the interests of consumers. The regulators vary substantially in size, reflecting differences in their remits and the size, complexity and features of each sector. Between them, they have annual running costs totalling £855 million.

3 The regulators each have individual functions and objectives to protect the interests of consumers. These include, for example: promoting competition to encourage fair prices and meaningful choice for consumers; setting rules and limits on the prices that providers can charge where competition is not sufficient; ensuring that services are provided to an adequate standard (such as reliable broadband connections or water supply); and preventing unfair practices such as unfair terms and conditions.

4 Government, Parliament and consumer representatives have expressed concerns about whether these sectors are working as well as they can for consumers, raising questions about the effectiveness of the regulators. They have highlighted a range of issues, including long-term above-inflation price rises in utilities, difficulties for consumers in accessing the best deals, poor quality of services, and high costs in consumer credit. These issues can have significant impacts on people. Government has launched or commissioned various reviews into whether regulation is proving effective, including the 2017 ‘Regulatory Futures Review’ and an ongoing regulation study by the National Infrastructure Commission.

5 In protecting the interests of current and future consumers, regulators have to consider the often-competing needs of different stakeholder groups. For example, companies will be seeking to maintain and maximise shareholder value, while government departments will be concerned that regulators support other policy objectives such as financial stability, sustainability of resources or security of supply. The outcomes regulators are seeking to achieve can also be affected by a range of factors over which they have limited influence, such as droughts or changes in the wholesale cost of energy.

6 Faced with these challenges and differing views over their effectiveness, it is vital that regulators measure and report transparently their intentions and achievements in meeting their duties towards consumers. This means they need to ensure that they:

- set out clearly their intended consumer outcomes, how they have dealt with competing incentives such as those of consumers and industry stakeholders, and any barriers or constraints they face in delivering their outcomes;
- examine whether they are achieving their intended outcomes and take corrective action where necessary; and
- demonstrate credibly to Parliament and other stakeholders how well they are discharging their duties and addressing the key issues for consumers.

7 In 2016, we published *Performance measurement by regulators*, a guide setting out best practice for regulators in measuring and reporting their performance. This was based on existing guidance, our experience from past work and input from a wide range of regulators. The guide also recognised that measuring performance is challenging for regulators, because they do not have direct control over their intended outcomes, and these are often achieved over the long term.

Scope of this report

8 This report assesses how well Ofwat, Ofgem, Ofcom and the FCA measure and report their performance in protecting the interests of consumers. We assess them against the principles set out in our 2016 guidance on performance measurement, as well as other recent work we have done on accountability and reporting in government. In particular, we examine:

- whether the regulators have good insight into the key issues that consumers face, and clearly define what they want to achieve and the barriers they face in doing so (Part Two);
- how well the regulators measure their own performance, understand the extent to which they are able to influence consumer outcomes, and use this information to improve their own effectiveness (Part Three); and
- whether the regulators report performance publicly in a way that is useful for Parliament and other stakeholders to hold them to account (Part Four).

9 The report does not evaluate the regulatory performance of each regulator, and it does not focus on their other statutory objectives.

Key findings

Focusing on what matters to consumers

10 **All four regulators have good insight into the key consumer issues in their sectors, based on their own research and consultation with other stakeholders.** To focus on what matters to consumers, regulators need a clear understanding of the problems they are seeking to address. We found that each regulator routinely engages with the statutory consumer representative and complaints bodies in its sector, and conducts its own surveys, research and data monitoring. For example, Ofgem, Ofcom and the FCA conduct regular large-scale surveys into consumers' experiences. The regulators use their consumer insight to identify key issues and set priorities, such as the FCA's annual sector views which use data from a number of sources to analyse the actual and potential harm that consumers face in each market it regulates. We also found that the regulators share insights into consumer issues, such as the particular challenges that vulnerable consumers face, including through the UK Regulators Network (paragraphs 2.3 to 2.5).

11 **The available evidence shows that consumers are facing significant issues across all four sectors.** We found that the regulators are seeking to address a number of common challenges for consumers, including affordability concerns, service failures and challenges for vulnerable consumers (paragraphs 2.6 to 2.10):

- **Affordability and debt.** The most common problem that consumers seek help from Citizens Advice within all four sectors is dealing with debt associated with paying bills and credit commitments. Affordability concerns play out differently in individual markets, but people who fall behind on their bills can often struggle across multiple services. For example, we reported in 2017 that of those seeking help with debt problems, 32% had issues in two of the four sectors and 11% in three of the four. These concerns are set against a backdrop of rising prices, including real-terms rises of 28% for gas, 37% for electricity and 6% for water since 2007.

