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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

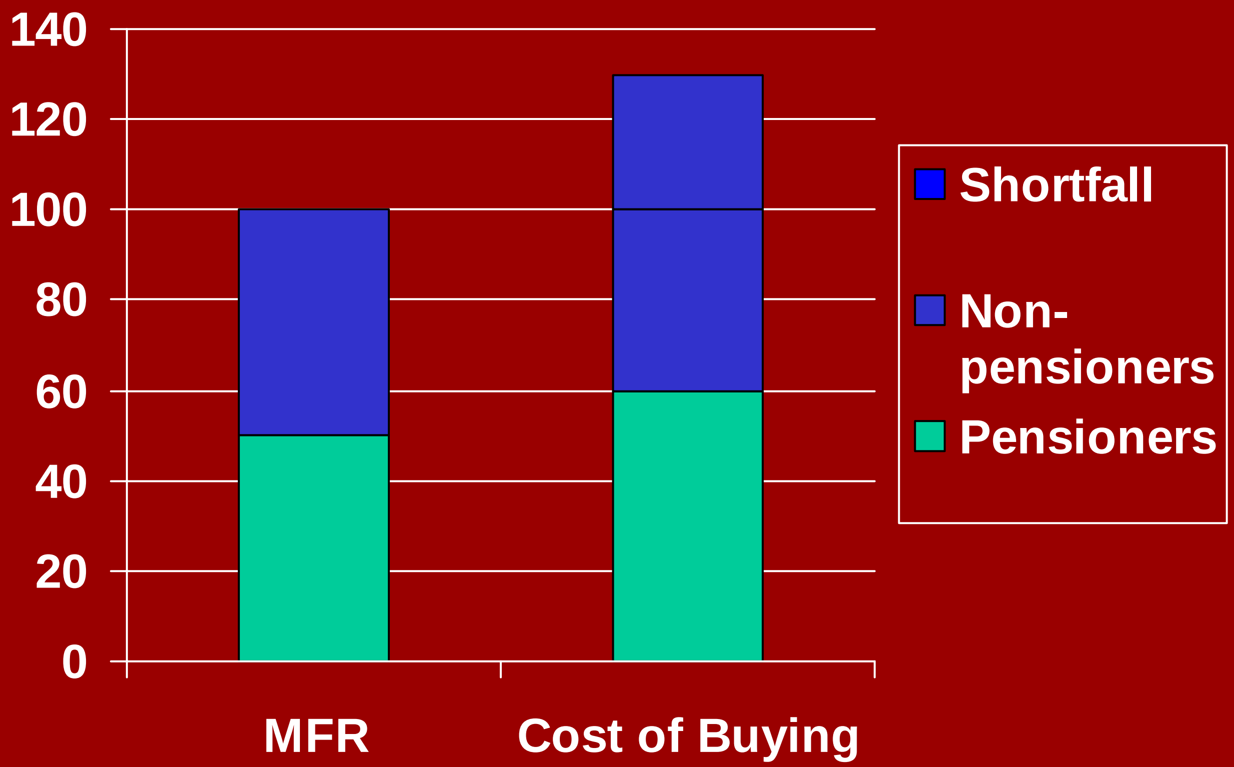
- New Government removed tax privileges!
- Dividend Yields declined steadily (partly as a result) and proved unstable
- Inflation Fell, making all the parameters anachronistic
- Bonds became accepted as best match for pension liabilities (also for accounting)

Effect of 2000 dividend changes on Equity-based MFR

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



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

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Discussion

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