Directors' Remuneration Report

Remuneration Committee Report

Chairman's Annual Statement

I am pleased to present the Remuneration Committee's report for the year to 31 March 2022.

One of the purposes of the Remuneration Committee is to put in place the incentive and retention structures that allow Southern Water to drive performance delivery and improvement across a broad and balanced set of outcomes. These outcomes are shaped to deliver benefits for our customers, the environment and our shareholders, while encouraging our employees to align with the high ethical values of the company of 'doing the right thing'.

Summary of the year

2021–22 has been another challenging year for the company. We have been heavily fined for what we know was an unacceptable level of performance between 2010–15, we have continued to strengthen our culture and underlying business performance and we have delivered for our customers through uncertain times as a result of the continuing global pandemic. Long-term and sustained changes in customer demand have been met.

In addition, the process that resulted in a fund managed by Macquarie Asset Management investing more than £500 million to recapitalise the company presented significant demands on a number of key senior executives. The major investment in the business is an endorsement of the improvements of the past years that have resulted in better outcomes for customers and stakeholders; it provides a solid foundation on which continued performance improvements can now be delivered. A small number of executives were incentivised to support a successful outcome to the investment transaction; details of the awards to the CEO and CFO are in the report.

Ian McAulay, CEO, declared his intention to retire from the organisation by 31 March 2023, and the process to find a successor has recently concluded; as reported elsewhere, Lawrence Gosden takes over as CEO from Ian on 1 July 2022. Ian's very substantial contribution to the ongoing transformation of the company has been recognised by the company Chair in his report. In addition, Sebastiaan Boelen will be leaving Southern Water later in July 2022 and his permanent replacement will be announced in due course. Nadim Ahmad will replace Sebastiaan as Interim CFO. The remuneration aspects of the changes to the executive directors will be reported on in 2022–23.

The bonus arrangements for the coming years have been reviewed and new arrangements designed to deliver stretching levels of performance, delivering customer, environmental and stakeholder benefit, will be introduced for April 2022 onwards.

Throughout the year, and within this context, the Remuneration Committee reviewed the remuneration policy, committee terms of reference and base and variable pay arrangements and satisfied itself on their application. It also sought the opinion of remuneration consultants at PwC on a number of matters.

Membership of the committee changed over the year as a consequence of the change in control of Southern Water and the related Board membership changes; it remains a majority of independent non-executive directors, the company Chair being considered independent for these purposes.

Remuneration outcomes for the 2021–22 Year

Delivering operational performance and better outcomes for customers was at the heart of the metrics agreed for the 2021–22 year; details of the metrics, and the associated targets, which the committee considered to be very stretching and linked to the delivery of the agreed business plan and customer outcomes, are in the Remuneration Report. In addition to measuring achievement against the agreed targets, the committee also had regard to legitimate concerns of all stakeholders, guidance from Ofwat, and broader corporate governance and ESG principles. In particular the committee has been satisfied that no employees have been inappropriately rewarded for environmental performance, including meeting environmental permits, and compliant with the undertakings given to Ofwat in October 2019, and taking heed of the letter from David Black of Ofwat dated 18 February 2022.

The committee chose to exercise its discretion to reduce the overall achievement against one of the customer metrics in light of the company's forecast ODI performance to the end of AMP7 being below levels anticipated at the end of 2020–21. The reduction was equal to the percentage bonus award earned in 2020–21.

The committee also chose to further reduce the overall bonus outcome to 50.00% of maximum. This reflected the committee's discretion to reflect overall outcomes for customers and other stakeholders against the calculated achievement of KPIs, as well as the anticipated reduction in the company's Environmental Performance Assessment to one star. It compared to 63.33% the previous year, and was awarded for all levels of the company.

As noted elsewhere, the committee has agreed to move to new incentive arrangements for 2022 onwards. It has therefore agreed that the existing Incentive and Retention Plan will close. Bonus awarded to executives this year will be paid into a 'deferred Incentive and Retention Pool' and as a result of the decision to close the existing scheme, 50% of an executive's pool will be paid in July 2022 with the balance being paid in July 2023, subject always to the rules of the scheme.

Looking ahead to 2022–23

In last year's report the committee signalled its intent to review the bonus arrangements for the coming year. Supported by PWC, the committee has now completed that review and has decided to put in place new arrangements for 2022–23 onwards. These new arrangements will incorporate an Annual Bonus Plan (ABP) and, for a very small group of senior executives, a three-year Long-Term Incentive Plan (LTIP). Targets will continue to be stretching and strongly aligned with delivering customer and environmental outcomes and associated appropriate behaviours. At the same time, with the recent investment from a fund managed by Macquarie Asset Management, the committee remains focused on ensuring that the company continues to strengthen its financial position in the interests of all of its current and future customers and stakeholders. Targets will be reported in due course. In designing the new schemes, the committee has had regard to Ofwat's guidance as well as industry market practice.

The Remuneration Committee remains committed to ensuring that the company maintains well designed and forward-looking variable pay arrangements that are flexible to the needs of all stakeholders.

Paul Sheffield

Chair of the Remuneration Committee

15 July 2022

Directors' Remuneration Report continued

Remuneration Committee Report continued

Introduction

This report details the activities of the Remuneration Committee for the period to 31 March 2022. It sets out the remuneration policy and remuneration details for the executive and non-executive directors of the company. It has been prepared in accordance with the Corporate Governance Code, the Ofwat Board, Leadership, Transparency and Governance Objectives and Principles, the guidance issued by Ofwat in Regulatory Accounting Guidance (RAG) 3.12 and, where relevant for a non-listed company, has taken into account the requirements of the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

The Remuneration Committee of Southern Water

The Remuneration Committee has the responsibility for setting the remuneration policy and structure of the executive directors and senior management. It is also responsible for setting the remuneration of the Chair. The committee has defined terms of reference, which are published at **southernwater.co.uk/board-committee-terms-of-reference**. These have been reviewed and revised during the year.

