



# Governance report

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# Governance overview

Sidney Taurel  
Chairman



“The board works closely with the executive team to shape Pearson’s accelerated strategic shift to digital, bringing independent challenge and scrutiny to plans, with a focus on ensuring long-term sustainability of the business.”

## In this Governance section

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## Dear shareholders,

During times of change, good governance is paramount. As a board we organise our work around five major themes where we believe we can add value: governance and risk, strategy, performance, leadership and people, and shareholder engagement. A summary of the key items covered by the board throughout the year appears on p64, and I have set out below further detail on our particular areas of focus during 2016.

### Leadership & effectiveness

[See full section on p60-69](#) →

In a year of continued business transformation and sectoral challenges, strategic review and planning has been an important feature of the board’s agenda through 2016. Working with external advisers, the board oversaw a strategic review of Pearson’s business portfolio, leading to our decision to simplify the business, including a reduction in our exposure to large-scale direct delivery businesses. The strategic review assisted the board in identifying areas of the business in which to capitalise on synergies, and helped us in making strategic and tactical decisions, including the acceleration of our higher education business towards digital and the decision to move towards a rental model for higher education textbooks.

In February 2016, we introduced a new dashboard and key milestones report showing performance against certain KPIs which align with the priorities of the executive team. This monthly report gives the board oversight of a broad range of performance and operational matters including financials, major projects, competitive performance, digital transformation, talent and succession, brand and impact on education. The report is provided to the board on a monthly basis, with progress against the KPIs being reviewed at every board meeting and particular items examined in detail through the course of the year.

To ensure robust oversight and continuing refinement of our corporate governance framework, we reconstituted our nomination committee with effect from 1 January 2017 as the nomination & governance committee, to be chaired by our senior independent director, Vivienne Cox. In addition to the normal nomination and succession planning focus, the committee will also have oversight of, and will devise and consider plans for, matters such as board evaluation, diversity and compliance with applicable governance frameworks, with its recommendations being escalated to the full board for formal adoption as necessary.

The board’s priorities moving forward are to continue to monitor the company’s strategic and tactical actions related to the refocusing of the business, to implement previously signposted portfolio decisions, to keep under review the cost base, to rebase the dividend appropriately, and to effect an optimal capital allocation, particularly following the outcome of negotiations regarding our investment in Penguin Random House, to ensure long-term sustainability. We will also continue to work closely with the executive team to ensure ongoing leadership development.

## Board and management composition

The Pearson board consists of senior executive management alongside a strong team of non-executive directors drawn from successful international businesses and education institutions with experience of corporate strategy, finance, education, emerging markets, technology and consumer marketing. Our non-executive directors, who bring a strong independent viewpoint, complement the executive perspectives of John Fallon and Coram Williams. In addition, we invite members of the Pearson executive (PEM) to attend a number of the board's sessions each year to bring insights and thoughts from across the business, such as at the board's strategy meetings in Minnesota and New Jersey.

As is best practice, we continually assess and refresh the board to ensure that we maintain an appropriate balance and diversity of skills and experience. In January 2016, Lincoln Wallen joined the board as a non-executive director bringing with him a wealth of digital and technology experience, and has since joined the audit and reputation & responsibility committees. The board works well together and all directors continue to make a significant contribution, including our most recent additions.

During the year, the board focused on talent and succession planning for the PEM, and we will continue increasing our involvement in both the development of our existing leaders and ensuring the right new additions are brought into our leadership and talent pool.

## Accountability

[See full section on p70–77](#) →

As a board, we are accountable for Pearson's successes and challenges. We aim to communicate to you in a transparent manner the steps we have taken to ensure that we have a clear oversight of the business and the work we have undertaken in respect of Pearson's strategy throughout the year. Our audit committee, led by Tim Score, plays a key role in monitoring and evaluating our risk management processes, providing independent oversight of our external audit and internal control programmes, accounting policies, business change projects, such as The Enabling Programme, and in assisting the board in reporting in a fair, balanced and understandable manner to our shareholders.

## Engagement

[See full section on p78–81](#) →

I engaged with shareholders throughout the year to understand their varying perspectives on Pearson's performance and strategy, and Elizabeth Corley, chair of our remuneration committee, led a programme of engagement to seek investor views on our proposed directors' remuneration policy. John Fallon and Coram Williams also joined with senior leaders from our higher education business to host Pearson's first dedicated investor day in eight years, allowing shareholders to experience for themselves our products and technology, and examine the market in greater detail. In common with most large, public companies, we have a wider range of stakeholders than just traditional investors, and our reputation & responsibility committee has oversight of our sustainability and social impact initiatives, government and public affairs matters, and engagement with the education community.

## Remuneration

[See full section on p82–106](#) →

Our remuneration policy was reviewed in 2016–17 to align with the company's updated strategy, as well as to reflect changes happening externally in our markets and ongoing changes we are making internally, and will be put to shareholders for approval in a binding vote at the 2017 AGM. We intend to operate executive remuneration in line with the new policy, should it be approved, in 2017. This year's annual report on remuneration also refers to further incremental changes we have made in line with policy in 2016 to better align executive director compensation with our long-term goals.

## UK Corporate Governance Code

This year, we are reporting against the 2014 edition of the UK Corporate Governance Code (the Code). The board believes that during 2016 the company was in full compliance with all relevant provisions of the Code. See p73 for our position on audit tendering and rotation.

A detailed account of the provisions of the Code can be found on the FRC's website at [www.frc.org.uk](http://www.frc.org.uk) and we encourage readers to view our compliance schedule on the company website at [www.pearson.com/governance](http://www.pearson.com/governance)

## Conclusion

I hope this report clearly sets out how your company is run, and how we align governance and our board agenda with the strategic direction of Pearson. We always welcome questions or comments from shareholders, either via our website ([www.pearson.com](http://www.pearson.com)) or in person at our Annual General Meeting.



Sidney Taurel  
Chairman

# Board of directors

## Chairman



**Sidney Taurel Chairman**  
aged 68, appointed 1 January 2016

Sidney has over 40 years of experience in business and finance, and is currently a board director and chairman of the compensation committee at IBM Corporation. Sidney is an advisory board member at pharmaceutical firms Takeda Pharmaceutical and Almirall. He was chief executive officer of global pharmaceutical firm Eli Lilly and Company from 1998 until 2008, chairman of the business from 1999 until 2008, and has been chairman emeritus since 2009. He was also a director at McGraw Hill Financial, Inc., a role which he held from 1996 until April 2016. Sidney has received three US presidential appointments to: the Homeland Security Advisory Council, the President's Export Trade Council and the Advisory Committee for Trade Policy and Negotiations, and is an officer of the French Legion of Honour.

## Key to committees

<b>A</b>	<b>R</b>
Audit	Remuneration
<b>N</b>	<b>O</b>
Nomination & governance	Committee chair
<b>RR</b>	
Reputation & responsibility	

## Executive directors



**John Fallon Chief executive**  
aged 54, appointed 3 October 2012

John became Pearson's chief executive on 1 January 2013. Since 2008 he had been responsible for the company's education businesses outside North America, and a member of the Pearson management committee. He joined Pearson in 1997 as director of communications and was appointed president of Pearson Inc., in 2000. In 2003, he was appointed CEO of Pearson's educational publishing businesses for Europe, Middle East & Africa. Prior to joining Pearson, John was director of corporate affairs at Powergen plc, and was also a member of the company's executive committee. Earlier in his career, John held senior public policy and communications roles in UK local government. He is an advisory board member of the Global Business Coalition for Education and a member of the Council of the University of Hull.



**Coram Williams Chief financial officer**  
aged 43, appointed 1 August 2015

Coram joined Pearson in 2003 and has held a number of senior positions including finance and operations director for Pearson's English Language Teaching business in Europe, Middle East & Africa, interim president of Pearson Education Italia and head of financial planning and analysis for Pearson. In 2008, Coram became CFO of The Penguin Group and was latterly appointed CFO of Penguin Random House in 2013. Coram trained at Arthur Andersen, and subsequently worked in both the auditing and consulting practices of the firm. He is a non-executive director of the Guardian Media Group.

## Non-executive directors



**Linda Lorimer Non-executive director**  
aged 64, appointed 1 July 2013

Linda spent almost 40 years serving higher education. She retired from Yale in spring 2016 after 34 years at the university where she served in an array of senior positions including vice president for Global & Strategic Initiatives. She oversaw the development of Yale's burgeoning online education division and the expansion of Yale international programmes and centres. During her tenure, she was responsible for many administrative services, ranging from Yale's public communications and alumni relations to sustainability, human resources and the university press. Previously, Linda was president of Randolph-Macon Woman's College and chair of the board of the Association of American Colleges and Universities. She also served on the boards of several public companies, including as presiding director of the McGraw-Hill companies. She is a member of the Trilateral Commission and the Council on Foreign Relations.



**Harish Manwani Non-executive director**  
aged 63, appointed 1 October 2013

Harish has an extensive background in emerging markets and senior experience in a successful global organisation. He was previously chief operating officer of consumer products company Unilever, having joined the company in 1976 as a marketing management trainee in India, and held senior management roles around the world, including North America, Latin America, Europe, Africa and Asia. He is non-executive chairman of Hindustan Unilever Limited in India, and serves on the boards of Whirlpool Corporation, Qualcomm Inc. and Nielsen Holdings. He is also on the board of the Indian School of Business and the Economic Development Board (EDB) of Singapore, and is global executive advisor at Blackstone Private Equity.

## Non-executive directors



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**Elizabeth Corley, CBE Non-executive director**  
aged 60, appointed 1 May 2014

Elizabeth is non-executive vice chair of Allianz Global Investors, where she was chief executive officer, initially for Europe then globally, from 2005 to 2016. She was previously at Merrill Lynch Investment Managers and Coopers & Lybrand. Elizabeth is a director of the FICC Markets Standards Board, a member of the ESMA stakeholder group and the advisory council of TheCityUK. She is a non-executive director of BAE Systems plc and the Financial Reporting Council. In addition, she is a member of FEAM's management committee, the CFA Institute Board of Governors, the Committee of 200 and a trustee of the British Museum. She is a fellow of the CFA UK Society and the Royal Society of Arts and is also a crime fiction author.



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**Vivienne Cox, CBE Senior independent director**  
aged 57, appointed 1 January 2012

Vivienne has wide experience in energy, natural resources and business innovation. She worked for BP plc for 28 years in global roles including executive vice president and chief executive of BP's gas, power and renewables business and its alternative energy unit. She is non-executive director of Stena International and chairman of the supervisory board of Vallourec, a leader in the seamless steel pipe markets. She is also non-executive director at pharmaceutical company GlaxoSmithKline plc. She is lead independent director at the UK Department for International Development.



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**Josh Lewis Non-executive director**  
aged 54, appointed 1 March 2011

Josh's experience spans finance, education and the development of digital enterprises. He is the founder of Salmon River Capital LLC, a New York-based private equity/venture capital firm focused on technology-enabled businesses in education, financial services and other sectors. Over a 25-year career in active, principal investing, he has been involved in a broad range of successful companies, including several pioneering enterprises in the education sector. In addition, he has long been active in the non-profit education sector, with associations including New Leaders, New Classrooms, and the Bill & Melinda Gates Foundation. He is also a non-executive director of several enterprises in the fin-tech/data, education and other sectors.

## Non-executive directors



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**Tim Score Non-executive director**  
aged 56, appointed 1 January 2015

Tim has extensive experience of the technology sector in both developed and emerging markets, having served as chief financial officer of ARM Holdings plc, the world's leading semiconductor IP company, a position he held for 13 years. He is an experienced non-executive director and currently sits on the boards of The British Land Company plc and HM Treasury. He served on the board of National Express Group plc from 2005 to 2014, including time as interim chairman and six years as the senior independent director. Earlier in his career Tim held senior finance roles with Rebus Group, William Baird, BTR plc and others.



A  
RR

**Lincoln Wallen Non-executive director**  
aged 56, appointed 1 January 2016

Lincoln is CEO of DWA Nova, a software-as-a-service company born out of DreamWorks Animation Studios in Los Angeles. He has worked at DreamWorks Animation for nine years in a variety of roles including chief technology officer and head of animation technology. He was formerly CTO at Electronic Arts Mobile where he was instrumental in shaping EA's approach to the mobile business. Lincoln's early career involved 20 years of professional IT and mathematics research, including a reader in Computer Science at Oxford. Lincoln graduated from Durham University in 1981 with a BSc in Mathematics and Physics, before completing his PhD in Artificial Intelligence at the University of Edinburgh. Lincoln is a non-executive director of the Smith Institute, an advisory board member of Hewlett Packard Enterprise and a member of the STEM Advisory Committee of the National Academy Foundation.

**Pearson board members bring a wide range of experience, skills and backgrounds which complement our strategy.**

### Executive experience of chairman and non-executive directors

Digital/technology experience

50%



Education/learning experience

38%



North American markets experience

75%



Emerging markets experience

75%



# Board governance and activities

## Board of directors

**Composition of the board** The board consists of the chairman, Sidney Taurel, two executive directors: the chief executive, John Fallon, and chief financial officer, Coram Williams, and seven independent non-executive directors.

**Chairman and chief executive** There is a defined split of responsibilities between the chairman and the chief executive. The roles and responsibilities of the chairman and chief executive are clearly defined, set out in writing and reviewed and agreed by the board on an annual basis.

**Chairman's significant commitments** In April 2016, the chairman stepped down from his position as a non-executive director of McGraw Hill Financial, Inc. There were no other changes to the chairman's significant commitments during 2016. On 1 January 2017, Mr Taurel also stepped down from his role as a senior adviser at the global investment bank, Moelis & Co.

**Independence of chairman** In accordance with the Code, Sidney Taurel was considered to be independent upon his appointment as chairman on 1 January 2016.

**Non-executive directors** Harish Manwani currently serves on five listed company boards, including Pearson, and is chairman of Hindustan Unilever Ltd. We do not believe these appointments

impact Mr Manwani's ability to commit to the Pearson board, and he has demonstrated a full attendance record at Pearson since his appointment to the board. However, Mr Manwani has discussed with our chairman his intent to step down from one of these appointments during the next twelve months, and if for any reason that should not happen, then he would not stand for re-election to the Pearson board at our 2018 AGM.

**Independence of directors** All of the non-executive directors who served during 2016 were considered by the board to be independent for the purposes of the Code. The board reviews the independence of each of the non-executive directors annually. This includes reviewing their external appointments and any potential conflicts of interest as well as assessing their individual circumstances in order to ensure that there are no relationships or matters likely to affect their character or judgement. In addition to this review, each of the non-executive directors is asked annually to complete an independence questionnaire to satisfy requirements arising from Pearson's US listing.

**Conflicts of interest** Under the Companies Act 2006 (the Act), directors have a statutory duty to avoid conflicts of interest with the company. The company's Articles of Association (Articles) allow the directors to authorise conflicts of interest. The company has established a procedure to identify actual and potential conflicts of interest, including all directorships or other appointments to,

## Roles and composition of the board

Role	Name	Responsibility
<b>Chairman</b>	Sidney Taurel	The chairman is primarily responsible for the leadership of the board and ensuring its effectiveness. He ensures the board upholds and promotes the highest standards of corporate governance, setting the board's agenda and encouraging open, constructive debate of all agenda items for effective decision-making. He also ensures that shareholders' views are communicated to the board.
<b>Chief executive</b>	John Fallon	The chief executive is responsible for the operational management of the business and for the development and implementation of the company's strategy as agreed by the board and management. He is responsible for developing operational proposals and policies for approval by the board, and promotes Pearson's culture and standards.
<b>Senior independent director</b>	Vivienne Cox	The senior independent director's role includes meeting regularly with the chairman and chief executive to discuss specific issues, as well as being available to shareholders generally should they have concerns that have not been addressed through the normal channels. She also leads the evaluation of the chairman on behalf of the other directors.
<b>Committee chairmen</b>	Tim Score Elizabeth Corley Vivienne Cox Linda Lorimer	The committee chairmen are responsible for leading the board committees and ensuring their effectiveness. They set the committees' agendas, in consultation with the company's management, and report to the board on committee proceedings.
<b>Company secretary</b>	Stephen Jones	The company secretary acts as secretary to the board and its committees, ensuring compliance with board procedures and advising on governance matters. He is responsible, under the direction of the chairman, for ensuring the board receives accurate, timely and clear information. The company secretary supports the chairman in delivery of the corporate governance agenda and organises director inductions and ongoing training.

### Gender split of board



### Nationality of directors



### Geographic locations of directors

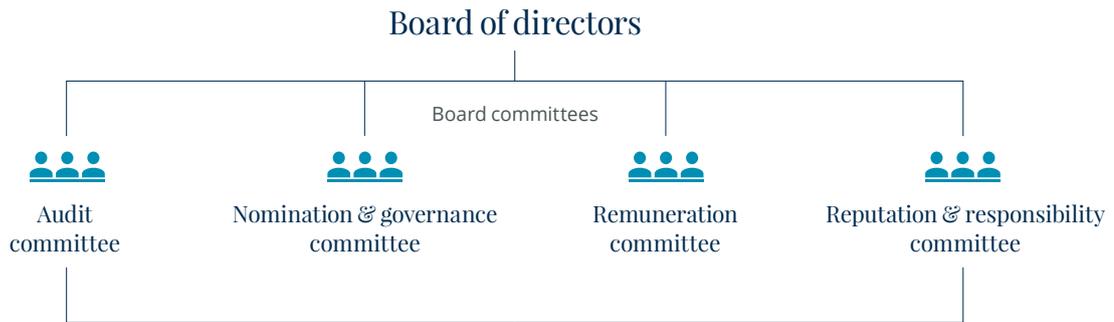


### Length of tenure of non-executive directors



# Governance at Pearson

FLOW OF INFORMATION



## Pearson executive management (PEM)

- Chief executive officer
- Chief financial officer
- Chief technology and operations officer
- Chief corporate affairs and global marketing officer
- Chief human resources officer
- Chief education adviser (until March 2017)
- General counsel and chief legal officer
- President, core markets
- President, growth markets
- President, North America
- President, assessments
- President, global product

### Operating councils

Operating councils operate primarily at sub-executive level, and have either executive representation or clear reporting lines into the Pearson executive. The councils are established to provide leadership and set Pearson's agenda and organisational policy in cross-functional areas, and are accordingly made up of interested parties from across the business.

Examples include:

- > Compliance council
- > Responsible business leadership council

### Leadership teams

Each member of the Pearson executive is supported by a leadership team in the planning and delivery of that executive's main duties. A leadership team typically consists of senior managers from the particular business area, and the strategic business partners who support them in day-to-day matters including representatives from enabling functions such as finance, HR and legal.

Examples include:

- > Core leadership team
- > Global corporate affairs and global marketing leadership team

## Operational responsibility leaders



## Global operations across Pearson

## Board governance and activities

or relationships with, companies which are not part of the Pearson Group and which could give rise to actual or potential conflicts of interest. Once notified to the chairman or company secretary, such potential conflicts are considered for authorisation by the board at its next scheduled meeting. The relevant director cannot vote on an authorisation resolution, or be counted in the quorum, in relation to the resolution relating to his/her conflict or potential conflict. The board reviews any authorisations granted on an annual basis.

### Board meetings

The board met seven times in 2016, with discussions and debates focused on the key strategic issues facing the company. Major items covered by the board in 2016 are shown in the table below.

In addition to the formal meetings, the board meets as necessary to consider matters of a time-sensitive nature.

### The role and business of the board

The board is deeply engaged in developing and measuring the company's long-term strategy, performance and values. We believe that it adds a valuable and diverse set of external perspectives and that robust, open debate about significant business issues brings an additional discipline to major decisions.

A schedule of formal matters reserved for the board's decision and approval is available on our website, at [www.pearson.com/governance](http://www.pearson.com/governance)

The key responsibilities of the board include:

- › Overall leadership of the company and setting the company's values and standards

- › Determining the company's strategy in consultation with management, reviewing performance against it, and overseeing management execution thereof
- › Major changes to the company's corporate, capital, management and control structures
- › Approval of all transactions or financial commitments in excess of the authority limits delegated to the chief executive and other executive management.

The board receives timely, regular and necessary financial, management and other information to fulfil its duties. Comprehensive board papers are circulated to the board and committee members at least one week in advance of each meeting and the board receives regular reports from the chief executive. In addition to meeting papers, a library of current and historic corporate information is made available to directors electronically to support the board's decision-making process. Directors can obtain independent professional advice, at the company's expense, in the performance of their duties as directors. All directors have access to the advice and services of the company secretary.

### Standing committee

A standing committee of the board is established to approve certain operational and ordinary course of business items such as banking matters, guarantees, intra-group transactions and to make routine approvals relating to employee share plans.

The committee has written terms of reference, reviewed and approved each year, which clearly set out its authority and duties. These can be found on the company website at [www.pearson.com/governance](http://www.pearson.com/governance).

## Board meeting focus during 2016

Area of responsibility	Activity
<b>Governance &amp; risk</b>	<ul style="list-style-type: none"> <li>› Annual review of authorised conflicts of interest</li> <li>› Review of division of responsibilities between chairman and chief executive</li> <li>› Brexit – implications and next steps</li> <li>› South African Black Economic Empowerment overview</li> <li>› Penguin Random House – investment update</li> <li>› Shareholder activism and defence plan</li> <li>› Board evaluation findings</li> <li>› Risk appetite</li> <li>› Enterprise risk management review <a href="#">Read more on p44-46</a> →</li> <li>› Approval of schedule of authority limits</li> <li>› Approval of committee terms of reference</li> <li>› Treasury policy approval</li> </ul>
<b>Strategy</b>	<ul style="list-style-type: none"> <li>› Operating and strategic plan updates</li> <li>› Restructuring plan updates</li> <li>› Strategic planning focusing on markets and portfolio, including dedicated meeting in New Jersey</li> <li>› Strategy meeting in Minnesota focusing on US higher education courseware and the assessments business <a href="#">Read more on p65</a> →</li> <li>› Interactive product demonstrations</li> </ul>
<b>Performance</b>	<ul style="list-style-type: none"> <li>› 2015 preliminary results and annual report and accounts</li> <li>› Monthly dashboard and milestone reports</li> <li>› Interim results and trading updates</li> <li>› Balance sheet strategy</li> <li>› 2016 operating plan update</li> <li>› Final and interim dividend proposals</li> <li>› Draft 2017 operating plan and three-year financials</li> </ul>
<b>Leadership &amp; people</b>	<ul style="list-style-type: none"> <li>› Chief executive's goals</li> <li>› Facilitated talent breakfasts at strategy meetings</li> <li>› Dinner with senior local management at strategy meetings</li> <li>› Talent and succession planning <a href="#">Read more on p69</a> →</li> </ul>
<b>Shareholders &amp; engagement</b>	<ul style="list-style-type: none"> <li>› Focus on forthcoming AGM</li> <li>› Review of shareholder issues and voting</li> <li>› Major shareholders and share register analysis</li> <li>› Review of investor relations strategy and share price performance</li> </ul>

## Culture and values

Pearson's core values – to be brave, imaginative, decent and accountable – go to the heart of our mission to improve learning outcomes, and the board and employees are committed to demonstrating these characteristics throughout their work and deliberations. The board monitors the culture of the company and levels of employee engagement and advocacy with the assistance of its reputation and responsibility committee and through regular updates from the chief human resources officer. It aims to foster a culture of collaboration, diversity and inclusion at all levels, including by engaging with employees from across Pearson at various events throughout the year.

