Market Performance Framework (MPF) Reform Programme

Consultation 4

Pre-consultation document

Section 2 of 3: Design principles for financial tools and performance standards

24 June 2024

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1. Introduction

The Market Performance Framework (MPF) is a key part of the non-household (NHH) market.

The framework focuses on the key aspects of trading parties' operations that affect the speed and quality of service customers receive. It then sets performance levels and monitors how companies are performing against them, with incentives and penalties where appropriate.

The need to reform the MPF was identified in 2021 following feedback from stakeholders that the current MPF was too complicated and not sufficiently customer focused, performance targets were not stretching enough, and incentives and penalties were too small to drive companies' behaviours.

In 2022 MOSL began a 'root and branch' reform of the MPF, working closely with retailers, wholesalers, and other stakeholders including Ofwat and CCW. The Business Case was published in December 2023.

MOSL has taken a step-by-step approach to reforming the MPF, involving and engaging stakeholders at each stage of the process.

MOSL has carried out three consultations to date. The last consultation determined the shape of the MPF model, following which the programme entered the detailed design phase. Consultation 4 will present proposals for financial tools and incentives.

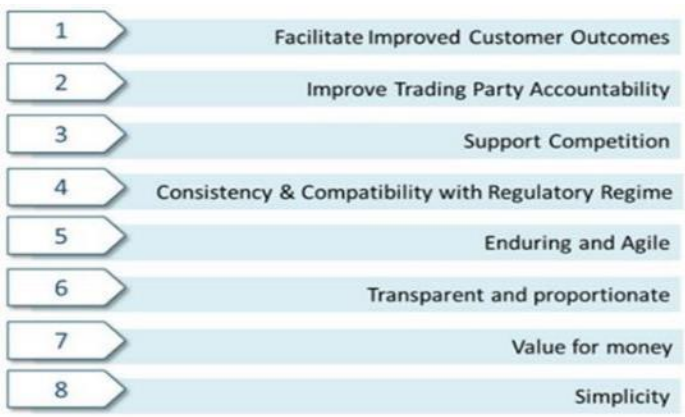
This document represents the second of three pre-reading documents ahead of Consultation 4, which is due to open on 8 July. The first document is available on the MOSL website here.

The first phase of the reformed MPF is due to come into effect in April 2025.

1.1. Aim and success criteria of the MPF programme

The aim of the MPF Reform programme is to create a simpler, more effective performance framework. One that:

- Has fewer, more effective, more intelligent measures, focused on areas within a trading party's control
- Is simple to understand, but powerful in application
- Provides confidence in the market at a reasonable and proportionate cost.



Eight key success criteria were developed for the programme from responses to MOSL's 2021 call for information (above, right).

Section 5 outlines the extent to which MOSL believes the proposals contained in this document meet these criteria.

1.2. Programme consultations

The third MPF consultation determined a much more focused MPF model, including:

- 9 key activities
- 21 metrics (Key Performance Indicators)
- 8 financial and non-financial intervention tools
- 4 levels of governance

The detailed design phase of the programme is made up of five parts:

Part	Description	Status
A	Governance	Approved by Ofwat
B	Non-financial metrics	Awaiting approval by Ofwat
C	Metrics (KPIs)	In development
D	Financial tools	Consultation 4
E	Other metrics (Market Indicators, Additional Metrics)	To follow

Consultation 4 will focus on Part D (Financial tools) and will determine the principles for financial tools and performance standards for the reformed MPF. Parts C and D are due to be considered at the Code Change Committee in December 2024.

The value of incentives (i.e. penalty charges, outperformance payments and compensation payments) and performance standards for each KPI will be subject to further discussion and consultation with stakeholders in October/November.

1.3. Purpose of this document

In line with previous consultations, MOSL is publishing a series of pre-reading documents ahead of Consultation 4 to give stakeholders time to familiarise themselves with key elements of the proposals:

Section	Description	Publish date
1	Consultation process and success criteria	Published 17 June
2	Principles for financial tools and performance standards	This document
3	Mapping metrics to tools	Mon 1 July

The purpose of this document is to:

- Outline the financial incentives being proposed for the reformed MPF
- Present the principles on which the financial tools and performance standards will be based
- Explain the rationale for the principles on financial tools and performance standards
- Allow stakeholders to seek any clarification that may be necessary ahead of Consultation 4
- Provide a view on the extent to which the proposals address the issues with the current MPF and meet the programme's success criteria
- Provide guidance to trading parties regarding the nature of the feedback MOSL will be seeking on this document at the consultation.

The proposals contained in this document are not expected to change materially before the start of the next consultation. If any material changes are made, a 'tracked changes' version will be made available.