We recognise that the independent non-executive directors have an important role to play in determining and challenging remuneration policy and practice. In order to reflect this, the independent non-executive directors are a majority on the committee. The Chair of the Company is considered independent for these purposes.

Only committee members are entitled to attend meetings, with the Chief Executive Officer and Chief Financial Officer attending by invitation. The Company Secretary acts as secretary to the committee.

No attendee participates in discussions regarding their own remuneration.

Committee membership

Paul Sheffield
Chair
Attendance 4/4

Keith Lough
Committee member
Attendance 1/1

Rosemary Boot
Committee member
Attendance 3/3

Sara Sulaiman
Committee member
Attendance 2/2

Kevin McCullough
Committee member
Attendance 2/2

Martin Bradley
Committee member
Attendance 2/2

Rosemary Boot left the Committee on 7 February 2022.

Sara Sulaiman left the Committee on 8 September 2021 upon her retirement from the Board.

Kevin McCullough left the Committee on 7 February 2022.

Martin Bradley joined the Committee on 8 September 2021. Martin left the Committee on 1 May 2022 and was replaced by Will Price.

Keith Lough joined the Committee on 7 February 2022.

Directors' Remuneration Report continued

Remuneration Committee Report continued

Remuneration at a glance

Key objectives

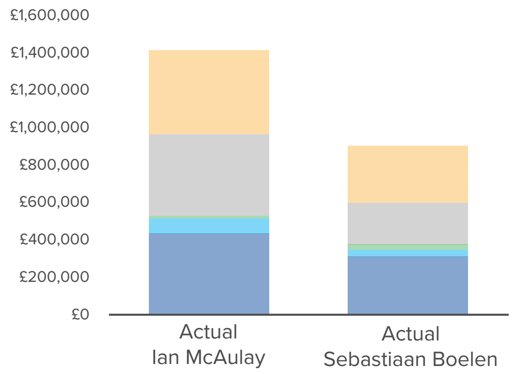
Providing transparent alignment between performance-related pay and quality customer outcomes	Governance, risk management and rigorous application	Applying stretching targets linked to customer outcomes

Executive directors' remuneration policy

Elements of executive directors' pay

Element	Aspects
Base salary	Attracts and retains executives of the quality required to deliver our strategy.
Incentive and Retention Plan	Drives and rewards performance against stretching financial, customer and operational KPIs, which are directly linked to business strategy.
Pension	Defined contribution scheme.
Other benefits	Provides market competitive benefits.

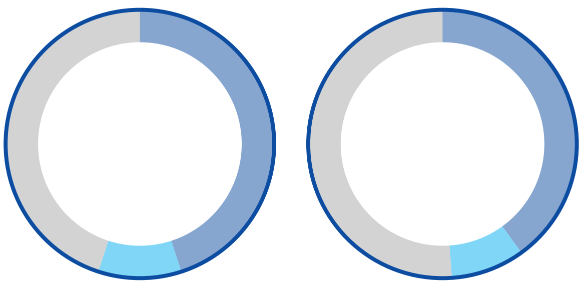
Single total figure of remuneration for executive directors for year ended 31 March 2022



Key:
- One-off investment transaction incentive
- Annual (IRP) bonus award
- Benefits
- Pension
- Salary

Ian McAulay

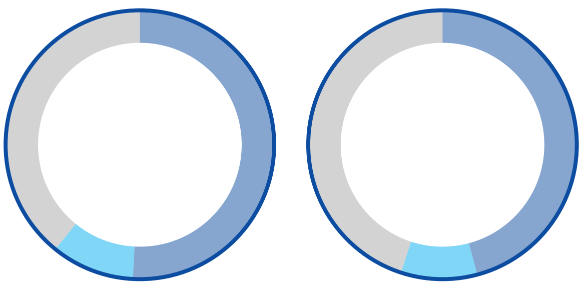
2021–22 2020–21



	2021–22	2020–21
Fixed	**55%**	**49%**
Base Salary	45%	40%
Pension and other benefits	10%	9%
Performance linked	**45%**	**51%**
Annual bonus – awarded	45%	51%

Sebastiaan Boelen

2021–22 2020–21



	2021–22	2020–21
Fixed	**61%**	**55%**
Base Salary	51%	46%
Pension and other benefits	10%	9%
Performance linked	**39%**	**45%**
Annual bonus – awarded	39%	45%

Exceptionally, for 2021–22 Ian McAulay and Sebastiaan Boelen were awarded a one-off investment transaction incentive linked to the successful delivery of the transaction which saw a fund managed by Macquarie Asset Management invest more than £500 million into the company. To aid comparison, these charts exclude this investment transaction incentive.

Directors' remuneration Report continued

Remuneration policy applicable in year (unaudited)

Purpose

This remuneration policy applies to all Southern Water employees. The Board of Directors has adopted the remuneration policy at the recommendation of the Remuneration Committee. This policy applies to remuneration earned from 1 April 2022 to 31 March 2025. This was last updated in May 2022.