## Board attendance

Directors are encouraged to attend all board and committee meetings but in certain circumstances, such as due to pre-existing business or personal commitments, directors may be unable to attend. In these circumstances, directors receive relevant papers and, where possible, will communicate any comments and observations in advance of the meeting for raising as appropriate during the meeting. They are updated on any developments after the meeting by the chairman of the board or committee, as appropriate. Individuals' attendance at board and committee meetings is considered, as necessary, as part of the formal annual review of their performance.

The following table sets out the attendance of the company's directors at scheduled board meetings during 2016:

Board meetings attended

Chairman	
Sidney Taurel	7/7
Executive directors	
John Fallon	7/7
Coram Williams	7/7
Non-executive directors	
Elizabeth Corley	7/7
Vivienne Cox	7/7
Josh Lewis	7/7
Linda Lorimer	7/7
Harish Manwani	7/7
Tim Score	7/7
Lincoln Wallen	7/7

## Succession planning

The board considers oversight of succession planning – not only at board and executive management level but for all key positions throughout the business – as one of its prime responsibilities, assisted by the nomination & governance committee.

The company has formal contingency plans in place for temporary absence of the chief executive for health or other reasons. The matter of chief executive succession is a standing item for discussion and review by the chairman and chief executive annually. Succession planning for the board and chair is also considered annually, and as part of the recent restructuring programme, there has been a review of key positions at executive management level.

Read more about Talent and succession planning on p69 →

## Governance in action: Minnesota visit



In June 2016, the board visited Bloomington, Minnesota, where they were hosted by the president of Pearson's assessments business, Bob Whelan.

Bloomington is the headquarters of Pearson's global assessments business which generated 22 % of Pearson's sales in 2016, with approximately 800 employees based there.

**Overview of assessments** Senior managers led a deep dive into each of the three distinct areas within the assessments business: US school assessment, global clinical assessment, and professional certification. While these are distinct businesses, the board heard about the synergies to be drawn from combining these under the leadership of Mr Whelan, such as an opportunity to share capabilities and platforms. In a focused session led by the chief corporate affairs and global marketing officer, the board discussed the reputational challenges and strategies relating to the testing business.

**US higher education courseware** Tim Bozik, Don Kilburn and Albert Hitchcock presented to the board on the need to focus primarily on our portfolio, product and the platform strategy that we will deploy to maximise digital adoption of our US higher education courseware over the next three years.

**A client perspective** The board discussed with the President and CEO of the Graduate Management Admission Council the need to gain a customer's perspective on the shifting global landscape of business education, primarily in postgraduate studies, and associated opportunities and challenges.

**Learning in action** The board toured a Pearson VUE professional testing centre, following which they took a computer-based test to better understand the customer experience. There was also an opportunity for the board and executive to join local employees to see at first hand the work carried out by two partner organisations, America's Promise Alliance and the Minnesota Literacy Council.

**The Pearson community** The board met for breakfast with the company's locally based emerging talent. The board also met with local leaders with the aim of advancing shared educational goals, in particular to prepare a diverse population of students for educational and employment success.

## Board governance and activities

The board meets with local staff and senior management every time board meetings are held away from the head office, such as during the board's 2016 visits to Bloomington, Minnesota and Hoboken, New Jersey. In addition, a number of London-based employees attended a reception with the board as part of its December meeting schedule. This allows the non-executive directors to share their experience and expertise with employees as well as allowing them to better understand their abilities and motivations, helping them to assess the company's prospects and plans for succession.

### Board evaluation

The board evaluation for 2016 was an internal assessment of board performance led by Vivienne Cox, senior independent director. In terms of process, a questionnaire was distributed as an advance indication of the evaluation's proposed areas of focus, following which Ms Cox held an open discussion with each director on an individual basis. Board members' views were sought on a range of areas including boardroom dynamics, strategy, risk, quality of information, market knowledge and board composition.

### Feedback and key themes

The evaluation found that the board has a culture of open and transparent discussion, with all directors being able to challenge and question rigorously. The board size and composition was felt to be appropriate for the business, and consideration was given to recruitment of future board members, including the skills, background and experience we might look for in any future non-executive directors, and succession planning for committee chairmen. Board members were in agreement that they should continue to focus on US higher education courseware at every meeting, and that additional measures will be built into the monthly dashboard to monitor this business. The directors also expressed a desire to make use of external expertise in digital technologies and agreed to explore this further. The nomination & governance committee will consider Ms Cox's findings and recommendations in greater detail in early 2017, as they commence planning for the 2017 evaluation which will be conducted on an external basis.

We also took a number of actions in 2016 in response to feedback arising from the directors during the 2015 board evaluation process. You can read more about these actions in the table below.

## Progress on findings of 2015 evaluation

Finding	Response / Action taken
Overall, the style and substance of board papers were well liked by the board, although executive summaries are welcome where information is particularly detailed.	Working with senior management, the chairman introduced a monthly dashboard, presenting performance against a range of financial and strategic KPIs, in a simple, consistent and readable style. The company secretarial and strategic development teams have reviewed and amended the format of board papers to bring greater consistency to the style and structure of the papers, including recommending the inclusion of a standard set of strategic information. This will be kept under review to ensure the papers continue to provide the appropriate level of detail in an accessible format.
Reviewing committee composition might allow meetings to run concurrently, allowing the time available to be more effectively used.	The chairman reviewed committee composition with the non-executives and the company secretary during the year. Revised committee compositions were introduced with effect from 1 January 2017 to allow concurrent meetings and more efficient use of available time.
Board dinners are most useful when there is a theme, a topic for discussion or external guests attending.	Whenever possible we hold a dinner for all directors prior to each board meeting. At its February 2016 dinner, the board reviewed its 2015 evaluation exercise and the chief executive discussed changes to the executive team. In June, the board met with community stakeholders and education thought leaders at its Minnesota strategy meeting, and in October the board discussed the upcoming US presidential election with political analysts in New Jersey.
Scheduling and frequency of board meetings generally considered to be appropriate, and there is a preference to set dates well in advance due to the full schedule.	We set our main meeting dates two years in advance in consultation with the board but there will inevitably be occasions where a meeting needs to be called at relatively short notice. On such occasions we facilitate directors joining by telephone or video conference, and try to accommodate time differences in doing so.
The board finds it helpful to receive corporate affairs updates and broker reports.	We have arranged for the regular internal corporate affairs briefing to be shared with non-executives, and the investor relations team provides a cross-section of analyst reports when appropriate to enable the board to keep abreast of market sentiment.
Informal product demonstrations are very useful in helping non-executive directors to better understand the products and customer experience.	We arranged hands-on product demonstrations at the February, June and October board meetings. Led by executive colleagues and product leaders, the board learned about our World Class Qualifications and next generation BTECs, six key products in higher education, and the Pearson VUE assessment methodology. The demonstrations were well received, and we will continue to include similar sessions at future board meetings when the opportunity arises.

### Individual evaluation

In addition to the evaluation of the board as a whole, executives are evaluated each year on their performance against personal objectives under the company's annual incentive plan. The chairman meets with each non-executive director individually on a regular basis and, in assessing the contribution of each, has confirmed that each director continues to make a significant contribution to the business and deliberations of the board. The non-executive directors, led by the senior independent director, also conduct an annual review of the chairman's performance.

### Committee evaluation

All committees undertake an annual evaluation process to review their performance and effectiveness. The process involves distribution of questionnaires to committee members, as well as key stakeholders in each committee, seeking views on matters including committee roles and responsibilities, quality and timeliness of meeting materials, opportunity for discussion and debate, dialogue with management and access to independent advice. Responses are then evaluated and presented to the respective committee at a scheduled meeting, with key themes being drawn out for discussion. Read more in the committee reports on the pages that follow.

### Directors' training and induction

Directors receive a significant bespoke induction programme and a range of information about Pearson when they join the board. This includes background information on Pearson and details of board procedures, directors' responsibilities and various governance-related issues, including procedures for dealing in Pearson shares and their legal obligations as directors. The induction also typically includes a series of meetings with members of the board, external legal advisers and brokers, the Pearson executive and senior management, presentations regarding the business from senior executives and a briefing on Pearson's investor relations programme.

The induction programme for Lincoln Wallen, our most recently appointed non-executive director, continued into 2016, tailored to his specific areas of focus, and included time with the chief technology and operations officer and president of our North American business, as well as sessions relevant to the board committees he has joined. In addition to matters highlighted above, the induction for our chairman, Sidney Taurel, included attending our North American higher education sales conference, the senior leaders' accelerated growth meeting in Texas, a visit to our Brazilian businesses, and meetings with substantial shareholders throughout the year.

All directors receive training in the form of presentations about the company's operations, through board meetings held at operational locations and by encouraging the directors to visit local facilities and management as and when their schedule allows, including if they are travelling to a country or region on non-Pearson business. The company secretary and general counsel, in conjunction with

Pearson's advisers, monitor legal and governance developments and update the board on such matters as agreed with the chairman. In 2016, the directors and other senior managers were briefed on the effect of the new EU Market Abuse Regulation on the company, and changes to their personal obligations arising from that legislation. Directors can also make use of external courses.

### Directors' indemnities

A qualifying third-party indemnity (QTPI), as permitted by the Articles and sections 232 and 234 of the Act, has been granted by the company to each of its directors. Under the provisions of the QTPI, the company undertakes to indemnify each director against liability to third parties (excluding criminal and regulatory penalties) and to pay directors' costs as incurred, provided that they are reimbursed to the company if the director is found guilty, the court refuses to grant the relief sought or, in an action brought by the company, judgment is given against the director. The indemnity has been in force for the financial year ended 31 December 2016 and is currently in force.

The company has purchased and maintains directors' and officers' insurance cover against certain legal liabilities and costs for claims in connection with any act or omission by such directors and officers in the execution of their duties.

### Board committees

The board has established four formal committees: audit, nomination & governance, remuneration, and reputation & responsibility. The chairmen and members of these committees are appointed by the board on the recommendation (where appropriate) of the nomination & governance committee and in consultation with each relevant committee chairman. In addition to these formal board committees, the standing committee also operates with board-level input.

Learn more about Pearson's governance structure on p63 →

### More committee information:

Audit committee	p70 →
Nomination & governance committee	p68 →
Remuneration committee	p82 →
Reputation & responsibility committee	p78 →
Standing committee	p64 →

The committees focus on their own areas of expertise, enabling the board meetings to focus on governance and risk, strategy, performance, and leadership and people, thereby making the best use of the board's time together as a whole. The committee chairmen report to the full board at each meeting immediately following their sessions, ensuring a good communication flow while retaining the ability to escalate items to the full board's agenda if appropriate.

# Nomination & governance committee report

## Committee chairman

Vivienne Cox

**Members** Elizabeth Corley,  
Vivienne Cox, Josh Lewis,  
Harish Manwani,  
Tim Score and Sidney Taurel



“As Pearson focuses on the changing needs of the world’s education markets, the committee’s role is to ensure the right leadership is in place to steer the company forward.”

### Committee responsibilities include:

#### Appointments

Identifying and nominating candidates for board vacancies.

#### Balance

Ensuring that the board and its committees have the appropriate balance of skills, experience, independence, diversity and knowledge to operate effectively.

#### Succession

Reviewing the company’s leadership needs with a view to ensuring the continued ability of the organisation to compete in the marketplace.

#### Governance

Review and oversight of Pearson’s corporate governance framework, board evaluation and training plans, and board diversity policy.

### Terms of reference

The committee has written terms of reference which clearly set out its authority and duties. These are reviewed annually and can be found on the company website [www.pearson.com/governance](http://www.pearson.com/governance) →

### Attendance

Attendance by directors at nomination committee meetings throughout 2016:

	Meetings attended
Sidney Taurel	2/2
Elizabeth Corley	2/2
Vivienne Cox	2/2
Josh Lewis	2/2
Linda Lorimer <sup>1</sup>	2/2
Harish Manwani	2/2
Tim Score	2/2
Lincoln Wallen <sup>1</sup>	2/2

**Note 1:** Linda Lorimer and Lincoln Wallen stepped down from the nomination committee on 31 December 2016.

## Role and business of the committee

The committee monitors the composition and balance of the board and of its committees, identifying and recommending to the board the appointment of new directors and/or committee members. The committee also oversees talent and succession plans for senior roles.

### Board search

Pearson uses a number of leading firms in its board search activities and ensures that we retain good relationships with these firms. However, no appointment or board search activity was undertaken during 2016.

### Changes to committee and 2016 activity

During 2016, in response to feedback from the chairman and other members of the board, a comprehensive review was carried out to look at the work done by each committee. The intention was to ensure the board worked effectively and used its time together well. As a result, changes were made to the membership of each committee and the role of the nomination committee was expanded to include corporate governance matters, including board diversity, oversight of the annual board evaluation processes, the company’s corporate governance policies and practices, compliance with the Code, and oversight of director induction and training. In respect of its governance remit, the committee will primarily take on the role of reviewing current practices on behalf of the board, and recommending actions or changes for the board’s formal approval.

As senior independent director, I have taken on the chairmanship of the committee, with the other members being independent non-executive directors, including the chairmen of the audit and remuneration committees, and the chairman of the board. The chief executive and other senior management attend committee meetings by invitation.

During the year, I was pleased to be invited by Kate James, Pearson’s chief corporate affairs and global marketing officer and executive sponsor of our Women in Leadership and Learning network (WILL) to give a virtual talk to employees on career and professional development.

### Diversity

The board embraces the Code’s underlying principles with regard to board balance and diversity, including gender diversity. The committee ensures that the directors of Pearson demonstrate a broad balance of skills, experience and nationalities, to support Pearson’s strategic development and reflect the global nature of our business. Appointments are made on merit and relevant experience, while taking into account the broadest definition of diversity.

We are pleased with the gender diversity of the Pearson board, having exceeded Lord Davies' 2015 target with 30% female representation on the board; however, we note the five recommendations of the Hampton-Alexander Review aimed at continuing to improve the representation of women in the leadership of large listed companies, and we are committed to work towards these. The recommendations include voluntary targets of at least 33% female representation on the board, executive committee and in their direct reports, increased transparency by companies in this regard, and proactive involvement of nomination committees in overseeing progress in these areas.

The chief executive and the chief financial officer are both members of the board. Among the other ten members of the executive team there are two females (20%), although for most of 2016 the percentage was 22% (two members out of nine). The senior leadership team, the two levels of managers reporting to the chief executive, has 32% women. This gives us confidence that we have a strong pipeline of women coming through, and the committee will monitor their development, and the development of all key talent, with care.

We also welcome the Parker Review's recent report into ethnic diversity on UK boards, including the voluntary target of at least one director of colour by 2021, and will consider the report's recommendations carefully when reviewing our board diversity policy and throughout our senior management succession planning process.

Learn more about diversity and inclusion throughout Pearson on p24 [→](#)

**Committee aims for 2017**

With the committee's expanded remit, we will have a full agenda for 2017, with a particular focus on planning for our three-yearly external board evaluation, reviewing the board's diversity policy and objectives, and ongoing oversight of governance and succession planning activity.



**Vivienne Cox**  
Chairman of nomination & governance committee

## Talent and succession planning

At a joint session with the board in April 2016, led by the chief human resources officer, the committee reviewed the talent and leadership implications of the growth and simplification plan, succession planning for chief executive and other Pearson executive roles, development of senior leadership talent, and high potential talent beyond the senior leadership group.

The committee was reminded of Pearson's talent philosophy which relates to the achievement of measurable goals, transparency and the Pearson behaviours – brave, imaginative, decent and accountable. The committee agreed the characteristics to be demonstrated by all leaders, reflecting business priorities.

The committee noted the strengthening of the executive team and a number of expanded roles over the past year as a result of the continuing Group-wide transformation. They reviewed in detail each member of the executive including identifying immediate interim successors for each executive role and discussing the longer term succession pipeline. Diversity in senior roles was discussed and the directors were keen to understand what more could be done to measure diversity and to think about it in its broadest sense and its alignment with the business strategy.

The committee concluded that Pearson has a strong talent bench, noting certain areas for improvement in terms of diversity and the succession pipeline, and offered their assistance as mentors to help in the development of key talent, as and when considered appropriate.

## Nomination committee meeting focus during 2016

Area of responsibility	Activity
Appointments	<ul style="list-style-type: none"> <li>› Appointment of Linda Lorimer as chairman of reputation &amp; responsibility committee</li> <li>› Appointment of Vivienne Cox as chairman of nomination &amp; governance committee</li> </ul>
Balance	<ul style="list-style-type: none"> <li>› Reviewing composition and remit of board committees</li> </ul>
Succession	<ul style="list-style-type: none"> <li>› Succession planning for executive director and executive management roles</li> <li>› Review of senior management and high potential talent pipeline</li> </ul>

# Audit committee report

## Committee chairman

Tim Score

**Members** Elizabeth Corley<sup>a</sup>, Vivienne Cox, Linda Lorimer, Tim Score and Lincoln Wallen



**“As a committee we provide independent scrutiny and challenge in times of strategic shift and operational enhancements throughout Pearson.”**

### Committee responsibilities include oversight of:

<b>Reporting</b>	The quality and integrity of financial reporting and statements and related disclosure.
<b>Policy</b>	Group policies, including accounting policies and practices.
<b>External audit</b>	External audit, including the appointment, qualification, independence and the performance of the external auditor.
<b>Risk &amp; internal control</b>	Risk management systems and internal control environment including the performance of the internal audit function.
<b>Compliance &amp; governance</b>	Compliance with legal and regulatory requirements in relation to financial reporting and accounting matters.

### Terms of reference

The committee has written terms of reference which clearly set out its authority and duties. These are reviewed annually and can be found on the company website [www.pearson.com/governance](http://www.pearson.com/governance)

### Attendance

Attendance by directors at audit committee meetings throughout 2016:

	Meetings attended
Vivienne Cox <sup>1</sup>	2/4
Linda Lorimer	4/4
Tim Score	4/4
Lincoln Wallen <sup>2</sup>	3/3

**Note 1:** Ms Cox was unable to attend two meetings due to (i) a pre-existing work commitment and (ii) her CBE investiture ceremony. On both occasions, Ms Cox communicated her observations to the committee chairman ahead of the meeting.

**Note 2:** Mr Wallen joined the audit committee on 1 March 2016.

**Note 3:** Elizabeth Corley joined the audit committee on 1 January 2017.

## Audit committee role

The committee has been established by the board primarily for the purpose of overseeing the accounting, financial reporting, internal control and risk management processes of the company and the audit of the financial statements of the company. As a committee, we are responsible for assisting the board's oversight of the quality and integrity of the company's external financial reporting and statements and the company's accounting policies and practices.

Pearson's internal auditor has a dual reporting line to the chief financial officer and to me, and external auditors have direct access to the committee to raise any matters of concern and to report on the results of work directed by the committee. As audit committee chairman, I report to the full board at every board meeting immediately following a committee meeting. I also work closely with the chief financial officer outside of the formal meeting schedule to ensure robust oversight and challenge in relation to financial control and risk management.

### Provision of non-audit services by external auditors

As a committee, we review the independence of the external auditors, including the provision of non-audit services to ensure that there is an appropriate audit relationship and that auditor objectivity and independence are upheld. During 2016, the committee approved revisions to Pearson's external auditor policy to take account of changes to the regulation of non-audit services which may be provided by external auditors. Learn more about auditors' independence on p74 and note 4 to the consolidated financial statements.

### Audit committee changes

In March 2016, Lincoln Wallen joined the committee, bringing extensive technology experience; and, as a result of the work conducted by the nomination committee and Mr Taurel to examine the composition and remit of the board's committees, Elizabeth Corley joined the committee with effect from 1 January 2017. As a committee, we have a good balance of skills and knowledge with experience covering all aspects of the sector in which Pearson operates – education, digital and services, and our key geographic markets.

### Fair, balanced and understandable reporting

We are mindful of the Code's provision C.1.1 relating to fair, balanced and understandable reporting and we build sufficient time into our annual report timetable to ensure that the full board receives sufficient opportunity to review, consider and comment on the report as it progresses. Learn more about fair, balanced and understandable reporting on p110 →

### Risk assessment, assurance and integrity

A key role of the committee is to provide oversight and reassurance to the board with regard to the integrity of the company's financial reporting, internal control policies, and procedures for the identification, assessment and reporting of risk. During 2016, we conducted a number of deep dives into selected principal risks, and the key risks on which the committee focused throughout the year are set out below. Learn more about principal risks and uncertainties on p47-55 →

## Business transformation

Ongoing business transformation is one of Pearson's key risks and opportunities. The Enabling Programme (TEP) is an important operational simplification project covering Pearson's key enterprise resource planning technology and processes including financial and HR systems and processes, and the committee received an update at each meeting as TEP progressed during the year. The key area of focus for the committee throughout the year was oversight of the implementation in the UK, which was the first sector of Pearson to go live, acting as a pilot for some of the global design decisions. Of particular importance before go-live were the complexities in Pearson's business model, the number of key interfaces and the need to address the customer-facing platforms as a priority. The committee focused on the schedule and risks to the UK go-live in relation to integration, design and build, and data, considering how those could be mitigated. They reviewed the operation of the TEP steering committee and agreed upon the timing and scope of PwC's external assurance work to complement the Group's own programme assurance activities.

