Electricity distribution licensee,
gas transporter licensees,
electricity transmission licensees
and other interested parties

Promoting choice and value for all gas and electricity customers

Our Ref:
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Date: 17 December 2012

Dear Colleagues

Open letter consultation on our pension deficit allocation methodology

In June 2010, we published our decision document, *Price Control Treatment of Network Operator Pension Costs Under Regulatory Principles* (ref 76/10). This set out our commitment that network operators' defined benefit (DB) pension scheme deficits as at the end of the prevailing price controls (the cut-off dates[1]) would be funded with two provisos. These were that the relevant schemes or schemes' costs are efficient and there has been no material failure of stewardship, to satisfy our first and third Pension Principles[2]. This was to ensure that the costs of addressing the established deficit are not higher than what is reasonable.

Our funding commitment does not cover future service of those employees still active in the scheme after the relevant cut-off dates for each price control, ie the incremental deficit, or that related to non–regulated activities.

Our decision requires network operators to attribute the deficit (or surplus) on their DB pension scheme to its constituent assets and liabilities between the established deficit, the incremental deficit and non-regulated activities. At the time, we did not propose a methodology to facilitate this. We have worked with network operators and their actuaries to develop a methodology that it is actuarially sound, economic and transparent to use in practice, and to provide an appropriate and not disproportionate audit trail.

The proposed methodology has been the subject of two years development jointly with network operators and actuaries. It is a pragmatic solution to what could have been a potentially onerous and disproportionate administrative requirement for record keeping at an individual (pension scheme) member level.

The methodology together with the data network operators are required to submit is set out in Annex 1 and Annex 2. Annex 1 sets out the procedures for applying the methodology for DPCR5, TPCR4 adapted rollover year and for RIIO price controls. Our intention is to incorporate this into the Regulatory Instructions and Guidance for reporting price control cost information. It will be subject to the network operators' licence condition for the

[1] Cut-off dates are, for DNOs the price control period ending on 31 March 2010, for GDNs – 31 March 2013 and for TOs and SOs – 31 March 2012
[2] Set out in our RIIO March 2011 Strategy paper and the respective price controls' Final Proposals documents

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Reporting of Price Control Cost Information and the licence condition for the *Modification of RIGs*.

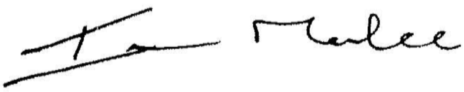
Views

We would welcome views from stakeholders on this methodology on whether it:

- achieves an appropriate balance between complexity and simplicity;
- is actuarially sound, economic and transparent to use in practise;
- will provide an appropriate and not disproportionate audit trail; and
- produces a fair allocation between the established deficit and the incremental deficit.

We welcome responses to this letter by 21 January 2013. Unless clearly marked as confidential, responses will be published on our website. Please email responses to william.mckenzie@ofgem.gov.uk.

Yours faithfully



Ian Marlee
Senior Partner, Smarter Grids & Governance: Transmission

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Annex 1 Draft pension deficit allocation methodology

Summary

Our[3] pension principles[4] and pension methodology[5] require network operators to attribute the deficit (or surplus) on their defined benefit pension scheme and its constituent assets and liabilities between the established deficit, the incremental deficit and non-regulated activities.

This pension deficit allocation methodology document sets out the proposed procedures for applying the methodology at DPCR5, TPCR4 adapted rollover year and for RIIO price controls. This will be incorporated into the Regulatory Instructions and Guidance for reporting price control cost information for all licensees. It will be subject to the network operators licence condition for the *Reporting of Price Control Cost Information* and the licence condition for the *Modification of RIGs*.

Contents

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[3] Ofgem is the Office of the Gas and Electricity Markets, which supports the Gas and Electricity Markets Authority (GEMA), the body established by section 1 of the Utilities Act 2000 to regulate the gas and electricity markets in Great Britain. The terms our, we, the Authority and Ofgem may be used interchangeably.
[4] As set out in the relevant Final Proposals documents
[5] As set out in the relevant price control Strategy decision documents and Price Control Final Methodology handbooks

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1. Introduction

1.1. This pension deficit allocation methodology (PDAM) sets out for each defined benefit (DB) pension scheme, of which a licensee is sponsoring or co-sponsoring employer, how:

(a) the assets and liabilities, are to be attributed to post Cut-Off Date pensionable service and pre Cut-Off Date pensionable service
(b) using the attributions in (a), the deficit in respect of pre and post Cut-Off Date pensionable service must be determined
(c) the deficits in (b) attributed to pre and post Cut-Off Date pensionable service must be attributed to:
   i. Regulated Business Activities; and
   ii. Non-Regulated Business Activities.

1.2. The principal requirements of the PDAM are that it is actuarially sound, economic and transparent to use in practice; and, secondly, that it must provide an appropriate and not dis-proportionate audit trail.

1.3. The PDAM does not provide detailed guidance of all the calculations which licensees will need to undertake but does aim to provide enough detail to ensure that any licensee carrying out the calculations will produce similar answers. Where indicated in the tables (at Annex 2) the basis of the calculation of attribution to the post Cut-Off Date sub-fund, including data and formulae applied must be provided by the reporting actuary. In order to ensure the PDAM achieves this aim, we will review the PDAM submissions and underlying calculations licensees will carry out based on the 31 March 2013 Valuation. Following this review the PDAM may need to be refined further.

1.4. We require licensees and their affiliates (and/or the scheme administrators on their behalf) to maintain, or cause to be maintained, appropriate records that will enable them to apply the methodology set out herein. This requirement is within the scope of the provisions of each licensee's licence condition for the *Price Control Review Information*[6]. The respective Regulatory Accounts licence condition and the EC Third Package requires licensees to maintain in their internal accounts segmental information, this necessarily extends to pension data. This level of recording may be additional to that which licensees (and their affiliates), or scheme administrators on their behalf, currently maintain.

1.5. The procedures set out herein are applicable at DPCR5, the TPCR4 Adapted Rollover, RIIO-T1, GD1 and ED1 and subsequent price controls.

1.6. Licensees are required to prepare and report in the Regulatory Reporting Pack (RRP) - deficit, asset and liability attribution data, and other pension scheme information in the format set out in Annex 2. This will be incorporated into the respective sectoral RRPs, triennially in accordance with the timetable in appendix 2.

2. Notional Sub-Funds

2.1. For each sponsored DB pension scheme, each licensee is required to attribute its assets and liabilities into a minimum of two Notional Sub-Funds, ie between pre and post Cut-Off Date pensionable service, as follows:

[6] Respectively Electricity Distribution standard licence condition 48, Electricity Transmission standard licence condition B15 and Gas Transporter standard special licence condition A40.

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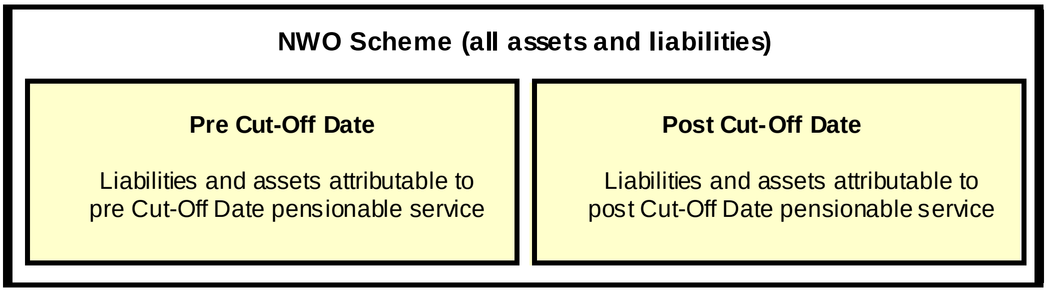

2.2. Where licensees are sponsoring employers in the same DB pension scheme then they may jointly report the attribution of assets and liabilities of the DB pension scheme to the above Notional Sub-Funds. In line with the approach set out in this methodology, they will then be required to identify the proportion of the deficit in each Notional Sub-Fund which relates to Regulated Business Activities for each licensee and Non-Regulated Business Activities.

