Corporate governance report
Review of the directors' remuneration policy

Around seven million people in the North West of England rely on United Utilities to provide reliable and affordable year-round water supplies to their homes, businesses and recreational spaces.

Over the five-year regulatory period from 2020-25, our business plan commits us to delivering affordable bills and excellent service to customers, alongside a programme of careful investment to sustain the region's water quality, reduce leakage and ensure reliability of water supply. At the same time the company must lay foundations for longer-term resilience and the provision of water in an environmentally sensitive and sustainable way.

When setting the remuneration arrangements for executive directors, the committee has always adopted a prudent and responsible approach, which aligns to company strategy.

This continues under the proposed remuneration policy, where the potential maximum quantum of reward available is unchanged, for both the annual bonus (which operates at all levels throughout the company) and for the Long Term Plan (LTP). The proposed policy also ensures that incentives for the executive directors are related to the delivery of key business plan goals for customers, and returns for shareholders, and operates over four and five year periods respectively when bonus deferral and LTP holding periods are taken into account.

The proposed changes to our current policy mainly affect the way we structure the LTP element of the executive directors' remuneration package. New measures are proposed, to assess performance in a way that reflects the financial and service priorities of shareholders, regulators and customers, while recognising the importance of both long-term sustainability and dividend certainty.

Further details of the two equally weighted measures proposed for the LTP are described in more detail on page 127.

Some other small changes to the policy are also proposed to reflect recent shareholder guidance, notably in the commitment to align pension contributions for new executive director appointments with those that apply to the wider workforce.

The proposed policy has been developed taking careful account of shareholder views that were sought during a comprehensive consultation exercise between December 2018 and April 2019, involving major shareholders and other key stakeholders. A summary of the key elements of the review and its outcome are shown on pages 119 to 120, with full details of the proposed policy provided on pages 124 to 130.

If approved by shareholders the new policy will take effect from the July 2019 AGM, so it will be in place ready to support both the annual bonus and Long Term Plan at the start of the new regulatory period in spring 2020.

Pictured: Liverpool waterfront

Element of policy	Focus of/rationale for review	Position following consultation
Long Term Plan – introduction of Return on Regulated Equity (RoRE) as a performance measure	The committee proposes to replace Relative Total Shareholder Return as the financial LTP measure with RoRE. RoRE is the return that the company is expected to earn relative to the equity portion of its Regulatory Capital Value. The committee considers RoRE to be a better incentive measure than relative TSR because it: more effectively incentivises management in that they have strong line of sight to the outcome; allows stretching but achievable targets to be set, including across regulatory periods; captures financial, operational and customer performance; is aligned to shareholder value creation, without the volatility of share price; and is recognised as a relevant measure for the sector, evaluated by the analyst community. Additionally, RoRE is used by Ofwat to assess each water and wastewater company's performance and is published annually as part of each company's Annual Performance Report, so it is comparable across companies.	Shareholders were supportive of the use of RoRE instead of TSR as a performance measure in the LTP. RoRE will therefore be used as a performance measure in the LTP, with a weighting of 50 per cent. See page 127 for further details.
Long Term Plan – introduction of a 'customer basket' of performance measures	Ofwat has made it clear that during the next regulatory period, financial rewards and penalties available to companies should be directly linked to customer service delivery. The committee believes it is therefore appropriate for a substantial part of the executive directors' long-term incentive to be based on the performance of a number of customer service measures. This 'customer basket' will include measures which demonstrate the long-term health of our assets and services and ensure the long-term resilience of our water networks.	Shareholders understood the rationale for ensuring that Ofwat's focus on customer service delivery was reflected in executive incentives. A customer basket of measures will therefore be used as a performance measure in the LTP, with a weighting of 50 per cent. The basket of customer measures will include both service measures and resilience measures, so will capture delivery of performance for customers across a broad range of criteria. For the service measures, we will use the new C-MeX and D-MeX metrics being introduced by Ofwat as replacements for SIM. Using our online research panel of nearly 8,000 customers, we will also ask customers to prioritise outcomes that they think we should focus on (e.g. reducing leakage). For the resilience measures, we will focus on metrics that capture the long-term health and serviceability of our networks and assets, thereby aligning executive performance pay with building long-term resilience of our water and wastewater services. Customers will benefit from long-term reliability in the quality of their water supplies, and ways of working that protect and improve the environment. See page 127 for further details.
Long Term Plan – use of a dividend delivery underpin	The committee recognises that providing dividend sustainability to shareholders is important and that the current sustainable dividends measure used in the LTP has been effective. However, setting robust targets that can cross into a new regulatory period poses a significant challenge.	The committee's use of dividends under the LTP will be modified in the proposed framework by making delivery of our dividend policy an overall underpin. Vesting under the proposed LTP structure will be dependent on the delivery of the company's declared dividend policy during the respective performance period (alongside the existing underpin of the committee being satisfied that the company's performance on these measures is consistent with underlying business performance).
Balance between annual bonus and LTP quantum	The committee considered whether, in order to be able to set the mix of incentives each year in consideration of relevant developments in the external environment, it would be advantageous to have the flexibility to vary the mix of annual bonus and Long Term Plan awards annually within the respective overall maximum quantums.	Based on shareholder feedback the committee did not progress further with this element and it does not feature in the proposed policy.