The HR systems go-live took place in the UK without major issue. The main finance system go-live in the UK took place in July 2016, and the committee continued to monitor TEP as the systems became embedded into business practices, noting that issues had been experienced due in part to complex data transition. These were

addressed in a methodical manner, with customer and year end issues being the priority. The committee discussed with management the lessons learned from the UK implementation, and heard how those would help to shape the governance structure for the US deployment with plans having been developed to de-risk the US implementation and to phase it over a longer period, expected to start in Q4 2017, with the rest of world implementation pushed back for 12 months. The committee will continue to consider TEP at each meeting as the project progresses throughout 2017. Learn more about The Enabling Programme on p48 →

## Data security and data privacy

The committee held deep dives with the chief technology & operations officer, chief information security officer and chief privacy officer to examine progress made in the second year of enhancements, and consider where efforts should be focused. A number of actions had been taken to strengthen the security of Pearson's technology estate, which increased visibility over the infrastructure and improved resilience to external attacks. The committee discussed the company's approach to dealing with information security and data privacy in legacy products, and how these would be addressed in products in the development pipeline. They heard how technology and legal teams had conducted a detailed review of Pearson's top products, including all of the key US and UK school assessment products and covering at least half

## Audit committee meeting focus during 2016

Area of responsibility	Activity
<b>Reporting</b>	<ul style="list-style-type: none"> <li>› Accounting and technical updates</li> <li>› Impact of legal claims and regulatory issues on financial reporting</li> <li>› Fair, balanced and understandable, Going concern and viability statements</li> </ul>
<b>Policy</b>	<ul style="list-style-type: none"> <li>› Accounting matters and Group accounting policies</li> <li>› Analysis supporting viability statement <a href="#">Read more on p55</a> →</li> <li>› Annual review and approval of external auditor policy</li> </ul>
<b>External audit</b>	<ul style="list-style-type: none"> <li>› Provision of non-audit services by PwC</li> <li>› Receipt of external auditors' report on Form 20-F and year-end audit</li> <li>› Half year review</li> </ul>
<b>Risk &amp; internal control</b>	<ul style="list-style-type: none"> <li>› Internal audit activity reports and review of key findings</li> <li>› Enterprise risk management <a href="#">Read more on p44-46</a> →</li> <li>› 2017 internal audit plan</li> <li>› Legacy product review</li> </ul>
<b>Compliance &amp; governance</b>	<ul style="list-style-type: none"> <li>› Fraud, whistleblowing reports and Code of Conduct matters</li> <li>› The Enabling Programme</li> <li>› Schedule of authorities</li> </ul>

## Audit committee report

of Pearson's digital revenues, and had developed a detailed risk management plan. Awareness and training campaigns continued to be rolled out to employees on both data security and data privacy, as employee education and cultural change would be key in ensuring integrity of systems and protection of data, and the company's data privacy governance continued to develop through implementation of new Group-wide policies and data privacy network.

### Anti-bribery and corruption (ABC)

The committee received an update on the global landscape for ABC regulatory enforcement actions, highlighting an increasing focus in Brazil, India and China, where Pearson has a number of businesses. The committee heard that Pearson has in place a good global ABC framework that is working effectively, and noted that a particular focus area for 2017 would be third-party risk, including review of due diligence on partners and the supply chain.

Pearson's ABC infrastructure includes a network of local compliance officers based in-country, being mainly members of the legal team. These officers have assumed responsibility for ABC compliance in their respective businesses, and function as the 'eyes and ears' of the organisation with the oversight of the central compliance and legal teams. The committee also reviewed ongoing work to train employees throughout the business in ABC matters, and noted that momentum continues to build within the organisation, thanks in part to the establishment of a cross-functional compliance council and co-ordinated communication and awareness campaigns.

### Tax

At a risk deep dive into Pearson's tax strategy led by the senior vice president (SVP) tax, the committee discussed the complexities and uncertainties in the global tax environment, noting that UK and US tax reform was possible as a result of the UK's decision to leave the European Union and the new administration in the US, as well as the EU's clarification on its perception of 'inappropriate tax benefits' in a number of jurisdictions, although the nature of any regime changes and the likely impact on Pearson was still very unclear. Management confirmed that they were fully prepared to review Pearson's Group tax strategy in 2017 if required as the exact position began to take shape. The committee noted that for the major countries in which Pearson operates the overall tax function was centralised and strong control operated from the Group tax function. For other countries tax controls are de-centralised in terms of day-to-day oversight, but the senior tax management team maintained good relationships with operations throughout the world and were well informed as to the tax position and possible risks across Pearson's global businesses.

### Audit committee meetings and activities

At every meeting, the committee considered reports on the activities of the internal audit and compliance functions, including the results of internal audits, risk reviews, project assurance reviews and fraud and whistleblowing reports. The committee also monitored the company's financial reporting, internal controls and risk management procedures, reviewed the non-audit services provided by PwC and considered any significant legal claims and regulatory issues in the context of their impact on financial reporting.

In February 2017, the committee also considered the 2016 annual report and accounts, including the preliminary announcement, financial statements, strategic report and directors' report.

Learn more about the key activities of the audit committee on p71 [→](#)

### Additional meeting attendees

In addition to the committee members, advisers and executives from across the business also attended meetings during the year, as outlined in the table below. This gives the committee direct contact with key leadership. The chairman and chief executive each attend at least one meeting per year, and the chief executive also attends for discussion of matters with an operational focus. The committee also met regularly in private with the external auditors and the SVP internal audit and compliance.

Attendees	Meetings attended
Chief financial officer	4/4
Legal counsel	4/4
SVP internal audit and compliance	4/4
SVP group finance	4/4
SVP finance, group reporting	4/4
Vice president compliance and risk assurance	4/4
Company secretary	4/4

### Audit committee training

The committee receives regular technical updates as well as specific or personal training as appropriate. In July 2016, PwC led a training session for the committee on regulatory updates, culture and behaviours.

Committee members also meet with local management on a periodic basis, such as when travelling for overseas board meetings, in order to gain a better understanding of how Pearson's policies are embedded in operations.

### Members

All of the audit committee members are independent non-executive directors and have financial and/or related business experience due to the senior positions they hold or have held in other listed or publicly traded companies and/or similar public organisations. Tim Score, who assumed the chairmanship of the committee in April 2015, is the company's designated financial

expert, having recent and relevant financial experience, and is an Associate Chartered Accountant. He also serves as audit committee chairman for The British Land Company plc. The qualifications and relevant experience of the other committee members are detailed on p60-61 [→](#)

## Committee evaluation

The committee undertakes an annual evaluation process to review its own performance and effectiveness, as well as that of the external auditors and Pearson's internal audit function.

In reviewing its own effectiveness, the committee sought input from its members, the chairman, the lead external audit partner, and senior executives. The responses illustrated an effective committee, which uses its time well and has an appropriate focus on the key issues.

## External audit

### Oversight of external auditors

The committee reviews and recommends to the board the appointment of the external auditors, taking account of the views of management.

The committee reviewed the effectiveness and independence of the external auditors during 2016, as it does every year, and remains satisfied that the auditors provide effective independent challenge to management.

The external auditor review was conducted by distributing a questionnaire to key audit stakeholders including members of the audit committee, the chief executive, chief financial officer, company secretary, SVP internal audit and compliance, SVP finance for each business area and other heads of corporate functions. Overall, responses to the questionnaire were very positive, indicating an effective external audit process.

In addition, in accordance with Pearson's external auditor policy, internal audit performs an annual assessment of audit fees, services and independence. Both the preceding review and the internal audit review are considered by the committee in forming its recommendation to the board in respect of the appointment and compensation of the external auditors.

The committee will continue to review the performance of the external auditors on an annual basis and will consider their independence and objectivity, taking account of all appropriate guidelines. There are no contractual obligations restricting the committee's choice of external auditors. In any event, the external auditors are required to rotate the audit partner responsible for the Pearson audit every five years. The current lead audit partner rotated onto Pearson's audit in 2013.

### Audit tendering and rotation

Pearson's last audit tender was in respect of the 1996 year end, and resulted in the appointment of Price Waterhouse as auditors. Developments at an EU level regarding mandatory audit rotation for listed companies have changed the UK landscape on audit tendering and rotation. The committee has reviewed the timetable for tendering and has taken into account relevant regulation and guidance. EU regulations and the ruling by the Competition and Markets Authority (CMA) impose mandatory tendering and rotation requirements, with EU rules requiring a new auditor to be appointed no later than for the 2024 financial year end.

In considering the appropriate audit tender timetable for Pearson in light of these requirements, the committee has also taken account of the significant business change being experienced by the Group

and is monitoring the extent to which the Group is drawing upon the services of other accounting firms. As noted elsewhere within this report, a series of programmes is underway throughout Pearson to implement major efficiency improvements across all our enabling functions – technology, finance, HR – to bring the general and administrative costs of running Pearson more in line with global best practice. These include a major transformation programme – The Enabling Programme (TEP) – which includes the implementation of new financial systems and changes to our transaction processing and control activities, which launched in the UK during 2016, and is expected to be rolled out throughout our businesses by 2020. Pearson is supported in these changes, such as in project assurance matters, and more broadly, by external advisers including accounting firms.

In its report last year, the committee expressed its intention to initiate a tender process during 2018, in order for the auditor selected to be in place in time for the audit of the financial year ending 31 December 2018. Due to the status of TEP and the involvement of accounting firms advising on TEP and other change projects, the committee is of the opinion that the level of disruption likely with a change of auditor, as well as the focus required by finance and management teams to conduct the tender process thoroughly and effectively, may unduly impact the Group and would not be in the best interests of shareholders. The committee therefore agreed at its meeting in December 2016 that it was appropriate in the current circumstances to defer the timing of the audit tender for the foreseeable future.

It is the current expectation of the committee that an audit tender process will commence in 2022 in order for the auditor selected as a result of the tender to be appointed for the financial year ending 31 December 2023. It would be our intention to look to accelerate this timing if feasible and appropriate following the completion of TEP, and we would communicate any change in our plans to shareholders in advance of any decision. For the reasons outlined above, the committee considers this timing to be in the best interests of Pearson's shareholders and will continue to monitor this annually in light of the effectiveness and independence of the current auditors, as well as considering whether the timing remains appropriate in light of business developments.

Once the next audit tender occurs, Pearson will adopt a policy of putting the audit contract out to tender at least every ten years.

### Compliance with the CMA Order

Pearson confirms that it was in compliance with the provisions of The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 during the financial year ended 31 December 2016. Learn more about Auditors' independence and non-audit services on p74 [➔](#)

### Review of the external audit

During the year, the committee discussed the planning, conduct and conclusions of the external audit as it proceeded.

At the July 2016 audit committee meeting, the committee discussed and approved the external audit plan and reviewed the key risks of misstatement of Pearson's financial statements, which were updated at the December 2016 committee meeting.

## Audit committee report

The table opposite sets out the significant issues considered by the audit committee together with details of how these items have been addressed. The committee discussed these issues with the auditors at the time of their review of the half-year interim financial statements in July 2016 and again at the conclusion of their audit of the financial statements for the full year in February 2017.

All the significant issues were areas of focus for the auditors. Learn more in the Independent auditors' report on p114-121 [→](#)

In December 2016, the committee discussed with the auditors the status of their work, focusing in particular on internal controls and Sarbanes-Oxley testing, and covering the significant issues outlined below.

As the auditors concluded their audit, they explained to the committee:

- › Their work in evaluating management's goodwill impairment exercise
- › Their focus on segments, cash-generating units (CGUs) and goodwill impairment and the related impact of Pearson's transformation
- › The work they had conducted over revenue, to apply independent oversight and assess several complex revenue contracts, including judgements in relation to provisions for returns
- › The work they had done to understand Pearson's tax strategy and identify business and legislative risks, to evaluate key underlying assumptions and assess the recoverability of deferred tax assets
- › Their evaluation of the recoverability of investments in digital platforms and pre-publication assets
- › The results of their controls testing for Sarbanes-Oxley Act section 404 reporting purposes and in support of their financial statements audit
- › The results of the company's going concern and viability statement reports
- › Their assessment of the amounts disclosed as arising from the major restructuring programme in 2016.

The auditors also reported to the committee the misstatements that they had found in the course of their work, which were insignificant, and the committee confirmed that there were no material items remaining unadjusted in these financial statements.

### Auditors' independence

In line with best practice, our relationship with PwC is governed by our external auditors policy, which is reviewed and approved annually by the audit committee. The policy establishes procedures to ensure the auditors' independence is not compromised, as well as defining those non-audit services that PwC may or may not provide to Pearson. These allowable services are in accordance with relevant UK and US legislation.

The audit committee approves all audit and non-audit services provided by PwC. Our policy on the use of the external auditors for non-audit services has been updated to reflect the restriction on the use of pre-approval in the 2016 FRC Guidance on audit committees, and accordingly all non-audit services, irrespective of value, are required to be approved by the audit committee. In particular, we now expressly prohibit the provision of certain tax, HR and other services by our external auditor. We will continue to review non-audit services on a case by case basis, including the effectiveness and appropriateness of our updated policy. The policy on provision of non-audit services by external auditors in use in 2016 was in line with previous FRC requirements. Where appropriate, during 2016, services were tendered prior to a decision being made as to whether to award work to the auditors.

The audit committee receives regular reports summarising the amount of fees paid to the auditors. During 2016, Pearson spent £1.4m less on non-audit fees with PwC compared with 2015, due to a reduction in billing on tax services and on the Efficacy programme. For 2016, non-audit fees represented 35% of external audit fees (57% in 2015).

For all non-audit work in 2016, PwC was selected only after consideration that it was best able to provide the services we required at a reasonable fee and within the terms of our external auditors policy. To assist in ensuring that independence and objectivity is maintained, for forward-looking tax advisory and due diligence work PwC assigns a different partner from the one leading the external audit.

Significant non-audit work performed by PwC during 2016 included:

- › Audit-related work in relation to potential and actual corporate finance transactions
- › Tax compliance services related to a routine audit by the US Internal Revenue Service
- › Tax advisory work on a number of UK, US and international tax matters
- › Consulting services related to the establishment of an auditable efficacy framework
- › Audit of IT general controls mandated by contractual commitments.

A full statement of the fees for audit and non-audit services is provided in note 4 to the consolidated financial statements on p140.



**Tim Score**  
Chairman of audit committee

## Significant issues

Area of focus	Issue	Action taken by audit committee	Outcome
<b>Impairment reviews</b> <a href="#">Read more in note 11 on p147-150</a>	<p>Pearson carries significant goodwill intangible asset balances. There is judgement exercised in the identification of CGUs and the process of allocating goodwill to CGUs and aggregate CGUs and in the assumptions underlying the impairment review. In 2016, Pearson made further significant impairments to goodwill in its North American business.</p>	<p>› The committee considered the results of the Group's annual goodwill impairment review and the key assumptions which are considered to be the cash flows derived from strategic and operating plans, long-term growth rates and the weighted average cost of capital. The committee considered the sensitivities to changes in assumptions and the related disclosures required by IAS 36 'Impairment of Assets'. The committee noted that a significant impairment had arisen in North America as a result of revised expectations for cash flows associated with the US higher education courseware business over the strategic plan period. The committee also considered sensitivity to assumptions in relation to other businesses.</p>	<p>› Annual impairment review finalised with confirmation of impairment in the North America business and sufficient headroom in other CGUs.</p>
<b>Revenue recognition</b>	<p>Pearson has a number of revenue streams where revenue recognition practices are complex and management assumptions and estimates are necessary.</p>	<p>› The committee regularly reviews revenue recognition practice and the underlying assumptions and estimates. In addition, the committee has visibility of internal audit findings relating to revenue recognition controls and processes and routinely monitors the views of external auditors on revenue recognition issues. During the year, the committee continued to monitor the impact of the new revenue recognition standard, IFRS 15 'Revenue from Contracts with Customers', and noted progress on the conversion project including the identification of potential changes to revenue recognition models across the key revenue streams. The committee noted that the standard would be adopted by Pearson in 2018 and considered the transition options permitted under the standard.</p>	<p>› Assumptions underlying revenue recognition were reviewed and challenged and considered to be appropriate. Progress on the project to convert to IFRS 15 and initial findings were reviewed.</p>
<b>Tax</b>	<p>There are a number of issues in different countries where management judgements and assumptions are made as to the correct tax treatment.</p>	<p>› The committee considered Pearson's approach to tax provisioning. Pearson operates in a large number of countries and, accordingly, its earnings are subject to tax in many jurisdictions. The judgement in relation to tax provisioning is a combination of the committee's assessment of the specific open tax issues and also a review of the time periods in which Pearson's tax affairs are open to enquiry by local tax inspectors in jurisdictions where it has a larger taxable presence. The committee addressed this matter through the presentation of two management reports on Pearson's tax affairs by the head of Group tax and through a presentation of the external auditors' assessment of the company's tax provisioning.</p>	<p>› The committee was satisfied with Pearson's approach to tax provisioning taking account of the views of management and the assessment of the external auditors.</p>
<b>Restructuring</b>	<p>Pearson announced a significant restructuring programme in early January 2016. There are a number of accounting judgements to be made regarding categorisation and timing of recognition of cost.</p>	<p>› The committee reviewed progress on the restructuring programme and considered the judgements required in accounting for the costs of redundancy, property rationalisation, renegotiation of supplier contracts and closure of certain systems, platforms and products. The committee also considered the disclosure of restructuring in Pearson's adjusted measures.</p>	<p>› The committee confirmed that the accounting and disclosure for the restructuring programme was appropriate.</p>
<b>Returns</b>	<p>In light of significant returns in the period, we reviewed our policy on reserving for returns.</p>	<p>› The committee considered return provisioning for the higher education courseware business following a high level of returns from retailers during the year. The returns methodology for this business was changed to focus more on customer and channel rather than academic discipline.</p>	<p>› Assumptions underlying the new returns reserve methodology were reviewed and agreed as being more appropriate in the light of recent developments.</p>

# Risk governance and control

## Control environment

The board of directors has overall responsibility for Pearson's systems of internal control and risk management, which are designed to manage, and where possible mitigate, the risks facing Pearson, safeguard assets and provide reasonable, but not absolute, assurance against material financial misstatement or loss. The board of directors confirms that it has conducted a review of the effectiveness of Pearson's systems of risk management and internal control in accordance with provision C.2.3 of the Code and the FRC Guidance on Risk Management, Internal Control and Related Financial and Business Reporting (FRC Guidance). These systems have been operating throughout the year and to the date of this report.

The board has delegated responsibility for monitoring the effectiveness of the company's risk management and internal control systems to the audit committee. The audit committee oversees a risk-based internal audit programme, including periodic audits of the risk processes across the organisation. It provides assurance on the management of risk, and receives reports on the efficiency and effectiveness of internal controls. Each business area, including the corporate centre, maintains internal controls and procedures appropriate to its structure, business environment and risk assessment, while complying with company-wide policies, standards and guidelines.

## Internal control and risk management

Our internal controls and risk oversight are monitored and continually improved to ensure their compliance with FRC Guidance. Our risk journey is described more thoroughly in the risk management section on p44-46.

Pearson's board of directors are ultimately accountable for effective risk management in Pearson and determine our strategic approach to risk. They agree risk appetite targets early in the year, receive and review semi-annual reports on the ERM process and the status of top Group-level risks.

They are supported in the following ways:

- › The audit committee is responsible for overseeing internal controls within Pearson which includes determining the risk appetite (recommended by Pearson executive management), reviewing and commenting upon key risks and ensuring that risk management is effective
- › Pearson's executive and leadership teams are responsible for identifying and mitigating risks, supported by the ERM team. Risk ownership was included in Pearson executive leadership goals for 2016 where appropriate

- › Leaders and managers at all levels in Pearson are responsible for managing risk in their area of responsibility, including the identification, assessment and treatment of risk
- › The ERM team owns the overall risk management framework for the company and facilitates consolidated reporting on risk
- › The internal audit team provides independent assurance on the adequacy of the risk management arrangements in place. The internal audit plan is aligned to identified Group-level risks reported by the ERM team and they present issues and risks arising from internal audits at each audit committee meeting.

The involvement of the board and audit committee in the design, implementation, identification, monitoring and review of risks (including setting risk appetite, determining which are principal to the company and how risk is being embedded in our culture) is outlined in more detail in the risk management section of the annual report on p44-46.

## Financial management and reporting

There is a comprehensive strategic planning, budgeting and forecasting system with an annual operating plan approved by the board of directors. Monthly financial information, including trading results, balance sheets, cash flow statements, capital expenditures and indebtedness, is reported against the corresponding figures for the plan and prior years, with corrective action outlined by the appropriate senior executive. Pearson's senior management meets regularly with business area management to review their business and financial performance against plan and forecast. Major risks relevant to each business area as well as performance against the stated financial and strategic objectives are reviewed in these meetings.

We have an ongoing process to monitor the risks and effectiveness of controls in relation to the financial reporting and consolidation process including the related information systems. This includes up-to-date Pearson financial policies, formal requirements for finance to certify that they have been in compliance with policies and that the control environment has been maintained throughout the year, consolidation reviews and analysis of material variances, finance technical reviews, and review and sign-off by senior finance managers. The Group finance function also monitors and assesses these processes, through a finance compliance function.

These controls include those over external financial reporting which are documented and tested in accordance with the requirements of section 404 of the Sarbanes-Oxley Act, which is relevant to our US listing. One key control in this area is the verification committee, which submits reports to the audit committee. This committee is chaired by the SVP internal audit and compliance, and members include the chief financial officer, general counsel, vice president investor relations, company secretary as well as senior members of financial management. The primary responsibility of this committee is to review Pearson's public reporting and disclosures to ensure that information provided to shareholders is complete, accurate and compliant with all applicable legislation and listing regulations.

The effectiveness of key financial controls is subject to management review and self-certification and independent evaluation by the external auditors.

### Internal audit

Pearson has an in-house internal audit function, supported by co-source agreements to augment our in-house resources, for example providing specific subject matter expertise or language skills. The internal audit function is responsible for providing independent assurance to management and the audit committee on the design and effectiveness of internal controls to mitigate strategic, financial, operational and compliance risks. The SVP of internal audit, risk and compliance reports formally to both the chairman of the audit committee and the chief financial officer and internal audit's mandate is reviewed annually by the audit committee.

The internal audit plan is approved annually by the audit committee. Completion and changes to the plan are also reviewed and approved by the audit committee throughout the year. The internal audit plan is aligned to our greatest areas of risk as identified by the enterprise risk management process, and the audit committee considers issues and risks arising from internal audits. Management action plans to improve internal controls and to mitigate risks, or both, are agreed with the business area after each audit. Formal management self-assessments allow internal audit to monitor business areas' progress in implementing management action plans agreed as part of internal audits to resolve any control deficiencies. Progress of management action plans is reported to the audit committee at each meeting. Internal audit has a formal collaboration process in place with the external auditors to ensure efficient coverage of internal controls. Regular reports on the findings and emerging themes identified through internal audits are provided to executive management and, via the audit committee, to the board.

The SVP internal audit and compliance oversees compliance with our Code of Conduct and works with senior legal and human resources personnel to investigate any reported incidents including ethical, corruption and fraud allegations. The audit committee is provided with an update of all significant matters received through our whistleblowing reporting system, together with an annual review of the effectiveness of this system. The Pearson anti-bribery and corruption programme provides the framework to support our compliance with various anti-bribery and corruption regulations such as the UK Bribery Act 2010 and the US Foreign Corrupt Practices Act.

### Treasury management

The treasury department operates within policies approved by the board and its transactions and procedures are subject to regular internal audit. Major transactions are authorised outside the department at the requisite level, and there is an appropriate segregation of duties. Frequent reports are made to the chief financial officer and regular reports are prepared for the audit committee and the board. The treasury policy is described in more detail in note 19 to the consolidated financial statements.

### Insurance

Pearson reviews its risk financing options regularly to determine how the company's insurable risk exposures are managed and protected. Pearson purchases comprehensive insurance cover and annually reviews coverage, insurers and premium spend, ensuring the programme is fit for purpose and cost-effective.

Pearson's insurance subsidiary, Spear Insurance Company Limited, is used to leverage Pearson's risk retention capability and to achieve a balance between retaining insurance risk and transferring it to external insurers.

