WESTERN POWER DISTRIBUTION
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Andrew MacFaul
Consultation Co-Ordinator
Ofgem
9 Millbank
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Date:
9 July 2015

Dear Mr MacFaul

Consultation on Ofgem's policy for funding Network Operators' pension deficits

I am writing as Chairman of the Group Trustees of the Western Power Distribution Group of the Electricity Supply Pension Scheme. The sponsoring employers of the Group are Western Power Distribution (South West) plc and Western Power Distribution (South Wales) plc. As you will no doubt appreciate, the Group Trustees consider themselves interested parties in relation to the subject matter of your consultation document dated 21st May 2015 and would like to take up the invitation to comment.
Our comments are in 5 main areas:

1. Interaction with the Pensions Regulator

We are pleased that you fully recognise the role of trustees in running and making decisions in relation to NWO pension schemes, including the pensions regulatory environment within which trustees must operate, and we are comfortable with how you have summarised this role. As you are aware, whilst Ofgem's Pension Principles are a key element in our overall assessment of the Employer Covenant, we must operate within guidance from the Pensions Regulator, and will be tracking any new guidance it may issue in the light of your consultation and its conclusion.

2. Definition of "Deficit" and Future Funding

We welcome the confirmation provided that Ofgem is minded to continue to extend pension allowances in the Employers' regulatory settlement beyond 15 years after the cut-off date (ie beyond 2025 in our case).

In relation to funding, we believe you are saying that the existing framework for pension allowances for the developing Established Deficit will be maintained, provided this does not lead to a need for increased pension allowances above those already determined for the current regulatory review cycle, but that any additional deficit may need to be funded by Ofgem over a longer timeframe (up to 15 years). Please confirm our understanding in this case. It would also be useful to see some examples of how any new proposals would operate in practice.

From a scheme funding perspective, we need to follow the Pensions Regulator's guidance, and a 15 year period for repairing the Technical Provisions deficit would be very difficult to agree based on current guidance. At the last valuation we agreed a recovery plan longer than most "strong" employers according to data from the Pensions Regulator. Given the scheme's maturity, we would expect recovery plans to be 5-10 years in the future without any re-spreading of existing deficits, although we will need to decide what is appropriate at the time.

It is also important to recognise that our ultimate duty is to settle benefits in full (which may involve at appropriate times buying out some or all benefits with insurers). We note the legal obligation of relevant employers under Regulation 6 of the 1990 Protection Regulation and would welcome Ofgem's explicit recognition that support will continue in the long term to help meet this statutory obligation.

We believe that surplus can only be stranded by reference to the above buy-out basis. We cannot envisage this being an issue in practice, at least for some considerable time, and even then there are sure to be mechanisms available to avoid stranded surplus arising.

3. Active Members' Benefits

In relation to your comments on benefits, and aside from any separate employment contract restrictions that may exist, it is very important to recognise significant legal protections members have:

- 52% of our active members are protected under the 1990 Regulations
- A further 9% of active members are protected under scheme provisions, so that 61% of the Group's active members are protected
- The independent trustee would need to agree any Rule change

In addition, members, and their representatives, will have built up over a period of time an in-depth understanding of their expected salary-linked benefits. It could prove very costly to change any benefits and have other unintended consequences.

4. Pension Incentive Exercises

In relation to pension incentive exercises, we are aware that the Pensions Regulator starts from the presumption that these exercises are unlikely to be in most members' interests, and we share this view. Even if such exercises are legal (in the context of the special legal protections our members have) and run in a balanced way cost-wise, they can be highly complex, costly in terms of important compliance, with potentially low (or at least unpredictable) interest from members, and then leave the scheme with an additional long-term risk of member complaint. Similar issues exist with introducing additional options into the scheme.

5. Investment Strategy

In relation to investment strategy, the Pensions Regulator Code of Practice on funding (para 94) says:

"As fiduciary stewards of scheme assets, trustees have a duty to invest them prudently in accordance with the scheme's provisions and the legislative framework. Trustees should be mindful of the impact that downside underperformance has on the likelihood of members receiving their promised benefits and any strain it would place on the employer covenant. Trustees should seek to understand the impact on the scheme's funding plan and contributions in the event of any adverse or better than expected investment outcomes. "

We recognise the strength of the Employer's Covenant in our Statement of Investment Principles. However, we are conscious of the fact that too much investment risk – whilst potentially reducing the proportion of Deficit Repair Contributions due from the Employer (and by implication shareholders and consumers) – could also have materially adverse consequences for members, the Employer, shareholders and consumers if investment returns fail to meet expectations relative to the liabilities. As a consequence we believe we have developed a sound long-term investment strategy for our scheme, taking a reasonable balanced approach to investment risk in the interests of both our members and the Employer.

In conclusion, the Trustees believe that the pre-requisite for a healthy scheme is a healthy sponsor. In recognition of this we believe we have followed the Pensions Regulator's guidance and taken into account the sustainability of the Employer and have developed a suitable basis for risk tolerance, risk-taking, long-term aims as well as an understanding of the Employer's overall business plans and the financial position of other stakeholders. We believe this to be the product of an effective working relationship which has been developed over many years. We emphasise the benefit the Pensions Principles have given us in assessing the Employer Covenant and we would be very concerned if any changes were introduced to undermine our Statements of Funding and Investment Principles, the strength of the Employer's Covenant, or the benefit expectations of our members that have built up over a period of time.

Please do let me know if you would like to discuss any of these issues further.

Yours sincerely

Ian Williams
Chairman of the Western Power Distribution Group
of the Electricity Supply Pension Scheme

cc	Charl Oosthiuzen, Finance Director	Western Power Distribution
	Sally Jones, Company Secretary	Western Power Distribution