Government
Actuary's
Department

2020 Reasonableness review

High-level review of network operators' pension costs

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At GAD, we seek to achieve a high standard in all our work. We are accredited under the Institute and Faculty of Actuaries' Quality Assurance Scheme. Our website describes **the standards** we apply.

1 Executive Summary

High-level review of pension costs

We have considered how the methods and assumptions adopted at the most recent actuarial valuations in 2018 or 2019 have changed since the previous valuations. Overall, we have no major concerns with the changes to benefit design, investment strategy and the method and assumptions used to determine the NWOs' defined benefit pension costs at the most recent valuations.

There were, however, several notable changes. Given the constantly changing nature of a pension scheme and the wider environment, it is expected that some changes will occur between valuations. The results are given in Section 3 of this report and summarised in Appendix B. The key findings were:

- **Long-term objective:** Many of the schemes are adopting approaches in line with the Pension Regulator's (tPR's) Fast Track compliance. The schemes may be able to tolerate more investment risk given the strength of the sponsor covenant. A higher-risk strategy would be expected to yield higher investment income in the long term, reducing costs for consumers, but at the expense of greater funding level volatility. Ofgem may wish to set out guidance on its preferred long-term risk position which appropriately reflects the consumer interest.

- **Employer contributions:** We have noted that not all NWOs are paying sufficient employer contributions to meet the expected cost of benefits accruing on the valuation assumptions. This could lead to a deficit emerging over time, unless factors such as investment outperformance or changes in valuation assumptions counteract the underpayment at the next valuation.

  SHEPS are in surplus and have a contribution holiday until they are fully funded on a gilts basis.

  Some schemes have very high employer contributions. Ofgem may wish to discuss the level of future service benefits with NWOs to seek a more cost-effective outcome for consumers. However, there may be restrictions on the changes that could be made.

- **Deficit recovery plan:** The majority of schemes have either maintained or reduced annual deficit payment amounts and the recovery plan length, largely as a result of improved funding. However, some schemes have made other changes.

- **COVID-19:** Some schemes have commented on the latest funding position after considering the impact of the COVID-19 pandemic on their investments. Given the long-term nature of funding pension scheme liabilities, it is appropriate to consider the long-term position without undue focus on short-term fluctuations. Therefore, it may be premature to increase deficit contributions at this time.

  NPESPS has only recently finalised its 2019 valuation, and the company is required to pay additional deficit contributions to correct some of the deficit resulting from the impact on the markets from the pandemic. We understand the additional contributions were triggered by a contribution mechanism agreed before the start of the COVID-19 pandemic which was intended to support management of a stranded surplus.

We have also considered the movement in assets and funding position of NGUKPS (Section B) and CGPS since sectionalisation in 2017. There is no indication from this high-level review that the sectionalisation was not a fair partitioning of the scheme's assets or liabilities.

Consumer interests

We have considered the comments provided in the NWO questionnaire responses provided by Ofgem. These describe how the NWOs believe they have interpreted the interest of consumers when engaging with the governance of its pension scheme (including setting investment and risk strategies).

All companies have been able to describe some examples of actions which they consider to be evidence of them acting in the consumer interest. We note that some companies have cited more examples than others, although it is recognised that scheme circumstances vary and views on how the consumer is best served can also differ.

It is possible that additional actions could have been explored further by some companies since the last reasonableness review. However, given the scope of this review and the information provided, we are not in a position to identify any actions (or lack thereof) which could indicate that companies have not fully acted in consumers' best interests. Viable ways to represent the consumer interest will depend on individual scheme circumstances and will vary between schemes.

An overview of the actions taken is given in Section 4, with a more detailed description of the actions cited by each NWO given in Appendix C. The actions of each NWO are summarised in the table in Appendix D.

2 Introduction

This report has been prepared by the Government Actuary's Department (GAD) at the request of the Office of Gas and Electricity Markets (Ofgem). The purpose of this report is to assist Ofgem in its consideration of price control allowances. This report does not represent advice on the appropriate funding of network operators' NWOs', or other, pension schemes.

Ofgem is the government regulator for gas and electricity markets in Great Britain whose role is to protect consumers now and in the future. Every three years, Ofgem review the pension allowances that the NWOs can recover as part of their regulated revenue.

To help inform Ofgem's review, Ofgem have asked GAD to perform a high-level review of network operators' (NWOs') defined-benefit pension costs. In particular, to review how the benefit design, investment strategy, as well as methods and assumptions used to determine the pension costs, have changed since GAD's previous review, which concluded in 2017. More details on this approach and a discussion of the findings is given in Section 3. A summary of these results is in Appendix B.

Further, Ofgem have also asked GAD to review NWO questionnaire responses which describe how they have interpreted the interest of consumers to inform participation in the governance of pension schemes. An overview of the actions taken is presented in Section 4 of this report, , with a more detailed description of the actions cited by each NWO given in Appendix C. The actions of each NWO are summarised in the table in Appendix D.

The limitations of this advice are outlined in Section 5.

3 High-level review of pension costs

Overall, we have no major concerns with the changes to benefit design, investment strategy and the method and assumptions used to determine the NWOs' defined benefit pension costs at the most recent valuations.

There were, however, several notable changes which we have outlined below. Given the constantly changing nature of a pension scheme and the wider environment, it is expected that some changes will occur between valuations. A summary of the results of the review can be found in Appendix B.

We have also considered the movement in assets and funding position of NGUKPS (Section B) and CGPS since sectionalisation in 2017. There is no indication from this high-level review that the sectionalisation was not a fair partitioning of the scheme's assets or liabilities.

Approach to the review

We have considered how the methods and assumptions adopted at the most recent actuarial valuations in 2018 or 2019 have changed since the previous valuations. For this review we have assumed Ofgem were content with the approach adopted by the NWOs' defined benefit pension schemes at the 2015 or 2016 valuations and have therefore only considered how the relevant methods and assumptions have changed.

We have carried out this comparison by considering the responses provided in the questionnaires, and the formal documentation from the previous two actuarial valuations, where provided.

The main areas we have considered in our review are:

Benefits – the more generous the benefits the higher the ultimate cost.

Long-term funding objective – this affects the planned long-term investment strategy and how quickly schemes aim to reach this, as well as the choice of discount rates. A lower risk long-term funding objective could increase costs.

Investment strategy – this affects investment returns which impact the amount of contributions needed to be paid into the scheme, as well as the choice of discount rate. Investment strategy is typically considered in terms of 'return-seeking assets' (such as equities) and 'matching' assets (such as bonds).

Discount rates – the lower the discount rate the higher the assessed cost of providing defined benefits as future expected cashflows are discounted back at a lower rate. Discount rates are typically expressed relative to the yields available on government bonds (gilts).

Deficit recovery plans – the period and rate at which any assessed funding deficit is paid off.

Funding position – the difference between the market value of the scheme's assets and the assessed value of the liabilities at the valuation.

Employer cost of accrual – The employers share of the contributions required to meet the expected cost of accruing future benefits.

Any other significant changes apparent from the documentation

We have also considered the sectionalisation of the National Grid UK Pension Scheme (NGUKPS).

UKPNPS

UKNPNS was out of scope of our 2014 and 2017 reviews. We have also excluded it from this high-level review, but have included the details in the comparison table in Appendix B for reference. Given the scope of this review, and the difference in maturity of UKPNPS, we have not benchmarked this scheme.

NGUKPS - Sectionalisation

The NGUKPS was sectionalised on 31 December 2016, and the first actuarial valuation for the sections occurred as at 31 March 2017, and the latest valuation was as at 31 March 2019. The Cadent Gas Pension Scheme (CGPS) was set up in January 2020 and intends to take transfer of Section C of the NGUKPS in 2020.

The previous GAD review dated 10 November 2017 considered the main methods and assumptions of the NGUKPS before sectionalisation. Therefore, it is not possible to carry out a review for Sections B and C of the NGUKPS this time based on comparing methods and assumptions with the previous review, as for other schemes.

Instead we have benchmarked the main methods and assumptions of Sections B and C of NGUKPS against the other NWO schemes. At a high-level, the discount rates adopted, investment strategy, recovery plan, funding level and employer contributions all appear in line with other NWOs’ approaches. I note that while these schemes have relatively low short/medium-term discount rates and proportions of growth assets compared to other NWOs, this appears reasonable given their high level of funding.

The tables in this report show the changes in method and assumptions for the two sections between the two latest valuations. Note that the NGUKPS (Section C) is referred to as CGPS throughout the report.

Results

Benefits

All of the schemes are closed to new entrants.

None of the schemes reported amending future benefit accrual since the previous report. While a reduction in future benefits could benefit consumers, schemes may be limited in their ability to make these changes given the protections some members have on their benefits, for example by protected persons legislation[1].

