Corporate governance report
Annual statement from the remuneration committee chair

We are confident that the review we have undertaken will continue to encourage a keen focus on the sustainable delivery of superior financial and operational performance which will, in turn, support the long-term success of the company.

Quick facts

- The Code requires that 'the board should establish a remuneration committee of at least three independent non-executive directors'
- The role of the committee is to set remuneration terms for all executive directors, other senior executives and the Chairman
- By invitation of the committee, meetings are also attended by the Chairman, the CEO, the company secretary, the business services director, the head of reward and pensions and the external advisor to the committee

Quick links

Terms of reference – **corporate.unitedutilities.com/corporate-governance**

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Remuneration committee members

- Sara Weller (chair)
- Dr Catherine Bell (stepped down 22 July 2016)
- Mark Clare
- Alison Goligher (appointed 1 August 2016)
- Brian May (appointed 16 May 2017)

Dear Shareholder

I am pleased to introduce the directors' remuneration report for the year ended 31 March 2017, which includes my statement, an 'at a glance' summary, a revised directors' remuneration policy which is intended to take effect from the date of our 2017 AGM (subject to shareholder approval) and the annual report on remuneration for the year ended 31 March 2017.

Remuneration review

During the year the committee undertook a review of executive pay arrangements, in advance of seeking shareholder approval for a new directors' remuneration policy at the 2017 AGM. The purpose of the review was to ensure that executive pay remains aligned with business strategy, reflects best practice expectations of shareholders and is appropriately positioned relative to the market. In developing the policy, we consulted with major shareholders and investor groups during November and December 2016. The consultation process was constructive and there was, in general, support for our proposals. The responses received were carefully considered, and played an important role in informing the review process.

Following this review, no significant changes are proposed to the current arrangements as feedback indicates these are working well. A few minor revisions to the policy are proposed as follows:

- to include the flexibility to adjust the balance of incentives in the reward package towards the longer term;
- to increase flexibility on how long-term performance metrics are weighted to enable appropriate measurement of performance over the life of the policy; and
- to strengthen recovery/withholding provisions.

See pages 91 to 97 for further detail on these proposed amendments.

Implementation of directors' remuneration policy

Salary increases

Executive directors received a base salary increase of 2 per cent with effect from 1 September 2016, in line with the headline increase applied across the wider workforce. Salaries will next be reviewed in September 2017 in line with our normal annual review process.

Annual bonus

The annual bonus measures incentivise and reward delivery of our business strategy and annual plan, and reflect the importance and challenge of regulatory commitments for the period 2015-20. These bonus measures apply not only to the executive directors, but also to managers and employees throughout the company, to ensure alignment to the business plan at all levels.

Pictured: Sara Weller, chair of the remuneration committee

As set out in detail in the annual report on remuneration, we have seen another strong year of performance in 2016/17 with progress made in moving towards our vision of becoming the UK's best water and wastewater company, providing great service to customers. Underlying operating profit was up by £19 million and customer service continues to improve with the achievement of our best ever score under Ofwat's revised qualitative SIM score for this regulatory period. The efficient and effective delivery of our capital programme is reflected in our Time, Cost and Quality index (TCQi) score which remains high at 92.9 per cent and our accelerated capital expenditure has helped us to optimise performance against our outcome delivery incentives. Our strong corporate responsibility and environmental credentials were recognised again this year when we retained a World Class ranking in the Dow Jones Sustainability Index for the ninth consecutive year.

During the year, the committee used our discretion to exclude any profit or loss arising from non-household services in the underlying operating profit figure used for setting the bonus targets and assessing the outcome. This was to recognise changes in the scope of business operations from the creation of a joint venture with Severn Trent in June 2016 to provide non-household services (Water Plus).

Overall company results, together with strong personal performance by the two executive directors, has resulted in annual bonus outturn of around 84 per cent of maximum (up from the 2015/16 outcome of around 54 per cent of maximum) and a company-wide bonus pool totalling £18 million (up from £13 million in the prior year). Half of the executive directors' annual bonuses will be deferred into shares for a period of three years.

In 2017/18, the annual bonus will operate in a broadly similar way with the exception that the Dow Jones measure (currently representing a maximum of four per cent of executive directors' bonuses) will be removed from the bonus scorecard and the weighting redistributed to the outcome delivery incentive (ODI) measure. The ODI targets, introduced in 2015, cover a broad range of customer priorities which closely link to the sustainable delivery of company performance, such as water quality, reliability of supply and wastewater network performance. The ODI targets also have a direct financial impact on shareholder value, and so on a going forward basis will, in the committee's view, form a stronger measure of performance for customers and shareholders than the Dow Jones measure.

In addition, in line with the revised policy, recovery and withholding provisions for the annual bonus scheme will be made more robust on an ongoing basis.

Long-term incentives

The Long Term Plan awards which were granted in 2014, and whose performance is measured over the three years to 31 March 2017, are expected to vest at 59.1 per cent. This reflects strong total shareholder return over the period of around 45 per cent and the achievement of the threshold level of sustainable dividend performance. The customer service excellence measure is expected to outturn between median and upper quartile versus comparator water companies. The awards for executive directors will vest following an additional two-year holding period.

Long Term Plan awards to be granted in 2017 will operate in a broadly consistent way, with the exception that, in line with the revised policy, recovery and withholding provisions will be made more robust on an ongoing basis and some changes will be made to the customer service measure to ensure we are measuring performance appropriately. For further details see page 102.

Agenda for 2017/18

The main focus of the committee's work over the past year has been on a thorough review of the remuneration policy, taking account of changes to best practice in the wider market and the related shareholder consultation process. We are confident that the review we have undertaken will continue to encourage a keen focus on the sustainable delivery of superior financial and operational performance which will, in turn, support the long-term success of the company. During 2017/18, we will continue to keep the remuneration arrangements under review, although no material changes in how our policy is implemented are expected. We remain mindful of the developing remuneration landscape and a key priority for 2017/18 will be to continue to monitor the executive pay environment, governance developments and market practice.

I hope we will receive your support for the resolutions relating to remuneration at the 2017 AGM.

Sara Weller
Chair of the remuneration committee