

Corporate governance report

Code principle – remuneration

5

Remuneration

Principle P: Remuneration policies and practices should be designed to support strategy and promote long-term sustainable success. Executive remuneration should be aligned to company purpose and values, and be clearly linked to the successful delivery of the company's long-term strategy.

We describe how our remuneration approach aligns with our business strategy on page 164.

Principle Q: A formal and transparent procedure for developing policy on executive remuneration and determining director and senior management remuneration should be established. No director should be involved in deciding their own remuneration outcome.

This is detailed in the committee's terms of reference which are available on the company website. The committee consults with shareholders when changes to policy are being considered.

Principle R: Directors should exercise independent judgement and discretion when authorising remuneration outcomes, taking account of company and individual performance, and wider circumstances.

The shareholder approved directors' remuneration policy outlines the ways in which the committee may exercise discretion.

The following table summarises how our shareholder approved remuneration policy fulfils the factors set out in provision 40 of the 2018 UK Corporate Governance Code.

CLARITY

The committee is committed to providing transparent disclosures to shareholders and the workforce about executive remuneration arrangements and, to this end, the directors' remuneration report sets out the remuneration arrangements for the executive directors in a clear and transparent way. Our AGM allows shareholders to ask any questions on the remuneration arrangements, and we welcome any queries on remuneration practices from shareholders throughout the year.

SIMPLICITY

Our remuneration arrangements for executive directors, as well as those throughout the group, are simple in nature and understood by all participants, having been operated in a similar manner for a number of years. Executive directors receive fixed pay (salary, benefits, pension), and participate in a single short-term incentive (the annual bonus) and a single long-term incentive (the Long Term Plan).

PREDICTABILITY

Payouts under the annual bonus and LTP schemes are dependent on the performance of the company over the short and long-term, and a significant proportion of executive director remuneration is performance-linked. These schemes have strict maximum opportunities, with the potential value at threshold, target and maximum performance scenarios provided in the directors' remuneration report.

RISK

The committee has designed incentive arrangements that explicitly do not encourage inappropriate risk-taking. The committee retains overarching discretion in both the annual bonus and LTP schemes to adjust payouts where the formulaic outcomes are not considered reflective of underlying business performance and individual contributions. Robust withholding and recovery provisions apply to variable incentives.

PROPORTIONALITY

Payments from variable incentive schemes require strong performance against challenging conditions over the short and longer term. Performance conditions have been selected to support group strategy and consist of both financial and non-financial metrics.

The committee retains discretion to override formulaic outcomes in both schemes to ensure that they are appropriate and reflective of overall performance.

ALIGNMENT TO CULTURE

Performance measures used in our variable incentive schemes are selected to be consistent with the company's purpose, values and strategy. The use of annual bonus deferral, LTP holding periods and our shareholding requirements provide a clear link to the ongoing performance of the group and ensure alignment with shareholders, which continues after employment.

REMUNERATION APPROACH

There are three key principles of our approach to executive remuneration.

1

Align

to our purpose, vision and strategy

2

Incentivise

great customer service

3

Create long-term value

for all of our stakeholders

Corporate governance report

At a glance summary: executive directors' remuneration

ALIGNING OUR REMUNERATION APPROACH TO BUSINESS STRATEGY

Our remuneration approach is aligned to our purpose, vision and strategy, thereby incentivising great customer service and the creation of long-term value for all of our stakeholders.

The following table provides a summary of how our incentive framework in 2020/21 aligns with our business strategy and the results that it delivers. Many of the performance measures are key performance indicators (KPIs) for the regulatory period 2020–25 (see pages 50 to 51). Details about how our approach to executive remuneration is aligned with the approach to remuneration across the wider workforce are shown on pages 172 to 175.