One scheme, ENWESPS, report monitoring the expected cost of future accrual regularly and are considering the options available to them, while taking into account the potential risks of any changes.

NWOs have made other changes to manage liabilities, such as pension increase exchanges, flexible retirement options and transfer exercises. These are summarised in the tables in Appendices C and D.

Long-term funding objective

The Pensions Regulator has recently consulted on a revised defined benefit funding code of practice[2]. The consultation sets out the Regulator's new proposed regulatory approach, the principles the Regulator thinks should underpin the new framework and how they could be applied in practice. A second consultation is planned in Spring 2021 and will focus on the draft code itself.

A focus of the proposed code of practice is on the reduction of risk and long-term strategies of pension schemes. In particular, the consultation proposes a twin track approach to scheme valuations, with "Fast Track" compliance for schemes adopting a long-term funding basis of gilts+0.25% to gilts+0.5% and a "Bespoke" approach which will provide more flexibility for schemes that choose not to follow the Fast Track approach. The Bespoke approach is expected to require evidence of suitability and how any additional risk has been managed.

Protected persons legislation provides additional constraints on some NWOs.

Since the 2017 review, the schemes have adopted views on long-term funding and reduced risk within their investment strategy, or at least put in place the framework of triggers to de-risk the investment strategy over time. A summary of the long-term funding objective for each scheme is included in the Consumer Interest table in Appendix C.

Many of the schemes have adopted long-term funding objectives in-line with the Fast Track approach, with some schemes adopting even more prudent targets. However, these schemes might be able to tolerate more investment risk given the strength of the sponsor covenant. If instead schemes were to adopt a Bespoke approach, this would reduce expected costs to the consumer.

Although a higher-risk strategy would be expected to yield higher investment income in the long term, this is at the expense of greater funding level volatility. For example, a scheme with a higher-risk investment strategy may have fared less well with the market impact of the COVID-19 pandemic than one with lower risk.

Ofgem may wish to set out guidance on its preferred long-term risk position which appropriately reflects the consumer interest, with regard to the implications of protected persons legislation.

[1] The Electricity (Protected Persons) (England and Wales) Pension Regulations 1990 (SI 1990/346).

[2] https://www.thepensionsregulator.gov.uk/en/document-library/consultations/defined-benefit-funding-code-of-practice-consultation

Investment strategy

Return-seeking assets

Five of the schemes changed the benchmark proportion of return-seeking assets held by 10% or more, as disclosed in the questionnaire responses[3]. These are:

- WWUPS: 19% reduction in return-seeking assets
- NGESPS: 15% reduction in return-seeking assets
- ENWESPS: 10% reduction in return-seeking assets
- SPPS: 14% increase in return-seeking assets
- NPESPS: 14% increase in return-seeking assets

A reduction in the proportion of return-seeking assets is a common trend for many UK private sector defined benefit pension schemes as their liability profiles mature. Given all the NWOs' schemes are closed to new entrants, their liability profiles will mature over time and a move from return-seeking assets to lower risk matching assets would be expected. Several of the schemes (including NGESPS and ENWESPS) have a de-risking plan in place which sets out a process by which the scheme will move to a matched investment strategy which is expected to reduce the risk of further deficits arising at future actuarial valuations. However, a lower risk investment strategy is also expected to yield lower returns in the long term and hence may increase the contributions required.

WWUPS' state that their change in investment strategy has significantly reduced risk for only a moderate reduction in expected return.

SPPS agreed a revised investment strategy following their 2015 valuation. They are still transitioning to this revised strategy and expect to complete the transition in 2021. Despite an increase to asset classes categorised as return-seeking, the company state that the revised investment strategy increases diversification and is expected to marginally reduce expected returns while significantly reducing risk. They also have a de-risking framework in place which will reduce investment in return-seeking assets as funding improves.

NPESPS agreed a revised investment strategy following their 2016 valuation. The new strategy resulted in a restructuring of both the growth and liability matching portfolios, with an increased investment in absolute return bonds. This has been classed a growth asset in the NWO's questionnaire response, but a matching asset in the scheme's valuation report. If classed as a matching asset rather than a growth asset, the scheme's allocation to growth assets would have reduced since the last valuation rather than increased. The effect of this transition is that the NPESPS was able to reduce investment risk through a higher matching strategy and greater diversification.

Inflation and interest rate hedging

Since the previous review, all schemes have made movements to increase the hedging within their investment portfolios against movements in the liabilities due to changes in the inflation and interest rates.

[3] Different asset allocations are possible and may give different results.

Inflation and interest rate risk emerge from the mismatching of the asset holder's portfolio with their liabilities. An investor's return is not compensated for carrying these risks. There has been an increased trend for pension schemes to seek to eliminate interest rate and inflation risk though the adoption of a more matched portfolio.

In the submissions from various schemes there is a difference in the basis upon which the benefits are valued – some schemes have provided details of the hedge assessed on the same basis that the scheme is funded, i.e. their Technical Provisions, and other schemes have provided their hedge on a more prudent basis with no outperformance above the yield available on government bonds. This would be expected to be more prudent than the schemes' Technical Provisions and more consistent with a long-term funding target of mature pension schemes.

Discount rate

Two schemes (other than UKPNPS and CGPS) have changed the structure of their discount rates since the previous review:

- WWUPS have changed from a pre-/post-retirement discount rate structure to one which differs before and after 2031, which is consistent with their long-term objective. The 2019 valuation report showed that the impact of the change in discount rate alongside other financial assumption changes marginally worsened the funding position.

- ENWESPS have changed from an RPI-based discount rate to a gilts-based assumption for past service, consistent with their planned investment strategy. They have also reduced their post retirement discount rate to reflect their pensioner buy-in.

SHEPS has increased their pre-retirement discount rate by 1% relative to gilt yields. However, it also decreased the post retirement rate by 0.3%, and given the maturity of the scheme the impact was broadly neutral, worsening the funding position by less than 1%.

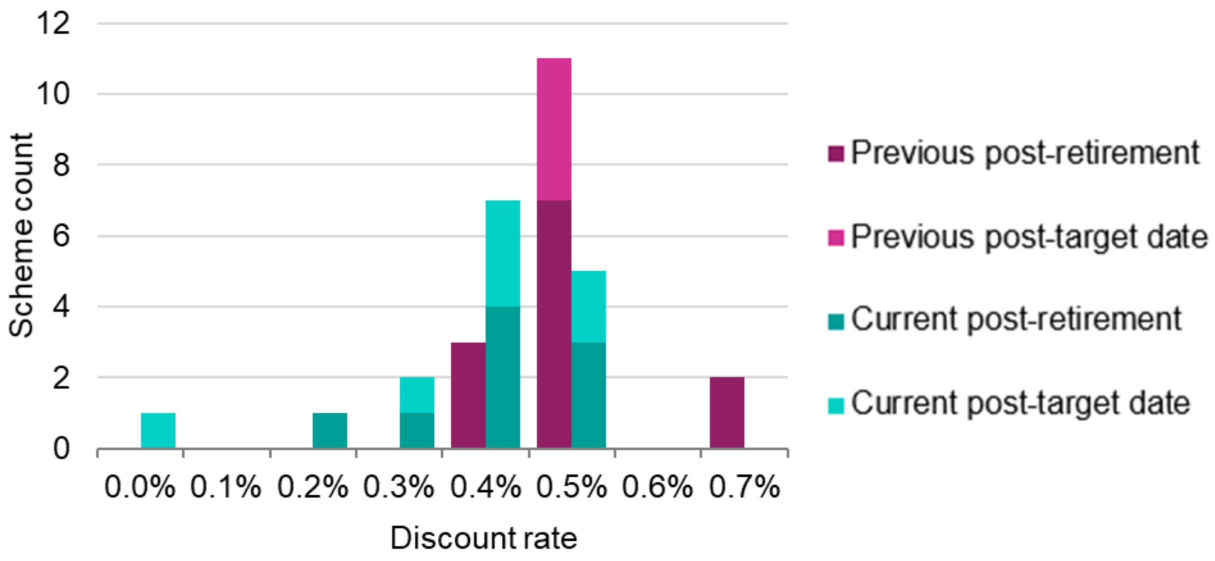
The remaining schemes have either retained the same discount rate relative to gilts or changed it by a small margin (within 0.5%).

The discount rates adopted appear reasonable given the investment strategies in place and wider UK practice.

The long-term discount rates – those that apply after retirement or after a target date – are summarised in Graph 1 below, which shows the number of schemes with each discount rate[4].

