

Chairman's Report September 2007

There are two aspects of the year under report that need comment; the first is the general situation regarding pensions and the second is developments in our own scheme.

The general situation regarding pensions and pensioners remains as fluid as before. We are clearly in an era of institutional instability. The Government has completely lost its way and the opposition parties don't seem to have any clear vision of what is or should be possible.

As I start to write this report we have had a week of helter-skelter rises and falls in the world stock markets. The Jeremiahs have, as always, delighted in telling us how many billions have been wiped off the value of pension funds. This short-term financial commentary is all the more regrettable as investment in pensions and pension fund management is about the long term. Funds are concerned not only with having funds to pay pensions in payment but to meet liabilities that can be fifty years away.

How has the roller coaster affected funds in general? We know from our own funds that three years ago pension funds had major deficits. However the historic long term trend for equity values is that they outpace the general decrease in the value of money, that is they offer good protection against inflation. This is distinct from gilts and bonds which simply protect capital rather than increase its value. Keeping the figures to the 21st century we had a stock market low in early 2003 of just below 3,300 and a recent peak of 6,700. So how significant was the recent drop to around 6,000? (now 6,300), The reality is that the market has improved by some 80 per cent in the last four and half years. This means that funds highly into equities will have done very well or have recovered their losses.

The same period saw bond yields fall as bond prices rose. This of course means that where fund managers and trustees sold out into bonds they may have frozen in losses. The bond yield situation reversed in 2007 and in mid summer yields reached their highest level since 2001. Since then yields have again fallen. This strengthens the point that trustees should always keep a good mix of investments, bearing in mind their duty to protect the long-term nature of the investments they manage on our behalf and, if at all possible, improve the benefits they are able to pay.

One of the more depressing aspects of the financial commentaries I have observed is how commentators keep referring to the market as having improved by 40%. Now I know an improvement of 2,700 points in 6,000 is

40% but really an improvement of 2,700 on 3,300 is 80%. Come on chaps, surely our education system is not that bad at teaching maths to university level. And we rely on these people for professional investment advice!

One other issue which has received some prominence recently following the concerns regarding the US sub prime market is the value of hedge funds. These funds have been widely promoted as a real panacea for the shorter term investments which trustees have to make. Their purpose is to reduce risk by limiting the gains which might be made but also by limiting the effects of a fall in the value of equities. However it is clear that some hedge funds have not performed up to expectation and we must all feel sad that hedge fund promoters are having to sell their ocean going yachts! Let's hope that our trustees have not over committed any of us to some of the less successful hedge funds!

Longevity or expectation of life is an issue which has suddenly emerged as a major issue for all pension funds. In reality it has been there all the time but the actuarial profession has at best been remiss, and some might argue negligent, in not being more alert to increased expectation of life brought about by better living conditions. It is only recently that the Institute of Actuaries and its Scottish counterpart have agreed to take a serious look at the issue and provide more up to date life expectancy tables. In the meantime we are left with somewhat unsatisfactory position that actuaries can give any advice they think appropriate to trustees and would only be negligent if the whole general body of actuaries considered the assumptions which had been made were so far removed from the norm as to be considered unreasonable.

Let me now turn to our own pension scheme. The ESPS has continued to develop organically. It is now seventeen years on from privatisation and we have seen company takeovers, mergers and the whole structure of the industry change out of all recognition from its publicly owned structure. The players in the industry consist of a broad mix from major international energy conglomerates to 'small' single function businesses such as electricity generators.

A key feature of many of these companies is that they are now run, in the main, by business people not electricity people. With respect to pensions this means that the board members are protected by their own carefully crafted pension arrangements and employees now, for the most part, are required to fend for themselves through money purchase arrangements. The days when board members and employees were all in the same pension lifeboat are long past.

All this means that company side trustees have no more than a straightforward commercial interest in the performance of the ESPS Groups. Their main concern, on behalf of the company and its shareholders, will be to reduce pension costs to the company. For this reason our elected trustees must be continually alert to what is being proposed and must not expect the company trustees to be looking solely at the interest of the pension scheme contributors and beneficiaries. Yes I know all trustees are supposed to act in the interest of the pension group but let's be realistic.

It is only very occasionally such as in some recent takeovers where company pensions trustees have taken a very strong line with regard to pension scheme deficits and have had a significant effect on the takeover process.

We have watched developments in the ESPS very carefully and we have a number of concerns. Two of these are manifest in motions to this year's Scheme AGM which will be held on 10 October.

