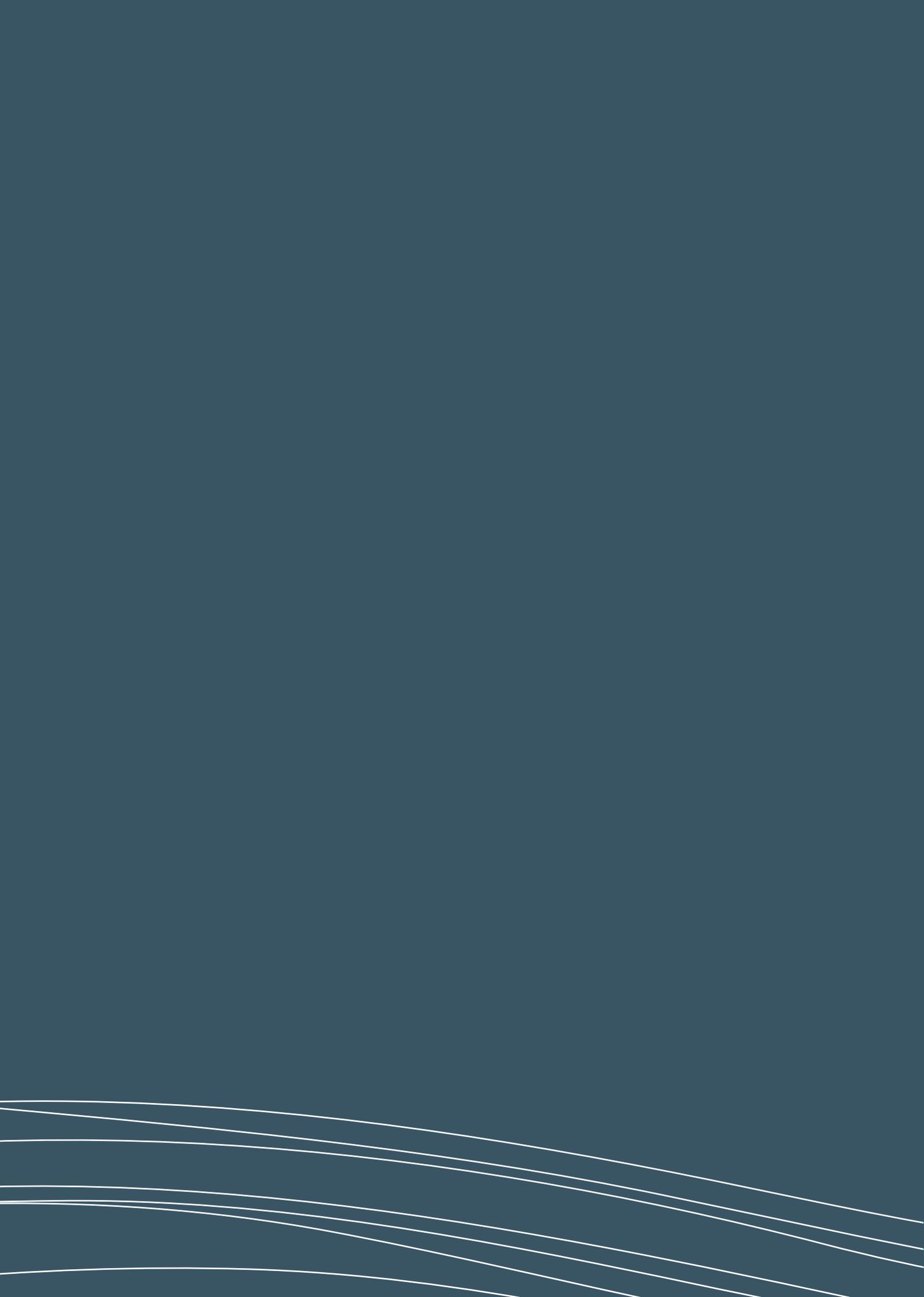


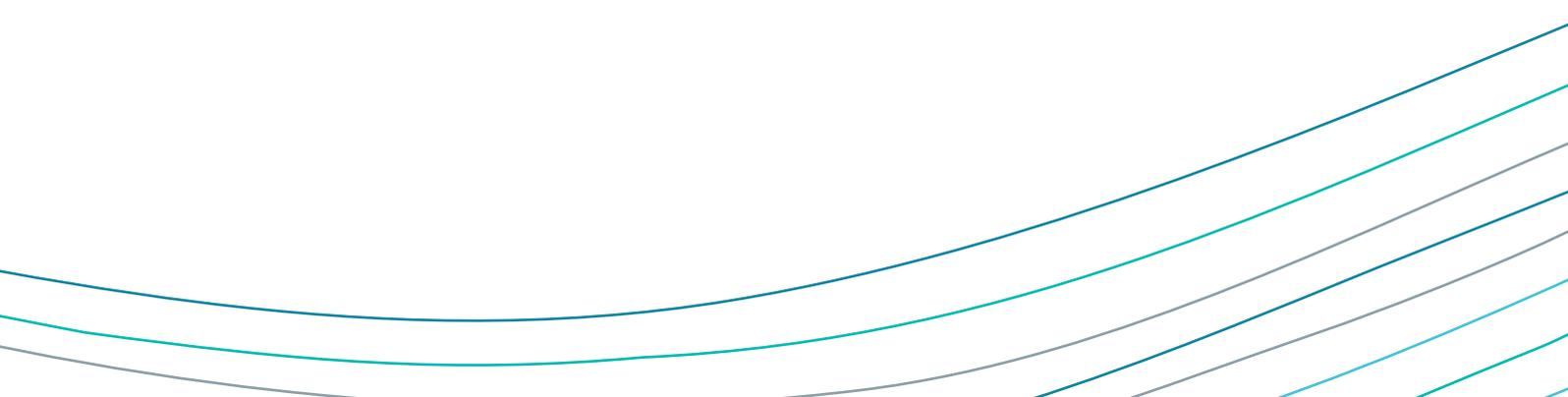
Quarterly Market Review
Q2 2018/19





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Foreword from our CEO



Welcome to our Quarterly Market Review. Reflecting another busy quarter we report important progress on work to drive improved market performance and data quality; the priority areas on which we plan to focus our work through our next Business Plan, a progress report on our imminent move to our new home in Southampton, and updates on the impact our market services are having.

Last time I reported that to be of most value this Review would in future focus only on the most important market issues and developments. That same theme - focusing to make the biggest impact – has been driving our thinking with the market on where we should focus our resources next year. We have just shared the results of that work in the draft MOSL Business Plan for 2019/20 on which we are currently consulting our members. The clear message running through every line and number is that the best way to make real progress resolving the serious performance issues holding the market back is to focus resources on tackling the biggest sources of market friction.

I am looking forward to seeing trading party feedback on our plans, especially on the priority issues we want to target:

- ◆ Driving real improvement in some key areas of performance and in data quality to benefit settlement, switching, billing and ultimately the customer experience
- ◆ Developing a market-backed solution to the core issue of difficult bilateral interaction between parties
- ◆ Stabilising the market and MOSL over the coming year and making sure our relocation to Southampton causes minimal disruption
- ◆ Finding ways to speed up and make smoother the way change is managed.

“ The best way to make real progress resolving the serious performance issues holding the market back is to focus resources on tackling the biggest sources of market friction. ”

I hope trading parties will be pleased by the story our spending plans tell. They show that while investment is needed in some key areas to drive improvements, we are committed to being cost-effective. The total 2019/20 market operator budget is £10,255k, a 4% decrease compared to the 2018/19 budget, and 7% lower than the £10,990k 2019/20 budget projected in the 2017/18 Business Plan. Like for like, excluding the bilaterals project, our proposed budget represents a 10% reduction from the 2018/19 budget.

The draft Business Plan's priorities were also shaped by views which came back through our Member Questionnaire, and the stimulating Market Forum we held after that to discuss key themes and issues which emerged. There was a very strong sense in the room that we need to make urgent progress in resolving the big issues that are shared across the market.

Of course, tackling long established ways of doing things is never easy. However, I have yet to see an issue in this market that cannot be fixed.