- **Difficulties accessing the most appropriate deal or service, particularly for vulnerable consumers.** Customers who do not switch provider typically pay more for the same service as new customers – in 2018, Citizens Advice estimated that this 'loyalty penalty' totals £4.1 billion a year across a range of communications and retail financial services markets. Vulnerable consumers are likely to be particularly badly affected. For example, Ofgem has found that elderly and lower social grade consumers are a third less likely than the average consumer to switch energy supplier to get a cheaper deal. The FCA has also identified that consumers in deprived areas of the country are 70% more likely to use an unarranged overdraft, which are twice as expensive as arranged overdrafts, than those in less deprived areas.

- **Service failures or poor quality of service.** We found issues in all sectors. For example, leakage increased by 3% across the water sector between 2015-16 and 2017-18, and 36,000 homes were left without water supply for more than a day following the severe cold weather in early 2018. Ofcom found in 2018 that 15% of broadband customers had reason to complain about their service, and that by far the most common cause was connection problems.

12 **Regulators have not been specific enough in defining the overall outcomes they want to achieve for consumers.** Clear success criteria such as outcomes-based targets are vital so that industry, consumers and consumer representatives are clear on regulators' expectations and priorities and how these address consumers' key areas of concern. Regulators set broad high-level aims, such as achieving high-quality and good-value services for consumers. However, apart from targets in some specific areas, they have not defined what these high-level aims mean in practical terms (for example, with market-wide targets or other success measures), such as what level and distribution of prices or service reliability would demonstrate either good progress or a need to take further action. During our study, the regulators raised concerns that, in some areas, specific targets can have negative unintended consequences. However, they also acknowledged that there is value in being more specific about what they are trying to achieve. The regulators also do not have a joined-up way of setting objectives for issues that cut across sectors such as affordability and debt (paragraphs 2.11 to 2.15).

13 **Regulators find it difficult to manage the trade-offs they face between competing objectives in protecting consumers.** To meet their objectives, regulators need to manage a number of potential conflicts or trade-offs between objectives or groups of consumers, or areas where their powers are limited. Our recent report on vulnerable consumers found that some measures to promote a competitive market, which reduces prices for consumers who switch to the best deals, can conflict with objectives to protect those in vulnerable circumstances who are less likely to switch and therefore benefit from cheaper prices. It concluded that regulators and government need to be clearer about their respective responsibilities. There are areas where government formally provides direction or strategic steer, for example, introducing legislation requiring regulators to introduce price caps or universal service obligations. However, regulators report that determining how to manage many of these trade-offs remains challenging (paragraphs 2.16 to 2.18).

Measuring and improving performance

14 **Regulators monitor data on consumers' experiences and outcomes, but do not routinely use this information to assess their own performance.** We found that regulators' boards and management teams are actively using performance information to assess progress and focus on corrective action where necessary. This information focuses on project-based measures, for example progress with introducing new regulatory rules, the status of ongoing investigations, or the number of successful enforcement cases. The regulators also track a range of outcomes data, such as prices, quality of service and levels of consumer satisfaction. However, this is not typically underpinned by a clear set of detailed indicators, attributable to the regulator, which makes it difficult for either the management or the board to assess how the regulator is performing against its overall consumer objectives (paragraphs 3.4 to 3.10).

15 None of the regulators has yet developed a good overall understanding of its influence over consumer outcomes and how to exert this through different regulatory approaches. To meet their objectives, regulators rely to varying degrees on the behaviour of consumers, providers and other stakeholders. For example, consumers switching to the best deal should stimulate provider competition, and thereby lower prices and improve quality. Although difficult, regulators need to understand the extent to which they are able to influence behaviours and the resulting outcomes to make sure they intervene in the most cost-effective way. No regulator has yet made significant progress with mapping or evaluating their overall influence on outcomes, although the FCA has begun work to understand its impact and influence and has evaluated the direct impact of three recent interventions. While these require investment of resources, the FCA considers the results extremely valuable to building a picture of its influence and informing future decisions (paragraphs 3.11 to 3.14).

16 The regulators are working to improve how they measure their performance, but have further to go to be able to do so robustly. All four regulators have recognised the need to improve how they measure their performance in protecting the interests of consumers, and are committing resources to this. The regulators are at various stages of maturity and have made particular progress in different areas, but all have further to go. As the largest of the regulators, the FCA has been able to prioritise resources to evaluating its impact, and has consulted publicly on a new overall approach. It is currently working to implement this new approach and recognises that it has more to do. Ofcom and Ofgem have also made some progress in monitoring a structured set of indicators for each of their high-level intended consumer outcomes. Ofwat is at an earlier stage in the process overall, and has recently started developing a new sector-wide approach that it intends to complement its existing approach to target setting and performance monitoring for individual companies (paragraphs 3.15 and 3.16).