The Scheme at Clause 26, as did the rules of our nationalised industry scheme(s), requires a national annual general meeting (AGM). When it was one scheme this was fine. Questions relating to issues arising in one board area could be answered as the issue affected everyone. With the emergence of groups it immediately became the practice to say that local issues could only be raised at the group annual meeting (GAM) and not at the AGM. However group meetings are a concession by the company and group trustees and not required by Part V of the Scheme. Nowhere in the Scheme does it require a group to hold an annual meeting although there is provision for an extraordinary meeting.

At least one group of trustees has done away with a GAM. This means that its members have nowhere to raise issues except through the tortuous disputes procedure. We think that it should be now become compulsory for each to hold a group annual general meeting (GAGM) where the trustees – half of whom are elected - will be fully accountable to members. Jack Andrews and myself have sponsored a motion to this effect at the Scheme AGM.

During the year our researches, and my thanks to Mike Moriarty for his efforts in this respect, have enabled us to highlight the very wide range of benefits which have developed in the Scheme. Perhaps the most extreme, and one which will concern many of us, is that of the spouses benefit which

now ranges from 50% at worst to 66% at best. I personally feel that this inequality is something the trustees should be aware of and do their best, in conjunction with the appropriate company, to remedy. This issue too is the subject to a motion at the Scheme AGM.

In this context I would ask all members to ensure that they use their right to vote at the Scheme AGM, by proxy if necessary, in favour of our motions. Formal notice of the Scheme AGM will be published shortly by the Scheme and you should receive notification of it from your group administrator. The date for the meeting is Wednesday 10 October.

Given my earlier comment about the role trustees have played in takeovers it was disappointing to see in no mention in the recent takeover of Scottish Power of consultations with MANWEB trustees. The very thick documentation provided certainly referred to consultations with the trade unions and Iberdrola SA made some vague promises that they would protect pensions for two years. We referred to this in our February Newsletter. Perhaps this year's annual report will be more forthcoming?

Another difficult issue that has been concerning us is the way elections for trustees are handled. In one case the trustees saw fit to criticise at length the election address of a candidate. Now I would think it only right and proper that a member standing for election should be able to say he is dissatisfied with the performance of the trustees. This might be tiresome for those in office but it is a democratic right that ought not be infringed. This issue is still dragging through various procedures. Once again we are looking for all election procedures to be transparent and for trustees who might be standing for re-election to declare their interest and not hide behind a general defence statement issued by the whole trustee body.

I am sure that we are going to see further changes in our scheme. One wonders how long the large companies will wish to be tied to a relic of a nationalised industry. In my own group last year the chairman of trustees mentioned that the trustees were talking in a preliminary way about purchasing annuities so that the group could be wound up. At this point in time this would require a change in the Scheme to permit such a buyout. Other groups may be considering similar approach.

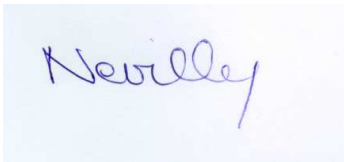
The reason for this consideration is the emergence of new players in the specialist bulk annuity buyout market. Companies such as Paternoster has been publicising in the specialist press their success in taking over a number of relatively small pension funds. Most recently Rank Group has

become the first major public company to put its pensions scheme up for sale. ESPS members will do well to examine any such proposals with extreme caution. An annuity purchase will freeze for all time any prospect of enhanced benefits and will also cause the loss of trustees and any accountability they have to members and beneficiaries. We will all wish to look closely out the safeguards which are built into any such sale, and to the long term liability of the electricity companies should the annuity provider fail.

I dwell on these issues because it is vitally important that none of us take our pension for granted. We must ensure that there are proper accountability processes in place throughout the Scheme. Just think how difficult it might be to requisition an extraordinary meeting. Could you find one hundred contributing members or, in the case of some groups, 10% of the members associated with the group? One of our strengths as AESP is that we do have a database that might be of assistance in getting a start.

AESP is now 10 years old. I have to admit that we remain a small organisation in terms of the total population of ESPS members. We now have good reserves which will allow us to at least support initial action should the need arise. We need more members. Our recent attempts at advertising for members have not been too productive. Please do all you can to promote our organisation. We believe we are an important rung in the ladder needed to ensure that all ESPS members and beneficiaries continue to enjoy the fruits of our investment in our pension, which is after all only deferred salary and not the magnanimous gift of a beneficent company.

Finally I thank all members for their continued support and members of Council for their collective and individual contributions to the detailed work of the Association.



Neville Wrench