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By email

Chairs of Remuneration Committees for all regulated water and wastewater and water-only companies, copied to company board chairs

18 February 2022

Dear Committee Chair

Performance related executive pay for 2021-22

You will be aware of the current high level of scrutiny and concern around water company performance amongst stakeholders and reflected widely in the media. Companies' performance in some areas, most notably on the environment, risks eroding trust and confidence in the sector. We have seen these concerns voiced in many forums over the last twelve months, including in Parliament during the passage of the Environment Act 2021 and in the Environmental Audit Committee's recent report, [Water quality in rivers](#). The current focus may be largely on environmental performance in relation to wastewater but environmental performance is also important for water services.

We are close to the time when you and your remuneration committee will be determining incentive pay for executive directors for 2021-22 and setting 2022-23 targets. Our regulatory approach incentivises companies to deliver better outcomes for customers and the environment and penalises them where they fall short. We were also clear as part of the 2019 price review that performance related executive pay should demonstrate a substantial link to stretching performance delivery for customers which includes environmental commitments and obligations. We therefore expect companies to ensure that these outcomes are reflected in performance related pay for executive directors, including recognition of poor performance and any non-compliance with regulatory and statutory obligations.

As a monopoly provider of an essential public service, customers and society expect the highest standards of corporate governance, including that legitimate concerns of stakeholders are taken into account, when making decisions on the application of remuneration policies. You will no doubt be aware of best practice, as set out by the Financial Reporting Council, in the UK Corporate Governance Code and its Guidance on Board Effectiveness, relating to the use of discretion and judgement by remuneration committees, as well as the need to ensure that pay outcomes should not reward poor performance. In a regulated sector such as water, we would expect to see clear evidence that this is happening as a matter of course, for example that you have discretion to recognise shortfalls that become apparent during the year, whatever the initial framework for incentives.

It is essential that companies provide robust and clear explanations of performance related executive pay, and how this links to performance for customers, and that these explanations are accessible to all of their stakeholders. This is especially important in the context of the requirement in companies' licences to meet the objectives of our board leadership, transparency and governance principles, including ensuring that the board's approach engenders trust in the company and ensures accountability to stakeholders for its actions.

Given the current concern about environmental performance, including the current investigations into compliance with environmental permits, we urge remuneration committees to give particular consideration to the clarity of reasoning for any awards made in this area. You should also be open about any malus and clawback provisions, and when these would be used. Customers and stakeholders are entitled to reassurance on this in situations where poor performance subsequently becomes apparent.

We will be assessing your company's approach in your 2021-22 remuneration report against the background of the issues and considerations raised in this letter.

Yours sincerely

David Black
Interim Chief Executive