

Price Control Pension Principles Consultation

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Principle 1

“customers of network monopolies should expect to pay the **efficient** cost of providing a **competitive** package of pay and benefits, including pensions, to staff of the **regulated** business, in line with **comparative** benchmarks”

Adherence

- Demonstrating adherence requires transparency of information
 - What level of benefits are being provided (including discretionary practices)
 - Against what benchmark is this judged to be “competitive”
 - How is the “efficient” cost of financing these benefits determined
 - How can we be sure that the costs for the “regulated” business are appropriate for that business and are not influenced by the needs of the non-regulated business

Factors influencing Pension Costs

- Actuarial assumptions
- Deficit funding periods
- Investment Strategy
- Benefit basis

All of these are used within the commercial world to contain and smooth pension costs balancing needs of members, trustees, company, shareholders and customers.

Actuarial Assumptions

Principle 4 states “pension costs should be assessed using reasonable assumptions in line with current best practice”

- Not clear how monitored and no visibility of challenge
- Disclosed information shows far more caution than in the private sector
- Consequence is that it appears that there is a degree of unnecessary prudence with higher costs being passed on to consumers

Deficit Funding Periods

- Deficit contributions can be significant
- Need to balance trustee and employer needs amongst others
- Strength of employer covenant – stronger covenant, longer period acceptable
- Need a fairer distribution of costs between generations of consumers

Investment Strategy

- Fundamentally affects the level of cost
- Should warrant scrutiny
- Appropriate balance between risk and return
- Efficient cost should minimise costs passed onto consumers
- Strength of employer covenant would lead to a freer investment strategy in private sector

Benefit Basis

- Addressed only once other factors have been considered
- In reality the majority of private sector employers
 - Have closed their DB schemes for new hires
 - Have increased member contribution rates, sometimes more than once
 - Are now taking more difficult steps as need to contain DB costs grows

Summary

- Currently licensees pass on DB costs in full – current regulation does not provide an actual constraint or incentive to reduce costs
- Not looking to place unreasonable demands on the licensees
- Want to see measures to ensure and demonstrate adherence to Principle 1
- Greater disclosure to consumers as to how the allowances have been determined and benchmarked