MFR: The Next Stage of Reform

The proposed package of interim measures and introduction of regulation 11

Note for Members

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1. Introduction

1.1 The Department for Work and Pensions' consultation document [*Minimum Funding requirement: The Next Stage of Reform* - http://www.dss.gov.uk/consultations/consult/2001/mfr_next/mfr.pdf] contains plans for draft Interim Measures to ease the regulatory burden of the MFR, pending its longer term replacement by a scheme-specific funding standard. The Board has set down some early thoughts on the draft Interim Measures to bring to members' attention some concerns about the proposed package, and to suggest some alternative proposals. One of the Pensions Boards' major concerns relates to the use of regulation 11 of the MFR regulations.

2. Overview

2.1 The Board is of the view that, if effected, the proposals would be very likely to impose significant and possibly counter-productive duties on scheme actuaries. However, whether or not problems will indeed materialise, could depend on any refinements to the regulation that the DWP may propose. For example, the DWP may decide to define more precisely the nature and size of the events which may cause regulation 11 to be triggered and it may provide a degree of certainty as to the nature of "significant effect" on the scheme's assets or liabilities, which is an inherent part of the judgement which trustees must make, in the context of regulation 11.

2.2 Subject to the above comments, the Pensions Board is concerned that:

- the potential implications of regulation 11 may not have been fully assessed. Many of its terms are not precisely defined, and if a wide interpretative meaning of this regulation should obtain, this would in itself introduce further regulatory burdens. In some cases this would possibly exceed the counter-effects of the abolition of the annual recertification requirement;

- as the precise intended meaning of the terms of this regulation is not fully explained in the consultation documents, how DWP intends the regulation to operate and the possible regulatory consequences of regulation 11 may not be fully understood. If so, this could lead to a misguided acceptance of the new proposals founded on a belief that the revised regulatory regime will be eased. If, however, the scope of regulation 11 should prove to be wider than first appears, the intended regulatory easement could actually prove to be an increased regulatory burden.

3. Impact of Regulation 11

3.1 The Board understands that regulation 11, once introduced, could require emergency valuations in certain circumstances. These will arise when the trustees alert their scheme actuary to the possibility of an event, or sequence of events, that could have significantly affected the value of the scheme's assets or liabilities. If, on investigation, the scheme actuary believes that such event(s) may have resulted in an inadequacy of the schedule of contributions for MFR purposes, an emergency valuation will be triggered.

3.2 In practice, the trustees will need considerable guidance from their scheme actuary as to the nature of the events which could trigger the requirements of regulation 11. Trustees will wish to be cautious, in order to fulfil their duties to scheme members and to comply fully with the regulatory requirements. Actuaries will also need to be cautious, and will recognise the wide scope for interpretation of the word "event" in this context. Indeed, if "significant" (in the context of the effect on the scheme's assets or liabilities) means simply that the current certificate of adequacy of the schedule of contributions may be invalidated, then it is even possible that the events that the trustees need to consider may extend beyond those which, to a layman, would have an obvious material financial effect on assets or liabilities. The effect could be much more subtle.

3.3 The definitions of regulation 11 include the “serious risk that the minimum funding requirement will not continue to be met throughout the schedule period”. Thus, the certainty of just one day’s failure to meet the MFR would bring in regulation 11 into play, however well funded the schedule might make the scheme at the end of the period.

3.4 Furthermore, the nature of the "event(s)" required to trigger regulation 11 could vary widely between schemes. An event with a significant financial effect for a small scheme could be a single retirement and be of a different order of magnitude from such events for larger schemes.

3.5 If these concerns are justified, the Board believes that the introduction of regulation 11, will require careful explanation and significant advice by actuaries to most of their trustee clients. Thereafter, the degree of monitoring of scheme's funding positions that will inevitably be needed as a consequence, will be particularly acute for schemes that are underfunded (should regulation 11 apply to these schemes), as well as for schemes with a small or moderate funding margin about the 100% funded level. This latter category will be the very schemes that the introduction of regulation 11 is meant to operate on most keenly, in return for an exemption from the automatic annual recertification requirement.

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