

Updated Valuation as at 31 December 2012

Central Networks Group

17 May 2013

Prepared for
Central Networks Group Trustees

Prepared by
Chris Vaughan-Williams FIA
Scheme Actuary

Aon Hewitt Limited | Registered in England & Wales No. 4396810
Registered office: 8 Devonshire Square London EC2M 4PL
aonhewitt.co.uk

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Introduction

Purpose

The purpose of this report is to provide an approximate update of the funding position of the Central Networks Group of the Electricity Supply Pension Scheme (the "Group") on a "going concern" basis as at 31 December 2012. Under this approach, the actual assets held are compared against a target amount planned to be sufficient to pay the benefits assuming that the employers will continue to support the Group. The calculations are performed by making a number of assumptions about the future – the assumptions will not be borne out in practice and this report enables the Trustees to assess the impact of experience differing from that assumed.

This report was commissioned by the Trustees who are both the addressee and the user of the information contained in the report. We understand that this report will also be shared with Ofgem in connection with the employer's obligations under RIIO-ED1 and the Pension Deficit Allocation Methodology (PDAM). This report includes information that Ofgem requires in line with the PDAM which is set out in Ofgem's Pension Regulatory Instructions and Guidance dated 12 April 2013. Please also note the "Scope of advice" section in Appendix D.

As well as assisting the employer with its Ofgem information requirements, you may choose to use this report to form an initial assessment of the continued adequacy of the contributions going into the Group given the updated funding position. This report should be read in conjunction with my report dated 27 April 2012 on the latest formal valuation of the Group as at 30 June 2011. If you intend to make any decisions after reviewing this report, please let me know and I will consider what further information I need to supply to help you make those decisions.

A snapshot view

This report concentrates on the Group's funding position at 31 December 2012. As time moves on, the Group's finances will fluctuate. If you are reading this report some time after its effective date, you should bear in mind that the Group's funding position could have changed significantly.

Definitions

Some technical terms in this report are shown in bold type. The terms are defined in the Glossary to my report on the valuation as at 30 June 2011.

Update Method, Data and Assumptions

Method and limitations The figures in this update have been based on the Group's funding position at 30 June 2011 and have been determined using methodology and assumptions that are consistent with those used for the valuation as at that date. This method and these assumptions are set out in the Trustees' **Statement of Funding Principles** ("SFP") dated 27 April 2012 (attached to this report for ease of reference).

The Group's funding position has been rolled forward in an approximate way based around the interaction of the Group's assets and liabilities and, in particular, on the economic and stock market movements which affect these. The roll forward does not take account of factors such as changes in the age/sex composition of the Group's membership, which are picked up at full actuarial valuations.

As the period of the roll forward increases, the accuracy of the projected funding position will decrease. Further details of the approximations made can be found in Appendix A.

You should refer to the valuation report dated 27 April 2012 for further information about the approach to funding, the calculation of the funding measures and the derivation of assumptions.

You should note that since the update is based on the **SFP**, it does not allow for any changes in:

- Investment policy
- Longevity expectations
- Company covenant

that might have occurred since the **SFP** was signed off.

Significant changes The update method used allows for the additional accrual of benefits by active members and the impact of redundancies/augmentations. I am not aware of any other material changes to benefits made by the exercise of discretions or brought about by transfers into or out of the Group since the valuation date. However, please let me know if you are aware of other changes that could have resulted in significant changes to the Group's liabilities.

Assets I have been provided with an unaudited valuation of the Group's assets by Cardano (the Trustees' investment advisers) and details of the net current assets by the Pensions Administration Team. This showed that the Group's assets (excluding AVCs, which are invested separately) had an estimated market value of £2,564.9M as at 31 December 2012, which is consistent with the asset value I have calculated using the roll-forward approach.

The market value of the Group's assets at 30 June 2011 was £2,240.7M. The main reason for the increase in the asset value since 30 June 2011 has been positive investment returns combined with deficit repair and future service contributions paid.

Key financial assumptions

The **SFP** links the key financial assumptions used for assessing the **technical provisions** to market interest rates. These have changed since the formal valuation date. The assumptions used in this funding update, together with the corresponding values used for the latest formal valuation, vary by duration and are set out in Appendix C. Sample spot rates for 20 year durations are as follows:

Assumption	31 December 2012 (% p.a.)	30 June 2011 (% p.a.)
RPI price inflation	3.1%	3.9%
CPI price inflation	2.4%	3.1%
Pension increases (in excess of GMP for final salary members)	3.2%	3.9%
Pay increases	4.6%	5.4%
Pre-retirement discount rate	5.1%	6.6%
Post-retirement discount rate	3.6%	5.1%

Demographic assumptions

The demographic assumptions are unchanged from those adopted for the latest formal valuation of the Group.

