Independent review of Highways England's remuneration framework

Phase 1: Senior Group review

Final report

December 2018

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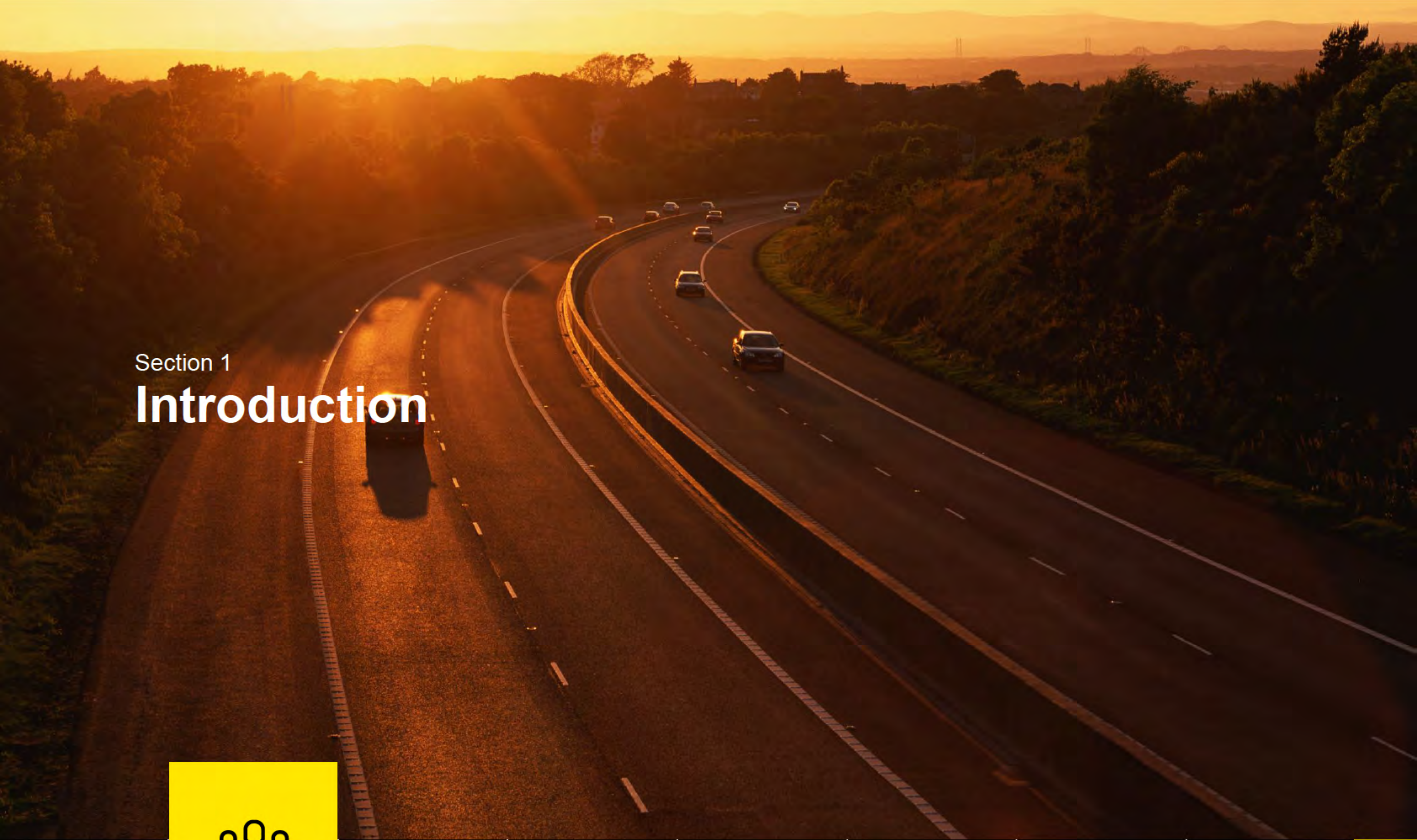
Section 1

Introduction



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Introduction

EY has been appointed by the Department for Transport ('DfT') to conduct an independent review of Highways England's (HE) remuneration framework. The purpose of this review is to establish whether HE's remuneration framework is working effectively, specifically in the context of the pay flexibilities and freedoms granted to HE on its establishment.

Following a light touch internal review of the remuneration framework (the 'Phase One review'), the scope of this review ('Phase Two review'), conducted independently by EY, is to assess the effectiveness of the remuneration framework with respect to:

1. Recruitment, retention and performance of HE employees to deliver the Roads Investment Strategy ('RIS');
2. The impact of HE's application of its pay flexibilities on the relativity of pay to other relevant DfT family and transport sector organisations;
3. Performance related pay ('PRP'), and consideration of the extent to which the PRP approach incentivises performance; and
4. The extent to which total remuneration levels reflect market conditions and represent value for money.

The 1st stage of the Phase Two review covers the Senior Group at HE only. The Senior Group comprises 90 employees in total - 80 'Senior 1', 9 'Senior 2' employees and the Chief Executive. The 2nd stage of our review will focus on the non-senior staff and is expected to be completed following the implementation of the new pay and grading framework at HE.

The 'Phase One review was completed by HE in April 2017 and focused on the practices applied by HE since the introduction of the new remuneration framework in areas such as managing specialist pay, pay inflation across the organisation, recruitment and reliance on contingent labour, and performance-related pay, among others. The Phase One review uncovered no issues of concern.

In our Phase Two review, we have undertaken a deep-dive analysis of the key areas reviewed in Phase One. It should be noted that the Phase One review covered the entire employee population, without presenting trends for the senior group specifically. Accordingly, we should be careful when seeking to compare Phase One outcomes with this report (as Phase One review covered a more expansive population).

Introduction (cont.)

The Phase Two review has been undertaken in accordance with the methodology set out below:

Step 1: Kick-off
- Project kick-off
- Discuss EY's request for information
- Data gathering

Step 2: Hypothesis building
- Understand business context and current reward framework
- Review findings from Phase One review
- Develop hypothesis
- Review gathered data

Step 3: Analysis and test
- Assess the effectiveness of HE remuneration framework
- Summarise results from the analysis and visualise key trends
- Identify potential causes

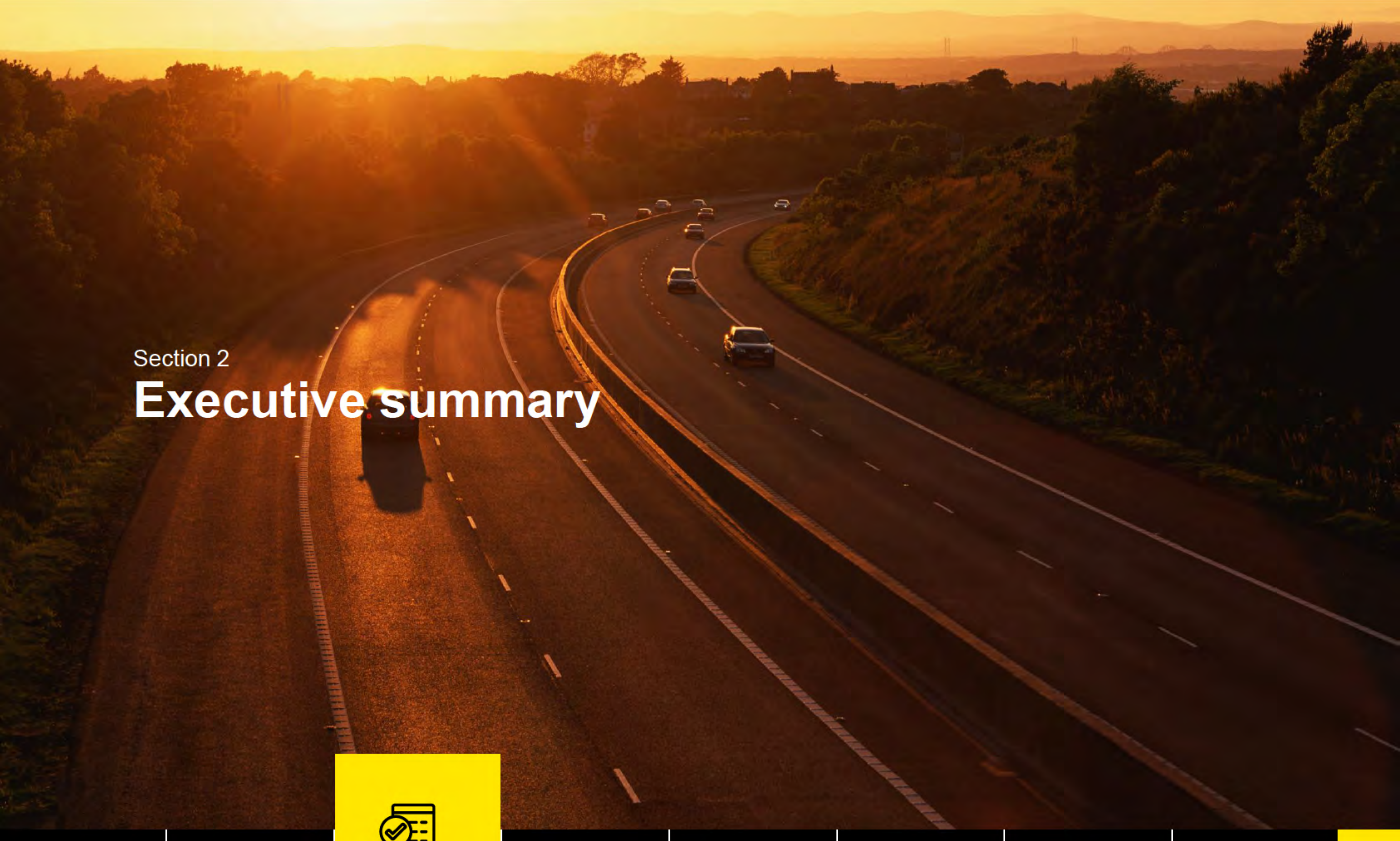
Step 4: Delivery of final report
- Develop high level practical and feasible recommendations for change
- Discuss recommendations with stakeholders
- Finalise report

This report covers the findings of Steps 2 and 3. We have reviewed information on current reward policies and practices over the past 3 years, provided by HE and DfT. For the purposes of this review, we have not split the HE senior population into specialist and non-specialist roles as it is not a categorisation currently used for that cadre of individual. Where the available data does not differentiate between senior and non-senior staff, we have assumed that the trends between the two populations are consistent.

HE has also provided additional context around the transformation it has undergone as an organisation following its establishment in 2015 and the impact this had on HR and reward practices. In particular, we understand that the strategic nature and long-term focus of the organisation has evolved significantly leading to the creation of new roles that were not required when HE was an agency (for example, capital portfolio directors, customer service directors and H&S directors) or increasing the scope and responsibilities of existing roles (for example, finance, legal and HR). We have intertwined this information with the findings of our quantitative review throughout this report, where relevant.

Section 2

Executive summary



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Executive summary (1/5)

Introduction

We have conducted a quantitative and qualitative review of HE's remuneration framework focussed on its Senior Group. The quantitative analysis was focussed on two key areas. First, to analyse key HR metrics, relevant to the ease with which HE (with pay freedoms) was able to attract and retain key talent and encourage its people to go the extra mile. These metrics could then be compared to a public sector organisation (without pay freedoms) to determine whether the pay freedoms made an identifiable difference. The second aspect was to analyse pay levels, pay inflation and the use of PRP to form a view on whether the overall spend on pay represented good value for money. The Senior Group comprises some 90 individuals – representing the most senior employees in an overall population of c.5,500. The key findings of this review are set out below.

Highways England remuneration philosophy and principles

The remuneration philosophy and underpinning remuneration principles of the organisation are fit for purpose. By this we mean that the stated intention of *how* HE wishes to pay its people, and *why*, makes sense given its purpose, positioning as a publicly funded entity and shareholder.

Implementation of the remuneration philosophy and principles

It is, of course, how the policy is implemented that matters. Our key findings in this regard are outlined overleaf.

Executive summary (2/5)

Salaries above the threshold of £142,500

- We have seen a high level of governance surrounding the use of the 10 posts with salaries above the pay threshold of £142,500. The documentation is clear and the sign off by the Remuneration Committee is appropriate.
- We have reviewed the rationale presented to justify the pay for a sample of the roles under consideration and each is clear. Our preference would be for any rationale presented in the future to follow a consistent methodology – built around the definition and justification for a 'specialist role' (see overleaf for more on this).
- We are of the view that these ten posts have been used proportionately and carefully.
- The business need for more posts at senior level is a management decision and, in our view, it should be driven by the strategic plan and the requirements for people at that level to deliver the plan. Based on our observations of the process and governance applied by the Remuneration Committee to date, we are comfortable that, should any additional roles be created, the justification for them and governance surrounding any eventual appointments would be of a high standard.
- We understand that there is a desire to increase the salary approval threshold from £142,500 to £150,000. We have no concerns with such proposed increase, as, in our view, the difference in quantum is not material and it may assist in the short term with the retention of employees with salaries around the £142,500 threshold.

Executive summary (3/5)

Specialist vs non specialist pay

- There is no concept of specialist pay used in the Senior Group. This means that pay levels for the totality of this group (with the exception of the ten roles referred to above) are set within a broad pay band of £66,000-£142,500. The positioning of each role within this pay band is determined by reference to benchmark pay data with an aim to not exceed a market median pay positioning.
- We are exploring with Dft and HE whether applying a different approach to setting specialist and non-specialist pay for the Senior Group was ever in contemplation.
- Either way, moving forwards we would recommend a different approach be adopted to the setting of specialist vs non-specialist pay. Where a role is considered to be specialist, we are comfortable that positioning base pay at the market median represents a sensible action to ensure the right candidates may be recruited and retained. In the absence of a role being determined "specialist", we would not expect roles to be necessarily positioned at a market median in base pay terms as a matter of course (unless there is an exceptional talent attraction/ retention issue).

