

Eliza Twaddell  
Regulatory Finance and Governance  
Ofgem  
9 Millbank  
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16 July 2015

Dear Ms Twaddell

**Northern Powergrid Group of ESPS - response to the consultation on Ofgem's policy for funding Network Operators' pension deficits**

This letter represents the views of the Group Trustees of the Northern Powergrid Group of the ESPS and sets out our response to the above consultation.

We have provided a general response to the consultation which focuses on the areas where the Group Trustees have an interest, rather than answering the consultation questions point by point.

**1) Proposed deficit funding methodology**

The clarity over continuing to fund the Established Deficit beyond 2025 is welcome.

It would be helpful to have some worked examples from Ofgem to understand how Ofgem intends the deficit funding mechanism to work in practice. The wording (paragraphs 2.11 and 2.12) appears to state that, if the funding position improves, the previously agreed pension allowances would be maintained in order to recover the deficit over a shorter time frame. However if the position worsens then a new timeframe of up to a further 15 years is envisaged.

The proposed benchmark deficit recovery period of 15 years is long compared to typical recovery periods for pension schemes supported by strong covenants. For example the latest Aon Hewitt survey ("Pension Scheme funding - an analysis of completed valuations", September 2014) shows an average recovery period of 6.1 years for schemes with a strong covenant. In addition, information published by the Pensions Regulator ("Scheme funding statistics, Valuations and recovery plans of UK defined benefit and hybrid pension schemes", May 2015) reveals the average length of recovery plan for schemes with strong covenants being 7 years. The Pensions Regulator's report also explicitly states that longer recovery plans tend to be associated with schemes with weaker covenant support. It would therefore be helpful to hear the view of the Pensions Regulator on this proposal.

Whilst we will consider the appropriate position for the Northern Powergrid Group of the ESPS at future valuations, the Group Trustees are, therefore, very unlikely to be able to agree to an ongoing 15 year recovery plan, especially given the increasing maturity of the Group which will in future make a long deficit repair plan even less appropriate.

## **2) Reasonableness review**

The Group Trustees welcome Ofgem's decision to change the focus of reasonableness reviews and to move away from benchmarking funding assumptions and seeking to identify outliers. We agree that this encouraged a herd mentality and was not an appropriate approach given the scheme specific framework of scheme funding and the significant governance and controls that already govern the robust process in place for agreeing assumptions between the Group Trustees and the Company.

With the focus now on the level of benefit provision and liability management, the Group Trustees wish to highlight again to Ofgem the protections that exist in the Northern Powergrid Group's Clauses and Rules and the Protected Persons legislation. This means that the scope to implement any changes to the benefits under the Group is much more limited than in most private sector defined benefit schemes. For example, the Northern Powergrid Group's Clauses and Rules include significant restrictions over the ability to alter member benefits and also the role of the Independent Trustee in setting the level of pension increases.

## **3) Scheme approach to risk**

The Group Trustees welcome the confirmation that Ofgem will not judge the outcomes of de-risking the investment strategy with the benefit of hindsight. We believe that a gradual plan to de-risk investments is likely to be in the best interests of all stakeholders and is in line with the strategies being adopted by other private sector pension schemes. We should point out that the major factor in determining the Group Trustees' strategy on de-risking is the growing maturity of the Group's scheme, not the availability or otherwise of deficit funding support.

Ofgem highlights consideration of the cost of de-risking when reviewing the investment strategy and this is a factor that the Group Trustees already and will continue to take into account. However, in our view, the potential increased cost that can result from not de-risking, in scenarios where investment risk causes the deficit to increase, should also be considered.

The Group Trustees agree that a clear and dynamic de-risking plan is appropriate and are putting such a plan in place. Ultimately some level of de-risking will be necessary as the Group matures regardless of other factors.

## **4) Stranded/ trapped surplus**

The Group Trustees would welcome clarity from Ofgem on what it means by 'surplus' in this context. We note that if a scheme is in surplus on the technical provisions basis, it is likely to still be in deficit on a low risk or buy out basis.

## **5) Trustee role and the Pension Regulator's expectations**

The Group Trustees welcome Ofgem's recognition that it does not regulate trustees (or, where it exists, the Independent Trustee) and that trustees already have a detailed framework, which guides their decision-making and behaviour. Our duty under both pensions legislation and the governance framework laid down by the Pensions Regulator is to our members. There is necessarily a tension between this duty and Ofgem's own duty to protect consumer interests, but we recognise that having a strong and healthy employer is a key factor in being able to

provide members' benefits as they fall due. We are comfortable that Ofgem has correctly described the trustees' role in relation to the framework.

We note that Ofgem states that it is working with the Pensions Regulator to ensure clear guidance for trustees and employers on areas such as the appropriateness of recovery plans. The Group Trustees look forward to seeing the Pensions Regulator guidance in this area, in particular addressing the apparent disparity between Ofgem's proposed 15 year benchmark for deficit recovery and the Pensions Regulator normal expectations of deficit recovery for a scheme with a strong sponsor.

## **6) Covenant**

As a final point we would like to highlight that we regard the pension allowances as an important part of the covenant that supports the Northern Powergrid Group. We would therefore be very concerned by any measures which sought to weaken Ofgem's Pensions Principles. Any such changes have the potential to undermine the view of the Group Trustees on the covenant and hence would have undesirable consequences for consumers.

Please do not hesitate to contact us if you wish to discuss the above matters in more detail.

Yours sincerely



**Peter McCormick**  
**Chairman of the Group Trustees**