1.4. Issues with the current MPF – and possible solutions

As mentioned above, feedback from stakeholders indicated that the current MPF is not delivering for customers and the market. This is partly due to the effectiveness of the current financial MPF tools.

The table below identifies some of the issues and proposals under consideration:

Current MPF	Reformed MPF considering
Performance levels currently too low to drive trading party performance and behaviours, meaning it can be cheaper to pay penalty charges than address the underlying cause of under-performance	• Increasing overall penalty charges (Nb: actual charges outside scope for Consultation 4) • Increasing the focus on customer outcomes • Reviewing the scale of penalty charges • Introducing rewards for outperformance • Option for one or more KPIs to be used as an input to the Business & Retailer Measure of Experience (BR-Mex)
The intended impact of penalties is undermined by penalties being capped and charges being redistributed annually to all trading parties, including poor performers	• Reviewing the capping of penalties and approach to redistributing penalty charges
Penalties lack sophistication and are levied at a flat rate	• Introducing a wider range of penalties that are designed to meet the needs of the metrics to which they are applied

Current MPF		Reformed MPF considering
Penalty charges for missing SLAs are currently binary. The MPF does not consider the 'lateness' of a company's performance against the SLA or the impact on other parties or customers	➡	• Concept of 'lateness' to be incorporated into design of metrics and tools
The absence of set targets for 'good' or 'poor' performance	➡	• Introducing performance standards targets
Penalise the offending trading party, without recognising the financial impact of the underperformance on other trading parties	➡	• Compensating trading parties that have been directly impacted by the performance of others

2. Financial incentives principles

The financial principles for the reformed MPF apply to:

- Penalty charges
- Outperformance payments
- Compensation charges/payments

Penalty charges and outperformance payments relate to a trading party's performance against the performance standards that are set by the Performance Assurance Committee (successor to the Market Performance Committee).

Compensation payments relate to situations where a trading party's performance has a direct and quantifiable impact on another trading party. Compensation charges will be based on industry average costs (see Pages 11 & 12).

Where applicable, a trading party will be charged for not meeting a performance standard and may receive a separate charge for the impact this has had on the other party.

The design principles on which each category will be based are described in more detail below.

MOSL

2.1. Penalty charges

#	Penalty charges:	Explanation and rationale
PC1	Are aimed solely at driving timely improvements	Penalty charges will apply to parties that are performing below a minimum standard against specific KPIs. The aim of charges is to encourage trading parties to quickly improve their performance to the required standard for the benefit of customers, other trading parties and the NHH market as a whole. If all trading parties perform above the minimum standard for a KPI no penalty charges would be levied. However, should this be the case, the PAC may choose to further raise the performance standard if the market's performance is considered to still be impacting the risks and activities related to the KPI to an undesirable degree (see PS12).
PC2	Only apply to relevant Key Performance Indicators (KPIs)	The MPF's KPIs measure companies' performances against the most important, customer-impacting activities in the NHH market. A number of KPIs have associated penalty charges and/or rewards for outperformance. The performance standards and charges and rewards will be carefully designed and calibrated, with further input from trading parties (Section 2.2). The MPF also includes other metrics that do not have penalty charges or rewards for outperformance. Market Indicators help assess whether overall performance is improving across the market and Additional Metrics may indicate areas of concern that need further investigation using discretionary tools, such as audit, so will not attract charges.
PC3	Will be based on a company's failure to deliver against a performance standard and levied at a flat rate across the market	Penalty charges will be calculated based company's failure to deliver against a performance standard. For simplicity and consistency, penalty charges will be calculated at a market level and will not consider regional differences in costs or impacts.
PC4	Will not be capped	The current MPF has a cap on penalty charges, i.e. a maximum amount that a trading party can be charged. This is recognised as a disincentive to companies addressing their performance once the cap has been reached. In the absence of further charges, there is nothing to discourage companies from allowing their performance to deteriorate further. The reformed MPF will therefore remove the cap on penalty charges.