Impact of remuneration framework on recruitment

- HE's senior team has grown significantly in the past 3 years, which demonstrates that pay freedoms have enabled HE to fill critical roles.
- The nature and complexity of HE roles creates the need for recruitment of candidates from outside the public sector, which is demonstrated by the high number of applicants from the private sector. However, based on the data provided, we also see that HE has hired a meaningful number of senior employees from the public sector. It is not clear from the data whether this outcome is coincidental or in some way a product of private sector candidates not being sufficiently attracted to the roles in question. Either way, going forward, we are of the view that public sector pay remains relevant to HE – particularly where the roles are not specialist in nature.

Executive summary (4/5)

Pay inflation

- Pay freedoms must logically increase pay levels across the organisation and HE data supports this. We observe an increase in average pay across the Senior Group, which is in part driven by recruitment activity. It is also impacted by the change in job size of certain existing roles following the establishment of HE, the change in complexity of certain existing roles as a consequence of HE becoming a corporate entity and HE's desire to align senior pay closer to the market median (to seek to retain key individuals who may otherwise have been at risk of leaving). As such, discretionary pay increases were approved by the Remuneration Committee and awarded to existing employees where one or more of these factors were relevant.
- This practice has been applied across the entire senior population, without a specific differentiation between specialist or non-specialist roles. As stated above, going forwards, we would recommend the use of these types of discretionary pay flexibilities to be focussed on specialist roles. We note that not all positions currently sit at market median – an outcome we would expect to continue when the overlay of specialist and non-specialist roles is applied.

Setting pay levels

- The setting of pay between the parameters of the broad band of £66,000 to £142,500 is based on the use of Hay market data. We are comfortable this data represents an appropriate data set to use.
- Assuming that market median is the desired market positioning, we are comfortable that pay is set appropriately around the competitive range[1] for the Senior Group (i.e. positioned appropriately around the median point – with some roles below, some at the median point and some above). We have seen evidence that when pay is set, roles are often positioned below market median where appropriate to do so – an example of this would be where a candidate benefits from a final salary pension arrangement.

1. Competitive range is defined by us as 20% above and 20% below the market median

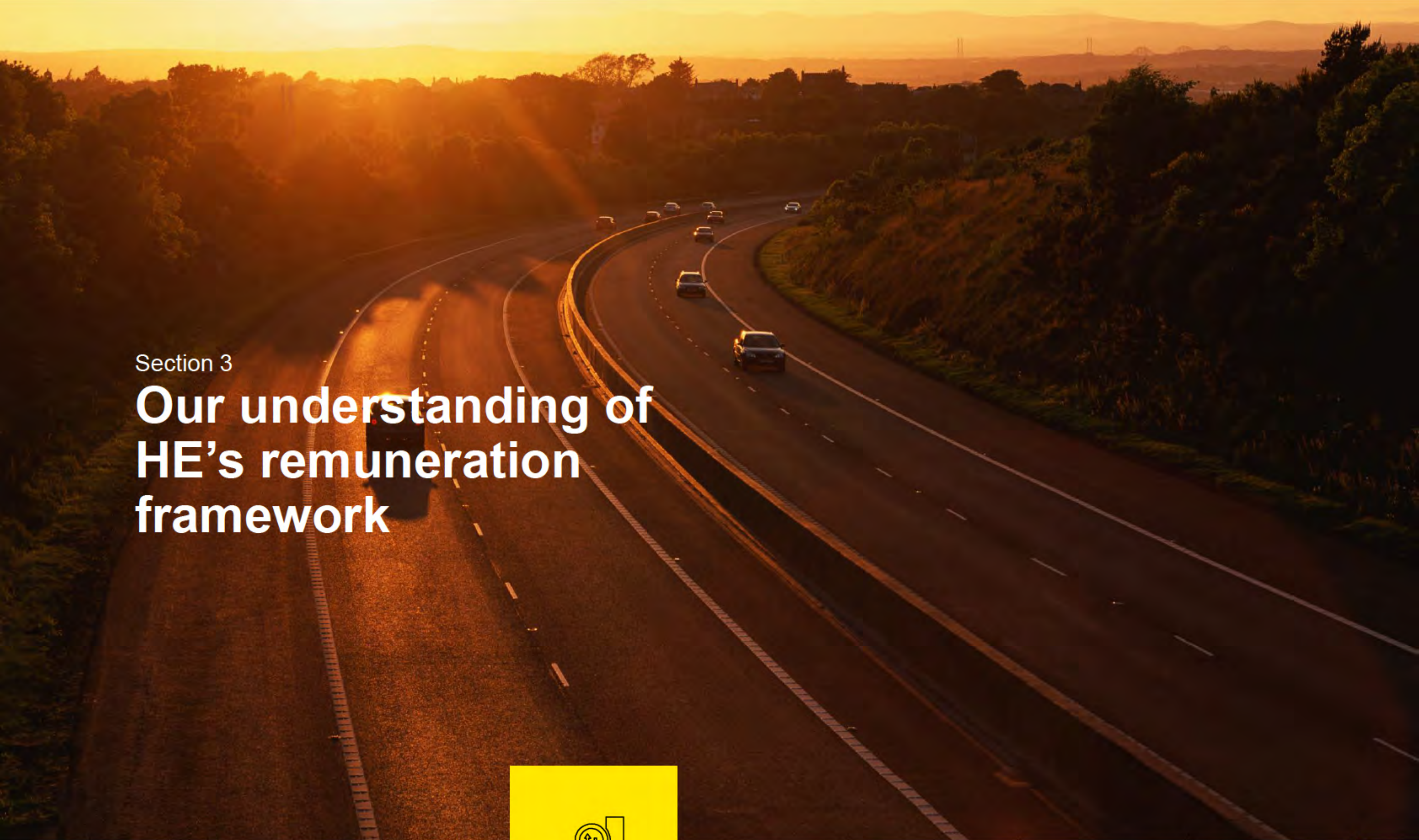
Executive summary (5/5)

Performance-related pay

- Overall, we are comfortable that the PRP arrangement is fit for purpose and appropriately used by HE.
- For example, we observe a meaningful alignment between company performance and bonus pay-out. The KPI's used are clearly aligned to the strategy of the business.
- In terms of recommendations for the future, we note that the application of the personal performance multiplier allows for a higher portion of bonus award to vest when corporate KPIs have not been fully met. In our view, this may, to some extent, discourage additional employee efforts for maximum corporate performance - as the PRP award vesting is overly impacted by personal performance.
- HE's current PRP award structure does not differentiate between roles or seniority levels within the Senior Group. In our view, applying a differentiated approach to PRP awards may give HE the opportunity to target a larger portion of PRP pot at specific roles (e.g. senior specialist roles). This would only be relevant if recruitment issues were so severe, the view was taken that the PRP pot should be focussed differentially on the hard to recruit roles.
- We note that HE currently uses a 'guided' distribution where 25% of the population are rated "unacceptable" or "working towards / new to role". In our experience, the "classic" forced ranking system would assume 90% of the population receiving an acceptable bonus rating (typically 20% of the population would sit at the top and 70% in the middle of the ranking scale), while only 10% of the population would sit at the bottom. If HE was to change its performance management system to bring it closer to market practice, we would expect to see a higher proportion of employees (currently 75% at HE) receiving a bonus payout in a year (i.e. 90% of the population based on the "classic" forced distribution).

Data

- Given the pay freedoms were provided on the basis that their efficacy would need to be evaluated, we do not believe a sufficient data set is being held by HE to enable this to be undertaken with confidence. We understand that this is due in part to moving from one payroll platform and HR system to another. However, it is an important point to note for the future.



Section 3

Our understanding of HE's remuneration framework

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HE remuneration philosophy and underlying principles

The HE remuneration framework is based on the following agreed principles:

01 Enable a **competitive, flexible and market based** pay policy, whilst having regard to **public sector pay** policy.

02 **Attract and retain** individuals of the calibre that will allow Highways England to successfully deliver the Road Investment Strategy.

03 Enable a **performance-driven culture** which rewards consistently good performance and aligns the whole organisation with the new strategic direction set out in the Road Investment Strategy.

04 Be **affordable and drive shareholder value**, commensurate with its duties under the Companies Act and its role as operator of the nation's strategic road network assets and its responsibility as a steward of taxpayers' money.

EY's observations:

- Based on our understanding of HE's business strategy and organisational context, we consider the outlined principles to be fit for purpose and supportive of the strategic direction of the organisation.
- We understand that DfT have recently agreed and shared with HE its Senior Pay Principles.

Pay flexibilities and freedoms

In order to allow HE to invest in the capabilities required to support the successful delivery of the RIS, HE was granted on establishment in 2015 flexibilities and freedoms with regards to pay and reward in line with its new status. We have summarised the key flexibilities below:

EY's observations:

- HE flexibilities are broadly in line with DfT Senior Pay Principles, in particular in relation to (1) salaries above ministerial approval threshold; (3) performance-related pay and (4) new pension scheme.
- We observe some discrepancies in relation to (2) specialist pay, which allows HE to position base pay at market median, whereas DfT provides for lower to mid quartile positioning for total remuneration against private sector comparators for specialist and technical roles.
- Annual pay awards at HE are also linked to performance, and, hence, certain increases (albeit justified by performance) may exceed that which could be found in the public sector.

1 Salaries above the threshold of £142,500

Secretary of State was delegated authority to approve up to 10 posts with salaries above the threshold for ministerial approval (£142,500), up to a maximum salary of £200,000.

Salaries above £200,000 to be approved by Chief Secretary to the Treasury (CST).

Specialist pay 2

HE was given the flexibility to pay in excess of the established public sector pay band maxima, in order to set pay at the appropriate market median.

The restriction on 1% pay awards was removed, replaced with performance-linked awards.

3 Performance-related pay

HE was given the flexibility to introduce performance related pay of to up 20% of salary.

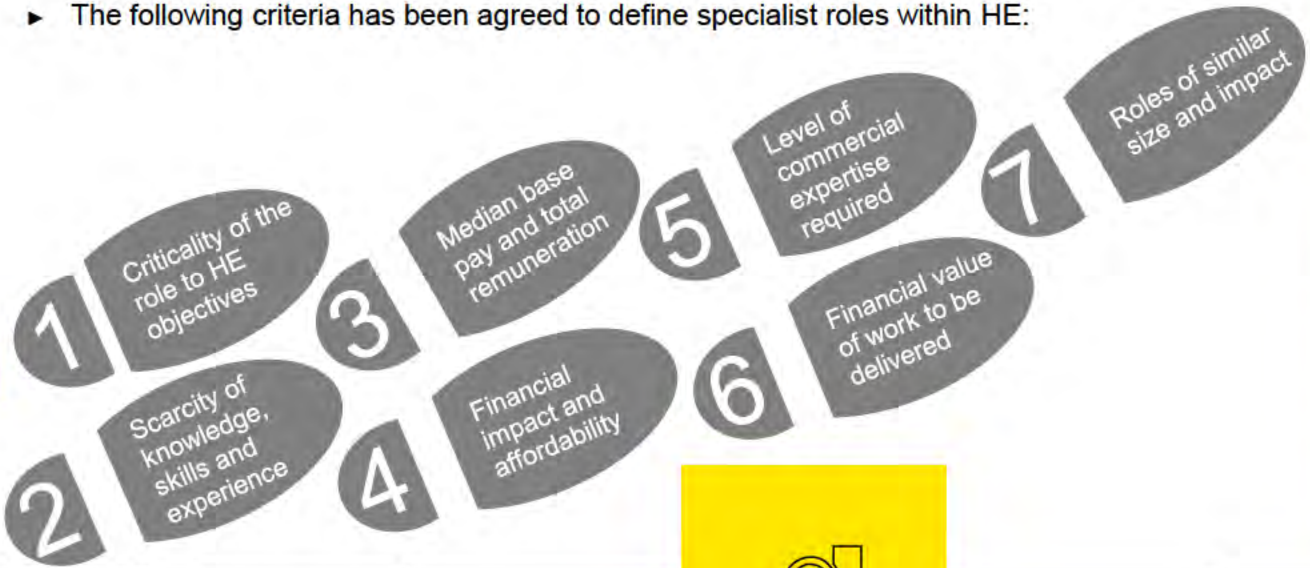
New DC pension scheme 4

New hires are eligible for employer's contributions at 10% and employees' contributions at 5%.

Existing employees will remain on Principal Civil Service Pension Scheme.

HE specialist roles - policy

- When pay flexibilities were first awarded, the 'specialist role' was not an explicitly defined term within HE. The HE Remuneration Framework document uses this concept to describe roles where particular high demand skills/ qualifications are needed and establishes a set of criteria to help determine specialist roles. The creation of these roles is overseen in the first instance by the Reward and Resourcing Executive (which comprises the CEO, CFO and HR Director).
- The HE Remuneration Framework stipulates the following differentiated approach to setting and reviewing base pay:
  - *Specialists*: salary to be pegged to the appropriate market median. This will impact mainly new recruits, but also existing staff where pay increases may be used as a retention tool.
  - *Non-specialists*: current base pay for these roles will be largely unchanged; limited wholesale changes expected outside the normal pay review process.
- The following criteria has been agreed to define specialist roles within HE:



EY's observations:

- The criteria selected by HE covers a wide range of factors, from role impact to financial affordability.
- We consider that these factors could be made clearer. In particular, the 7 factors used in the HE framework, to some extent, conflate the definition of what a specialist role is with the impact of a role being treated as specialist.
- For example, base pay is typically market driven and, as an external factor, does not necessarily reflect the full value of the role to the organisation. Similarly, recruitment concerns are typically driven by supply shortages, and hard to recruit roles may not always equate to high value generating roles in the organisation.
- As such, we would recommend agreeing a consistent definition of specialist role which highlights the specialist / technical nature of the role, the absence of such talent within the public sector (and its limited availability within the private sector) and the risk to HE of not being able to source suitable candidates.