# Reputation & responsibility committee report

## Committee chairman

Linda Lorimer

Members Vivienne Cox, Linda Lorimer, Harish Manwani and Lincoln Wallen<sup>2</sup>



“Our role is to ensure sustainability, learner impact, and stakeholder views remain central to Pearson’s mission.”

### Committee responsibilities include oversight of:

- Reputation** Pearson’s reputation among major stakeholders, including governments, investors, employees, customers, learners and the education community.
- Risk** Oversight of Pearson’s approach to reputational risk, including ensuring that clear roles have been assigned for management.
- Sustainability** Oversight of 2020 sustainability plan and performance against sustainability goals and commitments.
- Brand & culture** Management of the Pearson brand to ensure that its value and reputation are maintained and enhanced. Pearson’s approach to monitoring and supporting the values and desired behaviours that form our corporate culture.
- Ethics** Ethical business standards, including Pearson’s approach to issues relevant to its reputation as a responsible corporate citizen.
- Strategy** Strategies, policies and plans related to reputation and responsibility issues and the people, processes and policies that are in place to manage them.

### Terms of reference

The committee has written terms of reference which clearly set out its authority and duties. These are reviewed annually and can be found on the company website [www.pearson.com/governance](http://www.pearson.com/governance)

### Attendance

Attendance by directors at reputation & responsibility committee meetings throughout 2016:

	Meetings attended
Vivienne Cox	4/4
Josh Lewis <sup>1</sup>	4/4
Linda Lorimer	4/4
Harish Manwani	4/4

Note 1: Josh Lewis stepped down from the committee on 31 December 2016

Note 2: Lincoln Wallen joined the committee on 1 January 2017.

## Reputation & responsibility committee role

The committee works to advance Pearson’s reputation and to maximise the company’s positive impact on society and the communities in which we work.

We are committed to promoting Pearson’s 2020 sustainability plan, and the committee works in alignment with the company’s responsible business leadership council.

Read more about our 2020 sustainability plan on p20-27.

## Changes to the committee

As a result of work conducted by the nomination committee and the chairman of the board to examine the composition and remit of the board’s committees, Lincoln Wallen has joined the committee with effect from 1 January 2017, with Josh Lewis stepping down.

I am also privileged to take over the chairmanship of the committee from Vivienne Cox, whom I am pleased will remain a member of the committee. Vivienne initiated this committee in 2012, which is now an important part of our governance framework.

## Areas of focus during 2016

One of our prime responsibilities is to ensure strategies are in place to manage and improve Pearson’s reputation. The US is our largest market, so it is important for the committee to consider regularly our US reputational management strategy. To that end, we held a focused meeting in early 2016, led by the SVP corporate affairs for North America. We examined various aspects of our US strategy, including public policy initiatives, engagement with teachers and educators, community and stakeholder programmes, as well as media and brand work. We received regular updates on our US and global reputational work throughout the year, and in 2017 we intend to hold a similar focused session looking at our reputational management programmes in North America as well as in other key global markets.

Pearson will be reporting publicly, starting in 2018, on the efficacy of our products and services to demonstrate their measurable impact. Throughout 2016, the committee monitored the progress of our external reporting plans; we looked at how we are aligning our efficacy goals with our wider business strategy, and considered examples of product efficacy reports. We were joined for our efficacy sessions by PwC, which is providing external assurance for the efficacy reporting process.

Our recent sustainability report, published in July 2016, identified Pearson's nine most material sustainability issues, and we have introduced a programme of deep dives to consider each of these in turn. Through these sessions the committee will consider the public goals and targets the company is setting to address these issues, and examine their associated reputational impacts. In 2016, we considered the work under way to improve our product accessibility standards, which directly supports our ambition to reach more learners, and looked at the progress made in safeguarding our learners, which aligns with our aim of being a trusted partner.

Read more about our material sustainability issues on p21-22.

### Evaluation

During the year, the committee conducted its first effectiveness evaluation. The process involved distribution of a questionnaire to committee members and senior management who regularly attend meetings, to evaluate the committee's performance in line with its terms of reference, and to ensure that the meetings and papers were sufficient to facilitate effective input and challenge to the business. The review found that the committee performs effectively across its remit, with sufficient time allotted to the key areas. The committee has identified some particular areas of focus for 2017, including culture and values, and examining key policy issues on the ground in important geographies outside the US.

### Committee aims for 2017

Over the next year we will continue to explore Pearson's nine most material sustainability issues, including employability and 21st Century skills, affordability and economic empowerment. We will hold a deep dive into our reputational and risk management plans for our growth and core markets, evaluate and refine our 2018 efficacy reporting plans and consider performance against our efficacy growth and impact goals. In addition, we will continue to monitor the Pearson culture and employee engagement, particularly in light of the changes and rationalisations throughout the business in 2016, and we will review the progress made by Pearson's ongoing social impact initiatives and partnerships.



Linda Lorimer

Chairman of reputation & responsibility committee

## Reputation & responsibility committee meeting focus during 2016

Area of responsibility	Activity
Reputation	<ul style="list-style-type: none"> <li>› Updates on reputational 'hot topics' at each meeting</li> <li>› US reputational strategy deep dive</li> <li>› Stakeholder engagement in relation to AGM</li> <li>› Overview of UK apprenticeships</li> </ul>
Risk	<ul style="list-style-type: none"> <li>› Overview of reputational risk approach in growth and US markets, through in-country personnel and central corporate affairs team</li> <li>› Regular consideration of reputational risk dashboards</li> <li>› Safeguarding deep dive</li> <li>› Impact of US presidential election- preliminary view</li> </ul>
Sustainability	<ul style="list-style-type: none"> <li>› 2020 sustainability plan and sustainability reporting</li> <li>› Efficacy and research – spotlight on 2018 external efficacy reporting</li> <li>› Efficacy growth and impact goals</li> <li>› Sustainability initiatives including the launch of the 'Alphabet of Illiteracy' campaign and Tomorrow's Markets Incubator for employee intrapreneurs</li> </ul>
Brand & culture	<ul style="list-style-type: none"> <li>› Demonstration of LearnED, Pearson's online digital newsroom</li> </ul>
Ethics	<ul style="list-style-type: none"> <li>› Modern Slavery Act – implications and statement</li> <li>› Consideration of ethical issues in the wider context of reputational risk identification</li> </ul>
Strategy	<ul style="list-style-type: none"> <li>› Social innovation and impact venturing strategy</li> <li>› Pearson Affordable Learning Fund review</li> <li>› Product accessibility deep dive</li> <li>› Environmental strategy update</li> </ul>

# Stakeholder engagement

## Engaging with shareholders

Pearson has an extensive programme of communication with all of its shareholders – large and small, institutional and private.

**Shareholder outreach** In 2016, we continued with our shareholder outreach programme, seeing approximately 600 institutional and private investors at more than 300 different institutions in Australia, Canada, Dubai, Greater China, Continental Europe, Japan, Singapore, the UK and the US.

**Trading updates** There are five trading updates each year and the chief executive and chief financial officer present our preliminary and interim results updates. They also attend regular meetings throughout the year with investors in the UK and around the world, tailored to investor requirements, to discuss the performance of the company, the company's strategy, our change programme, structural and cyclical changes in our markets, and risks and opportunities for the future. We also held an investor and analyst day in June 2016. You can read more about this below.

**Chairman and non-executive directors** The chairman meets regularly with shareholders to understand any issues and concerns they may have. This is in accordance with both the Code and consistent with the duties of investors under the UK Stewardship Code. The non-executive directors meet informally with

shareholders both before and after the AGM and respond to shareholder queries and requests as necessary. The chairman ensures that the board is kept informed of investors' and advisers' views on strategy and corporate governance. At each board meeting, the directors consider commentary from advisers on major shareholders' positions and Pearson's share price. In addition, the nomination & governance and remuneration committees consider shareholder views on corporate governance and remuneration matters, respectively, as required.

**Consultations** During the year, we also consulted with our major shareholders and with shareholder representative bodies on our directors' remuneration policy.

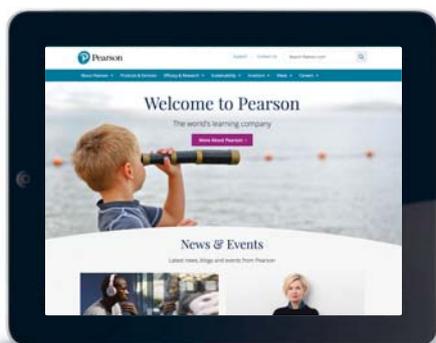
Read about Remuneration on p82-106 →

**Private investors** Private investors represent over 80% of the shareholders on our register and we make a concerted effort to engage with them regularly. Shareholders who cannot attend the AGM are invited to e-mail questions to the chairman in advance at [chairman-agm@pearson.com](mailto:chairman-agm@pearson.com)

We encourage our private shareholders to become more informed investors and have provided a wealth of information on our website about managing Pearson shareholdings. We also encourage all shareholders, who have not already done so, to register their e-mail

## Visit [pearson.com](http://pearson.com)

- › Investor relations information
- › Company announcements and shareholder presentations, webcasts and conference calls
- › Past announcements and presentations
- › Historical financial performance
- › Share price data
- › Calendar of events
- › Information about our businesses and products



## Investor and analyst day



Pearson hosted an investor and analyst information day in June 2016 at its head office in London.

Presentations from the chief executive, chief financial officer, president of North America and other company leaders focused on our US higher education courseware and higher education online services businesses.

The event provided analysts and investors with more information on the market and our strategy, the new products and services we're bringing to market, our sales and marketing capabilities, our ability to implement and our journey along the digital transition.

addresses through our website and with our registrar. This enables them to receive e-mail alerts when trading updates and other important announcements are added to our website. See Shareholder information on p196 or visit our website [www.pearson.com/investors/shareholder-information.html](http://www.pearson.com/investors/shareholder-information.html)

### Annual General Meeting

Our AGM, on 5 May 2017, is an opportunity for all shareholders to meet the board and to hear presentations about Pearson's businesses and results.

### Share dealing service

Due to its continued popularity we again provided shareholders with smaller holdings the opportunity to use our registrar's low-cost share dealing service, giving them the chance to add to or reduce their stake in Pearson at significantly reduced dealing rates, or to donate shares to charity with ease. This service proved popular with shareholders, and consequently we intend to offer it again at a future date. We believe it is important that our employees have a shared interest in the direction and achievements of Pearson and are pleased to say that a large number of our employees are shareholders in the company.

### Engaging with all stakeholders

We post all company announcements on our website, [www.pearson.com](http://www.pearson.com), as soon as they are released, and key shareholder presentations are made accessible via webcast or conference call. Our website contains a dedicated investor relations section with an extensive archive of past announcements and presentations, historical financial performance, share price data and a calendar of events. It also includes information about all of our businesses, links to their websites and details of our sustainability policies and activities. Learn more about our approach to Sustainability on p20-27 [➔](#)

## Employee engagement

The board views employee engagement as a key element of its oversight of the company's culture, and an opportunity to become directly involved in leadership and talent development activities.

### Board talent breakfasts

The board attended two talent breakfasts during the year, engaging with employees at the overseas meetings in Bloomington and Hoboken. Since their introduction, these sessions have proved consistently popular with the non-executive directors and have evolved to include a broad range of participants, new and long-serving staff, at various levels of seniority within the company and across all areas of the business. At the Hoboken breakfast, employees participated in facilitated discussions with directors and members of the executive, with conversations focused on employee learning and career development to aid the board in their understanding of talent and retention matters. Following the event, the feedback from participants was overwhelmingly positive with many of them indicating that they had felt inspired and that the experience had been both insightful and valuable.

### Discovery Days

In 2016, we launched a series of Discovery Days. These employee-only days provide an opportunity to showcase our products while giving staff the chance to learn more about our brand and strategy from senior leaders, engage with Pearson's product experts and participate in a variety of career and personal development activities.

### Senior leaders' receptions

On three occasions during the year, the board joined a reception for locally based leaders from product and customer-facing areas of the business as well as corporate functions. These informal occasions provided an opportunity for the board to understand the motivations of colleagues and to discuss some of the day-to-day challenges faced by the business.

**“It is clear that while challenges and change are a constant, the passion to solve the challenges that face us and our customers by doing good, meaningful work drives us all.”**

Employee at board talent breakfast, Hoboken, October 2016

# Remuneration overview

## Committee chairman

Elizabeth Corley

## Members

Elizabeth Corley, Josh Lewis,  
Tim Score and Sidney Taurel



“Remuneration outcomes reflect a difficult 2016 for the company and our shareholders. In a challenging environment, we have reviewed policy to ensure that it underpins our strategy to return Pearson to growth. As a result of our review, the remuneration policy remains broadly the same but there are three key changes that will support Pearson’s accelerated transition to a more digitally sustainable and efficient business.”

## Key changes to remuneration policy for 2017

- › Introduction of performance metrics linked to strategic imperatives for part of the Annual Incentive Plan
- › Reweighting of measures in the Long-Term Incentive Plan
- › Updated Total Shareholder Return peer group to ensure that it aligns better with Pearson following the sales of the Financial Times and our share in The Economist.

## In this remuneration section

Part 1: Remuneration overview	p82
Part 2: 2016 remuneration report	p88 (and 106)
Part 3: 2017 remuneration policy	p97

## Terms of reference

The committee’s full charter and terms of reference are available on the Governance page of the company’s website. A summary of the committee’s responsibilities is shown in the table on p83.

## Board committee attendance

The following table shows attendance by directors at committee meetings throughout 2016:

	Remuneration
Elizabeth Corley	6/6
Vivienne Cox <sup>1</sup>	5/6
Josh Lewis	6/6
Tim Score	6/6
Sidney Taurel	6/6

Note 1: Unable to attend one remuneration committee meeting due to personal reasons. Leaves the remuneration committee in 2017.

[www.pearson.com/governance](http://www.pearson.com/governance)

## Dear shareholders,

On behalf of the remuneration committee and the board, I am pleased to present the directors’ remuneration report for 2016.

I would like to start by recognising that this has been a challenging year for Pearson and our shareholders. Although there has been some positive progress made in a number of priority business areas, the significant decline in the US higher education courseware business means that we no longer expect to reach our prior operating profit goal for 2018. As outlined by the chairman in his introduction, the whole board and company is focused on a rigorous plan to address the challenges, and to accelerate the transition to a more digital and sustainable business.

As we approached both the implementation of our 2016 policy and proposals for the new 2017 policy, the need for effective remuneration and incentive structures to support this has been at the forefront of the remuneration committee’s thinking.

During our engagement meetings, several of our shareholders asked about employee retention, resilience and morale so before moving into the main report, I will address this topic briefly. Throughout the year, one of the committee’s priorities has been to review the way in which the company attracts and retains the talent needed in the execution of the transformation. We have considered incentive structures and retention plans for the wider management team, which are well aligned to the delivery of our digital strategy and to creating further sustainable efficiencies in our business.

The selective retention plans that were put in place for 2016 have worked well (no executive director participated in these). However, following a nil Annual Incentive Plan (AIP) payout for 2015 in addition to nil vesting of the 2012 Long Term Incentive Plan (LTIP), we were keen to re-evaluate the applicability of both plans for the management population below executive directors to ensure that incentive arrangements were fit for purpose in a company undergoing significant and sustained change. As a result of this, we have approved a much simplified, single management incentive plan for implementation in 2017. The new plan is closely aligned to achievement of business priorities but also has clear linkage to personal objectives. It applies to the Pearson executive management team that reports to the executive directors, and to the senior leadership group, so is not a part of our remuneration policy proposal but we felt that shareholders would appreciate insight to a change that we think enhances both relevance and incentive potential.

## Performance outcomes in 2016

Although our 2016 results are in line with the lower end of expectations, and our 2016 restructuring programme was delivered in full and with financial benefits higher than planned, the committee has been mindful in all its deliberations of the consequences of the removal of future guidance to the market and the significant shortfall in courseware sales, notably in North America.

The primary principle of our remuneration policy remains to support the company’s strategy which is focused on delivering sustained performance and the creation of long-term value for all stakeholders. Remuneration for executive directors is closely tied to short and long-term objectives that aim to deliver on these

commitments while being sensitive to the shareholder experience. Taking all of these considerations into account, the incentive outcomes for our executive directors in 2016 were as follows:

### Annual incentive plan summary

As explained in last year's directors' remuneration report, the on-target funding for the 2016 AIP was cut significantly compared to 2015 (a cut of circa one third).

Above threshold performance on a number of measures, including Group EPS, operating profit and operating cash flow, meant that there was a calculated achievement of 55% of base salary for the CEO and 47% of base salary for the CFO. This is on a like-for-like exchange rate; i.e. there is no foreign exchange benefit passed through.

The remuneration committee rigorously reviewed all the AIP performance targets for 2016 given the results outcome. We concluded that the targets had been set on a reasonable basis and that these outcomes reflected annual achievement towards the lower end of guidance for relevant performance indicators. We also assessed the quality of cost reductions and the manner in which the financial targets had been met. We noted that the cost reductions had not compromised the company's increasing investment in digital products and services and that they were contributing to a more efficient and aligned business.

Notwithstanding this, discretion has been exercised to reduce the total AIP funding by 20%. This results in a CEO pay-out reduction from 55% to 44% of base salary and a CFO reduction from 47% to 37% of base salary. This represents 24% and 22% of maximum AIP opportunity for the CEO and CFO respectively.

### Long-term incentive summary

The awards made in 2014 under the LTIP are expected to vest without value, the fifth year in which this will have been the case.

The LTIP quantum and targets for 2016 were derived from the 2018 guidance that had been given to the market in January. As the CEO was already very substantially behind comparable market levels of compensation, (and the CFO modestly behind) we did not reduce the LTIP quantum at that point but we did set demanding performance targets aligned to guidance.

### Summary of remuneration policy proposals

The committee undertook a wholesale review of our remuneration policy during 2016 to assess whether it remained fit for purpose, taking into account how the company has evolved since the policy was last approved in 2014. We first thought about philosophy and principles for the organisation as a whole and we then distilled this into policy for the executive directors. Central to the review was engaging with our largest shareholders and seeking their input on the future direction of policy. The committee is grateful to those shareholders who took the opportunity to engage with us in this process.

In summary, the committee concluded that the remuneration policy continues to underpin the company's strategic objectives and does not therefore require material change. However, recognising that our growth strategy is contingent on a number of vital, shorter-term strategic initiatives, the committee concluded it appropriate to introduce performance metrics linked to strategic imperatives into

#### Committee responsibilities:

##### Determine and review policy

Determine and regularly review the remuneration policies for the executive directors, the presidents and other members of the Pearson executive management (who report directly to the CEO), and overview the approach for the senior leadership group. These policies include base salary, annual and long-term incentives, pension arrangements, any other benefits and termination of employment.

##### Review and approve implementation

Regularly review the implementation and operation of the remuneration policy for executive management and approve the individual remuneration and benefits packages of the executive directors.

##### Approve performance related plans

Approve the design of, and determine targets for, any performance-related pay plans operated by the Group for Pearson executive management and approve the total payments to be made under such plans.

##### Review long-term plans

Review the design of the company's long-term incentive and other share plans operated by the Group and where relevant recommend such plans for approval by the board and shareholders.

##### Set termination arrangements

Advise and decide on general and specific arrangements in connection with the termination of employment of executive directors.

##### Review targets

Review and approve corporate goals and objectives relevant to executive directors' remuneration and evaluate the executive directors' performance in light of those goals and objectives.

##### Determine chairman's remuneration

Delegated responsibility for determining the remuneration and benefits package of the chairman of the board.

##### Shareholder engagement

Ensure the company maintains an appropriate level of engagement with its shareholders and shareholder representative bodies in relation to the remuneration policy and its implementation.

##### Appoint remuneration consultants

Appoint and set the terms of engagement for any remuneration consultants who advise the committee and monitor the cost of such advice.

## Remuneration overview

### Remuneration committee meeting focus during 2016

Areas of responsibility	Activities			
<b>Market</b>	Noted Willis Towers Watson's overview of the current remuneration environment	Noted Willis Towers Watson's market data and research on remuneration policy design	Noted Executive Remuneration Working Group report	Noted various updates to investor guidelines on executive compensation
<b>Performance</b>	Noted management's overview of prior year and year to date performance and business plans	Noted and reviewed the status of the outstanding long-term incentive awards based on the current view of likely Pearson financial performance	Noted and reviewed the status of the 2016-17 retention arrangements and impact on voluntary turnover	
<b>Implementation</b>	<p>Reviewed and approved the 2015 annual incentive nil pay-out and 2016 remuneration packages for executive directors</p> <p>Reviewed and approved 2015 annual incentive plan nil pay-out for the Group</p>	<p>Approved nil pay-out under 2013 long-term incentive plan</p> <p>Approved nil pay-out of 2013 annual bonus share matching awards and release of shares</p>	<p>Reviewed and approved 2016 long-term incentive awards for the executive directors and Pearson executive management</p> <p>Noted 2015 long-term incentive awards for senior leaders and managers below Pearson executive management (granted in March 2016)</p>	<p>Noted remuneration packages for new appointments to the Pearson executive management and termination arrangements for leavers</p> <p>Noted the deployment of 2016-17 retention arrangements</p>
<b>Governance</b>	Noted the activity of the standing committee of the board in relation to the operation of the company's equity-based reward programmes	Noted company's use of equity for employee share plans	Reviewed the committee's performance	
<b>Policy</b>	<p>Reviewed remuneration principles and policy and incentive arrangements in the wider organisation and approved a simplification of pay design below the board for 2017</p> <p>Reviewed directors' remuneration policy ahead of binding vote at 2017 AGM</p>	<p>Reviewed and approved 2015 directors' remuneration report</p> <p>Reviewed and approved pay freeze for 2016 for the Pearson executive management and other senior employees</p>	<p>Reviewed and approved 2016 Pearson annual incentive plan targets</p> <p>Reviewed and approved 2016 individual annual incentive opportunities for the executive directors and Pearson executive management</p>	<p>Reviewed 2016 long-term incentive performance conditions for the executive directors and Pearson executive management</p> <p>Considered approach to 2016 long-term incentive awards for senior leaders and managers below the Pearson executive management</p>
<b>Disclosure and engagement</b>	Considered feedback from Committee Chairman's meetings with key shareholders on 2016 implementation and 2017 policy	Noted shareholder feedback on 2015 directors' remuneration report	Reviewed 2016 Annual General Meeting season, shareholder voting and engagement strategy	Noted template and outline of 2016 report on directors' remuneration and shareholder engagement strategy

See Total single figure remuneration on p89 →

AIP. Under the proposed new policy up to 25% of the AIP will be measured against strategic imperatives (non-financial metrics). Any pay out in respect of achievement of strategic imperatives will be subject to attaining a minimum level of performance on financial metrics.

In addition, the committee concluded it is appropriate to re-weight the metrics attaching to future LTIP awards to increase the TSR portion, such that earnings per share (EPS) would account for 40% with return on invested capital (ROIC) and relative total shareholder return (TSR) 30% each respectively (currently one half, one third and one sixth).