		PC11 outlines how the proceeds from charges will be used.
PC5	May be charged at different levels	There may be different charging levels (e.g. different charges based on time parameters or variation from a performance standard) associated with a given KPI. Multiple charging levels can, however, increase complexity and may discourage performance resolution until the next level of charge approaches if the levels are too broad. To help ensure the reformed MPF achieves its aim to be simple, focused and clear, the number of charging levels will be limited.
PC6	Will only be applied by the MPF or BR-Mex, not both	Ofwat's Business and Customer Measure of Experience (BR-Mex) measure may include a company's performance against select MPF KPIs to determine a score and any related incentives or penalties. To ensure trading parties are not incentivised or penalised twice (i.e. to avoid 'double jeopardy'), and ensure consistency and compatibility with the regulatory regime, the MPF will not levy penalty charges on metrics used in BR-Mex. *Compensation* charges may still apply on select KPIs should they be included in Ofwat's BR-Mex measure, however. This is because compensation charges and payments perform a difference function to penalty charges. The former provides compensation to a counterparty for non-delivery, while the latter provides an incentive to perform to a given level.
PC7	Will be calculated based on a trading party's performance and applied at the reporting frequency of the KPI	For simplicity and accuracy, charges will be system-based (i.e. not require manual intervention) and applied based on the frequency of the KPI. In most cases penalty charges will be levied monthly. Such charges will be administered and handled by MOSL (e.g., calculated based on a company's performance and invoiced in arrears, but as close to the underperformance as possible).
PC8	Should exceed the cost of addressing the performance issue	Penalty charges provide a financial incentive for trading parties to meet minimum performance standards. The reformed MPF aims to improve trading party accountability and facilitate improved customer outcomes. Charges should be higher than the average market cost of the task being incentivised and the average market cost of addressing the underlying cause of under-performance (i.e. market avg cost + X%)

PC9	May be calculated on a unit charge per SPID or a unit charge multiplied by the trading party's portfolio. Only the proportion of the performance below the minimum performance standard will be charged (PS8).	The MPF needs to fairly account for both the scale and severity of failures across different trading party types and sizes. Charges may be calculated in several ways to account for this, either via: • A unit charge per supply point (SPID)/meter/service request, etc. (as appropriate) that failed to meet the standard; or • A unit charge multiplied by the size of the portfolio (SPIDs/meters/service request, etc. as appropriate), scaled based on how far the standard has been missed (i.e. a unit charge per percentage point under the required performance level or per day behind required timescale, etc). If a KPI has an associated penalty charge, such charges will be levied only for the proportion of performance (either 'percentage points' or equivalent number of 'failed events') that falls into the below minimum performance zone.
PC10	Will be allocated in a particular order of priority	For the reformed MPF to 'move the dial' in terms of companies' performances, trading party accountabilities and customer outcomes, the annual 'performance neutral' redistribution of penalty charges will need to be minimised (i.e. redistribution of charges regardless of performance levels). Penalty charges collected from KPIs will therefore be allocated as follows (in order of priority): 1. The Market Improvement Fund (MIF); value to be set by the Strategic Panel 2. Outperformance payments; value to be set by the Strategic Panel 3. Any funds remaining will be redistributed to trading parties as per the current MPF process

2.2. Outperformance payments

#	Outperformance payments:	Explanation and rationale
OP1	Are designed to reward exceptional performance, not 'business as usual'	Outperformance payments are intended to reward trading parties for meeting or exceeding stretching performance standards. They are not intended to reward companies for simply doing their job. 'Business as usual' accepts that some failures against KPIs are to be expected. Any service provider that fails against some KPIs, but whose overall performance is sufficiently high, should nevertheless be considered for an outperformance payment. This approach is considered preferable to the current approach of redistributing penalty charges to trading parties regardless of their performance (i.e. 'performance-neutral'). This will be an important consideration when determining performance standards.
OP2	Will be based on a company's ability to exceed delivery against a performance standard	Outperformance payments will be calculated based on a company's delivery exceeding a particular performance standard. For simplicity and consistency, outperformance payments will be calculated at a market level and will not consider regional variations in costs or impacts.
OP3	Will be based on average performance	Payments for outstanding performance are based on a company's overall/average performance over the financial year. Outperformance payments can therefore still be achieved even if a company's performance falls below the necessary standard for a proportion of the year. This approach is considered fairer and pro-competition than introducing an unnecessary barrier. It also recognises the reality of operating in the market and ensures there is a constant incentive to outperform.
OP4	Will only apply to Key Performance Indicators (KPIs)	Outperformance payments provide a counterbalance to penalty charges. As per penalty charges, outperformance payments only apply to KPIs, not additional metrics or market indicators.