HE specialist roles – practice

- There is currently no system driven means of identifying specialist roles across the entire HE population. However, HE confirmed that a mark-up feature has been added to the new system in 2018.
- Based on our discussion with the Executive Director Human Resources & OD and Head of Reward and Performance on 20 August 2018, we understand that:
  1. The criteria to establish specialist roles has evolved since HE Remuneration Framework was agreed and not all factors listed on the previous page are currently being taken into account when defining specialist roles. The definition of such roles is largely driven by the supply and demand in the infrastructure industry, and the need of HE to compete for talent with major infrastructure players. Roles with 10%+ differential between HE maximum and market median pay ranges or unique skillset will also be deemed specialist.
  2. There are currently no roles categorised as specialist at Senior Group level (although clearly many of the Senior Group would in practice fall within a heading of specialist for this purpose). It is HE's view that at this level there is no need to adopt such a classification. In effect, the broad pay band adopted for the Senior 1 and 2 population within HE has been sufficient to pay at an appropriate level – without needing to pay an agreed percentage outside this band (except for those employees positioned above the £142,500 threshold).
  3. It should be noted, however, that Phase One review report did identify 2 Senior 1 roles (Programme Directors and Capital Portfolio Directors) as specialist.
- When looking at how the Senior Group pay levels have been set or moved, we understand that the following factors have influenced HE's approach:
  - New roles were created following the establishment of HE as a company (these roles had no previous comparator level of pay and, hence, were placed within the band at what was considered to be an appropriate level, following a job evaluation exercise, market benchmarking and consideration of internal relativities)
  - The scope of some existing roles has become larger (necessitating a move to a higher place in the pay band)
- As such, it has been HE's practice to:
  - Assess senior pay for new recruits against the appropriate market median (considering internal relativities, experience and future prospects);
  - Move salary levels for existing senior employees towards market median, where base pay has fallen below market median due to legacy pay freezes and where attraction / retention concerns exist;
  - Pay freedoms for the 10 roles with pay above the ministerial approval threshold have been diligently applied.

EY's observations:

- Given that there is no concept of a specialist role within the Senior Group, it is not possible to assess whether the specialist pay freedoms specifically have enabled HE to recruit senior staff at best value for money.
- In the absence of the concept of specialist pay in the Senior Group, it appears that pay levels for this population have been moved upwards to reflect role changes and/ or market pressures and/ or historical pay freezes, as well as attraction and retention concerns.
- Later in this report, we provide our observations on the impact of this practice on pay inflation across the Senior Group.

Our understanding of HE's current reward arrangements for the Senior Group

Base pay

- Reflect the role seniority, contribution to HE and incumbent's experience, performance and knowledge in the role
- Pegged to market median against relevant peer group
- Reviewed annually, in terms of individual performance, benchmarking and affordability. We have been informed that 2017 pay increases were linked to individual performance as follows:
  - Box 1 (Distinguished) – 2.0%
  - Box 2 (Exceeds) – 1.5%
  - Box 3 (Achieves) – 1.0%
  - Box 4 (Working towards/new role) - 0.5%
  - Box 5 (Unacceptable)- 0.0%
- Internal employees promoted to a new role within the Senior Group are positioned at an appropriate level within the band based upon the size of the role. External hires are appointed on FTE salaries within the Senior Group broader pay range, again such positioning driven by the size of the role.
- There are no agreed pay ranges for each level at the Senior Group (i.e. Senior 1, 2 and 3). We understand there is a broad range of £66,000 to £142,500 for Senior 1 and 2; however, we note that based on remuneration data provided a number of Senior 1 roles sit above this pay range (with the appropriate CST approval).
- In the process of setting / reviewing pay in accordance with the above, we understand that HE would (1) evaluate the role, (2) review what market is paying (at market median) and (3) consider internal market relativities and affordability. Any discretionary increases are subject to Remuneration Committee approval.

EY's observations:

- The pay band for Senior 1 and 2 is too broad to be used to manage pay and internal relativities.
- If one looks at the 2017 Senior Group salary review, around 80% of the total pay increase spend was awarded on a discretionary basis to reflect either role change, market movement or legacy pay freezes. We note that the majority of these roles were Regional Directors, Engineering, Major Projects but there are some corporate / operational roles as well [redacted]. The remaining 20% of pay increases were linked to performance or promotion.
- We understand that such discretionary increases have been awarded to select employees in 2016 but have not been provided with an overview of the affected employees.

Our understanding of HE's current reward arrangements for the Senior Group

Performance-related pay

- All employees are eligible, however, payments are made only to up to 75% of the employee population (subject to satisfactory performance)
- The maximum opportunity for the Senior Group is 20% of base salary, linked to both individual and corporate performance as follows:

  PRP Payment = % KPIs met x (0.2 x individual base salary) x Individual Performance Multiplier
- Number of KPIs may vary, and these are set at the beginning of the year, subject to DfT and Secretary of State approval. 2017/18 PRP is based on 11 KPIs, equally weighted at c. 9.1%
- Individual performance is captured through the Individual Performance Multiplier, which varies based on performance rating.

EY's observations:

- The application of the Individual Performance Multiplier in the bonus calculation would appear to produce an outcome of over 20% of salary if all KPIs are met. HE has confirmed that bonus is capped at 20% should this occur. We comment on this further later in this report.

Our understanding of HE's current reward arrangements for the Senior Group

Benefits and pension

- All employees eligible, however, the level of some benefits may vary dependent on the employee joining data
- Salary sacrifice scheme for cycle to work and childcare vouchers
- Everyday discounts from a selection of retailers
- Paternity leave: Up to a maximum of 15 days (3 weeks) of Ordinary Statutory Paternity Leave (OSPL). For employees joining after 31 March 2015, OSPP may be enhanced to contractual rate of pay
- Maternity leave: up to 52 weeks, made of Ordinary Maternity Leave of 26 weeks with full pay, Additional Maternity Leave of up to 26 weeks, with 13 weeks pay at SMP rate and 13 weeks unpaid
- Adoption leave: Ordinary Adoption Leave of 26 weeks, followed by 26 weeks of Additional Adoption Leave (AAL). Statutory adoption pay of up to 39 weeks is available to employees who meet a certain criteria
- Annual leave is in the range of 25-31.5 days depending on employee joining date
- Civil service pension (employees appointed before 1 April 2015) and group personal pension (employees appointed after 31 March 2015).

EY's observations:

- The existence of two pension arrangements within the organisation makes the cost of employment for one employee group higher than for the other. We understand why this is, but it should be noted that the total package defines the attractiveness of the reward proposition and not just the base pay offer.
- This is particularly relevant where pay freedoms have been applied to a role (based on private company market data) where the incumbent also participates in Civil Service Pension Scheme.
- We understand from the HE Executive Director HR and OD that pension offering is considered when awarding discretionary pay increases and note this consideration is also referenced in Remuneration Committee papers relating to the annual pay review. However, these papers are more focused on ensuring that a pay increase does not create an unforeseen tax liability due to exceeding annual allowance parameters. In such circumstances, a non-pensionable allowance could be paid in place of a consolidated increase to salary (we note this payment is not a cash alternative to pension, for the avoidance of doubt).
- We also observe a higher percentage increase in base salaries of existing employees (eligible for Civil Service Pension) in comparison to the new recruits who participate in a DC scheme, although it should be noted that the average annual salary for new recruits is positioned higher than base pay for Civil Service Pension participants.

Section 4

EY’s hypothesis

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EY's hypothesis

- How can one determine whether a remuneration framework is delivering its desired outcomes? There are many outcomes that remuneration framework could be intended to deliver. For example, value for money would be a key consideration for DfT when viewing the effectiveness of HE's pay model.
- Our hypothesis is that we would expect to see an effective remuneration framework deliver 3 key outputs. The importance of these 3 outputs needs to be balanced against a fourth requirement – to provide value for money and probity in the use of public funds. Accordingly, we have considered all 4 aspects in our review.

1

Attract better candidates

Successful organisations receive more job applications, their candidates have better experience / qualification and come from diverse backgrounds.

2

Retain employees longer

Successful organisations retain employees for longer, so that the average length of service across the organisation is higher, turnover is lower and we see a higher number of employees returning to the organisation.

3

Encourage employees to go the extra mile

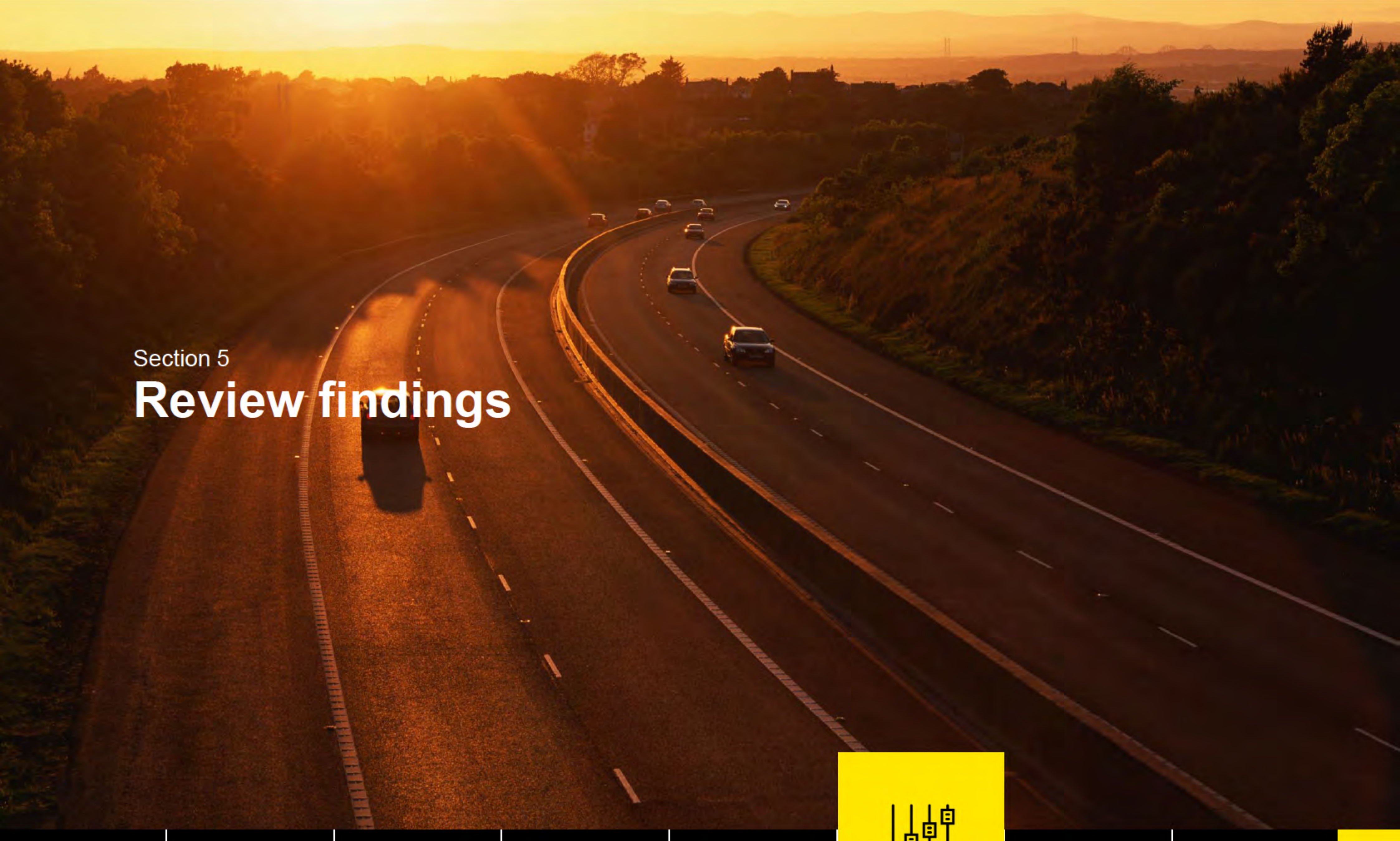
Organisations can demonstrate stronger alignment between individual and corporate performance. There is a clear link between bonus payout and performance. Employee engagement is high.

A caveat to the hypothesis

- Reward cannot be viewed in a vacuum. An organisation's reward proposition can go some way in assisting with recruitment, retention and motivation but it will never be the sole driver of such outcomes.
- We tend to view reward as a "hygiene" factor. Get it wrong and an organisation will have a problem. Get it right and the organisation can focus on the real drivers of success such as vision, purpose, leadership, career development and working environment.
- Accordingly, this report (focused as it is on reward only) can only tell part of the story. To put it another way, high performing organisations tend to have optimised their reward arrangements. However, optimising reward arrangements does not make an organisation high performing in and of itself. Accordingly, whilst we are seeking to use data to demonstrate the effectiveness of the pay freedoms based upon our hypothesis, we need to be very careful that we understand the difficulty in proving the cause and effect between a reward decision and an organisational outcome.

Proving the hypothesis

- To test the hypothesis, it was agreed that we would compare HE reward outcomes against those of a public sector organisation that did not have pay freedoms in place. Assessing the impact of the pay flexibilities and freedoms, awarded to HE, on recruitment, retention and performance against a public sector control would allow us to determine how effective HE remuneration framework has been in comparison to an organisation which does not have such pay flexibilities.
- Based on our discussions with DfT and HE, we agreed that DfT and its agencies would provide a suitable comparator given the history of HE and its relationship with DfT. We do recognise, however, that there will be discrepancies in the business context, stage of development and organisation structure, industry focus and infrastructure spend between these organisations, and have highlighted such differences throughout the report.
- We have been provided with data both for DfT and the DfT family, which includes DfT, DVSA, MCA, DVLA and VCA. We have used any available information to compare against HE's practices, and have assumed that trends are broadly consistent across populations where we have not been provided with sufficient detail in terms of any specific member of the DfT family.