Reporting of consumer outcomes

17 Regulators' public reporting does not provide a meaningful overall assessment of how well they are protecting consumers' interests. The only place that regulators currently provide an overall assessment of performance is their annual reports. However, these do not consistently provide a clear line of sight between what they are trying to achieve, what they have done to meet these objectives, and what the actual outcomes are for consumers. Performance information is also not presented in a consistent way, meaning that year to year comparisons are not possible, and there are few benchmarks (such as expected outcomes) against which to assess progress. Consumer representatives and other stakeholders told us that regulators' reporting would benefit from clear benchmarks and consistency from year to year (paragraphs 4.11 to 4.13).

18 **Consumer representatives find regulators' publications on specific interventions and issues useful.** Our 2016 guide recommended that regulators engage with users of performance information to understand what is most useful to them. Consumer representatives, in particular, use regulators' publications to hold them to account. Most stakeholders we interviewed, including consumer representatives, reported that the regulators engage well to understand their interests, and provide useful information on particular interventions or consumer issues. Specific examples included reports and data from Ofgem and Ofwat on vulnerability and affordability, and Ofcom's progress reports on the roll-out of superfast broadband. However, some also highlighted gaps, including a lack of benchmarks against which to measure success, and a lack of clarity on why a certain approach was chosen over alternative options (paragraphs 4.4 to 4.7).

19 **Regulators find it challenging to articulate what difference they are making to the performance of each sector.** The performance of a market or sector is also influenced by other factors. For example, government policy can increase prices for consumers (such as environmental protections or government mandated projects like the roll-out of smart meters) by increasing providers' costs, as can changing economic conditions. However, price rises may also occur if the regulator is not doing enough to keep costs and prices competitive. Regulators need to make the distinction so that there is clarity about what they can be held accountable for and what they have less control over. All four regulators have and use powers to request data from providers and report on how each market, section of a market or individual company is performing in priority areas such as prices, complaints, service disruptions, levels of switching or customers in arrears. However, regulators could improve sector reporting by, for example, supplementing it with assessments of their own performance (paragraphs 4.8 to 4.10).

20 **Regulators have no common set of standards for what or how to report.** Unlike for financial reporting, regulators are not subject to specific performance reporting requirements on consumer outcomes. While we would expect each regulator to report different information relevant to their role and sector, common standards would prompt reporting based on agreed best practice and make the information more accessible and consistent for users of the reports. We reported in 2018 that central government departments had found that efforts to improve reporting based on a common approach have helped them to clarify objectives and internal accountabilities and take a more professional approach to planning. Regulators have not developed equivalent standards or principles with which to drive improvements to their reporting (paragraphs 4.14 to 4.16).

Conclusion on value for money

21 Consumers of regulated services are facing a number of significant difficulties, from rising bills to the impact of service failures. The regulators who have statutory duties to protect consumers in these sectors all face common challenges in meeting their objectives. They have to balance the often-competing needs of consumer and provider interests, alongside other duties covering issues such as sustainability, security of supply, or financial stability, and they often have only limited influence over outcomes. In the context of concerns over the ability of regulators to protect consumers it is imperative that they are clear and specific about the outcomes they are seeking to achieve and are transparent in reporting their performance.

22 The regulators in this review have good insight into consumer concerns and issues. However, they are not sufficiently specific and targeted in setting out what overall outcomes they want to achieve for consumers, and therefore what information they need to evaluate and report on their overall performance robustly. Regulators are all taking steps to improve how they define, measure and report their performance in protecting consumers, but all have further to go to do so in a meaningful way. Until they achieve this, they will not be able to give consumers confidence that they are providing value for money, or adequate overall levels of protection for those who need it.

Recommendations

23 Regulators should:

a Do more to translate their high-level intended consumer outcomes into what this means in practical terms. This should be underpinned by detailed indicators or targets that, where possible, are attributable to their regulatory performance, and that can be used to measure performance in protecting the interests of consumers. It is up to regulators to determine where targets may not be appropriate (for example where they are likely to lead to unintended consequences), and to demonstrate how they plan to measure success and drive improvement.

b Work together, for example through UK Regulators Network, to develop a consistent approach to modelling and measuring regulatory influence and impact, and providing links between regulatory activities, outputs and consumer outcomes.

c Ensure that their public reporting of performance includes clear benchmarks, trends over time and analysis of the underlying factors affecting outcomes.

24 Regulators should work in consultation with government and other key stakeholders to:

d Ensure there is clarity over how best to manage trade-offs between regulatory objectives or groups of consumers, particularly in areas that overlap with government policy such as affordability and vulnerability.

e Develop principle-based standards for public reporting of regulatory performance in annual reports or other regular publications. This should include consideration of how regulatory performance can be distinguished from other impacts, such as direct government interventions which affect consumer costs and outcomes.

f Set common expectations and standards for evaluating significant regulatory decisions and interventions, particularly where regulators cannot afford to do this within existing resources.

While it is not possible to put a timescale on these recommendations, we would expect to see clear signs of progress with each annual reporting round.