Providing transparent alignment between performance-related pay and quality customer outcomes

The policy reflects the Board's commitment to being open and transparent in respect of executive pay. In line with the expectations set out in Ofwat's 'Putting the sector back in balance' the Board has also committed during the year to ensuring 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 by:

- setting stretching performance targets that are based on the performance ambitions set out in our business plan
- 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 and therefore productivity
- ensuring employees feel encouraged to create sustainable results and that a clear link exists between customers, shareholders and employees' interests
- ensuring that performance payments do not compromise employees' compliance with the Ofwat Section 19 requirements
- aligning pay to the market-median position, recognising the need, from time to time, to implement specific arrangements for certain individuals
- ensuring employees are offered a competitive and market median-aligned remuneration package, which balances the fixed and variable remuneration components according to job role
- ensuring that Southern Water is able to attract, develop and retain high-performing and motivated employees in a competitive market.

The table on page 183 summarises the elements of our executive directors' remuneration package and our policy for each item.

Governance, risk management and rigorous application

The Board applies sound and effective risk management principles to ensure that the policy is rigorously monitored and applied through:

- the application of good corporate governance by taking into account regulatory requirements and, among others, the UK Corporate Governance Code and any corporate governance principles issued by its regulator, Ofwat, from time to time
- a stringent governance structure for setting relevant and stretching goals, which are aligned to customer outcomes, and communicating these goals to employees
- clear alignment with our business strategy, company values, priorities and long-term goals
- the Remuneration Committee consists of two independent non-executive directors and one non-executive director and no executive directors, which avoids any conflicts of interest and aligns the principle of protection of customers and the interests of investors
- a commitment to the transparent reporting of executive pay within our Annual Report and Financial Statements, and any other channels as appropriate in accordance with legal and regulatory requirements, including the Ofwat Board leadership, transparency and governance principles
- a commitment to transparently report any changes to the policy, including the underlying reasons, within the Annual Report and Financial Statements, and any other channels as appropriate
- an annual review of the constitution and terms of reference of the Remuneration Committee to maintain its operational effectiveness and publishing these on our website for transparency
- ensuring the ongoing effectiveness of the Board and its committees through regular external and independent evaluation.

Directors' Remuneration Report continued

Remuneration policy applicable in year (unaudited) continued

Read more on pages 76 to 91

Applying stretching targets linked to customer outcomes

The Board sets stretching bonus targets linked to outcomes for customers that require equivalent stretching performance. The Board is committed to setting more than 50% of bonus targets that are linked to these outcomes. For 2021–22 these included customer outcomes such as ODIs, C-MeX, D-MeX, efficiency of service delivery, service through people as well as treating the environment as our customer.

Customers will also benefit from the value metrics, which will drive the long-term financial resilience of the organisation and capture the financial consequences of delivering for our customers, aligned with the needs of our shareholders. For 2021–22, these included outcomes such as totex and net operating cash flow.

All metrics were used throughout the organisation so that all company employees are incentivised to achieve stretching levels of customer service. More detail can be found on pages 76 to 91 of this report.

Executive remuneration components

Executive remuneration comprises both fixed and variable elements with the four remuneration components detailed as follows:

- Fixed remuneration (including fixed supplements)
- Performance-based remuneration (variable percentage of salary)
- Pension schemes, where applicable
- Other benefits in kind (e.g. car allowance and private medical cover).

The fixed remuneration is determined on the basis of the role and position of the individual employee, including professional experience, responsibility, job complexity and local market conditions and is frequently benchmarked against industry peer groups.

The performance-based remuneration motivates and rewards those employees who significantly contribute to sustainable results, perform according to set expectations for the individual in question, strengthen long-term delivery of quality outcomes for customers and generate income and shareholder value.

The Board of Directors has determined a maximum percentage of performance-based remuneration relative to the fixed salary remuneration for the executive management positions. The table below shows the maximum limit on variable remuneration (excluding any pension allowance) for the CEO and CFO for 2021–22. The maximum percentages are made up of customer metrics and value metrics as follows:

	CEO	CFO
Customer metrics range and maximum:	0% – 100%	0% – 80%
Value metrics range and maximum:	0% – 100%	0% – 75%
Total maximum variable remuneration	0% – 200%	0% – 155%

Performance-based remuneration is disbursed as a cash bonus. The total of any executive bonus earned during the year is added to the individual's bonus pool carried over from prior years. Each year, 50% of the pool is paid out in cash, with the remaining 50% deferred and retained as the bonus pool for future years. Rules of the scheme include bonus recovery provisions, which allow for the possibility of a reduction or clawback of bonuses already earned, or those deferred, to incentivise sustained, long-term executive performance. The Committee has determined that new arrangements for executive bonuses will be put in place for future years and that the current scheme will close. Therefore, following the addition of the current year's earned bonus to the individual's bonus pool, 50% will be paid in July 2022, with the remaining 50% paid in July 2023, subject to the rules of the bonus scheme.

Executive directors are covered by an insured four times salary 'death in service' lump sum benefit and a contribution to a personal pension arrangement. The CEO currently receives an 18% of base salary contribution rate and the CFO receives 15%. Where retirement savings have exceeded the Lifetime Allowance (as defined by HMRC for their circumstances) the employer contribution may instead be taken as a pay supplement, subject to the relevant tax and National Insurance deductions.

The policy is that remuneration should be market-competitive relative to other comparable companies, with a significant proportion being performance-related. The performance-related element is only paid out if stretching targets are achieved that benefit both customers and shareholders. In setting the remuneration policy for executive directors, the committee takes into account the remuneration practices found in other UK companies of a similar size or operating in the same sector. It also 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.

In particular, the committee is kept informed on a regular basis of the following, which it uses to set executive remuneration policy:

- The level of salary increase for the general employee population
- Company-wide benefit provision and any proposed changes
- Overall spend on management bonus arrangements
- The gender pay gap across the company.