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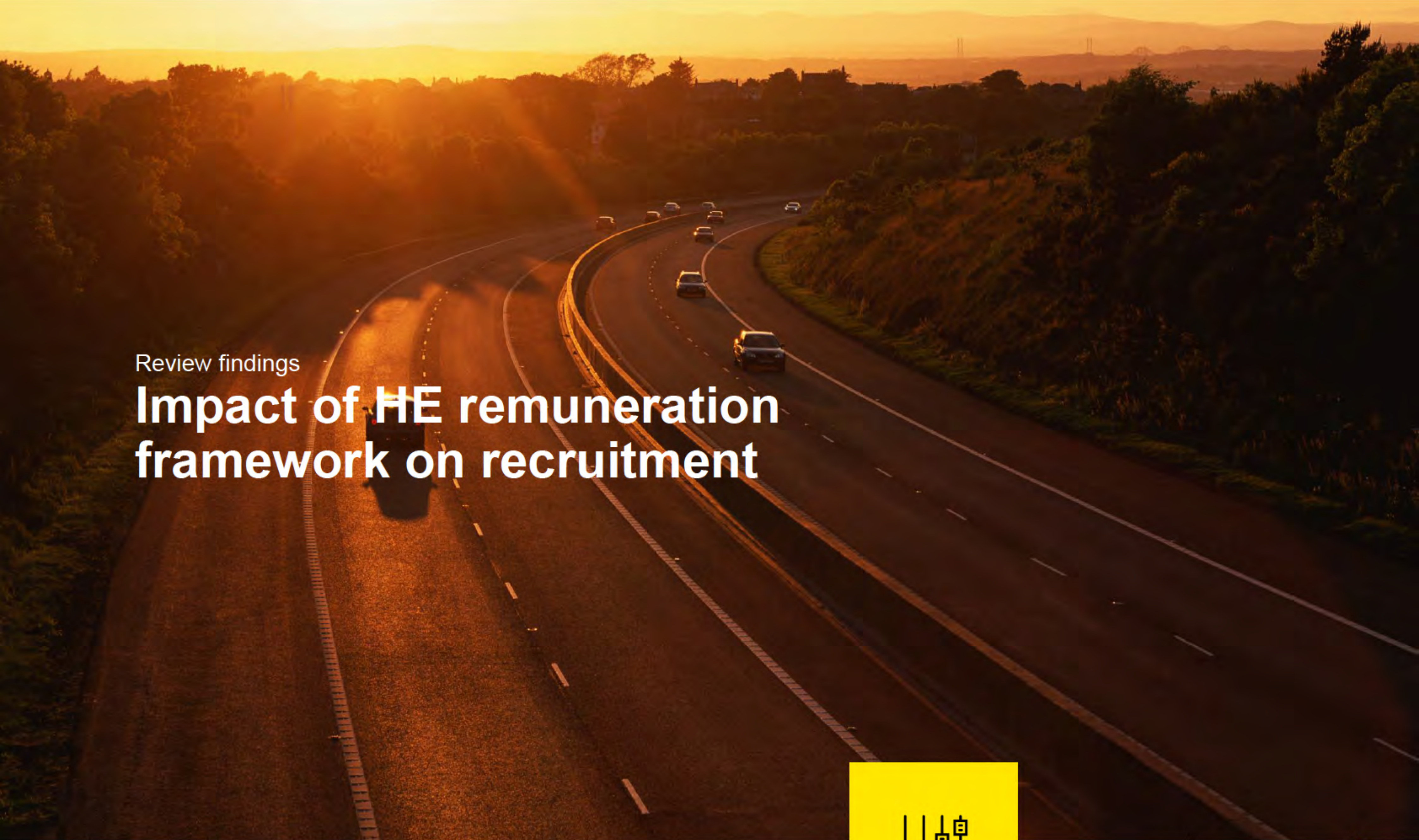
Review findings



Review findings

Impact of HE remuneration framework on recruitment

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HE has experienced significant headcount growth and recruited numerous senior roles (1/2)

- HE headcount has grown significantly since its establishment, both in terms of its general population and the Senior Group, which, we understand, has been mainly driven by the transformation of the organisation and the new strategic direction of HE.
- Specifically, the Senior Group has grown from 44 employees in 2016 to 59 employees in 2017 (34% increase year-on-year) to 90 employees in 2018 (60% increase year-on-year). We understand that the increase in senior team roles is driven to a large extent by the creation of new roles at HE, which were not required when it was a DfT agency.
- We appreciate that the context of HE's recruitment activity is different to DfT's, and, as such, we should be wary in drawing significant conclusions from a like-for-like comparison. The nature of the roles HE are seeking to fill mean that the available talent pool for such roles is proportionately smaller and there is less possibility of seeking internal transfers from other Civil Service departments. Additionally, the Civil Service offers final salary pension, so that the opportunity for civil service / public sector employees to keep their final salary pension when moving within departments makes such a move more attractive than a transfer to HE.

EY's observations:

- The data provided shows that HE (with pay freedoms) has managed to fill its vacant roles as efficiently as DfT (without pay freedoms). However, given the differences between the two organisations, we are of the view that the dataset is not sufficient to derive a firm conclusion based on evidence.
- We observe some misalignment between the number of vacant roles and new recruits to the senior team (i.e. there were 22 open positions in 2017[1] but 31 senior employees appear to have joined the business in 2017/18). From our discussion with HE Executive Director HR and OD, we understand that some discrepancies in data were due to the way vacancies were recorded on the then used recruitment software. Further, we understand that HE's Resource and Reward Executive approves reward and recruitment cases, ensuring oversight of recruitment proposals for new/additional roles.
- Based on our experience in a broader commercial context, being able to offer flexibility around pay does facilitate recruitment where the candidates are primarily sourced from the private sector. The volume of recruitment undertaken by HE over the years in question supports this view.
- However, it should be noted that we would not expect such flexibilities to apply to all senior roles in the context of HE's organisation – but only to specialist roles. We believe that this caveat would create the appropriate balance between the need to recruit the best talent and providing value for money for the taxpayer.

1. Data was provided by HE for 2015-2017. For the purposes of this analysis, we have assumed data is as of the start of FY16, FY17 and FY18.

HE has experienced significant headcount growth and recruited numerous senior roles (2/2)

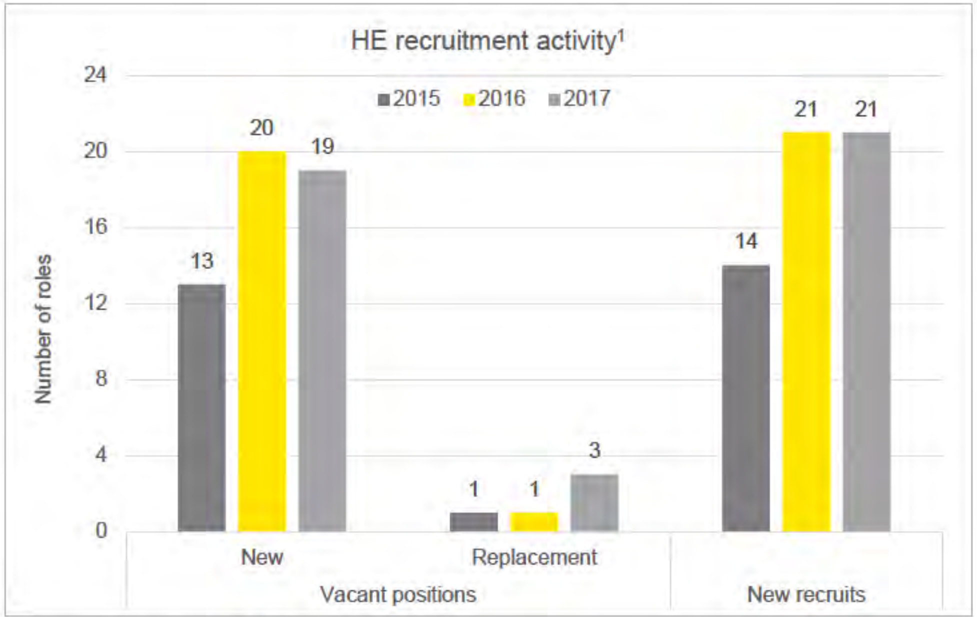


Chart 1: HE recruitment activity

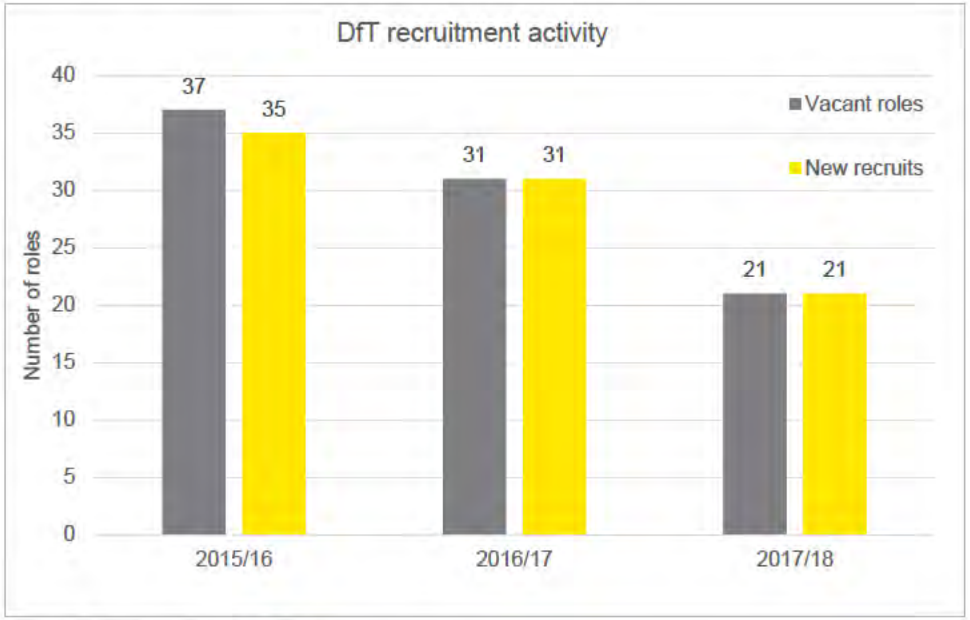


Chart 2: DfT recruitment activity

- We observe a significant recruitment activity at HE senior level, as shown in Chart 1. All positions have been filled, apart from one position remaining vacant in 2017. We understand that HE system does not capture a clear reflection of new and replacement roles, and, therefore, the dataset has been adjusted to reflect actual outcomes as verified by the Executive Director HR & OD.
- Senior vacant positions represent about 10% of the DfT's SCS population (16% in 2016) in comparison to such roles representing 24% of HE's Senior Group (36% in 2016). This perhaps reflects the early stage nature of the HE organisation (and the more established nature of the DfT operation).

1. Data was provided by HE for 2015-2017. For the purposes of this analysis, we have assumed data is as of the start of FY16, FY17 and FY18.

HE is experiencing particular challenges recruiting senior roles with specific capabilities (1/2)

- Based on our discussion with HE's Head of Reward & Performance and Head of Resourcing & Learning on 5 July 2018, we understand that HE is facing the following key challenges in terms of recruitment, both with respect to senior and non-senior staff:

1 Reduce reliance on contingent labour

Some critical roles are very hard to recruit and, therefore, have a higher volume of contingent workers (e.g. commercial roles, contract management, portfolio and programme management, delivery, asset management, supply chain management).

2 Scarcity of talent and pay competition

It is difficult to recruit particular skills as HE is competing against larger companies with significant investment ability. HE's locations (e.g. Birmingham, Bedford, Guildford) also make it difficult. Even with pay flexibilities, pay inflation is challenging.

3 Senior roles recruitment

Senior recruitment campaigns are drawn out and HE is struggling to find comparable roles in the Civil Service. Particular challenges felt around matching salary, incentive opportunity and benefits. Candidates are sourced from or leave for big construction companies, but also start-ups.

4 Need to bring in specific capabilities

Transitioning into next investment period requires additional capabilities, in particular in technology and innovation space. Increases reliance on 3rd parties as unable to get the specific skills.

5 Look for transferrable skills from other sectors

Recruiting from Highway sector and transport families (e.g. rail / airlines); Utilities (asset and portfolio management); other government departments (secondees); Emergency services / armed forces (customer-facing roles); private sector (admin roles).

EY's observations:

- The feedback from HE is qualitative in nature. However, it does paint a picture that some critical roles will need to be sourced from the private sector. It also tells us that the pressure to find high-quality candidates is not easing.
- We would suggest this qualitative feedback is supportive of the need for pay freedoms, subject to the caveat that it is only really the case for specialist roles requiring such freedoms that has been made.
- Accordingly the definition and process for agreeing specialist roles remains critical. Moreover, the appropriate benchmarking of such specialist roles (particularly the agreement of a suitable peer group or peer groups) requires continued focus. This is dealt with in more detail later in our report.

HE is experiencing particular challenges recruiting senior roles with specific capabilities (2/2)

- HE have provided us with some case studies, outlining the challenges they have experienced around recruitment and pay setting for some of their senior roles. Below, we have included relevant extracts from these case studies:

1

Case study 1

A salary proposal of up to £180K was submitted for a role but was rejected on the basis that the market for that specific role was untested. HE felt that a number of recent recruitment campaigns for similar roles provided suitable evidence of the market. A robust recruitment process was run and a salary of £180K was required to secure the preferred candidate with the required skills and experience to do the role successfully. A second business case was then submitted, however, by the time the formal offer was made to the candidate (some 6+ months after the original business case), the candidate had decided to take an alternative offer, citing the delay as the key reason for choosing the alternative offer over the one from HE.

2

Case study 2

An incumbent on £140K salary was considered a flight risk due to their aspirations for an increase in base pay – this base pay increase, however, could not be offered due to a limited number of roles above the £142.5K threshold. Subsequently, the individual left HE for a similar role on a higher salary.

A new business case was submitted for approval to recruit a replacement on a salary in the range of £180K - £200K. Salary approval up to £195K was granted, and recruitment began with starting salary of £140K. None of the candidates were invited for a second stage of the selection process. The second recruitment search offered a higher salary towards the top end of the approval and an offer of £195K was made to a suitable candidate. The candidate had vast experience and decided to join HE despite HE's proposed remuneration package being valued at c 55% of the candidate's previous package.