3. Valuation requirements

3.1. At each Valuation Date (set out for guidance in the timetable in Appendix 2) for each pension scheme, a licensee must obtain at its own expense, and provide to the Authority with the PDAM data tables, a report prepared by a Reporting Actuary (either the Scheme Actuary or a Corporate Actuary) which provides the information required as part of the PDAM based on the results of:

- a Triennial Valuation; or
- an Updated Valuation.

which includes detail of the assets and types of assets held by the pension scheme.

3.2. The requirements for the report are set out in Appendix 4.

4. Attribution of liabilities to pre and post Cut-Off Date Notional Sub-Funds

Liabilities at the Cut-Off Date Valuation

4.1. At the Cut-Off Date Valuation, all liabilities will be attributed to the pre-cut off date Notional Sub-Fund, as no liabilities will exist in respect of post Cut-Off Date pensionable service.

Liabilities at each subsequent Valuation Date

4.2. At each subsequent Valuation Date, the value of the liabilities (including those liabilities which relate to benefits based on prospective service) determined by a Triennial Valuation or an Updated Valuation must be attributed to the pre and post Cut-Off Date Notional Sub-Funds. This must be done, based on the actual accrued pensionable service data recorded for members, allowing for any transferred in service as set out in section 8 but making no allowance for part-time service.

For simplicity, we assume that for each member, the value placed on the liabilities for each year of pensionable service is the same. Where this is not approximately the case, a more detailed calculation may be undertaken using individual member data to compute post Cut-Off Date liabilities at an individual member level. Licensees must advise us in writing before submission of the tables if they propose to use the latter more detailed basis. The method adopted at the Valuation Date subsequent to the

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Cut-Off Date must be adopted at all subsequent Valuations unless an application is made to us in the light of scheme changes.

4.3. The liability value attributed to the pre Cut-Off Date Notional Sub-Fund must be calculated as:

	the total value of liabilities in respect of benefits earned to the Valuation Date
minus	the value of liabilities in respect of post Cut-Off Date benefits earned to the Valuation Date as calculated in 4.2 above

4.4. When placing a value on the liabilities in a Triennial Valuation or an Updated Valuation, the following items must be included:

- liabilities in respect of members' Additional Voluntary Contributions to the extent that they have secured additional defined benefits; and
- liabilities in respect of members who have secured additional defined benefits using a money purchase fund.

5. Attribution of assets to pre and post Cut-Off Date Notional Sub-Funds

Assets at the Cut-Off Date Valuation

5.1. At the Cut-Off Date Valuation, all assets will be attributed to the pre-cut off date Notional Sub-Fund, as no assets will exist in respect of post Cut-Off Date pensionable service.

Assets at each subsequent Valuation Date

5.2. Unless the trustees are separately tracking the assets in the Notional Sub-Funds, at each subsequent Valuation, the value of assets attributed to the post Cut-Off Date Notional Sub-Fund must be calculated as set out below. Further detail of each of the items is provided in Section 5. The licensee must provide details of this calculation to the Authority (in table 2 of Annex 2).

	a.	assets attributable to post cut off date pensionable service at previous Valuation
plus	b.	employer contributions paid towards future benefit accrual since last Valuation
plus	c.	member contributions paid towards future benefit accrual since last Valuation, including any age-related contracting-out rebates
plus	d.	employer contributions paid since last Valuation towards the deficit attributable to post Cut-Off Date pensionable service
plus	e.	employer contributions paid since last valuation towards Pension Strain Costs attributable to post Cut-Off Date pensionable service
plus	f.	employer contributions paid since last valuation towards other benefit

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		augmentations attributable to post Cut-Off Date pensionable service
plus	g.	employer contributions to meet post Cut-Off Date scheme administration expenses and PPF Levies since last Valuation
plus	h.	other employer contributions paid since last Valuation in respect of post Cut-Off Date pensionable service
plus	i.	assets paid in as part of a Bulk Transfer and individual transfers-in in respect of post Cut-Off Date pensionable service
minus	j.	benefits paid or transferred out since last Valuation in respect of post Cut-Off Date pensionable service
minus	k.	money paid out to meet post Cut-Off Date scheme administration expenses and PPF levies since last Valuation
minus	l.	assets paid out as part of a Bulk Transfer in respect of post Cut-Off Date pensionable service
minus	m.	any other payments out of the scheme since last Valuation in respect of post Cut-Off Date pensionable service
plus	n.	actual investment returns achieved by the pension scheme's assets during the period as applied to post Cut-Off Date assets and cashflows set out in (a) to (m) above

Where trustees are separately tracking assets or specific assets to liabilities of identifiable groups or section of members, the reporting actuary and licensee must provide the supporting calculations and the basis on which the matching is made, eg Statement of Funding Principles (SFP), Statement of Investment Principles (SIP) or other supporting document. The supporting document(s) must relate to the period under review.

5.3. The value of assets attributed to the pre Cut-Off Date Notional Sub-Fund must be calculated as:

- the total asset value at the Valuation Date; *less*
- the value of assets attributed to the post Cut-Off Date Notional Sub-Fund as calculated in 5.2 above.

5.4. A check must be carried out to ensure that the value of assets attributed to the pre Cut-Off Date Notional Sub-Fund is reasonable when compared to the value of assets which would have been attributed had the approach detailed in 5.2 above been used.

Where the total of the assets calculated in paragraphs 5.2 and 5.3 using the approach to allocating investment returns in paragraph 6.14, differs significantly to the actual assets held by the scheme at the same date, it may be necessary to refine the above calculation. This is required so that the investment return applied to all cashflows or certain cashflows accurately allows for the period from either payment or receipt date, as applicable.

These calculations must be provided to the Authority at the same time as the tables in Annex 2.

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Adjustment

5.5. For pension schemes with different pre and post retirement discount rates it is recognised that the above approach of allocating the actual investment returns achieved by the pension scheme's assets to the post Cut-Off Date assets will not match the rationale for the split discount rates (which notionally envisage backing non-pensioner liabilities with a greater proportion of return seeking assets). This mismatch may result in a higher / lower Incremental Deficit and a lower / higher Established Deficit.

5.6. Where licensees believe this issue to be significant, the licensee must agree an adjustment to the Incremental Deficit and Established Deficit with Ofgem. The licensee must request such an adjustment at least 30 days prior to the date for submission of the tables and the actuary's report.

5.7. Paragraphs 6.14 to 6.18 provide further guidance on attributing investments returns on assets to different sub-funds.

6. Asset reconciliation attributions

6.1. This section provides further guidance regarding the items that are used to calculate the value of the assets that must be attributed to the post Cut-Off Date Notional Sub-Fund at each Valuation Date in section 5.

Employer contributions paid towards future benefit accrual

6.2. The employer contributions to meet the cost of new benefits accruing during the period for active members must be extracted from the scheme records. These contributions must be allocated to the post Cut-Off Date Notional Sub-Fund.

Member contributions paid towards future benefit accrual

6.3. Active members pay contributions to meet part of the cost of the benefits they accrue during the period. The total member contributions paid during the period must be obtained from the scheme's administrators and must be allocated the post Cut-Off Date Notional Sub-Fund.

