REGULATED INDUSTRIES COMMISSION

Treatment of Pension Costs for Regulatory Decision-Making

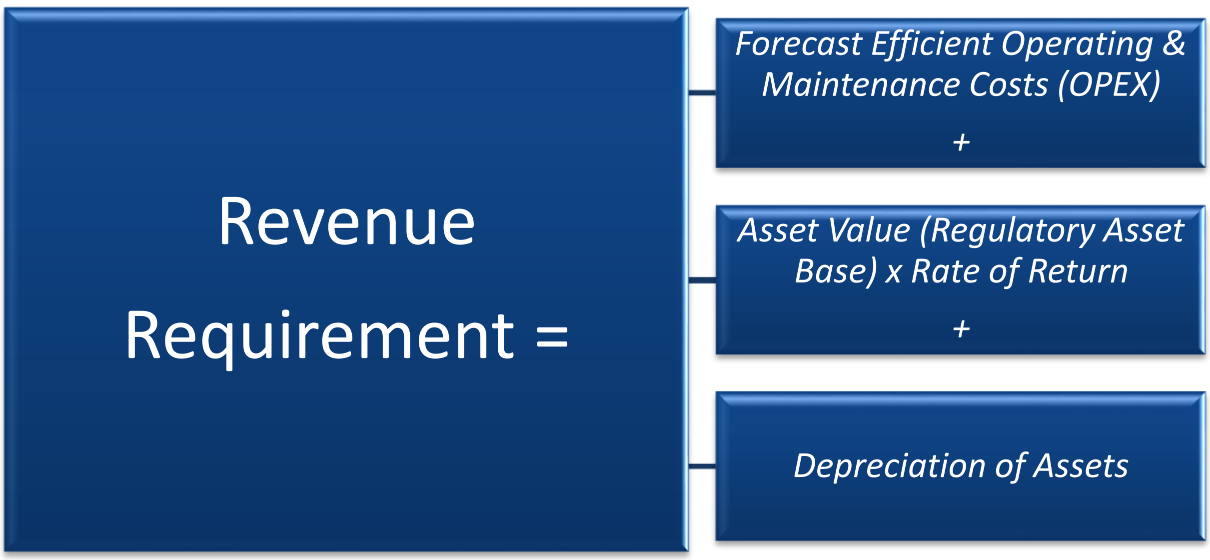
February 2021

This document is a summary of the RIC's consultative paper exploring a specific aspect of the treatment of pension costs for regulatory decision making in the electricity sector.

Summary Document

Why Assess Pension costs for Rate Reviews

The Regulated Industries Commission's (RIC) has a duty to set price limits that allow an efficient utility to properly finance its operations. The RIC utilizes a "building block" methodology to determine the total revenue requirement that the service provider can collect from customers via tariffs. This methodology derives a total revenue requirement from the following cost components:



