

Northern Ireland Electricity Pension Scheme (NIEPS)

Effect on the NIEPS's funding position as at 31 March 2011 of certain past factors

Note by GAD for the Utility Regulator – 10 April 2012

1. As part of the process of the RP5 price control review for Northern Ireland Electricity (NIE), the Utility Regulator is investigating the factors that have caused the current funding deficit in the NIEPS (£87.6 million as at 31 March 2011).
2. The Utility Regulator asked the Government Actuary's Department (GAD) to calculate the contributions to the regulated share of NIEPS's funding deficit as at 31 March 2011 of certain factors since March 1997:
 - > The effects of company contributions to the pension scheme differing from past price control allowances. This comprises two elements:
 - (i) Differences between NIE's regular employer contributions to the NIEPS and its past price control allowances; and
 - (ii) The effect of special (additional) contributions to the NIEPS in 2005/06 and 2006/07. (For the avoidance of doubt, these additional contributions are excluded from point (i) above.)
 - > The effects of past benefit improvements; and
 - > Enhanced early retirement costs, where not funded by additional employer contributions at the time of award.
3. The Utility Regulator has asked that:
 - > Effects before March 1997 are excluded;
 - > Only the Defined Benefit (DB) section of the NIEPS (called the "Focus" section) is included, since no material actuarial surplus or deficit would be expected to arise in the Defined Contribution (DC) section (called the "Options" section); and
 - > Only the regulated share of these effects (that relating to NIE T&D) should be included.
4. All amounts and calculations in this note are in cash terms (in other words, they have not been converted into constant prices terms) unless otherwise stated.

Calculations

5. GAD's calculations are shown in the table on the following page. Important comments on the methodology and data used follow in the remainder of this note.

Effect on regulated share of NIEPS's funding position as at 31 March 2011 of certain past factors

Factor	Period	Effective date for investment roll forward	Effect during period ¹ £m	Investment return to March 2011 % pa	Effect rolled forward to March 2011 ² £m in cash terms	Effect rolled forward to March 2011 £m in 2009/10 prices
Actual contributions less price control allowances	RP2 (97/98 – 01/02)	March 2000	– 7.1	2.9%	– 9.7	– 9.0
	RP3 (02/03 – 06/07)	March 2005	14.3	7.7%	22.3	20.7
	RP4 (07/08 – 11/12)	March 2010	17.0	7.7%	18.3	17.0
	Total				30.9	28.7
Special contributions	05/06 – 06/07	March 2006	59.3	5.5%	77.5	72.0
	Total				77.5	72.0
Benefit improvements	97/98 – 99/00	March 2000	– 15.8	2.9%	– 21.6	– 20.1
	00/01 – 02/03	March 2003	– 31.6	9.3%	– 64.4	– 59.8
	Total				– 86.0	– 79.9
Early retirement costs	97/98 – 99/00	March 2000	– 9.9	2.9%	– 13.6	– 12.6
	00/01 – 02/03	March 2003	– 23.7	9.3%	– 48.3	– 44.9
	Total				– 61.9	– 57.5
Overall total	Total				– 39.5	– 36.7

¹ Effect causes a surplus if positive or a deficit if negative.

² Example of calculation: Special contributions effect of £59.3m at effective date of March 2006 rolls forward to £59.3m x 1.055⁵ = £77.5m at March 2011.

6. The table above shows that the deficit is £39.5m larger at 31 March 2011 than it would otherwise have been, due to differences between actual contributions and past price control allowances, and decisions made to augment members' benefits (including on early retirement). This figure depends on the data and methodology described below. In other words, if the company had paid contributions to the scheme equal to past price control allowances and had not granted any benefit improvements or unfunded enhanced benefits on early retirement since March 1997, then the NIE T&D's regulated share of the NIEPS's funding deficit would have been £39.5m smaller at 31 March 2011.
7. I understand that the Utility Regulator presents results in 2009/10 price terms for the purposes of its price control analysis. Using the change in the Retail Prices Index (RPI) between October 2009 and March 2011 for this purpose, the last column in the table above shows the relevant effects in 2009/10 prices. On this basis, the overall effect of negative £39.5m in cash terms at March 2011 equates to negative £36.7m in 2009/10 price terms.

Data

8. GAD's calculations are based on data provided by the Utility Regulator. While GAD has checked the data for reasonableness and consistency with other sources, this does not represent a full independent audit of the data provided.
9. In some cases, full data is not available and so approximations have been made. GAD and the Utility Regulator have agreed that the approximations used are reasonable given the purpose of the calculations and the fact that the Utility Regulator's analysis will be issued for consultation before the price control allowances are finalised. Details of the data and approximations used have been set out and agreed in correspondence between GAD and the Utility Regulator.

Methodology

10. The calculation is attempting to answer a hypothetical question: what would NIE T&D's share of the NIEPS's funding deficit be at March 2011 had certain actions not happened in the past. It assumes that, in such a hypothetical scenario, there would have been no consequential changes to, for example, subsequent investment strategy or funding decisions.
11. The calculation rolls the effects from various past periods forward to March 2011 using the NIEPS's actual investment returns.
12. Where the action has solely affected the scheme's assets (for example, differences between actual and expected contributions), using the scheme's investment returns is clearly appropriate. Where the action initially increased the scheme's liabilities (for example, benefit improvements), the approach adopted is to consider the effect on the NIEPS's funding position of NIE having not paid an additional contribution to the scheme at the time to offset the increase in the liabilities. On this basis, rolling forward such past effects using the scheme's investment returns is also appropriate.

13. A more detailed calculation of the effect on the funding position at March 2011 of past actions which increased the scheme's liabilities could take into account factors including (i) interest on the liabilities from the effective date to the earlier of the relevant benefit payment or March 2011, (ii) where benefit payments have already been made, the reduction in investment returns due to the additional benefit payments, and (iii) any changes in the valuation of the liabilities since the effective date. Given that the results of such an alternative approach might not necessarily be significantly different to the methodology adopted here, and that sufficient data is not available for such a calculation to be carried out, I consider that the methodology adopted in this note is acceptable for this purpose.
14. For the purposes of the price control, the Utility Regulator proposes to apply a regulatory fraction of 79% to the NIEPS's overall funding deficit in order to reflect the share that relates to the regulated business (NIE T&D). The adjustments made to reflect NIE T&D's share of the effects considered in this note use this percentage, where appropriate.
15. The Utility Regulator has requested that only 50% of enhanced early retirement costs are taken into account in order to reflect broadly subsequent efficiency savings which consumers benefitted from due to the redundancy exercises. This is reflected in the amounts shown in the table above.
16. When rolling amounts forward to March 2011, investment returns have been applied from the March following the mid-point of the relevant period for the effects of actual contributions differing to price control allowances, and from the effective dates of the actuarial valuation reports from which the effects of benefit enhancements have been taken.
17. The calculation considers the effects on NIE T&D's share of the NIEPS's funding deficit at March 2011 of certain past actions. It is for the Utility Regulator, not GAD, to decide what, if any, adjustments should be made to the NIEPS's funding deficit, or NIE T&D's expected future pension contributions, for the purposes of the RP5 price control.

Basis of provision of advice

18. This note has been prepared for the use of the Utility Regulator and is covered by the terms of the Service Level Agreement between the Utility Regulator and GAD.
19. GAD is aware that the Utility Regulator may wish to publish this note in full. Other than the Utility Regulator, no person or third party is entitled to place any reliance on the contents of this note. GAD has no liability to any person or third party for any act or omission taken, either in whole or part, on the basis of this note.

Government Actuary's Department
10 April 2012