This shows that post-retirement discount rates have generally decreased across schemes, and with the highest discount rate used reducing from 0.7% to 0.5%, in line with tPR's Fast Track. Two schemes have adopted post-retirement or long-term discount rates that are more prudent that tPR's Fast Track.

[4] Rounded to 0.1%



Graph 1: Count of schemes with specific long-term discount rates

Deficit recovery plan

There appears to be a range of approaches to changes in recovery plans since the previous valuations. Most schemes have either maintained or reduced the annual deficit payment amounts and the length of the recovery plan. This approach, summarised in the table below, is consistent with lower reported deficits since the previous report, except for SPPS and MANESPS. Both of these schemes have seen a small deterioration in funding level, but negotiated with Trustees to maintain the recovery plan:

		Recovery period end date	
		Maintained	**Reduced**
Annual deficit contributions	**Maintained**	SPPS MANESPS	NGUKPS NGESPS UKPNESPS ENWESPS
	Reduced	SGNPS NPESPS[5]	CGPS WPDESPS CNESPS

Other approaches adopted include:

- WWUPS increased deficit contributions and kept the period unchanged; they resisted a shorter recovery period proposed by the Trustees.

- SEESPS has reduced contributions up to the end of 2022/23, and increased contributions from 2023/24 to 2026/27, while reducing their recovery plan end date by one year. The company states this has not increased the cost to the consumer

[5] This includes additional contributions to manage the impact of the COVID-19 pandemic

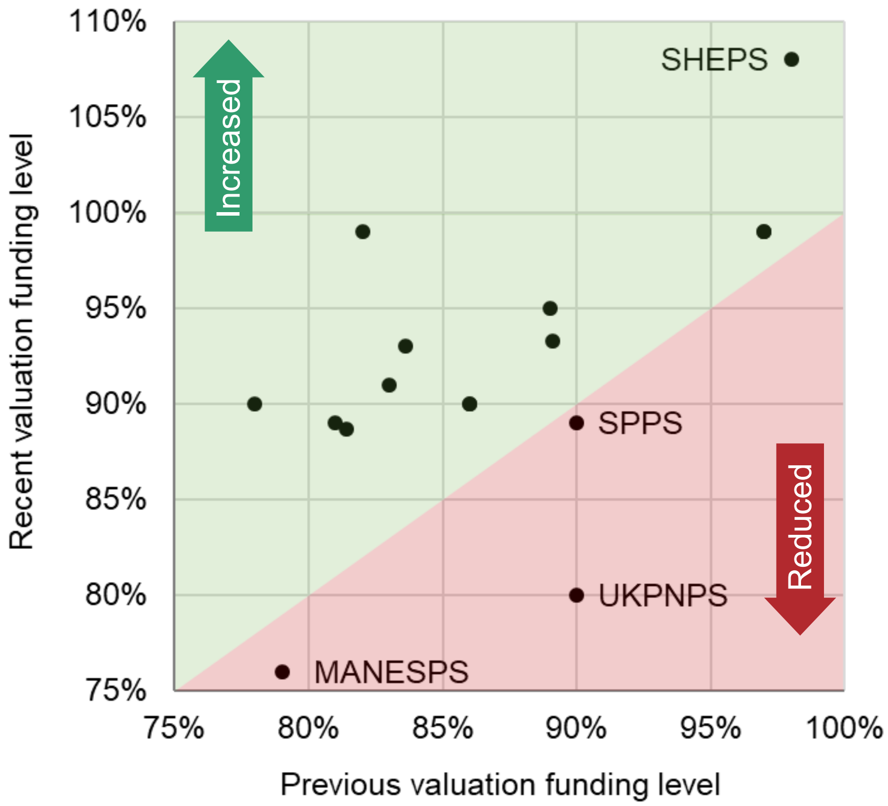
- NGNPS has an asset backed contribution structure to repair the deficit and has four years following its long-term self-sufficiency target date to repair any deficit, should one exist at this point.
- SHEPS currently has a funding surplus, and so is not making any deficit recovery contributions.
- UKPNPS extended the period over which they would pay contributions towards eliminating a deficit

Appendix B summarises the changes in recovery plans.

NWOs' adopting different recovery periods will result in costs filtering through to consumers at different rates. Costs for current customers will increase as recovery periods reduce and payments increase (assuming a fixed deficit), and this has implications for intergenerational fairness between different cohorts of consumers. This is discussed in more in Section 4. I am aware that in 2017 Ofgem published their policy on deficits[6].

Funding position and employer cost of future accrual

The funding levels for most schemes have increased from the previous valuations, with only 3 schemes seeing a reduction in funding level. The majority have funding levels between 90% and 100%, although five schemes have a lower funding level of between 75% and 90%, and SHEPS is now in surplus. This is shown in Graph 2 below.



Graph 2: Funding level as at previous and most recent valuations for all schemes

[6] https://www.ofgem.gov.uk/system/files/docs/2017/04/decision_on_policy_for_funding_pseds.pdf

Broadly this change in funding level at the last valuation has been a result of strong investment performance and deficit recovery contributions paid, offset or partially offset by a deterioration in market conditions (with regard to how the discount rates to assess the liabilities are set).

For most schemes, contribution rates payable by employers with respect to future accrual have increased. This is predominantly due to the deterioration in market conditions resulting in lower discount rates (and consequently a higher assessment of the value benefits accruing). This is consistent with trends witnessed in UK private defined benefit pension schemes whose discount rates are typically set with reference to the yield available on UK government bonds. The yield available on UK government bonds have fallen to record lows in recent years.

In particular the WWUPS and NGNPS have seen an increase in the employer contribution required since the 2017 Actuarial Valuation of 22% and 20% respectively such that the required contribution rates are 78% and 69% of pensionable salary – this would be considered to be very high relative to many other defined benefit schemes. This increase is in line with the decrease in gilt yields of around 1% seen between 31 March 2016 and 31 March 2019.

NGESPS has seen an increase in employer contributions of more than 10%. WPDESPS expect an increase of more than 10% from 1 April 2023.

Ofgem may wish to discuss the level of future service benefits with NWOs to seek a more cost-effective outcome for consumers. However, there may be restrictions on the changes that could be made to future benefits, **for example due to protected persons legislation.**

Some schemes have agreed to contribute at a modified contribution rate that is lower than the calculated cost of accrual on the technical provisions basis. This could lead to a deficit emerging over time, unless factors such as investment outperformance or changes in valuation assumptions counteract the underpayment at the next valuation. In particular, SGNPS and SEESPS have seen no increase in employer contributions, despite an increase in the cost of future service accrual. SHEPS has a contribution holiday while it is in surplus on a gilts basis.

COVID-19

The latest valuations for all of the schemes had an effective date before the start of the COVID-19 pandemic and thus the latest valuations were unaffected by the impact of the pandemic on the market.

It is not yet clear what the long-term impact of the COVID-19 pandemic will be, either on the investments or the liabilities of the pension schemes. It would be reasonable to expect a long-term view with regard to the impact of COVID-19 to be adopted, which recognised the volatility in the investment market. Where the funding level has deteriorated, it may be premature to increase deficit contributions at this time. However, if funding level triggers exist, changes in deficit contributions may arise.

Some schemes have commented on the latest funding position after considering the impact of COVID-19 on their investments. While some schemes have reported that their funding position has remained relatively stable since the latest valuation despite negative market movements due to the pandemic, other schemes have noted that their funding position has deteriorated.

For NPESPS, in finalising its 2019 valuation in September 2020, , we note that additional deficit contributions were required to address some of the deficit resulting from the impact on the markets from the COVID-19 pandemic. The scheme has funding level triggers in place to reduce these additional deficit contributions in the future. We understand that the company agreed a contribution mechanism with the trustees to support management of a stranded surplus before the start of the COVID-19 pandemic.

Comments on Cadent transfer

The Cadent Gas Pension Scheme (CGPS) was set up in January 2020 and intends to take transfer of Section C of the NGUKPS in 2020. The NGUKPS was sectionalised on 31 December 2016, and the first actuarial valuation for the sections occurred as at 31 March 2017.

The Lead Section Employer sponsoring Section C was Cadent Gas Limited, who have proposed a bulk transfer of the existing assets and liabilities of Section C to the CGPS, also sponsored by Cadent Gas Limited, with a target date of 30 September 2020.

The results of the valuation of Section C of the NGUKPS as at 31 March 2019 have been agreed, and my review considers the ongoing costs agreed as a part of the 2019 actuarial valuation. I have considered whether the sectionalisation that occurred at 31 December 2016 was appropriate through assessing:

- That the movement in Section C's invested assets is broadly in line with what might be considered reasonable as compared to the investment performance of Section B; and

- That the movement in Section C's funding level is broadly in line with the movement seen in the funding levels of Section B.