OP5	Will be funded by penalty charges	Outperformance payments will be funded from penalty charges allocated by the Strategic Panel. Penalty payments collected from KPIs will be allocated as follows (in order of priority): 1. The Market Improvement Fund (MIF); value to be set by the Strategic Panel 2. Outperformance payments; value to be set by the Strategic Panel 3. Any funds remaining will be redistributed to trading parties as per the current MPF process This approach will minimise redistribution of penalty charges in any one financial year. Outstanding performance payments will be issued on a pro-rata basis. Retailers' outperformance payments will be funded solely from Retailer penalty charges. Wholesalers' outperformance payments will be funded from Wholesaler penalty charges. The average outperformance payment is expected to be less than the cost of failure in most cases. This represents a notable improvement to the approach used in the current MPF, which is entirely penalty-focussed.
OP6	Will be calculated based on a trading party's monthly performance and applied annually	Outperformance payments will be system-based (i.e. without manual intervention) for simplicity and accuracy; calculated based on a trading party's monthly performance as averaged across the year and applied annually. The payments will be administered and handled by MOSL.
OP7	Should encourage good performance for all customers equally	The outperformance payments should not unduly encourage trading parties to deliver a good performance for some customers at the detriment of others.
OP8	Should be large enough to incentivise a trading party to outperform	Outperformance payments should be large enough to incentivise trading parties to outperform. The payments should recognise that a proportion of average additional costs may be incurred, noting outperformance brings its own benefits in terms of customer retention/attraction (e.g. set at market average cost + y%). It is unlikely that outperformance payments on their own will cover the cost to provide an individual service. They will, however, reduce the cost to deliver high performance.

OP9	May be calculated on a unit charge per SPID or a unit charge multiplied by the trading party's portfolio	As per PC10 (above), the MPF needs to fairly account for scale of outperformance across different trading party types and sizes. Outperformance payments may be calculated to account for this by either: • A unit charge per supply point (SPID)/meter/service request, etc. (as appropriate) that exceeded or significantly exceeded the expected standard, or • A unit charge x the size of the portfolio (SPIDs/meters/service request, etc. as appropriate). This approach would be scaled based on how far the standard has been exceeded (i.e. reward for each unit/per percentage point under or over the required performance level or per day behind required timescale, etc)

2.3. Compensation payments

#	Compensation payments:	Explanation and rationale
CP1	Are based on a company's failure to deliver against a task which has impacted another party	Compensation payments cover cost and impact for a Retailer dealing with customers where poor performance of a Wholesaler, or another Retailer, has impacted the service and experience provided. Compensation payments can be made from a Wholesaler to a Retailer or a Retailer to another Retailer. It does not apply to KPIs that would require Retailers to compensate Wholesalers. This is different to penalty charges, which incentivise improvement in performance, but they do not reimburse the aggrieved party as the money is held by MOSL and allocated accordingly (see PC11). Compensation payments aim to offer a remedy to the affected party. Such payments may complement a penalty charge for some KPIs. Note that compensation payments are expected to be relatively small compared to penalty charges.
CP2	Will involve payments exclusively from one party to another	Compensation payments are exclusively between two parties. They do not apply from one party to multiple parties. To keep things simple, where there is a different water and wastewater retailer, only one of these parties will receive a compensation payment. In most cases, we anticipate that this will be the water retailer.

CP3	Will be levied at a flat rate across the market	Compensation payments will not be based on the precise financial impact on a given trading party. For simplicity and transparency, they will instead be calculated at a market level and will not consider regional differences in costs or impacts (see CP5)
CP4	Unit charges must be a 'genuine pre-estimate of loss'	The unit charge of compensation payments must be a genuine pre-estimate of loss (GPoL). As per CP3 (above), the GPoL for any applicable KPI will be calculated using industry average costs, which will be determined later in the MPF programme using a combination of costing methods (e.g., market surveys, REC costings, etc). The unit charge for the GPoL will then be applied in a code-specified calculation (as per CP6) to determine the final compensation payment for a given event.
CP5	Will be calculated and distributed monthly	Compensation payments will be administered and handled by MOSL. They will be calculated based on a company's monthly performance and invoiced at an appropriate frequency, depending on the scale of the charges (e.g. one month in arrears).
CP6	Will be calculated on a unit charge per SPID	Will be calculated on a unit charge per supply point (SPID)/meter/service request, etc (as appropriate). The value of compensation is determined on a charge per failure basis only – given the purpose of compensation payments is different to that of penalty charges, there will be no additional amendment based on the degree to which a performance standard has not been achieved.
CP7	Will not be capped	The current MPF does not include compensation payments. By its nature, under-performance that results in a compensation payment being appropriate has a direct impact on the other party and/or customer. As such, no cap is proposed when the reformed MPF comes into effect. However, this will be kept under review by the PAC.

2.4. Additional financial incentive principles

#	Other financial incentive principles include:	Explanation and rationale
AP1	The framework should not reward failure	With the introduction of performance standards, the reformed MPF aims to reward success, not lesser degrees of failure. For example, with metric M03 (Lateness of overdue cyclic meter reads) the trading party has failed to achieve the required standard and will be charged accordingly.