3

[redacted]

A larger number of candidates come from the private sector and time to hire is taking longer than desired (1/2)

- Based on recruitment activity data for Feb 2016 – Mar 2017 (FY17) provided by HE, we observe a lower number of applicants per open senior position at HE (21 applicants on average) in comparison to DfT (32 applicants on average). It should be noted, however, that applicant numbers fluctuate year-on-year (e.g. DfT had on average 26 applicants per open position in 2016, but only 16 applicants in 2018).
- Based on our discussions with HE's Executive Director HR & OD, we understand that a direct comparison between HE and DfT in this space is not possible. This is mainly due to HE using recruiting agencies and search firms to source their talent that pre-select candidates and ensure only suitable applicants are put forward, which ultimately results in a lower number of formal applicants.
- We understand that for certain roles, where recruiting a candidate with the most relevant expertise has been difficult due to HE offering a less competitive remuneration package, HE has considered "step up candidates". This has not been always possible as some roles have specific short- to medium-term priorities, however, it is clear that HE is aiming to strike a balance between getting the right candidates and achieving value for money.

EY's observations:

- We have not been provided with any data other than that which covers the period Feb 2016 – Mar 2017. Therefore, it is not possible to conclude from the data whether pay flexibilities have allowed HE to attract more candidates than DfT.
- The volume of private sector applicants for the HE roles demonstrates that these positions cannot be filled exclusively from the public sector. It also evidences that private sector applicants are considering HE as a potential employer.
- Securing applicants from the private sector is a key indicator that pay and reward is not presenting an insurmountable barrier to attract candidates.
- However, the data shows us that nearly half of the appointments were made from the public sector. It is not clear from the data whether this outcome is coincidental or in some way a product of private sector candidates not being sufficiently attracted to the roles in question.

A larger number of candidates come from the private sector and time to hire is taking longer than desired (2/2)

- The majority of applicants for HE roles in the period of Feb 2016 – Mar 2017 came from the private sector, as shown in Table 1. However, nearly half of the appointments were made from the public sector.
- [redacted] However, a candidate from Aecom was appointed to only 1 of the 9 positions and no offer was made to or accepted by a candidate from Network Rail.
- On average, there was 1 internal candidate applying for each open position. However, we note that an internal appointment was made in 1 (of the 9) cases reviewed only.
- About 40% of job applicants at HE are invited to interview. We do not have interview statistics for DfT.

[redacted]

Pay freedoms have historically made an impact on pay across the Senior Group (1/2)

- Overall, the **average salary** for new recruits across the HE Senior Group in 2017/18 was 10% higher than the average salary for existing employees (£121,667 vs £110,194 respectively), as shown on Chart 3 opposite.
- The difference between the new hires and existing employees' **median salaries** is significantly higher – at 25% (£120,000 vs £95,950), as shown on Chart 4.
- In comparison, the difference between the average salary for new hires and existing employees at DfT was only 2.8% (£91,886 vs £89,337 respectively). It should be noted that DfT hires would benefit from final salary pension, more holiday and a different benefits mix.
- It can also be seen from Chart 3, that while average base salaries for new recruits have remained relatively flat, average salaries for existing hires across the Senior Group have increased at a rate significantly higher than the performance-related pay increases established by HE. This is due to the new recruits joining the organisation on higher base pay in the previous year and the impact of discretionary pay increases.

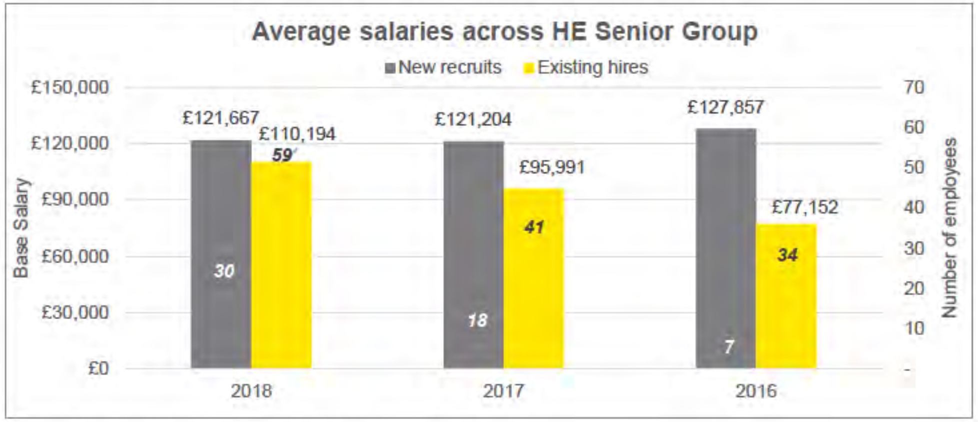


Chart 3: Average salaries across HE Senior Group

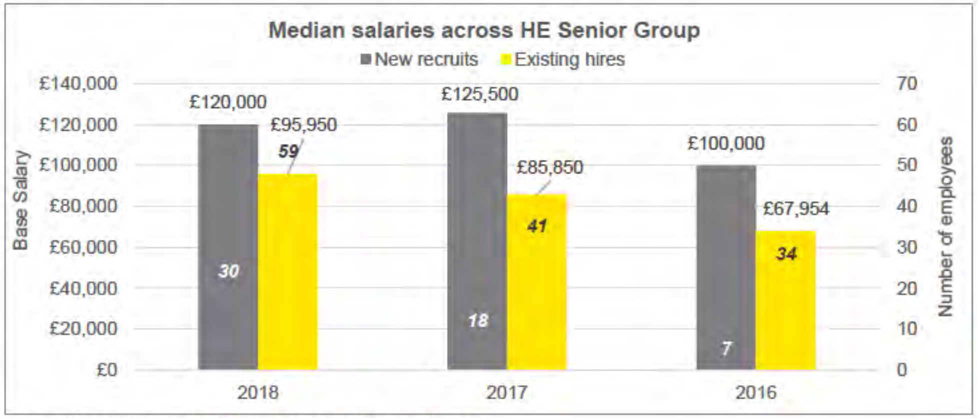


Chart 4: Median salaries across HE Senior Group

Pay freedoms have historically made an impact on pay across the Senior Group (2/2)

- As shown in the tables opposite, we observe a significant jump in base salaries for the existing population (after stripping away the impact of new hires increases). In this assessment, the year-on-year increase in **average base salary** of the 2016 existing hires was 15% in 2017 and 9% in 2018. The salary increase calculated based on **median salaries** is higher – 25.1% in 2017 and 8.7% in 2018.
- Based on our discussion with Executive Director HR & OD on 20 August, we understand that the 2017 increases were mainly discretionary and were awarded to existing employees due to change in their job size following the establishment of HE, change in complexity of certain roles as a consequence of HE becoming a corporate entity and HE's desire to align senior pay closer to the market median where base pay was lagging behind the market median due to pay freezes or other limitations. It should be noted that the 2016 existing hires joined the organisations prior to April 2015, and as such were all eligible to receive Civil Service pension.

EY's observations:

- Based on provided data, pay freedoms have led to increased pay levels across the organisation. This is only to be expected.
- In particular, it would seem that one of the drivers for the salary inflation for existing hires was the decision to peg salaries at market median. The impact of promotions on pay levels year-on-year is the other logical explanation. We do not have sufficiently robust data to enable us to strip out the impact of promotion.

	Salary inflation - 2016 existing hires (2016 - 2018)			
	# employees	2016	2017	2018
Average salary	34	£77,152	£88,700	£96,444
Average salary increase		-	15.0%	8.7%
Median salary	34	£67,954	£85,000	£92,430
Median salary increase		-	25.1%	8.7%

	Salary inflation - 2016 new hires (2017-2018)			
	# employees	2016	2017	2018
Average salary	7	£127,857	£131,407	£142,459
Average salary increase		-	-	8.41%
Median salary	7	£100,000	£101,000	£107,641
Median salary increase		-	-	6.58%

Table 2: Salary inflation (existing hires)

Use of contingent labour has decreased significantly, however, we still observe some reliance on such roles across the organisation (1/2)

- The majority of the Senior Group are permanent employees (86), with only one of the 90 employees being a contingent worker, one employee categorised as 'pending worker' (i.e. employee has not started at the date of data download) and two employees on fixed term contracts. We understand that currently there are no contingent workers within the senior population of DfT.
- We have been provided with a contingent labour summary for the entire employee population at HE over the past 3 years. As shown on the Charts 4 and 5 opposite, the number of contingent workers and spend have fluctuated significantly year-on-year, with the major labour gaps appearing in major projects, commercial and procurement, as well as operations in 2017.

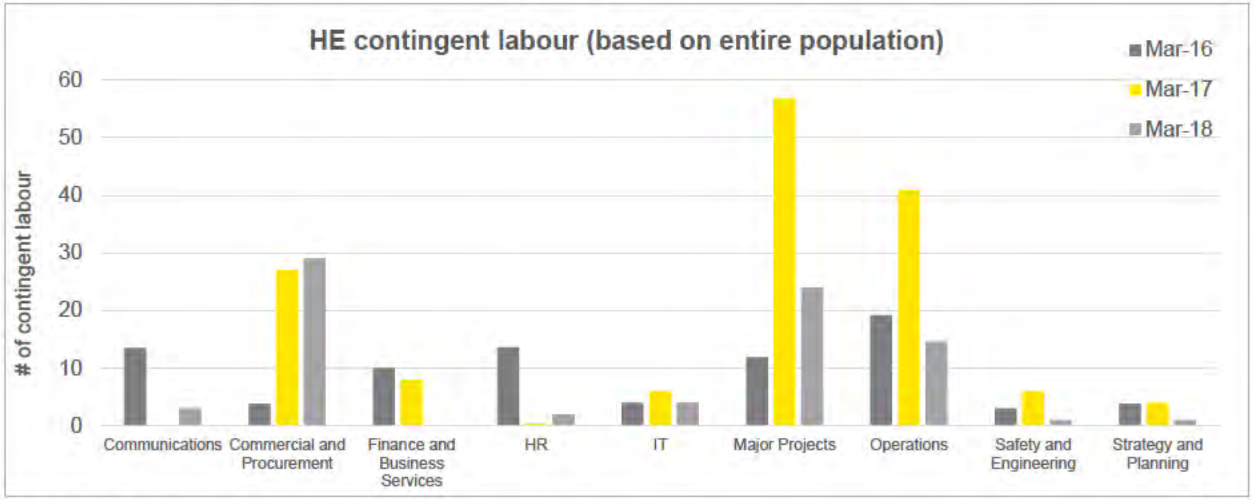


Chart 4: HE contingent labour

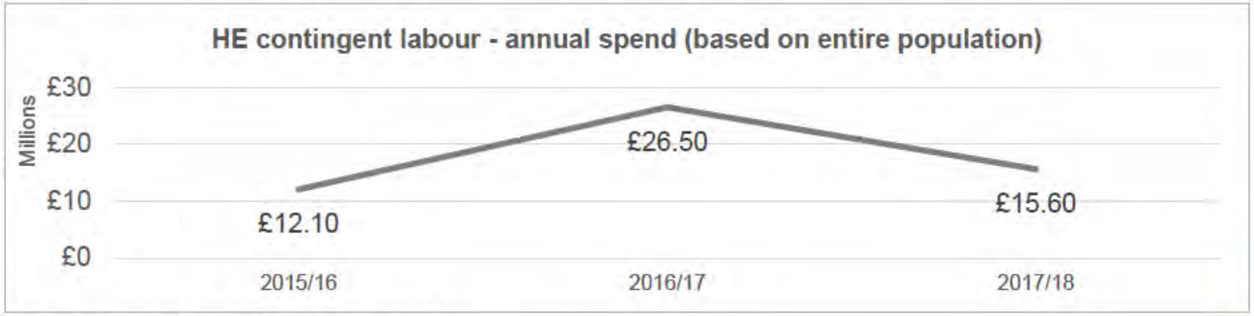


Chart 5: HE contingent labour – annual spend

Use of contingent labour has decreased significantly, however, we still observe some reliance on such roles across the organisation (2/2)

- We understand, however, that the contingent labour data is not representative of the real picture. Historically, it used to take HE significant time to recruit critical roles. In response, some departments hired contingent workers to close the capability gaps; however, these individuals were not captured as contingent workers on the HR system. Therefore, based on our discussions with Executive Director HR & OD, we understand that the spend on contingent labour in 2015/16 was significantly higher than shown on Chart 5 (by c. 50%-100%). An adjustment of this nature would mean that the spend on contingent labour has been going down over the past 3 years.
- We have been provided with 2017 and 2018 Remuneration Committee papers summarising the position on the use of contingent labour. We cannot reconcile the numbers used in these papers with the numbers HE currently are using (as shown on Chart 4 on the preceding page).
- Finally, we understand that HE will require around 2% of total workforce as contingent labour going forward.

EY's observations:

- It can be seen that the number of contingent workers (both senior and non-senior staff), in, for example, Major Projects reduced significantly between 2017 and 2018. This was coupled with a significant increase in permanent hires in Major Projects over the same period (of c. 30%). It is not unreasonable to link the reduction of contractors with the increase in permanent FTEs.
- HE also provided qualitative evidence that the reliance on contingent labour has been decreasing, and explained that data on contingent labour has not been tracked properly early in the review period.
- We note that corporate support functions of HE (for example, HR and Finance) have reduced their spend on contingent labour materially. This tells us that the pressure to use contingent labour exists primarily in the technical areas of the business. It is these technical areas where the business case to have specialist roles (with pay freedoms) exists.