6.4. Member contributions arising because of a member's Additional Voluntary Contributions securing DB benefits directly must all be allocated to the Pre or Post Cut-Off Date Notional Sub-Funds according to when they were received. Lump sum contributions securing DB benefits (normally arising from money purchase funds, deficiency costs or additional benefits) must be allocated to the post Cut-Off Date Notional Sub-Fund based on the ratio of post Cut-Off Date pensionable service to total pensionable service accrued at each Valuation Date.

Employer contributions towards deficit

6.5. The total employer deficit contributions must be extracted from the scheme records. The allocation of the employer deficit contributions to the post Cut-Off Date Notional Sub-Fund in the period must be based on the ratio of the deficit (or surplus) in the post Cut-Off Date Notional Sub-Fund to total scheme deficit, as reported at the previous Valuation Date.

Similarly, for the purposes of paragraph 9.3, the proportion of deficit payments that must be allocated to the remaining additional liabilities that relate to unfunded ERDCs, must be based on the ratio of the deficit in respect of residual unfunded ERDCs to total scheme deficit, as reported at the previous Valuation Date.

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Employer contributions towards Pension Strain Costs and other benefit augmentations

6.6. Total contributions towards Pension Strain Costs and other benefit augmentations must be extracted from the scheme records and must be allocated to the post Cut-Off Date Notional Sub-Fund in the same proportion as the additional liabilities due to Pension Strain Costs were allocated to the post Cut-Off Date Notional Sub-Fund in section 4.

Employer contributions to meet scheme administration expenses and PPF Levies

6.7. Total contributions paid to the scheme during the period to meet scheme administration expenses (excluding investment advisor fees) and / or PPF Levies must be extracted from the scheme records. These expenses must be allocated to the post Cut-Off Date Notional Sub-Fund based on the ratio of the liabilities attributed to the post Cut-Off Date Notional Sub-Fund to total pension scheme liabilities, as reported at the previous Valuation Date.

Assets paid in as part of a Bulk Transfer and Individual transfers in

6.8. The amount of any additional assets received as part of a Bulk Transfer into the scheme or due to individual transfers in, must be allocated to the post Cut-Off Date Notional Sub-Fund. This must be performed using the same proportion as was used to allocate the additional liabilities received to the post Cut-Off Date Notional Sub-Fund in section 4, (ie using a member's pensionable service or a more detailed calculation).

Benefits paid or transferred out

6.9. Total pension scheme benefits paid during the period must be obtained from the scheme's administrator, including those DB benefits accrued from, or converted from, members' Additional Voluntary Contributions. For this purpose, benefits paid includes transfer values out of the scheme on an individual basis (eg to a personal pension).

6.10. Licensees must allocate total pension scheme benefits paid to the post Cut-Off Date Notional Sub-Fund by extracting the benefit paid amounts in respect of the post Cut-Off Date Notional Sub-Fund from the pension administration records.

Money paid out to meet scheme administration expenses and PPF Levies

6.11. The total money paid out of the scheme during the period to meet scheme administration expenses (including investment advisor fees) and / or PPF Levies must be extracted from the scheme records. These expenses must be allocated to the post Cut-Off Date Notional Sub-Fund based on the ratio of the liabilities attributed to the post Cut-Off Date Notional Sub-Fund to total pension scheme liabilities, as reported at the previous Valuation Date.

Assets paid out as part of a Bulk Transfer

6.12. Amounts paid out of the scheme as a result of a Bulk Transfer must be allocated to the post Cut-Off Date Notional Sub-Fund based on the same proportion as the reduction in liabilities were allocated to the post Cut-Off Date Notional Sub-Fund in section 4 (ie using a member's pensionable service or a more detailed calculation).

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Other payments

6.13. The amount of any other payments out of the scheme not reported above, since the last Valuation in respect of post Cut-Off Date pensionable service must be reported separately. These must be attributed the in the same proportion as they have been made.

Actual investment return on assets during the period

6.14. The actual total investment return achieved by each pension scheme in each year of the relevant period (net of expenses including investment management fees) must be extracted from scheme records. Except as noted below, these annual actual total investment returns must be attributed to the post Cut-Off Date Notional Sub-Fund. This will be done using the annual average investment returns achieved across all asset classes, ie equities, fixed interest bonds, index-linked bonds etc, assuming that annual net cashflows (including assets paid in or out) as reported in the asset reconciliation statement arise evenly each year.

6.15. Where a scheme operates Liability Driven Investment or hedging strategies specified against part of their fund, the returns on these assets must be allocated to the relevant Notional Sub-Fund(s) first and be excluded for allocating the remainder of the investment returns between the various Notional Sub-Funds as described below.

6.16. For the remaining assets there are two options dependent on whether the scheme has a separate sub-funds policy (as evidenced in their SFP or SIP) or not:

(a) Some schemes will have an actual sub-fund that includes one or more of the Notional Sub-Funds. For schemes where this is the case, the investment return derived from those assets must be allocated to the Notional Sub-Funds included in the legally separated sub-fund, using the total investment return in that actual sub-fund rather than the total investment return for the scheme as a whole.

(b) For schemes where the investment strategy has been considered for the scheme as a whole (with no legally separated sub-funds) and with a regular re-balancing of investments against strategy and between Notional Sub-Funds, the attribution must be made by using the overall scheme return over the period derived from aggregated asset and cash flow data.

6.17. For example, applying (a) above for a legally separate sub-fund being maintained for the pre Cut-Off Date liabilities of the scheme, then the portion of the actual total investment return during the period allocated to the pre Cut-Off Date Notional Sub-Fund must be based on the actual investment returns achieved during the period for the separate pre Cut-Off Date sub-fund. Similarly, the portion of the actual total investment return allocated to the post Cut-Off Date Notional Sub-Funds must be based on the actual investment returns on the remaining scheme assets (ie those maintained for the post Cut-Off Date liabilities) during the period.

6.18. The sum of each Notional Sub-Fund's investment return during the period must equal the actual total investment return during the period for the pension scheme as a whole. In following this approach, licensees must apply reasonable and prudent judgement.

6.19. If licensees are not using the approach in this section 6, they must provide written justification for the approach taken with their submission.

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7. Attribution of pre and post Cut-Off Date deficit to Regulated / Non-Regulated Business Activities

Pre Cut-Off Date deficit

7.1. The deficit in the pre Cut-Off Date Notional Sub-Fund, at any point in time, must be calculated as:

- the value of the liabilities attributed to the pre Cut-Off Date Notional Sub-Fund (in 4.3 above); less
- the value of assets attributed to the pre Cut-Off Date Notional Sub-Fund (in 5.3 above).

Established Deficit

7.2. The Established Deficit, at any point in time, must be calculated as:

Deficit in pre Cut-Off Date Notional Sub-Fund (in 7.1 above)	x	[Pre Cut-Off Date Regulatory Fraction (as defined); minus ERDC adjustment (as calculated in section 9)]

Post Cut-Off Date deficit

7.3. The deficit in the post Cut-Off Date Notional Sub-Fund, at any point in time, must be calculated as:

	the value of the liabilities attributed to the post Cut-Off Date Notional Sub-Fund (in 4.2 above);
minus	the value of assets attributed to the post Cut-Off Date Notional Sub-Fund (in 5.2 above).

