Executive directors’ remuneration policy for 2020/21

Background

The Company’s executive remuneration policy is designed to attract and retain good quality senior executives having regard to other UK-based businesses. It provides for a remuneration package, the variable element of which reflects the Company’s performance against stretching customer service, operational and financial objectives.

Updated remuneration policy – effective from 1 April 2020

The Board acknowledges and fully agrees with Ofwat’s recent pronouncements on its expectations with respect to companies being transparent about how executives are remunerated and especially how any performance-related element is linked to customer interests and the measures are stretching in nature. The Board has considered the comments provided by Ofwat in the area of executive remuneration as part of the PR19 business plan process, together with Ofwat’s latest views in its January 2019 report on Board Leadership, Transparency and Governance principles.

Therefore, the Remuneration Committee developed an updated and enhanced executive director pay policy (the ‘updated remuneration policy’ or ‘updated policy’), effective from 1 April 2020. This updated remuneration policy has strengthened the substantial link between executive pay and delivery for customers, in both the areas of annual bonus and long-term incentive plans (LTIPs), with the latter now specifically including customer-based targets and measurement criteria. Performance targets will be regularly assessed to ensure they remain stretching throughout the 2020 to 2025 business plan period.

Specifically, the Remuneration Committee has:

- Adjusted the weighting of the annual bonus targets for the Chief Executive Officer and Chief Financial Officer, so that 70% of any annual bonus relates directly to a range of customer pledges.
- Defined clearly the specifics of what constitutes exceptional delivery of these pledges to customers.
- Retained personal targets within the annual bonus scheme to allow the Committee to include specific targets for the executive directors.
- Redefined the targets and measurement criteria for future LTIPs (starting with the 2020 LTIP commencing 1 April 2020) to include specific business resilience and customer resilience targets that are directly linked to customer service. Such customer-centric targets now account for 80% of any potential LTIP payments, with the remaining 20% based on reputational targets.
- Retained the power to reduce all or part of performance-related pay payments resulting from exceptional circumstances

To ensure that the updated policy and associated annual bonus targets are sufficiently stretching, the Board will ensure any outperformance is only payable if the Company is earning a net reward for the delivery of the customer pledges in any one year. This ‘gateway’ approach will be particularly demanding given the Company’s targets for 2020 to 2025 are typically in the industry upper quartile.

In addition, introducing business resilience into the LTIPs as opposed to simply financial performance will ensure that executives have a responsibility to ensure the long-term financial sustainability of the Company and this will be assessed using a set of measurements such as bond ratios, totex efficiency and credit ratings. Such business resilience targets also include network infrastructure, operational and information technology infrastructure resilience measurements.

As part of this review of business resilience, the impact of COVID-19, and how the executives have managed the long-term operational and financial sustainability of the business in the crisis, is a key consideration.

Through our Remuneration Committee, we are committed to being fully transparent and continuously reviewing executive pay policies over time and, where they develop and change, we will explain the reasons in our Annual Report and signal changes to stakeholders. We will also include accessible explanations in 'Keeping it clear', our customer-friendly guide to how we are owned, run and financed.

Components of executive directors' remuneration within the updated policy

There are five components of the executive directors' remuneration – three fixed elements (Base salary, Benefits and Retirement Benefits) and two variable elements (Annual bonus and LTIPs). These five components of renumeration are detailed below.

1. Base salary

Purpose and link to strategy - Core element of fixed remuneration, reflecting the size and scope of the role. Purpose is to recruit and retain directors of the calibre required for the business to drive success and delivery for customers in line with the top quartile of the industry.

Operation - Reviewed annually and normally fixed for 12 months commencing 1 April. Whilst executive directors are contractually entitled to an annual review of their salary, there is no entitlement to an increase as a result of this review.

Salary levels are determined by the Committee taking into account a range of factors including:
- Role, experience and performance.
- Prevailing market conditions.
- External benchmarks for similar roles at comparable companies.
- Award levels of the rest of the business.

Opportunity - Increases in base salaries are reviewed in the context of salary increases across the Company as a whole. The Committee considers any reasons why increases should diverge from this benchmark, including:
- Increase in scope, complexity or responsibility of the role.
- Increase on promotion to executive director.
- A salary falling significantly below market positioning.

Performance metrics - Contribution and overall performance in the role are taken into account in determining whether any increase in base salary should be awarded, and if so, at what level.

2. Benefits

Purpose and link to strategy - Ensures the overall package is competitive to recruit and retain directors of the calibre required for the business.

Operation - Executive directors receive benefits in line with market practice, which include a car allowance, private medical insurance and life assurance. Other benefits may be provided based on the role and individual circumstances. These may include, for example, relocation and travel allowances.

Opportunity - Set at a level which the Committee considers appropriate against the market and provides a sufficient level of benefit based on individual circumstances.

Performance metrics - Not applicable.

3. Retirement benefits

Purpose and link to strategy - Purpose is to recruit and retain directors of the calibre required for the business and to provide market-competitive post-employment benefits.

Operation- Executive directors are eligible to participate in the Company's defined contribution pension scheme (or such other pension plan as may be deemed appropriate) and, if a member before closure of the scheme, the Company's defined benefit scheme. The defined benefit scheme was closed to new entrants from 1 May 2002. Any executive director who is a member of the closed scheme can continue to receive benefits in accordance with the terms of the scheme. The executive directors are not members of the defined benefit scheme.