		However, the reformed MPF proposes to introduce outperformance payments where performance is 'above and beyond'.
AP2	Only one type of financial incentive out of penalty charges and compensation payments will normally apply to a KPI	For simplicity, only one type of financial incentive will normally apply to a KPI (i.e. either a penalty charge or a compensation payment), unless there is justification for more than one. For example, there may be benefit of applying both to a given KPI, noting the impacts to be mitigated on customers and other parties. It is unlikely that a KPI will have an associated outperformance payment if it doesn't also have an associated penalty charge.
AP3	Financial tools are applied at an individual KPI level	Penalty charges, compensation payments and outperformance payments will apply at an individual KPI basis, instead of being determined by holistic or averaged performance across a combination of KPIs.
AP4	The MPF framework should be consistent in the treatment of charges for KPIs that are similar in theme and calculation wherever possible	For consistency, clarity and simplicity, but not at the expense of the effectiveness of the design for any given KPI. For example, all 'lateness' themed KPIs may be treated in a similar way and all 'proportion' themed KPIs may be treated in a similar way, unless there is strong rationale for not doing so. Note that the size of the incentive may not necessarily be the same across similar types of KPIs.
AP5	Charge values and methodologies will be set out in the Market Codes	The codes will set out the charge values and charging methodology for each applicable KPI, alongside the performance calculation for that KPI. Changes to the values (above and beyond inflationary adjustments – see AP6) and charging methodology will therefore be governed by the code change process.
AP6	Inflationary increases to charges will be code mandated. The PAC will agree that charge or reduce the increase	The codes will mandate inflationary increases to charges, which MOSL will calculate and recommend to the PAC. The PAC will decide whether to approve the increase.

3. Performance standards principles

3.1. Candidate principles for performance standards

#	Candidate principles:	Explanation and rationale
PS1	Most KPIs will have a defined 'minimum' and 'outstanding' performance standard	Most KPIs will have a standard for minimum performance and outstanding performance. For some KPIs the standard may need to be confirmed after the reformed MPF is launched to allow time to consider companies' performance levels under the new framework.
PS2	The 'minimum' and 'outstanding' performance standards can be the same	The minimum performance standard and outstanding performance standard may be set at the same level for an individual KPI, e.g., 100% success or completion. This may be the case where there is no justifiable reason for trading parties not to complete a task. In such instances, there would also not be scope for outperformance payments.
PS3	Performance standards will be absolute standards where possible	Performance standards will be absolute performance standards in most cases. Performance for some KPIs may be assessed using alternative methods e.g. based on relative performance against other parties and/or market averages. In many cases alternative methods may only be needed temporarily, for example, until the necessary evidence can be gathered following the launch of the reformed MPF to inform the setting of performance standards.
PS4	The 'minimum' and 'outstanding' performance standards will be visible in peer comparison reports	The minimum performance standard and outstanding performance standard will be called out on public peer comparison reports regardless of the KPI being associated with a financial tool. This will help to maximise reputational incentives and speaks directly to improving trading party accountabilities.
PS5	KPIs that measure 'failure' may have performance standards set at effectively 100%	KPIs that measure failure, e.g., M06 (lateness of missing transfer meter reads) may have standards set at effectively 100% (e.g. 'zero' days late).
PS6	Standards will be consistent across the market	Standards will be calculated at a market level on a KPI-by-KPI basis, with no variation across geographic regions.

PS7	Companies' performances against the standards will affect the value of penalties or rewards	If the KPI is associated with a financial tool, a company's performance against the standards is the principal factor that will impact the value of penalty charges or outperformance payments owed (see Section 4).
PS8	If the KPI is associated with a penalty charge, penalties will be charged only for the proportion of performance that falls into the below minimum performance zone	Where a KPI has an associated penalty charge, the performance will be charged only for the proportion of performance (either percentage points or equivalent number of failed events) that falls into the below minimum performance zone
PS9	For KPIs with an associated outperformance payment, companies will need to exceed the outstanding performance standard for payments to apply	If the KPI is associated with an outperformance payment, an outstanding performance standard across the year will need to be exceeded (by virtue of monthly performance averaged across the year) on that KPI for payments to apply on that KPI.
PS10	Companies' performances against performance standards will not affect compensation payments	Compensation payments are based on a failure per task, regardless of overall performance against a standard. For example, a Retailer or Wholesaler might exceed a minimum performance standard on a given KPI and therefore not incur any penalty charges (if these are an option*) or be considered for intervention by the PAC, but because each task failure has a significant impact on another Retailer, the responsible party may still be required to pay a compensation payment for each failure. *Note that in most cases, only one type of financial incentive will apply to an individual KPI (see OP2)
PS11	The PAC will not intervene if a trading party is meeting the minimum performance standard	The PAC will decide whether to intervene on a KPI-by-KPI basis. The PAC will not intervene on a party's performance against a KPI where the party is performing above the minimum performance standard for that KPI. However, a positive performance against KPI(s) does not mean the PAC will not intervene on other KPIs where performance is below the minimum required standard.