Incremental Deficit

7.4. The Incremental Deficit, at any point in time, must be calculated as:

Deficit in post Cut-Off Date Notional Sub-Fund (in 7.3 above)	x	Post Cut-Off Date Regulatory Proportion (in 7.5 below)

7.5. The Post Cut-Off Date Regulatory Proportion in paragraph 7.4 above must be calculated at each Valuation by weighting the Proportions of Service in respect of the three years since the last Valuation as follows:

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$$\frac{\sum \left(\text{Proportions Of Service in each post Cut-Off Date year since the previous Valuation} * \text{Total Pensionable Salary in each post Cut-Off Date year since the previous Valuation} \right)}{\text{Total Pensionable Salary for all post Cut-Off Date years since the previous Valuation}}$$

and combining this "Weighted Proportion" with the Post Cut-Off Date Regulatory Proportion at the previous Valuation as follows:

$$\frac{\text{Weighted Proportion} * \text{post Cut-Off Date value of benefits accrued since the previous Valuation} + \text{Post Cut-Off Date Regulatory Proportion at previous Valuation} * \text{value of post Cut-Off Date benefits accrued before the previous Valuation}}{\text{Total value of liabilities for all benefits accrued since post Cut-Off Date}}$$

Pension Strain Costs

7.6. Pension Strain Costs refers to the cost of providing enhanced pension benefits granted under severance or reorganisation arrangements on or after 1 April 2004. These enhanced pension benefits will be fully matched by increased contributions so no adjustment is required to the Post Cut-Off Date Regulatory Proportion for Pension Strain Costs. Where this is not the case, an adjustment must be made to reflect the mismatch.

Bulk Transfers

7.7. Where a licensee intends to admit members under a Bulk Transfer or individual transfer from another licensee, subject to the special situations exclusion in paragraphs 8.3 and 8.4, the assets and liabilities associated with the transfer must be treated as relating to Non-Regulated Business Activities, in accordance with Pension Principle 2. As a result, an adjustment may be required to the Pre Cut-Off Date Regulatory Fraction and Proportions Of Service. The licensee must agree in writing with us, at least 30 days before the tables and the actuary's report are to be submitted, the approach they will use to adjust the Pre Cut-Off Date Regulatory Fraction and the Proportions Of Service determined from the RRPs.

Adjustments to Pre Cut-Off Date Regulatory Fraction and Proportions Of Service

7.8. The Pre Cut-Off Date Regulatory Fraction will have been determined in advance of each Cut-Off Date. This will apply up to the next reset date, subject to movements as set out in paragraph 7.10, unless there are structural changes to the scheme.

7.9. Adjustments to the Pre Cut-Off Date Regulatory Fraction and Proportions Of Service may also be required in situations other than due to a Bulk Transfer (eg transfers out of the scheme, changes to membership profile, and other structural changes as set out in the Pension Principles). In these situations, the licensee must agree in writing with us, at least 30 days before the tables and the actuary's report are to be submitted, the approach to be applied to revise the Pre Cut-Off Date Regulatory Fraction and the Proportions Of Service. Any true up adjustments may be made on a time apportionment based on the date of the structural change(s).

7.10. The non-regulated component of Pre Cut-Off Date pension liabilities should logically reduce over time in a closed pension scheme for a predominantly wires or pipes only business due to a change in the proportion of Pre Cut-Off Date liabilities attributable to regulated business activities (eg due to changes in membership profile). Thus, the allowed Pre Cut-Off Date Regulated Fraction should increase over time. This will be calculated by determining the proportion of Pre Cut-Off Date liabilities attributable to regulated business activities and the movement in this proportion from that determined at the previous price control. For DNOs, over time, this should increase the Pre Cut-Off Date Regulatory Fraction (where supported by the necessary records) from the 80:20 pragmatic split applied at DPCR4. Post DPCR4, the Pre Cut-Off Date Regulatory Fraction has already been updated using this approach. This approach to updating the Pre Cut-Off Date Regulatory Fraction is only applicable to electricity distribution licensees and may be updated at each reset date. It does not apply to the calculation of any true up adjustment. Licensees using this approach to adjust their Pre Cut-Off Date Regulatory Fraction must provide detailed supporting evidence.

7.11. An example of the calculation is shown in Section G of the illustrative table 1 at Annex 2. The calculation is made at an individual licensee level. This takes the 80:20 split of liabilities at DPCR4, as known or implied from the 80:20 start point at DPCR4. Then, using the proportion of Pre Cut-Off Date liabilities attributable to regulated business activities, updates the Pre Cut-Off Date Regulatory Fraction for DPCR5 as at 31 March 2010 and as at 31 March 2013. This will need repeating at subsequent three-year reset dates.

7.12. From the updated Pre Cut-Off Date Regulatory Fraction determined in paragraphs 7.9 or 7.10 will be deducted the residual balance of unfunded ERDCs from pre 1 April 2004 (see below) which will be expressed as a percentage of the Pre Cut-Off Date deficit (as calculated in section 9).

7.13. Data to inform a revision to the Pre Cut-Off Date Regulatory Fraction is required to be input to Section F (for structural changes in paragraph 7.9) and to Section G (for DNO specific changes in paragraph 7.10) of Table 1 at Annex 2 and in the detailed DB pension scheme data table in the respective RRPs.

8. Treatment of transfers in

8.1. Bulk Transfers-in which occur after the respective Cut-Off Dates will, subject to the special situations set out in paragraphs 8.3 and 8.4, be treated as relating to Non-Regulated Business Activities, ie the licensee carries all the risk that the transferred-in assets will continue to meet the transferred-in liabilities over time.

8.2. This treatment of Bulk Transfers-in may not be equitable in all situations. Where licensees regard the treatment of the transfer to be inequitable, they must apply to Ofgem, in writing and in advance of the Bulk Transfer event setting out their case. Ofgem will endeavour to respond within a reasonable period, not exceeding 30 days. If the Authority is satisfied that there are exceptional circumstances and licensees have demonstrated this, eg that the transfer relates to pre Cut-Off Date regulated activities, these costs may be treated as part of the Established Deficit and / or Incremental Deficit and may be funded accordingly (through the appropriate mechanism – specific allowance or as part of benchmarked totex).

8.3. The treatment of the assets and liabilities associated with the transfer-in of an individual Protected Person who is transferring within the industry and, whose benefits are governed by legislative requirements will be preserved in the receiving scheme provided they are not part of a Bulk Transfer.

8.4. Where a Bulk Transfer includes individuals (not just Protected Persons), transferring within the industry and whose pension benefits cannot be amended due to the provisions of the trust deed and rules of their pension arrangements or due to legislative requirements, the treatment of their assets and liabilities will be preserved in the receiving scheme. Under the Pension Principles, we retain the option to deal with Bulk Transfers on a case-by-case basis.

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9. Pre Cut-off Date Regulatory Fraction and unfunded ERDCs

9.1. Unfunded residual Early Retirement Deficiency Costs (ERDCs) represent the balance of any remaining additional liabilities, resulting from early retirements due to redundancy or re-organisation prior to 1 April 2004, which were funded using surpluses rather than by increased contributions.

9.2. Since 31 March 2004, ERDCs are a matter solely for shareholders and are not funded by consumers.

9.3. The adjustment for unfunded residual ERDCs in paragraph 7.2 is calculated, at any point in time, as follows:

$$\frac{\text{rolled forward amount of unfunded ERDCs}}{\text{pre Cut-Off Date deficit}}$$

The rolled forward amount of unfunded ERDCs above is to be calculated as:

	amount of unfunded ERDCs at the start of the current price control period (rebased using RPI to real prices)
plus	expected returns, calculated using the pre-tax vanilla weighted average cost of capital (WACC) determined for each year of the relevant price control
minus	the proportion of deficit payments that can be attributed, in line with the approach detailed in 6.5, to the remaining additional liabilities which relate to unfunded ERDCs, allowing for expected returns calculated using WACC (as above) determined for the relevant price control.

9.4. In certain circumstances, as set out in paragraph 7.9 and in accordance with Pension Principle 2, the Pre Cut-Off Date Regulatory Fraction may need to be updated.