	Alignment to strategy	Link to strategic themes	Alignment to purpose reflecting views of different stakeholders
Annual bonus			
Underlying operating profit	Key measure of shareholder value.		
Customer service in year	Delivering the best service to customers is a strategic objective.		
<ul style="list-style-type: none"> C-MeX ranking Written complaints 	Ofwat can apply financial incentives or penalties depending on our customer service performance.		
Maintaining and enhancing services for customers	Delivering the best service to customers is a strategic objective.		
<ul style="list-style-type: none"> Outcome delivery incentive (ODI) composite Time, cost and quality of the capital programme (TCQI) 	<p>There is a direct financial impact on the company of Ofwat incentives and penalties for delivery/non-delivery of customer promises.</p> <p>Keeping tight control of our capital programmes ensures we can provide a reliable service to our customers at the lowest sustainable cost.</p>		
Compulsory deferral of bonus	Deferral of part of bonus into shares aligns the interests of executive directors and shareholders.		
Long Term Plan (LTP)			
Return on Regulated Equity (RoRE)	Outperformance will result in an increase to RoRE which should translate into higher returns for investors through share price performance.		
Customer basket of measures	Delivering the best service to customers is a strategic objective.		
	There is a direct financial impact on the company of Ofwat incentives and penalties for delivery/non-delivery of customer promises.		
Additional holding period (at least two years)	Ensures continued alignment with shareholder interests and provides an additional period over which withholding can be applied.		
Shareholding guidelines	It is important that each executive director builds and maintains a significant shareholding in shares of the company to provide alignment with shareholder interests.		

KEY

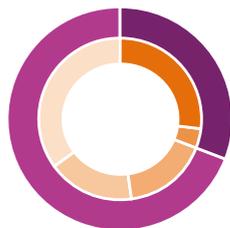
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|--------------------------------|-------------|-----------|
| The best service to customers | Communities | Investors |
| At the lowest sustainable cost | Customers | Suppliers |
| In a responsible manner | Environment | |

EXECUTIVE DIRECTORS' REMUNERATION POLICY

Elements of executive directors' pay

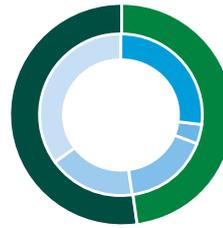
A significant proportion of executive directors' pay is performance-linked, long-term and remains 'at risk' (i.e. subject to withholding and recovery provisions for a period over which the committee can withhold vesting or recover sums paid):

Fixed vs performance-linked (%)⁽¹⁾



Fixed	31%	Performance-linked	69%
Base salary	27%	Annual bonus – cash	17%
Pension and other benefits	4%	Annual bonus – shares	17%
		Long Term Plan (LTP)	35%

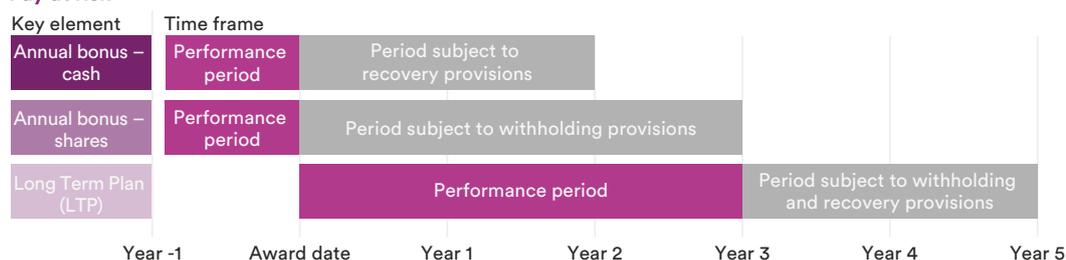
Short-term vs long-term (%)⁽¹⁾



Short-term	48%	Long-term	52%
Base salary	27%	Annual bonus – shares	17%
Pension and other benefits	4%	Long Term Plan (LTP)	35%
Annual bonus – cash	17%		

(1) Based on maximum payout scenario for executive directors in line with the current remuneration policy, assuming the normal maximum award level of 130 per cent of salary for the Long Term Plan (LTP).

Pay at risk



Further details on what triggers the withholding and recovery provisions can be found on page 184.

