



# Ongoing pension normalisation

Cost Assessment Working Group

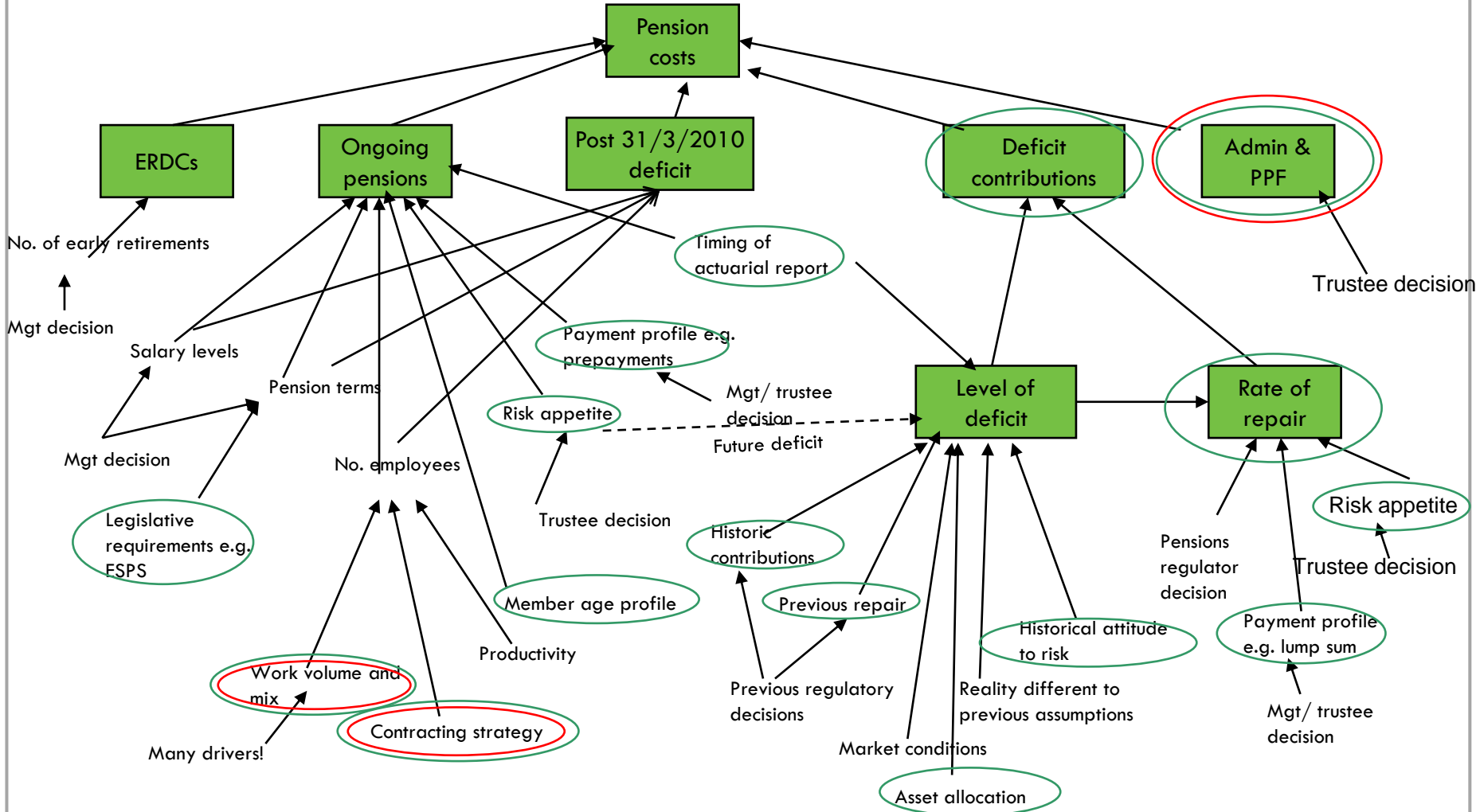
26 June 2012



- Drivers of pension costs
- Key questions for CAWG
- Possible approach

- Drivers of pension costs are complex
- DNOs do not directly control all pension costs
  - Trustees control some things – DNOs influence by negotiation
  - Trustees are driven by guidance from the Pension Regulator and the actuarial profession

