Ofgem Price Control Pension Principles Second Consultation document

UNISON Response
09 September 2009

UNISON supports several thousand members working in the electricity and gas regulated businesses including everyone from clerical and administrative staff to senior managers.

We know that our members value their pension rights very highly and particularly those that previously accrued pension benefits in the electricity and gas industries prior to privatisation. Legislation such as The Electricity (Protected Persons) (England and Wales) Pension Regulations 1990 has been vital in ensuring that members whom entered employment on the promise of being provided with a good quality pension scheme have the reassurance of continuity of such provision.

We are very much committed to looking to both protect and improve the pension rights of all our members in both the electricity and gas industries and hence the purpose of our consultation response.

We also support the belief that the protection that consumers and the community need would be better delivered by public ownership of the regulated monopoly businesses.

General comments
It's clearly an unprecedented poor time for final salary pension schemes in the sense that actuarial valuation results are being hit very hard by a combination of falling asset values and low interest rates which is detrimentally effecting the yields on both gilts and corporate bonds to the extent that their discount rates are low and hence the value of liabilities is greater.

Furthermore, we are aware that many final salary pension schemes have strengthened their mortality assumptions in line with the concerns raised by The Pensions Regulator in 2008. This has had the effect of further increasing liabilities and in this respect it's worth noting that The Pensions Regulator's own estimation of such cost is that for each 2 years of increased life expectancy, pension liabilities increase by approximately 5%.

To this extent it's welcome to see that the electricity and gas pension schemes appear to be employing relatively conservative mortality assumptions (as indeed most of their assumptions appear to be) which has the effect of inflating liabilities. Clearly in the longer term this will hold them in good stead and should not result in relatively dramatic liability increases and hence future contribution rates as we have seen recently with some private sector schemes whom have recently "strengthened" their mortality assumptions.

It's our view that final salary pension scheme deficits and indeed costs will start to stabilise and gradually reduce in coming years as the economic climate becomes more favourable and this fact should not be lost. Although we are appreciative of the fact that trading conditions in the recent and current economic climate have been very difficult for employers and that rising pension costs have not helped employers causes, we have certainly seen evidence of some “opportunistic” employers seeking to take advantage of trading conditions as a means of dramatically looking to cut their pension scheme costs, usually by looking to close their final salary pension schemes to all accrual where possible and replace with far inferior and cheaper defined contribution pension schemes.

We are obviously concerned that your proposals do not lead to a similar dumbing down of pension provision across electricity and gas companies as this is not in the public good.

Relative cost containment

Although UNISON agrees that the employer Standard Contribution Rates across the electricity and gas pension schemes are significant, we do not believe these costs to be vastly different to many of the future service contribution rates that we are seeing emanating from recent valuations of some private sector pension schemes. We certainly believe your typical “15-16%” consultation assertion to be fanciful.

Also it’s very relevant to note that with the exception of Western Power Distribution, EDF, and “protected person” schemes, all final salary schemes across the sector appear to be closed to new members. This is a clear long-term cost containment as the schemes offered to new members are not as generous or costly.

Although we accept that the electricity and gas final salary pension schemes are relatively good we certainly do not accept any notion that they are gold-plated or significantly better than typical private sector final salary pension schemes. 80^{th} accrual rate pension schemes are hardly over generous and it’s worth noting for example that most employees whom work in State related employment or indeed did previously and have been TUPE transferred have access to the Local Government Pension Scheme or NHS Pension Scheme which have accrual rates of $1/60^{th}$, schemes which themselves have recently been subjected to revisions to make them more affordable and sustainable.

This also seems an opportune moment to point out that these schemes in closing to new members have already been subjected to cost considerations independent of any influence from Ofgem, meaning that both the sponsoring employers and Trustee Boards have been conscious of the needs to ensure affordable and sustainable schemes.

Deficits and Recovery Periods

It appears to us that existing employer deficit contributions as revealed in your consultation document are perhaps higher than they can be because of relatively short Recovery Periods with no scheme appearing to adopt a Recovery Period in excess of 10 years.

Although very much aware of The Pensions Regulator’s 10 year trigger period for reviewing Recovery Plans we have seen numerous examples of schemes adopting significantly longer recovery period than 10 years. For example, we are aware of one scheme having a recovery period of 25 years.

Indeed The Pensions Regulator has recently stated that they do not have a problem with schemes submitting recovery plans in excess of 10 years as long as this is backed up by a sufficient employer convenant.

To this extent we would have thought there scope for electricity and gas pension schemes adopting recovery periods in excess of 10 years where appropriate in order to contain deficit contributions. It's hard to imagine that the financial strength of the companies would not be sufficient to make this a viable possibility. Also, where appropriate, perhaps better use could be made of Contingent Assets to act as a sufficient guarantee of funds in the event of greater employer security being needed.

Relative prudence of valuation assumptions

The information contained in both your consultation document and GAD's analysis of the questionnaire results that they reviewed seems to point to the electricity and gas pension schemes generally employing relatively conservative assumptions. Mortality and investment assumptions being cases in point.

Although UNISON does not generally welcome overly conservative assumptions as this has cost repercussions and can lead to employer's becoming panicked and unnecessarily looking to reduce these, we need to bear in mind that most of the electricity and gas pension schemes are closed to new members and hence the practicalities of such mean that more conservative assumptions are necessary. We should also not forget that conservatism is helpful in reducing the potential for long-term cost volatility.