The current TSR peer group of global media companies would also be replaced with the FTSE 100, of which the company is a constituent. Following a thorough review of alternatives, this was considered the most appropriate comparator group as it represents a comparable investment alternative for shareholders; its constituents are of a comparable size, scale and maturity to Pearson; and are similarly impacted by global macro-economic influences. Adopting a commonly used TSR peer group would also be a simplification to the plan.

It is proposed, subject to approval at the 2017 AGM, that these changes be made effective from the start of the 2017 AIP and LTIP performance periods (January 1).

Finally, there has been an evolution and strengthening of governance, initiated by the Pearson chair, which has a modest remuneration policy impact. In line with other Pearson committees and market practice, non-executive director fees for those on the Nomination & Governance Committee will be set at £15,000 for the committee chairman and £8,000 for committee membership. These would take effect from the date of the 2017 AGM.

Also, in response to the increase in responsibilities associated with the undertakings of the Reputation & Responsibility committee, the committee fees for the chair and membership committee members will increase to £13,000 (£10,000) and £6,000 (£5,000) respectively.

The aggregated increase in non-executive director fees associated with this further strengthening of governance will be in the region of £58,000 per annum.

### Summary of proposed changes

For the Annual Incentive Plan (AIP):

- › In 2017, financial metrics will account for 75% of total opportunity and will continue to include targets based on Group EPS, operating profit, sales and operating cash flow. Strategic imperatives will account for 25% of total opportunity and will be drawn from three key areas aligned with milestones currently tracked formally by the board. In 2017 our strategic imperatives focus predominantly on competitive performance and transformation. The metrics are drivers of our strategy, growth and simplification plans already communicated to the market. More detail on the metrics is included on p86.

For the Long-term Incentive Plan (LTIP):

- › For 2017, LTIP awards shall be contingent on EPS (40%), ROIC (30%) and relative TSR (30%) targets. The awards and the targets will be agreed at the May remuneration committee meeting and fully disclosed in the 2017 report on directors' remuneration.

Both the committee and board strongly believe that the final proposals maintain a strong pay-for-performance relationship and that the 2016 incentive out-turns and approach to implementation of policy in 2017 will best serve the company's future ambitions by incentivising our executive directors to return value to you, our shareholders.

### Looking forward to 2017

The remuneration committee has decided that the base pay for both the CEO and CFO will not be increased in 2017. This will be the second year of no increase in base salary for either the CEO or CFO. While it is recognised that the CEO is substantially behind market, the committee concluded that this was not a relevant consideration in the current trading environment.

In acknowledgement of the value erosion in the Pearson share price, the remuneration committee intends to reduce the volume of 2017 LTIP awards to the executive directors such that their value is materially lower than prior practice. The eventual scale of this reduction will be judged by reference to all relevant factors prevailing at the award date (in May), including share price. The remuneration committee also notes that the re-weighted 30% TSR element is likely to be significantly out of the money on grant, due to the averaging period used to determine the start point, which is the three-month period to the end of December 2016. We will not be changing this methodology.

If current share price conditions were to continue, the committee might judge that the economic value of the 2017 LTIP grant would be reduced by in the region of 20-25%.

In the current trading environment the committee has exercised its discretion to reduce incentive payment payouts. We remain focused on the need to reflect on shareholder experience in compensation decisions, while at the same time recognising when there is genuinely strong delivery against stretching and demanding performance targets. Pearson is undergoing substantial change as the company delivers on digital transformation and continuously improving efficiency, while at the same time meeting the needs of all our stakeholders. This requires strong and resilient leadership and our policy proposals are designed to provide the appropriate balance of reward for performance and accountability.

My meetings with shareholders have been invaluable in understanding your perspectives and I look forward to continuing the dialogue in 2017.



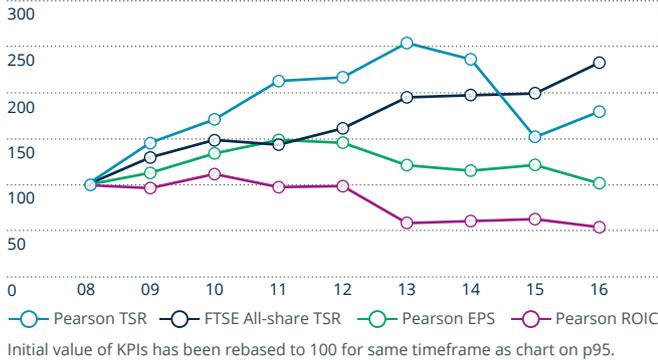
**Elizabeth Corley**  
Chairman of remuneration committee

14 March 2017

# Remuneration overview

## Executive remuneration in 2016

### Key performance indicators



### Executive directors' 2016 single figure breakdown



## Summary of policy changes

A summary of the material changes to be introduced in the new policy is provided below. More comprehensive detail immediately follows in the future policy table.

### Base salary

#### Key features of current policy:

Base salary increases not ordinarily more than 10% p.a. with exceptional increases capped at 25% over the normal maximum limit.

#### Policy changes:

No change.

### Allowances and benefits

#### Key features of current policy:

Total value not ordinarily in excess of 15% of base salary p.a. with exceptional increases capped at 25% above the normal limit.

#### Policy changes:

No change.

### Retirement benefits

#### Key features of current policy:

New employees are eligible to join the Money Purchase section of the Pearson Group Pension Plan.

Company contributions capped at 16% of pensionable salary or cash in lieu (double the amount of the employee contribution, which is limited according to certain age bands).

Normal retirement age is 62, but, subject to company consent, retirement is currently possible from age 55 or earlier in the event of ill-health.

#### Policy changes:

Simplified disclosure to reflect that currently Pearson only has UK executive directors. Detail on US pension provision has been removed but, if needed, provision would be on a consistent basis to a UK new hire.

### Annual Incentive Plan (AIP)

#### Key features of current policy:

Overall limit of 200% of base salary maximum with annual opportunity ordinarily limited to 180% (CEO) and 170% (CFO). Metrics based on:

- > Group EPS (30%)
- > Operating profit (30%)
- > Sales (20%)
- > Operating cash flow (20%).

#### Policy changes:

- No change to maximum incentive opportunity. Introduction of performance metrics linked to strategic imperatives for up to 25% of total annual opportunity. Financial metrics for at least 75% of total annual opportunity, weighted:
- > Group EPS (22.5%)
  - > Operating profit (22.5%)
  - > Sales (15%)
  - > Operating cash flow (15%).

Performance metrics linked to strategic imperatives to be subject to attaining a minimum level of performance on financial metrics.

### Change in CEO remuneration 2015/16

<b>Base salary</b>	<b>Allowances and benefits</b>
= no change	↑ +37%
<b>Annual incentives</b>	<b>Total</b>
↑ see note 4	↑ +20%

### Change in employee remuneration 2015/16

<b>Base salary</b>	<b>Allowances and benefits</b>
↑ +1%	↑ +7%
<b>Annual incentives</b>	<b>Total</b>
↑ +55%	↑ +5%

**Note 1** The figures for all employees reflect average salaries and average employee numbers each year at constant exchange rates. Annual incentives include all plans, including sales incentives.

**Note 2** The difference in CEO base salary single figure reflects effect of full year of 2015 increase introduced in April 2015. No increase in 2016.

**Note 3** CEO allowances and benefits change reflects increase in cost of car benefit and travel expenses of c.£20,000 over 2015.

**Note 4** As there was no AIP paid in 2015, relative percentage change for the CEO is incalculable.

**Note 5** The increase in allowances and benefits on an average employee basis is inflated by a change in population post-restructuring.

**Note 6** As there was no AIP paid in 2015, relative percentage change for employees reflects 2016 Group-wide bonus pay-outs versus a small selection of local plans in 2015.

See full 2017 remuneration policy table for 2017–2020 on p97 →

### Long-Term Incentive Plan (LTIP)

#### Key features of current policy:

- Maximum face value of 400% of base salary with exceptional increases capped at 25% over the normal maximum limit.
- Three-year performance period with metrics based on:
  - > Group EPS (1/2)
  - > ROIC (1/3)
  - > Relative TSR (1/6)
  - > Two year post-vesting holding period.

#### Policy changes:

- No change to maximum incentive opportunity.
- No change to performance period or holding period.
- Re-weighting of measures to:
  - > Group EPS (40%)
  - > ROIC (30%)
  - > Relative TSR (30%).
- In addition, change in TSR peer group from a predominantly media-focused peer group to the FTSE 100 to ensure that it aligns better with Pearson following the sales of the Financial Times and our share in The Economist.

### Non-Executive Directors

#### Policy change:

Change in fee levels for some committees.

## Strategic alignment of pay 2017–2020

In addition to financial performance, there are a number of vital, shorter-term initiatives that the board requires the executive directors to deliver that are not fully captured by financial metrics. These initiatives are key both for the achievement of our transformation goals, and for the long-term growth and success of the company.

Our 2017 remuneration policy intends to create a closer linkage between our key strategic imperatives and executive goals, to enhance further the alignment of executive director incentives with shareholder outcomes and sustained shareholder value creation.

Read more comprehensive detail in the future policy table on p98-101 and the Remuneration report on p106 →

### Financial objectives

KPI	Incentive scheme
<b>Drive revenue growth</b>	
> Sales	> AIP
<b>Deliver sustainable returns</b>	
> Total adjusted earnings per share	> AIP / LTIP
> Operating profit	> AIP
> Return on invested capital	> LTIP
> Total shareholder return	> LTIP
<b>Manage our cash position effectively</b>	
> Operating cash flow	> AIP

### Strategic imperatives

KPI	Incentive scheme
<b>Competitive performance</b>	
> Holding or gaining share in major markets	> AIP
> Higher Education direct/e-commerce sales to consumers	
<b>Transformation</b>	
> Delivery of Enabling Programme milestones to upgrade the customer experience, accelerate the digital transformation and the delivery of on-going cost, efficiency and process transformations	> AIP
<b>Culture, talent &amp; brand</b>	
> Improvement in brand favourability and year-on-year improvement in employee engagement survey scores	> AIP

Each metric will be measured, using third party data or externally audited internal data (where third party data is not available or applicable).

Performance metrics linked to strategic imperatives can be selected annually to support Pearson's transformation strategy.

# 2016 remuneration report

## This report comprises a number of sections:

The remuneration committee	<a href="#">p88</a> →
Voting outcome at 2016 Annual General Meeting	<a href="#">p89</a> →
Single figure of total remuneration and prior year comparison*	<a href="#">p89</a> →
Notes to single figure table	<a href="#">p90</a> →
Executive directors annual incentive payments in 2016*	<a href="#">p91</a> →
Long-term incentives*	<a href="#">p91</a> →
Retirement benefits*	<a href="#">p93</a> →
Movements in directors' interests in share awards*	<a href="#">p92</a> →
Movements in directors' interests in share options*	<a href="#">p92</a> →
Remuneration paid to the chairman and non-executive directors*	<a href="#">p93</a> →
Payments to former directors*	<a href="#">p93</a> →
Payments for loss of office	<a href="#">p93</a> →
Interests of directors and value of shareholdings*	<a href="#">p94</a> →
Executive directors' non-executive directorships	<a href="#">p95</a> →
Historical performance and remuneration	<a href="#">p95</a> →
Comparative information	<a href="#">p96</a> →
Information on changes to remuneration for 2017	<a href="#">p106</a> →

Where required under current regulations, the tables marked \* have been subject to audit.

## The remuneration committee in 2016

Role	Name	Title
Chairman	Elizabeth Corley	Independent non-executive directors
	Vivienne Cox	
	Josh Lewis	
	Tim Score	
	Sidney Taurel	
Internal advisers	John Fallon	Chief executive
	Coram Williams	Chief financial officer
	Melinda Wolfe	Chief human resources officer
	Stuart Nolan	SVP, reward
	Stephen Jones	Company secretary
External advisers	Willis Towers Watson	

Sidney Taurel was a member of the committee throughout 2016 as permitted under the UK Corporate Governance Code.

## Annual remuneration report

The remuneration committee presents the annual remuneration report, which will be put to shareholders, along with the annual statement, as an advisory (non-binding) vote at the Annual General Meeting to be held on 5 May 2017.

## Remuneration compliance

This report was compiled in accordance with Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 and was approved by the board of directors on 14 March 2017. The committee believes that the company has complied with the provisions regarding remuneration matters contained within the UK Corporate Governance Code.

Internal advisers John Fallon (Chief executive), Coram Williams (Chief financial officer), Melinda Wolfe (Chief human resources officer), Stuart Nolan (SVP, reward) and Stephen Jones (Company secretary) provided important assistance to the committee during the year. They attended meetings of the committee, although none of them were involved in any decisions relating to his or her own remuneration.

To ensure that the committee receives independent advice, Willis Towers Watson supplies survey data and advises on market trends, long-term incentives and other general remuneration matters. Willis Towers Watson was selected and appointed by the committee through a formal tendering process. Willis Towers Watson also advised the company on health and welfare benefits in the US and provided consulting advice directly to certain Pearson operating companies. Willis Towers Watson is a member of the Remuneration Consultants' Group, the body that oversees the Code of Conduct in relation to executive remuneration consulting in the UK. During the year, Willis Towers Watson was paid fees for advice to the committee, which were charged on a time spent basis, of £224,000. This can be split £90,000 for annual standing matters and £134,000 for policy-related work. As part of its annual review of its performance and effectiveness, the committee remains satisfied that Willis Towers Watson's advice was objective and independent and that Willis Towers Watson's provision of other services in no way compromises its independence.

## Committee performance

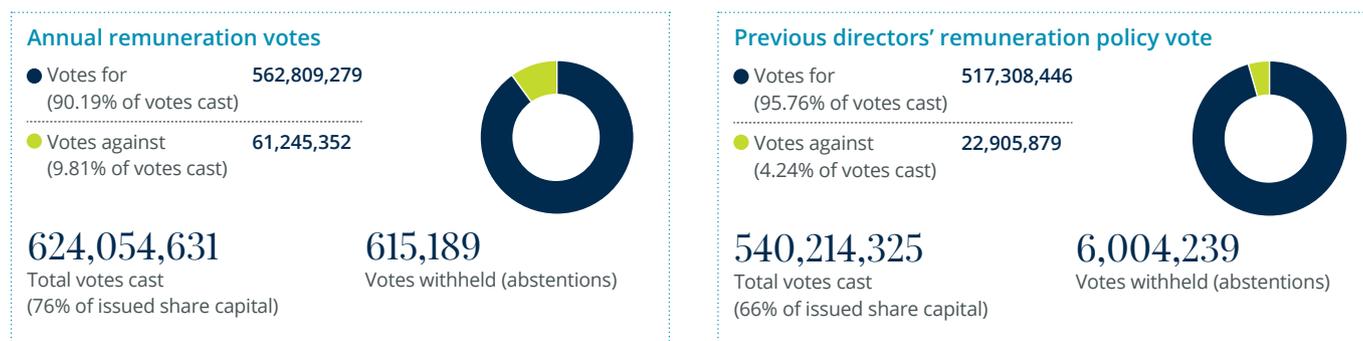
Annually, the committee reviews its own performance, constitution, and charter and terms of reference to ensure it is operating at maximum effectiveness and recommends any changes it considers necessary to the board for approval. The committee participated in a survey to review its performance and effectiveness in July 2016, looking at areas such as the clarity of roles and responsibilities, the composition of the committee, the use of time, the quality and timeliness of meeting materials, the opportunity for discussion and debate, dialogue with management and shareholders and access to independent advice. Whilst the committee concluded that it was broadly operating effectively, there were a number of improvements identified for the year ahead, such as:

- › Greater dialogue with management and external remuneration consultants between meetings
- › Advance meeting materials to be clearer and more concise.

Minor amendments were made to the committee's terms of reference on 23 February 2017 and are available on the Governance page of the company's website.

## Voting at the 2016 Annual General Meeting

The following table summarises the details of votes cast in respect of the resolutions on the report on directors' remuneration at the 2016 Annual General Meeting and the previous policy vote at the 2014 Annual General Meeting.



As in previous years and as required by law, details of the voting on all resolutions at the 2017 Annual General Meeting will be announced via the RNS and posted on the Pearson website following the Annual General Meeting.

## Single total figure of remuneration and prior year comparison

Total aggregate emoluments for executive and non-executive directors were £3.528m in 2016. These emoluments are included within the total employee benefit expense in note 5 to the financial statements (p141).

### Executive directors

The remuneration received by executive directors in respect of the financial years ended 31 December 2016 and 31 December 2015 is set out below.

### Executive director remuneration

Element of remuneration £000s	John Fallon		Coram Williams		Total	
	2016	2015	2016	2015*	2016	2015
<b>Base salary</b>	<b>780</b>	776	<b>515</b>	258	<b>1,295</b>	1,034
<b>Allowances and benefits</b>	<b>85</b>	62	<b>53</b>	0	<b>138</b>	62
Travel	48	28	22	0	70	28
Healthcare	2	2	1	0	3	2
Risk	35	32	0	0	35	32
Relocation	-	-	30	-	30	-
<b>Annual incentives</b>	<b>343</b>	0	<b>193</b>	0	<b>536</b>	0
Pay-out (% of maximum)	24%	0%	22%	0%	-	-
Pay-out (% of target)	44%	0%	44%	0%	-	-
Pay-out (% of salary)	44%	0%	37%	0%	-	-
<b>Long-term incentives</b>	<b>0</b>	54	-	-	<b>0</b>	54
LTIP	0	0	-	-	0	0
Dividends	0	46	-	-	0	46
WWSFS	0	8	-	-	0	8
<b>Retirement benefits</b>	<b>310</b>	371	<b>47</b>	18	<b>357</b>	389
Defined benefit accrual	107	169	47	18	154	187
Allowances in lieu of benefits	203	202	-	-	203	202
<b>Total remuneration</b>	<b>1,518</b>	1,263	<b>808</b>	276	<b>2,326</b>	1,539

See summary of remuneration policy on p98 →

\*part year

## Remuneration report

### Notes to single figure table

#### Single total figure of remuneration

In accordance with the regulations, we show a single total figure of remuneration, which includes retirement benefits and long-term incentives in addition to the other elements of remuneration that have been shown in previous reports.

#### Base salary

In accordance with policy, the committee considered reports from the chief executive on general morale and chief human resources officer on retention, employee engagement and effectiveness of reward plans. For 2016, the company had reiterated its starting principles that base compensation provides the appropriate rate of remuneration for the job, taking into account relevant recruitment markets, business sectors and geographic regions and that total remuneration should reward both short and long-term results, delivering competitive rewards for target performance, but higher rewards for exceptional company performance. For the US and UK, the budget guideline issued for adjustments to base pay for 2016 was 1%. For other markets, local inflation rates and market conditions were taken into account for setting budget guidelines for base pay adjustments. However, in 2016 there was a general pay freeze for all senior management including executive directors. The difference in CEO base salary single figure reflects effect of full year of 2015 increase introduced in April 2015.

#### Allowances and benefits

Travel benefits comprise company car, car allowance, private use of a driver and reimbursements of a taxable nature resulting from business travel and engagements. Health benefits comprise healthcare, health assessment and gym subsidy. Risk benefits comprise additional life cover and long-term disability insurance. In addition to the above benefits and allowances, executive directors may also participate in company benefit or policy arrangements that have no taxable value.

#### Annual incentives

For more detail, see table below. Annual incentives for the directors are funded by Pearson global annual financial and non-financial KPIs, and pay-outs take into account individual performance against personal objectives. For more detail, see below.

#### Long-term incentives

The single figure of remuneration for 2016 includes all long-term incentive awards that were subject to a performance condition where the performance period ended, or was substantially (but not fully) completed, at 31 December 2016, and awards where the performance condition has been satisfied but where the release of shares is subject to a further holding period. The same methodology has been applied for the single figure of remuneration for 2015. In 2016, the performance conditions for the 2014 Long-Term Incentive Plan (LTIP) were not met and so this award will not vest in 2017.

#### Worldwide Save For Shares

No share options became exercisable during 2016.

### Executive directors' annual incentive payments in 2016

As explained in last year's directors' remuneration report, the on-target funding for the 2016 AIP was cut significantly compared to 2015 (a cut of circa one third).

Above threshold performance on a number of measures, including Group EPS, operating profit and operating cash flow, meant that there was a calculated achievement of 55% of base salary for the CEO and 47% of base salary for the CFO. This is on a like-for-like exchange rate; i.e. there is no foreign exchange benefit passed through.

The remuneration committee rigorously reviewed all the AIP performance targets for 2016 given the results outcome. We concluded that the targets had been set on a reasonable basis and that these outcomes reflected annual achievement towards the lower end of guidance for relevant performance indicators. We also assessed the quality of cost reductions and the manner in which the financial targets had been met. We noted that the cost reductions had not compromised the company's increasing investment in digital products and services and that they were contributing to a more efficient and aligned business.

Notwithstanding this, discretion has been exercised to reduce the total AIP funding by 20%. This results in a CEO pay-out reduction from 55% to 44% of base salary and a CFO reduction from 47% to 37% of base salary. This represents 24% and 22% of maximum AIP opportunity for the CEO and CFO respectively.

For 2016, annual incentives were funded by Pearson global annual financial results based on the performance measures set out below. Individual pay-outs take into account performance against personal objectives. Actual performance against the financial targets for 2016, and the respective AIP pool funding level, were as follows:

Measures	Target funding	Threshold for 2016	Target for 2016	Maximum for 2016	Actual performance in 2016	Funding in 2016 (% of target)
Group sales (£m)	20%	4,622	4,895	4,958	4,552	0.0%
Operating profit after restructuring (£m)	30%	226	426	506	284	7.5%
Group EPS (p)	30%	52.1	70.3	77.7	57.6	7.9%
Operating cash flow after restructuring (£m)	20%	219	410	492	496	40.0%
<b>Total</b>	<b>100%</b>					<b>55.4%</b>

#### Weighting ratio



Group sales	20%
Operating profit	30%
Group EPS	30%
Operating cash flow	20%

Executive director	Group funding	Adjusted funding	Target AIP as % of salary	Actual % of salary in 2016	% of maximum AIP for 2016	Final payout in 2016 (000s)
John Fallon	55%	44%	100%	44%	24%	£343,332
Coram Williams	55%	44%	85%	37%	22%	£192,610
<b>Total</b>						<b>£535,942</b>

**Note 1:** To align the AIP with the specific restructuring achievements required in 2016, operating profit after the cost of restructuring was added to the metrics with a 30% weighting.

**Note 2:** As operating cash flow after restructuring exceeded the stretch target, this element achieved a calculated maximum pay-out.

**Note 3:** Targets shown like-for-like with actual performance, based on actual exchange rates for 2016 and constant portfolio.

**Note 4:** Actual performance figures in the table above do not reconcile to those elsewhere in the report and accounts as they include adjustments that would be needed to reflect further bonus accruals should the calculated pay-out level have been awarded.