An investor representative non-executive director sits on the committee and as such is involved in setting remuneration levels, monitoring the performance of the executive directors, agreeing payments and approving any changes to executive reward packages. This involvement ensures that shareholders play a key part in shaping remuneration policy and decisions. Along with the independent non-executive directors they ensure that the link between pay and performance is closely managed.

To ensure that our remuneration practices remain competitive, the committee periodically calls upon experienced specialist consultants. During the year, the committee also received some guidance and market practice information from external, independent advisers, PwC.

Remuneration components

Element of remuneration	Purpose and link to strategy	Policy and approach	Maximum opportunity 2021–22
Base salary	Takes into account experience and personal contribution to our strategy and performance. Attracts and retains executives of the quality required to deliver our strategy.	• Reviewed annually with changes effective from 1 July if applicable. • Consideration given to individual and company performance. • General pay increases to all employees taken into consideration. • Aim to pay within a mid-market range, but may pay higher salaries to attract and retain executives of the right calibre or for out-performance by the individual or company. • Referenced against UK companies of a similar size, utility companies and other water companies.	Base salary increases are applied in line with the annual review.
Incentive and Retention Plan	Drives and rewards performance against stretching financial, customer and operational KPIs, which are directly linked to business strategy. It is also structured to provide retention incentives to executives.	• Details of the operation of the plan are shown on page 184. • Performance metrics and targets are established annually by the committee, making sure they are sufficiently stretching while also recognising the nature and risk profile of the company. • Where applicable, 80% of the opportunity available for each measure is created for achieving a threshold target. 100% is awarded for achieving the actual target, with stretch targets creating between 120% and 150% for achieving outstanding performance. • The committee has discretion to amend or withdraw payments based on the consideration of other factors which could significantly affect business performance. • Plan awards are disclosed on pages 188 to 189. • New bonus plans being put in place for 2022–23 onwards to replace the Incentive and Retention Plan.	200% of salary for the CEO 155% of salary for the CFO

Directors' Remuneration Report continued

Remuneration policy applicable in year (unaudited) continued

Element of remuneration	Purpose and link to strategy	Policy and approach	Maximum opportunity 2021–22
Pension	Defined contribution scheme minimises the risk to the company associated with defined benefit pension plans.	• A company contribution into a defined contribution scheme, and/or • A cash allowance in lieu of pension.	CEO 18% of salary CFO 15% of salary
Other benefits	Provides market competitive benefits.	May consist of: • Car allowance • Health cover • Disturbance or relocation allowances.	Based on individual circumstances.

Notes to the policy table

Directors' pay

Executive directors who served during the 2021–22 year are shown below:

Ian McAulay	Chief Executive Officer
Sebastiaan Boelen	Chief Financial Officer

Details are given on page 188 to 189 of the amounts paid to them in the year ended 31 March 2022.

Operation of the Incentive and Retention Plan

The Incentive and Retention Plan operates as follows:

1. **Annual contribution:** Each year, participants have had the opportunity to earn an annual bonus contribution based on performance against targets pre-determined by the Board. This is then added to the 'bonus pool'.
2. **Annual pay-out:** Each year, following the Annual Contribution, 50% of the total amount in the 'bonus pool' is paid out to participants in cash.
3. **Deferred value:** Each year, the remaining 50% of the 'bonus pool' is carried forward. These deferred amounts will therefore roll over to the subsequent years. As the plan is closing, following the addition of the current year's earned bonus to the individual's bonus pool, 50% will be paid in July 2022, with the remaining 50% paid in July 2023, subject to the rules of the bonus scheme.

Measures used in the Incentive and Retention Plan

During the year, the Remuneration Committee identified and operated both customer and value performance measures in the Incentive and Retention Plan. The customer performance measures for 2021–22 were focused on issues that affect customers such as:

- Customer satisfaction, as measured by our C-MeX performance
- Delivery of our business plan commitments, as measured by our in-year ODI performance
- A number of measures aimed at delivering financial performance of the company
- Delivery of measurable milestones as set out in our environment plan, which was approved by the Board in March 2021
- Progress against the PR19 maturity assessment and our S19 undertakings.

Value metrics for 2021–22 included a number of KPIs, all of which underpinned performance improvement.

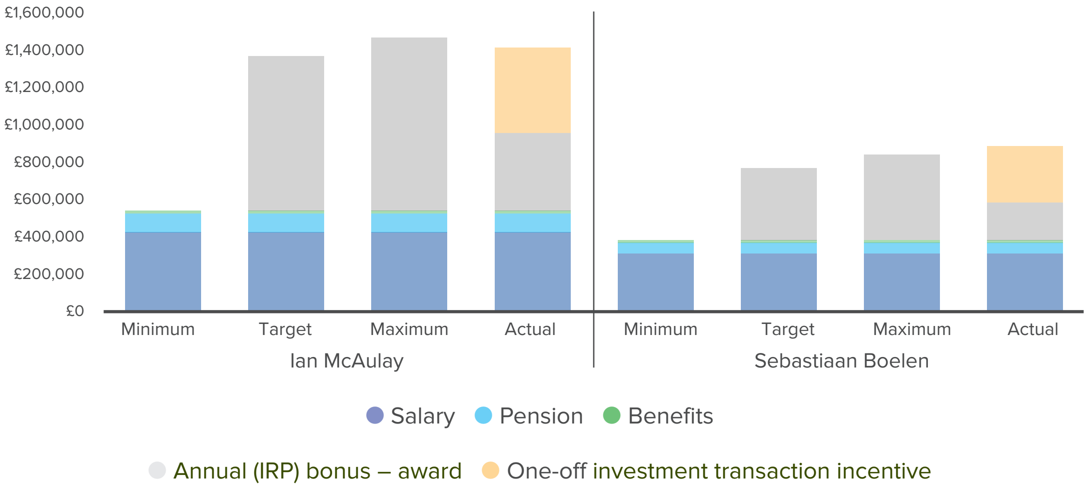
An executive leaving the company will only be eligible for release of any deferred incentives if they are deemed as a 'good leaver' and meets specific targets prior to departure.

