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Dear Bill,

Reasonableness review of energy network operators pension costs

Both SSE and SGN welcome the opportunity to comment on Ofgem's letter of 18 October on the above topic. We set out our views on the proposed process and the terms of reference for the pensions reasonableness review below.

Overview

We continue to be supportive of both the Ofgem 2010 pensions principles and the pensions reasonableness review. We do, however, have some observations and feedback about the way in which the previous review in 2011 and 2012 by the Government Actuary Department (GAD) and the subsequent follow up review by Ofgem was undertaken. We believe there are lessons that both Ofgem and NWOs can learn from that process that will aid the forthcoming review process to make it as effective as possible for all stakeholders.

We would also like to highlight a number of technical pensions issues and points that we believe Ofgem needs to consider as part of this consultation in advance of the review.

Process and Timetable

We note that this review is referred to as a "reasonableness review". In 2010, following the publication of the DPCR5 final proposals and the Ofgem Pensions Principles, we understood that the proposed reviews were to examine the efficiency of the NWO schemes and adjustments to funding levels would be made if schemes were deemed not to be operated or managed efficiently. We are slightly concerned that the move to a "reasonableness review" over the past two years may result in a higher degree of subjectivity being applied to potential deficit funding adjustments than had originally been envisaged in 2010; both Ofgem and NWOs need to work together to ensure that this is avoided.

The GAD review concluded that there was no evidence of inefficient management of schemes and that the NWO schemes were very much in line with best practice in UK DB pension scheme management, funding and investment when industry specific legislation was considered. We were slightly surprised that the secondary review process initially focused on the identification of actuarial assumptions that appeared to be "outliers" compared to other NWO schemes and a very rigid approach was taken to the interpretation and application of specific scheme rules. All of the schemes have different membership profiles, scheme and benefit rules and therefore the asset mix and management and performance, actuarial assumptions and funding plans reflect this and in our case, we believe we showed Ofgem over the last 2 years that there were valid actuarial reasons for differing actuarial assumptions being made and the application of scheme rules.

We believe that the open and detailed dialogue that we had with Ofgem during the latter part of the review was useful and beneficial to both parties. We recognise that it is vital that Ofgem fully understand the specific circumstances that exist for each pension scheme, the reasons for the selection of specific actuarial assumptions, investment strategies adopted and the legal basis for the application of scheme rules. We are fully supportive of Ofgem's desire to engage with companies and where appropriate the scheme trustees. This will, hopefully, ensure that the degree of subjectivity that was applied to the initial part of the secondary review is avoided in the forthcoming review.

The timetable that is proposed in Ofgem's terms of reference appears to be very tight, particularly if a secondary process is required after the conclusion of the consultant's review. We also believe that it is not clear in the 18 October letter what the process and timescales would be for NWOs to comment and possibly challenge the outcome of the review. If individual companies do not agree with proposed adjustments in October 2014 we are unclear whether this would be included in the annual iteration process (AIP) due in November 2014. We strongly believe that if agreement is not reached by October 2014 to enable any adjustments to be included in the 2014 AIP then it should be delayed until the 2015 AIP.

Roles and Relationship between Ofgem, NWO and Scheme Trustees

The Pension schemes' Trustees are legally responsible for making sure that the benefits due from the schemes they are responsible for are paid and funded for according to the Trust deed and rules, pensions legislation and regulatory guidance from the pensions regulator.

The Trustees must act impartially, prudently, honestly and in the best interests of all the scheme members. Ultimately they are responsible for the proper running of the pension scheme and the sustained security of the members' benefits.

The Trustees are fully aware of the Company covenant and will negotiate a sustainable funding plan for the scheme and therefore are also aware of the importance of Ofgem's role in monitoring the scheme funding on behalf of customers. This importance is reiterated by the Company during discussions and negotiations with the Trustees and their advisors.

We support the involvement of the Trustees (this would be best achieved through the Chair of Trustees of each Scheme) in discussions and regular updates of our scheme performance and strategy with Ofgem, to help explain their role, the way they engage with their advisers and also work with the Companies that fund the schemes over the medium to long term.

Use of Neutral Estimates

We note that Ofgem is considering requesting information on neutral estimates as part of the review process. A neutral estimate is not typically the actuarial method that Trustees or the pensions regulator would expect pension schemes of the size and maturity that exist in the network sector to use in the ongoing assessment of actual funding requirements. We therefore do not see the benefit of doing this as part of the review.

Value at Risk

We welcome Ofgem's recognition that risk is a key issue for all pension schemes and central to the ongoing discussions on funding plans and investment and contribution strategies that the Trustees and the companies have; to make sure that the balance between risk and return supports the sustained and secure funding of the benefits due from the schemes.

The risk profile of each scheme will reflect the profile of each schemes membership and the attitude to risk of the trustees based on their advice and the input from the companies funding the schemes.

We are happy and support the sharing of our approach taken to managing and monitoring risk across our schemes and how this reflects our aim of balancing the needs of the members, Trustees and customer.

Involvement of Pensions regulator

We believe that it would be very useful to obtain as early as possible in the process the views of the pensions regulator on a number of issues to ensure that it fully understands the position that may be adopted by Ofgem and the impact that this has on decisions made by network Companies and scheme Trustees. We would be supportive of a tripartite meeting between Ofgem, the pensions regulator and NWOs at some stage during the review.

**Summary**

SSE and SGN look forward to working with Ofgem during the course of this review. It is essential that Ofgem and the NWOs work together to fully understand the rationale for all actuarial assumptions, investment decisions and application of scheme rules made by Companies and Trustees in both the management and operation of pension schemes. We also believe that the actuarial and technical pensions points we have highlighted in this response should be fully considered by Ofgem and we would strongly support tripartite discussion with the pensions regulator.

Yours sincerely,

Malcolm J. Burns
Senior Regulation Manager