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cc Martin
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20 August 2003
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Dear Mr Gray

Developing network monopoly price controls – initial conclusions
Response of the Group Trustees of The National Grid Company Group of the Electricity Supply Pension Scheme

I refer to your letter of 30 June 2003 to Steve Lucas and welcome the opportunity to comment on your consultation on the treatment of pension fund costs.

Enclosed is a copy of our response which I hope that you will find a useful contribution to the debate.

If you have any queries or points of clarification please do not hesitate to contact me.

Yours sincerely

Maggie Hurt

Maggie Hurt
Chairman of the Group Trustees of
The National Grid Company Group of the
Electricity Supply Pension Scheme

cc Steve Lucas, Group Finance Director, National Grid Transco plc

Response to Ofgem's Consultation Document
Developing network monopoly price controls – Initial conclusions

1. Introduction

The Group Trustees of The National Grid Company Group of the Electricity Supply Pension Scheme (the Group Trustees) welcome the opportunity to comment on the section *Treatment of pension fund costs* in Ofgem's consultation document *Developing network monopoly price controls – Initial conclusions*. We also welcome the guidelines in general.

This response represents the views of the Group Trustees in relation to our role as trustees of The National Grid Company Group of the Electricity Supply Pension Scheme. It is not a response on behalf of National Grid Transco plc or the Scheme Trustee (see below for more details on the Scheme structure).

For completeness we would confirm that our response is not confidential.

2. Background to the Scheme

The Electricity Supply Pension Scheme (the Scheme) is a contracted out salary related occupational pension scheme. The Scheme has 26 separate actuarially independent sections (known as 'Groups') in respect of the companies participating in the Scheme as Principal Employers, and each Group has its own share of the assets of the Scheme. Only some of these Groups are regulated by Ofgem.

Each Group is administered by a body of trustees known as Group Trustees. The Group Trustees' structure of The National Grid Company Group provides for a total of 9 Group Trustees, 3 appointed by National Grid Company PLC and 6 elected by members.

In addition there is a central Scheme Trustee, Electricity Pensions Trustee Limited (EPTL). EPTL is a trust corporation with a board of Directors.

3. Background to the Group

As at 31 March 2003 the membership, fund size and split of investments of The National Grid Company Group of the Electricity Supply Pension Scheme (the Group) was as follows:

Summary of membership

Contributors	2,568
Pensioners	4,962
Dependants	1,742
Deferred Pensioners	2,228
Total	**11,500**

Fund Value = £978.7M

Investments by category

Asset type	**% of Group assets**
UK Equities	28.4
Overseas Equities	30.9
UK Bonds	15.0
Overseas Bonds	0.6
Index-Linked Gilts	13.3
Managed funds and unit trusts	0.4
Property	8.7
Cash/Other	2.1
AVC Investments	0.6
Total	**100**

4. *Position Statement*

Our duty is to administer the Group in accordance with the Scheme documents and in particular to pay the promised benefits to members. This duty applies to all members i.e. contributing members, members with deferred pension entitlements and members in receipt of a pension.

Whilst we consider that discussion regarding the treatment of pension fund costs is primarily one for Ofgem and the relevant employers, we recognise the importance of the employer's covenant to our members and so would not welcome any proposals that weaken the employer's covenant.

Additionally, we have considered any practical implications of the proposals as they may affect our management of the Group.

5. *Specific responses*

We respond to paragraphs 4.20 to 4.36 of the consultation document using the document's heading and numbering.

5.1 Paragraphs 4.20 to 4.34 inclusive

We have no particular comments on these paragraphs that are not addressed in our response to the Guidelines themselves. However, we welcome the recognition of the specific issue identified in paragraph 4.23 in relation to the Electricity Act 1989; we understand that the Electricity Pensions Limited (the Principal Employers' Co-ordinator) are addressing this with Ofgem and so we will not repeat those comments here.

5.2 Paragraph 35

Guideline 1

Customers of network monopolies should expect to pay the cost of providing a competitive package of pay and other benefits, including pensions, to staff of the regulated business, in line with comparative benchmarks.

We welcome the recognition in this guideline that pensions costs efficiently incurred should be paid by the customer.

We believe that this efficient management action extends to the Group Trustees to the extent that we incur reasonable costs in the course of our stewardship of the scheme, for example, professional fees.

Guideline 2

In principle, each price control should make an allowance for the ex ante cost of providing pension benefits accruing during the period of the control, and similarly for any increase or decrease in the cost of providing benefits accrued in earlier periods resulting from changes in the ex ante assumptions on which these have been estimated.

We welcome the recognition of the long-term nature of the pension costs and the need to consider any increase or decrease in the cost of providing benefits accrued in earlier periods.

Guideline 3

Pension costs should be assessed using actuarial methods, on the basis of reasonable assumptions in line with current best practice.

We agree with the principle that the actuarial method used should be based on reasonable assumptions and in line with current best practice. We would draw Ofgem's attention, however, to the structure of the Electricity Supply Pension Scheme whereby central actuarial assumptions (and methodology) are set by the Scheme Actuary in consultation with EPTL and Group specific assumptions agreed between the Group's Actuary, Employer and Group Trustees. Ultimately, both the Scheme Trustee (EPTL) and the Group Trustees will be guided by their actuary as to the most appropriate methodology and assumptions to be used.

Guideline 4

Increases or decreases in the future costs of providing accrued benefits resulting from under- or over-funding in prior periods will need to be considered on a case-by-case basis.

We have no specific comments on this guideline other than to reiterate our position that the employer should be able to pass on all appropriate pension costs so as not to weaken its covenant and so provide reassurance to our members. We would be concerned if this were not the case because this would lead to the position that pension promises made before privatisation (which were underpinned then by statutory regulations) and since that date become less secure.

Guideline 5

Increases or decreases in the future cost of providing accrued benefits resulting from differences between ex ante and ex post investment returns in prior periods will also need to be considered on a case-by-case basis.

We welcome the acknowledgement that investment returns should be considered on a case by case basis and that there will be no attempt to judge investment performance with the benefit of hindsight.

We would point out to Ofgem that their commentary in relation to this guideline does not reflect our view of the investment responsibilities, as follows:

The Group Trustees are responsible for:-

- **setting investment strategy** i.e. the strategic allocation of the fund between asset classes (principally Bonds, Equities and Property). In setting this strategy we take advice from the Group Actuary and our Investment Adviser. We also consult with the employer (this is a requirement under the Pensions Act 1995); whilst the legal obligation is only to consult we conduct an open dialogue with the employer and consider its views. However, the decision ultimately rests with us.

  Our primary duty when setting the investment strategy is to the Group's members as a whole. This strategic asset allocation decision is perhaps the most important investment decision as this has the most influence on the fund's ability to match its liabilities and so meet the pensions promise.

- **the appointment of the fund managers** that manage the asset classes selected. Again we take advice and consult with the company. However the final decision is ours.

Guideline 6

Liabilities in respect of the provision of pension benefits that do not relate to the regulated business should not be taken into account in assessing the efficient level of costs for which allowance is made in the price control.

We have no specific comments on this guideline.

Guideline 7

Companies will also be expected to absorb any increase (and may retain the benefit of any decrease) in the cost of providing enhanced pension benefits granted under severance arrangements which have not been fully matched by increased contributions.

We have no specific comments on this guideline.

6. Conclusion

We hope that this response will prove a useful contribution to the consultation process and would appreciate the opportunity to comment further as Ofgem's detailed approach to the proposed guidelines evolves.

August 2003