On this basis, I conclude that there is no indication from this high-level review that the sectionalisation was not a fair partitioning of the scheme's assets or liabilities. However, a firm conclusion cannot be drawn without a more detailed review.

4 Consumer interests

All companies have been able to describe some examples of actions which they consider to be evidence of them acting in the consumer interest, including:

- Commissioning analysis which considered consumer interests
- Negotiating with Trustees on valuation concessions
- Engaging with Trustees on investment strategy

We note that some companies have cited more examples than others, although it is recognised that scheme circumstances vary and views on how the consumer is best served can also differ.

Given the scope of this review and the information provided, it is not possible to draw any firm conclusions. It is possible that additional actions could have been explored further by some companies since the last reasonableness review. However, given the scope of this review and the information provided, we are not in a position to identify any actions (or lack thereof) which could indicate that companies have not fully acted in consumers' best interests. Viable ways to represent the consumer interest will depend on individual scheme circumstances and will vary between schemes.

An overview of the actions taken is given in this section, with a more detailed description of the actions cited by each NWO given in Appendix C. The actions of each NWO are summarised in the table in Appendix D.

Approach

We have considered the main comments provided in NWOs' questionnaire responses, which describe how the NWOs believe they have interpreted the interest of consumers when engaging with the governance of its pension scheme (including setting investment and risk strategies). In this context, examples of actions that may demonstrate that the NWO has actively considered and represented consumer interests may relate to the following (note that this is not an exhaustive list):

- *Governance* – we would expect NWOs to be keen to ensure that their pension schemes have robust governance processes in place and that their running expenses represent good value for money. Ofgem indicated that schemes could explain to Trustees the risks of stranded surpluses and need to consider consumer interests.

- *Long-term objective* – we would expect NWOs to represent consumer interests when discussing the long-term funding objective with Trustees.

- *Investment strategy* – we expect that NWOs would be keen to ensure that the investment strategy reflects an appropriate balance between risk and reward, having considered the risk appetite of its consumers.

- *Valuation outcomes* – evidence that the NWO has represented consumer interests during discussions with the Trustees on triennial valuation outcomes (e.g. relating to assumptions, deficit recovery plans).

- *Managing liabilities* – we would expect NWOs to be managing benefits as efficiently as possible and ensuring that consumers do not meet the cost of any unnecessary benefit provisions (e.g. enhanced early retirement or redundancy terms) and that any potential benefit cost savings are passed on to the consumer. We have summarised the actions companies have stated are in consumer interests but have not considered the legal risk or impact on members. The ability to amend future benefits may be restricted by protected persons legislation.

- *Consideration of stranded surplus* - this is where a scheme is overfunded, but the surplus cannot be used to the benefit of the company (and ultimately consumers). As schemes approach full funding this will become more of a consideration when setting investment and funding strategies. After the previous review, we would expect schemes to be considering ways to manage this risk. We suggest Ofgem consider policy in this area and understand if the possibility of a stranded surplus is a problem for any the schemes.

- *Consumer research* – by conducting consumer research schemes will be able to better understand consumers' interests, such as risk appetite, and reflect those interests in their decision making and negotiations with schemes.

- *PPF levy* – the Pensions Protection Fund is central discontinuance fund for UK defined benefit pension schemes, funded through charging a levy on pension schemes each year similar to an insurance premium. The levy comprises two calculations – the scheme-based levy, based on the size of the scheme, and the risk-based levy, which considers the employer's insolvency risk, the scheme's underfunding risk and the scheme's investment risk. It would be expected that schemes endeavour to take steps to mitigate the size of the risk-based levy through actuarial certification where it is cost effective to do so. The PPF are due to consult on changes to the calculation method of the risk-based levy for 2021/22, and schemes should be aware of any changes to the calculation methodology as a part of their monitoring.

We recognise that there may be different views on what outcome would best represent consumers in some areas (e.g. the level of risk in the investment strategy), however we understand that Ofgem are particularly interested in understanding the process followed by NWOs in considering the consumer interest.

Findings

All companies have been able to describe some examples of actions which they consider to be evidence of them acting in the consumer interest.

We note that some companies have cited more examples than others. It is possible that additional actions could have been explored further by some companies since the last reasonableness review, however given the scope of this review and the information provided, we are not in a position to identify any actions (or lack thereof) which could indicate that companies have not fully acted in consumers' best interests. Viable ways to represent the consumer interest will depend on individual scheme circumstances and will vary between schemes.

Please note we have summarised the evidence provided by the companies. We have not independently verified the accuracy or completeness of the information provided.

Governance

All NWOs state that they have good governance arrangements including that they work collaboratively with Trustees and have actively represented consumers in discussions with Trustees.

Some NWOS have given further examples, such as:

- providing training to Trustees on consumer interests or stranded surplus
- requesting that their advisors carry out analysis on, or explicitly consider, consumer interests.

Long-term objective

All NWOs provided some information of Trustee's long-term objectives, which are summarised in the table in Appendix C. An overview of long-term objectives is provided in Section 3.

Investment strategy

Several NWOs state that they have worked with Trustees to develop an investment strategy that considers consumer interests. These include:

- increasing hedging to reduce unrewarded risk
- reducing volatility and/or de-risking as funding levels improve
- maintaining returns in the medium term, balanced against additional risks
- creating subfunds, in some cases notionally, to allow for different risk strategies – e.g. relating to:
  - established/ incremental deficit – with less risk in the assets underlying the established deficit
  - pensioner/ non-pensioner/ future service liabilities – with less risk in the assets underlying the pensioner liabilities
- increased diversification
- reducing costs

Pensioner Buy ins and longevity hedges

Several schemes have considered or implemented a pensioner buy-in or longevity hedge to reduce risk. The efficiency of this approach will depend on the cost agreed. We have not commented on the appropriateness of any buy-ins or longevity hedges.

Valuation outcomes

All NWOs gave examples of negotiating with Trustees on valuation outcomes in the consumer interest, such as reducing prudence in the valuation assumptions (to reduce the size of the deficit) and negotiating on the recovery plan.

Recovery plan outcomes are discussed in Section 3 and are summarised in Appendices B and D. Generally, NWOs aimed to lengthen the recovery period and reduce contributions (compared to Trustee proposals). National Grid (for NGUKPS and NGESPS) considered a shorter recovery plan to be in the consumer interest, as it feels this protects future cohorts of consumers paying for historic deficits.

SGNPS also stated that it resisted Trustee proposals to accelerate de-risking the investment strategy and to improve benefits.

Contingent assets

Some NWOs offer contingent assets, such as security and guarantees or asset-backed contributions. This has strengthened their negotiating position to enable less prudent assumptions or longer recovery plans. NGNPS paid its deficit contributions via the coupons on its asset backed contributions arrangement.

Some companies are considering adopting contingent assets in future: WWUPS is considering asset-backed contributions and UKPNPS, UKPNESPS, and ENWESPS are considering escrow accounts.

Managing liabilities

Most schemes have carried out liability management exercises since the last review. These have included:

- Pension increase exercises
- Transfer options
- Early retirement, flexible retirement and voluntary redundancy

Some of these were existing options that have helped to improve the funding level of the scheme rather than new company-led exercises.

ENWESPS state that it is monitoring cost and options for future accrual. We note that the ability to amend future benefits may be restricted by protected persons legislation.

Stranded surplus

All companies have mentioned how it is in the consumer interest to avoid 'stranded surplus' and have given examples of how this has been managed (except for SEESPS). These include:

- contingent assets
- contribution triggers
- valuation outcomes
- liability management exercises

Examples that are detailed elsewhere in the responses have not been repeated in the table in Appendix C as examples of managing stranded surplus.

SHEPS is in surplus and negotiated a contribution holiday until the scheme reaches 100% funding on a gilts basis. It does not consider the surplus to be stranded.

De-risking

Some companies have cited de-risking as a strategy to avoid a stranded surplus, as it reduces the likelihood of any surplus. This may not always be in the consumer interest as it may not prevent too much money being paid into the scheme and is expected to reduce the investment income earned from the schemes’ assets, potentially increasing cost to consumers.

Consumer research

Most companies carried out some form of consumer research, such as surveys, focus groups, workshops or consumer feedback. Some schemes considered other scheme’s analysis. However, care is needed with this approach to ensure that any differences between schemes are taken into account.

NGUKPS and NGESPS reported that attempts to achieve a consensus view of how to manage consumer interest with other members of the Energy Networks Association were unsuccessful and concluded that investment strategies are best tailored to scheme characteristics.

PPF levy

Several of the schemes report having no risk-based levy, with the majority of the remaining schemes noting that they monitor the levy. WWUPS states that it reduced the levy by obtaining public credit rating and making accelerated deficit payments and SHEPS and SEESPS state that they reduced the levy due to certifications and parent company support.

