CHAPTER: One
Question 1: Do you believe our proposals will provide protection against adverse cost of capital impacts?

Answer: Yes, provided there is firm committed regulatory certainty from Ofgem that consumers will fund the Established pension deficits payments on a "pass-through" basis for the long term e.g. the next 50 years and therefore the commitment needs to be confirmed for the next six 8 year price control periods.

CHAPTER: Two
Question 1: What do you think of our proposed deficit funding policy?

Answer: It is helpful that Ofgem has clarified that it will fund established deficits that may arise following the end of the current 15 year funding period.

However, there is some uncertainty as to how long this commitment extends post 2025 etc. For instance, paragraph 2.12 indicates that an increased deficit could be met by extending the funding period to a "new 15 year horizon". It appears that the intention is to move to "pass-through" of funding of established deficits and to assess whether the amounts are reasonable on a triennial basis. However, it would be helpful if it could be confirmed that the intended policy is to apply beyond say the establishment of a new 15 year funding period (e.g. from 2025 to 2040).

What is the likely timescale for agreeing the new policy? Our 2015 valuations are already progressing and negotiations with Trustees may be impacted by the outcome of the consultation if the new policy is to take effect immediately.

Will the new policy take effect from the next triennial reset due in 2018 based on the results of the March 2016 valuation? For our schemes, these will be roll-forward valuations based on this year's triennial valuation results.

Will Ofgem take in to account the current length of recovery periods when deciding on what is reasonable when new recovery periods are agreed based on 2015/16 valuations? Most schemes will already have used 2025 (e.g. DNOs) as the target for recovery periods for 2012/13 valuations. Or will recovery periods less than 15 years automatically result in a review if for instance these result in higher deficit reduction contributions compared to the previous valuation? We think the new policy from Ofgem needs to clarify the circumstances for a review of the deficit reduction contributions.

If conditions improved and it is possible to remove the established deficit prior to 2025 (e.g. for DNOs), without increasing or reducing deficit reduction contributions, would Ofgem fund over the shorter period or calculate allowances based on the remainder of the period to 2025? So if "pass-through" of costs is intended, can we assume that the current funding end dates of 2025 etc. are to be removed?

We note from section 2.11 that NWOs are to account for "their" choice of funding period. However, it should be noted that agreement of the recovery period is as a result of joint negotiations between Company and Trustees.

How would existing true-up mechanisms be affected? For instance, if the funding end date of 2025 were removed, could this lead to different spreading periods for true-up amounts? Further detail on how existing and any new true-up of differences between actual payments and allowances would be dealt with would be helpful.

Question 2: Do you agree that Ofgem's commitment to funding established deficits should be clarified?

Answer: Yes

CHAPTER: Three
Question 1: Do you agree with our suggested future focus for the reasonableness review?

Answer: We welcome the move from benchmarking individual actuarial assumptions to the focus on benefits and liability management etc. However, note our later comments regarding the likely limited scope for taking actions that will reduce established deficits.

Also, the size of administration expenses is in most cases likely to be a small proportion of pension costs (as noted in the consultation document). There is likely to be limited scope for NWOs to ensure significant savings in this area, especially given the existing governance controls in place for Trustee appointed advisers etc. Therefore, it would be helpful to understand the level of detail that is expected to be required in any additional reports. We would ask that any additional reporting in this area is proportionate.

Question 2: What else, if anything, so you believe the reasonableness review should consider?

Answer:

Question 4: How do you believe the incentive and penalty mechanisms should work?

Answer: Ofgem correctly acknowledge the protections in place which makes changes to benefits difficult. Therefore, we would suggest that Ofgem consider the current scheme benefit structure and practices as the baseline position before assessing NWO behaviour at future reviews. A future reasonableness review could highlight where there has been a change to benefits etc.

As mentioned in the consultation, the cost of an increase in benefits is unlikely to be funded unless it could be justified to be in the consumer interest.