PS12	The PAC may increase the minimum performance standard if it is being achieved by a significant proportion of trading parties - or decrease it where it is not being achieved	For the MPF to drive continual improvement in the NHH market, and set stretching but fair expectations of performance, it will be necessary to adjust performance standards over time. If a significant proportion of the industry is meeting and/or exceeding the minimum performance standard, the PAC may intervene by raising a standard for the next performance year. The PAC will also have the option to lower outperformance levels if they are proving impossible to achieve. It is assumed that minimum service levels will remain fixed. All such decisions will take account of the risks and impacts associated with the activity being monitored and the effects of a given performance level.
PS13	Performance standards will be maintained outside the codes by the PAC with changes subject to Panel approval	Performance standards will be maintained outside the codes by the PAC with changes subject to Panel approval. The process by which the PAC can change the standards will be set out in the codes. This aligns to the need for the new PAC to have an increased role in managing performance and flexing the framework efficiently.
PS14	The PAC will be required to consult before changing any standards and must give trading parties sufficient notice before any changes are implemented	The PAC is responsible for maintaining and, where appropriate, flexing standards to drive continuous improvements in the market's performance. Changes to standards must be consulted on, and parties must be given notice of changes, e.g. with a minimum of a quarter's notice or implementation at the beginning of the next financial year.

4. Performance Standards Model

The current MPF has been criticised for levying charges for not achieving service level agreements (SLAs) but having no concept of 'good'.

The reformed MPF proposes to address this by having two performance levels: a 'minimum standard' and 'outstanding standard' for each KPI.

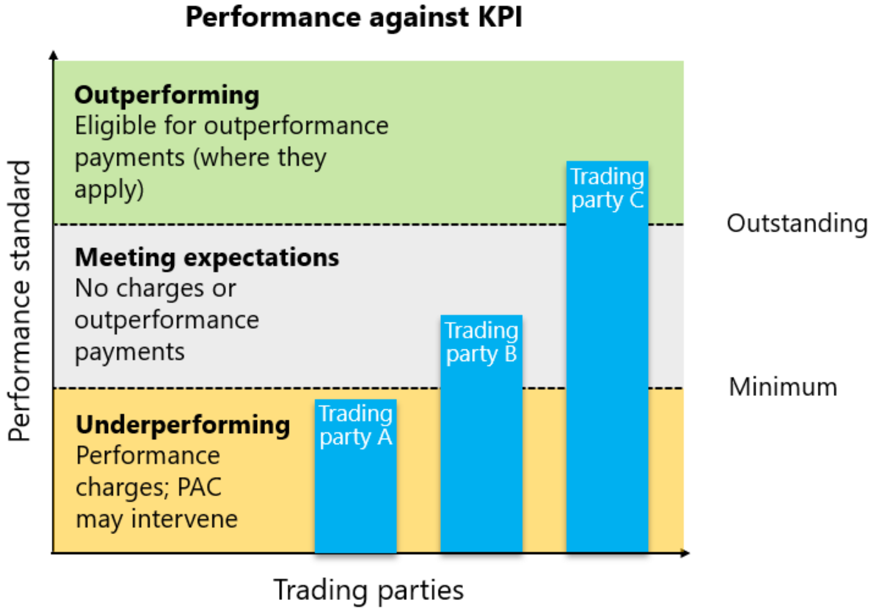
As outlined in [Consultation 3](), KPIs report the degree to which particular tasks (e.g. reading a water meter) are met. Given their nature, Market Indicators and Additional Metrics are not expected to have performance standards.