These actions are summarised in the table in Appendix D only.

5 Limitations and compliance

The purpose of this report is to assist Ofgem in its consideration of price control allowances. This report does not represent advice on the appropriate funding of NWOs', or other, pension schemes.

For this review we have assumed Ofgem were content with the approach adopted by the NWOs' defined benefit pension schemes at the latest valuations and have therefore only considered how the relevant methods and assumptions have changed since the last valuation. The main methods and assumptions have been benchmarked for NGUKPS (Section B) and CGPS/NGUKPS (Section C), since the previous GAD review dated 10 November 2017 considered the main methods and assumptions of the NGUKPS before sectionalisation.

The consumer interests summary table is based on our interpretation of the statements provided. Other interpretations may be viable. A blank entry does not necessarily indicate the action has not been undertaken or that it would have been appropriate to do so.

We have not reviewed any annual funding updates or Pension Deficit Allocation Methodology (PDAM) reports.

Information used

In preparing this report, GAD has relied on the data and other information provided by Ofgem. In particular, GAD has relied on the general completeness and accuracy of the information supplied without independent verification. In limited instances we have adjusted the data provided in the questionnaires to more accurately reflect the information provided in valuation reports. Where there was an inconsistency in figures that wasn't resolved, figures provided in the questionnaire were adopted.

Distribution and publication of this report

This report has been prepared for the use of Ofgem. I am aware that Ofgem may publish this report in full alongside their final decision of the 2020 reasonableness review.

Advice provided by GAD to Ofgem is intended solely for the use of Ofgem. GAD does not accept any responsibility to any third party who may read this report, or extracts from it, for any action taken or for any failure to act, either in whole or in part, on the basis of this report.

Compliance

This work has been carried out in accordance with the applicable Technical Actuarial Standard: TAS 100 issued by the Financial Reporting Council (FRC). The FRC sets technical standards for actuarial work in the UK.

Appendix A: Pension schemes and abbreviations

	Defined benefit pension scheme	Most recent formal valuation	Abbreviation used
Gas	Northern Gas Networks Pension Scheme	March 2019	NGNPS
	Scotia Gas Networks Pension Scheme	March 2018	SGNPS
	National Grid UK Pension Scheme – Section B	March 2019	NGUKPS (Section B)
	Cadent Gas Pension Scheme	March 2019	CGPS
	Wales & West Utilities Pension Scheme	March 2019	WWUPS
Electricity	Scottish Hydro-Electric Pension Scheme	March 2018	SHEPS
	ScottishPower Pension Scheme	March 2018	SPPS
	UK Power Networks Pension Scheme	March 2019	UKPNPS
	Northern Powergrid Group of the ESPS	March 2019	NPESPS
	ESPS National Grid Electricity Group	March 2019	NGESPS
	ESPS UK Power Networks Group	March 2019	UKPNESPS
	ESPS Manweb Group	March 2018	MANESPS
	ESPS ENW Group	March 2019	ENWESPS
	ESPS Southern Electric Group	March 2019	SEESPS
	ESPS WPD Group	March 2019	WPDESPS
	ESPS Central Networks Group	March 2019	CNESPS

Appendix B: Summary of results

The following table summarises the main differences between the two most recent formal actuarial valuations.

	Scheme	Change in discount rate (relative to gilts) (pre-/post retirement)[7]		Change in return seeking asset allocation	Change in hedging:[8]		Change in recovery end date (years)	Change in recovery period annual amount	Change in funding level	Change in employer contributions, pa[9]
		Pre	Post		Interest rate	Inflation				
Gas	NGNPS	-0.2%	-0.2%	-3%	31%	31%	See footnotes[10]		17%	+20%
Gas	SGNPS	0.0%	-0.3%	-7%	48%	39%	0	Reduced	4%	0%
Gas	NGUKPS	-0.1% to March 21 -0.1% April 21 to March 30 0% from April 30		-4%	5%	5%	-3	No change	2%	0%
Gas	CGPS	Change in methodology	0.0%*	-4%	9%	7%	-3	Reduced	2%	0%
Gas	WWUPS	Change in methodology*		-19%	35%	35%	0	Increased	8%	+22%
Electricity	SHEPS	+1.0%	-0.3%	-8%	57%†	42%†	N/A	N/A	10%	Contribution holiday
Electricity	SPPS	0.0%*	-0.1%*	14%	30%	10%	0	No change	-1%	+3%
Electricity	UKPNPS	Change in methodology		-1%	38%	40%	+3	No change	-10%	+11% from 01/01/21
Electricity	NPESPS	0.0%	-0.1%	15%	15%	15%	0	Reduced	4%	+6%
Electricity	NGESPS	-0.3%	0.0%	-15%	15%	15%	-3	No change	9%	+10%
Electricity	UKPNESPS	0.0%*	0.0%*	4%	27%	27%	-2	No change	4%	+9% from 01/01/21
Electricity	MANESPS	0.0%*	-0.1%*	5%	36%	20%	0	No change	-3%	+3%
Electricity	ENWESPS	Change in methodology		-10%	44%	12%	-1	No change	6%	+3%
Electricity	SEESPS	0.0%	-0.2%	6%	18%†	27%†	-1	No change?	7%	0%

[7] Those marked with a * are relative to LT funding objective date rather than retirement
[8] Those marked with a † are relative to 2013
[9] Not all employers are paying for the full cost of accrual
[10] Recovery period increased to 4 years after reaching LT target funding date; coupons from asset-backed contributions security met

Scheme	Change in discount rate (relative to gilts) (pre-/post retirement)[7]		Change in return seeking asset allocation	Change in hedging:[8]		Change in recovery end date (years)	Change in recovery period annual amount	Change in funding level	Change in employer contributions, pa[9]
	Pre	Post		Interest rate	Inflation				
WPDESPS	-0.1% LT	-0.1%	0%	33%	28%	-1	Reduced	12%	-1% to 31/03/20, +11% from 01/04/23
CNESPS	-0.1% LT	-0.1%	0%	22%	11%	-2	Reduced	8%	-0.5% to 31/03/20, +9% from 01/04/23

Appendix C: Representation of consumer interests

	Acting in the consumer interest – examples presented by companies as evidence
NGNPS	**Governance:** The company report collaboration with the scheme through a joint working group and meetings between seniors. It believes this relationship allows them to manage key risks and effectively represent consumer interests in its discussions. As an example, it cites being consulted on actuarial factors. It also works to improve Trustee understanding of the regulatory framework and its impact on consumers. Its advisors consider consumer interests, and in particular it has commissioned advice and analysis to confirm that its actions have been in the interests of consumers. **Long-term objective:** To be self-sufficient by 2028 on a discount rate of gilts +0.2% by 2032. **Investment strategy:** The company report that it has worked with the trustees to develop an investment strategy which takes account of consumer interests by aiming to minimise the volatility of pension contributions by gradually de-risking as the funding level improves, whilst avoiding the risk of over funding and the surplus becoming stranded. This has led to increased hedging of inflation and interest rates, while reducing growth assets. **Valuation outcomes:** The company requires evidence from Trustees to justify updates to assumptions, which is reviewed by the company's advisors. It also utilised asset backed contributions to increase the recovery period and so reduce costs for consumers (the coupons covered the required deficit contributions at the latest valuation and the security enabled an extended recovery plan to 2032 – i.e. 4 years from the target date for full funding). **Managing liabilities:** The company have reduced the risk profile of the scheme liabilities via a pension increase exchange option exercise and continuing its shareholder-funded early retirement programme. The company is also considering an insurance buy-in of pensioner liabilities, which in its view would stabilise costs for consumers and reduce the risk of a stranded surplus. The company claims to monitor opportunities to gain further efficiencies. **Actions taken to prevent stranded surplus:** The company report using asset backed contributions and the resulting longer payment period to reduce the risk of a stranded surplus. **Consumer research:** The company state it has considered consumer feedback and other schemes' research. The company believe a lower risk strategy is in consumer interests to avoid volatility and risk of stranded surplus.
SGNPS	**Governance**: The company report collaboration with the scheme through a joint working group and meetings between seniors. It describes the relationship as professional, objective and collaborative. Trustees also attend company board sub-committee meetings as required. The company reports working together with trustees to develop and review an overall pension scheme strategy (including the management of risks). Both the trustees and company monitor the situation jointly and separately with jointly agreed interventions. The company has independent advisors. **Long-term objective:** Consulting with consumers on a revised long-term objective. Previous objective was to be invested in a low-risk portfolio (e.g. gilts) by 2029. **Investment strategy:** Since 2016 the company has moved 15% of its assets from growth/income to protection type. The company state that its investment strategy has resulted in a reduction in pension costs for consumers. The company are currently consulting on a new strategy which would create two sub-funds, each with their own investment strategy, as proxies for the liabilities in the Established Deficit (sub-fund 1) and the