### Long-term incentives

The status of outstanding awards under the Long-Term Incentive Plan (LTIP) and performance against the performance conditions as at 31 December 2016 are described in the table below. For each executive director, details of awards under the LTIP that were awarded, vested, released, lapsed or held during 2016 and notes to this table and the following table are provided overleaf.

#### Status of outstanding awards under the Long-Term Incentive Plan

##### Long-Term Incentive Plan (LTIP)

Date of award	Share price on date of award	Vesting date	Performance measures	Weighting	Performance period	Pay-out at threshold	Pay-out at maximum	Actual performance	% of award vested	Status	
3 May 2016	805.0p	3 May 2019	Relative TSR	1/6	1 Jan 2016 to 31 Dec 2018	25% at median	100% at upper quartile	-	-	Outstanding subject to performance	
			ROIC	1/3	2018	25% for ROIC of 5.5%	100% for ROIC of 6.7%				
			EPS	1/2	2018	25% for EPS 61.4p	25% for EPS 78.3p				
1 May 2015 (1 Aug 2015)	1,337.0p	1 May 2018 (1 Aug 2018)	Relative TSR	1/6	1 Jan 2015 to 31 Dec 2017	25% at median	100% at upper quartile	-	-	Outstanding subject to performance	
			ROIC	1/3	2017	25% for ROIC of 6.5%	100% for ROIC of 7.5%				
			EPS growth	1/2	2017 compared with 2014	25% for EPS growth of 6.0%	100% for EPS growth of 12.0%				
1 May 2014	1,102.0p	1 May 2017	Relative TSR	1/6	1 Jan 2014 to 31 Dec 2016	30% at median	100% at upper quartile	31st percentile	Nil	Estimated to lapse in 2017	
			ROIC	1/3	2016	30% for ROIC of 6.5%	100% for ROIC of 7.5%	5.0%	Nil		Will lapse in 2017
			EPS growth	1/2	2016 compared with 2013	30% for EPS growth of 6.0%	100% for EPS growth of 12.0%	-5.7%	Nil		

**Note 1** As noted in the 2015 report, the final Annual Bonus Share Matching Plan (ABSMP) award lapsed in 2016.

**Note 2** 2016 LTIP award targets linked to market guidance issued January 2016.

# Remuneration report

## Movements in directors' interests in share awards during 2016

Plan	Date of award	Vesting date	Number of shares as at 1 Jan 2016	Awarded	Released	Dividends awarded and released	Lapsed	Number of shares as at 31 Dec 2016	Status
John Fallon									
LTIP	3 May 2016	3 May 2019	0	383,000				383,000	Outstanding subject to performance
	1 May 2015	1 May 2018	230,000					230,000	Outstanding subject to performance
	1 May 2014	1 May 2017	274,000				274,000	0	Expected to lapse in 2017
<b>Total</b>			<b>504,000</b>	<b>383,000</b>	<b>0</b>	<b>0</b>	<b>274,000</b>	<b>613,000</b>	
Coram Williams									
LTIP	3 May 2016	3 May 2019	0	222,000				222,000	Outstanding subject to performance
	1 Aug 2015	1 Aug 2018	129,000					129,000	Outstanding subject to performance
<b>Total</b>			<b>129,000</b>	<b>222,000</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>351,000</b>	

**Note 1:** For all awards, Pearson's reported financial results for the relevant period were used to measure performance and no discretion has been exercised.

**Note 2:** Vested means where awards are no longer subject to performance conditions. Released means where shares have been transferred to participants. Held means where awards have vested but shares are held pending release on the relevant anniversary of the award date. Outstanding means awards that have been granted but are still subject to the achievement of performance conditions. Dividends refers to dividend equivalent shares that have been added without performance conditions to vested shares under the LTIP and released immediately on award.

**Note 3:** No variations to terms and conditions of plan interests were made during the year.

**Note 4:** TSR is measured relative to the constituents of the FTSE World Media Index over a three-year period.

**Note 5:** The 2014 award is expected to lapse, subject to confirmation of the TSR outcome.

**Note 6:** The value of shares included in the single figure of remuneration is the number of shares multiplied by the share price on release.

**Note 7:** Coram Williams' 2015 award was made on his appointment to the board on 1 August 2015 and will vest three years from this date on 1 August 2018, subject to the same performance conditions and holding periods as for other executives.

**Note 8:** The value of the LTIP awards in 2016 for the executive directors is shown below, based on the relevant (spot rate) share price on the date of award also shown:

Director	Date of award	Vesting date	Number of shares	Face value	Face value (% of base salary)	Value for threshold performance (% of 2016 salary)	Share price at date of award
John Fallon	3 May 16	3 May 19	383,000	£3,083,150	395%	99%	805.0p
Coram Williams	3 May 16	3 May 19	222,000	£1,787,100	347%	87%	805.0p

## Movements in directors' interests in share options during 2016

John Fallon also holds options under the Worldwide Save For Shares plan as follows:

Director	Date of grant	Number of shares under option held as at 31 Dec 2016	Option price	Earliest exercise date	Expiry date	Vesting in 2016 single figure £
John Fallon	30 Apr 2014	1,109	811.2p	1 Aug 2017	1 Feb 2018	0

**Note 1:** No variations to terms and conditions of share options were made during the year.

**Note 2:** Acquisition of shares under the Worldwide Save For Shares plan is not subject to a performance condition.

## Executive directors' retirement benefits and entitlements

Details of the directors' pension entitlements and pension-related benefits during the year are as follows:

Director	Value of defined benefit over the period £000	Other pension costs to the company over the period £000	Other allowances in lieu of pension £000	Total annual value in 2016 £000	Normal retirement age	Accrued pension at 31 Dec 16 £000
John Fallon	107	-	203	310	62	96
Coram Williams	47	-	-	47	62	28

**Note 1:** The accrued pension at 31 December 2016 is the deferred pension to which the member would be entitled on ceasing pensionable service on 31 December 2016. It relates to the pension payable from the UK plan.

**Note 2:** The value of defined benefit over the period comprises the defined benefit input value, less inflation, less individual contribution.

**Note 3:** Other pension costs to the company over the period comprise contributions to defined contribution arrangements for UK benefits.

**Note 4:** Other allowances in lieu of pension represent the cash allowances paid in lieu of the previous FURBS arrangements.

**Note 5:** Total annual value is the sum of the previous three columns.

## Plans

### John Fallon – Pearson Group Pension Plan

Accrual rate of 1/30th of pensionable salary per annum, restricted to the plan earnings cap (£150,600 per annum in 2016/17). In addition, he received a taxable and non-pensionable cash supplement. There are no enhanced early retirement benefits.

### Coram Williams – Pearson Group Pension Plan

Accrual rate of 1/60th of pensionable salary per annum, restricted to the plan earnings cap (£150,600 per annum in 2016/17), with continuous service with a service gap. There are no enhanced early retirement benefits.

## Chairman and non-executive director remuneration

The remuneration paid to the chairman and non-executive directors in respect of the financial years ended 31 December 2016 and 31 December 2015 are as follows:

Director £000s	2016						2015					
	Salary/ basic fee	Committee chairmanship	Committee membership	SID	Taxable benefits	Total	Salary/ basic fee	Committee chairmanship	Committee membership	SID	Taxable benefits	Total
Sidney Taurel	500	-	-	-	16	516	-	-	-	-	-	-
Elizabeth Corley	70	22	-	-	0	92	70	15	3	-	1	89
Vivienne Cox	70	10	25	22	3	130	70	10	25	22	5	132
Josh Lewis	70	-	15	-	10	95	70	-	10	-	12	92
Linda Lorimer	70	-	20	-	4	94	70	-	20	-	7	97
Harish Manwani	70	-	5	-	3	78	70	-	5	-	5	80
Tim Score	70	28	10	-	3	111	70	19	7	-	1	97
Lincoln Wallen	70	-	13	-	3	86	-	-	-	-	-	-
<b>Total</b>	<b>990</b>	<b>60</b>	<b>88</b>	<b>22</b>	<b>42</b>	<b>1,202</b>	<b>420</b>	<b>44</b>	<b>70</b>	<b>22</b>	<b>31</b>	<b>587</b>

**Note:** Taxable benefits refer to travel, accommodation and subsistence expenses incurred while attending board meetings during 2016 that were paid or reimbursed by the company which are deemed by HMRC to be taxable in the UK. The amounts in the table above include the grossed-up cost of UK tax to be paid by the company on behalf of the directors.

## Payments to former directors

There were no payments made to former directors in 2016.

## Payments for loss of office

There were no payments for loss of office made to or agreed for directors in 2016.

# Remuneration report

## Directors' interests in shares and value of shareholdings

### Directors' interests

The share interests of the directors and their connected persons are as follows:

Director	Ordinary shares at 31 Dec 16	Conditional shares at 31 Dec 16	Total number of ordinary and conditional shares at 31 Dec 16	Current shareholding	Current value (% salary)	Guideline (% salary)	Guideline met
<b>Chairman</b>							
Sidney Taurel	50,000	-	-	50,000	-	-	-
<b>Executive directors</b>							
John Fallon	303,056	613,000	916,056	303,056	265%	300%	Yes <sup>(see note)</sup>
Coram Williams	10,010	351,000	361,010	10,010	13%	200%	n/a
<b>Non-executive directors</b>							
Elizabeth Corley	3,956	-	-	3,956	-	-	-
Vivienne Cox	3,980	-	-	3,980	-	-	-
Josh Lewis	9,214	-	-	9,214	-	-	-
Linda Lorimer	4,099	-	-	4,099	-	-	-
Harish Manwani	5,393	-	-	5,393	-	-	-
Tim Score	7,990	-	-	7,990	-	-	-
Lincoln Wallen	1,903	-	-	1,903	-	-	-

**Note 1:** Conditional shares means unvested shares which remain subject to performance conditions and continuing employment for a pre-defined period.

**Note 2:** The current value of the executive directors' current shareholdings is based on the closing market value of Pearson shares of 682.0p on 1 March 2017 against base salaries at 31 December 2016. The shareholding guidelines do not apply to the chairman and non-executive directors.

**Note 3:** Ordinary shares include both ordinary shares listed on the London Stock Exchange and American Depositary Receipts (ADRs) listed on the New York Stock Exchange. The figures include both shares and ADRs acquired by individuals under the long-term incentive plan and any legacy share plans they might have participated in.

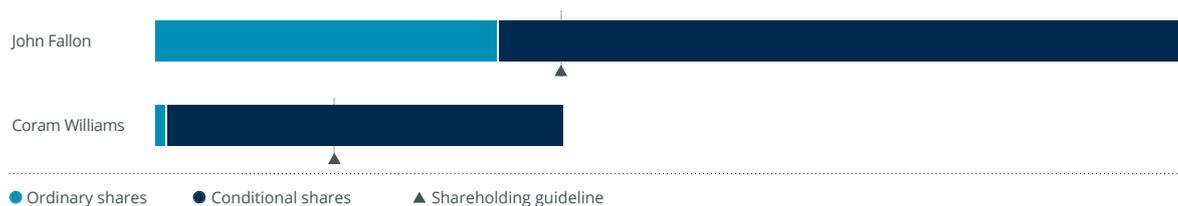
**Note 4:** The market price on 31 December 2016 was 818.5p per share and the range during the year was 657.5p to 975p.

**Note 5:** Coram Williams has five years from the date of his appointment as an executive director to reach the shareholding guideline.

**Note 6:** Ordinary shares do not include any shares vested but held pending release under a restricted share plan.

**Note 7:** John Fallon has met the shareholding guideline. However, as a result of the decrease in share price in January 2017, the current value of his shareholding is less than 300% of salary. He has not sold any shares during 2016 and the number of ordinary shares held has increased from 293,056 at 31 December 2015.

### Interests of directors and value of shareholdings £



### Shareholding guidelines

Executive directors are expected to build up a substantial shareholding in the company in line with the policy of encouraging widespread employee ownership and to align further the interests of executives and shareholders. With effect from 2014, target holding is 300% of salary for the chief executive and 200% of salary for the other executive directors. Shares that count towards these guidelines include any shares held unencumbered by the executive, their spouse and/or dependent children plus any shares vested but held pending release under a share plan. Executive directors have five years from the date of appointment to reach the guideline. With effect from 2014, these guidelines were extended to include all members of the Pearson executive management at 100% of salary.

Once met, the guideline is not re-tested, other than when shares are sold.

The shareholding guidelines do not apply to the chairman and non-executive directors. However, a minimum of 25% of the basic non-executive directors' fee is paid in Pearson shares that the non-executive directors have committed to retain for the period of their directorships.

### Dilution and use of equity

Pearson can use existing shares bought in the market, treasury shares or newly issued shares to satisfy awards under the company's various share plans. For restricted stock awards under the Long-Term Incentive Plan, the company would normally expect to use existing shares.

There are limits on the amount of new-issue equity we can use. In any rolling ten-year period, no more than 10% of Pearson equity will be issued, or be capable of being issued, under all Pearson's share plans, and no more than 5% of Pearson equity will be issued, or be capable of being issued, under executive or discretionary plans. At 31 December 2016, stock awards to be satisfied by new-issue equity granted in the last ten years under all Pearson share plans amounted to 1.9% of the company's issued share capital. No stock awards granted in the last ten years under executive or discretionary share plans will be satisfied by new-issue equity. In addition, for existing shares, no more than 5% of Pearson equity may be held in trust at any time. Against this limit, shares held in trust at 31 December 2016 amounted to 0.9% of the company's issued share capital. The headroom available for all Pearson plans, executive or discretionary, and shares held in trust is as follows:

Headroom	2016	2015	2014
All Pearson plans	8.1%	8.4%	8.3%
Executive or discretionary plans	5.0%	5.0%	5.0%
Shares held in trust	4.1%	4.2%	4.1%

#### Executive directors' non-executive directorships

Coram Williams is engaged as a NED of Guardian Media Group plc under a letter of appointment dated 14 December 2016. Although he formally joined the board on 26 January 2017 his remuneration is payable from 1 January 2017 recognising time spent in preparation and induction. His remuneration is at the rate of £34,000 p.a., rising to £39,000 p.a. from 1 April 2017 when he will become chair of the audit committee. In accordance with our policy, Coram is permitted to retain these fees.

### Historical performance and remuneration

#### Total shareholder return performance

We set out below Pearson's total shareholder return (TSR) performance relative to the FTSE All-Share index on an annual basis over the eight-year period 2008 to 2016. This comparison has been chosen because the FTSE All-Share represents the broad market index within which Pearson shares are traded. TSR is the measure of the returns that a company has provided for its shareholders, reflecting share price movements and assuming reinvestment of dividends (source: DataStream).

In accordance with the reporting regulations, this section also presents Pearson's TSR performance alongside the single figure of total remuneration for the CEO over the last eight years and a summary of the variable pay outcomes relative to the prevailing maximum at the time. The table below summarises the total remuneration for the CEO over the last eight years, and the outcomes of annual and long-term incentive plans as a proportion of maximum.

#### Total shareholder return £

○ Pearson TSR  
○ FTSE All-share TSR



CEO remuneration	Marjorie Scardino				John Fallon			
Total remuneration (single figure, £000s)	6,370	8,466	8,340	5,330	1,727	1,895	1,263	1,518
Annual incentive – incumbent (% of maximum)	91.3%	92.1%	75.7%	24.2%	34.3%	50.5%	Nil	24.4%
Long-term incentive – incumbent (% of maximum)	80.0%	97.5%	68.3%	36.7%	Nil	Nil	Nil	Nil

**Annual incentive** is the actual annual incentive received by the incumbent as a percentage of maximum opportunity.

**Long-term incentive** is the pay-out of performance related restricted shares under the Long-Term Incentive Plan where the year shown is the final year of the performance period for the purposes of calculating the single total figure of remuneration.

**Total remuneration – John Fallon:** John Fallon's total remuneration opportunity is lower than that of the previous incumbent. Variable pay-outs under the annual and Long-Term Incentive Plans reflect performance for the relevant periods.

# Remuneration report

## Comparative information

The following information is intended to provide additional context regarding the total remuneration for executive directors.

### Relative percentage change in remuneration for CEO

The following table sets out the change between 2015 and 2016 in three elements of remuneration for the CEO, in comparison to the average for all employees. Whilst the committee reviews base pay for the CEO relative to the broader employee population, benefits are driven by local practices and eligibility is determined by level and individual circumstances which do not lend themselves to comparison.

#### Change in CEO remuneration 2015/16

##### Base salary

⊖ no change

##### Annual incentives

⬆ see note 4

##### Allowances and benefits

⬆ +37%

##### Total

⬆ +20%

#### Change in employee remuneration 2015/16

##### Base salary

⬆ +1%

##### Annual incentives

⬆ +55%

##### Allowances and benefits

⬆ +7%

##### Total

⬆ +5%

**Note 1** The figures for all employees reflect average salaries and average employee numbers each year at constant exchange rates. Annual incentives include all plans, including sales incentives.

**Note 2** The difference in CEO base salary single figure reflects effect of full year of 2015 increase introduced in April 2015. No increase in 2016.

**Note 3** CEO allowances and benefits change reflects increase in cost of car benefit and travel expenses of c.£20,000 over 2015.

**Note 4** As there was no AIP paid in 2015, relative percentage change for the CEO is in calculable.

**Note 5** The increase in allowances and benefits on an average employee basis is inflated by a change in population post-restructuring.

**Note 6** As there was no AIP paid in 2015, relative percentage change for employees reflects 2016 Group-wide bonus pay-outs versus a small selection of local plans in 2015.

## Relative importance of pay spend

The committee considers directors' remuneration in the context of the company's allocation and disbursement of resources to different stakeholders. In particular, we chose operating profit because this is a measure of our ability to reinvest in the company. We include dividends because these constitute an important element of our return to shareholders.

All figures in £ millions	2016	2015	Change	
			£m	%
Operating profit	635	723	-88	-12%
Dividends	424	423	1	0%
Total wages and salaries	1,661	1,507	154	10%

**Note 1:** Operating profit is as set out in the financial statements.

**Note 2:** Wages and salaries include continuing operations only and include directors. Average employee numbers for continuing operations for 2016 were 32,719 (2015: 37,265). Further details are set out in note 5 to the financial statements on p141.

**Note 3:** Total wages and salaries would be -1% at constant exchange rates. Excluding redundancies and bonuses this would be -12% at constant exchange rates.

# 2017 remuneration policy

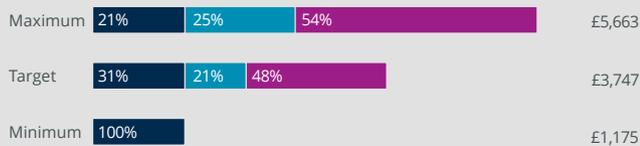
The remuneration committee presents the 2017 directors' remuneration policy (2017 policy), which will be put to shareholders for binding vote at the Annual General Meeting to be held on 5 May 2017. Subject to shareholder approval, the effective date of this policy will be 5 May 2017. However, it is proposed, subject to approval at the AGM, that changes to executive director incentives be made effective from the start of the 2017 performance periods. The intention of the committee is that the policy will remain in place for three years from the date of its approval.

We have evolved our remuneration policy to match our updated remuneration principles:

<p><b>1</b></p> <p><b>Sustainability and affordability</b></p> <p>Funded through results; strong link to sustainable performance, cost control and appropriate capital allocation.</p>	<p><b>2</b></p> <p><b>Pay for performance</b></p> <p>Pay mix focuses on variable pay; aligned fully with KPIs: EPS; operating profit; sales; operating cash flow; total shareholder return and return on invested capital.</p>	<p><b>3</b></p> <p><b>Flexibility</b></p> <p>Performance metrics linked to strategic imperatives can be selected annually to give us the agility to "move more quickly" in support of Pearson's transformation strategy.</p>	<p><b>4</b></p> <p><b>Alignment</b></p> <p>Incentive plans are designed to reflect sustainable value creation in our drive for growth and efficiency through "becoming a simpler, more focused business".</p>	<p><b>5</b></p> <p><b>Reward for sustainable company performance</b></p> <p>Stretching financial and strategic business imperative metrics support delivery of strategy.</p>
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## Pay and performance scenario analysis

### Chief executive officer (John Fallon) £000



- Base salary, allowances, benefits and pension
- Annual incentive
- Long-term incentives

### CEO fixed vs variable at target



Consistent with its policy, the committee places considerable emphasis on the performance-linked elements i.e. annual and long-term incentives.

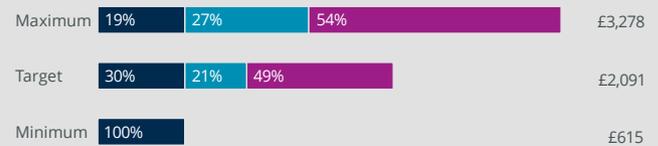
The charts above show what each director could expect to receive in 2017 under different performance scenarios, based on the definitions of performance opposite.

On this basis, the relative weighting of fixed and performance-related remuneration and the absolute size of the remuneration packages for the chief executive officer and the chief financial officer are shown above.

We will continue to review the mix of fixed and performance-linked remuneration on an annual basis, consistent with our overall policy.

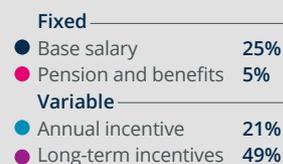
**Note** The value of long-term incentives does not take into account dividend awards that are payable on the release of restricted shares nor any changes in share price. Nor does this infer a precedent for future LTIP awards in 2017 onwards which will be implementation decisions in each year. See p106 for more information on 2017 awards.

### Chief financial officer (Coram Williams) £000



- Base salary, allowances, benefits and pension
- Annual incentive
- Long-term incentives

### CFO fixed vs variable at target



Performance scenario	Elements of remuneration and assumptions
Maximum	2017 base salary; allowances, benefits and retirement benefits at the same percentage of base salary as in 2016; maximum individual annual incentive as per policy; maximum value of 2016 long-term incentive award
Target	2017 base salary; allowances, benefits and retirement benefits at the same percentage of base salary as in 2016; target individual annual incentive as per policy; target value of 2016 long-term incentive award (Willis Towers Watson's independent assessment of the expected value of the award i.e. the net present value taking into account all the conditions)
Minimum	2017 base salary; allowances, benefits and retirement benefits at the same percentage of base salary as in 2016; no annual or long-term incentives

## Remuneration policy

### Future policy table for executive directors

Total remuneration is made up of fixed and performance-linked elements, with each element supporting different strategic objectives. Total remuneration is normally reviewed annually in the context of business performance and conditions prevailing, and is routinely benchmarked against total remuneration for similar positions in comparable companies.

#### Base salary

##### Purpose and link to strategy

- › Helps to recruit, reward and retain.
- › Reflects level, role, skills, experience, the competitive market and individual contribution.

##### Operation

Base salaries are set to provide the appropriate rate of remuneration for the job, taking into account relevant recruitment markets, business sectors and geographic regions. Base salaries may be set in sterling or the local currency of the country in which the director is based.

