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26th April 2016

Dear Ian

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

National Grid owns and operates the electricity transmission system in England and Wales. National Grid also owns and operates the gas transmission system throughout Great Britain and through our gas distribution businesses, we distribute gas to approximately 11 million offices, schools and homes.

We welcome the clarity provided in this Second Consultation around interpretation of Ofgem's Pensions Principles, which we believe will improve Networks' ability to continue to manage pension liabilities efficiently in an evolving environment.

Our response to the consultation consists of a general response to the issues raised in the main body (Section 2) of the consultation document, followed by specific comments to some of the technical detail contained in Section 3 and Appendices 1 and 2 of the consultation. These two sections should be considered together.

General Response

Funding

We welcome the clarity provided in regard to Ofgem's enduring commitment to consumer funding of efficiently incurred Established Deficits. This provides further certainty of regulatory support beyond the initial 15 year funding period.

When coupled with Ofgem's openness to shorter deficit funding periods - where appropriate, we believe this provides a good framework for achieving a fair and appropriate spread of the financial burden across existing and future consumers.

Future Focus

We also welcome the change in the focus of Reasonableness Review away from benchmarking outliers toward a more qualitative approach. We also agree that it is not appropriate to penalise Networks for not taking up liability management initiatives which have not been specified and consulted upon in advance.

Scheme Approach to Risk

National Grid agrees with Ofgem that in providing the Company input into the evolution of each scheme's investment strategy and de-risking activities, the impact on consumers should be specifically considered.

We welcome Ofgem's position of avoiding prescriptive guidance on risk management or the appropriate level of risk, and agree that it is inappropriate to judge risk strategies on the basis of outcomes.

We welcome Ofgem's acknowledgement that movements towards de-risking are appropriate for maturing schemes. While we believe de-risking can often offer the prospect of protecting consumers from significant volatility in deficit funding contribution levels at a reasonable cost, we also agree with Ofgem that de-risking may not always be in consumer's interests.

Surpluses

We remain of the view that stranded surpluses are surpluses that arise after a scheme is fully funded on a self-sufficiency basis. Well governed schemes should be managed to reduce the risk on consumers of further funding as the scheme moves toward full funding on a self-sufficiency basis.

We acknowledge the desire for symmetry for consumers facing both downside risks and upside benefits. But we continue to believe that the probability of stranded surpluses in this environment is minimal. However, we agree that if surpluses were used for ongoing contribution holidays – the net benefit should be passed on to consumers.

We support Ofgem's openness to using alternative funding mechanisms such as asset-backed contributions as potential means of further minimising the risk of unrecoverable over-funding arising. We would welcome a further commitment to the recovery of the associated costs of alternative funding mechanisms where these mechanisms are demonstrated to be in consumers' interest.

Trustee Role and Pensions Regulator's Expectations

We support Ofgem's stated aim of continuing to work with the Pensions Regulator to improve communication and to provide further clear guidance around considering the consumer interest within the pension regulatory framework.

Regulatory Corporate Governance

We remain supportive of transparency and accountability in scheme management and governance, with a preference for any regulatory governance requirements to provide appropriate flexibility to Networks to evidence their governance processes with information that is readily available to the sponsor, as opposed to being held by the trustees.

We believe the proposals within this consultation, combined with the existing approach provide balanced and appropriate treatment of Network's pension costs and liabilities.

We would like to remain actively involved in future discussions with Ofgem in developing agreed approaches to these issues.

If you require any further information, or if you have any questions regarding our response, please contact me directly on 01926 655585. This response is not confidential.

Yours sincerely

James Kerrane
Pension Finance Manager

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Appendix 1 - Specific Comments in relation to Section 3 and Appendices 1 & 2

Section 3 - Developed Proposals

We welcome the setting out of specific proposed revisions to Ofgem's statement of guidance on the Pensions Principles, changes to the Financial Handbook and revisions to the Pension Deficit Allocation Methodology (PDAM).

We agree with the principle and proposed mechanism to change the determination of Pension Scheme Established Deficit (PSED) repair allowances as set out in 3.5 to 3.9.

We welcome the ability to propose a different Base Annual PSED allowance and repair period, alongside a case for protecting consumers' interests. We agree that asset backed funding arrangements can potentially help protect the interests of consumers, and would therefore welcome a further commitment from Ofgem to providing recovery of costs associated with these arrangements, and a clarification that paragraph 3.14 doesn't prevent recovery of reasonably incurred costs of this type of arrangement.

We agree that Networks can be effective consumer advocates, and we welcome Ofgem's openness to funding initiatives capable of generating material benefits to consumers. We believe that it is also in customers' interests that funding is made available to Networks to cover the costs of the development of alternative funding mechanisms and benefit management initiatives. Non-allowance of these development costs may provide an unwanted disincentive on Networks to drive change.

Appendix 1 - Pension Principles

For the avoidance of doubt in Paragraph 6, we suggest amending the wording to include 'post cut-off' such that the paragraph reads:

'Conversely, our funding commitment does not cover any element of deficit falling outside the scope of the Established Deficit (e.g. non–regulated activities and bulk transferees) or the ***post cut-off*** service of those employees who were or are still active in the scheme after the relevant cut-off date.'

Appendix 2 - Financial Handbook

We understand that these proposals only directly relate to RIIO-ED1 by way of an example, and that appropriate modifications for RIIO-T1 and RIIO-GD1 will be made. In this regard, it's worth noting that there are some considerable differences that will need to be accounted for.

For example, different treatment of Administration and PPF Levy costs means that Footnote 14, (which states that Admin and PPF costs are included in Ongoing Pension Costs) would have to be changed for RIIO-T1 and RIIO-GD1, (similarly Paragraph 3.15(c)).

It appears that in order to avoid double counting, a revision to the RIGs is likely to be needed to ensure that Totex amounts in respect of existing members are taken into account in the event of making any PDAM adjustments driven by ongoing contribution holidays resulting from pre cut-off date surpluses.

We would expect to fully review the proposed technical updates to the RIIO-T1 and RIIO-GD1 Financial Handbooks once these have been amended. However, on the basis that the amendments will be consistent with the proposed changes in the narrative, we do not have any particular concerns.