The diversity demographics across HE have not changed significantly since the introduction of pay freedoms

- We have not been provided with a breakdown of diversity data for senior and non-senior staff at DfT, so we are unable to provide a comparison between the two organisations.
- However, our main observations on HE's ability to attract a more diverse workforce are summarised below:
  - The proportion of female new recruits has decreased over time, resulting in a male : female split of the Senior Group of 70% : 30% as shown on Chart 6 opposite. We understand from HE that this split is representative of the entire organisation.
  - With respect to ethnicity, we note that all new recruits over the past 3 years were 'White – British' (where this information was declared), as shown on Chart 7 opposite. Thus, the majority of the Senior Group are 'White – British / Other' and we have seen no movement across the other ethnicities.
  - This is relatively consistent with the overall population ethnicity statistics across DVLA and DVSA, where the majority of the population (c. 73%) are of 'White – British' (c. 23%) and 'White – Other' (c. 51%) ethnicity.

EY's observations:

- The data does not tell us that pay freedoms have had any impact on enabling the recruitment of a more diverse workforce. However, there is no evidence that pay quantum does drive a more diverse workforce. In contrast, flexibility around working practices and parental leave practices would drive different outcomes in terms of gender balance, for example.

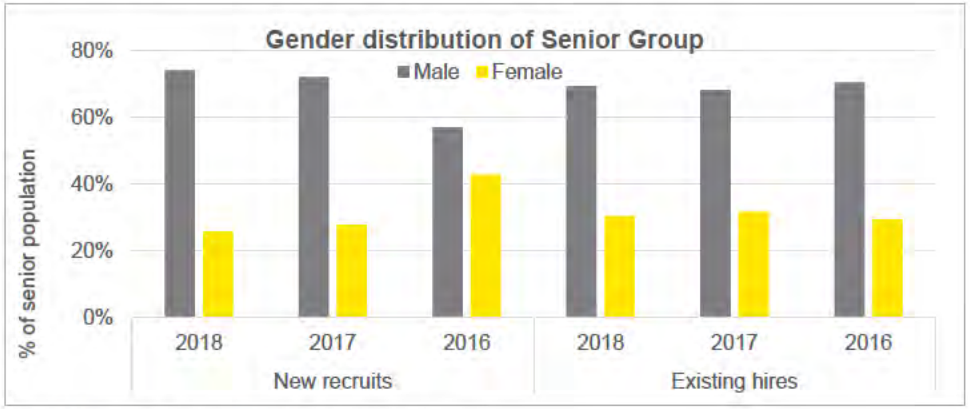


Chart 6: Gender distribution of Senior Group

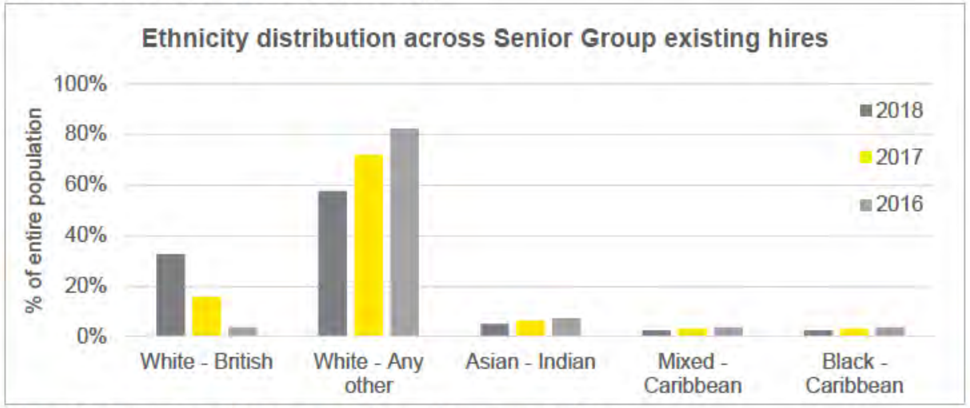
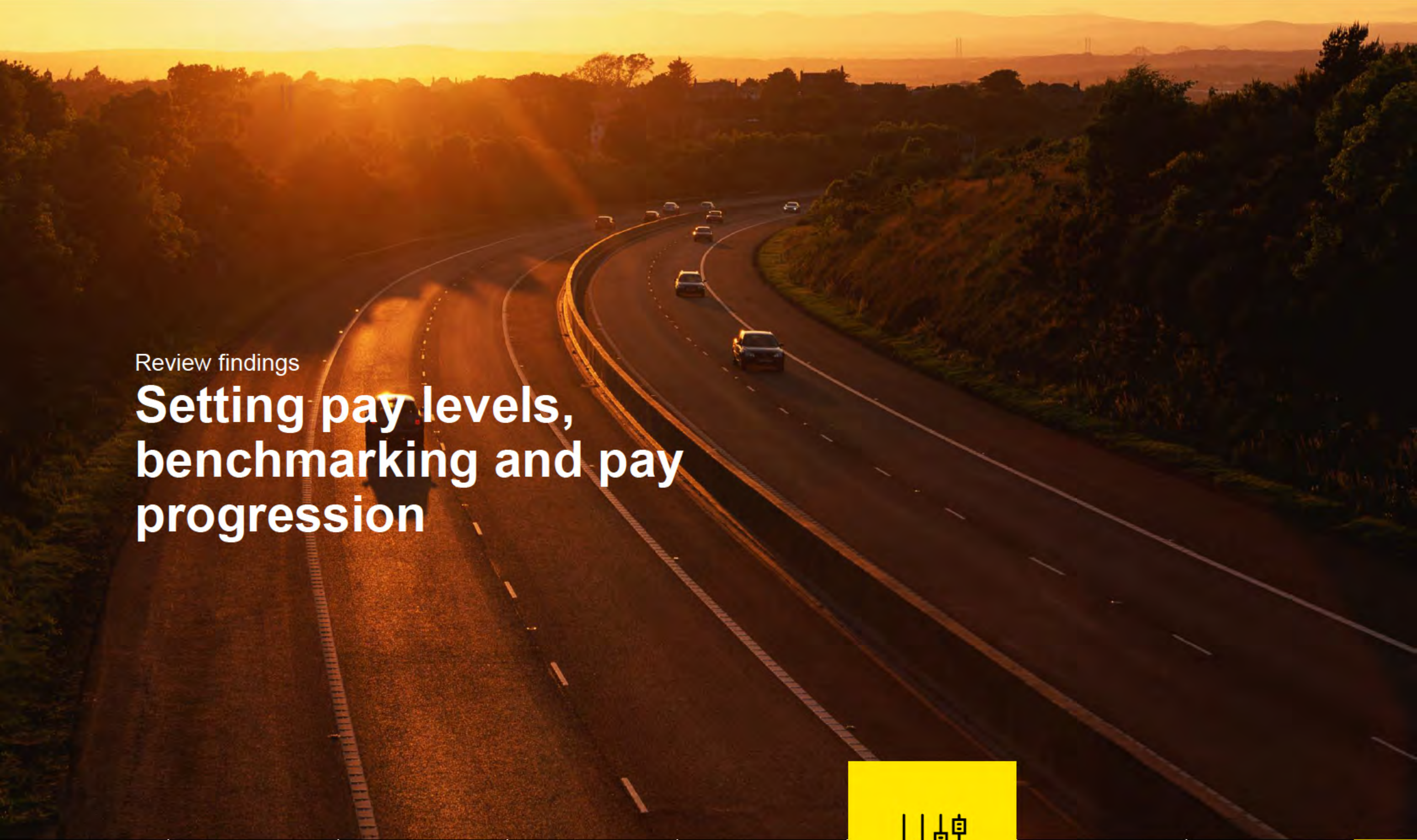


Chart 7: Ethnicity distr bution across Senior Group existing hires
Please note that about one third of employees have not disclosed ethnicity data



Review findings

Setting pay levels, benchmarking and pay progression

Setting pay levels

- In general, HE currently uses the existing Civil Service grading structure, however, we understand that HE is in the process of developing a new pay and grading framework. This is not expected to impact the pay bands and levels of the Senior Group.
- Within the Senior Group, HE currently has 3 job levels. We understand there are no internal pay bands for each senior level, but there is a pay range of £66,000–£142,500 for the Senior 1 and 2 population.
- We understand that base salaries for roles within the senior bands refer to the market median, based on Hay reference levels, and Senior 1 and 2 are roughly mapped to the pay bands for Senior Civil Servants, SCS1 and SCS2. However, we note that SCS ranges are based around lower Hay reference levels in comparison to HE's bands, as shown below.

HE job level (Hay reference levels)	# of employees	SCS pay band (Hay reference levels)	SCS ranges	Hay median ranges
Senior 1 (21-23)	80	SCS 1 (20-22)	£66,000 - £117,800	£104,157 - £145,009
Senior 2 (24-27)	9	SCS 2 (23-25)	£89,500 - £162,500	£168,208 - £331,872
Senior 3 (28)	1 (CEO)	SCS 3 (26-28)	£108,000 – 208,100	£474,750

- We note that the discrepancy between the Hay median range for Senior 1 and SCS range for SCS 1 is actually smaller than shown above as HE Senior 1 roles appear to start at Hay reference level 20 (and not 21) which is equivalent to £88,051. When one adjusts for this, the map across between SCS ranges and Senior 1 population becomes much clearer. We also note the Senior 2 spans Hay reference levels 23-25, where information per role is provided.
- We have independently verified the Hay market median ranges and are comfortable that the above shown figures represent a sensible market reference point (assuming Senior 1 roles begin at Hay reference level 20). We have also reviewed several HE roles and their mapping to Hay reference levels and the levelling framework applied appears to be logical.
- Additionally, we have been told that the market used for the Hay median ranges is based on a mixture of public and private sector. We cannot see the impact of public sector spread in this pay sample, and, in our view, the Hay median ranges used would appear to be more reflective of private sector pay than public sector. We cover two important aspects of pay benchmarking - peer group selection and market positioning – in more detail overleaf.

EY's observations:

- The most persuasive evidence for the need for pay freedoms would be if we were able to demonstrate that the pay freedoms are being used to pay no more than median in a relevant market in which a specialist skill is required.
- Assuming the HE Senior 1 population starts at Hay reference level 20, we are comfortable that the methodology adopted to market test pay for specific roles is fit for purpose.
- The key to the methodology producing the right outcome is for the roles to be appropriately mapped to the correct Hay reference levels.

Pay benchmarking – peer group selection

HE approach to benchmarking

Provider:

- Korn Ferry Hay Group (primary source) and Towers Watson (additional data source)

Peer group:

- Public and private sector, with private sector organisations being the majority.
- Entire sample of survey participants, excluding FS companies

Positioning:

- Market median of the peer group for base salary

CSEP approach to benchmarking

Provider:

- Korn Ferry Hay Group (primary source) and Radford (additional data source).

Peer group:

- Public and private sector (20:80 split)
- May remove Oil & Gas and FS companies, but tend to use entire sample (700 cos)

Positioning (based on DfT Senior Pay Principles)

- Lower to mid quartile total remuneration for specialist / technical roles when compared to directly relevant private sector
- Mid to upper quartile total remuneration for non-specialist posts when compared to equivalent public sector comparators, including the Civil Service and other ALBs

EY's observations

- We would expect to see a different desired market positioning for specialist and non-specialist roles. This approach would be aligned with the HE remuneration principle of offering flexible market based pay, while taking into account public sector pay policy.

We have also been provided with business cases for agreeing salary increases/ approving new recruit's pay and have the following observations:

- HE typically considers data for both the public and private sector provided by Hay Group. As expected, private sector benchmarking is significantly higher than that for the public sector and we note that, for many roles, we have seen preference being given to the private sector data, albeit target pay is usually positioned below / around the median.
- We also observe that when pay for new recruits is determined, HE often considers supplementary pay data by recruitment consultants, showing individual levels across various, mainly private sector, organisations. In our experience, this data is not always fully reliable as it would typically carry a recruitment premium.
- Additionally, we note that some roles have been previously compared to FTSE listed or Financial Services companies (e.g. Chief Information Officer). Although we understand that this comparison may be driven by scarcity of market data for senior roles, such companies tend to be high payers and we would not consider these to be appropriate comparators.
- We note that consultancy savings achieved though the recruitment of a new role are sometimes used as a justification for setting certain pay levels. In our view, this is misleading and should not be a factor when setting senior pay. However, it plainly is a factor of importance when referencing the value for money a permanent hire offers versus a contractor.

Pay relativities

- We have been provided with Hay Group individual market benchmarking for the majority of senior roles. Chart 8 shows the competitive positioning distribution across the Senior Group (based on competitive range of +/-20% around the market median):
  - Within the Senior 1 group, majority of the roles are positioned within the competitive range, with equal proportions of employees sitting above or below the competitive range limits;
  - Within the Senior 2 group, all employees are comfortably sitting within the competitive range.
- We have also assessed the competitiveness of 2018 HE base salaries against the Hay market median (for reference levels 20-23 for Senior 1 and 23-27 for Senior 2) and SCS pay bands midpoint.
  - We have developed a competitive range around the Hay market median and the midpoint of SCS pay ranges of + / - 20%, and assessed the positioning of HE senior roles within this competitive range.
  - As shown on the chart opposite, the majority of the roles are within the competitive range of Hay market median. All the roles are within or above the competitive range. When assessed against the SCS pay band ranges, the majority of the roles are either within or above the competitive range, which is due to SCS ranges being targeted at lower Hay reference points.