Results and Commentary

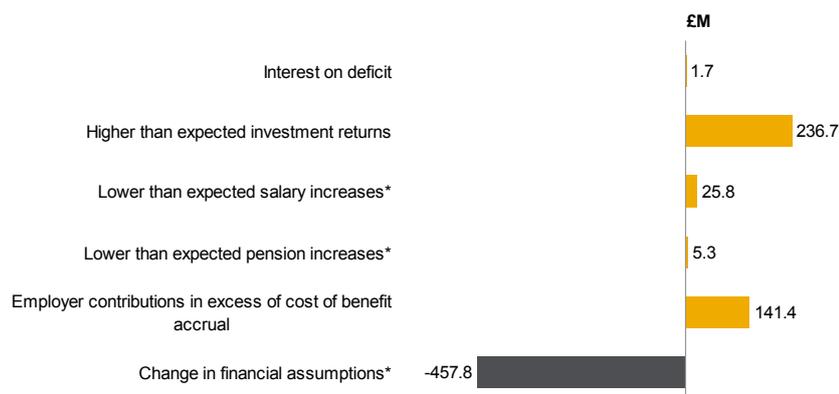
Results

The estimated results as at 31 December 2012 are summarised below where they are compared to the results at 30 June 2011:

	31 December 2012	30 June 2011
Technical provisions (£M)	3,142.3	2,771.2
Market value of assets (unaudited) (£M)	2,564.9	2,240.7
Funding surplus/deficit (£M)	(577.4)	(530.5)
Funding ratio (%)	82%	81%
Employer future service contribution rate (including expenses)		
- final salary members	32.1% of Salaries	28.1% of Salaries
- retirement balance members	13.5% of Salaries	11.5% of Salaries

Commentary

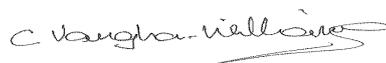
The estimated funding position has worsened by £46.9M since the previous valuation, explained as follows:



The analysis shows that the factor worsening the funding position since the previous valuation is the change in financial assumptions, which reflects the significant fall in index-linked gilt yields. However, this has been largely offset by better than expected investment returns and deficit contributions paid over the period since the last valuation.

Items marked above with * represent the unexpected changes to the Group's **technical provisions** on account of yield changes (financial assumptions) and actual salary and pension increases (compared to expected increases).

Signed



Chris Vaughan-Williams FIA
Scheme Actuary

Appendix A – Approximations

Update method

The **funding ratio** and liability value shown in this report are based on estimates of the developing financial position of the Group since 30 June 2011. These estimates are approximate and intended for illustration to show the broad relative movements in assets and liabilities.

The **technical provisions** are rolled forward on an approximate basis starting with the 30 June 2011 position. The roll forward allows for the impact of changes in gilt yields on the financial assumptions used to calculate the Group's liabilities (the assumptions are determined in a consistent manner to those used for the valuation as at 30 June 2011 but allowing for changes in gilt yields since that date). It also allows for interest accruing on the liabilities, the additional benefits accruing to active members, benefits paid to pensioners and the actual levels of salary and pension increases.

Limitations

The figures in this report are consistent with, and update using approximate methods, the results of the Group's latest actuarial valuation at 30 June 2011. The assumptions used have been modified only insofar as is necessary to maintain consistency with the valuation, reflecting the change in the effective date and in the relevant market conditions, as envisaged in the Trustees' **SFP**.

The technical provisions represent the funding target for a scheme agreed as part of the actuarial valuation. The values placed on the technical provisions are higher than neutral estimates of the liabilities (i.e. those with a 50% chance of overstating or understating the true cost).

The estimates of the liabilities of the Group do not reflect the following changes:

- Membership changes, in relation to the numbers of active members, deferred pensioners and pensioners;
 - Switches in the age, sex or benefit composition of the membership;
 - The impact of the Group's experience (except for redundancies and augmentation costs) in relation to mortality, early retirement, withdrawal from service, and other demographic items being different from that assumed in the valuation.
-

Appendix B – Contributions and benefits payment data

Information about contributions and benefit payments were received from the Group administrators. We received actual contributions paid and benefit payment details for the period 30 June 2011 to 31 December 2012.

