

tie Limited

Paper to : tie Remuneration Committee

Subject : Bonus Proposals – Approval of Terms of Reference

Date : September 2009

1. Introduction

This paper sets out two important areas of reward strategy for consideration by the Committee.

The first provides an update on our approach to benchmarking salaries against the wider market for similar jobs thereby ensuring that **tie** is rewarding employees at the appropriate level. The second area is that of bonuses and this paper proposes a revised bonus scheme for immediate implementation, subject to proper consultation, including the concurrence of the CEO, Edinburgh City Council.

2. Salary and Total Reward

The Issues

At present internal and external appointment salaries are determined by internal comparisons or with the help of data supplied by recruitment consultants. Roles are not objectively evaluated.

This could lead to a position where internal comparisons compound previous errors and where reliance upon recruitment consultants' advice leads to salary inflation.

Clearly it is not in **tie's** interest to either over or underpay and consequently we are embarking upon a market survey to ensure that we are providing value for money and protecting ourselves from legal challenges to our pay structures in the context of pay equality legislation.

It is worth noting some particular issues affecting **tie's** current position, notably;

- **tie** offers basic salary and a final salary pension scheme
- **tie** does not offer any other benefits such as healthcare, company car or allowance, or equity options
- **tie** does not offer any long term security and only limited career progression
- **tie** does offer a bonus plan for all staff, differentiated by seniority.

Proposed Solution

We have now started a benchmarking exercise with the support of HAY reward consultants. This relatively straightforward activity will see twenty one jobs evaluated and used as market benchmarks. The other jobs in tie will be slotted alongside these roles by the Executive Committee.

This activity will enable salaries, bonuses and benefits to be benchmarked to the market.

It is anticipated that this activity would be completed by December 2009 and the likely cost is £2,500.

3. Bonus/incentive scheme

The current incentive scheme provides for bonus payments driven mainly by achievement of individual objectives. There are two levels of bonus payment – up to 50% of salary for 16 senior employees and up to 25% of salary for the remaining employees.

As was the case in 2008/2009 the fact that bonuses were linked to personal objectives with insufficient account given to company objectives could have given rise to a situation where individual bonus moved towards the top end of the award range in circumstances where, for whatever reason, the company was not meeting its stated objectives.

It is proposed therefore, to formally revise the incentive scheme, to one which is much more heavily weighted towards the project outcomes. The revised scheme is also designed to increase the retention effect with a much greater proportion of the total award deferred until project completion.

In addition, there is little evidence of effective performance management within the organisation and the revision of the scheme is an opportunity to increase the focus on performance management. The revised scheme will therefore be accompanied by a much more structured approach to management of performance.

It is also proposed that there will be two incentive schemes, Scheme 1, for the most senior company managers and Scheme 2 for all others.

Fundamentally, Scheme 1 is a “life time of project” plan whilst Scheme 2 is an annual incentive plan with a deferred element, nonetheless there are a number of characteristics which the plans share in order to encourage “top to bottom” organisational alignment.

- Both schemes will be based on a mix of personal performance and company performance measures against cost, programme and KPIs.
- Both schemes will use the same basket of project KPIs
- Both schemes will be based on a % of salary
- Both schemes will require a degree of subjective assessment/discretion by the Remco
- Scheme 1 only pays out after the Open for Revenue Service (ORS) date, whereas scheme 2 has a mix of annual payments and payments linked to ORS

5. KPIs

Both schemes rely on performance against a basket of KPIs. The 4 areas in this basket will be;

- Safety
- Operational readiness
- Stakeholder support
- Team culture

By their very nature these targets are subjective. It is proposed that management presents to the Board (both annually and at project completion) their assessment of the extent to which the targets have been met. The Board will be invited to approve this assessment or amend it at its discretion. An independent assessment to assist the Board and the CEO of CEC in their deliberations will be arranged if required.

6. Scheme 1, Senior Director Scheme

As previously stated, this is a “life of project” scheme and is applicable to the following:

- CEO
- 6 Executive Committee members (although one is currently a consultant, and one is currently an interim so these two individuals will not be eligible)
- Infracore director
- Commercial Director
- Deputy Project Director

(It should be noted that there are 6 individuals who are currently on a 50% bonus scheme who we propose will not be eligible for the revised 50% scheme and would be moved onto the new scheme 2. This will create some challenges and risks)

Under Scheme 1 there will be no bonus paid until the project achieves open for revenue status and only then if ORS is achieved within the agreed cost and timing criteria (as set out in Appendix 1).