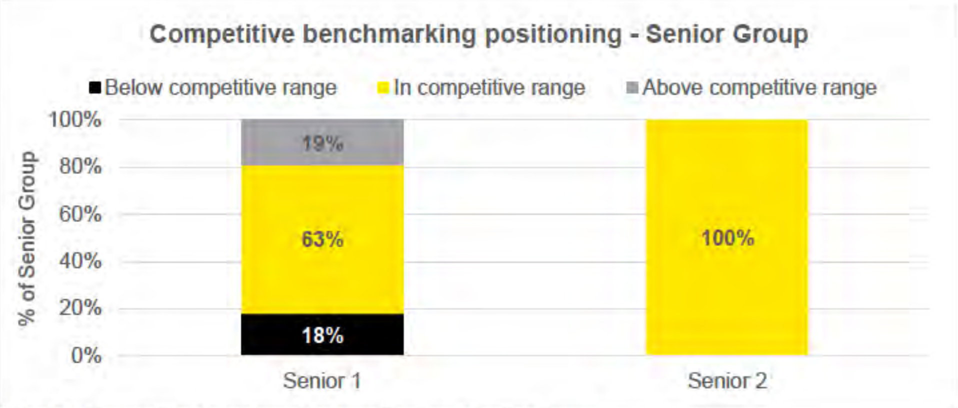


Chart 8: Competitive benchmarking positioning - Senior Group

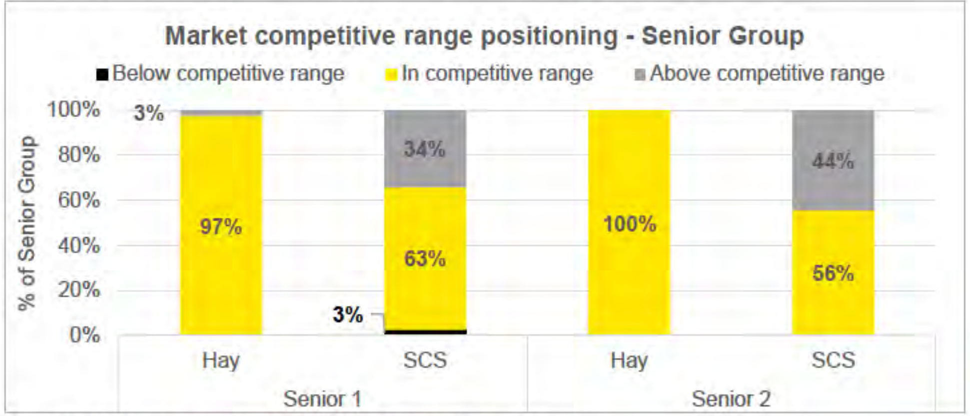


Chart 9: Market competitive range positioning - Senior Group

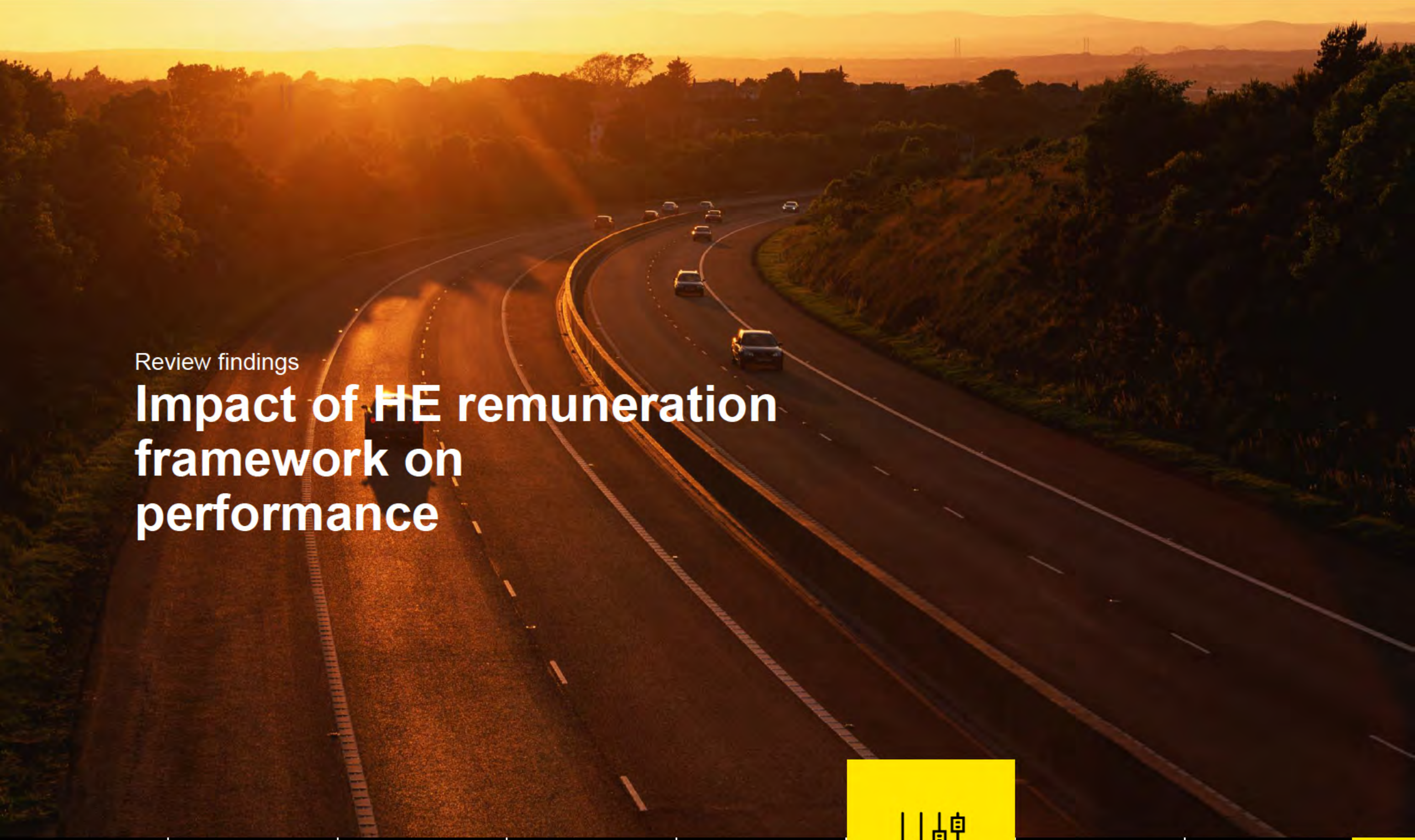
Pay progression over the past 3 years

- HE's policy is to award base pay increases linked to performance. We have reviewed the alignment between annual pay increases awarded in 2018 and 2017 and the average performance rating in previous years (as a determining factor for pay increases in the following year), and we were not able to establish a direct link between these. We understand this misalignment is mainly driven by discretionary pay increases awarded to certain employees.
- The majority of senior population (63% in 2018 and 44% in 2017) received salary increases of less than 5%; however, there are a number of employees who received a significant salary increase despite developing / average performance, in particular in 2016.
- We also note that proposed salary increases in April 2018 exceeded budget by c. £73,000 but were deemed to be affordable.

Chart 10: Link between salary increases and performance – Senior Group

EY's observations:

- We understand that discretionary pay increases have been awarded to employees in 2016 to bring base pay closer to market median levels where scope and responsibilities of existing roles have increased or attraction/ retention concerns existed.
- To achieve a balance between pay increases and bonus payout in the year, HE has applied discretion to decrease performance ratings for some of the employees receiving higher pay increases in order to ensure proportionate bonus is paid out in the year.



Review findings

Impact of HE remuneration framework on performance

Performance-related pay – annual awards (1/2)

- HE has operated a PRP scheme since FY 2015/16. The PRP scheme measures corporate and individual performance and offers differentiated opportunity to employees based on their level and performance.
- Given both HE and DfT use guided distribution to determine the number of employees at each performance rating, it is not possible to determine whether the PRP scheme has encouraged HE employees in a more efficient manner to go the extra mile.
- We note that DfT / agencies do not operate annual bonus schemes of this nature. DVLA last awarded bonus to employees in 2016/17, and average bonus was in the range of 5-6% of salary for Box 1 rated employees.

EY's observations:

- We would expect to see corporate performance driving the size of a bonus pool and personal performance influencing distribution of the bonus pool. The change in performance ratings and personal multipliers has made it difficult to discern the interaction between company and personal performance.
- It is our understanding that PRP opportunity at HE lags behind the typical opportunity across private companies. HE may wish to consider if they would like to apply a more differentiated approach to PRP awards, offering specific roles (e.g. specialist / technical roles) higher PRP opportunity (e.g. above 20%) and thus making them more attractive to candidate (while reducing the maximum opportunity below 20% for non-specialist roles). In this manner, HE may be able to offer a more competitive total remuneration for specialist roles, without significantly increasing the cost of employment.
- The application of the personal multiplier allows for a higher portion of bonus award to vest when corporate KPIs have not been fully met. In our view, this may, to some extent, discourage additional employee efforts for maximum corporate performance as the bonus award vesting to KPI achievement ratio is disproportionately impacted.
- For example, rather than multiply the % of KPIs met by 20% (opportunity) it should be multiplied by c. 15%. Then, when one applies the highest performance multiplier (of 1.3x), the output would be no more than the stated 20% cap. By doing this, HE would ensure that the primary driver of PRP is corporate performance.

Performance-related pay – annual awards (2/2)

- We have reviewed the alignment between performance and bonus payout, as shown in Table 3 opposite, and have the following observations:
  - We observe an alignment between company performance and PRP payout (bonus outturn of 66.05% in 2018 vs 40.2% in 2017 vs 50.9% in 2016)
  - There is a very small difference (of c. 1%) between average PRP as a % of salary in 2016 and 2017, although higher proportion of KPIs were met in 2016 in comparison to 2017. We understand, however, that the PRP pot in 2016 was reduced due to fatality leading to this discrepancy.
  - There is a very small differentiation (1%-2% only) in average PRP levels across each performance rating.

	2018 PRP awards		
	Entire population (n=90)		
2018 Performance rating	# employees	Average PRP (£)	Average PRP (% of salary)
1	7	22,088	17.10%
2	23	16,470	14.51%
3	43	12,394	11.91%

	2017 PRP awards		
	Entire population (n=54)		
2017 Performance rating	# employees	Average PRP (£)	Average PRP (% of salary)
1	6	7,913	8.14%
2	20	7,038	7.31%
3	27	6,728	6.43%

	2016 PRP awards		
	Entire population (n=35)		
2016 Performance rating	# employees	Average PRP (£)	Average PRP (% of salary)
1	12	7,785	9.82%
2	23	7,649	8.56%
3	0	-	-

Table 3: PRP annual awards

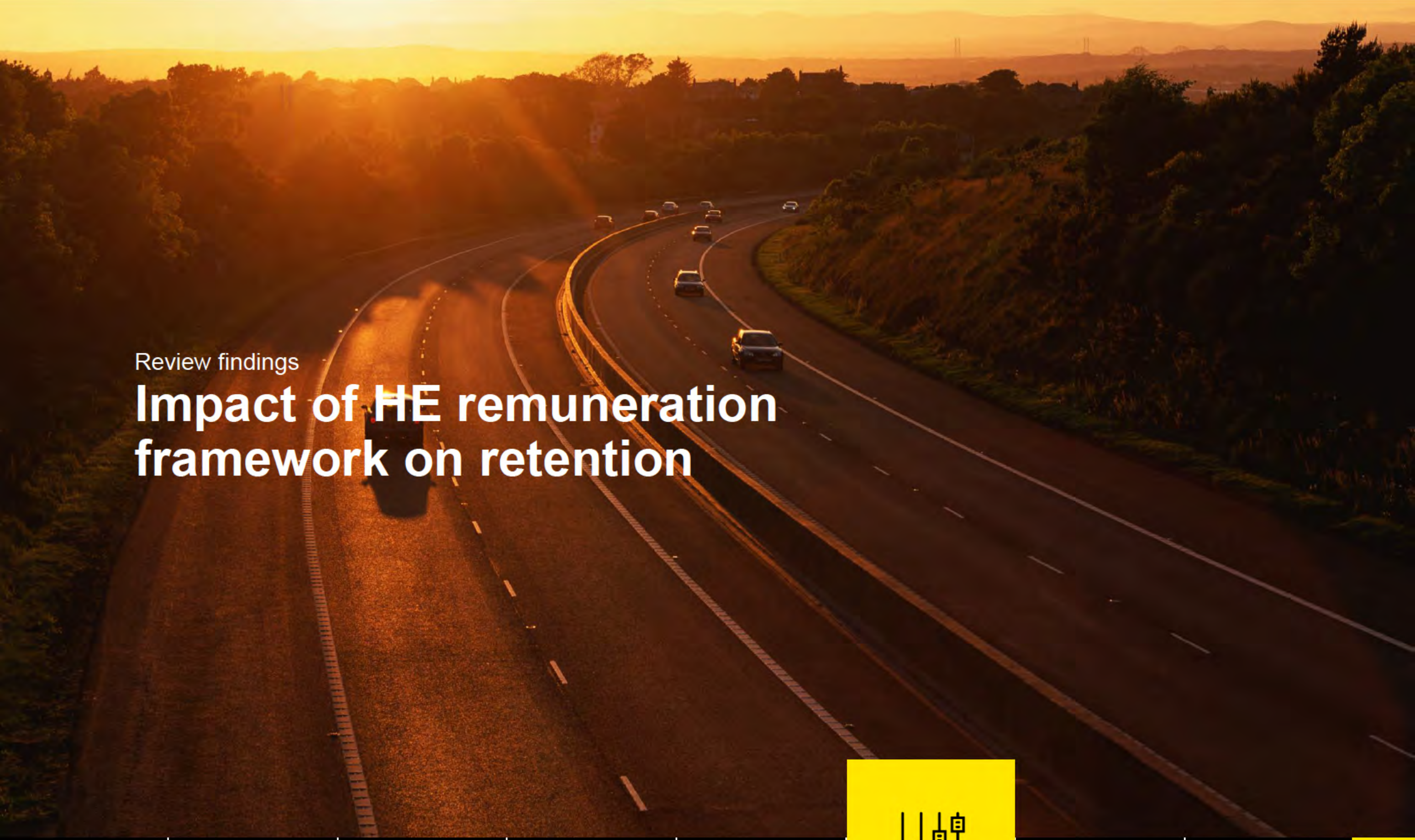
Performance-related pay – structure

- HE's PRP was subject to 11 performance metrics in 2018, equally weighted at 9.1%, which are aligned with the business KPIs, as shown in Table 4 opposite.
- We note that 11 performance metrics is significantly above market average. Companies would typically select up to 3-4 corporate metrics (typically of financial /strategic nature) in order to ensure senior leaderships is focused on the appropriate levers to drive business performance. In our experience, having a large number of performance metrics, which contribute to a very small portion of annual bonus, may lead to senior staff not valuing these metrics sufficiently and, therefore, diminishing their focus.
- We understand, however, that the PRP KPIs have had a material impact on driving the focus and performance of the Senior Group, and subsequently the success of the organisation. As such, we do not suggest introducing small number of generic KPIs, but possibly consideration could be given to grouping the KPIs into four clear areas to ensure messaging around them can be made easier. For example, 'Safety, Efficiency, Growth and Environment'.
- We note that HE currently uses a 'guided' distribution where 25% of the population are rated "unacceptable" or "working towards / new to role". In our experience, the "classic" forced ranking system would assume 90% of the population receiving an acceptable bonus rating (typically 20% of the population would sit at the top and 70% in the middle of the ranking scale), while only 10% of the population would sit at the bottom. If HE was to change its performance management system to bring it closer to market practice, we would expect to see a higher proportion of employees (currently 75% at HE) receiving a bonus payout in a year (i.e. 90% of the population based on the "classic" forced distribution).