Driving improved performance remains high on our agenda this year. I was delighted to see, as we report here, a strong trading party response to our call for Data Improvement Plans. It was a clear signal that the Market Improvements Strategy and the introduction of Performance Charges is driving real change for the better in the way this market responds to challenges.

Finally, I am pleased to report that following market governance changes which members approved, Andy Hughes of Water Plus has joined our Board in a new role elected by associated retailers and Josh Gill of Everflow has joined having been elected by unassociated retailers. I am pleased that we continue to have CEO representation in all elected posts and also note that a strong field of seven candidates stood for these roles. John Reynolds has stood down after three years and the Board thanked him for his strong contribution to the creation of the market and the company.

I hope you find this Quarterly Review useful and informative.



Chris Scoggins

Chief Executive Officer,
Market Operator Services Limited (MOSL)

Business Update

MOSL Business Plan

Survey feedback

We asked for views on market priorities from member CEOs and Water Leaders and received valuable responses. Under our five pillars of stabilisation, engagement, governance, innovation and service we asked where we should focus MOSL's output.

Key themes in the responses included the desire for current engagement channels to be more accessible, improvements to the speed of code changes and improved data quality on behalf of the wider industry.

Market Forum

Our recent Market Forum held earlier this month was a great opportunity for industry leaders to discuss the opportunities and challenges facing the market, and where MOSL could best contribute to improving the market for trading parties and their customers.

There was strong representation across all categories of member and the workshop discussions were particularly valuable. We reflected upon what we heard during those discussions and it was taken into account when taking forward the Business Plan 2019/20.

Business Plan

We have listened to the feedback from the questionnaire, the Market Forum and the Panel, and this year we have provided a more granular plan to better show how trading parties will receive value for money.

This Business Plan will see MOSL focus primarily on four themes:

- ◆ Real progress with improving market performance and data quality by driving significant and measurable change in the key areas of settlement, switching and accurate billing, and a better experience for customers
- ◆ Improving bilateral engagement between parties by developing a market-backed solution which lowers cost, improves integration between wholesalers and retailers; reduces the need for manual reconciling of data issues; improves data quality and insight and improves the customer experience
- ◆ Improving the stability of both the market and MOSL: will make usability changes to make it easier to use the Central Market Operating System (CMOS) and provide improved reporting. Our recruitment and knowledge transfer plans will minimise the impact of our relocation to Southampton on both us and the market. We will identify and act quickly on any emerging risks
- ◆ Taking steps to enable a greater pace of change. For example, we will develop proposals that Ofwat should no longer need to review and approve the large number of low level changes proposals. We will consult on whether more CMOS releases per year would be an effective way to speed up change delivery.

Our approach in this Business Plan is to concentrate on the core areas that will have most impact in driving a more efficient market over the next financial year. The Plan is out for consultation with members.

Relocation

Our relocation plans are in full swing. Our office in Southampton will be in the White Building which is centrally located and a short walk from the Southampton Central train station. We move into the office on 12 November. Recruitment is in full swing and is proceeding to plan, with high quality candidates accepting positions.