Data used for the roll forward calculations

Company future service contributions paid	£30.8M
	<ul style="list-style-type: none"> ▪ Paid monthly between July 2011 and April 2012 ▪ £13.8M in May 2012 as a pre-payment
Company deficit contributions paid	£145M
	<ul style="list-style-type: none"> ▪ £10M in March 2012 ▪ £100M in April 2012 ▪ £35M in May 2012
Company contributions towards administration expenses and PPF levies	£2.5M
	<ul style="list-style-type: none"> ▪ Paid monthly between July 2011 and April 2012 ▪ £1.2M in May 2012 as a pre-payment
Company contributions towards early retirement costs and augmentations	£42.1M
Member contributions paid (including age-related rebates and added years)	£7.7M
Benefits paid or transferred out	£224.5M

Appendix C – Financial assumptions

Financial Assumptions at 30 June 2011

The detailed assumptions as at 30 June 2011 are shown below – these are the annual “forward” rates that apply from time t-1 to time t. The forward gilt yield curve rates shown are also before allowing for expected outperformance of 2.0% p.a. up to retirement and 0.5% p.a. post retirement.

Term	Gilt yield curve	RPI inflation	RPI pension increases	LPI pension increases
1	0.68%	3.58%	3.58%	3.43%
2	1.29%	3.01%	3.01%	2.86%
3	2.22%	2.36%	2.36%	2.34%
4	3.11%	2.63%	2.63%	2.68%
5	3.87%	2.91%	2.92%	2.98%
6	4.50%	3.23%	3.24%	3.31%
7	5.01%	3.53%	3.55%	3.61%
8	5.39%	3.81%	3.82%	3.85%
9	5.64%	4.03%	4.04%	4.04%
10	5.78%	4.19%	4.21%	4.18%
11	5.84%	4.31%	4.33%	4.28%
12	5.83%	4.39%	4.41%	4.35%
13	5.77%	4.44%	4.47%	4.40%
14	5.67%	4.46%	4.49%	4.43%
15	5.56%	4.47%	4.50%	4.44%
16	5.44%	4.46%	4.50%	4.44%
17	5.32%	4.45%	4.49%	4.44%
18	5.20%	4.42%	4.47%	4.42%
19	5.09%	4.39%	4.45%	4.40%
20	4.98%	4.35%	4.41%	4.36%
21	4.88%	4.31%	4.37%	4.33%
22	4.78%	4.25%	4.33%	4.28%
23	4.68%	4.20%	4.28%	4.23%
24	4.59%	4.14%	4.22%	4.17%
25	4.50%	4.07%	4.17%	4.12%
26	3.77%	3.23%	3.42%	3.28%
27	3.77%	3.63%	3.77%	3.69%
28	4.33%	3.83%	3.96%	3.90%
29	4.89%	3.92%	4.04%	4.00%
30	4.24%	4.08%	4.19%	4.17%
31	3.72%	4.08%	4.19%	4.19%
32	3.80%	3.85%	3.99%	3.98%
33	3.87%	3.75%	3.90%	3.89%

34	3.86%	3.74%	3.89%	3.89%
35	3.86%	3.74%	3.90%	3.90%
36	4.08%	3.74%	3.90%	3.92%
37	4.26%	3.87%	4.01%	4.05%
38	4.25%	3.92%	4.06%	4.10%
39	4.06%	3.83%	3.99%	4.02%
40	3.92%	3.66%	3.84%	3.84%
41	3.93%	3.67%	3.85%	3.83%
42	3.92%	3.66%	3.84%	3.81%
43	3.92%	3.66%	3.84%	3.80%
44	3.92%	3.66%	3.84%	3.80%
45	3.93%	3.67%	3.86%	3.81%
46	3.91%	3.66%	3.85%	3.81%
47	3.91%	3.66%	3.85%	3.81%
48	3.91%	3.66%	3.85%	3.81%
49	3.92%	3.67%	3.86%	3.82%
50 & above	3.91%	3.66%	3.85%	3.81%

The above inflation linked curves exclude the adjustment applied to allow for the RPI reference date used for actual pension increases.