An individual is usually deemed to be a 'good leaver' if they leave the company in the following circumstances:

- Retirement
- Redundancy
- Disability
- Death
- Other circumstances which the committee deems appropriate.

Remuneration scenarios for 2021–22

The following chart sets out the remuneration scenarios payable to the executive directors for various levels of performance as well as the actual remuneration for 2021–22, which includes the exceptional, one-off investment transaction incentive.



Notice periods for joiners and leavers

The table below sets out the contractual notice periods for the executive directors. If the notice period is worked, no termination payment is payable, otherwise a payment up to a maximum equivalent to the notice period of basic salary, pension and car allowance is payable.

	Notice period
Ian McAulay, CEO	12 months by either party
Sebastiaan Boelen, CFO	Six months by either party

Ian McAulay was replaced as CEO by Lawrence Gosden on 1 July 2022. Sebastiaan Boelen will be leaving the company later in July 2022 to be replaced by Nadim Ahmad as Interim CFO. Details of the final remuneration arrangements for Ian McAulay and Sebastiaan Boelen, and the remuneration of their successors will be reported in the Annual Report for 2022–23.

Directors' Remuneration Report

Annual remuneration report

Single figure of remuneration for 2021–22 (audited)

Details of the remuneration received by the executive directors are shown below. The figures shown are the amounts paid or awarded for each of these financial years. Base salary is generally reviewed in July each year and so the amounts reported for base salary reflect a part-year effect of any pay award granted.

£'000		Base salary paid	Benefits	Annual Bonus/ Incentive and Retention Plan[1]	Investment transaction incentive[2]	Total	Pension related benefit	Total including pension
Ian McAulay	**2021–22**	**435.0**	**18.5**	**435.0**	**435.0**	**1,323.5**	**78.3**	**1,401.8**
	2020–21	435.0	18.2	550.9	–	1,004.1	78.3	1,082.4
Sebastiaan Boelen	**2021–22**	**302.3**	**14.6**	**234.8**	**300.0**	**851.7**	**45.3**	**897.0**
	2020–21	300.0	14.4	290.8	–	605.2	45.0	650.2

1 The amount reported is added to the bonus pool for the year as shown in the table under Incentive and Retention Plan on page 188. That table also provides details of payments made from the bonus pool and that carried forward to future years.

2 The executive directors were incentivised to support a successful outcome to the investment transaction whereby Macquarie Asset Management invested £530 million to recapitalise the company.

Notes to the single figure of remuneration (unaudited)

Base salary

The base salary for Ian McAulay was reviewed on 1 July 2021 and, as in previous years, at Ian's request (which was supported by the Board), remained unchanged from the 1 July 2018 level of £435,000. The base salary for Sebastiaan Boelen was reviewed on 1 July 2021, a 1% increase was applied, increasing his salary from £300,000 to £303,000 per annum. Salary was paid monthly via PAYE.

Incentive and Retention Plan (customer and value metrics)

The performance measures agreed by the Committee for 2021–22 were:

- In-year ODIs – delivery of performance commitments
- ODIs RIF (minus C-MeX and D-MeX) – total five-year forecast position
- Retail cost to serve (retail Totex), including bad debt – efficient delivery of the operational promises made to customers as part of our business plan
- C-MeX – incentivises excellent customer experience for residential customers across the retail and wholesale parts of the value chain
- D-MeX – incentivises excellent customer experience for developer services (new connections) customers
- Environment – building our future environmental plan
- Gallup Q12 people rating – colleague engagement
- Health, Safety, Security and Wellbeing – ensuring our employees are kept safe and healthy at work
- TCC Opex – total expenditure within plan
- Capital Delivery TCC capex – total expenditure within plan
- Non-Capital Delivery TCC capex – total expenditure within plan
- Progress against PR19 Maturity Assessment and Section 19 Plan – progress against the commitments agreed with Ofwat to ensure we robustly manage performance to avoid further regulatory breaches
- Net operating cash flow – cash generation.

The performance for 2021–22 was assessed by the committee in May 2022. Details of the maximum bonus achievable, targets and outturn percentage for each executive director are shown in the tables below.

CEO	Maximum bonus achievable	Outturn %	Outturn as a % of salary
Customer targets	100%	24.32%[1]	24.32%
Value targets	100%	87.92%	87.92%
Discretionary adjustment applied			**-12.24%[2]**
Total outturn as a percentage of salary	**200%**		**100.00%**

1 Includes discretionary reduction of the overall achievement against one of the customer metrics in light of the Company's forecast ODI performance to the end of the current five-year investment period being below levels anticipated at the end of 2020–21. The reduction was equal to the percentage bonus award earned in 2020–21.

2 To reflect the committee's discretion to recognise the overall outcome for customers and other stakeholders against the calculated achievement of KPIs as well as the anticipated reduction in the company's Environmental Performance Assessment to one star.

CFO	Maximum bonus achievable	Outturn %	Outturn as a % of salary
Customer targets	80%	24.32%[1]	19.45%
Value targets	75%	87.92%	65.94%
Discretionary adjustment applied			**-7.89%[2]**
Total outturn as a percentage of salary	**155%**		**75.5%**

1 Includes discretionary reduction of the overall achievement against one of the customer metrics in light of the Company's forecast ODI performance to the end of the current five-year investment period being below levels anticipated at the end of 2020–21. The reduction was equal to the percentage bonus award earned in 2020–21.