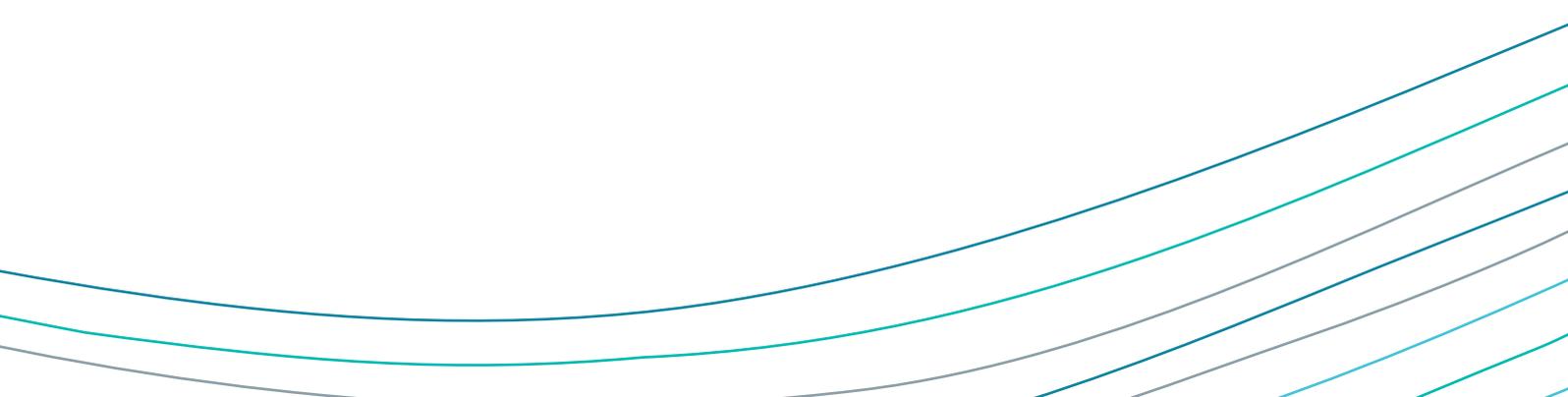
We are implementing a knowledge transfer programme and this is rolling out with our second wave of recruitment. This will serve to transfer knowledge as people leave the business and add resilience to our operations. It will help create a learning organisation that is flexible and agile in order that we can respond appropriately to the demand-led work we need to deliver. We will do all we can to ensure that during this period there is no drop in service to trading parties, or to the wider market. We will maintain a London office until 31 January.

Market Audit

We are in the process of commissioning the independent market audit for 2018/19. We expect this audit to support confidence in the market as the audit programme targets the key market risks and issues.

The audit provides an independent review of both trading party compliance and MOSL compliance. It includes an assurance opinion on CMOS, providing members with the necessary revenue assurance that the data provided from CMOS through settlement reports is appropriate.

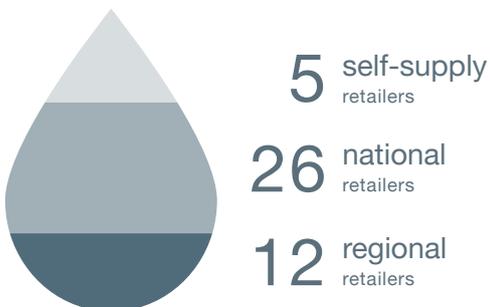
We have also heard members' feedback with regards to the cost of the market audit. We are therefore adjusting the approach for the third year and continue to monitor progress against already identified issues and agreed remedies.



Market update

Market trends

- ◆ Four unassociated retailers accounted for over 55% of switching gains this quarter
- ◆ Smaller retailers (with fewer than 1500 supply points) trebled their gains when comparing this quarter with the last
- ◆ Over 10,000 switches were cancelled during this quarter, more than any other quarter in the market, the majority of which were on the grounds of outstanding debt
- ◆ Two prospective self-supply retailers and one national retailer started the market entry process during the quarter
- ◆ The start of RF settlement for the live market was deferred due to Code inconsistency in the Market Terms and Business Terms with respect to post-RF invoicing
- ◆ Code changes continue to be raised on a wide variety of topics from changes to standing reports to digital certificates and enabling the deletion of system generated ('G') reads with appropriate controls.



175,828
services switched

10.4m
transactions

2.7m
supply points

45 code changes
considered by the Panel



Market Improvement

Our market improvement programme has been well underway this quarter. As detailed in the Market Performance Operating Plan (MPOP), the focus in the last three months has been on improving the efficiency of settlement and switching.

In September we published our first market dashboards providing the ability for trading parties to view market and peer performance in relation to metrics affecting settlement and switching. We improved this capability in October to enable trading parties to view, filter and extract their performance data to enable them to target their market improvement activity.

In response to Ofwat's decision to defer the commencement of final RF settlement run, we accelerated our request for 59 trading parties to submit data improvement plans for data affecting the efficiency of settlement. We have received data improvement plans from 41 trading parties with a market coverage of approximately 98% of supply points. We are analysing the plans currently and will report our view on their adequacy soon.