	Incremental Deficit (sub-fund 2). The company states that this approach enables the trustees to take a more efficient approach to de-risking the assets in sub-fund 1 and to run an investment strategy with a greater weighting towards growth assets in sub-fund 2. The company states that modelling of this approach indicated that this would result in a lower overall cost for consumers. **Valuation outcome**s: The company report resisting or not agreeing actions which would increase costs for consumers, including accelerated asset de-risking, benefit improvements (e.g. commutation factors), and excessive margins for prudence in valuation assumptions. Negotiations have also led to reductions in deficit contributions and maintaining the employer contribution rate, reducing costs for consumers. **Managing liabilities:** Flexible retirement options have reduced the number of active members. The company is monitoring demand for further exercises in future. **Actions taken to prevent stranded surplus:** The company reports considering a Reservoir Trust, but it concluded that the sub-funds strategy was more appropriate to manage stranded surplus risk. It also reports reducing deficit contributions to reduce stranded surplus risk. **Consumer research:** The company have an ongoing consumer consultation on the revised long-term objective for its pensions strategy.
NGUKPS (Section B)	**Governance:** The company state that it has a strong collaborative working relationship with the trustees. The company regularly attends Trustee meetings and Funding & Investment Committee meetings to input on the consumer perspective in all investment and de-risking decisions. It also provides training to Trustees to help them consider consumer impacts. The Trustees monitor risks and update the Funding and Investment Committee (which includes a company representative) at least quarterly. The company states that the impacts of investment decisions and valuation outcomes are continually analysed for their effect on consumers. The company uses alternative valuation methods to evaluate trustee investment and valuation proposals and to monitor consumer risk exposures. This allows them to strongly represent stakeholder and consumer interest to the Trustees. **Long-term objective:** To get to a position of self-sufficiency in the medium term, with a targeted date 2030. **Investment strategy:** The risk in the investment strategy has been reduced as the funding level has increased, locking in previous positive investment performance for consumers. Additional de-risking triggers are in place that provide further protection to consumers. Since the 2016 valuation there has been an increase in hedging of interest and inflation risk, a pensioner buy-in and a reduction in equity and hedge fund exposure. **Valuation outcomes:** The company has provided additional security and guarantees to minimise prudence in the technical provisions. This, combined with analysis of consumer impacts , has enabled the company to successfully negotiate a recovery plan which ends 3 years earlier, which it feels protects future cohorts of consumers paying for historic deficits, ongoing contributions maintained at the current level, and scheme funding for administration costs and the PPF levy from 2026. **Managing liabilities:** The company report it has carried out a pensioner buy-in which removed mortality risk without any increase to scheme technical provisions deficit at the time, it introduced a member transfer tool in 2019 and gained Trustee agreement to consider future option exercises to reduce risk. **Consumer research:** The company report that it unsuccessfully worked with other members of the Energy Networks Association to achieve a consensus view of how to manage consumer interest, but concluded that investment strategies best tailored to scheme characteristics. It also considered other schemes' research and agreed with NPg's research that its consumers prefer certainty and are risk averse.
CGPS	**Governance:** Established January 2020 with a proposed bulk transfer of existing assets and liabilities of Section C of NGUKPS. The company states that it works with the NGUKPS Trustees to maintain a strong relationship, to represent customer interests and highlight the need to avoid a stranded surplus. It regularly attends Trustee meetings and sub-committee meetings and engage with the Trustee Executive team. The

	company reports actively engaging with the Trustee to manage risks in the interests of both scheme members and consumers. **Long-term objective:** The Trustees' long-term target is lower than the long-term discount rate agreed for the 2019 valuation of gilts +0.4% from 2030, but the company has not recognised this lower rate as part of the valuation negotiations, which it believes is in consumers' interests. **Investment strategy:** The strategy was set at sectionalisation. Since then, the level of interest rate and inflation hedging has increased and de-risking triggers in 2018 have resulted in a slight reduction in the scheme's target investment return. At 2019 valuation, the company agreed to a reduced exposure to more volatile investments to give more certainty of cost to consumers, and to reduce the risk of worsening the funding level. The company reduced equity holdings and terminated a Liquid Alternatives mandate, which it believes increased efficiency by reducing investment monitoring. The current strategy review has been deferred due to proposed transfer to CGPS. During 2019, the company and its advisers have considered views and it believes that customers' interests would be best served by a move to a low-cost cashflow driven investment strategy which seeks to match payments as they become due, which it state could be implemented at low cost to consumers. It has begun discussions with both Trustee boards which it expects to continue with CGPS Trustee board once the proposed bulk transfer is completed. **Valuation outcomes:** The company reports it negotiated valuation assumptions, including higher discount rate than Trustees long-term target, which reduced the deficit and deficit contributions. It also agreed ongoing security arrangements to support lower deficit amount, The company discussed a longer recovery period with Trustees and considered an asset backed mechanism, but these were not considered appropriate given the low deficit. **Managing liabilities:** The company reports that scheme rules prevent changes to benefits, however a cap on pensionable pay is already in place. Transfers out and a voluntary redundancy programme have reduced liabilities, and it has also introduced a transfer tool and an IFA for members. **Actions taken to prevent stranded surplus**: The company state that the valuation outcomes achieved were facilitated by its security arrangements, and that this has minimised the risk of a stranded surplus. **Consumer research:** The company reports that it carried out workshops and focus groups with consumers and identified a consumer preference for a stable bill with costs known upfront with financial information published for review.
WWUPS	**Governance:** The company cites a strong relationship with the Trustees and takes the view that the interests of consumers are best served by a positive constructive relationship and continual dialogue. It regularly works with Trustees, attending Trustee meetings and exchanging formal correspondence. It negotiates to balance the needs of consumers with those of other stakeholders. It also proactively engages with the Trustees in managing risks, taking into account the interests of the customers. For example, it proposed a health study of members to better understand scheme mortality. **Long-term objective:** Around 2031, when the scheme is expected to be fully funded, substantial risk will be taken out of the investment strategy, and this is reflected in the 2019 valuation with a discount rate of gilts +0.3% from 2031. **Investment strategy:** Following the last review, the company has increased interest rate and inflation hedging and moved its growth assets to contractual type assets to reduce the likelihood of impact in detrimental investment conditions and the potential for 'stranded surplus' . However, it remains in line with the company's strategy to maximise returns over the medium period term (so less cost is passed on to customers) before further de-risking once the scheme is fully funded. **Valuation outcomes:** The company negotiated lower life expectancy assumptions and an allowance for member transfers in the valuation, reducing the deficit and hence costs to consumers. It also negotiated to maintain the recovery period, against the Trustee position to reduce recovery plan to 7 years.

	Actions taken to manage liabilities: The company report it has reduced risk and improved the funding position by supporting process for members to opt to transfer out at retirement, including a providing a preferred IFA. It also proposed a pension increase exchange, but this was rejected by trustees. **Actions taken to prevent stranded surplus:** The company reports that it has also obtained preliminary guidance on implementing an asset backed funding arrangement. **Consumer research:** The company state it has conducted a comprehensive customer and stakeholder engagement programme to better understand customers' perceptions and reflect their preferences in the 2019 business plan.
SHEPS and SEESPS	**Governance:** The company describes its engagement with Trustees as pro-active. and states that it attends quarterly Trustee meetings and has appointed individuals with regulatory knowledge to act as Trustees. the company also regularly presents to Trustees on the requirement to consider consumers. **Long-term objective:** To be fully funded on a gilts basis by 2033, including all future service post 2033, for SHEPS and to be fully funded on a gilts basis by 2030 for SEESPS. **Investment strategy:** The strategy aims to reduce volatility and rely on consumers less and has sought to enhance asset performance while introducing de-risking 'trigger points'. Both SHEPS and SEESPS have increased inflation and interest rate hedging, reduced equity and property investments, and moved to income-based strategies. The company state that through active management, the SHEPS strategy has increased returns, and reduced costs for consumers, and that the SEEPS strategy has increased diversification and aims to increase liability benchmark, inflation and interest rate hedging. **Valuation outcomes:** The company secured a contribution holiday for SHEPS given their surplus while the gilts funding level of the scheme remains above 100%. For SEESPS, the company negotiated with the Trustees to reduce the proposed deficit through alternative assumptions. It states that, previously the recovery period was extended but now has reduced by 1 year with no increase in contributions, and is longer than equivalent schemes with a strong covenant. **Managing liabilities:** The company states that it has either implemented or considered: a transfer support process, annual and lifetime allowance support, flexible retirement options, and a sale of business leading to bulk transfer. SHEPS has hedged longevity with a combination of pensioner and dependent longevity swap and buy-ins, which has improved funding. SEESPS has considered a longevity swap but found it did not represent good value at the current funding position and agreed to explore this again better funded. **Actions taken to prevent stranded surplus:** The company state it does not see the surplus in SHEPS as definite (since the scheme has several years before it can be closed) or stranded. It did not explicitly state any actions or considerations to address the risk of stranded surplus for SEESPS **Consumer research:** The company report engagement with stakeholder representatives.
SPPS and MANWEB	**Governance:** The company states that it works with Trustees, attending quarterly Trustee meetings and engaging when material events take place. A company-appointed Director sits on the joint governance sub-committee, which is responsible for managing risks. **Long-term objective:** The company reports a long-term funding objective to reach full funding on a basis of gilts +0.4% by 2028 for both schemes. **Investment strategy:** The company states it negotiated increased diversification in the investment portfolio and agreed a liability driven investment framework which partially hedges the inflation and interest rate, intending to reduce volatility, which is an important factor for consumers. There is also a de-risking framework in place to reduce growth assets exposure only when it is deemed affordable to do so. Stochastic modelling

