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Dear Sir,

RIIO-T1: Initial Proposals

The Trustees of the National Grid UK Pension Scheme (the Scheme) felt it appropriate to respond to the pension aspects of the Initial Proposals released by Ofgem on 27 July 2012. This response covers questions you have posed to sponsoring companies on de-risking strategies, and costs associated with contingent assets.

In terms of de-risking strategies, it is worth emphasising that in accordance with the relevant pension legislation responsibility for the Scheme's investment strategy rests with the Trustees, taking into account their fiduciary duties, including the requirement to act in the best interests of members. In setting investment strategy, the Trustees are required to consult with Lattice Group plc (the Company) on any planned changes to the Trustees' Statement of Investment Principles but ultimately under the legislation the Trustees are not required to obtain the Company's agreement to any changes.

Ofgem will be aware that the Trustees and the Company have anticipated an element of future investment de-risking into the Scheme's Statement of Funding Principles, which forms part of the Trustees' investment strategy which it has agreed with the Company following consultation in the past. Such de-risking strategies are therefore consistent with the existing funding arrangement, and are also aligned with market sentiment and practice to remove risk from pension schemes at an affordable price.

With regard to costs associated with contingent assets, there is a direct link to the funding of the Scheme and negotiations between the Trustees and the Company at the time of the triennial valuation. From the Trustees' perspective, the use of contingent assets can provide helpful flexibility when seeking agreement with the Company to funding arrangements – for example the pace of funding of any deficit in the Scheme - recognising the requirements of the Pensions Act 2004 and associated regulations.

Further, in relation to Scheme funding, the Trustees are obliged to take account of the requirements of the Pensions Regulator, as outlined in Codes of Practice and associated guidance. In this regard, there is a recognised 'tension' between the requirements of the Pensions Regulator and Ofgem, which the Trustees and Company sought to address by way of independent meetings with both parties at the time of the 2010 actuarial valuation.

Clearly, with regard to both aspects, the Trustees are mindful of the covenant strength of the Company, and the impact any decision on de-risking and/or funding may have on the future covenant strength.

It is in this context that the response has been prepared.

De-risking

As outlined above, responsibility for setting the Scheme's investment strategy rests with the Trustees, and therefore the question needs to be directed to the robustness of the approach taken by the Trustees, in consultation with the Company.

As mentioned earlier, the Trustees and the Company have already built in de-risking strategies into the funding plan, and further de-risking considerations should be deemed a natural extension, bearing in mind the significant risks (for all stakeholders) associated with the Scheme, given its size and maturity.

From this perspective, there is a clear alignment of interests of all stakeholders to consider de-risking strategies that reduce the downside risks at an appropriate price, thereby reducing future reliance on the covenant, and ultimately consumers.

The Trustees would be happy for the Company to outline to Ofgem the approach taken to de-risking strategies to provide comfort on its robustness.

To the extent that current levels of investment risk lead to favourable outcomes, then we would hold the view that de-risking of the Scheme towards its target should take priority over a reduction in pension contributions.

The Trustees would be concerned if the success or otherwise of a de-risking strategy were measured with hindsight. With hindsight there will almost certainly have been alternative more rewarding opportunities to switch assets and also less attractive strategies. The appropriate measure of the appropriateness of the de-risking strategy will have regard to the range and likelihood of the possible unknown future states of the world in which the Scheme will operate that were relevant at the time the strategy was set.

Costs associated with contingent assets

As mentioned earlier, there is a clear tension between the two regulatory regimes. This was identified as part of the 2010 valuation negotiations between the Trustees and the Company. The approach adopted for the 2010 valuation was to introduce a contingent asset to bridge the gap between the conflicting requirements of the regulators regarding the period over which funding deficits should be repaired. As such, it would seem appropriate that the cost of the contingent asset is deemed efficient, and therefore should be allowed under the regulatory price control regime.

Yours faithfully,

Peter Boreham
Chairman of the Trustees of the National Grid UK Pension Scheme