

Ian Rowson  
Ofgem  
9 Millbank  
LONDON  
SW1P 3GE

By email only to: [regfinance@ofgem.gov.uk](mailto:regfinance@ofgem.gov.uk)

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Dear Ian

## **Second Consultation on Ofgem's policy for funding Network Operators' Pension Scheme Established Deficits**

Thank you for the opportunity to comment on the above consultation. This response should be regarded as a consolidated response on behalf of UK Power Networks' three distribution licence holding companies: Eastern Power Networks plc, London Power Networks plc, and South Eastern Power Networks plc. For convenience, the three licensees are collectively referred to as "UK Power Networks" throughout. Please note that our response is not confidential and can be published via the Ofgem website.

As your consultation is not seeking feedback to specific questions, we have grouped our feedback into the following two areas:

- General feedback on the consultation as a whole
- Factual feedback on the methodologies proposed

### **General feedback on the consultation as a whole**

We have found that the second consultation delivers most of the clarification sought following the first consultation. UK Power Networks feels that this document goes a long way to alleviating the fears that the regulatory environment will be overly penal on Network Operators (NWOs) for factors outside their control. Ofgem's desire to achieve an appropriate balance between members and consumers through a robust regulatory governance framework is clearly articulated and the inclusion of references from the Pensions Regulator is helpful for both Trustees and NWOs.

Turning to specific points:

- We believe that you have sufficiently recognised the primacy of the role of the pension fund Trustees and the limited capacity in which NWOs can directly represent consumers' interests within pension scheme decision making. We accept that Ofgem will be looking for NWOs to demonstrate through robust governance that, when negotiating or consulting with the Trustees, they have considered how their position will impact consumers including inter-generational equity. We also welcome Ofgem's clear statement that they will assess

decisions on the basis of a robust and well justified strategy, not on the success of outcomes themselves.

- As Incremental Deficits and ongoing service costs are included within the totex benchmarking mechanism, we welcome the clarification that the reasonableness review extends only to the Established Deficits.
- Ofgem's position not to introduce a rolling 15 year repair programme (points 2.19 and 2.20) is welcomed. Eliminating Established Deficits as quickly as possible within the existing allowances is welcomed and reflects a more aligned approach between the two regulators.
- The more detailed understanding of the barriers of liability management exercises is acknowledged by Ofgem along with the supportive statements in 2.31 and 2.32.
- We agree that the area of risk management is a complex one as stated in 2.37. The lack of prescriptive approach in this area is positive and Ofgem's expectation in terms of how consumers' interests should be accounted for within the governance framework is clear, as is the statement of how these strategies will be assessed (by business case, not hindsight).
- However, the consultation is less clear when linking de-risking and the potential prospect of a funding surplus. Ofgem has not defined what it means by the term "surplus". A true surplus would be a surplus arising on a buy-out basis. It is this lack of definition that creates some ambiguity.

We believe that Ofgem, when referring to a surplus, means a funding surplus that is greater than the target defined within the Statement of Investment Principles. For the avoidance of doubt, this could be a de-risked position.

A number of years ago UK Power Networks' primary pension scheme developed a de-risking objective in the form of a self-sufficiency funding target. This has been communicated to Ofgem over past reasonableness reviews and is typical for a scheme of its maturity. Whilst the Trustee will routinely review the de-risking objective, we do not believe that either Ofgem or the Pensions Regulator is encouraging schemes to re-risk as a result of this consultation.

Therefore, as a principle, we understand Ofgem to be confirming that Established Deficits can be funded past a technical provision target to a self-sufficiency target, providing it is supported by the appropriate due diligence confirming how this strategy will benefit consumers.

However, we would like to take this opportunity to outline what we believe to be the application of determining surplus:

- De-risking is common place as pension schemes mature and the concept is generally supported by Ofgem and clearly encouraged by the Pensions Regulator in terms of managing the overall risk in a scheme.
- Ofgem also acknowledges that investment strategy is a primary responsibility of the Trustee with consultation with the NWO. Ofgem would expect NWOs to consider the impact on consumers when consulting on any de-risking strategy and be able to demonstrate that the needs of both consumers and pension schemes members have been balanced when forming a decision.

- The expression ‘de-risking’ is particularly broad and can be used to encompass a number of different approaches. This may include mechanisms such as increased hedging levels, more prudence in assumptions or a self-sufficiency funding target.
- We understand that this part of the consultation is aiming to protect consumers in the event that a material surplus arises over the agreed funding plan (which may not be a self-sufficiency funding target if it was part of an already agreed de-risking strategy).
- Ofgem is looking for consumers’ interests to be represented when Trustees, in consultation with the NWO, are determining the course of action in this eventuality. We recognise that Ofgem is looking for consumers to benefit from this scenario.
- We understand that it is within this scenario that opportunistic/excessive de-risking over and above the already justified strategy will not be supported by Ofgem, as it is not balancing the gain between consumers and members. It will be for NWOs to demonstrate how further de-risking is in the best interests of consumers in this scenario.
- The contribution holiday mechanism suggested within the consultation has already been catered for within the formula. Ofgem will assess the suitability of any actions taken in this scenario as part of the reasonableness review.

In the event that our interpretation is incorrect we seek further discussions with Ofgem on this very significant point to ensure Ofgem understands our position. Any such discussions should take place as soon as possible, i.e. in the next month.

### **Factual feedback on the methodologies proposed**

We would like to make the following points for further consideration by Ofgem in respect of the draft methodologies:

- Table 3.1 – Expected timetable for EDE value revision (page 37). The deadline date for provision of the PDAM information is now showing as 31 August. This had originally been 30 September, assuming that valuations would be completed by 30 June. We understand that this date has been changed to allow for the earlier completion of the reasonableness review. We propose that the deadline of 31 August applies for those valuations signed off by 31 May with an extension to 30 September if the negotiations take the full 15 month period to 30 June.
- We understand that a combined response on the detailed formulas is being submitted by the Energy Networks Association and we have provided input into this.

If you have any questions about our response please do not hesitate to contact me in the first instance.

Yours sincerely



James Hope  
Head of Regulation & Regulatory Finance, UK Power Networks

Copy Paul Measday, Regulatory Returns & Compliance Manager, UK Power Networks