10. Sectionalisation of a scheme

10.1. A licensee-sponsored DB pension scheme may be sectionalised. This may occur at any point within a price control period or 15-year notional funding period, for example, when a licensee or affiliate is sold. The licensee sectionalising a scheme must, in relation to the period from the last Valuation Date (as set out in Appendix 2) up to the date of sectionalisation or sale, provide us with the information, data tables and other returns required under this PDAM for each section. When preparing its tables , the acquiring licensee(s) (in relation to the new scheme) and the selling licensee(s) (in relation to the retained scheme) must, for the period from the date of sectionalisation to the next Valuation Date (as set out in Appendix 2), provide us with the information required under this PDAM.

10.2. In each case the licensee must inform us in writing in advance, where possible, otherwise as soon as possible, of sectionalising a DB scheme; and Ofgem will determine the reporting requirements on a case-by-case basis and will advise the licensee within a reasonable time.

11. Pension administration records

11.1. In accordance with the *Reporting of Price Control Cost Information* licence condition, licensees are required to maintain (and ensure that any Affiliate or Related

Undertaking of the licensee maintains) such accounting records, other records and reporting arrangements as are necessary to enable the licensee to prepare Price Control Cost Information for submission to the Authority. This includes the appropriate pension scheme administration records. Licensees, or their scheme administrators on their behalf, must maintain pension scheme administration records that contain sufficient detail to enable the attribution of pension scheme assets and liabilities to the Notional Sub-Funds to a reasonable degree of accuracy.

Employment records

11.2. In each Post Cut-Off Date year, for each pension scheme, the licensee shall determine the proportion of pension costs attributable to:

- Regulated Business Activities for the licensee; and
- Regulated Business Activities for any other licensee; and
- Non-Regulated Business Activities for the licensee.

Such proportions will represent the regulated and non-regulated post Cut-Off Date Proportions Of Service (the "Proportions Of Service") and must add up to 100 per cent.

11.3. For each licensee, the Proportions Of Service for each pension scheme will be determined each year using the ongoing DB pension cost allocation in the relevant table of the RRP. The Proportions Of Service determined for each pension scheme will be recorded in the annual RRP submission (as set out in table 1 of Annex 2).

Pension scheme administration record requirements

11.4. For the purposes of this methodology, licensees must maintain, or arrange to have maintained, records at the necessary level of granularity to enable the attribution of pension scheme assets and liabilities (for the schemes which they are a sponsor or co-sponsor) between pre and post Cut-Off Date Notional Sub-Funds.

11.5. It is recommended that licensees record, or arrange for their pension scheme administrators to record, the following:

- for each active member, the number of years of pre and post Cut-Off Date pensionable service; and
- for deferred pensioners and pensioners the proportion of benefits which relate to pre and post Cut-Off Date pensionable service.

However, licensees can record alternative data to the above, as long as the data recorded enables the attribution of total pension scheme assets and liabilities between the pre and post Cut-Off Date Notional Sub-Funds to a reasonable and appropriate degree of accuracy to complete the data table and provide an appropriate audit trail.

Triennial processing of pension scheme administration records

11.6. The licensee (and its affiliates) shall provide, or ensure that the scheme administrator provides, the required data to enable the attribution of total pension scheme assets and liabilities between the pre and post Cut-Off Date Notional Sub-Funds.

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12. Alternative approach

12.1. Where a licensee proposes to adopt an alternative approach to any aspect of the methodology set out herein, they must work with us to ensure that their procedures are consistent with the spirit and intention of this guidance and that they are transparent and equitable and provides an appropriate audit trail. Any alternative approach must be submitted in writing to us three months prior to applying it. We reserve the option to consult on any alternative approach to ensure that it is equitable, actuarially sound and does not advantage or disadvantage any other licensee.

12.2. If a licensee wishes or needs to change their alternative methodology, once we have consented in writing, the process in 12.1 above must be repeated.

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Assumptions:	
Discount rate – 31.3.2010	5.75% p.a.
Discount rate – 31.3.2013	5.25% p.a.
Investment return	5.00% p.a.
Deficit contributions	£19.70m p.a.
Benefits paid	£13.33m p.a.
Pension strain costs	£3.33m p.a.
Duration of liabilities	20 years

Appendix 1: Asset & liability reconciliation worked examples

Example 1 – Pension Scheme with liabilities that relate to two DNOs

Valuation at Cut-Off Date of 31 March 2010

- Liabilities = £1,000m
- Assets = £800m
- Deficit = £200m

Deficit reconciliation provided as part of valuation report prepared by Scheme Actuary:

	£m
Deficit at 31 March 2010:	(200)
Interest on deficit:	(36.5)
Employer contributions in excess of cost of benefit accrued:	59.1
Lower than expected investment returns:	(15.8)
Change in financial assumptions:	(127.7)
Deficit at 31 March 2013:	(320.9)

Valuation at 31 March 2013

- Liabilities = £1,344.7m
- Assets = £1,023.8m
- Deficit = £320.9m

Pre cut off date notional sub fund

- Liabilities = £1,344.7m – £77.5m = £1,267.2m
- Assets = £1,023.8m - £67.6m = £956.2m
- Deficit = £311m

Post cut off date Notional sub fund

- Liabilities = £1,344.7m * 48%[1] * 3[2]/25[3] = £77.5m
- Assets = £52.5m (employer cost of benefit accrual)
  + £9.0m (employee cost of benefit accrual)
  + £10.0m x 3/25 = £1.2m (pension strain costs)
  + £4.9m (investment returns)
  = £67.6m
- Deficit = £9.9m

Pre cut off date regulatory fraction for DNO 1: 41%

Post cut off date regulatory fraction for DNO 2: 43%

Post cut off date regulatory proportion for DNO1:
{Year 1: 40.2% x £50.0m
Year 2: 41.6% x £50.0m
Year 3: 42.8% x £50.0m} / £150.0m = 41.5%

Post cut off date regulatory proportion for DN02:
{Year 1: 36.2% x £50.0m
Year 2: 39.0% x £50.0m
Year 3: 41.8% x £50.0m} / £150.0m = 39.0%

Established deficit for DNO1
= £311m x 41% = **£127.5m**

Established deficit for DNO2
= £311m x 43% = **£133.7m**

Incremental deficit for DNO1
= £9.9m x 41.5% = **£4.1m**

Incremental deficit for DNO2
= £9.9m x 39.0% = **£3.9m**

1. Assumed active proportion. For simplicity, calculation assumes there are no deferred or pensioner members with post cut off date service.
2. Liability weighted average post cut-off date service for active members.
3. Liability weighted average service for active members.

Example 2 - Pension Scheme with liabilities that relate to one DNO and one TO

31 March 2012 - for TO

Assumptions:

Discount rate – 31.3.2010	5.75% p.a.
Discount rate – 31.3.2012	5.75% p.a.
Investment return	5.00% p.a.
Deficit contributions	£19.70m p.a.
Benefits paid	£13.33m p.a.
Pension strain costs	£3.33m p.a.
Duration of liabilities	20 years

Valuation at 31 March 2010

- Liabilities = £1,000m
- Assets = £800m
- Deficit = £200m

Deficit reconciliation provided as part of valuation report prepared by Scheme Actuary:

	£m
Deficit at 31 March 2010:	(200)
Interest on deficit:	(23.7)
Employer contributions in excess of cost of benefit accrued:	39.4
Lower than expected investment returns:	(10.7)
Change in financial assumptions:	(0.0)
Deficit at 31 March 2012:	(195.0)

Valuation at Cut-Off Date of 31 March 2012

- Liabilities = £1,140.5m
- Assets = £945.5m
- Deficit = £195m

Pre cut off date notional sub fund

- Liabilities = £1,140.5m
- Assets = £945.5m
- Deficit = £195m

Post cut off date Notional sub fund

- Liabilities =£1,140.5m * 48%[1] * 0[2]/24[3] = £0.0m
- Assets = £0.0m
- Deficit = £0.0m

Pre cut off date regulatory fraction for TO: 6.2%

Post cut off date regulatory proportion for TO: N/A

Established deficit for TO
= £195.0m x 6.2% = **£12.1m**

Incremental deficit for TO
= **£0.0m**

1. Assumed active proportion. For simplicity, calculation assumes there are no deferred or pensioner members with post cut off date service.
2. Liability weighted average post cut-off date service for active members.
3. Liability weighted average service for active members.