Base salaries are normally reviewed annually for the following year taking into account: general economic and market conditions; the level of increases made across the company as a whole; particular circumstances such as changes in role, responsibilities or organisation; the remuneration and level of increases for executives in similar positions in comparable companies; and individual performance.

For benchmarking purposes, we review remuneration by reference to different comparator groups. We look at survey data from: select UK human capital intensive businesses; and UK and US 'media convergence' companies with a focus on digital, information services and technology. These companies are of a range of sizes relative to Pearson, but the method our independent advisers, Willis Towers Watson, use to make comparisons on remuneration takes this variation in size into account. We also look at publicly disclosed and proxy data for global media convergence comparators with a focus on media and technology and consider base salary levels within the broader FTSE 100. We use these

companies because they represent the wider executive talent pool from which we might expect to recruit externally and the pay market to which we might be vulnerable if our remuneration was not competitive.

Base salaries are paid in cash via the regular employee payroll (monthly in the UK and every two weeks in the US) and are subject to all necessary withholdings.

No malus or clawback provisions apply to base salary.

##### Opportunity

Base salary increases for executive directors will not ordinarily exceed 10% per annum and will take account of the base salary increases elsewhere within the company.

The committee will retain the discretion to deliver base salary increases up to 25% over the normal maximum limit in specific individual situations including internal promotions and material changes to the business or the role. This discretion will be exercised only in exceptional circumstances and the committee would consult with major shareholders before doing so, proceeding only where there was clear consensus in favour among those consulted.

##### Performance conditions and period

None, although performance of both the company and the individual are taken into account when determining an appropriate level of base salary increase each year.

There is no relevant performance period.

#### Allowances and benefits

##### Purpose and link to strategy

- › Help to recruit and retain.
- › Reflect local competitive market.

##### Operation

Allowances and benefits comprise cash allowances and non-cash benefits and inter alia include: travel-related benefits (comprising company car, car allowance and private use of a driver); health-related benefits (comprising healthcare, health assessment and gym subsidy); and risk benefits (comprising additional life cover and long-term disability insurance that are not covered by the company's retirement plans). Allowances may also include, where appropriate, location and market premium and housing allowance although no continuing director is in receipt of such allowances. Allowances and benefits received in 2016 are set out in the annual remuneration report.

Directors are also covered by the company's directors' and officers' liability insurance and an indemnity in respect of certain third-party liabilities.

Other benefits may be offered on the same terms as to other employees.

Allowances and benefits do not form part of pensionable earnings.

No malus or clawback provisions apply to allowances and benefits.

##### Opportunity

The provision and level of cash allowances and non-cash benefits are competitive and appropriate in the context of the local market.

The total value of cash allowances and non-cash benefits for executive directors will not ordinarily exceed 15% of base salary in any year, other than in the case of increases in the cost of benefits that are outside Pearson's control and changes in benefit providers. The committee will retain the further discretion to deliver a total value of benefits up to 25% above the normal limit in specific individual situations including changes in individual circumstances such as health status and changes in the role such as relocation. This discretion will be exercised only in exceptional circumstances and the committee would consult with major shareholders before doing so, proceeding only where there was clear consensus in favour among those consulted.

Executive directors are also eligible to participate in savings-related share acquisition programmes in the UK, US and rest of world, which are not subject to any performance conditions, on the same terms as other employees.

##### Performance conditions and period

None.

There is no relevant performance period.

## Retirement benefits

### Purpose and link to strategy

- › Help to recruit and retain.
- › Recognise long-term commitment to the company.

### Operation

New employees in the UK are eligible to join the Money Purchase 2003 section of the Pearson Group Pension Plan.

Under the Money Purchase 2003 section of the Pearson Group Pension Plan, normal retirement age is 62, but, subject to company consent, retirement is currently possible from age 55 or earlier in the event of ill-health. During service, the company and the employee make contributions into a pension fund. Account balances are used to provide benefits at retirement. Pensions for a member's spouse, dependent children and/or nominated financial dependants are payable on death.

Depending on when they joined the company, directors may participate in the Final Pay section of the Pearson Group Pension Plan, which is closed to new members.

Under the Final Pay section of the Pearson Group Pension Plan, normal retirement age is 62, but, subject to company consent, retirement is currently possible from age 55 or earlier in the event of ill-health. During service, the employee makes a contribution of 5% of pensionable salary and the pension fund builds up based on final pensionable salary and pensionable service. The accrued pension is reduced on retirement prior to age 60. Pensions for a member's spouse, dependent children and/or nominated financial dependants are payable on death.

Executive directors may be entitled to additional pension benefits to take account of the cap on the amount of benefits that can be provided from the all-employee pension arrangements in the UK.

Members of the Pearson Group Pension Plan who joined after May 1989 are subject to an upper limit of earnings that can be used for pension purposes, known as the earnings cap. This limit, £108,600 as at 6 April 2006, was abolished by the Finance Act 2004. However, the Pearson Group Pension Plan has retained its own 'cap', which will increase annually in line with the UK government's Retail Prices Index (All Items). The cap was £150,600 as at 6 April 2016.

UK executive directors who are, or become, affected by the lifetime allowance or new hires who opt out of membership of the plan may be provided with a cash supplement of normally up to 26% of salary as an alternative to further accrual of pension benefits.

No malus or clawback provisions apply to retirement benefits.

### Opportunity

In the UK, company contributions for eligible employees to the Money Purchase 2003 section of the Pearson Group Pension Plan amount up to 16% of pensionable salary (double the amount of the employee contribution, which is limited according to certain age bands).

John Fallon is a member of the Final Pay section of the Pearson Group Pension Plan. His pension accrual rate is 1/30th of pensionable salary per annum, restricted to the plan earnings cap. Until April 2006, the company also contributed to a Funded Unapproved Retirement Benefits Scheme (FURBS) on his behalf. Since April 2006, he has received a taxable and non-pensionable cash supplement in replacement of the FURBS.

The company has no ongoing financial liabilities in respect of the FURBS.

Coram Williams is a member of the Final Pay section of the Pearson Group Pension Plan with continuous service with a service gap. His pension accrual rate is 1/60th of pensionable salary per annum, restricted to the plan earnings cap.

If any executive director is from, or works, outside the UK, the committee retains a discretion to put in place retirement benefit arrangements for that director in line with local market practice including defined benefit pension arrangements operated by Pearson locally. The maximum value of such arrangement will reflect local market practice at the relevant time. The committee will also honour all pre-existing retirement benefit obligations, commitments or other entitlements that were entered into by a member of the Pearson Group before that person became a director.

### Performance conditions and period

None.

There is no relevant performance period.

# Remuneration policy

## Annual incentives

### Purpose and link to strategy

- › Motivate the achievement of annual business goals and personal objectives.
- › Provide a focus on key financial metrics.
- › Reward individual contribution to the success of the company.
- › Align to strategy execution priorities.

### Operation

Annual incentive does not form part of pensionable earnings.

Measures and performance targets are set by the committee at the start of the year with payment made after year end following the committee's assessment of performance relative to targets.

The plan is designed to incentivise and reward underlying performance. Actual results are adjusted to remove the effect of foreign exchange and portfolio changes (acquisitions and disposals) and other relevant factors that the committee considers do not reflect the underlying performance of the business in the performance year.

Annual incentive plans are discretionary. The committee reserves the right to adjust payments up or down before they are made if it believes exceptional factors warrant doing so. The committee may in exceptional circumstances make a special award where it is satisfied that the normal operation of the annual incentive does not provide an appropriate incentive or reward to participants.

The committee also reserves the right as a form of malus to adjust payments before they are made if special circumstances exist that warrant this, such as financial misstatement, individual misconduct or reputational damage to the company.

The committee also reserves, in the same special circumstances, a right to reclaim or claw back payments or awards that have already been made.

### Opportunity

Annual incentives will not exceed 200% of base salary.

For the chief executive officer, the individual maximum incentive opportunity that will apply for 2017 is 180% of base salary and 170% for the chief financial officer (which are the same opportunities as applied for 2016).

There is normally no pay-out for performance at threshold.

### Performance conditions and period

The committee has the discretion to select the performance measures, targets and relative weightings from year to year to ensure continuing alignment with strategy and to ensure targets are sufficiently stretching.

The committee establishes a threshold below which no pay-out is achieved and a maximum at or above which the annual incentive pays out in full.

The funding of annual incentives will normally be related to the performance against financial and strategic imperatives performance targets. For 2017 and onwards, financial metrics will normally account for at least 75% of the total annual opportunity and be related to the performance against targets for Pearson's adjusted earnings per share and/or operating profit, sales, and operating cash flow. For 2017, the weightings will be: adjusted earnings per share 22.5%, operating profit 22.5%, sales 15% and operating cash flow 15%. The remaining total annual opportunity will be subject to performance metrics linked to strategic imperatives set by the committee as it considers appropriate in each year. These will be linked to:

### Strategic imperatives

KPI

#### Competitive performance

- › Holding or gaining share in major markets
- › Higher Education direct/ecommerce sales to consumers

#### Transformation

- › Delivery of Enabling Programme milestones to upgrade the customer experience, accelerate the digital transformation and the delivery of on-going cost, efficiency and process transformations

#### Culture, talent & brand

- › Improvement in brand favourability and year-on-year improvement in employee engagement survey scores

Each metric will be measured, using third party data or externally audited internal data (where third party data is not available or applicable).

Performance metrics linked to strategic imperatives can be selected annually to support Pearson's transformation strategy.

A pay-out will only be made if a minimum level of performance has been achieved under the financial metrics, as determined by the committee each year.

Annual incentive pay-outs will also take into account individual performance against personal objectives. Personal objectives are agreed with the chief executive (or, in the case of the chief executive, the chairman) and may be functional, operational, strategic and non-financial and include, inter alia, objectives relating to environmental, social and governance issues.

Details of performance measures, weightings and targets will be disclosed in the annual remuneration report for the relevant financial year if and to the extent that the committee deems them to be no longer commercially sensitive.

The performance period is one year.

## Long-term incentives

### Purpose and link to strategy

- › Help to recruit, reward and retain
- › Drive long-term earnings, share price growth and value creation
- › Align the interests of executives and shareholders
- › Encourage long-term shareholding and commitment to the company.

### Operation

Awards of restricted shares are made on an annual basis.

Awards of restricted shares for executive directors vest on a sliding scale based on performance against stretching corporate performance targets measured at the end of the three-year performance period.

Performance will continue to be tested over three years and 75% of the vested shares will be released at that point. However, there is a mandatory restriction on participants' ability to dispose of the 75% of the vested shares (other than to meet personal tax liabilities) for a further two years. Furthermore, participants' rights to the release of the 25% of the vested shares will be subject to continued employment over the same period.

Where shares vest, participants also receive additional shares representing the gross value of dividends that would have been paid on these shares during the performance period and reinvested.

The plan permits awards of restricted shares to be made that are not subject to performance conditions to satisfy reward and retention objectives. However, other than in the circumstances described in the recruitment section of this policy below, it is the company's policy not to award restricted shares to executive directors without performance conditions.

The Long-Term Incentive Plan also provides for the grant of stock options. While it is not the committee's intention to grant stock options in 2017 or the foreseeable future, the committee believes that it should retain the flexibility of granting stock options in addition to, or instead of, restricted stock awards in the right circumstances. Any decision by the committee to grant stock options in the future would take account of best practice prevailing at the time. The committee would consult with shareholders before granting stock options to executive directors.

Pearson's reported financial results for the relevant periods are used to measure performance.

The committee reserves the right to adjust pay-outs up or down before they are released taking into account exceptional factors that distort underlying business performance or if it believes exceptional factors warrant doing so. In making such adjustments, the committee is guided by the principle of aligning shareholder and management interests.

The committee also reserves the right as a form of malus to adjust pay-outs before they are released if exceptional circumstances exist that warrant this, such as financial misstatement, individual misconduct or reputational damage to the company.

The committee also reserves, in the same special circumstances, a right to reclaim or claw back payouts or awards that have already been released.

### Opportunity

We set the level of individual awards by taking into account:

- › The face value of individual awards at the time of grant, assuming that performance targets are met in full
- › Market practice for comparable companies and market assessments of total remuneration from our independent advisers
- › Individual roles and responsibilities
- › Company and individual performance.

Restricted share awards to executive directors may normally be made up to a maximum face value of 400% of base salary. Awards in excess of 400% of base salary (and up to 25% over the normal maximum limit) may

be made in exceptional circumstances, for example, for retention purposes or to reflect particular business situations. This discretion will be exercised only in exceptional circumstances and the committee would consult with major shareholders before doing so, proceeding only where there was clear consensus in favour among those consulted.

The committee retains flexibility to make exceptional awards of up to 25% above the normal limit in specific circumstances. The reasons for any such exceptional awards will be disclosed in the annual report for the year in which they are made.

The value of awards at pay-out is subject to the extent to which performance and any other conditions are met and the share price at the time of vesting.

While it is not the committee's intention to grant stock options in 2017 or the foreseeable future, the maximum value of stock option awards would be the equivalent expected value of, and in place of, the maximum restricted share awards set out above, based on an independent assessment of their net present value taking into account all the conditions.

### Performance conditions and period

The committee will determine the performance measures, weightings and targets governing an award of restricted shares prior to grant to ensure continuing alignment with strategy and to ensure that targets are sufficiently stretching.

The committee establishes a threshold below which no pay-out is achieved and a maximum at or above which the award pays out in full. The proportion of the award that vests at threshold level of performance under each performance condition is 25%.

For 2017 and onwards, awards will normally be subject to the achievement of targets for earnings per share, return on invested capital and relative total shareholder return. For 2017, and following shareholder consultation, the weighting of the performance metrics within the Pearson Long-Term Incentive Plan will be changed to 40% earnings per share, 30% return on invested capital and 30% relative total shareholder return (previously, one half, one third and one sixth, respectively).

As with restricted shares, the committee will determine the performance conditions that apply to any awards of stock options prior to grant. The intention would be that these conditions would be the same as apply to restricted shares.

Total shareholder return (TSR) is the return to shareholders from any growth in Pearson's share price and reinvested dividends over the performance period. For long-term incentive awards made in 2017 and onwards, TSR will be measured relative to the constituents of the FTSE 100 over a three-year period. Companies that drop out of the index are normally excluded i.e. only companies in the index for the entire period are counted. Share price is averaged over three months at the start and end of the performance period. Dividends are treated as reinvested on the ex-dividend date, in line with the Datastream methodology. The vesting of shares based on relative TSR is subject to the committee satisfying itself that the recorded TSR is a genuine reflection of the underlying financial performance of the business.

Return on invested capital (ROIC) is adjusted operating profit less cash tax expressed as a percentage of gross invested capital (net operating assets plus gross goodwill).

Adjusted earnings per share (EPS) is calculated by dividing the adjusted earnings attributable to equity shareholders of the company by the weighted average number of ordinary shares in issue during the year, excluding any ordinary shares purchased by the company and held in trust (see note 8 of the consolidated financial statements for a detailed description of adjusted earnings per share).

The performance period is three years.

# Remuneration policy

## Notes to the policy table

### Selection of performance measures and target setting

In the selection and weighting of performance measures for the annual and long-term incentive awards the committee takes into account Pearson's strategic objectives and short- and long-term business priorities.

In the case of annual incentives, the committee identified sales, earnings per share, operating profit, operating cash flow and key strategic business imperatives as being relevant measures of Pearson's performance against its shorter-term strategic objectives and business priorities.

In the case of long-term incentives, the committee judged the following to be most closely matched to sustained delivery of strategy and alignment with shareholders' interests: earnings per share rewards the delivery of the desired outcomes from our strategic growth objectives and is imperative if we are to improve our total shareholder return and our return on invested capital. Return on invested capital is used to track investment returns and to help assess capital allocation decisions within the business. We selected total shareholder return relative to the constituents of the FTSE 100 because, in line with many of our shareholders, we considered that part of executive directors' rewards should be linked to performance relative to companies of comparable size, scale and maturity that are similarly impacted by global macro-economic influences.

The performance ranges chosen set a careful balance between upside opportunity and downside risk and are normally based on targets in accordance with the company's operating and strategic plans.

### Pre-existing commitments

In addition to the remuneration arrangements described above, Pearson's policy is to honour all pre-existing obligations, commitments or other entitlements that were entered into before the effective date of this policy, including those entered into at a time when the relevant individual was not a director of Pearson or when the terms of those arrangements were consistent with the shareholder approved directors' remuneration policy then in force.

### Remuneration policy for other employees

The approach to remuneration for the broader employee population varies by level and geography, but is broadly consistent with that of directors:

- › The approach to setting base salary increases elsewhere in the company takes into account economic factors, competitive market rates, roles, skills, experience and individual performance
- › Allowances and benefits for employees reflect the local labour market in which they are based

- › As part of their overall retirement arrangements, executive directors participate in the same underlying pension arrangements that have been set up for other Pearson employees in the UK
- › Many employees participate in some form of cash-based annual incentive, bonus, profit-share or sales commission plan based on annual performance targets and selected senior employees are also eligible to receive share awards. Incentive plans for the Pearson executive management team form the basis of the incentive plans throughout the organisation in the principal operating companies and establish performance measures and standards and set the ceiling for individual incentive opportunities
- › Approximately 5% of the company's employees below the Pearson executive management – selected on the basis of their role, performance and potential – currently hold performance or time-vesting shares under the Long-Term Incentive Plan
- › All employees (including executive directors) are also eligible to participate in savings-related share acquisition programmes in the UK, US and the rest of the world, which are not subject to any performance conditions.

### Recruitment

The committee expects any new executive directors to be engaged on the same terms and to be awarded variable remuneration within the same normal limits and subject to the same conditions as for the current executive directors outlined in the policy.

In setting the basic salary for any new executive director, the committee will apply a level appropriate to recruit a suitable candidate, having regard to the factors set out in the future policy table.

The committee recognises that it cannot always predict accurately the circumstances in which any new directors may be recruited. The committee may determine that it is in the interests of the company and shareholders to secure the services of a particular individual which may require the committee to take account of the terms of that individual's existing employment and/or their personal circumstances. The committee may do this in the following circumstances:

- › Where an existing employee of the company is promoted to the board, in which case the company will honour all existing contractual commitments including any outstanding share awards, benefit and pension entitlements
- › Where an individual is relocating in order to take up the role, in which case the company may provide certain benefits such as reasonable relocation expenses, accommodation for a short period following appointment and assistance with visa applications or other immigration issues and ongoing arrangements such as tax equalisation, annual flights home and housing allowance

› Where an individual would be forfeiting valuable variable remuneration in order to join the company, in which case the committee may award appropriate compensation. The committee would require reasonable evidence of the nature and value of any forfeited award and would, to the extent practicable, ensure any compensation was provided on a like-for-like basis and was no more valuable than the forfeited award.

In light of the various legacy pension arrangements enjoyed by the incumbent executive directors, in determining the pension arrangements for any new recruit, the committee expects to offer a defined contribution arrangement with company contributions not exceeding those set out on p99 but would have regard to the recruit's existing arrangements, the market norms in the home country and the existing pension vehicles available within the company.

In making any decision on any aspect of the remuneration package for a new recruit, the committee would balance shareholder expectations, current best practice and the requirements of any new recruit and would strive not to pay more than is necessary to achieve the recruitment. The committee would give full details of the terms of the package of any new recruit in the next annual remuneration report.

Pearson expects any new chairman or non-executive director to be engaged on terms that are consistent with the general remuneration principles outlined in the relevant sections of this policy. However, in the case of the chairman, the committee may consider it appropriate to offer a remuneration package that differs from that of the existing incumbent if that is necessary to attract the most capable candidate or to reflect the individual's expected duties.

### Service contracts and termination provisions

In accordance with long established policy, all executive directors have service agreements under which, other than by termination in accordance with the terms of these agreements, employment continues indefinitely.

There are no special provisions for notice or compensation in the event of a change of control of Pearson.

It is the company's policy that the company may terminate the chairman's and executive directors' service agreements by giving no more than 12 months' notice.

As an alternative, for executive directors the company may at its discretion pay in lieu of that notice. Payment in lieu of notice may be made in equal monthly instalments from the date of termination to the end of any unexpired notice period. Payment in lieu of notice in instalments may also be subject to mitigation and reduced taking into account earnings from alternative employment.

For executive directors, payment in lieu of notice comprises 100% of the annual salary at the date of termination and the annual cost to the company of providing pension and all other benefits. For the chairman, payment in lieu of notice comprises 100% of the annual fees at the date of termination. In limited circumstances, in addition to making a full payment in lieu of notice, the company may permit an executive director to stay employed after the announcement of his or her departure for a limited period to ensure an effective hand-over and/or allow time for a successor to be appointed.

The company may, depending on the circumstances of the termination, determine that it will not pay the director in lieu of notice and may instead terminate a director's contract in breach and make a damages payment, taking into account as appropriate the director's ability to mitigate his or her loss. The company may also pay an amount considered to be reasonable by the remuneration committee in respect of fees for legal and tax advice and outplacement support for the departing director.

On cessation of employment, save as otherwise provided for under the rules of Pearson's discretionary share plans, executive directors' entitlements to any unvested awards lapse automatically. In the case of injury, disability, ill-health or redundancy (as determined by the committee), where a participant's employing company ceases to be part of Pearson, or any other reason if the committee so decides in its absolute discretion:

- › Awards that are subject to performance conditions will stay in force as if the participant had not ceased employment and shall vest on the original vesting date
- › Awards that are not subject to a performance condition will be released as soon as practicable following cessation of employment
- › The number of shares that are released shall be pro-rated for the period of the participant's service in the restricted period (although the committee may in its absolute discretion waive or vary the pro-rating).

In determining whether and how to exercise its discretion under Pearson's discretionary share plans, the committee will have regard to all relevant circumstances distinguishing between different types of leaver, the circumstances at the time the award was originally made, the director's performance and the circumstances in which the director left employment.

On cessation of employment, executive directors, having been notified of participation in an annual incentive plan for the relevant financial year, may, at the committee's discretion, retain entitlement to a pro rata annual incentive for their period of service in the financial year prior to their leaving date. Such pay-out will normally be calculated in good faith on the same terms and paid at the same time as for continuing executive directors.

## Remuneration policy

Eligibility for allowances and benefits including retirement benefits normally ceases on retirement or on the termination of employment for any other reason.

The rules of Pearson's discretionary share plans make provision for the treatment of awards in respect of corporate activity, including a change of control of Pearson. The committee would act in

accordance with the terms of the awards in these circumstances, which includes terms as to the assessment of performance conditions and time apportionment.

Details of each individual's service agreement are outlined in the table below. Employment agreements for other employees are determined according to local labour law and market practice.

