

Appendix 2 : Interim statement of Glas Cymru Policy for the Remuneration of Directors

Introduction

This interim statement of remuneration policy will be updated once the current review of Welsh Water's business plan for the period to 2005 is complete. Targets will be set by the remuneration committee of the Board which, in the light of the business plan, are challenging and focused on the priorities for the business determined by the Board.

Overview

The Board of Glas Cymru intends to implement a remuneration policy for executive directors which will create strong incentives to deliver benefits to water and wastewater customers.

Governance

The remuneration committee of the Board is responsible for making recommendations to the Board on the framework for executive remuneration and incentivisation lies with the remuneration committee. The committee comprises all the non-executive directors of the Board, all of whom are independent of the company management and none of whom have any financial interest in Glas Cymru other than fees paid to them as non-executive directors. The committee is chaired by Alison Carnwath, and has taken independent benchmarking advice from Hewitt Associates. The committee will ensure that the necessary disclosures are made in respect of remuneration policy and directors' remuneration.

These arrangements are consistent with the "Combined Code" of the London Stock Exchange. Under a new modification to its licence, the company is required to apply the Combined Code as far as is practicable.

Objective

The overall objective of the remuneration policy is to attract, retain, and motivate managers of the required calibre, in particular to apply incentive arrangements which align the interests of the individual with the interests of customers over the long term.

Executive Directors' Remuneration

In order to meet this objective for the executive directors' remuneration packages, the remuneration committee decided that a high proportion of maximum pay should be "at risk".

Specifically:

- base salary would be fixed initially below market levels (at or around lower quartile) by comparison with industry benchmarks;
- bonus arrangements would incentivise Directors and managers across a wide range of performance measures; and
- the proportion of base salary represented by maximum bonus would be set well in excess of market norms, so that the levels of maximum and achievable bonus would broadly align total remuneration with average remuneration paid by comparable companies.

Accordingly, the committee has fixed remuneration levels for executive directors in 2001/02 as follows:

Managing Director Basic Salary £175,000
Executive Directors Basic Salary £125,000

Basic salary will be reviewed annually by the committee. Maximum bonus is capped at 100% of basic salary.

Half of annual bonus will be payable immediately. The other half will be deferred for three years, but will be forfeited in the event that employment ceases in the meantime. Executive Directors have service contracts that are subject to twelve-month notice of termination.

Incentive Arrangements

Half of maximum bonus will be based on financial performance (measured by the growth in financial reserves). The other half will be based on how well the company delivers services to customers. Each will be capped so it can contribute no more than 50% of maximum bonus potential.

Generation of financial reserves: growth in reserves has been chosen as one of the prime measures for incentivising management because it best captures the fundamental dynamics on which Glas Cymru's proposals have been developed. Improved performance and efficiency in the way the business is financed and operated will all be captured by growth in financial reserves. Since the main use of reserves will be to deliver lower bills to the customer, this is a direct and simple way of aligning the interests of directors and managers with those of customers.

Improved service to customers and the environment: The performance of directors and managers will be assessed against the "overall service performance" assessed and published by Ofwat annually for all water companies in England and Wales. This independent assessment of the company's performance across a wide range of customer service measures provides an uncomplicated framework which rewards improvement in performance compared with the previous year (reflected in Welsh Water's ranking) or penalises any deterioration in performance.

The non-financial performance assessed by Ofwat include:

- Water supply targets (e.g. interruptions to supply, restrictions on supply, and drinking water compliance)
- Sewerage measures (e.g. sewage flooding incidents and quality of effluent discharges to the environment)
- Customer service measures (e.g. speed of response to billing enquires and written complaints).

Other benefits

Executive Directors' have the use of an expensed company car and mobile telephone. They also benefit from participation in Welsh Water's pension and medical and life insurance schemes. Details of these benefits will be set out in the Annual Report to Members of Glas Cymru for 2001/2002.

Non-executive directors

The Board has also fixed the fees payable to the chairman and the non-executive directors for the next two years as follows.

Chairman: £140,000

Non-executive Directors: £ 35,000

Non-executive directors will receive no additional fees for membership of board committees or the undertaking of special responsibilities. They do not have contracts of service, nor do they receive any taxable benefits in kind (e.g. pension or health care benefits). However, the company reimburses reasonable expenses incurred by non-executive directors in carrying out their duties.