SRN63 Executive Pay and Dividend Policies Technical Annex

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Version 1

WATER for LIFE

from Southern Water

Contents

1. Dividend and Executive Pay Policies

1.1. Introduction

This technical appendix includes further detail on our policies towards executive pay and dividends.

1.2. Executive pay policy

The setting of policy and decisions on pay for executive directors of Southern Water Services Limited is delegated to the Remuneration Committee of the Board in accordance with terms of reference agreed by the Board and published on Southern Water's website. The Remuneration Committee receives external advice where necessary. The duties of the Remuneration Committee are clearly set out in those terms of reference which are available to view on the company's website.

The Board receives regular updates from the Remuneration Committee. In accordance with the Board, Leadership, Transparency and Governance (BLTG) Principles issued by Ofwat, the Remuneration Committee is made up of a majority of independent non-executive directors. Its chair is an independent non-executive director.

Full disclosure of all pay for executive directors is made in Southern Water's annual reports.

Our current remuneration policy sets out how we seek to attract, recruit and retain the talented individuals required to deliver the requirements of our business plan and we will extend that policy for the 2025-30 period to continue to ensure alignment with delivery for:

- Customers;
- the environment;
- shareholders and other stakeholders;

consistent with Ofwat's expectations in its final methodology and other guidance. This includes the letters to Chairs of Remuneration Committees dated 18 February 2022 and 5 December 2022. The policy will continue to reflect and take account of the continuing turnaround of Southern Water.

In addition to setting executive base pay and benefits to ensure a competitive offer to deliver our ambitious plans, consistent with Ofwat's guidance, the policy for 2025-30 will adopt the following principles relating to performance related pay:

Alignment to delivery for customers and the environment: We will continue to offer short- and long-term bonus schemes to executives with targets, set annually or over appropriate longer-term periods which contain stretching delivery for customers and the environment.

In the present 2020-25 period, KPIs for the annual bonus scheme include the following measures:

- Customer service (CSS part of C-MEX)
- Pollutions
- Water quality and transformation delivery
- Internal sewer flooding

- Health & Safety Transformation
- Leakage; and
- Financial metrics

All are considered to benefit customers and to support our environmental performance and ambition and the same suite of short-term metrics applies to all employees in the company to ensure appropriate focus and incentivisation. There is a close alignment to the company's ODIs.

KPIs for the longer-term LTIP scheme applicable to executive directors (as well as certain senior employees) include the following measures:

- EPA performance
- CRI
- C-MEX overall performance
- Botex performance
- Business plan quality

As with the KPIs for the short-term incentives, these are considered to be measures which benefit customers and the environment.

Stretching targets: The Remuneration Committee sets stretching targets for each KPI on an annual basis for short-term bonus schemes and for the term of long-term schemes. In each case, there is a threshold, below which no reward is earned for that KPI, an on-target level, and a stretch target.

Overall performance: The 2025-30 policy will set out the Remuneration Committee's discretion to adjust bonus outcomes to reflect overall performance. As set out below, the Annual Bonus Plan and the LTIP rules allow discretion to the Remuneration Committee to take account of internal and external factors; this includes the turnaround of the company. Additionally, performance against personal objectives allows the Remuneration Committee to further reflect overall performance.

Underpins, malus and clawback: The rules of the company's Annual Bonus Plan and LTIP Scheme contain rigorous provisions relating to malus and clawback, as well as setting an approach for underpinning and a general discretion as noted above. These are also set out in the remuneration policy. The Remuneration Committee has demonstrated its commitment to ensuring delivery for customers and the environment during the 2020-25 period by exercising its discretion to withhold bonus payments.

Additionally, underpins are built into the KPIs and targets for the Annual Bonus Plan.
Outcomes are subject to adjustment for serious pollutions, C-MEX performance, and Health & Safety.

As noted above, the 2025-30 remuneration policy will build upon the policy for 2020-25 and will continue to be reviewed and revised as necessary before and during the 2025-30 period. Appropriate bonus schemes, KPIs and stretching targets matching the policy will be designed.

The current policy is set out below:

Executive Remuneration
It is our policy to ensure that performance related executive pay has a clear alignment to delivering stretching performance improvement, which is in the interests of customers as well as providing sustained and long-term value creation for shareholders and other stakeholders, and protecting the environment.

Salaries for the executive population are reviewed annually in line with the market and their personal performance against stretching targets. Salaries are reviewed in line with the annual increase applied to all employees.

It is also the policy to incentivise senior executives such that a significant proportion of variable pay is linked to stretching performance conditions.

Until 31 March 2022, this group participated in a non-contractual Incentive and Retention Plan (IRP), that incentivised stretching performance improvement across a number of KPIs.

From 1 April 2022, the IRP was replaced by an Annual Bonus Plan (ABP).

More than 50% of the KPIs in both the IRP and the ABP are aligned to delivering stretching customer outcomes and/or benefits to the environment. All KPIs link to the agreed execution plan and/or the transformation plan. The significant majority of total potential remuneration is non-contractual and variable and is linked to stretching performance improvement. Any potential award linked to environmental permits will be carefully assessed to ensure they do not drive wrong behaviours and comply with the section 19 undertakings given by SWS to Ofwat in October 2019.