2 To reflect the committee's discretion to recognise the overall outcome for customers and other stakeholders against the calculated achievement of KPIs as well as the anticipated reduction in the company's Environmental Performance Assessment to one star.

Directors’ Remuneration Report continued

The overall bonus awarded across the business of 50.00% is the weighted average of the customer and value target performance shown above. The outturn as a percentage of salary is calculated by multiplying the maximum bonus achievable by the outturn percentage.

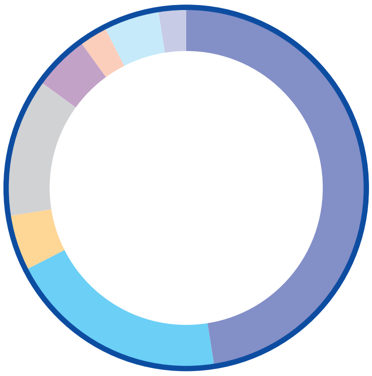
Incentive and Retention Plan 2021–22	2021–22	Threshold performance level	Target performance level	Stretch performance level	Performance[1]	CEO weighting (% of salary)	CFO weighting (% of salary)	CEO pay-out (% of salary)	CFO pay-out (% of salary)
In-year ODIs	Performance	-£24.25m	-£23.1m	-£20.79m	-£37.4m	30.0%	24.0%	0.0%	0.0%
	Bonus percentage	80%	100%	150%					
ODIs RIF (minus C-MeX and D-MeX)	Performance	-£81.4m	-£74.4m	£66.96m	-£88.9m	10.0%	8.0%	-10.20%[2]	-8.16%[2]
	Bonus percentage	80%	100%	150%					
Retail cost to serve (Retail Totex), excluding Bad Debt	Performance	£69.08m	£62.8m	£56.52m	£64.4m	15.0%	12.0%	14.24%	11.39%
	Bonus percentage	80%	100%	120%					
C-MeX	Performance	15th	14th	13th	16th	17.5%	14.0%	0.0%	0.0%
	Bonus percentage	75%	100%	120%					
D-MeX	Performance	14th	13th	12th	14th	7.5%	6.0%	5.63%	4.50%
	Bonus percentage	75%	100%	120%					
Environment (Progress against plans)	Performance	n/a	Satisfactory	Excellent	Satisfactory	10.0%	8.0%	10.0%	8.0%
	Bonus percentage	0%	100%	120%					
Gallup Q12 Colleague Engagement	Performance	3.89	3.95	4.00	3.93	5.0%	4.0%	4.65%	3.72%
	Bonus percentage	80%	100%	120%					
Health, Safety & Wellbeing	Performance	90%	95%	100%	74%	5.0%	4.0%	0.0%	0.0%
	Bonus percentage	80%	100%	120%					
Total Controllable Costs (TCC) Opex	Performance	£489.56m	£445.05m	£400.55m	£467.91m	30.0%	22.5%	26.92%	20.19%
	Bonus percentage	80%	100%	120%					
Capital Delivery TCC Capex	Performance	£352.91	£336.11	£319.31	£293.39m	15.0%	11.25%	15.0%	11.25%
	Bonus percentage	80%	100%	120%					
Non-Capital Delivery TCC Capex	Performance	£233.68m	£212.43m	£191.19m	£245.96m	15.0%	11.25%	0.0%	0.0%
	Bonus percentage	80%	100%	120%					
Progress against PR19 Maturity Assessment	Performance	Satisfactory progress	Good progress	Excellent progress	Good progress	10.0%	7.5%	10.0%	7.5%
	Bonus percentage	80%	100%	120%					
Progress against Section 19 Plan	Performance	Satisfactory progress	Good progress	Excellent progress	Excellent progress	10.0%	7.5%	12.0%	9.0%
	Bonus percentage	80%	100%	120%					
Net operating cash flow	Performance	-£232.54m	-£211.40m	-£190.26m	-£131.0m	20.0%	15.0%	24.0%	18.0%
	Bonus percentage	80%	100%	120%					
Total								**112.24%**	**85.39%**
Discretionary adjustment								-12.24%[3]	-7.89%[3]
Total awarded								**100.0%**	**77.5%**

1 Where the performance has been based on the latest forecast position available at the time, any subsequent changes to the final outcome position will be adjusted for in the following performance year and in accordance with the IRP scheme rules.

2 This KPI was intended to continue to motivate and stretch the executive to develop a viable plan to minimise ODI penalties for the whole five-year period, even if they were missing out on the short term. In 2020–21 a credible plan saw the ODI forecast penalty over the five-year period to be in-line with the original business plan levels. This earned a bonus award of 10.2%. For a number of reasons (weather included), the ODI target for the year was missed and the plan for the remainder of the five-year period is no longer hitting the cumulative target. In light of this, the remuneration committee exercised its discretion by applying a negative 10.2% pay-out for the ODI RIF in the current year, effectively reversing that earned for ODI RIF in 2020–21.

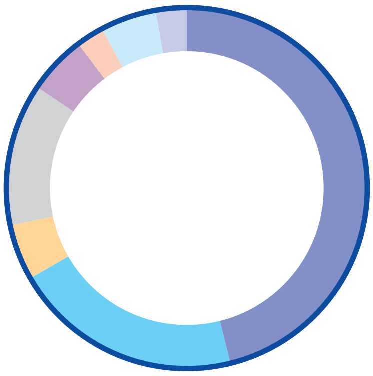
3 To reflect the committee’s discretion to recognise the overall outcome for customers and other stakeholders against the calculated achievement of KPIs as well as the anticipated reduction in the company’s Environmental Performance Assessment to one star.