A summary of the proposed metric types and examples is provided below:

#	Metric	Description and application	Examples of metrics
21	**Key Performance Indicators (KPIs)**	Primary metrics used to measure a trading party's performance in completing a particular activity. KPIs combine with financial or non-financial intervention tools to incentivise trading parties' performances.	• M01 - Proportion of meter reads submitted within SLA • M15 - Average lateness of failed SLAs for bilateral requests
16	**Market Indicators**	Metrics that help assess whether overall performance is improving across the market and that the KPIs and tools being used are proving effective.	• M22 - Proportion of Long Unread Meters • M23 - Proportion of settlement on actuals • M30 - Proportion of rejected switches • M34 - Average premises address data accuracy • M37 - Complaints to CCW
10	**Additional Metrics**	Metrics designed to assist in identifying and resolving underlying issues affecting trading party performance. Data on these metrics is collected and monitored as appropriate. They do not correlate as closely with a trading party's performance as KPIs as there may be other drivers that affect them. However, they are useful to monitor as they may indicate areas of concern that need further investigation using discretionary tools such as audits.	• M39 - Proportion of all meters read within 12 months • M44 - Number of meters that have bilateral requests raised against them • M43 - Number of multiple B5 bilateral transaction service requests raised on the same meter • M46 - Proportion of rejections on the last day of the SLA

4.1. Performance against a task vs expected performance standards

The reformed MPF will expect trading parties to meet a minimum performance standard against KPIs.



If a trading party's performance for a task is between the 'minimum' and 'outstanding' performance standard, no penalty charges will be incurred. Neither will the trading party be eligible for any outperformance payments that apply to that KPI.

Outperformance payments are reserved for exceptional performances that go 'above and beyond'. They are not designed to reward companies for simply doing their job. Outperformance payments are not expected to exceed penalty charges in frequency of occurrence or value.

The outstanding performance level will be set at a challenging level and will remain under review by the Performance Assurance Committee (PAC), which may wish to increase the target over time to encourage continuous improvement.

Trading parties not achieving the minimum performance level are under-performing and may incur penalty charges. These performance levels will also be kept under review.

Depending on the degree or duration of under-performance, the PAC may intervene, for example by monitoring additional metrics or carrying out targeted audits (see Section 6.2 of the Consultation 3 'tools' proposals and CPM058b & CPW149b Final Recommendation Report).

Compensation payments are determined on a failure-by-failure basis and are not impacted by overall performance against these standards.

4.2. Calculating performance standards

A trading party's performance standard against a KPI is calculated by dividing the number of successful tasks (e.g. reading a meter on time) by the total number of tasks under that KPI.

The number of tasks performed by trading parties can range from a handful per month to tens of thousands per year, depending on the size of organisation.

Let's assume a task is carried out 200 times per month and that the minimum performance standard for the KPI is 70% and outstanding is 90%.

If the trading party carries out 170 of 200 successfully (i.e. fails 30), their overall performance for that KPI would be 85%; comfortably above the minimum standard, but below 'outstanding'.

If a trading party carried out 47 of 100 tasks successfully (i.e. fails 53), their overall performance for that KPI would be 47%. This would be well below the minimum level and would be subject to penalty charge if the KPI has a financial tool associated with it. The PAC may also take steps to intervene.

More examples at different performance levels are provided in the table below. Please note that the performance standards shown are for illustrative purposes only.

More information about the method of calculating performance standard-related incentives will be included in the third pre-reading document, which is due to be published on Monday 1 July.

4.3. More worked examples

	Minimum	Outperforming
Performance standard for illustrative purposes only	70%	90%

Performance		**Smaller trading parties**			**Larger trading parties**		
		A	**B**	**C**	**D**	**E**	**F**
Month X	No of times task is performed	100	100	100	1,000	1,000	1,000
	Successes	65	75	95	650	750	950
	Failures	35	25	5	350	250	50
	Performance (%)	65%	75%	95%	65%	75%	95%
	Performance vs standard	Under-performing	Meeting expectation	Out-performing	Under-performing	Meeting expectation	Out-performing
Annual[1]	Performance (%)	95%	80%	95%	95%	80%	95%
	Performance vs standard	Out-performing	Meeting expectation	Out-performing	Out-performing	Meeting expectation	Out-performing
Impact[2]	Penalty charges in month X	Yes	No	No	Yes	No	No
	Eligible for out-performance payment at year's end	Yes	No	Yes	Yes	No	Yes

1. Example performance across 12 months (individual months not shown)
2. Impact: penalty payments or eligibility for outperformance payments will depend on the task/metric being measured

4.4. Frequency of calculation and application of charges and rewards for outperformance

As stated in Section 2, Page 6:

- Penalty charges will be calculated based on a trading party's performance and applied depending on the KPI, as close to the underperformance as possible.
- Outperformance payments will be calculated based on a trading party's monthly performance and applied annually, and
- Compensation payments will be calculated and distributed on an appropriate frequency, depending on the scale of the payments (e.g. monthly in arrears)

5. Ahead of Consultation 4

5.1. Questions for consideration

Ahead of Consultation 4, trading parties are encouraged to consider the following questions:

1. Do you agree that KPIs should have a 'minimum' and 'outstanding' performance standard?
2. Should performance standards be codified (and under purview of CCC and Ofwat) or be outside the Market Codes and subject to MPF governance (i.e. PAC/Strategic Panel/industry consultation and not requiring code change)?
3. Which principles do you support, which do you think should be excluded and are there any you believe should be added? Consultation 4 will ask you to confirm and/or explain your reasons
4. Whether you agree with MOSL's view on the extent to which the principles for financial tools and performance standards, taken together, satisfy the success criteria on page 3 (see below).