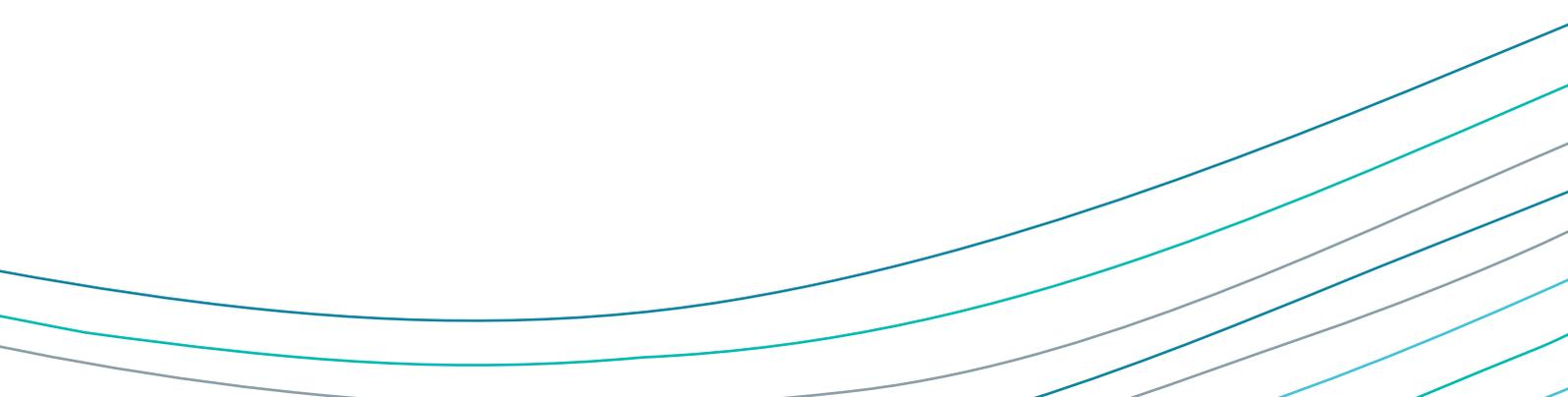
Many retailers have programmes of market improvement underway and at a market level are forecasting that the number of meters not being read in 12 months will reduce from around 15% today (7% at market opening) to 5% by the end of 2019/20. These gains will come through improved scheduling and submission of meter reads and by working with wholesalers to improve location details and reduce skip rates.

In addition to the work wholesalers are doing with retailers to improve the amount settled based on actual meters reads, they are focusing their efforts on reducing the number of incorrectly unpaired supply points. In total, wholesalers have 90 activities to address data improvement for settlement underway or planned by the end of 2019/20.

During the quarter we also issued the first Initial Performance Rectification Plans to eight retailers and six wholesalers regarding underperformance against the Market Performance Standards (MPS). We are expecting to receive these plans back by 6 November and will review and monitor improvement by trading parties against these plans.

During the next quarter we will continue our targeted efforts to improve the efficiency of settlement and switching whilst broadening our focus to include ensuring an equitable and effective market for retailers. Work is also progressing on addressing issues with bilateral interactions between retailers and wholesalers.

We believe there are significant benefits to be had from the provision of a bilateral solution which would address parties needs whilst enabling continued access to, and use of, individual portals and back-end systems.



Performance Standards, charging and redistribution

The review of the redistribution mechanism for MPS Charges has been underway by the Market Performance Committee and Panel, supported by MOSL. At its October meeting, the Panel proposed to recommend to Ofwat that the redistribution mechanism is amended to include performance-based redistribution mechanisms. We look forward to Ofwat's decision on the redistribution mechanism as this will provide a clear steer to the market on its intent with regards to financial incentivisation of performance.

The Market Performance Committee established the Operational Performance Standards (OPS) Working Group earlier this year. During this quarter the working group has developed a proposal to increase the standardisation of OPS reporting with a view to enabling the introduction of OPS Charging from April 2019. The outcome of this proposal seeks to increase incentives on wholesalers to improve OPS performance and to create consistency with the approach to MPS incentives. We are confident that this approach will improve with the introduction of a bilateral solution which will increase standardisation and transparency for wholesalers and retailers.