Opportunity - The executive directors have personal pension plans.

Performance metrics - Not applicable.

4. Annual bonus

Purpose and link to strategy - Rewards performance against annual targets which support the strategic direction of the Company.

Operation - Annual targets include shared corporate targets for the levels of service to customers and other aspects of operational performance, financial performance, and individual targets for the achievement of personal goals. Targets are set by the Board (advised by the Remuneration Committee) before the start of each financial year and are assessed following audit of the Company's financial statements and independent assurance of the levels of service achieved, prior to publication of the Company's Annual Report and signature of the Risk and Compliance Statement. As with all bonuses, they remain discretionary and can be adjusted or removed at the Company's discretion, which is exercised by the Remuneration Committee on behalf of the Board.

Opportunity – The maximum bonus opportunities for the Chief Executive Officer and Chief Financial Officer are 55% and 35% respectively.

Performance metrics - The weighting of annual targets, under the updated policy, is now across two main categories as follows:

	Customer pledges* (70%)	Personal targets (30%)	Total
Chief Executive Officer	38.5%	16.5%	**55%**
Chief Financial Officer	24.5%	10.5%	**35%**

The specific customer pledges are broken down further into the following key components, which will be measured and monitored for achievement by the Remuneration Committee. These specific customer pledges have been determined by the Remuneration Committee to be those of most relevance to delivering quality and consistent levels of high customer service in the year-ended 31 March 2021.

* Customer pledges	% split
Water quality	16.7%
C-Mex	16.7%
Leakage	16.7%
Supply interruptions	16.7%
Per Capita Consumption	16.7%
Affordability	16.7%
Total	**100.0%**

Performance metrics are selected to align with the Company's strategy. The targets set are designed to be stretching and require year-on-year improvements in overall business performance. In setting stretching performance targets, the Committee takes into account a range of factors, including the Company's medium-term business plans, commitments to customers, regulatory and other obligations, and shareholder expectations.

Personal targets focus upon critical areas of business development, including process and service enhancements, demonstration of the Company's values, and employee leadership and development.

5. Long-term incentive plan

Purpose and link to strategy - Rewards performance against longer term financial targets which support the strategic direction and value of the Company and the Group of which it is a part. In addition, this plan provides an incentive for executives to remain in the business, which provides stability and continuity of key individuals in a competitive marketplace, allowing full focus on achieving customer objectives.

Operation -Targets for financial performance over three years for the Company and the Group of which it is a part are set by the Board (as advised by the Remuneration Committee) annually before the start of the three-year performance period. Rewards only crystallise if the shared corporate targets for the levels of service to customers and other aspects of operational performance (as applicable under the annual bonus) are achieved. Performance is assessed annually following audit of the Company's financial statements and independent assurance of the levels of service achieved, prior to publication of the Company's Annual Report and signature of the Risk and Compliance Statement. Rewards only become payable at the end of the three-year performance period, when performance over the three-year period as a whole is assessed. As with all bonuses, they remain discretionary and can be adjusted or removed at the Company's discretion, which is exercised by the Remuneration Committee on behalf of the Board.

Opportunity - Incentive payments for the three-year period vary from on-target performance to maximum opportunities as shown below:

LTIP	On-target	Maximum available
Chief Executive Officer	35%	70%
Chief Financial Officer	30%	60%

Performance metrics - The updated Remuneration policy substantially changed the targets and measurement criteria for the Company's LTIPs commencing 1 April 2020. The updated Remuneration policy has not changed the on-target and maximum available opportunities available under the LTIP for the CEO and CFO. However, the performance targets that comprise such opportunities are now set as follows, together with a requisite weighting:

- Business resilience - 50%
- Customer resilience - 30%
- Reputational - 20%

The specific measurement criteria are broken down further into the following key components, which will be measured and monitored for achievement by the Remuneration Committee. With the focus now on business and customer resilience criteria, all specifically aimed at long-term customer benefits, 80% of any potential LTIP award is now clearly aligned to customer performance and service.

Business resilience

Target	Measurement criteria	Weighting
Systems-based resilience	- Progress on key aspects of the company-wide resilience plans with a focus on network and operational resilience. - Such progress will be achieved through effective totex spend to minimise leakage, supply interruptions and supply failures and efficient capex programmes to minimise unplanned outages and ensuring performance commitments are met. Digital resilience will be a key part of achieving this overall systems-based resilience.	15%
Financial resilience	– Outperformance of budget. – Business plan financial covenant and gearing ratios are met. – Progress on enduring financial resilience solutions, including long-term refinancing and sinking fund solutions.	35%
Total weighting		**50%**

Customer resilience

Target	Measurement criteria	Weighting
Value to customers	Development, deployment and delivery of a company-wide, cost effective customer plan that solidifies our position as a customer-orientated organisation and drives improvements in our C-MeX standing.	15%
Financial hardship	Achievement of social tariff and Priority Services Register targets in line with the Company's business plans.	15%
Total weighting		**30%**

Reputational resilience

Target	Measurement criteria	Weighting
Proactive steps	Proactive steps taken to enhance reputation, including embracing and implementing a social value agenda and bring to life the Company's environmental agenda (aligned to the water sector's Public Interest Commitments, including net zero carbon).	10%
Reactive management	Appropriateness of steps taken by management in light of potential reputational issues.	10%
Total weighting		**20%**