Final payout for Scheme 1 will be based on a maximum of 50% of the total cumulative salary from the ‘Start Date’ to the ‘Payment Date’ (as defined later) subject to achievement of objectives, as determined by the Remco. The bonus percentage will be based on performance against 4 areas of the business, weighted as shown below;

- a. 35% cost
- b. 35% time
- c. 15% business KPI's
- d. 15% individual performance

Achievement against each of the targets a, b, & c will be determined by the Remco in accordance with the tables in appendix 1 and 2, and may be subject to audit at the Remco's discretion. It is recommended that achievement against the cost targets is determined in consultation with the Chair of the Audit Committee.

Achievement of personal objectives under d. will be at the discretion of the CEO and chairman, except for the CEO, whose performance will be assessed by the chairman and Remco. Our objective will be to assist the RemCo in its deliberations by the provision of a robust framework of measurement and evaluation criteria.

In the event that either cost or timetable targets are not achieved then the entire bonus is forfeit. In such a circumstance the RemCo may wish to consider emergency retention arrangements to ensure that the organisation retains the required expertise to complete the project.

'Start Date' will be 1/04/09 or such later date as an individual may join the organisation, or be invited to join the scheme.

'Payment Date' will be two complete calendar months after ORS and the date used for the calculation of cumulative salaries, unless another later date is agreed between the company and the individual.

Worked example 1 senior director

Assumptions

Employee annual salary £100,000

Max possible bonus 50%

Start date 1/4/09

Project complete at £575m on 31st May 2012 (see appendix 1 for scoring)

Payment date 31st July

Project Completion KPI (PCKPI) score 80% (as assessed by RemCo)

Personal score 76% (as assessed by CEO/Chair)

Calculations

Total eligible salary £100,000 x 3 years and 4 months (3.33 years) = £333,000

Cost element of bonus 75% x 35% weighting = 26.25%

Date element of bonus 75% x 35% weighting = 26.25%

PCKPI score 80% x 15% weighting = 12%

Personal score 76% x 15% weighting = 11.4%

% of possible maximum bonus is 26.25 + 26.25 + 12 + 11.4 = 75.9%

Bonus £333,000 x 50% x 75.9% = £126374

What if?

- **An individual leaves the business before the 'Payment Date'?**
It depends if they are a good leaver or not. Good leavers will have any bonus entitlement frozen at the date of leaving, but they will not be paid until the payment date, and any payment will still be subject to the same performance test as if they had not left the company. Examples of good leavers are:

Anyone made redundant
Anyone who transfers to TEL or Lothian Buses at the company's request.
Anyone who retires on the grounds of age or ill health

If people leave for any other reason they will have no entitlement to any bonus.
- **The cost or date targets become unachievable and have to be reset?**
At the time the Board agree to resetting of targets, the 'Start Date' is reset and any bonus is calculated using the new 'Start Date' and the new targets. Any resetting of cost and date targets will also affect the deferred element of scheme 2 (see below for more information).
- **ORS is achieved but there is no clarity of the likely final cost? (e.g. there are major claims still to be settled)**
Remco will make an assessment of the likely outcome of the cost debate and make an award on that basis. The Remco may opt to make a conservative interim award until such time as it is confident that it can achieve sufficient certainty.

7. Scheme 2

This is an annual bonus scheme with an element of deferral and is open to all permanent employees who are not eligible to participate in Scheme 1. Temporary, fixed term and contract staff will not be eligible.

Scheme 2 offers the possibility to earn a maximum bonus of up to 25% of salary, with 15% (being 60% of the of 25%) awarded and paid annually based on personal performance and company performance, and 10% (being 40% of 25%) deferred until 'Payment Date', and subject to personal and company performance.

Annual award and payment

At the end of each financial year each employee's performance will be assessed against the personal objectives agreed between them and their line manager. The process for setting personal targets, and assessing performance against them is the subject of a separate piece of work on enhancing our approach to performance management.

The output of this annual appraisal will be a Personal Performance Score (PPS%) for each individual.

At the end of each financial year the Board will agree how well the business is performing against its corporate objectives (as set out in appendix 1 – cost and programme, and appendix 2, KPIs). This will give rise to the Annual Corporate Performance Score (ACPS%)

The payment then made to the individual for that year will be:
Annual salary x 15% x PPS x ACPS

Deferred Award and Payment

The 10% deferred element of bonus will then be based on:
15% Average Personal Performance Scores since 'Start Date'
15% Project Completion KPI Score
35% Cost
35% Time

Worked example 2

Assumptions

Employee annual salary £40,000
Project complete at £575m, and on 31st May 2012.
Payment Date 31st July
Start date 1/4/09

Annual Bonuses Paid

09/10
PPS for 09/10: 78%
ACPS for 09/10: 80%
Bonus £40,000 x 15% x 78% x 80% = £3,744

