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for energy consumers

Call for Input – Proposed pension policy review

Background

The defined benefit pension schemes sponsored by most energy network operators have their roots in employee remuneration packages that existed before the privatisation of the energy networks between 1986 and 1991. All network operators defined benefit pension schemes are now closed to new members, although most continue to accrue obligations in respect of the pensionable service of existing members. A small number are closed to all future accrual.

Ofgem have had a long-standing commitment to consumer funding of deficits in defined benefit pension schemes in existence before privatisation. To reflect this commitment, our price controls provide a form of pass-through funding by consumers of 'Pension Scheme Established Deficits' (those attributable to service before certain specified cut-off dates).

We last reviewed the policy in 2017,[1] and this clarified the nature of our commitment to provide funding for Pension Scheme Established Deficits of network operators subject to price control under our RIIO regimes. Most schemes are now approaching full funding, with some schemes in surplus.

Current Situation

On a triennial basis, we review the pension allowances that network operators can recover as part of their regulated revenue under the price controls, which consumers fund through their energy bills. Our review looks at the latest valuations and the governance arrangements the network operators have in place.

Our most recent review was completed in November 2023,[2] and this determined the revenues that RIIO network companies can recover to fund their established pension deficits for the next three years commencing 1 April 2024.

The total average annual pension allowance for the next three years reduced from a net allowance figure of £334 million to net recovery position of £10 million, a reduction of

[1] https://www.ofgem.gov.uk/publications/decision-ofgems-policy-funding-pension-scheme-established-deficits
[2] https://www.ofgem.gov.uk/publications/revised-pension-allowance-values-and-completion-2023-reasonableness-review

£344 million per year.[3] This reduction is a result of the latest actuarial valuations which showed that the funding position of all but one scheme had improved since the last valuation with the majority now over 90% funded and five schemes in surplus.

Against this backdrop of schemes approaching full-funding / moving into surplus we believe now is the appropriate time to consider a review of our current policy for funding Pension Scheme Established Deficits and specifically who should bear that risk beyond 31st March 2027 (the end of the November 2023 review period).

As a comparison, Ofwat in its Price Review 2024 (PR 24) has confirmed that (except for one company where recovery extends to 2025-30) no further allowance will be granted for companies to recover remaining deficits from customers beyond 2024-25. Remaining deficits will fall wholly under the responsibility of management and shareholders.

Call for Input and next steps

We are keen to engage with a wide range of industry and other interested parties. To start this process and help us shape the considerations in this proposed review we would welcome written comments on the following questions:

1. Do you agree that now is an appropriate time to commence a review of our existing policy?

2. If you do not agree that now is an appropriate time to review the existing policy, please explain why not?

Please email responses to david.simpson@ofgem.gov.uk by 4th April 2024.
Unless clearly marked as confidential, we will publish responses on our website shortly after the response deadline.

Subject to consideration of the responses we receive, and if we are minded to proceed with a review of the policy, we intend to publish an informal consultation on this issue and provide stakeholders with further detail around policy options, evaluation criteria and timelines.

Mick Watson

Chief Financial Advisor, Deputy Director

[3] 2020-21 price base