CEO Bonus distribution



- Customer-focused financial performance
- Performance commitments
- Environment
- Customer service
- Preparation for 2020–25
- Employee engagement
- Section 19 plan
- Health, Safety, Security and Wellbeing

CFO Bonus distribution



- Customer-focused financial performance
- Performance commitments
- Environment
- Customer service
- Preparation for 2020–25
- Employee engagement
- Section 19 plan
- Health, Safety, Security and Wellbeing

The threshold, target and stretch bonus percentages shown reflect the level of bonus award for achievement of the threshold, target and stretch performance levels for each metric.

Incentive and Retention Plan Contribution 2021–22	(a) Bonus pool brought forward (£'000)	(b) Bonus awarded in year (£'000)	(c) Bonus paid out (£'000) (50%)	(d) Bonus pool carried forward to be paid in 2023 (£'000) (50%)
Ian McAulay	513.6	435.0	474.3	474.3
Sebastiaan Boelen	224.0	234.8	229.4	229.4

The amounts paid out (c) and carried forward (d) are each calculated as ((a) + (b)) ÷ 2. The closure of the Incentive and Retention Plan means that the balance of an individual's bonus pool will be paid in July 2023.

Pension contributions

The pension contribution for the executive directors is set out in the table below:

Pension	Salary received (£'000)	Pension contribution as a % of base salary	Cash allowance in lieu of pension (£'000)	Pension contribution to scheme (£'000)	Total Pension related benefit (£'000)
Ian McAulay	435.0	18%	74.3	4.0	78.3
Sebastiaan Boelen	302.2	15%	31.1	14.2	45.3

Following the closure of the company's defined benefit pension scheme to future accrual and the introduction of a new defined contribution scheme for the company's workforce, the Remuneration Committee reviewed the pension contribution payable to the executives. In doing so, the Remuneration Committee also considered the expectation in Provision 38 of the UK Corporate Governance Code that the pension contributions payable to the executive directors are aligned to that of the workforce. Accordingly, it was agreed that from 1 April 2020, the employer pension contributions offering for new executive director appointments would be aligned to the 'all employee' rate of 11%.

Directors' Remuneration Report continued

Non-executive director fees for the year (audited)

The Chair and the non-executive directors each receive a fee and do not participate in any performance-related incentive arrangements. The investor-nominated non-executive director does not receive any remuneration from the company.

The Board as a whole is responsible for setting the level of non-executive director fees and in doing so receives input from the Remuneration Committee.

Details of the emoluments received by the Chair and non-executive directors are shown below:

	2021–22			2020–21		
£'000	Fees	Other	Total	Fees	Other	Total
Keith Lough (Chair)	**275.0**	**3.9**	**278.9**	275.0	7.7	282.7
Paul Sheffield (Senior independent non-executive director)	**70.0**	**0.6**	**70.6**	70.0	0.0	70.0
Rosemary Boot (Independent non-executive director)	**50.0**	**1.1**	**51.1**	50.0	0.2	50.2
Mike Putnam (Independent non-executive director)	**60.0**	**0.6**	**60.6**	60.0	1.4	61.4
Dame Gillian Guy DBE (Independent non-executive director)	**50.0**	**0.3**	**50.3**	50.0	0.0	50.0
Kevin McCullough (Independent non-executive director)	**65.0**	**0.7**	**65.7**	65.0	2.3	67.3
Malcolm Cooper (Independent non-executive director)	**65.0**	**0.7**	**65.7**	65.0	0.8	65.8
Marykay Fuller (Greensands Board-nominated non-executive director) (from 15 June 2020 to 8 September 2021)	**26.3**	**0.1**	**26.4**	47.7	0.4	48.1
Martin Bradley (Investor-nominated non-executive director) (from 8 September 2021)	**–**	**–**	**–**			
Will Price (Investor-nominated non-executive director) (from 8 September 2021)	**–**	**–**	**–**			
Mark Mathieson (Investor-nominated non-executive director) (from 8 September 2021)	**–**	**–**	**–**			
Sara Sulaiman (Investor-nominated non-executive director) (to 8 September 2021)	**–**	**–**	**–**	–	–	–

The base fees for the non-executive directors are £50,000.

In May 2022, the Remuneration Committee reviewed the fees paid to the Chair and independent non-executive directors, comparing the fee data between 2014–15 and 2020–21 of a number of other companies in the sector. Following this review, the Remuneration Committee agreed to increase the Chair's fees from £275,000 to £290,000 with effect from 1 July 2022.

The same data was subsequently presented to the Board at its May meeting, at which it was agreed to increase the base fees of non-executive directors from £50,000 to £55,000 per annum with effect from 1 July 2022, noting that there had been no increase since 2014. The Board also agreed that a responsibility supplement should be paid to the Chair of the newly-formed ESG Committee, Rosemary Boot, with effect from 1 May 2022.

The table below provides details of applicable responsibility payments for 2021–22.

	Current Chair and date appointed	Responsibility supplement	Comments on supplement
Audit Committee Chair	Malcolm Cooper 23 December 2019	£15,000	Increased from £10,000 with effect from 1 July 2019
Health, Safety and Operational Risk Committee Chair	Mike Putnam 1 July 2019	£10,000	Introduced with effect from 1 July 2019
Remuneration Committee Chair	Paul Sheffield 1 April 2015	£10,000	Introduced with effect from 1 October 2018
Senior independent non-executive director	Paul Sheffield 1 July 2015	£10,000	With effect from 1 August 2015
Workforce non-executive director	Kevin McCullough 26 February 2020	£15,000	Role introduced with effect from 26 February 2020
Greensands Board-nominated director	Marykay Fuller 15 June 2020 to 8 September 2021	£10,000	With effect from 15 June 2020

The other amounts payable to the non-executive directors include taxable expenses incurred in connection with attendance at Board meetings and shareholder events.