Financial Assumptions at 31 December 2012

The detailed assumptions as at 31 December 2012 are shown below – these are the annual “forward” rates that apply from time t-1 to time t. The forward gilt yield curve rates shown are also before allowing for expected outperformance of 2.0% p.a. up to retirement and 0.5% p.a. post retirement.

Term	Gilt yield curve	RPI inflation	RPI pension increases	LPI pension increases
1	0.33%	2.50%	2.50%	2.39%
2	0.29%	2.17%	2.18%	2.20%
3	0.74%	2.17%	2.18%	2.29%
4	1.29%	2.38%	2.40%	2.46%
5	1.80%	2.58%	2.62%	2.60%
6	2.26%	2.74%	2.82%	2.78%
7	2.64%	2.87%	2.97%	2.93%
8	2.97%	2.97%	3.09%	3.04%
9	3.24%	3.05%	3.18%	3.12%
10	3.47%	3.12%	3.23%	3.18%
11	3.66%	3.18%	3.27%	3.24%
12	3.84%	3.26%	3.32%	3.31%
13	3.99%	3.34%	3.38%	3.40%
14	4.13%	3.43%	3.45%	3.51%
15	4.26%	3.52%	3.53%	3.64%
16	4.37%	3.63%	3.62%	3.77%
17	4.47%	3.73%	3.71%	3.90%
18	4.56%	3.83%	3.81%	4.02%
19	4.62%	3.91%	3.89%	4.11%
20	4.66%	3.99%	3.97%	4.16%
21	4.69%	4.05%	4.03%	4.18%
22	4.69%	4.09%	4.08%	4.20%
23	4.68%	4.11%	4.11%	4.23%
24	4.65%	4.12%	4.12%	4.26%
25	4.61%	4.11%	4.11%	4.30%
26	4.86%	4.25%	4.25%	4.51%
27	4.96%	4.25%	4.26%	4.56%
28	4.22%	4.05%	4.06%	4.37%
29	3.96%	3.99%	4.01%	4.30%
30	4.00%	3.83%	3.86%	4.10%
31	4.54%	3.05%	3.11%	3.25%
32	4.03%	3.66%	3.70%	3.82%
33	3.98%	3.78%	3.81%	3.89%
34	3.98%	3.78%	3.82%	3.87%
35	3.89%	3.75%	3.79%	3.84%
36	3.90%	3.61%	3.65%	3.70%

37	3.88%	3.60%	3.65%	3.70%
38	3.76%	3.35%	3.41%	3.46%
39	3.76%	3.29%	3.36%	3.43%
40	3.34%	2.86%	2.95%	3.01%
41	2.79%	2.77%	2.86%	2.92%
42	2.79%	2.77%	2.87%	2.94%
43	2.79%	2.79%	2.89%	2.97%
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50 & above	2.78%	2.89%	3.01%	3.08%

The above inflation linked curves exclude the adjustment applied to allow for the RPI reference date used for actual pension increases.

Appendix D – The small print

Purpose of small print	This appendix sets out some important information about the legal and actuarial framework under which this report is issued.
Scope of advice	<p>This report and any enclosures or attachments are prepared under the terms of the agreement dated 8 April 2011, between Aon Hewitt Limited and the Trustees on the understanding that it is solely for the benefit of the addressees (the Trustees).</p> <p>Unless prior written consent has been given by Aon Hewitt Limited, this report should not be disclosed to or discussed with any third party unless they have a legal right to see it, and in such case, Aon Hewitt Limited should be advised of such disclosure where lawfully permitted.</p> <p>Notwithstanding such consent, neither Aon Hewitt Limited nor I accept or assume any responsibility or liability to anyone other than the addressees of this report.</p>
Professional Guidance requirements	<p>This actuarial report is consistent with and updates the Group's latest formal valuation carried out as at 30 June 2011, the full results of which can be found in the valuation report dated 27 April 2012. The assumptions used have been modified only insofar as is necessary to maintain consistency with the valuation, reflecting the change in the effective date and in the relevant market conditions, as envisaged in the Trustees' Statement of Funding Principles.</p> <p>The Technical Actuarial Standards on Pensions, Reporting Actuarial Information, Data and Modelling apply to this report, and the work relating to it, and have been complied with. This report should be read in conjunction with:</p> <ul style="list-style-type: none">▪ My report dated 27 April 2012 on the latest formal valuation of the Group as at 30 June 2011.▪ The Trustees' SFP dated 27 April 2012.▪ The Schedule of Contributions dated 27 April 2012.