Bilaterals

We have identified through feedback that difficult bilateral arrangements between wholesalers and retailers are causing friction in the market through inconsistent adoption of the codes, proliferation of diverse technology, poor data quality and poor operational integration between parties. Although these issues do not affect all parties in the same way, or to the same extent, we believe that most of the market would benefit from resolution of these issues and have elevated bilateral arrangements to a priority area for resolution in 2019/20 in our Business Plan.

MOSL strongly believes that in a healthy market, industry solutions should be adopted for industry-wide issues, as this reduces the risk of regulatory intervention.

So far in 2018 we have supported industry collaboration to identify the tangible issues caused by bilaterals. We engaged industry across both strategic and operational levels through involvement with operational groups, the Panel, User Forum, Digital Strategy Committee, Self-Supply Forum and individual trading parties. We received helpful responses to our questionnaire sent to all interested parties which helped shape understanding of the key issues. Our engagement with OFWAT indicated strong support, and the Water Retail Council agree.

Our assessment of the themes emerging from this engagement shows that friction is being caused by:

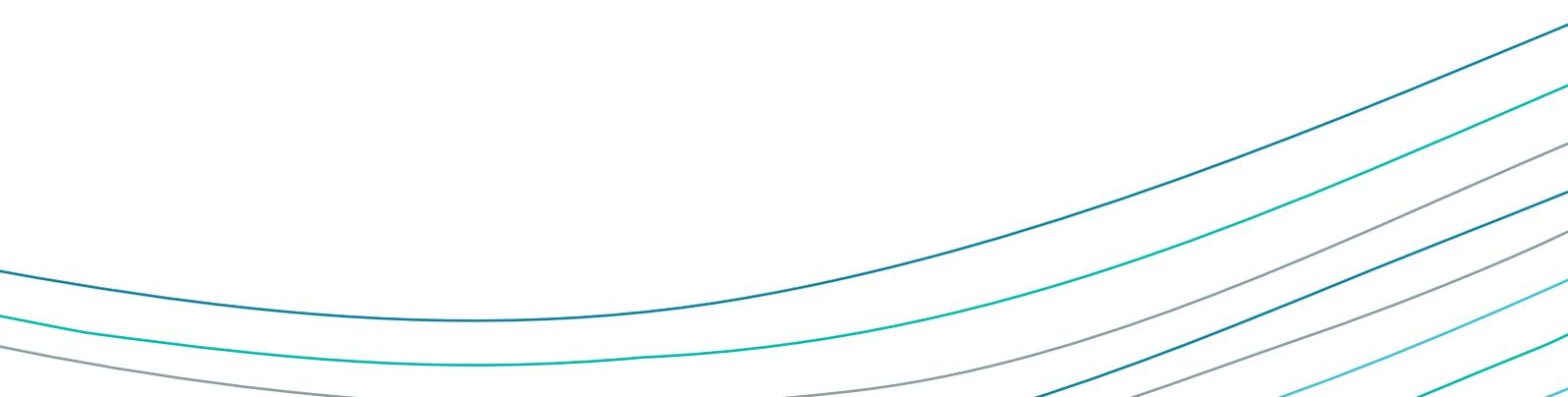
- ◆ High level of rejection rates from incomplete/inaccurate forms
- ◆ Inconsistent practices handling forms and processes
- ◆ Multiple user access and authentication (Single Sign On)
- ◆ Costly staff education and training caused by diverse ways of working
- ◆ Lack of adoption of the API standard that supports the Operational Terms
- ◆ Lack of visibility of SLAs and inconsistent operational standards

This leads to:

- ◆ Poor integration between wholesalers and retailers
- ◆ Inefficient operation manually reconciling data issues
- ◆ Poor data quality and insight
- ◆ Less than optimal customer experience

By addressing bilateral issues we anticipate:

- ◆ Improved customer experience
- ◆ Reduced risk of regulatory intervention
- ◆ Lower overall cost to operate
- ◆ Evolution of the market to a natural position of standardised processes
- ◆ Better industry readiness to manage bio and water resources markets in PR19, which are also bilateral arrangements by their nature.