# Drivers of pension costs (2)

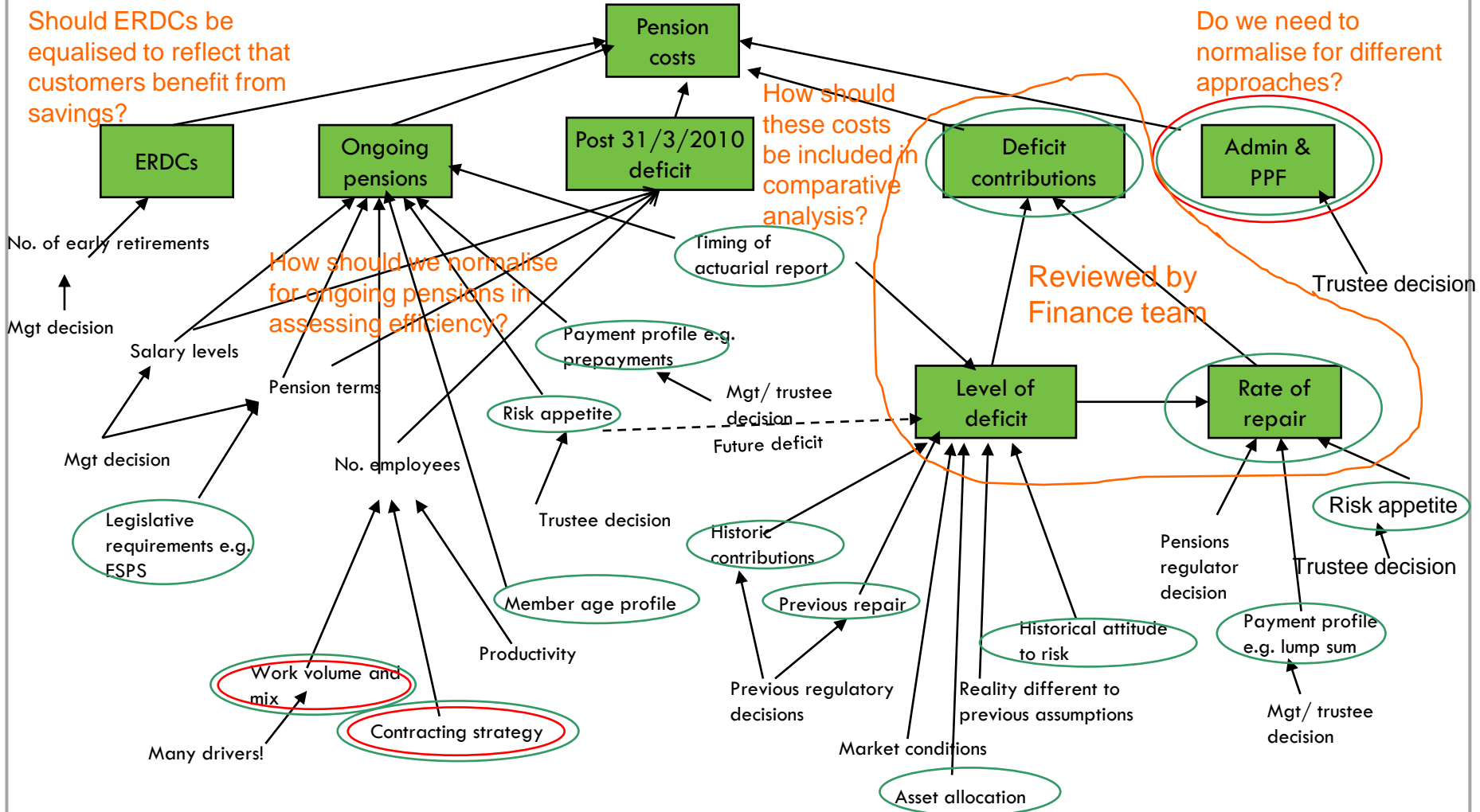


Full normalisation probably impossible

# Pensions – key questions for CAWG

Should ERDCs be equalised to reflect that customers benefit from savings?

Do we need to normalise for different approaches?



- Key normalisation for analysis of non-pension costs
- Key normalisation within pension costs

## ERDCs

- Suggest efficiency sharing factor for ERDCs should be equalised (as all other types of cost for ED1) to recognise that customers will benefit from the savings
- Should ERDCs be included in efficiency assessment? Electricity North West view is that DPCR5 costs should not be included given that they are explicitly shareholder funded, but that any proposed schemes in ED1 should be reviewed as part of assessing well justified business plans

## Post 31 March 2010 deficit

- Electricity North West view is that drivers of this cost are sufficiently complex to merit separate review (rather than absorbed across all activities)
- Topic lends itself to external review by company with actuarial experience
- Need to resolve ongoing debate about how should be reported first!

## Normalisation of admin & PPF levy

- Not huge sums – no need to normalise. Aggregation at average costs should largely remove issue

### Normalisation of ongoing pensions

- Appropriate to include ongoing pensions given observed differences in insourcing/ outsourcing approach
- Need mechanism to adjust for pension assumptions without adjusting for differences in operating structures
- Cannot simply adjust ratio of labour to pensions as labour includes non pensionable costs eg agency staff, overtime, etc
- One simple option could be to adjust all companies' pension costs to average contribution rate across DNOs
  - Propose using weighted average pension contribution rate per pensionable salaries
  - To test this need some data that is currently not shared: % contribution rate for DC schemes and DC: DB spend in ongoing pensions.
- Would need reversal of adjustment for allowance setting – this would need some assumptions
- Would probably need separate review of whether any differences in ongoing contribution rate represent inefficiency/ efficiency rather than systematic scheme differences due to eg member age profile (GAD-like review)

# Appendix: Proposed weighted average pension contribution rate calculation

$$\underbrace{(K12 \times ((K6-K7) / \text{⌘})) + (K70 \times ((K64-K65) / \text{⌘})) + (K129 \times ((K123-K124) / \text{⌘}))}_{\text{Table F7}} +$$

$$\underbrace{(K9 \times ((K6/K9) / \text{⌘})) + (K15 \times ((K15/K12) / \text{⌘}))}_{\text{Table F9}} = \text{weighted average contribution rate}$$

$$\text{⌘} = \underbrace{K6 - K7 + K64 - K65 + K123 - K124}_{\text{Table F7}} + \underbrace{(K6 / K9) + (K15 / K12)}_{\text{Table F9}} \quad (\text{pensionable salaries})$$