



08 May 2023

Iain Coucher
Chairman
Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4UA

Dear Iain,

[Protecting Customer Interests on Performance Related Executive Pay](#)

The Thames Water Remuneration Committee welcomes the opportunity to respond to Ofwat's consultation on protecting customer interests on performance related executive pay. No part of this response is confidential, and we are content for our response to be published in full. This response is being sent in the context of my meeting with David Black and Jenny Block on 12 April 2023.

I and the rest of the Remuneration Committee recognise that Thames Water's performance is under close public scrutiny. Matters of remuneration are a critical part of the board's role and we take them very seriously. We know that public trust and confidence in the sector as a whole, and in Thames Water specifically, is at a low ebb. It is for precisely these reasons that Thames Water needs to attract, incentivise and retain the highly capable leaders that are needed to deliver the company's turnaround plan. The Committee believes the latter is critical to the long-term interests of our customers, communities and the environment as it will be through the significant efforts of these leaders that the company improves its all-round performance.

We agree that transparency of the relationship between pay and performance is vital. All stakeholders should be able to see clearly how performance related pay (PRP) is aligned to the delivery of stretching performance for customers and the environment. We are confident we are able to clearly articulate the link between performance improvements and pay. We have a stretching turnaround plan which has been shared with Ofwat and is now being independently verified. Our focus is on motivating not only the executive directors but the senior leaders of the company, to deliver sustainable performance improvement.

We agree with the overall principle that we should not pay for under-performance or failure, and that performance related pay should be based on stretching targets. Our concern is the definition of these terms, particularly in the context of Thames Water's eight-year turnaround plan. The Executive Team and Board have been open with Ofwat that we do not expect the company to meet many of its performance commitments in the next few years and performance will be measured against the turnaround plan. We need to be able to incentive incremental performance improvements, having regard to the rate of change, that leads to sustainable performance delivery for our customers and the environment.

As such, we are pleased to see Ofwat's recognition that each company will need to consider what is stretching in the context of their own company and the metrics being used. For Thames Water, we believe it is critical our measures and targets support the delivery of our turnaround plan. Our concern through this consultation is whether retrospective decisions will be made as to what is fair, objective

and stretching. We would much prefer to have these discussions earlier in setting the performance related pay mechanisms and, as discussed during our meeting on 12 April, we intend to share our proposed new framework with Ofwat for comment.

We have accepted the feedback from Ofwat that our current plan has insufficient measures relating to the environment and will be rectifying this, this year. We will structure our performance related pay plan into the categories of customer, environment and financial resilience although we are still identifying the most appropriate measures and targets. We are specifically discussing other appropriate environmental measures as well as wider ESG elements such as energy generation which are becoming of increasing importance to our communities and interest groups.

With regards to Ofwat's assessment of 'overall' and 'in-the-round' performance, we feel it is critical that our overall performance is taken in the context of our turnaround plan. We are strongly aware that the performance of Thames Water is not where the Board, the Executive, our customers, the environment, and stakeholders need it to be. To motivate, incentivise and retain a senior team capable of delivering our stretching turnaround plan, we need to be able to reward performance improvements, even when those improvements fall short of meeting our performance commitments.

Our existing performance related plans contain deferral, malus and clawback clauses and we have recent history of applying clawback. We have concerns about withholding awards subject to an ongoing enforcement action given the time these can take and the uncertainty of the outcome. Our preference would be to instigate our malus/clawback provisions.

We understand the aim and sentiment behind this consultation document and, as we have commented above, we agree with the overall principle that Ofwat is trying to achieve i.e. customers should not pay for failure. However, we have specific areas of concern which we would be happy to discuss in more detail:

- The application of these changes to the current regulatory period, and mid-way through a performance year. We believe this is inconsistent with regulatory best-practice and creates unnecessary uncertainty.
- The actual mechanism for Ofwat's decision-making on how it decides whether it believes a company has paid for failure, and whether a company has met Ofwat's expectations on performance related pay is unclear and we are concerned that it could be highly subjective. We have strived to build objective, fact-based measures into our incentive plans and we believe that this is a more appropriate reference point.
- Retrospective actions impact our ability to plan, and it is not clear from the consultation when any decision would be communicated and actioned.
- Our need to balance the expectations of all stakeholders including our customers, regulators, shareholders and colleagues. Shareholders have not taken a dividend in 5 years. The Executive Directors and Executive Team have not been awarded a pay increase for three years. It is critical to the long-term success of Thames Water we are able to attract external investment and high calibre individuals.

I would be delighted to discuss the contents of this letter with you in more detail.

Your sincerely,

Jill Shedden
Remuneration Committee Chair