31 March 2013 – for DNO

Assumptions:	
Discount rate – 31.3.2010	5.75% p.a.
Discount rate – 31.3.2013	5.25% p.a.
Investment return	5.00% p.a.
Deficit contributions	£19.70m p.a.
Benefits paid	£13.33m p.a.
Pension strain costs	£3.33m p.a.
Duration of liabilities	20 years

Valuation at Cut-Off Date of 31 March 2010
- Liabilities = £1,000m
- Assets = £800m
- Deficit = £200m

Deficit reconciliation provided as part of valuation report prepared by Scheme Actuary:

	£m
Deficit at 31 March 2010:	(200)
Interest on deficit:	(36.5)
Employer contributions in excess of cost of benefit accrued:	59.1
Lower than expected investment returns:	(15.8)
Change in financial assumptions:	(127.7)
Deficit at 31 March 2013:	(320.9)

Valuation at 31 March 2013
- Liabilities = £1,344.7m
- Assets = £1,023.8m
- Deficit = £320.9m

Pre cut off date notional sub fund
- Liabilities = £1,344.7m – £77.5m = £1,267.2m
- Assets = £1,023.8m - £67.6m = £956.2m
- Deficit = £311m

Post cut off date Notional sub fund
- Liabilities = £1,344.7m * 48%[1] * $3^2/25^3$ = £77.5m
- Assets = £52.5m (employer cost of benefit accrual)
  + £9.0m (employee cost of benefit accrual)
  + £10.0m x 3/25 = £1.2m (pension strain costs)
  + £4.9m (investment returns)
  = £67.6m
- Deficit = £9.9m

Pre cut off date regulatory fraction for DNO: 50.0%

Post cut off date regulatory proportion for DNO:
{Year 1: 50.0% x £50.0m
Year 2: 51.4% x £50.0m
Year 3: 52.4% x £50.0m} / £150.0m = 51.3%

Established deficit for DNO
= £311.0m x 50.0% = **£155.5m**

Incremental deficit for DNO
= £9.9m x 51.3% = **£5.1m**

1. Assumed active proportion. For simplicity, calculation assumes there are no deferred or pensioner members with post cut off date service.
2. Liability weighted average post cut-off date service for active members.
3. Liability weighted average service for active members.

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Assumptions:

Discount rate – 31.3.2012	5.75% p.a.
Discount rate – 31.3.2013	5.25% p.a.
Investment return	5.00% p.a.
Deficit contributions	£19.70m p.a.
Benefits paid	£13.33m p.a.
Pension strain costs	£3.33m p.a.
Duration of liabilities	20 years

31 March 2013 – for TO

Valuation at Cut-Off Date of 31 March 2012

- Liabilities = £1,140.5m
- Assets = £945.5m
- Deficit = £195m

Deficit reconciliation provided as part of valuation report prepared by Scheme Actuary:

	£m
Deficit at 31 March 2010:	(195)
Interest on deficit:	(11.2)
Employer contributions in excess of cost of benefit accrued:	19.7
Lower than expected investment returns:	(6.7)
Change in financial assumptions:	(127.7)
Deficit at 31 March 2013:	(320.9)

Valuation at 31 March 2013

- Liabilities = £1,344.7m
- Assets = £1,023.8m
- Deficit = £320.9m

Pre cut off date notional sub fund

- Liabilities = £1,344.7m – £25.8m = £1,318.9m
- Assets = £1,023.8m - £21.1m = £1,002.7m
- Deficit = £316.2m

Post cut off date Notional sub fund

- Liabilities = £1,344.7m * 48%[1] * $1^2/25^3$ = £25.8m
- Assets = £17.5m (employer cost of benefit accrual)
  + £3.0m (employee cost of benefit accrual)
  + £3.3m x 1/25 = £0.1m (pension strain costs)
  + £0.5m (investment returns)
  = £21.1m
- Deficit = £4.7m

Pre cut off date regulatory fraction for TO: 6.2%

Post cut off date regulatory proportion for TO:
{Year 1: 6.75% x £50.0m} / £50.0m = 6.75%

Established deficit for TO
= £316.2m x 6.2% = **£19.6m**

Incremental deficit for TO
= £4.7m x 6.75% = **£0.3m**

1. Assumed active proportion. For simplicity, calculation assumes there are no deferred or pensioner members with post cut off date service.
2. Liability weighted average post cut-off date service for active members.
3. Liability weighted average service for active members

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Appendix 2: Key dates

A2.1 This appendix sets out the key dates affecting pension returns, efficiency reviews, true up and reset for each price control. This is for guidance only; reference must be made to the respective Price control Financial Model handbooks for definitive dates.

Regulatory year ending 31 March	*Attribution statement due date on or before 30 September*	*Based on valuation date as at 31 March*	*Efficiency review performed*	*True up effective in revenues from 1 April*	*Reset of revenue allowances effective from 1 April*
2014	2014	2013	2014	2015	2015
2015	none due				
2016	none due				
2017	2017	2016	2017	2018	2018
2018	none due				
2019	none due				
2020	2020	2019	2020	2021	2021
2021	none due				
2022	none due				
2023	2023	2022	2023	2024	2024
2024	none due				
2025	none due				
2026	2026	2025	2026	2027	2027
2027	none due				
2028	none due				
2029	2029	2028	2029	2030	2030

A2.2 For DNOs the notional 15-year funding period ends on 31 March 2025 and, unless there are Significant Additional Deficits, the final reset and true up adjustments using the Triennial Valuations as at 31 March 2025 will be required over 2027-28.

A2.3 For TSOs the notional 15-year funding period ends on 31 March 2027 and, unless there are Significant Additional Deficits, the final reset and true up adjustments using the Valuations as at 31 March 2027 will be required over 2029-30.

A2.4 For GDNs the notional 15-year funding period ends on 31 March 2028 and, unless there are Significant Additional Deficits, the final reset and true up adjustments using the Triennial Valuations as at 31 March 2028 will be required over 2030-31.

A2.5 Where there is a significant increase in the Established Deficit, which occur towards the end of the notional 15-year funding period, caused by exogenous factors, for example market movements or justifiable changes in actuarial assumptions (a "Significant Additional Deficit"), we reserve the right to review the spreading period. We do this to protect consumers as set out in our Pension Principles. We will deal with any occurrence on a case-by-case basis.

A2.6 Valuations to be used to set initial deficit funding allowances at each price control and reset allowances are as follows:

Sector	***Valuation Date***	***Valuation Date for true up of initial allowances****
Electricity distribution for DPCR5	30 September 2009	31 March 2010
Transmission for TPCR4 Adapted Rollover	31 March 2011	31 March 2012
Gas distribution for RIIO-GD1	30 June 2012	31 March 2013

*and for determining the established deficit and Pre Cut-Off Date Regulatory Fraction

A2.7 Pension deficit allowances are not reset at each subsequent price control, as there is a rolling reset and true up as set out above. As shown above the first Valuation Date after which all sectors deficit funding allowances are reset and trued up is 31 March 2013.