We believe it is misleading to compare the investment returns of electricity and gas pension schemes with those of typical private sector final salary pension schemes as the scheme compositions are likely to be significantly different. For example, we would be surprised if the average age of a member in an electricity and gas final salary pension scheme is not greater than the private sector average. This itself could account for a difference in investment practice.

Ofgem's Role

It's UNISON's view that there are sufficient incentives for electricity and gas network operators to ensure that their pension scheme costs are not prohibitive or excessive to the extent that consumers pay the price.

This is evidenced by the fact that there are virtually no final salary pension schemes open to new members in the Sector which suggests that the companies are sufficiently conscious of their pension scheme costs and the need to keep these in some sort of check.

Furthermore you quote in your consultation document that 7 to 8% of total Network Operator Costs derives from pension costs which in our view does not strike us as excessive or against the public interest. In our opinion, the main bone of contention for the general public is their perception of the exorbitant energy and gas costs as evidenced through their electricity and gas bills whilst simultaneously being told that wholesale prices are reducing. We do not believe for one minute that one of the main drivers of these "exorbitant costs" is pension costs and suspect that shareholder value is the most significant reason.

We do not believe the public would look favourably on Ofgem for implementing proposals that could well detrimentally affect the pension rights of ordinary employees at the expense of adding shareholder value.

The public and customers would much prefer that greater control was exercised over wholesale and retail companies where competition is clearly failing to deliver affordable prices.

Dumbing down of pension provision
Clearly in a tough economic environment we are seeing many examples of employers looking to reduce their costs opportunistically by unjustly attacking their pension schemes as this can be an easy target.

The result is potential retirement misery for many as in most cases the alternative pension schemes offered by their employers, if indeed a scheme is offered at all, is unfit for purpose in that it will not provide significant income for individuals in retirement to make it a worthwhile savings vehicle.

UNISON is very worried that defined contribution pension schemes in particular are not the answer in both encouraging saving and indeed in increasing pensioner prosperity as typical contribution rates tend to be less than in final salary pension schemes, as do the typical pensions in retirement. Mainly through a deadly combination of less money invested, poor investment returns and poor annuity rates. As a case in point, a typical male aged 65 would need to generate a fund value of approximately £100,000 simply to get an annual pension in retirement of around £7000 per annum. This would typically be a flat rate pension that does not increase and would not even provide survivors benefits on death.

We are aware of one employer inparticular within the electricity sector whom offers a relatively low cost defined contribution pension scheme to new staff where the take up rate is only approximately 50%. This is a very worrying sign and shows the public's concerns about the inadequacy of low cost defined contribution pension provision.

We do not see it as being the role of a statutory regulator to take a proactive role in potentially initiating incentives for employers to look to make detrimental changes to their existing pension provision for staff and flies in the face of government policy of looking to increase pensioner poverty in retirement.

Response to consultation questions
CH1 Q1 - UNISON does not believe that it's necessary for Ofgem to set incentives for electricity and gas network operators to look to contain and reduce pension costs and very much believe that sufficient incentive already exists as is evidenced by the fact that nearly all final salary pension schemes within the electricity and gas sector are closed to new members. What does this evidence if not cost containment?

CH3 Q1 – We believe that retention of the status quo is an effective incentive on management to manage pension costs for the reasons mentioned in part above and throughout our overall consultation response.

CH3 Q2 – UNISON does not support any "incentivising" approach and believe sponsoring employers and Trustee Boards are best equipped to make their own decisions in relation to containment, if appropriate, of pension scheme costs.

CH3 Q3 – Again, we do not believe that Ofgem is any better placed than pension schemes and sponsoring employers themselves, with guidance from The Pensions Regulator, to put forward options for potential pension scheme cost containment. It should not be the role of a statutory regulator to look to dictate pension policy and terms for employers that fall within its regulation.

CH4 Q1 – Potential pension scheme de-risking approaches should be the prerogative of both the Trustee Board and sponsoring employer and if deemed to be in the best interests of the scheme as a whole then Trustees and sponsoring employers should be free to implement such de-risking strategies as buy-outs and buy-ins as they deem appropriate without fear of having to provide sufficient justifications to Ofgem.

CH4 Q2 – UNISON's view is that the most appropriate valuation would be the latest interim valuation update so as to ensure the most up to date information is taken into account. However, as has been expressed throughout this consultation document, we do not be believe it to be the role of Ofgem to review pension scheme valuations with a view to providing incentives for employers to look to make detrimental pension scheme changes to cut costs.

Conclusion
UNISON is very concerned with the contents of your consultation document in that essentially you appear to be proposing potential incentives on employers to cut pension scheme costs on the grounds of providing better price value to energy and gas consumers whereas the reality is that these costs are contained to an extent and will hopefully improve as economic conditions improve. Furthermore, we do not believe an overall pension cost of between 7-8% of total network operator costs to be excessive and feel that the drive to offer better shareholder value is the main component of high energy and gas prices, a component which no doubt provides sufficient incentive for energy and gas employers to look to contain pension scheme costs in any event, without the need for any interference from Ofgem.

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