	was used to assess potential investment strategies against consumer interests and other practical considerations. **Valuation outcomes:** The company undertook a detailed review of prudence in the proposed 2018 valuation assumptions and successfully negotiated less prudent assumptions for: the discount rate, salary growth, longevity and proportion married. This allowed for deficit contributions and the recovery plan to remain unchanged., which the company note is longer than the UK average It also negotiated for the pension increase exercise to be taken into account to lower costs. **Managing liabilities:** The company proposed a pension increase exchange exercise which was carried out in 2019 for SPPS and is planned for 2021 for Manweb. Flexible retirement and pension increase exchange options are already available at retirement for active members. **Consumer research:** The company commissioned a consumer survey which it reports showed that the key areas of importance from a consumer perspective were the pension cost element of future bills and the year-on-year variability of bills due to pension costs (which is consistent with previous data gathered on Western Power's domestic consumers in 2016).
UKPNPS	**Governance:** The company state that it has open and collaborative working relationship with the Trustees. It reports that it holds at least quarterly pensions committee meetings and attend Trustee meetings and that the Trustee present to company seniors annually. **Long-term objective:** To achieve full-funding on a low-risk basis incorporating a discount rate of gilts +0.5% before a very high degree of maturity is reached. **Investment strategy:** To further minimise risk whilst maintaining a level of return to achieve the Scheme's objectives. The company state that this is in the interest of consumers as a lower risk portfolio reduces the likelihood that a material new deficit emerges in future, while maintaining expected returns is necessary to support the agreed technical provisions discount rates and the current recovery plan. It has also agreed in principle to a secondary funding target framework to reach the LTO, which will aim to affordably de-risk while balancing risk and contribution reductions. The company report a desire to remove unrewarded financial risk, and so has increased interest rate hedging and plans to keep inflation hedging under review in light of RPI reform. **Valuation outcomes:** The company state that it worked to avoid prudence, e.g. in mortality assumptions as well as a change in the discount rate structure. It also agreed a three-year extension to the recovery plan, and RPI linked contributions. The company ensured there is a strong covenant and have provided additional security via a Covenant Support Agreement in 2010. **Actions taken to prevent stranded surplus:** The company states it has already given initial consideration to using an escrow arrangement and have raised this as an option with the Trustee for future formal valuations. **Managing liabilities**: The company considers liability management to be of limited impact, however it is keeping this under review. **Consumer research:** The company stated that there was no need for consumer engagement over the period, as it did not make any strategic decision which would have a material impact on the Scheme's funding or risk position.
NPESPS	**Governance:** The company states that is has a strong and constructive working relationship with the Trustees, which facilitates robust dialogue where required. The company works with the Trustees to ensure the Group's key risks are identified and discussed. It has an in-house pensions team with support by external expert advisers as necessary. There are quarterly pension progress meetings and company attendance of Trustee meetings. The Trustees manage risks and consult with the company on the most significant risks.

	Long-term objective: The company reports pausing a review of the long-term funding objectives due to COVID. However, it states that the post-retirement discount rate adopted at the 2019 valuation (gilts +0.4%) will afford a healthy level of protection against future deficits emerging for consumers. **Investment strategy:** Since 2017 the company has increased inflation and interest rate hedging and reduced growth assets, whilst also moving corporate bonds to absolute return bond funds. This has reduced volatility with a modest increase in returns, which the company says should benefit customers in the long-term. A material allocation in growth assets has been retained as the company believe there is significant value in targeting growth, although it disagrees that consumers might prefer a higher risk and higher return investment strategy given the strength of the sponsor covenant. The company has started further review of the investment strategy; however, discussions of further de-risking have been postponed due to the market volatility created by the COVID pandemic. **Valuation outcomes:** The company reports using customer research to influence Trustee negotiations. The company also encouraged experienced-based assumptions, e.g. new assumptions negotiated for transfer values. and negotiated with Trustees to maintain rather than reduce the recovery period, with reduced deficit contributions, and agreed to a lower discount rate which will reduce risk, while achieving these outcomes. **Managing liabilities:** The company investigated the potential of a pension increase exchange exercise. However, the company concluded this was not justifiable given the significant experience of transfers out of the scheme. **Actions taken to prevent stranded surplus:** The company states it has introduced contribution triggers whereby deficit contributions can be reduced or ceased between valuations. The company consider this a material factor as the scheme targets full funding in 2025. The company would welcome views from Ofgem on measures to manage risk of stranded surplus as it is concerned that some measures may be costly and inefficient. **Consumer research:** The company states that 2017 consumer research indicated that consumers are risk averse and prefer certainty. Its stakeholder engagement group reaffirmed this in 2019, but with a view that consumers may have become more risk averse. The company are keen for collaborative research with other distribution network operators.
NGESPS[11]	**Governance:** The company state that it has a strong collaborative working relationship with the trustee board and regularly attends Trustee meetings and Investment Committee meetings to input on the consumer perspective in all investment and de-risking decisions. The company reports that it also gives presentations to Trustees and relevant investment advisors to help them consider consumer interests. The company states that the impacts of investment decisions and valuation outcomes are continually analysed for their effect on consumers. The company state that it uses alternative valuation methods to evaluate trustee investment and valuation proposals and to monitor consumer risk exposures. This allows them to strongly represent stakeholder and consumer interest to the Trustees. The company states that it will look to negotiate payment of future scheme admin and PPF levy costs from any future surpluses that arise in the scheme. The company have also discussed issues of stranded surplus with Trustees, who have demonstrated a willingness to explore options to minimise this risk at the 2022 valuation, when the scheme is near to full funding. **Long-term objective:** This is being reviewed with a key objective of self-sufficiency in the medium term (previously by the aspirational date of 2027). The company state that it has attempted to balance the risk faced by consumers, such that existing consumers bear the majority relating to past pension liabilities. **Investment strategy**: The scheme has de-risked as its funding position improved, with increased inflation and interest rate hedging while reducing exposure to equity and hedge funds. Additional de-risking triggers are in place. The company states that these investment strategy changes leave consumers with lower costs and lower risks and that, since the scheme is near full funding, it views this is in consumer interests as it

[11] Joint response by National Grid Electricity Transmission licensees (Electricity Transmission Operator and Electricity System Operator), which legally separated on 1 April 2019.