Implementation of directors' remuneration policy in 2020/21

The table below summarises the implementation of the directors' remuneration policy for executive directors in 2020/21. For further details see the annual report on remuneration on pages 167 to 181.

Key element	Implementation of policy in 2020/21
Base salary	<ul style="list-style-type: none"> No salary increase for Steve Mogford in 2020. Phil Aspin's salary was set at £400,000 on his appointment as Chief Financial Officer from 24 July 2020. See page 167 for further details.
Benefits and pension	<ul style="list-style-type: none"> Market competitive benefits package. Steve Mogford has a cash pension allowance of 22 per cent of base salary. His pension arrangements will be aligned to those of the wider workforce as part of the next directors' remuneration policy. See page 167 for further details. Phil Aspin has a cash pension allowance of 12 per cent of base salary in line with the wider workforce.
Annual bonus	<ul style="list-style-type: none"> Maximum opportunity of 130 per cent of base salary. 2020/21 annual bonus outcome of 81.8 per cent of maximum. 50 per cent of 2020/21 annual bonus deferred in shares for three years. Withholding and recovery provisions apply.
Long Term Plan	<ul style="list-style-type: none"> Award of 130 per cent of base salary. Estimated long-term incentive vesting of 89.6 per cent for the performance period 1 April 2018 to 31 March 2021. These awards will vest after an additional two-year holding period. Withholding and recovery provisions apply.
Shareholding guidelines	<ul style="list-style-type: none"> Personal shareholding for Steve Mogford remains above the 200 per cent of salary minimum guideline. Phil Aspin is expected to reach the minimum guideline within five years of his appointment to the board. Post-employment shareholding requirements apply. See page 176.

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At a glance summary: executive directors' remuneration

SINGLE TOTAL FIGURE OF REMUNERATION FOR EXECUTIVE DIRECTORS FOR 2020/21

Fixed pay comprises base salary, benefits and pension. Further information on the single figure of remuneration can be seen on page 167.



ALIGNING PAY WITH PERFORMANCE

ANNUAL BONUS – YEAR ENDED 31 MARCH 2021

Underlying operating profit⁽¹⁾
£763.0m

C-MeX ranking versus the other water companies
5th out of 17

Written complaints
16.51

Outcome delivery incentive (ODI) composite
£18.1m

Time, Cost and Quality index (TCQi)
95.3%

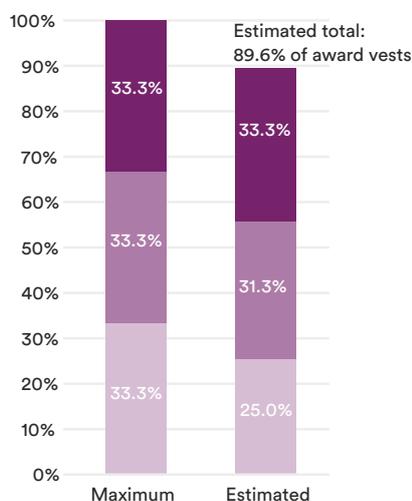
ANNUAL BONUS AND LONG TERM PLAN (LTP) OUTCOMES

The charts below show the results of the performance against targets for the annual bonus and LTP. Further information about the annual bonus is shown on page 168 and about the LTP on page 169.

2020/21 Annual bonus outcome



Estimated 2018 Long Term Plan (LTP) outcome



LONG TERM PLAN – THREE YEARS ENDED 31 MARCH 2021

Relative total shareholder return (TSR)⁽²⁾
48.0%

Sustainable dividends⁽³⁾
1.35

Customer service excellence⁽⁴⁾
4th out of 11

Key:

- At or above stretch target
- Between threshold and stretch targets
- Below threshold target

- (1) For the purpose of annual bonus, underlying operating profit excludes infrastructure renewals expenditure and property trading.
- (2) Above stretch versus the comparator group. See page 169 for further details.
- (3) Average underlying dividend cover over 2018/19 and 2019/20.
- (4) The estimated ranking versus the other WASCs in a combined customer service measure comprising C-MeX and written complaints.