

Appendix 4c: Senior Executive Pay

Contents

Contents	2
Appendix 4c: Senior executive pay	3
Introduction	3
Annual performance award	4
LTIP	5

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Introduction

Most customer cannot choose their water company so there is, rightly, high expectations set of us. One of these expectations is that the way in which we reward our people; and particularly our senior executives, reflects how well the company is delivering services for our customers and how well we are making sure that the company remains resilient; now and into the long term.

It is also important that everyone can see how our senior executives are paid, this is why we publish it every year in our Annual Performance Report:

<https://www.yorkshirewater.com/reports>

This appendix sets out how we will ensure that we have introduced even stronger links between the long-term health of the company and its performance each year, to the pay that our most senior people receive.

We have engaged with our customers, the wider public and stakeholders about how we define our role in providing trusted, critical public services. This conversation is central to both our long-term strategic plan and our PR19 customer plan.

Our ongoing, innovative and detailed customer research has enabled us to understand our priorities as defined by our customers. Our PR19 plan is designed to deliver significantly higher standards of performance in the areas that matter most to our diverse customers.

In delivering our service improvements we have also identified our biggest ever efficiency programme. This efficiency must be delivered in a sustainable and resilient way to ensure that we offer a safe and reliable service now and into the long term. These factors add up to an ambitious and stretching plan that will challenge our company.

Our executives are accountable for the company achieving the ambition and stretch in our PR19 plan, leading the company on a day to day basis as well as meeting its long-term strategic direction as approved by the board. To attract the best people to lead the

business, the remuneration committee has developed an overall pay structure for 2020 – 2025 which will attract, retain and motivate the best available executives whilst meeting the challenge of legitimacy and fairness for customers, all colleagues and stakeholders.

The pay structure for executives must be understandable, transparent and reflect the true performance of executives in delivering for the public as well as shareholders. The plan must incentivise the right short and long-term performance, and strike the right balance between service, financial performance and resilience. Overall pay should also be compared to comparator groups with clear justification for divergence.

An important and significant element of pay should be entirely dependent on measurable performance, these elements of pay are known as variable pay or incentives which come in two forms:

- A bonus that is awarded annually (annual performance award)
- A long-term incentive plan (LTIP)

Annual performance award

The annual performance award is designed to:

- Incentivise through stretching performance targets the maximum positive impact that YW has on its customers in that year
- Ensure that health, safety and wellbeing; and employee motivation, remain key
- Ensure that performance is delivered efficiently

To incentivise success through stretching performance targets, success will be measured through the performance commitments that most impact customers in a year and that are in period measures. These are further split between primary measures i.e. those which most impact customers and which are most valued by customers via the PR19 research and secondary measures which, whilst important, do not have such an immediate impact on customers.

In the annual incentive mechanism, all measures will have stretching targets and the primary measures will be significantly more weighted than the secondary measures.

This weighting will be given more precision as we progress through the price review process.

Primary measures: C-Mex, D-Mex, leakage, affordability of bills, meeting vulnerable customer needs, drinking water quality, interruptions to supply, including those over 12 hours, low pressure, pollution incidents, internal and external sewer flooding, bathing water, carbon and per capita consumption.

Secondary measures: Water recycling, creating value from underused resources, gaps sites, voids verification, replacing customer owned pipes, abstraction incentive mechanism, quality agricultural products and renewable energy generation.

Full details of the measures can be found in the price control sections of our PR19 plan. The annual targets will be based on stretch targets on the non-financial measures. Alongside the delivery of these performance commitments, the annual performance award will also be evaluated by considering achievement of budgeted costs, health and safety performance and our colleague engagement score.

Using these measures will make sure that our executives are incentivised to deliver leading service for our customers each and every year, keep bills low by meeting efficiency targets and ensure that colleagues are subject to strong health, safety and wellbeing management and are motivated.

LTIP

The LTIP award is designed to ensure that directors are incentivised to look after the long-term health of the company and the design has been developed to ensure that the annual incentive is not earned at the expense of long term corporate health and resilience.

We have applied the leading edge 'capitals approach' to develop our understanding of our overall contribution and impact on society and the environment and our long term corporate health and resilience. This work has informed the thinking of the Remuneration Committee and enabled it to design a reward mechanism that reflects long term customer and financial performance whilst maintaining or improving long term resilience.

Financial performance (and financial resilience) will be assessed via the achievement of longer term stretching totex targets, outperforming financing costs and strong working capital management which are all essential to maintaining efficiency - important to both financial health, the customer sharing mechanisms and achieving gearing targets. The realisation of net ODIs will also be included as they incentivise innovation (intellectual capital) and are rewarded for strong customer performance, allowing a strong balance between longer term financial performance and customer outcomes.

The initial target performance is assessed against stretching financial targets, including net ODI performance. This performance and that of the annual incentive must demonstrably not compromise long term resilience. Any award therefore will be reduced where there has been a deterioration or non-performance in key aspects of long term resilience. The combined approach to the “capitals”, the work on resilience and the development of the performance commitments with customers suggests that the following moderators are applied:

Human capital: up to 20% reduction

- 10% for not meeting key long term health and safety targets
- 10% for not meeting key long term colleague engagement targets

Social capital: up to 40% reduction

- 15% for not meeting long term C-Mex targets
- 5% for not meeting long term D-Mex targets
- 5% each for not meeting each of: bill affordability, direct support for customers, awareness of priority services, meeting vulnerable customer needs long term targets

Manufactured capital: up to 10% reduction

- 2.5% for not meeting long term discharge permit compliance targets
- 2.5% for not meeting long term sewer collapse targets
- 2.5% for not meeting long term unplanned water treatment works targets
- 2.5% for not meeting long term mains repairs targets

Environmental Capital: up to 30% reduction

- 10% reduction for not meeting the long term leakage target
- 5% for not meeting the long term drought risk target
- 5% for not meeting the waste water flooding long term target
- 2% each for not meeting each of the long term targets for: working with others, land conserved, integrated catchment management, surface water removal, Per Capita Consumption (PCC)

Financial capital strength is measured by the achievement of the financial performance targets as noted above. There is no specific moderator for intellectual capital (although it is incentivised via the ODI element of financial performance) as there is no associated performance commitment. YW is however due to undergo some significant transformation plans and the delivery against these will be built into the annual incentive. Much of this work will be completed by 2020 however where transformation continues this will be built into the remuneration package.

Some performance commitments feature in both the short term and long term incentives: C-Mex and D-Mex, affordability of bills, meeting vulnerable customer needs and leakage. This is because they are seen to have an immediate impact in any year but are also essential to key aspects of long term resilience. This is also the case for people and safety although it is anticipated that those measures will be different and more reflective of the time periods involved.

This section sets out the principles we will adopt in arriving at executive variable pay. Final details and weightings will be agreed with the Remuneration Committee once we have the draft determination response from Ofwat with details of any intervention. It is essential to the achievement of our long-term aim of openness that the pay structure and award of our executives is fair, understandable, openly reported and assured. We will continue to report openly in our Annual Report and Financial Statements and Annual Performance Report. We will also continue to have the associated calculations externally assured.

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