An additional incentive linked to longer term targets has been implemented with effect from 1 April 2023. The targets are designed to deliver customer and environmental benefit and to put SWS in the best position to start AMP8. As with the one-year targets, any potential award linked to environmental permits will be carefully assessed to ensure they do not drive wrong behaviours, and will comply with section 19 undertakings given by SWS to Ofwat in October 2019

The Executive participate in other taxable benefits including: pension; life assurance; monthly car allowance; family PMI and health checks.

Executive performance related pay

It is our policy to provide transparent alignment between performance-related pay and stretching outcomes for all our stakeholders and specifically including our customers.

The policy reflects the Board's commitment to being open and transparent in respect of executive pay, through:

- ensuring that more than 50% of variable pay is directly aligned to customer outcomes with the remainder also benefiting our customers though longer-term value creation and financial resilience;
- recognising environmental performance is important to our customers;
- setting stretching performance targets that are based on the performance ambitions set out in our business plan commitments;
- ensuring that targets and metrics have a substantial and demonstrable link to stretching performance delivery and quality outcomes that align with the interests of customers;
- transparently reporting how performance related executive pay is linked to the underlying performance of the company;
- embedding behavioural competence built around company values to underpin the cultural change and instil a way of working that will increase employee engagement, productivity, environmental performance and permit compliance, without rewarding inappropriate behaviours and customer delivery.

It is our policy to apply stretching targets linked to customer outcomes.

The Board is committed to setting more than 50% of bonus targets that are linked to outcomes for customers that require stretching performance. These will include customer outcomes such as ODIs, C-Mex, efficiency of service delivery, as well as acknowledging the importance of the environment to our customers.

Customers will also benefit from other metrics, driving the longer-term financial resilience of the organisation and capturing the financial consequences of delivering for our customers, aligned with the needs of our shareholders, and preparing SWS for AMP8. These will include outcomes such as controllable opex.

It is our policy to apply rigorous application of scheme rules and to provide independent governance of remuneration decisions, whilst taking into consideration risk management principles.

This is monitored and applied through the Remuneration Committee, which consists of an independent chair, two independent non-executive directors and one non-executive director. This avoids any conflicts of interest and aligns the principle of protection of customers and investors. The Remuneration Committee reports through to the Board.

Our policy is to:

- apply good corporate governance by taking into account regulatory requirements and, among others, the UK Corporate Governance Code, any corporate governance principles or guidance issued by our regulator, Ofwat, from time to time;
- ensure compliance with our Section 19 undertakings given to Ofwat;
- maintain a stringent governance structure for setting relevant and stretching goals, which are aligned to customer outcomes, and communicating these goals to employees;
- ensure clear alignment with our business strategy, company values, key priorities and long-term goals;
- transparently report executive pay within our Annual Report and Accounts, and any other channels as appropriate;
- report any changes to the policy, including the underlying reasons, within the Annual Report and Accounts, and any other channels as appropriate;
- review annually the constitution and Terms of Reference of the Remuneration Committee to maintain its operational effectiveness and publishing these on our website for transparency;
- ensure the ongoing effectiveness of Board and its committees though regular external and independent evaluation;

The Board of Directors has set a maximum percentage of performance-based remuneration relative to the fixed salary remuneration for the executive management positions. Performance-related pay is non-contractual and, as such, the range of reward is from zero.

It is our policy to take into account the remuneration practices found in other UK companies of a similar size or operating in the same sector.

This ensures that the remuneration arrangements for the executive directors are appropriate when compared with those for other senior executives and the wider workforce. Attracting and retaining first class leadership is vital to the long- term success of the company.

To ensure that our remuneration practices remain competitive, the Committee periodically calls upon experienced specialist consultants.

1.3. Dividend policy

Our dividend policy for the 2025-2030 period will ensure a fair and balanced reward between customers, stakeholders and investors. When we are successful in the delivery of our business plans, all stakeholders share in our success: customers benefit through environmental and water resilience improvements, better services and lower bills, and shareholders earn a fair return on the money they have invested.

Our dividend policy is reviewed annually by the Board and published in our Annual Report each July. No material changes are currently planned to be made to the existing policy ahead of the next investment period (2025–30) but the Board will keep this under review. Therefore, the dividend policy for the 2025-30 period will follow the principles below:

When proposing payment of a dividend, the directors of Southern Water Services Limited, acting independently in accordance with their directors' duties and in accordance with the company's licence, will apply the following principles:

1. Determination of a base level of dividend, based on an equity return consistent with our most recent Final Determination and our actual level of gearing. This recognises our management of economic risks and capital employed.

2. In assessing any adjustment to the base level of dividend, we will take into account all aspects of our performance and consider this in the round. This would reflect our overall financial performance as compared to the final business plan as agreed by Ofwat and would explicitly consider a qualitative assessment of customer service levels, performance against planned customer and environmental outcomes and how customers share in our successes.

3. We will consider our financial resilience ahead of any dividend decision and whether any financial out-performance should be reinvested to benefit customers. This consideration will include taking into account the interests of our employees, other stakeholders, and our pension schemes. Our dividend policy is intended to support the financial resilience and investment grade credit ratings of the business and ensure continued access to diversified sources of finance. As part of step three, we carry out an assessment of:

    - headroom under debt covenants
    - the impact on the company's credit rating
    - the liquidity position and ability to fulfil licence conditions
    - key areas of business risk.

4. We will be transparent in the payment of dividends and will clearly justify the payment in relation to the factors outlined above.

5. We will publish our dividend policy annually (in the Annual Report) and highlight any changes.