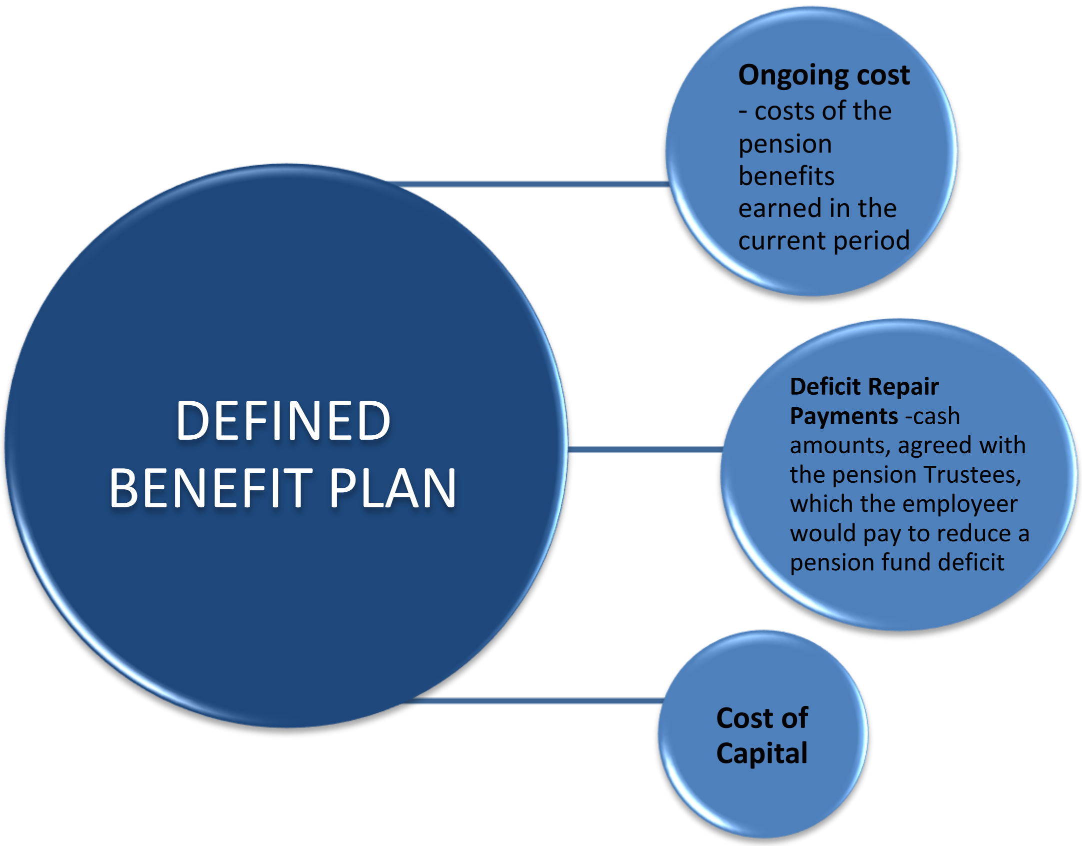
As part of setting the revenue requirement, the treatment of pension costs is one area of importance considered in operating expenditure. The RIC will assess the requested pension costs of the Trinidad and Tobago Electricity Commission (T&TEC) based on its principal duties and functions as set out in the RIC Act which requires it to consider only efficient costs. There are two types of pension plans, which include the Defined Contribution plans[1] and the Defined Benefit plans.[2]

[1] With a defined contribution plan the employer pays fixed contributions into a separate entity (a fund) and has no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service.

[2] With a defined benefit plan, the employer is obligated to pay an employee the agreed pensionable amount regardless of the pension plan's performance.

RIC's Principles for Assessing Pension Cost

T&TEC currently operates a Defined Benefit plan for its permanent employees. There are three issues that arise with respect to a Defined Benefit plan and these are shown in the diagram below.



These issues are important and relevant to regulators for assessing the efficiently incurred costs of providing regulated services and the way these are taken into account in regulatory decisions will impact the final tariffs. Furthermore, in the first rate review for the period 2006 - 2011, only the ongoing pension costs were taken into account for T&TEC. The problem arises when deficit repair payments are to be funded by employers (service providers) to reduce the pension fund deficit through regulated charges. Related to this issue of deficit refund payments is whether the deficit would be funded by a loan taken out by the service provider and thus be included in the cost of capital. The RIC proposals concerning the three issues relating to the defined benefit plan are shown below.

RIC's Proposals for the treatment of Pension Costs and other related issues

Ongoing Pension Costs

- The ongoing pension costs include all employee and employer contributions made to T&TEC's pension plan and are a legitimate expense and the RIC must, therefore, include T&TEC's contribution towards the pension plan in the determination of tariffs.

Deficit Repair Payments

- The RIC proposes that any loss incurred in the pension plan due to high risk investments (pension deficit payments) should not be passed onto customers when setting regulated charges, as this deficit may be as a result of management's poor decision-making in managing its pension plan assets.
- The exclusion of deficit repair payments would be quite consistent with the RIC's duties as set out in the Act, especially with respect to the promotion of economy and efficiency.

Cost Of Capital

- The RIC's proposes not to allow deficit repair payments in price controls, as such, it would be inconsistent to make any adjustment to the cost of capital. The service provider must bear the risks and rewards of the pension scheme.

All persons wishing to comment on the Treatment of Pension Costs for Regulatory Decision-Making are invited to review the main document and submit their comments using any of the options provided.