None of the directors who held office during the financial year had any disclosable interests in the shares of Southern Water or the group; there are no share options in place and no payments were made to them by any other group companies.

Gender pay (unaudited)

Creating an environment to enable a diverse and inclusive workforce will have a positive effect on our organisation and this is a key part of Southern Water's People Strategy.

This year there was an increase in the mean gender pay gap from 1.9% to 4.8%. The median gap also increased from -2.0% to -0.2%, a gap in favour of women. The increase was due to a number of senior roles being vacant in 2020 which were subsequently filled by men. We noted a small reduction in the mean bonus gap from 35.0% to 34.4%, and a reduction in the median bonus gap from 24.5% to 16.1%. We believe this is largely due to the actions taken in response to COVID-19 with the removal of performance measures being linked to bonus payment. With the reintroduction of this measure and based on our gender balance we expect this will widen the gap again in the 2022 report.

The company will continue to support the aspirations of its female employees, concentrating on further improvements in the areas of recruitment, talent development and remuneration as well as policies which further support colleagues to achieve a balance of work with family commitments. For more information, see the report on our gender pay gap at **southernwater.co.uk/gender-pay-gap**.

Creating a workplace where all of our people feel they belong

We have deliberately designed our diversity and inclusion approach and outcomes to be understandable, actionable and deliverable. We have created a clear vision that communicates our intent to consciously recognise and value our differences, ensuring that all of our people feel they belong and that we succeed together. So far we've made significant progress against our action plan and have welcomed external recognition through our improvement in the Inclusive Top 50 UK Employers list where we moved from 49th to 46th within 12 months. In terms of pay, we are committed to ensuring that we have a fair pay structure and that we have processes in place to make sure we have a consistent and fair approach. We recognise that while we do not have all the answers, we are keen to learn and grow, valuing the different experiences and perspectives that our people bring.

Directors' Remuneration Report continued

Executive pay gap reporting

From 2020 onwards, the Companies (Miscellaneous Reporting) Regulations 2018 require all publicly-listed companies with more than 250 UK employees to publish the ratio between their CEO's full-time equivalent remuneration and that of employees at the 25th, 50th and 75th percentile when total remuneration is calculated and ranked from highest to lowest.

Although not a listed company, Southern Water has chosen to publish this information in line with our commitment to providing information about pay diversity and fairness within our organisation.

The regulations set out three options for calculating the pay ratio.

- Option A – takes into account all forms of remuneration and payments (pension etc)
- Option B – uses the gender pay calculation figures
- Option C – uses some other method

Our ratio has been calculated using 'Option A' as this takes into account full remuneration and is therefore the most comprehensive comparison.

Year	Method	25th Percentile Ratio	50th Percentile Ratio	75th Percentile Ratio
2021	A	**43.4:1**	**34.3:1**	**26.6:1**
2020	A	27.3:1	22.0:1	17.2:1

We have seen an increase in our Executive Pay Gap this year. This is in relation to a small number of executives, including our CEO and CFO, who were incentivised to support the investment transaction.

Implementation of policy for 2022–23 (unaudited)

Base salary

The base salary for the new CEO and CFO will be reported in next year's annual report.

The revised base salaries for each executive director are as follows:

Base salary	Base salary for 2021–22 (£'000)	Base salary increase (%)	Base salary to 30 June 2022 (£'000)
Ian McAulay	435.0	0%	435.0
Sebastiaan Boelen	303.0	n/a	n/a

Annual Bonus Plan and Long Term Incentive Plan

The Annual Bonus Plan will be based on performance conditions designed to focus the executive directors on the areas of key strategic importance for the company. As such, the performance conditions will be strongly aligned with delivering customer and environmental outcomes and associated appropriate behaviours, while ensuring that the company continues to strengthen its financial position in the interests of customers and stakeholders alike.

We have fully committed to comply with Ofwat's code of practice for executive remuneration for 2020–25 and our Remuneration Policy sets out:

- our policy to provide transparent alignment between executive performance-related pay and stretching outcomes for all our stakeholders and, substantially, for our customers
- our policy to apply stretching targets linked to customer outcomes
- our policy to apply rigorous application of incentive scheme rules and provide independent governance of remuneration decisions, while taking into consideration risk management principles
- our policy to defer an element of bonus so that performance can be measured over the medium to long term.

Our performance measures for 2022–23 will focus on positive outcomes for our customers and other stakeholders

In determining the performance measures for 2022–23, the Remuneration Committee considered the expectation under the Ofwat Principles that the company's performance-related elements should be linked to stretching delivery for customers, as well as the steps needed to further embed the Ofwat code of practice for executive remuneration. It was agreed that the following measures will be used to assess our performance:

Annual Bonus Plan objectives

- 4 x Ofwat PR19 ODI performance commitments (Pollution incidents; Internal sewer flooding incidents; Leakage; C-MeX score)
- 2 x Health, Safety, Security and Wellbeing (Lost time accident frequency rate and progress on actions set out in the Health and Safety Transformation Plan)
- Controllable Opex
- Role-specific objectives

LTIP objectives

- ODIs
- 2 x Delivery of Customer plans (Capital scheme completions; Achievement of regulatory outputs)
- Delivery of five strategic projects
- 2 x Environment
- 3 x PR24 Outcomes

Weightings and targets, along with actual performance, will be fully disclosed in the 2022–23 Remuneration Report.