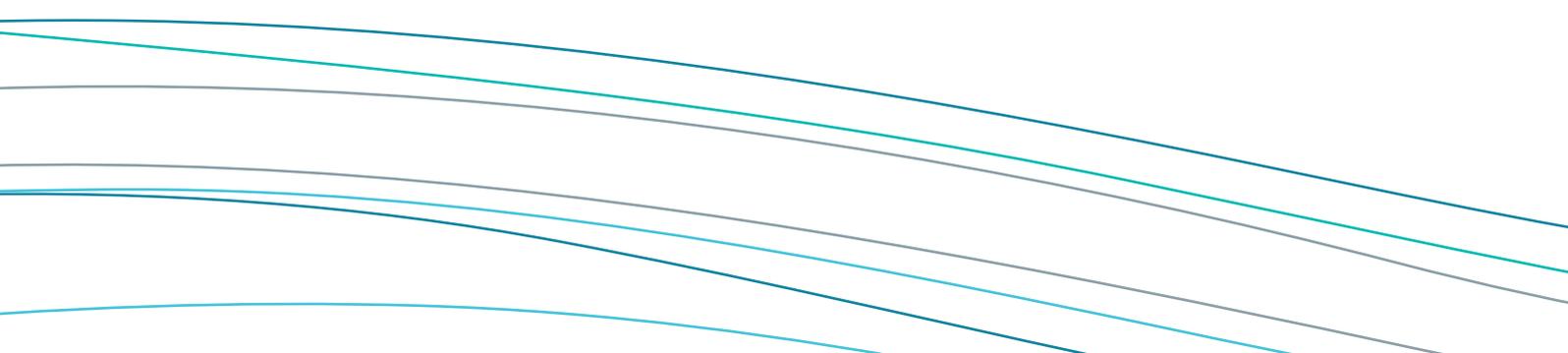
MOSL Service

At this half way point in the financial year, it is a good time to reflect on the services we have provided so far.

We have delivered several important projects during the year:

- ◆ Began the relocation to a lower cost base in Southampton, with a strategy to retain key knowledge and operational capability
- ◆ Resolved discrepancies between our governance documents, and gave all members a full voice in our corporate decision-making
- ◆ Stabilised CMOS enabling better operations by trading parties (153 CMOS defects fixed in three releases)
- ◆ Facilitated 38 Change Proposals (code and system-impacting) that were recommended by the Panel to Ofwat
- ◆ Published the Panel Plan, which identifies three key areas of focus and a number of work streams which will deliver against these three areas. These three key areas are: Promote effective competition; reduce friction in the market and embed good working practice in market code governance
- ◆ Developed MPS charging in-house allowing cheaper and quicker change, and published MPS performance transparently each month
- ◆ Issued the Market Issues Register, Market Improvement Strategy, and Market Performance Operating Plan (MPOP) which sets out the areas of focus and targeted interventions and outcomes
- ◆ Delivered Medium Volume Interface capability (for retailers who want more than the manual processes offered by the Low Volume Interface but not all the functionality of the High Volume Interface)
- ◆ Removed Peek & Dequeue worklists, enabling trading parties to spend time on higher value activities

For the second half of this financial year will put a renewed focus on IT initiatives, such as an increase in engagement through better reporting and monitoring.



MOSL KPI	Description	Target	Cumulative Position	Performance September	Performance August
MO Compliance* %/high/ med/low	For information:	100%	98%	98%	98%
	MO compliance % is a measure of MOSL compliance with its code obligations categorised by impact to the market (high, medium or low)	High impact 90%	99%	99%	99%
		Medium impact 80%	88%	88%	88%
		Low impact			
Query turnaround time with SLA	MOSL dealing with queries within SLA	85%	95.16%	100%	100%
Settlement timeliness	All settlement reports and supplementary reports have been published to designated areas before 6pm on publication date	100%	99.78%	100%	100%
Customer calls/service requests dealt with within SLAs	CGI dealing with queries within contractual SLA	85%	94.4%	92.4%	93.2%

*We report our compliance quarterly to trading parties. When our work with respect to Business Continuity Management (BCM), the Market Incident Management Plan (MIMP) and achieving ISO accreditation is complete we will be fully compliant with all high impact obligations. Further details on MOSL compliance can be found on our website.



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