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4th December 2013

Reasonableness review of energy network operators pension costs

Dear Bill,

In response to Ian Rowsons' letter of 28 October 2013 on the above subject, we set out below our response.

Generally we are supportive of Ofgem's reasonableness review approach which now includes pension scheme governance and risk management. We do though have a number of comments which are set out below.

Pension scheme governance

As I am sure you are aware, in addition to complying with pensions legislation and the Pension Regulators' codes of practice, the primary responsibility of trustees is to their pension scheme members.

Thus, whilst the Trustees will take account of the financial position of the sponsoring company, usually through a covenant review, there is no explicit requirement for the Trustees to consider consumer interests. However, it will be in the NWOs interest to consider consumer's interests in order that they can maximise business performance, part of which would be through making efficient pension payments.

Covenant review

Whilst we will endeavour to provide copies of any sponsoring company covenant review to Ofgem, it should be noted that these are reviews performed at the request of the Trustees and that they are confidential to the Trustees. In addition, the terms of reference agreed with the preparer may specifically prevent wider distribution of the report. We would not expect Ofgem to infer anything adverse should the Trustees decide not to release this information.

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Value at risk

Calculation of Value at Risk is a subjective area, with a number of different models which can be used. Consequently, if Ofgem is going to request this information, it will be important that it is prepared using a consistent approach.

Neutral estimate

As with Value at Risk, the Scheme Actuary uses judgement in arriving at a neutral estimate of the pension schemes' liabilities. It is therefore unlikely that Ofgem would be able to use this measure to compare NWOs' technical provisions to identify outliers accurately.

GAD has previously reviewed the assumptions underpinning each NWOs pension position to assess their relative prudence for Ofgem, and it would seem sensible to continue with this approach.

Actions taken to reduce or mitigate increases in pension liabilities

Ofgem states that it will compare the actions taken by the wider private sector and other regulated companies to reduce or mitigate increases in pension liabilities for benchmarking purposes.

It should though be noted that there are additional restrictions (pension protections) that were put into place in the gas and electricity industries at privatisation that will not be reflected in the wider private sector or other utility companies. This makes such a comparison inappropriate, as non-regulated private sector companies generally have more flexibility in dealing with their pension obligations.

Benefit levels provided by NWO pension schemes

Without looking at the wider cost of employment, only benchmarking the level and cost of defined benefit pension provision in isolation against the wider private sector may not be appropriate.

Should you have any queries on the above, please do not hesitate to contact us.

Yours sincerely,



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