10/11
PPS for 10/11: 73%
ACPS for 10/11: 70%
Bonus £40,000 x 15% x 73% x 70%=£3,066

11/12
PPS for 11/12: 76%
ACPS for 11/12: 65%
Bonus £40,000 x 15% x 76% x 65%= £2,964

Project completion bonus

Assumptions

Project complete at £575m on 31st May 2012 (see appendix 1 for scoring)
Payment date 31st July
Project Completion KPI (PCKPI) score 80% (as assessed by RemCo)

Calculations

Average PPS: $78+73+76=227/3 = 75.66\%$, weighting 15%	= 11.35%
Project Completion KPI Score = 80%, weighting 15%	= 12%
Cost bonus 75% weighting 35%	= 26.25%
Date bonus 75% weighting 35%	= 26.25%
Total % of maximum achievable	77.85%

Project Completion Bonus Value
Cumulative salary $\text{£}40,000 \times 3.33 = \text{£}133,200$
Deferred bonus maximum allowable: 10%
Combined performance score: 77.85%
Bonus $\text{£}133,200 \times 10\% \times 77.85\% = \text{£}10,370$

Total bonuses paid $\text{£}3,744 + \text{£}3,066 + \text{£}2,964 + \text{£}10,370 = \text{£}20,144$

The Remuneration Committee is invited to approve this proposal.

Prepared by: George Bramhill

Recommended by: Richard Jeffrey

Date: 16th September 2009

Appendix 1

Bonus payout compared to achievement of targets

Cost (35% weighting)

£545m pays 100%

£575m pays 75%

£600m pays 0%

Intermediate figures calculate on a linear basis

Date (35% weighting)

Feb 2012 pays 100%

May 2012 pays 75%

Aug 2012 pays 50%

Nov 2012 pays 25%

Feb 2013 pays 0%

Intermediate dates calculate on a linear basis

Appendix 2 KPIs

Performance against each KPI will be assessed taking into account the measures set out against each KPI. For the annual assessment of performance against KPIs judgement will have to be used to establish progress/performance. At project completion the assessment will be based on actual performance against the board's expectations.

The KPI's below are draft only and are subject to agreement with the Board.

Safety KPI	Measurement
<p>Deliver the tram safely</p>	<p>There have been zero project fatalities and zero serious injuries with any degree of tie implication or lack of possible prevention or expected intervention. We have demonstrated improvement in our H&S performance during the project in the following areas</p> <p>Morale – Our Accident Frequency Rate is better than industry average Financial – We received no substantial claims or damages as a result of H&S incidents</p> <p>Legal – tie have not been prosecuted We are progressively demonstrating improvement against the deliver the tram safely strategy and the Annual Safety Plan targets:</p> <ul style="list-style-type: none"> • Improvement in the number uninjured workers and members of the public • Minimising the financial value of claims and damages to services • Successful engagement and interface with the Regulatory bodies including no enforcement action.
<p>Deliver a safe tram</p>	<p>A “No Objection” to operate the Tram was given by the ICP (and/or) There are no temporary speed restrictions as a result of inadequate design or construction</p> <p>We are progressively demonstrating improvement against the deliver a safe tram strategy:</p> <ul style="list-style-type: none"> • Design is to an acceptable standard • Construction is to an acceptable design and quality • The ICP is engaged/ No major RFI's outstanding

Stakeholder Support	Measurement
Press Coverage, quantity of coverage and positive to negative article ratio	
Complaints that are received	
Feedback from stakeholder groups	
Feedback from politicians	
Any public opinion survey that may be available	

Operational Readiness	Measurement
Are plans in place and are they being delivered against	Plans for preparing for the tram are being progressed
Are staffing structures in place and is recruitment up to speed	<p>Organisation designed and clearly thought through with organisation design principles set from the start.</p> <p>Terms and conditions thoroughly researched into before recruitment begins.</p> <p>Appropriate recruitment process designed to attract the right candidates.</p>
Are health and safety issues properly covered	Health and safety procedures for tram operating in place.
Relationship with Lothian Buses	Integration of the buses and trams investigated and maximised. Integrated ticketing successful.
Successful opening day/first week/ first month	Public opinion surveys

Team Culture	Measurement
Develop the OEM	<p>Values for staff developed and visible in the organisation.</p> <p>Vision, objectives and strategies are widely communicated including to new starters and reviewed regularly.</p>
Performance Management	<p>All employees have a mid-year review and final appraisal</p> <p>Developmental discussions have taken place</p> <p>Objectives set within the month after financial year end for every employee. A stronger focus on performance management within tie.</p>
Leadership Development	<p>Leaders are assessed regularly on their performance against the values. ('how')</p> <p>The values are embedded in everything they do.</p> <p>Personal profiles for every employee.</p>