Reset of allowances effective from 1 April	***Number of years over which reset allowances and true up adjustments are spread***		
	DNOs	TOs/SOs	GDNs
2015	10	12	13
2018	7	9	10
2021	4	6	7
2024	1	3	4
2027	Final year (unless A2.5 applies)		1
2029		Final year (unless A2.5 applies)	
2030			Final year (unless A2.5 applies)

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Appendix 4: Statement by Reporting Actuary

Reporting requirement

1.1. In accordance with Section 3 of the PDAM, the licensee, at its own expense, must arrange for a Reporting Actuary to prepare a report for each DB pension scheme of which the licensee is a sponsor or co-sponsor. This report must include a certificate by the Reporting Actuary that provides:

- the input information required on Table 2 in Annex 2;
- confirmation that the information has been prepared from the Valuation (i.e. a Triennial Valuation or an Updated Valuation) of the licensee's defined benefit pension schemes as at the Valuation Date;
- confirmation that the input information has been prepared in accordance with the methodology set out in this document; and
- confirmation that they have received all the information necessary to calculate and complete the input in accordance with this methodology as required and the source(s) of that information.

This certificate must be in the following format:

I certify that:

- *the information above has been prepared from [my / A N Other's] valuation report to the Trustees of [name of scheme] dated DD MMM YYYY;*

- *the input information has been prepared for the [name of] scheme in accordance with the methodology set out in Ofgem's Pension Deficit Allocation Methodology document dated DD MMM YYYY; and*

- *that I have received all the information necessary to calculate and complete the inputs in accordance with Ofgem's Pension Deficit Allocation Methodology document as required and the source(s) of that information are shown in [insert relevant sections of report].*

Signed:

Date:

1.2. The licensee must provide the Authority with a certified copy of the required certificate from the Reporting Actuary.

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Appendix 4: Data tables (at annex 2)

1.1. The licensee is to complete data table 1, and arrange for data table 2 to be completed by the Reporting Actuary on or before 30 September in the year specified in appendix 2.

1.2. The illustrative data tables are set out in separate excel workbook (Annex 2 attached).

Note: These data tables are illustrative only. They will be refined as part of the consultative process with stakeholders, and to develop the Regulatory Instructions and Guidance and RRP workbooks (in accordance with the respective Price Control Cost Reporting licence conditions).

Detailed guidance for completing these tables will be inserted in the RIGs, together with additional requirements on licensees for additional narrative in the Commentary document that is submitted by licensees with the RRPs.

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Appendix 5: Definitions and interpretations

Additional Voluntary Contributions (AVC) means contributions over and above a member's normal contributions, if any, which the member elects to pay to a DB scheme to obtain additional benefits.

Affiliate and **Related Undertaking** have the meaning given in the NWO's licence conditions

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Ofgem is the Office of the Gas and Electricity Markets, which supports the Gas and Electricity Markets Authority (GEMA), the body established by section 1 of the Utilities Act 2000 to regulate the gas and electricity markets in Great Britain. These terms and 'we' or 'our' may be used inter-changeably.

Benefits based on prospective service means those benefits whose amounts are calculated by reference to service after the calculation date, as well as service already completed.

Bulk Transfer means a transfer of assets and liabilities involving individuals or groups of individuals (but not whole or substantially the whole of a scheme) into or out of a pension scheme. Post Cut-Off Date the deficit associated with a Bulk Transfer in will not be funded by consumers through specific price control allowances, except for the special situations exclusions in paragraphs 2.7 and 2.8 or where the Authority has agreed a different treatment in special situations (as provided for in the Pension Principles).

Corporate actuary means the Actuary appointed by the licensee to prepare the input data in accordance with the PDAM and to report on such

Cut-Off Date means 31 March 2010 for DNOs, 31 March 2013 for GDNs and 31 March 2012 for TOs and SOs

Defined benefit (DB) pension scheme means a pension scheme where the benefits that accrue to members are normally based on a set formula taking into account the final salary and accrual of service in the scheme. It is also known as a final salary pension scheme

Defined contribution (DC) pension scheme means a pension scheme where the benefits that accrue to members are based on the level of cash contributions made to an individual account and the returns on those funds are used to provide a cash amount to purchase an annuity on retirement

Distribution Network Operators (DNOs) means a company which owns and operates the electricity distribution network which includes all parts of a network from 132kV down to 230V in England and Wales. In Scotland 132kV is considered as part of the transmission rather than distribution so their operation is not included in the DNO's activities

DPCR4
Distribution Price Control Review 4 – the price control regime for the 14 incumbent DNOs applicable for the period from 1 April 2005 to 31 March 2010

DPCR5
Distribution Price Control Review 5 – the price control regime for the 14 incumbent DNOs applicable for the period from 1 April 2010 to 31 March 2015

Early Retirement Deficiency Contributions (ERDCs) means the cost of providing enhanced pension benefits granted under severance arrangements prior to 1 April 2004 which were not fully matched by increased contributions

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Established Deficit means the difference between assets and liabilities, determined at any point in time, attributable to pensionable service up to the end of the respective Cut-Off Dates and relating to Regulated Business Activities under Pension Principle 2. The term applies equally if there is a subsequent surplus

GDPCR1
The review of the price control applying to Gas Distribution Networks for the period from 1 April 2008 to 31 March 2013

Gas Distribution Networks (GDNs) means companies which own and operate the transportation infrastructure that transports gas from the National Transmission System to final consumers and to connected system exit points

Incremental Deficit means the difference between the assets and liabilities, determined at any point in time, attributable to post Cut-Off Date pensionable service and relating to Regulated Business Activities. The term also applies equally where there is a surplus for the post cut-off date regulated Notional Sub-Fund

Liability Driven Investments (LDI) means an investment vehicle designed to match the profile of the investments more closely to the profile of the liabilities of the pension scheme for all or part of those liabilities

National Transmission System (NTS)
The high-pressure gas transmission system in the UK

Network Operators (NWOs) mean companies which own and operate the gas and electricity networks in Great Britain. This includes DNOs, GDNs and TSOs

Non-Regulated Business Activities means activities which are not remunerated by base demand revenues and for TO, SOs and GDNs include excluded service, de minimis, metering, distributed generation, LNG storage and other consented activities and those activities of co-sponsoring affiliates of the licensee which are not themselves regulated NWOs. For DNOs in DPCR5 and RIIO-ED1 means non-licensed and non-regulated business activities, which are not distribution business activities of the licensee and those of co-sponsoring affiliates of the licensee which are not regulated DNOs

Notional Sub-Fund means the pre and post Cut-Off Date notional sub-funds where the assets and liabilities of a defined benefit pension scheme are reported under the PDAM. The sub-funds are notional in that there are not actual sub-funds recognised by the scheme and are a regulatory construct reported in accordance with the methodology set out in this document

Pension Protection Fund (PPF) means the statutory body established to pay compensation to members of eligible defined benefit pension schemes, when there is a qualifying insolvency event in relation to the employer; and, where there are insufficient assets in the pension scheme to cover PPF levels of compensation

PPF Levy means the levy on pension schemes by which the PPF is financed. This levy has a number of constituent elements including a fixed element (based on scheme liabilities), and a risk based element (based on the perceived insolvency risk of each scheme). Additionally there is an administration levy charged to cover the PPF running costs

Pensioner Liabilities means all pension scheme liabilities as determined by an actuarial Valuation of the pension scheme that relate to pensioners and dependents who are in receipt of a pension from that pension scheme in accordance with the scheme rules (including liabilities for benefits that will be payable on the death of such members)

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Pension Methodology means the methodology for setting and resetting pension allowances as published for the respective price controls or incorporated in the licence or charge restriction conditions applicable to each licensee

Pension Principle(s)
Ofgem's price control Pension Principles and guidance notes as set out in Annex 2 to the Final Proposals December 2012 –for each of RIIO-T1 and GD1 Finance and Uncertainty supporting document, and the February 2013 Strategy document for the next electricity distribution price controls ED1 – Financial issues. It shall include any revision to the guidance notes from time to time

