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Dear Ian,

### **Reasonableness review of energy network operators pension costs**

Thank you for the opportunity to comment on these proposals. We welcome the expanded the scope of the reasonableness review to include the governance and risk management procedures adopted by pension schemes as, in our opinion, having a clear long term strategy for pension scheme funding, investment and risk management will ultimately ensure the efficient management of a pension scheme.

Within this context, I have set out below our main comments in relation to your letter.

- **Governance relationship with trustees and network operators**

As you are aware, the primary concern of pension scheme trustees is to ensure the proper running of a pension scheme for their members including the collection of contributions, the investment of assets and the security and payment of benefits. In addition, as part of their role trustees need to ensure they maintain their independence, comply with pension legislation and comply with the Pensions Regulator's codes of practice.

As a result of the above, although the trustees may include the support provided to the pension scheme by consumers in their overall assessment of covenant strength, there is no requirement for trustees to recognise consumer interests when deciding on their funding and investment strategies.

Notwithstanding the above, please note that consumer interests will be recognised by network operators as part of their negotiations with trustees as, in order to maximise business performance, there will be a desire among network operators to only pay an efficient level of pension contributions.

- **Additional information requests**

#### *Covenant review*

As you have acknowledged in your letter, it is up to the trustees and their covenant reviewer (who may place restrictions on how the information is used) as to whether or not they decide to provide the company and Ofgem with a copy of the covenant review report.

We will clearly use our reasonable endeavours to obtain this information for you. However, given that the provision of this information is outside our control, it seems odd that the

non-provision of this report may draw adverse inferences from Ofgem and the independent experts.

#### *Value at risk*

As you may be aware, there are a number of different modelling approaches which can be used to calculate Value at Risk for a pension scheme. As a result, if Ofgem are going to request this information you need to provide clear guidance as to how you expect the Value at Risk to be calculated.

#### *Neutral estimate*

As you may be aware, the neutral estimate of a scheme's liabilities is calculated by the Scheme Actuary and is based on the Scheme Actuary's judgement. As a result, this measure of a scheme's liabilities is unlikely to provide Ofgem with a consistent measure of the level of prudence incorporated in each network operator scheme's technical provisions and therefore will not enable Ofgem to identify outliers with any degree of accuracy. Given this, in our opinion, Ofgem should consider an alternative approach to identifying outliers

- **Benchmarking actions taken to reduce or mitigate increases in pension liabilities**

The letter states that Ofgem will use the actions taken by the wider private sector and other regulated companies to reduce or mitigate increases in pension liabilities for benchmarking purposes. However, using the wider private sector for benchmarking purposes in this area may not be appropriate given that non-regulated private sector companies generally have more flexibility to make changes to benefit and contribution levels as they do not have the additional restrictions of the various pension protections that were put into place in the gas and electricity industries at privatisation.

- **Benchmarking the benefit levels provided by pension schemes and the contributions payable**

Benchmarking the level and cost of defined benefit provision in isolation may not be appropriate as, although the cost of defined benefit provision for network operators may be higher than the wider private sector, the overall cost of employment may not be. As a result, we believe that Ofgem should benchmark overall employment costs in order to ascertain whether Network Operator costs are out of line with the private sector rather than focusing on one diminishing element of total employment costs.

We look forward to discussing the above further with you. In the meantime if you have any questions or wish to discuss any specific points in this response please do not hesitate to contact Gareth Jones or myself.

Yours sincerely



**Stephen Parker**  
**Regulation Director**