The MFR
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The Origins of Pension Funding

- First plans generally in public sector
  - often unfunded (State promised to pay)

- Large Private Sector
  - funded on the advice of the actuary every 3-5 years

- Usually 1/60 for each year of service
  - (or 1/80 pension plus 3/80 as a lump sum)

- Funding benefited from tax privileges
Funding Not Compulsory

- Pace of funding up to actuary advising company
- Trustees often the same as the employer
- New plans sometimes began with existing liabilities
- Initial funding could include company stock or debt
- Unfunded plans still exist (usually for higher paid executives)
Contracting-Out

“Partial privatisation” of State benefits
- if plans could promise as good a benefit as the new State earnings-related pension

Funding compulsory
- to avoid the State having to pay the benefits if there were inadequate assets

Certification by Actuaries

Still a small part of plan assets
Maxwell!

- Theft of pension plan assets
  - (most plan members received their benefits eventually including some State help)
- Created close interest in pension funding
  - may also have inadvertently put some members off joining
- Conclusion that pensions ought to be funded
- Creation of an MFR - profession made clear this was not a solvency test
Design of the MFR

- Pensions in Payment - Bond Matching
- Pre-retirement - Equity Investment
  - (phased in over 10 years up to retirement)
- Standard Mortality
  - (except for schemes with large pension liability)
- Large Scheme Pensioners valued using equities ("equity easement")
Financial Parameters

- Inflation 4%
- Salary Growth 6%
- Government Bond Return 8%
- Equity Return (pre-ret) 9%
  - (allows for 1% expenses)
- Equity Return (post-ret) 10%
- Dividend yield (gross) 4.25%
What Went Wrong

- New Government removed tax privileges!
- Dividend Yields declined steadily (partly as a result) and proved unstable
- Inflation Fell, making all the parameters anachronistic
- Bonds became accepted as best match for pension liabilities (also for accounting)
Effect of 2000 dividend changes on Equity-based MFR

Jan-00  Apr-00  Jul-00  Oct-00
Other Criticisms

- Asset mix couldn’t actually be matched
- No allowance for overseas investment or property
- Complex scheduling of contributions
- Mortality far too heavy given recent improvements
- 100% MFR didn’t mean benefits could be paid.
The MFR does not deliver protection

- MFR
- Cost of Buying

- Shortfall
- Non-pensioners
- Pensioners
The Profession’s Review of MFR

- Bonds are the only real match
- Corporate bonds much more prevalent
- A new standard based on corporate bonds
- Not accepted by government
- Myners report focussed on improving equity attractiveness (less on member security)
Where now?

- What will be our “statutory duty of care”?
- How will we report on solvency level?
- How will we set valuation bases in future? (given tension between employer and trustee)
- How will we regulate transfers between plans?
- Lessons from other countries essential
Discussion

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