5.2. How the proposals meet the success criteria

#	Criteria	MOSL view
1	Facilitates improved customer outcomes	Penalty charges are intended to steadily increase with the duration and extent of poor performance, driving trading parties to successfully complete customer-impacting tasks first time or as soon as possible. Compensation charges/payments are intended to cover the costs incurred by a Retailer in addressing the impact of another party's poor performance (CP1). These payments may ultimately pass onto customers via the impacted retailer, either directly or in the form of improved services. Outperformance payments will be reserved for 'above and beyond' performance, noting that some failures against KPIs are to be expected and those performing near, or above, expectations should still be incentivised to continuously improve.

		These outperformance payments could support innovation or sustain operations which directly benefit customers. Without outperformance payments, it is likely that penalty payments will need to be returned to the market at years' end (minus those used for the MIF), which dilutes the impact of penalty charges. The ability of the PAC to change performance standards (through a code defined process and with appropriate notice) should enable the MPF to adapt in accordance with market issues and priorities, including where customer outcomes are considered at risk or in need of improvement.
2	Improves trading party accountability	The concept of compensation notes the need for the reformed MPF to better recognise the reality of responsible and impacted parties in the context of delivering key market activities. The concept of performance standards will clearly and publicly identify parties that are not performing to minimum standard against those that are, and those significantly exceeding expectations (PS4).
3	Supports competition	Performance standards will be publicly presented in peer comparison reports, which will enhance the reputational incentive provided by these (PS4). Outperformance payments may be used to help fund improved service offerings and innovation. The use of performance standards will also reflect the fact that some KPI failures are to be expected, and parties should not be unnecessarily penalised for factors that are reasonably outside control.
4	Consistent and compatible with regulatory regime	Should any KPI feature in Ofwat's final determinations for BR-MeX, the KPI will not have an equivalent financial incentive applied through the MPF (see PC6).
5	Enduring and agile	Performance standards may be flexed (through a code defined process) by the PAC, subject to Panel ratification (see PS13). This will enable the expectations of performance to efficiently evolve with the reality of the market and change in risks and issues. Charge values may similarly change in line with inflation (see AP6).
6	Transparent and proportionate	The charging methodology for each applicable KPI will be codified and governed by the associated code change control process (AP5). Given the need for the new PAC to have an increased role in managing performance, other areas of the framework, such as performance standards, will have a greater degree of flexibility, while remaining subject to clear and codified decision-making processes (see PS13).

		The adoption of performance standards will also reflect that some failures against KPIs are to be expected and parties should not be unnecessarily penalised for factors that are reasonably outside control.
7	Value for money	Where possible, the design of the financial tools and charging methods will be consistent across KPIs of similar type and calculation (see AP4). This will save development cost.
8	Simple	Charge calculations (AP5) will be based on simple codified formula, and where possible, charging methods will be consistent across KPIs of similar type and calculation (see AP4). Charges and standards will be determined at a market level to avoid the complication and uncertainty of geographic variations.

6. More information

- More information about the MPF Reform programme is available on the MOSL website
- A summary of responses to MOSL's survey following Consultation 3 is available here
- The Full Business Case for the MPF programme, published in November 2023, provides further background and examines the strength of business case from a strategic, economic, commercial, funding and delivery perspective.
- Details of the interim improvements were published in March 2024
- A 'walk through' of how the reformed MPF will work from a trading party and market perspective is available here, including slides and a recording of the presentation.

7. Stay up to date

We need your help to create a market performance framework that works for customers, trading parties and the environment. Your engagement and involvement matters.

MOSL publishes regular updates about the programme and is running a series of meetings to keep trading parties up to speed, including a monthly planning update and regular webinars.

Please ensure you have registered to receive regular email updates from the MOSL programme team or updated your preferences as necessary.

There is also an open invitation for trading parties wishing to attend the Performance Advisory Group (PAG) to take part in conversations about particular topics, or simply to see how MOSL is working with trading party subject matter experts.

If you have any questions or queries about the MPF reform programme or Consultation 4, please email mpfreform@mosl.co.uk.