

## **OFGEM: Price Control Pension Principles 3<sup>rd</sup> Consultation document**

Our comments relate to the proposal set out in 1.16 to assess the movement in the value of each company's pension scheme against movements in the Pension Protection Fund 7800 index. The proposal being that if a company's pension assets or liabilities move more than 5 per cent above or below movements in the index, this would trigger a review by OFGEM.

As actuaries, we are concerned that the PPF7800 index is neither designed for, nor suitable for, the purpose proposed.

The PPF do not value the benefits that a scheme pays. Rather, they value the benefits that they would pay if they took over a scheme. There are some significant differences between PPF benefits and scheme benefits: for instance, the PPF give no increases in payment to benefits accrued before 1997; and the PPF cap increases in payment to post-97 benefits at 2.5% pa. This means that in times of high inflation, some schemes' benefits would increase by far more than PPF benefits, while others would not. It would be hard to criticise the management of any companies for the resultant movement in scheme liabilities against that of the PPF index.

Another major source of deficit is pensioner longevity. In particular, small schemes and young schemes may find that relatively few of their pensioners are dying, compared to the index. Again, it would be hard to penalise a company for this.

The document appears to imply that companies whose investments perform worse than "the index" should be penalised. However, it is important to recognise that responsibility for investments rests with a scheme's trustees, not with company management. Further, trustees are supposed to determine their investment strategy by choosing investments that are appropriate for their own scheme's benefits: they are certainly not supposed to copy other schemes.

The document appears to implicitly recognise that there may be problems with its proposed trigger, as indicated by statements such as:

1.17 ...it would be for the network company concerned to demonstrate that it had managed its pension fund effectively and efficiently on behalf of consumers. If it cannot do so...

1.20 In setting this trigger we want to be clear that it is not our intention to interfere or influence in any way the investment decisions made by pension trustees.

It is our opinion that in the vast majority of cases where companies have deficits “higher than that demonstrated than the index”, the company would, but at a significant cost, be able to demonstrate that its pension fund had indeed been managed effectively and efficiently. There are generally perfectly valid explanations that would make it hard to justify any accusation of ineffective or inefficient management. Thus, this whole exercise would create an administrative burden both for OFGEM and for pension schemes, without any benefit at all.

We consider that, contrary to 1.20, any attempt to penalise companies for the investment decisions of the trustees of their pension schemes would be seen as an attempt by OFGEM to interfere with these decisions. There is a considerable risk that, in attempting to please OFGEM, companies would put pressure on trustees to act in a manner at variance with their statutory duties. This would of course be highly displeasing to The Pensions Regulator.

In conclusion, we believe that this document would introduce an expensive and damaging process that would not benefit consumers in the slightest.

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First Actuarial is a firm of actuaries and consultants providing actuarial, consultancy, investment and administrative services to pension schemes in the private, public and not for profit sectors.