The Actuarial Profession
making financial sense of the future

Consultation Response

Department of Energy and Climate Change

Consultation on the amendment of the Nuclear Decommissioning and Waste Handling (finance and fees) Regulations 2011

13 June 2012

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

The Actuarial Profession
making financial sense of the future

13 June 2012

Dear Sir,

1. Our references to paragraph numbers are to those contained in the consultation document dated 27 April 2012.

2. We welcome the proposal to separate verification into two reports (paragraph 2.5). This should facilitate the involvement of scientific and engineering experts, on the one hand, and advisers such as ourselves who are expert on long term financing. However, this change requires an effective and open relationship between the verifiers to ensure that the financial verifier has a full understanding of future costs, their incidence and likely variation (including the approach taken to assessing prudence). Such a relationship between verifiers may be facilitated by DECC guidance.

3. As one particular aspect of this relationship, it appears that Designated Technical Matters (DTM) costs are required to be reported in the Funded Decommissioning Programme (FDP) in present money terms but the FDP will explain how those costs will be increased to reflect inflation. Actuaries are accustomed to working with inflation as financial modellers, but are not experts on its impact in the nuclear area. It may be helpful if DECC guidance could possibly comment on what is expected from scientific verifiers in terms of the particular effect of inflation on these nuclear costs, so that actuaries can take this into account in valuing liabilities. We note that the inflation of nuclear costs should not necessarily reflect inflation in the economy as a whole. We appreciate that DTM costs are to be assessed without regard to possible technological developments, so this factor may need to be ignored in considering future inflation.

4. A crucial aspect of the verification process is the approach to prudence, a criterion which we are accustomed to dealing with in our work on the long term stability of various financial institutions. As a general comment, we note that the prudence and resilience of this regime should ultimately be assessed as a whole, in terms of whether it ensures that sufficient monies are properly set aside on a timely basis for these liabilities whilst stations are still operating. In other words, all aspects of the funding regime need to be considered from this standpoint, including, for example, the arrangements for holding and investing funds.

5. We believe that prudence as such is a subjective concept and we do not think that the proposed wording mentioned in paragraph 2.8 obviates the need for a verifier to form a view as to the prudence of the approach taken. It would be helpful if the financial verifier could rely on guidance from DECC, for example in advising that, in the following areas:

(a) a market related approach should be used in assessing the value of future payments by operators;
(b) the assets of the Fund should be valued at market value;
(c) the liabilities should be valued on a “risk free” basis. In other words, the amount required to meet the liabilities would be determined as if the funds were retained in Government stock.

6. The above suggested guidance only briefly indicates an approach and would need careful consideration and drafting. Our professional body has worked with other Government departments and regulators in developing guidance and practice in the application of prudence in insurance and pensions matters. Guidance along these lines could reasonably be described as prudent in our view.

7. We agree that it would be helpful (paragraph 2.11) for a standard verification certificate to be developed but we suggest that different versions might be appropriate as between scientific and financial verification. Standardisation would help to ensure consistency and focus.

8. Turning to modifications, it appears that the 5% threshold is in relation to the total liabilities in present money terms. This means, for example, that a change in say 50 years’ time is given equal weight to a change of the same money value this year, even though the former has much less significance because of the effect of discounting. Perhaps operators could be allowed to use discounted values for testing against the threshold on the basis that they provided evidence of the calculation of such discounted values.

9. In paragraph 3.11, we suggest that the condition mentioned therein should be certified by independent verification rather than by the operator.

10. Members of the Actuarial Profession will be pleased to work with DECC in developing these proposals.

Yours Sincerely

Derek Cribb
Chief Executive