Corporate governance report
Review of the directors' remuneration policy

Element of policy	Focus of/rationale for review	Position following consultation
Alignment of executive pension contributions with those applying to the wider workforce	There have been growing calls from investors and proxy bodies for pension provision for executive directors to be aligned to the wider workforce, and this expectation of pension alignment has now been included in the revised UK Corporate Governance Code (Code).	Shareholders were supportive of the committee's decision to align pension provisions for new executive to those applying to the wider workforce, with the maximum company pension contribution for new executive directors set at 14 per cent of salary, or a cash allowance of 12 per cent of salary (which is of broadly equivalent cost to the company). The current executive directors will receive a cash allowance of 22 per cent of salary and will no longer have the option to take any level of pension contribution instead.
Use of discretion	Shareholders expect that remuneration committees have the authority to exercise discretion diligently and in a manner that is aligned with shareholders' interests.	The committee already has sufficient power to exercise discretion, and in fact has exercised and disclosed the use of such in recent years, by applying downward adjustments to the executive directors' bonus outcomes in 2015/16 and 2017/18. The potential use of discretion is articulated more clearly in the proposed policy.
Recovery and withholding provisions	The committee is aware that the revised Code reminds remuneration committees of the expectation that incentive schemes will include recovery and withholding provisions in certain specified circumstances, and the guidance to the Code lists examples: payments based on erroneous or misleading data, misconduct, misstatement of accounts, serious reputational damage and corporate failure. Our incentive scheme rules already contain recovery and withholding provisions that can be used in cases of misstatement of accounts, error in calculations and gross misconduct. The rules also provide for withholding (but not recovery) to be applied in cases of serious reputational damage, serious failure of risk management, and such other circumstances where the committee determines they should apply.	The current provisions already go beyond what is typical market practice and provide flexibility including, for example, the ability to apply the provisions in the event of corporate failure. Importantly, the committee is satisfied that the provisions are fully enforceable. The potential use of the recovery and withholding provisions is articulated more clearly in the proposed policy.
Post-employment shareholding requirements	The policy review commenced some months ago before the current positions held on this topic by some stakeholders were published. Our current approach to incentives ensures that executive directors would continue to have significant shareholdings for at least two years after departure, because under our current policy they are not entitled to accelerated vesting of their unvested share awards. This means that long-term incentive awards within the two-year holding period do not vest until the end of that holding period; long-term incentive awards still in the performance period vest no sooner than two years after departure; and deferred bonuses do not vest until the end of the deferral period (which could potentially be up to three years after departure) so a former executive director could still have a material value in unvested share awards two or three years after departure.	Having carefully considered this area, including the context of the current political uncertainty impacting our industry, we do not intend to introduce additional post-employment shareholding requirements as part of this policy review. The post-employment vesting provisions that apply currently to the incentive plans already require unvested awards to be held after departure, and ensures they remain subject to robust recovery and withholding provisions. It was clear during the consultation process that some shareholders are keen for such provisions to be introduced, but the committee's rationale for not doing so at the current time was understood. The approach will be considered again in the next policy review, and market practice will be monitored in the meantime.