Metrics	KPIs	PRP KPI
Network safety – KSI reduction	✓	✓
Accident frequency rate: Supply chain	✓	✓
Accident frequency rate: Operations	✓	✓
User satisfaction	✓	✓
Traffic flow: Incident management	✓	✓
Network condition: Network maintenance delivery	✓	✓
Economic growth: Scheme milestones achieved (50 schemes)[1]		✓
Environment: Environment scheme delivery (370 schemes)	✓	✓
Efficiency: Capital efficiency savings	✓	✓
Smart motorways performance: Sign setting and technology availability (new KPI for 2017/2018)[1]		✓
Employee engagement[1]		✓
Economic growth: Delay (seconds)	✓	
Traffic flow: network availability	✓	
Environment: Noise important areas mitigated	✓	
Vulnerable users: deliver new and upgraded crossings	✓	

Table 4: KPIs and PRP metrics alignment

1. The KPI is mentioned as a business KPI in PRP documentation, but is not disclosed in 2018 ARA



Review findings

Impact of HE remuneration framework on retention

There is no visible link between pay freedoms and average length of service

- Average length of service across the Senior Group is an important measure of HE's ability to retain the best talent over the long term. The chart opposite demonstrates that HE's average length of service is significantly lower than DfT's.
- There are, however, a number of factors that influence average length of service, such as the number of new recruits. HE's Senior Group has grown significantly over the past 3 years, which explains the downward trend in the length of service. If we strip out the effect of new recruits throughout each year of assessment, the average length of service figures are much higher. The average length of service is still decreasing, but this is largely impacted by the new recruits in previous years.

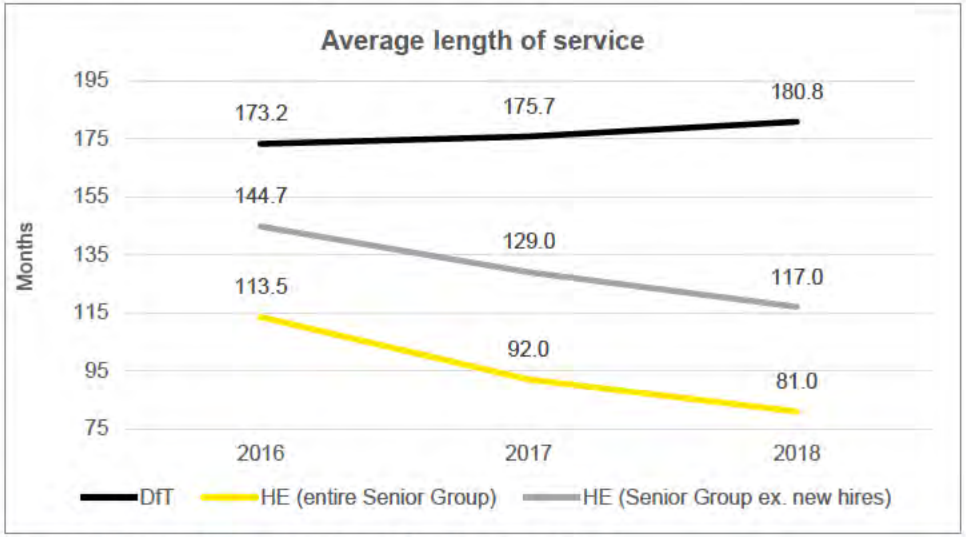


Chart 12: Average length of service – DfT vs HE Senior Group

EY's observations:

- Given the stage of development of HE, we do not believe length of service comparisons with DfT (and any difference in average length of service between the two organisations) may be attributed to reward.
- In our view, the average length of service at HE is in line with common market practice. Overall, the average tenure in the UK has been around 105 months in the past few year, which HE seems to exceed on an existing hires basis.

1. Please note we have not been able to verify whether DfT data is based on senior civil servants information or entire employee population. Data for HE is based on Senior Group

HE average employee turnover across senior staff is relatively consistent with industry

- The average turnover rate at HE in 2018 (based on entire employee population) was 9.6%, whereas DfT's turnover rate was significantly lower, at 4.9%.
- We have assessed the average turnover rate for the HE Senior Group in 2016 and 2017 (2018 data is not available) against the turnover rates for senior civil servants across DfT and agencies, as shown in the chart below.
- Despite the significant gap in 2016, 2017 turnover rates are aligned at c. 12.5%.
- In our experience, a turnover rate of 12.5% is consistent with HE's industry and occupational groups, where average turnover rate tends to be c. 10% -12%. Given the business cycle of HE, it is not surprising to see higher fluctuation in turnover rates in comparison to an established organisation such as DfT.

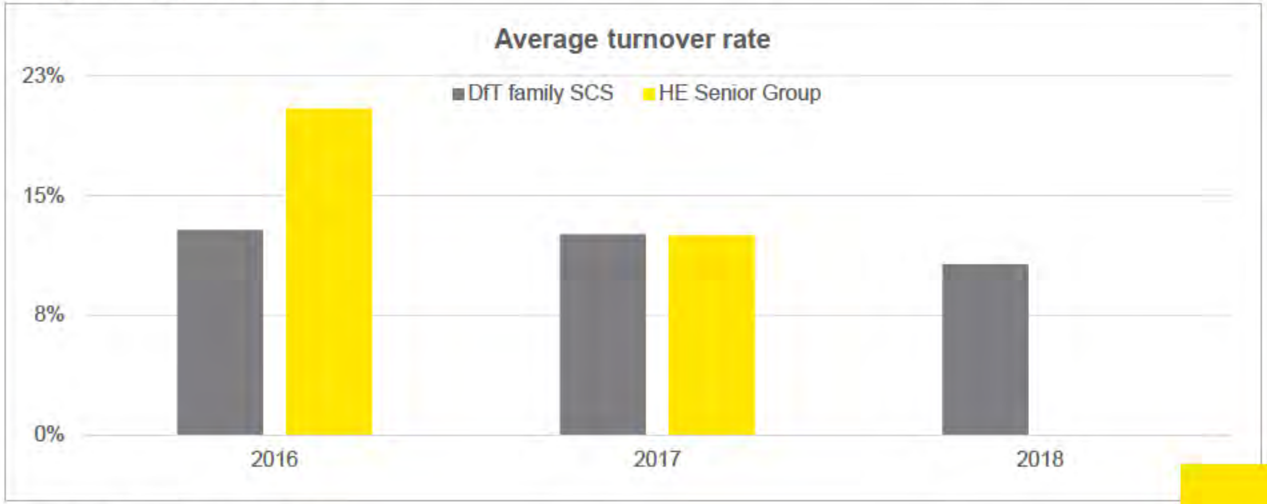


Chart 14: Average turnover rate

- Top 5 reasons for leaving HE (based on latest employee survey across HE entire employee population):
  1. Better pay and/or conditions (41%)
  2. Job expectation (31.4%)
  3. Lack of promotion (31%)
  4. Work / life balance (27.4%)
  5. Travelling distance (21%)
- These reasons are relatively consistent with the Top 5 reasons for DfT's SCS leaving the Civil Service (travelling distance was not a Top 5 reason for DfT employees)
- In our experience, this is in line with typical market practice, as competitive base pay is a top attraction and retention driver. Further factors which contribute to long-term retention are career development, relationship with management, trust in leadership and work / life balance.

Section 6

Recommendations

Initial recommendations

- Based on our review findings presented in our report, there are a number of actions HE could take to ensure its remuneration framework is effective, both in terms of policy and specific implementation:

1

Quantitative evidence

Ensure better historical pay and HR data is kept to evidence the effective use of pay freedoms (incl. contingent labour / spend overview, promotions etc.).

2

Specialist role definition

Establish a clear definition of specialist roles across the Senior Group (and broader population).

Determine differentiated approach to senior pay across specialist and non-specialist roles (incl. setting pay and awarding pay increases).

3

Benchmarking

Agree clear approach to benchmarking, including appropriate peer group selection and market positioning.

Consider aligning approaches with CSEP to ensure consistency of outcomes. Alternatively, understand the difference in approach and the bridge between outcomes to enable HE pay levels to be confirmed by CSEP on a by-exception basis.

4

Performance-related pay

Consider the use of individual multiplier and its impact on total PRP award opportunity.

Review the need of more differentiated PRP awards across specialist roles

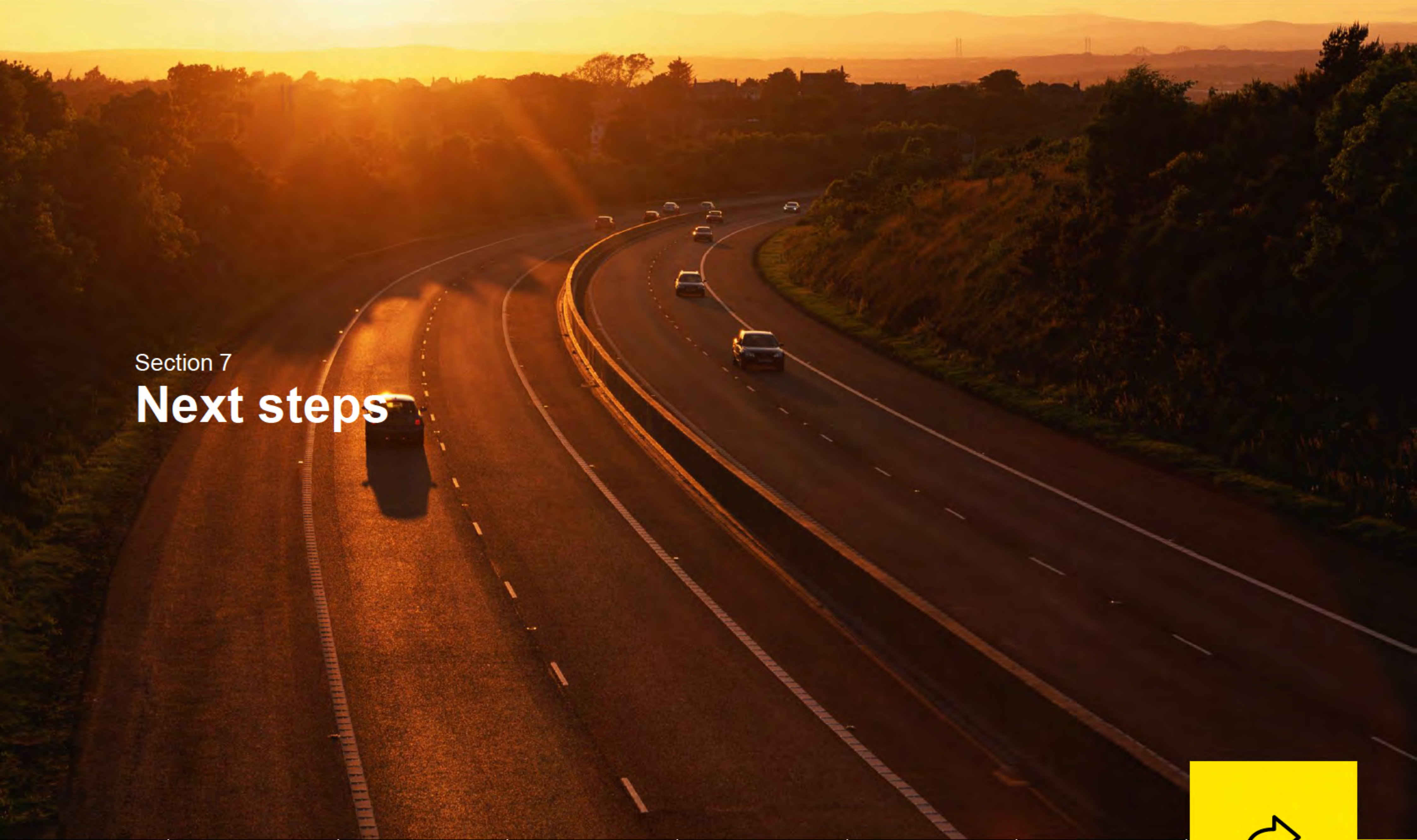
Segment KPIs thematically, to ensure sufficient focus and line of sight

5

Setting base pay

Review the need for pay bands within the Senior Group and the appropriate alignment to Hay reference levels.

Ensure there is the potential to map between HE and SCS pay bands for non-specialist roles.



Section 7

Next steps

HOME
SECTION 1
SECTION 2
SECTION 3
SECTION 4
SECTION 5
SECTION 6
SECTION 7

Next steps

- Agree approach and timelines for Stage Two review (non-senior staff)

Disclaimer

- In preparing this report; we relied solely on the facts, representations and assumptions below as provided by HE and DfT.
- In rendering our advice, we have relied upon the accuracy and completeness of the facts, assumptions and representation contained in the documents and information provided to us. DfT / HE have represented that such facts, assumptions and representations are true, correct, and complete. However, we have not independently audited or otherwise verified any of these facts, assumptions or representations.
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