### Individual service agreements

Position	Date of agreement	Notice periods	Compensation on termination of employment by the company without notice or cause
Chairman	25 October 2015	12 months from the director; 12 months from the company	Payment in lieu of notice of 100% of annual fees at the date of termination
Executive directors	31 December 2012 (John Fallon) 26 February 2015 (Coram Williams)	6 months from the director; 12 months from the company	Payment in lieu of notice of 100% of annual salary at the date of termination and the annual cost of pension and all other benefits

**Note** Under pay in lieu of notice, the annual cost of pension for executive directors is normally calculated as the sum, where applicable, of: an amount equal to the company's cost of providing the executive's pension under the pension plan based on the Future Service Company Contribution Rate for the relevant section of the pension plan as stated in the most recent actuarial valuation (as at the date of termination of employment) as limited by the earnings cap; and any cash allowance in lieu of pension or to take account of the fact that pension benefits and life assurance cover are restricted by the earnings cap.

### Executive directors' non-executive directorships

The committee's policy is that executive directors may, by agreement with the board, serve as non-executives of other companies and retain any fees payable for their services.

### Employment conditions

In accordance with the committee's charter and terms of reference, the committee's remit includes oversight of certain remuneration matters below that of the chief executive, the other executive directors and other members of the Pearson executive management team. Before the remuneration packages for the Pearson executive management team are set for the year ahead, the committee considers reports from the chief executive on general morale and chief human resources officer on retention, general pay trends in the market and the level of pay increases and incentives across the company as a whole. This helps to ensure that executive remuneration packages are reviewed in the context of the wider organisation.

The company consults with various employee representative bodies – including trade unions and works councils in some jurisdictions – about the company's strategy, competitiveness and performance of the business and other matters affecting employees. The company also conducts an employee engagement survey to find out how people feel about working for Pearson, what they think about the work they do, the opportunities they have and the rewards they get (including a section on pay and benefits). The company uses all of this feedback to inform decisions on people-related activities, resources and investment, local management action plans and wider business unit and organisational strategies.

It is the company's intention to continue to engage with employees and employee representatives in this way in the future.

The committee has not consulted directly with employees on the setting of the directors' remuneration policy.

### Shareholder views

The company consults regularly with shareholders on all matters affecting its strategy and business operations. As part of that process, we also engage with shareholders on matters relating to executive remuneration.

The committee continues to be aware of and respond to best practice guidelines of shareholders and their representative bodies.

In November 2016 we wrote to our key shareholders and the voting advisory agencies, seeking their views on the proposed changes to Pearson's remuneration policy.

The chairman of the Remuneration Committee met or corresponded with a number of our shareholders to understand better their views on our proposals and to answer their questions on why the proposed changes were appropriate.

We received valuable feedback on a number of points, which reflected a significant range of opinions. These matters have been addressed in this policy report.

We are committed to continued engagement going forward and where it concerns the implementation of this policy.

## Future policy table for chairman's and non-executive directors' remuneration

The table below summarises policy with respect to the remuneration of the chairman and non-executive directors:

### Purpose and link to strategy

To attract and retain high-calibre individuals, with appropriate experience or industry-relevant skills, by offering market competitive fee levels.

### Operation

The chairman is paid a single fee for all of his responsibilities.

The chairman's fee is set at a level that is competitive with those of chairmen in similar positions in comparable companies. The chairman is not entitled to any annual or long-term incentive, retirement or other employee benefits.

The non-executive directors are paid a basic fee. The chairmen and members of the main board committees and the senior independent director are paid an additional fee to reflect their extra responsibilities. Following a review of the structure of the fees paid to non-executive directors, the board has determined that it would be appropriate to introduce additional fees for membership and chairmanship of the nomination & governance committee. Having taken independent advice from Willis Towers Watson, the fee that has been set by the board reflects the median level within the FTSE 100.

The chairman and the non-executive directors are covered by the company's normal arrangements for directors' and officers' liability insurance and an indemnity in respect of certain third-party liabilities.

The company reimburses the chairman's and non-executive directors' travel and other business expenses and any tax incurred thereon, if applicable.

A minimum of 25% of the chairman's and non-executive directors' basic fee is paid in Pearson shares that the non-executive directors have committed to retain for the period of their directorships. Shares are acquired quarterly at the prevailing market price with the individual after-tax fee payments.

Fees for non-executive directors are determined by the full board having regard to market practice and within the restrictions contained in the company's Articles of Association. The chairman and non-executive directors receive no other pay or benefits (other than reimbursement for expenses incurred in connection with their directorship of the company) and do not participate in the company's equity-based incentive plans.

Non-executive directors serve Pearson under letters of appointment which are renewed annually and do not have service contracts. For non-executive directors, there is no notice period or entitlement to compensation on the termination of their directorships.

### Opportunity

The chairman's fees were reviewed in 2017 and have not been increased since his appointment. Fees for the non-executive directors were last increased with effect from 1 May 2014. Following a review of fees paid to non-executive directors, the board has determined that most fees will remain unchanged, other than a small increase to apply to membership and chairmanship of the reputation & responsibility committee. A fee has also been introduced for the newly formed nomination & governance committee. These changes will take effect from the AGM on 5 May 2017, subject to the approval of this policy.

The structure of non-executive directors' fees with effect from the date of this policy is as follows:

Director	Fee
Non-executive director	£70,000
Chairmanship of audit committee	£27,500
Chairmanship of remuneration committee	£22,000
Chairmanship of reputation & responsibility committee	£10,000 (£13,000 with effect from AGM)
Chairmanship of nomination & governance committee	£15,000 (with effect from AGM)
Membership of audit committee	£15,000
Membership of remuneration committee	£10,000
Membership of reputation & responsibility committee	£5,000 (£6,000 with effect from AGM)
Membership of nomination & governance committee	£8,000 (with effect from AGM)
Senior independent director	£22,000

The maximum opportunity per director depends on individual duties or combination of duties in accordance with this structure. The total fees payable to the non-executive directors (excluding the chairman) are subject to the limit set out in the Articles of Association of the company (currently £750,000) and as increased by ordinary resolution from time to time.

The fee for the chairman remains unchanged at £500,000 per year.

### Performance conditions

None.

### Performance period

None.

# Remuneration report

## Information on changes to remuneration for 2017

The committee undertook a wholesale review of our remuneration policy during 2016 to assess whether it remained fit for purpose taking into account how the company has evolved since the policy was last approved in 2014. We first thought about philosophy and principles for the organisation as a whole and we then distilled this into policy for the executive directors and wider management. Central to the review was engaging with our largest shareholders and seeking their input on the future direction of policy. Some specific issues which impact 2017 implementation are described below.

### Executive directors' base salaries

We have taken into account general economic and market conditions, specific company conditions, the level of increases made across the company as a whole, the remuneration of executives in similar positions in comparable companies and individual performance. While it is recognised that the CEO is substantially behind market the committee concluded that this was not a relevant consideration in the current trading environment. Base salaries for the CEO and CFO are therefore unchanged.

### Annual incentive plan

The key design principles underlying the company's approach to annual incentives for 2017 are:

- › A clear, transparent, coherent, consistent, organisation-wide approach to incentives and performance management with common principles for all business units and enabling functions and a strong focus on operational priorities that will drive successful achievement of our strategy
- › Subject to shareholder approval of the new policy the AIP will operate in 2017 based on 75% financial metrics and 25% performance metrics linked to strategic imperatives.

Financial metrics will be weighted as follows: Group EPS (22.5%), Operating profit (22.5%), Sales (15%), Operating cash-flow (15%).

Performance metrics linked to strategic imperatives will focus predominantly on competitive performance and transformation. Any pay out in respect of achievement of strategic imperatives will be subject to attaining a minimum level of performance on financial metrics.

The board considers the performance targets for 2017 to be commercially sensitive. Details of all performance measures, weightings and targets will be disclosed in the annual remuneration report for 2017 unless the committee determines that they remain commercially sensitive.

For the 2017 AIP, the proposed performance metrics linked to strategic imperatives would be drawn from three key areas, all aligned with milestones already tracked formally by the board in a periodic performance dashboard. Each metric would have KPIs against which to be measured, using third party data or externally audited internal data (where third party data is not available or applicable). See the remuneration overview on p87 for more detail on these metrics.

### Long-term incentive plan

Subject to shareholder approval of the new policy the LTIP awards in 2017 will be contingent on the following metrics: Group EPS (40%), ROIC (30%), Relative TSR (30%).

The previous TSR comparator group of global media companies will be replaced with the companies comprising the FTSE 100 to ensure that it aligns better with Pearson following the sales of the Financial Times and our share in The Economist.

Performance will continue to be tested over three years and 75% of the vested shares will be released at that point. However, there remains a mandatory restriction on participants' ability to dispose of the 75% of the vested shares (other than to meet personal tax liabilities) for a further two years. Furthermore, participants' rights to the release of the remaining 25% of the vested shares will continue to be subject to continued employment over the same period.

At the time of writing, the committee has yet to approve the 2017 long-term incentive awards and the associated performance targets for the executive directors. These are expected to be determined at the May remuneration committee meeting.

In acknowledgment of the value erosion in the Pearson share price, the remuneration committee intends to reduce the volume of 2017 LTIP awards to the executive directors such that their value is materially lower than prior practice. The eventual scale of this reduction will be judged by reference to all relevant factors prevailing at the award date, including share price. The remuneration committee also notes that the re-weighted 30% TSR element is likely to be significantly out of the money on grant, due to the averaging period used to determine the start point, which is the three-month period to the end of December 2016. We will not be changing this methodology.

If current share price conditions were to continue, the committee might judge that the economic value of the 2017 LTIP grant would be reduced by circa 20-25%.

Full details of individual awards for the executive directors and the performance targets for 2017 will be set out in the annual remuneration report for 2017.

### Chairman and non-executive directors

As already mentioned, there has been an evolution and strengthening of governance which has a modest remuneration policy impact. In line with other Pearson committees, and market practice, non-executive director fees for those on the Nomination & Governance Committee will be £15,000 for the committee chairman and £8,000 for committee membership. These will take effect from the date of the 2017 AGM.

Also, in response to the increase in responsibilities associated with the undertakings of the Reputation & Responsibility committee, the committee fees associated with chair and committee membership will increase to £13,000 (£10,000) and £6,000 (£5,000) respectively.

The aggregated increase in non-executive director fees associated with this further strengthening of governance will be in the region of £58,000 per annum.

The directors' remuneration report has been approved by the board on 14 March 2017 and signed on its behalf by:



**Elizabeth Corley**  
Chairman of the remuneration committee.

# Additional disclosures

Pages 58-110 of this document comprise the directors' report for the year ended 31 December 2016.

Set out below is other statutory and regulatory information that Pearson is required to disclose in its directors' report.

## Going concern

The directors have made an assessment of the Group's ability to continue as a going concern and consider it appropriate to adopt the going concern basis of accounting.

## Viability statement

As set out on p55 the board has also reviewed the prospects of Pearson over the three-year period to December 2019 taking account of the company's strategic plans, a 'severe but plausible' downside case and further stress testing based on the principal risks set out on p47-55.

Based on the results of these procedures, and considering the company's strong balance sheet, the directors have a reasonable expectation that Pearson will be able to continue in operation and meet its liabilities as they fall due over the three-year period ending December 2019. Further details of the Group's liquidity are shown in Financial review (see p30-35).

## Share capital

Details of share issues are given in note 27 to the consolidated financial statements on p173. The company has a single class of shares which is divided into ordinary shares of 25p each. The ordinary shares are in registered form. As at 31 December 2016, 822,126,713 ordinary shares were in issue. At the AGM held on 29 April 2016, the company was authorised, subject to certain conditions, to acquire up to 82,162,378 ordinary shares by market purchase. Shareholders will be asked to renew this authority at the AGM on 5 May 2017.

Information provided to the company pursuant to the Financial Conduct Authority's Disclosure and Transparency Rules (DTR) is published on a Regulatory Information Service and on the company's website.

As at 31 December 2016, the company had been notified under DTR 5 of the following holders of significant voting rights in its shares.

	Number of voting rights	Percentage as at date of notification
BlackRock, Inc.	45,041,824	5.48%
Schroders plc	42,151,560	5.12%
Silchester International Investors LLP	41,437,136	5.04%
Ameriprise Financial, Inc. and its group	41,236,375	5.02%

Between 31 December 2016 and 14 March 2017, being the latest practicable date before the publication of this report, the company received further notifications under DTR 5, with the most recent positions being as follows:

- › Schroders plc disclosed a holding of 11.17%
- › BlackRock, Inc. disclosed a holding of 7.03%, including securities lending (2.36%) and CFD (0.13%)
- › Lindsell Train Limited disclosed a holding of 5.035%.

## Annual General Meeting

The notice convening the AGM, to be held at 12 noon on Friday, 5 May 2017 at IET London, 2 Savoy Place, London WC2R 0BL, is contained in a circular to shareholders to be dated 29 March 2017.

## Registered auditors

In accordance with section 489 of the Act, a resolution proposing the reappointment of PricewaterhouseCoopers LLP (PwC) as auditors to the company will be proposed at the AGM, at a level of remuneration to be agreed by the audit committee.

## Amendment to Articles of Association

Any amendments to the Articles of Association of the company (the Articles) may be made in accordance with the provisions of the Act by way of a special resolution.

## Rights attaching to shares

The rights attaching to the ordinary shares are defined in the Articles. A shareholder whose name appears on the company's register of members can choose whether his/her shares are evidenced by share certificates (i.e. in certificated form) or held electronically (i.e. uncertificated form) in CREST (the electronic settlement system in the UK).

Subject to any restrictions below, shareholders may attend any general meeting of the company and, on a show of hands, every shareholder (or his/her representative) who is present at a general meeting has one vote on each resolution, and on a poll, every shareholder (whether an individual or a corporation) present in person or by proxy shall have one vote for every 25p of nominal share capital held. A resolution put to the vote at a general meeting is decided on a show of hands unless before, or on the declaration of the result of, a vote on a show of hands, a poll is demanded. A poll can be demanded by the chairman of the meeting, or by at least three shareholders (or their representatives) present in person and having the right to vote, or by any shareholders (or their representatives) present in person having at least 10% of the total voting rights of all shareholders, or by any shareholders (or their representatives) present in person holding ordinary shares on which an aggregate sum has been paid up of at least 10% of the total sum paid up on all ordinary shares. At this year's AGM voting will again be conducted on a poll, consistent with best practice.

## Additional disclosures

Shareholders can declare a final dividend by passing an ordinary resolution but the amount of the dividend cannot exceed the amount recommended by the board. The board can pay interim dividends on any class of shares of the amounts and on the dates and for the periods they decide. In all cases the distributable profits of the company must be sufficient to justify the payment of the relevant dividend.

The board may, if authorised by an ordinary resolution of the shareholders, offer any shareholder the right to elect to receive new ordinary shares, which will be credited as fully paid, instead of their cash dividend.

Any dividend which has not been claimed for 12 years after it became due for payment will be forfeited and will then belong to the company, unless the directors decide otherwise.

If the company is wound up, the liquidator can, with the sanction of a special resolution passed by the shareholders, divide among the shareholders all or any part of the assets of the company and he/she can value assets and determine how the division shall be carried out as between the shareholders or different classes of shareholders. The liquidator can also, with the same sanction, transfer the whole or any part of the assets to trustees upon such trusts for the benefit of the shareholders.

### Voting at general meetings

Any form of proxy sent by the shareholders to the company in relation to any general meeting must be delivered to the company (via its registrars), whether in written or electronic form, not less than 48 hours before the time appointed for holding the meeting or adjourned meeting at which the person named in the appointment proposes to vote.

The board may decide that a shareholder is not entitled to attend or vote either personally or by proxy at a general meeting or to exercise any other right conferred by being a shareholder if he/she or any person with an interest in shares has been sent a notice under section 793 of the Act (which confers upon public companies the power to require information with respect to interests in their voting shares) and he/she or any interested person failed to supply the company with the information requested within 14 days after delivery of that notice. The board may also decide, where the relevant shareholding comprises at least 0.25% of the nominal value of the issued shares of that class, that no dividend is payable in respect of those default shares and that no transfer of any default shares shall be registered.

Pearson operates an employee benefit trust to hold shares, pending employees becoming entitled to them under the company's employee share plans. There were 7,718,966 shares held as at 31 December 2016. The trust has an independent trustee which has full discretion in relation to the voting of such shares. A dividend waiver operates on the shares held in the trust.

Pearson also operates two nominee shareholding arrangements which hold shares on behalf of employees. There were 2,950,764 shares held in the Sharestore account and 403,153 shares held in the Global Nominee account as at 31 December 2016. The beneficial owners of shares held in Sharestore are invited to submit voting instructions online at [www.shareview.co.uk](http://www.shareview.co.uk) and Global Nominee participants are invited to submit voting instructions by e-mail to [nominee@equiniti.com](mailto:nominee@equiniti.com). If no instructions are given by the beneficial owner by the date specified, the trustees holding these shares will not exercise the voting rights.

### Transfer of shares

The board may refuse to register a transfer of a certificated share which is not fully paid, provided that the refusal does not prevent dealings in shares in the company from taking place on an open and proper basis. The board may also refuse to register a transfer of a certificated share unless: (i) the instrument of transfer is lodged, duly stamped (if stampable), at the registered office of the company or any other place decided by the board, and is accompanied by the certificate for the share to which it relates and such other evidence as the board may reasonably require to show the right of the transferor to make the transfer; (ii) it is in respect of only one class of shares; and (iii) it is in favour of not more than four transferees.

Transfers of uncertificated shares must be carried out using CREST and the board can refuse to register a transfer of an uncertificated share in accordance with the regulations governing the operation of CREST.

### Variation of rights

If at any time the capital of the company is divided into different classes of shares, the special rights attaching to any class may be varied or revoked either:

- (i) with the written consent of the holders of at least 75% in nominal value of the issued shares of the relevant class; or
- (ii) with the sanction of a special resolution passed at a separate general meeting of the holders of the shares of the relevant class.

Without prejudice to any special rights previously conferred on the holders of any existing shares or class of shares, any share may be issued with such preferred, deferred, or other special rights, or such restrictions, whether in regard to dividend, voting, return of capital or otherwise as the company may from time to time by ordinary resolution determine.

### Appointment and replacement of directors

The Articles contain the following provisions in relation to directors:

Directors shall be no less than two in number. Directors may be appointed by the company by ordinary resolution or by the board. A director appointed by the board shall hold office only until the next AGM and shall then be eligible for reappointment, but shall not be taken into account in determining the directors or the number of directors who are to retire by rotation at that meeting. The board may from time to time appoint one or more directors to hold executive office with the company for such period (subject to the provisions of the Act) and upon such terms as the board may decide and may revoke or terminate any appointment so made.

The Articles provide that, at every AGM of the company, at least one-third of the directors shall retire by rotation (or, if their number is not a multiple of three, the number nearest to one-third). The first directors to retire by rotation shall be those who wish to retire and not offer themselves for re-election. Any further directors so to retire shall be those of the other directors subject to retirement by rotation who have been longest in office since they were last re-elected but, as between persons who became or were last re-elected on the same day, those to retire shall (unless they otherwise agree among themselves) be determined by lot. In addition, any director who would not otherwise be required to retire shall retire by rotation at the third AGM after they were last re-elected.

Notwithstanding the provisions of the Articles, the board has resolved that all directors should offer themselves for re-election annually, in accordance with the Code.

The company may by ordinary resolution remove any director before the expiration of his/her term of office. In addition, the board may terminate an agreement or arrangement with any director for the provision of his/her services to the company.

### Powers of the directors

Subject to the company's Articles, the Act and any directions given by special resolution, the business of the company will be managed by the board who may exercise all the powers of the company, including powers relating to the issue and/or buying back of shares by the company (subject to any statutory restrictions or restrictions imposed by shareholders in general meeting).

### Significant agreements

The following significant agreements contain provisions entitling the counterparties to exercise termination or other rights in the event of a change of control of the company:

Under the \$1,750,000,000 revolving credit facility agreement dated August 2014 which matures in August 2021 between, among others, the company, Barclays Bank plc (Agent) and the banks and financial institutions named therein as lenders (the Facility), any such bank may, upon a change of control of the company, require its outstanding advances, together with accrued interest and any other amounts payable in respect of such Facility, and its commitments, to be cancelled, each within 60 days of notification to the banks by the Agent. For these purposes, a 'change of control' occurs if the company becomes a subsidiary of any other company or one or more persons acting either individually or in concert, obtains control (as defined in section 1124 of the Corporation Tax Act 2010) of the company.

Shares acquired through the company's employee share plans rank *pari passu* with shares in issue and have no special rights. For legal and practical reasons, the rules of these plans set out the consequences of a change of control of the company.

## Additional disclosures

### Other statutory information

Other information that is required by the Companies Act 2006 (the Act) to be included in the directors' report, and which is incorporated by reference, can be located as follows:

Summary disclosures index	See more
Dividend recommendation	p34
Financial instruments and financial risk management	p160-162
Important events since year end	p35
Future development of the business	p6-27
Research and development activities	p18-19
Employment of disabled persons	p24
Employee involvement	p23-24
Greenhouse gas emissions	p25

With the exception of the dividend waiver described on p108, there is no information to be disclosed in accordance with Listing Rule 9.8.4.

No political donations or contributions were made or expenditure incurred by the company or its subsidiaries during the year.

### Fair, balanced and understandable reporting

As required by the Code, we have established arrangements to ensure that all information we report to investors and regulators is fair, balanced and understandable. A process and timetable for the production and approval of this year's report was agreed by the board at its meeting in December 2016. The full board then had opportunity to review and comment on the report as it progressed.

Representatives from financial reporting, corporate affairs, company secretarial, legal and internal audit and compliance are involved in the preparation and review of the annual report to ensure a cohesive and balanced approach and, as with all of our financial reporting, our verification committee conducts a thorough verification of narrative and financial statements.

The audit committee is also available to advise the board on certain aspects of the report, to enable the directors to fulfil their responsibility in this regard. The directors consider that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.

The directors also confirm that, for each director in office at the date of this report:

- › So far as the director is aware, there is no relevant audit information of which the company's auditors are unaware
- › They have taken all the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

### Directors in office

The following directors were in office during the year and up until signing of the financial statements:

E P L Corley	H Manwani
V Cox	T Score
JJ Fallon	S Taurel
S J Lewis	L Wallen
L K Lorimer	C Williams

The directors' report has been approved by the board on 14 March 2017 and signed on its behalf by



**Stephen Jones**  
Company secretary

# Statement of directors' responsibilities

## Statement of directors' responsibilities

The directors are responsible for preparing the annual report in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the Group and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and the Group and of the profit or loss of the Group for that period.

In preparing these financial statements, the directors are required to:

- › Select suitable accounting policies and then apply them consistently
- › Make judgements and accounting estimates that are reasonable and prudent
- › State whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements
- › Prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and the Group and enable them to ensure that the financial statements and the report on directors' remuneration comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the directors, whose names and functions are listed on p60-61, confirms that, to the best of their knowledge:

- › The Group financial statements, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Group
- › The strategic report contained in the annual report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that it faces.

This responsibility statement has been approved by the board on 14 March 2017 and signed on its behalf by



**Coram Williams**  
Chief financial officer