Pension Strain Costs mean the cost of providing enhanced pension benefits granted under severance arrangements on or after 1 April 2004 which were fully matched by increased contributions

Pre Cut-Off Date Regulatory Fraction means the opening or initial Regulatory Fraction as determined at the relevant Cut-Off Date. In accordance with section 9 of this PDAM, this fraction may be subject to adjustment after the Cut-Off Date

Post Cut-Off Date Regulatory Proportion means the proportion of a company's pension scheme liabilities that relates to licensed Regulated Business Activities after the relevant Cut-Off Date

Projected Unit Method means a funding method in which the actuarial liability makes allowance for projected earnings. The contribution rate is that necessary to cover the cost of all benefits which will accrue in the control period following the Valuation Date by reference to earnings projected to the dates on which the benefit becomes payable

Proportions Of Service means the annual proportion of post Cut-Off Date liabilities which can be attributed to Regulated Business Activities

Protected Persons means people covered by The Electricity (Protected Persons) (England and Wales) Pension Regulations 1990 (SI 1990/346) and Electricity (Amendment of Scottish Pension Schemes) Regulations 1990. These regulations place obligations on successor employers to fund the pension benefits accrued to date and provide a certain level of future pension benefit provision

Regulated Business Activities means for TOs, SOs and GDNs the licensed regulated business activities, ie distribution or transportation business activities and which are remunerated by base demand revenues and which are not Non-Regulated Business Activities. For DNOs, in DPCR5 and RIIO-ED1, means licensed regulated business activities, ie distribution business activities and which are not Non-Regulated Business Activities of the licensee

Regulatory Fraction means the proportion of a company's pension scheme liabilities that relates to licensed Regulated Business Activities before the relevant Cut-Off Date and does not include an adjustment for ERDCs

Reporting Actuary means the DB Scheme's actuary that prepared the Valuation on which the input information is based or the corporate actuary.

Reporting of Price Control Cost Information licence condition for DNOs this is standard licence condition 48; for GDNs and gas TSOs Standard Special Licence Condition A40; and for electricity TSOs standard licence condition B15. This includes any subsequent changes or re-numbering

Regulatory Instructions and Guidance (RIGs) has the meaning as set out in the respective **Reporting of Price Control Cost Information** licence conditions

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RIIO-ED1 means the review of the price control applying to incumbent Electricity Distribution Network licensees for the period from 1 April 2015 to 31 March 2023

RIIO-GD1 means the review of the price control applying to incumbent Gas Distribution Network licensees for the period from 1 April 2013 to 31 March 2021

RIIO-T1 means the review of the price control applying to incumbent electricity and gas transmission network licensees for the period from 1 April 2013 to 31 March 2021

Regulatory Reporting Pack (RRP)
Price control cost information submitted in accordance with the RIGs and the respective Reporting of Price Control Cost Information licence conditions

Scheme actuary means the Actuary appointed by the DB Scheme's trustees to prepare and report on a Triennial Valuation

Shared Services means members of the pension scheme in an affiliated shared service operation providing common services to one of more affiliates or related undertakings

Shared Service Employee means an employee of a licensee who works for or across a number of licensees or Regulated and Non-Regulated Business Activities

Significant Additional Deficits means a significant increase in the Established Deficit, which occurs towards the end of the notional 15-year funding period, caused by exogenous factors, for example market movements or justifiable changes in actuarial assumptions

Standard Actuarial Techniques means generally accepted actuarial techniques or methods and procedures recognised by members of the Institute and Faculty of Actuaries

Statement of Funding Principles (SFP) means the statement, prepared by the trustees to satisfy the requirements of section 223 of the Pensions Act 2004, which sets out their policy to meet the requirement on them for securing the Statutory Funding Objective. It also details the principal assumptions to be used for calculating the scheme's Technical Provisions

Statement of Investment Principles (SIP) means a written statement of investment objectives and the principles governing decisions about investment for a DB pension scheme, which trustees are required to prepare and maintain

Statutory Funding Objective means (as set out in section 222 of the Pensions Act 2004) the requirement to have sufficient and appropriate assets to cover the Technical Provisions

System Operators (SOs) means the respective operators of the Great Britain electricity and gas transmission systems

Technical Provisions means the value placed on a pension scheme's liabilities when calculated using the principal method and assumptions detailed in the Statement of Funding Principles. The general principles that are adopted by trustees are that the assumptions used, taken as a whole, will be sufficiently prudent for pensions and benefits already in payment to continue to be paid, and to reflect the commitments which will arise from members' accrued pension rights

Totex means the aggregate net network investment, net network operating costs and indirect costs, less the cash proceeds of sales of assets and scrap

TPCR4
The review of the price control applying to electricity and gas transmission network licensees (TOs and SOs) for the period from 1 April 2007 to 31 March 2012

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TPCR4 Adapted Rollover
A one year roll-over of the TPCR4 price control for the period from 1 April 2012 to 31 March 2013 and for which the Pension Methodology first set out in DPCR5 and the June 2010 Pension paper[7] applies

Transmission Owners (TOs) means the companies which own and operate the gas and transmission networks in Great Britain

TSOs generic term for both TOs and SOs

Triennial Valuation means an actuarial valuation of a pension scheme which has been carried out to met the requirements of Section 224(2)(a) of the Pensions Act 2004 and which details in a written report, prepared and signed by the Scheme Actuary, the value of the scheme's assets and Technical Provisions. Actuarial valuations are usually produced triennially but the term may also refer equally to any full actuarial valuation that is not an Updated Valuation

Updated Valuation means a report, prepared and signed by the Scheme Actuary, which updates a Triennial Valuation to a later date.

For the avoidance of doubt, Updated Valuations must use the Statement of Funding Principles agreed at the latest Triennial Valuation to derive the assumptions at each Valuation Date.

The actuary's report prepared for Ofgem purposes must detail, at the Valuation Date, the following:

- the market value of a DB pension scheme's assets;
- an updated calculation of the Technical Provisions based on up to date market conditions; and
- an update of the ongoing contribution rate.

In addition to the valuation, the following information must be included in the actuary's report prepared for Ofgem purposes:

- a copy of the SFP on which the roll forward valuation is based;
- a statement from that actuary setting out the basis of the valuation;
- a schedule of the actuarial assumptions used at both the last Triennial Valuation and Updated Valuation;
- an explanation of the following changes since that last Triennial Valuation:
    - Asset values and how they have been recalibrated from known asset data and latest asset allocations, which must be specified, eg index returns and which ones;
    - Movements in liabilities as a result of yields and hence inflation and discount rate assumptions;
    - Movements in contributions (specifying lump sum contributions (and date) separately from ongoing service and deficit contributions);
    - Movement from benefit payments;
    - Confirm it maintains the assumption that demographic experience is in line with assumptions in the last Triennial Valuation;
    - Significant Bulk Transfers out (eg arising from corporate transactions);
    - Significant Bulk Transfers in (eg arising from corporate transactions).

- detail of the experience items which have been reflected in the Updated Valuation including:

[7] http://www.ofgem.gov.uk/Networks/Documents1/Price_Control_Treatment_of_Pension_Costs_final.pdf

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- Variations in liabilities arising from salary rises, deferred pension revaluation or pension increases differing relative to assumptions;
- Variations between actual and expected demographic experience (eg early retirement or mortality); and
- Benefit changes.

Valuation means a Triennial Valuation or an Updated Valuation

Valuation Date means the dates set out in the relevant Price Control Financial Model handbook and repeated, for guidance, in Appendix 2 of this PDAM.

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Annex 2 Draft Data Tables

[This are in a separate excel document]

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