	maximises the use of positive investment returns, not least since consumers will not generally be able to benefit from scheme surpluses. The company's advisors consider the impact on consumers of any strategies considered and have rejected approaches that have no clearly demonstrable consumer benefit. It has also sought to ensure there is no unrewarded risk in the investment strategy. **Valuation outcomes:** The company has provided additional security and guarantees to negotiate less prudent assumptions in the technical provisions. This, combined with analysis of consumer impacts, has enabled the company to successfully negotiate a recovery plan which ends 3 years earlier, which it feels protects future cohorts of consumers paying for historic deficits. **Managing liabilities:** The company have purchased longevity hedges to pass pensioner mortality risk exposure to an insurer. It has also secured Trustee agreement to consider future option exercises. Previous actions include capping pensionable salary (2013) and passing on contracting out cost increases. It has also negotiated to reduce requirement to hold securities in the form of cash, gilts, letters of credit or surety bonds, reducing annual costs. **Consumer research**: The company report that it unsuccessfully worked with other members of the Energy Networks Association to achieve a consensus view of how to manage consumer interest, but concluded that investment strategies were best tailored to scheme characteristics. It also considered other schemes' research and agreed with NPg's research that their consumers prefer certainty and are risk averse.
UKPNESPS	**Governance:** The company state that it has open and collaborative working relationship with the Trustees. It reports that it holds at least quarterly pensions committee meetings and attend Trustee meetings and that the Trustee present to company seniors annually. The company states that its advisors consider consumer interests. **Long-term objective:** Full-funding on a low-risk basis incorporating a discount rate of gilts +0.5% by 2026 before a very high degree of maturity is reached. **Investment strategy:** The company state that it has introduced a secondary funding target framework to reach the LTO, which includes affordable de-risking while balancing risk reduction and contribution reductions, which the company believes to be in the consumers' interests. The company state that the strategy ensures an appropriate balance of risk and return and is underpinned by the belief that the scheme should not take unrewarded financial risk and reduces costs. It outlines changes in investment strategy to increase diversification, reduce costs as well as to increase inflation and interest rate hedging. **Valuation outcomes:** The company stated that it worked to avoid excessive prudence in valuation assumptions, e.g. in salary increase and mortality assumptions as well as a reduction in the discount rate. It negotiated a small increase in recovery period while maintaining deficit contributions – the Trustees resisted a recovery plan with reduced contributions. The company ensure there is a strong covenant and have provided additional security in a Deed of Undertaking in 2010. **Actions taken to prevent stranded surplus:** The company states it will consider all flexibilities available at future valuations and have already given initial consideration to using an escrow arrangement. **Managing liabilities:** The company implemented a pension increase exchange exercise and structured its pay deal to manage pensionable pay. It also piloted an enhanced transfer exercise, but did not roll out further due to lower than expected take-up. It also undertook transfer-in of legacy Protected Persons obligations, as felt it was in consumer interest to also have assets rather than top up PPF pension. And a provision has been made for GMP equalisation. **Consumer research:** The company stated that there was no need for consumer research over the period, as it did not make any strategic decision which would have a material impact on consumers.

ENWESPS	**Governance:** The company state that it has a strong relationship with Trustees. The company has a joint working group with the Trustees, and report collaborative working. The company takes independent advice. **Long-term objective:** To be fully funded on a discount rate of gilts +0.5%. **Investment strategy:** The company reports that since 2016 inflation and interest rate hedging has increased, and there was also a pensioner buy-in exercise which reduced risk for consumers. This was in line with the de-risking strategy. The investment strategy has evolved from a one that notionally split assets into pensioner and non-pensioner liabilities (to recognise the longer period before the liabilities fall due for non-pensioners), to also include a third notional portfolio relating to 3 years of future service contributions. The company states this is to keep future service costs at a manageable level at the same time as providing a reduced-risk approach for the more non-pensioner liabilities. **Valuation outcomes:** The company resisted pressure for increased contributions and a shorter repair period, and instead continued with the 2016 recovery plan. It also argued for an allowance for asset outperformance in the recovery plan, reducing costs for consumers. **Actions taken to prevent stranded surplus**: It has also received advice on establishing an escrow arrangement, which it currently view as financially unviable due to interactions with corporation tax relief. **Managing liabilities:** The company reports it has carried out a pensioner buy-in for the oldest pensioners which advisors stated was in the consumer interest. It states that it is also considering changes to future service benefits or closing to future accrual, and a potential future pension increase exchange. It carried out a bulk transfer exercise with limited take up, and are monitoring other exercises – e.g. transfer value exercises, bridging pensions and trivial commutation exercises The company also reports no increases to current commutation factors following a Company review which included consideration of customer interests. **Consumer research:** The company reports having carried out focus groups and surveys. Its advisors analysed the results and stated that customers prefer low risk and support the pensioner buy-in.
WPDESPS and CSNESPS	**Governance**: The company regularly engages with the Trustees, and describe the relationship as professional, cordial and based on mutual trust. The company takes independent advice. **Investment strategy:** The company implemented its consumer-driven pension strategy at the 2016 valuation, and this was acknowledged by Ofgem. The strategy remains fundamentally the same, except inflation and interest rate hedging has increased, which aims to reduce volatility for consumers while reducing the probability of additional costs arising. The company resisted a long-term funding objective of gilts +0.3% on the grounds that this would place too much of a burden on current consumers. **Valuation outcomes:** The company negotiated with the Trustees to push back on a lower long-term discount rate, and to maintain the future service contribution rate and maximise the length of the recovery plan. It also negotiated an additional asset out-performance allowance in the Recovery Plan, thus reducing the deficit repair amounts payable. **Managing liabilities**: The company state that a previous study identified that negotiating with Trustees could potentially yield the greatest benefit compared to other risk management initiatives and so have not pursued any liability management. **Consumer research**: The company has not carried out any consumer research since its 2016 submission.

Appendix D: Summary of representation of consumer interests

We have provided a simplified summary of the reported recent actions taken by NWOs to reflect consumer interests in the table below. This table is based on information reflected in companies’ consumer interest questionnaire response, as provided by Ofgem.

All companies state that they have actively represented consumers in discussion/committee meetings involving the trustees. This is in part expected due to statutory requirements.

The summary table is based on our interpretation of the statements provided, other interpretations may be viable. A blank entry does not necessarily indicate the action has not been undertaken or that it would have been appropriate to do so, as:

- the relevant information may have been omitted from the statement
- viable ways to represent the consumer interest will depend on individual scheme circumstances and will vary between scheme, so not all the actions may be relevant to all schemes

We note that some companies have cited more examples than others. It is possible that additional actions could have been explored further by some companies since the last reasonableness review, however given the scope of this review and the information provided, we are not in a position to identify any actions (or lack thereof) which could indicate that companies have not fully acted in consumers’ best interests.

	Scheme	Investment strategy reviewed	Additional govern-ance[12]	Valuation concessions	Contingent assets[13]	Liability management exercises[14]	Pensioner buy-in (B) or longevity hedging (L)	Recovery plan[15]	Consumer research	PPF levy
Gas	**NGNPS**	Y	A	*	ABC	PIE; ER	Considering B	*	Feedback; Other schemes	No risk-based levy
Gas	**SGNPS**	Y	A	Y		FRO; Monitoring demand for future exercises		DRC	Consulting on LT funding	Monitoring
Gas	**NGUKPS**	Y	T; A	Y	S/G	Support TO; Considering future exercises	B	M	Consensus sought with ENA; Other schemes	No risk-based levy
Gas	**CGPS**	Deferred		Y	S/G	Support TO; Voluntary redundancy		DRC	Workshops; Focus groups	No risk-based levy
Gas	**WWUPS**	Y	A	Y	Considering ABC	Support TO; Considering PIE			Customer and stakeholder engagement	Monitoring; Accelerated payment; Credit rating
Electricity	**SHEPS**	Y	T	Contribution holiday		Support TO; FRO; Sale of business	B and L (dep)	N/A	Stakeholder engagement	Certifications
Electricity	**SPPS & MANESPS**	Transitioning	A	Y		PIE (MANESPS planned); FRO		M	Survey	Monitoring
Electricity	**UKPNPS**	Y		Y	Considering E	Considered to be of limited impact - monitoring		RP	Not since 2016	No risk-based levy
Electricity	**NPESPS**	Y		Y		Considered PIE		DRC	Stakeholder engagement (reaffirmed 2017)	No risk-based levy

[12] Trustee training (T); advisors consider consumer interests (A)
[13] Asset backed contributions (ABC), escrow arrangement (E); other security or guarantee (S/G)
[14] Pension increase exercise (PIE); early retirement (ER); flexible retirement options (FRO); Protected Persons (PP); transfers out (TO); transfer exercise (TE)
[15] Reduced deficit recovery contributions (DRC); extended recovery plan (RP); maintained contributions while reducing or maintaining recovery period (M)
* The company state that the process for discussing valuation outcomes was limited given ABCs. These enabled longer recovery period, as agreed in 2017.

Scheme	Investment strategy reviewed	Additional govern-ance[12]	Valuation concessions	Contingent assets[13]	Liability management exercises[14]	Pensioner buy-in (B) or longevity hedging (L)	Recovery plan[15]	Consumer research	PPF levy
NGESPS	Ongoing	T; A	Y	S/G	Considering future exercises	L	M	Consensus sought with ENA; Other schemes	No risk-based levy
UKPNESPS	Y	A	Y	S/G; Considering E	PIE; PP transfer-in; Pilot TE		M	Not since 2016	Monitoring
ENWESPS	Y	A	Y	Considering E	Considering PIE; Considering accrual changes; TE and others	B	M	Focus groups; Surveys	No risk-based levy
SEESPS	Y	T	Y		Support TO; FRO; Sale of business	Considered L		Stakeholder engagement	Certifications
WPDESPS & CNESPS	Monitored		Y				DRC	Not since 2016	Monitoring