In terms of incentive mechanisms, Ofgem could consider a similar mechanism to that used for ongoing costs in TOTEX. For instance, if a particular action by the NWO could be demonstrated to reduce the established deficit by a certain amount then it could retain say 50% of the corresponding reduction in the allowance. Alternatively, Ofgem could agree to accelerate any existing true-up amounts (if for instance at a previous review Ofgem decided to fund over a longer period than that agreed with Trustees)?

With regard to any penalties (or incentives), Ofgem may consider whether the impact on established deficit is material before disallowing costs etc. Existing legislation and individual scheme Rules will impact on the behaviour of NWOs with regard to benefit amendment and liability management exercises.

Further detail would be required as to when the penalty/incentive mechanism would be effective.

Question 5: Do you believe there is scope to change benefits and engage in constructive liability management?

Answer: We believe that there is limited scope to make changes to benefits as a result of existing legislation (e.g. Pension Act section 67 legislation and the pension obligations for protected persons). In particular there is limited scope for reductions to past service liabilities which will impact on established deficit funding.

Some liability management exercises may be possible (e.g. Pension Increase Exchange - PIE). It may also be possible to offer members flexible options on retirement (e.g. including PIE in addition to offering a transfer payment to an alternative arrangement). However, note that there may be restrictions in scheme rules which could prevent such options/exercises.

Question 6: What support would NWOs need from us to encourage and support benefit and liability management exercised?

Answer: We are comfortable with your proposal that exercises are considered on a case by case basis and we are encouraged by your intention not to penalise adverse outcomes if they result from decisions that were reasonably made to further consumer interest.

We would suggest that consultation with Ofgem would only be appropriate for significant one-off exercises that impact on a large proportion of the scheme membership.

CHAPTER: Four
Question 1: How do you believe NWOs should approach setting (and advocating for) risk levels that best serve the interests of consumers?

Answer: It should be noted that the Trustees are responsible for setting the investment strategy of the pension scheme and hence the risk levels. They have a duty to consult with the employer to understand their growth plans etc. Therefore, the NWO would be able to advocate a certain level of risk based on their analyses etc. However, Trustees have a duty to invest assets prudently in accordance with the scheme provisions and be consistent with their key funding objective to pay promised benefits. So the final risk levels set by Trustees will take in to consideration both this key funding objective and the need not to adversely impact on the sustainable growth plans of the employer.

We have concerns regarding the suggestion to consider consultation with consumer groups. A consumer group may have very different attitudes to risk based on the particular demographics of that group. In setting the investment strategy of the Scheme, the Trustees are required to consider the particular risk profile of their Scheme e.g. maturity of scheme and liquidity requirements. There may also be practical difficulties for Ofgem in assessing whether opinions obtained from one consumer group are more informed than those from another and how applicable they are to the individual circumstances of each scheme and employer.

We would suggest that NWOs continue to rely on their own professional advisers who are expert in the pensions and investment arena to provide advice on appropriate risk levels taking into consideration business plans, specific risk profile of the scheme and the clarified longer term funding commitment from Ofgem. To the extent that this advice considers issues such as the extent and potential term of regulated funding, then this will help to ensure that the consumer interest is considered. These advisers will also have access to general data on private sector schemes’ investment strategies and approaches to risk from their client base.

In line with the code of practice, the Trustees will independently receive professional advice when finalising the investment strategy for their Scheme.

Question 2: Do you agree with our comments on de-risking? Do you believe we need a different or more prescriptive policy?

Answer: Note that the Trustees rather than the NWO are ultimately responsible for setting investment strategy of the scheme (see prior comments). We agree that de-risking activities should be based on the information available at implementation and not judged with the benefit of hindsight.

We consider that the current policy is sufficient. We welcome the confirmation that Ofgem supports the move to de-risking given the maturity of the schemes.

CHAPTER: Five
Question 1: What do you believe the likelihood of a stranded surplus occurring is?

Answer: In line with the comments in the Pension Principles, we have interpreted that liabilities would be assessed on a buyout basis when considering if a stranded surplus is likely.

We consider that there is a very low risk of a surplus appearing on a buyout basis in the near term.

Question 2: What would be an appropriate measure for Ofgem to take if a stranded surplus occurs?

Answer: Given the current market conditions and low probabilities associated with a surplus appearing on a buyout basis, we do not consider that this is a material issue at present.

It is noted that Ofgem does not object in principle to de-risking. Improvements in funding levels will allow progressive de-risking which will reduce the likelihood of a stranded surplus appearing.

In the case of a surplus appearing on a buyout basis then, depending on the Rules of the scheme (e.g. power of wind-up), it may be possible to assume gradual settlement of the liabilities over time. Additionally, it would be unusual for Scheme Rules to allow Trustees to enhance member’s benefits without the consent of the Employer.

We would suggest that each instance is reviewed on a case by case basis reflecting specific issues such as scheme rules.

Question 3: Would a formal policy on alternative funding arrangements be beneficial? Is so what form should this policy take?

Answer: We do not consider that a formal policy should be necessary.

Question 4: Does Ofgem's existing pension allowance framework provide sufficient support for alternative funding arrangements?

Answer: Yes

CHAPTER: Six
Question 1: Does this correctly describe the trustees' role in relation to this framework?

Answer: Yes. Note that with regard to the investment policies of the Schemes, these are the ultimate responsibility of the Trustees.

Question 2: Are the approaches of the two regulators sufficiently consistent to enable NWOs and trustees to agree scheme valuations and recovery plans?

Answer: Where there is clear commitment from Ofgem to fund established deficits, then this will assist NWOs and Trustees to agree valuations and recovery plans. However, if there is uncertainty on the appropriate period of funding then this will make agreement to recovery plans more difficult.

The Pension Regulator (tPR) has stated in their 2015 Annual Funding Statement that they expect 2015 valuation deficits to have increased relative to the previous triennial valuation. tPR guidance is that if schemes are in a position to take additional risk, then modest increases in recovery plans may be possible. However, if there is limited capacity to take additional risk, then tPR expects Trustees to seek higher Deficit Reduction Contributions with a view to maintaining the same recovery plan end date (assuming additional contributions do not adversely affect sustainable growth plans).

Their analysis highlights that they expect many sponsors to be able to afford the required increases in contributions whilst minimising any adverse impact on their sustainable growth.

It is likely that most NWOs will be in a position where there is limited capacity to take additional risk and so based on the existing tPR guidance, Trustees would look to maintain the current recovery plan end date. This would be inconsistent with Ofgem's view that an increase in deficit could be met for instance by extending the recovery period.

We note you are working with tPR to issue guidance for Trustees and employers to cover areas such as the appropriateness of recovery plans etc. When is this likely to be available?

We note that Ofgem's proposals put the onus on NWOs to negotiate with Trustees on behalf of consumers. Ofgem's proposed policy effectively establishes a need to have an integrated framework/policy on funding the deficit agreed between the company (on behalf of consumers) and trustees on the level (and period) of funding when deficits reduce/increase. The trustees and their advisors rely on guidance from tPR; so, if NWOs are going to be able to act on behalf of consumers there needs to be firm agreed views/guidance for trustees and their advisors set down *jointly* by Ofgem and tPR. For example, this guidance might include a non-specific case study from tPR of how they believe regulated organisations should act regarding deficit negotiations.

CHAPTER: Seven
Question 1: Do you have any comments on our proposed inclusion of pensions governance in the Statement of Regulatory Governance?

Answer:
Given that, in accordance with UK Trust law and pensions legislation, the Trustees are responsible for the overall governance of the pension scheme we would expect the statement would focus only on areas that for instance require the agreement of the employer (e.g. agreement of the recovery plan at the triennial valuation).

Question 2: Do you believe this level of accountability will be effective in influencing NWOs' behaviour?

Answer: Yes