FACULTY & INSTITUTE
RESEARCH WORKING PARTY

COMMUNICATION OF MFR & SOLVENCY

Contents

Executive Summary

The report discusses what the MFR was intended to achieve, how it has become (wrongly in our view) synonymous with solvency and thereafter why this should be and how it should be addressed. It discusses the situation from the standpoint of all the major stakeholders and how the issue of communication should be addressed with regard to all such stakeholders. It concludes with a list of proposed actions which, if performed in concert, should reduce the scale of the mis-communication on this topic.

Introduction

During 1997 the Faculty and Institute of Actuaries decided to set up a Research Working Party to look at the subject of the communication of solvency, particularly as this related to the MFR. The Working Party comprised those listed in Appendix 2 and met on a number of occasions between December 1997 and January 1999. We addressed the Terms of Reference reproduced at Appendix 3 which required us to complete the project by October 1998. The attached is the product of our labours and is presented, in the first instance, to the Technical Support and Research Committee of the Faculty and Institute and now made available to the profession via our web site.

Although it does not fully address all the elements in the Terms of Reference we feel that it does cover the most important elements of our remit. The major omission is in respect of possible general communications and also a note of terms which should be used in giving information about the solvency position of a scheme (although much of the content of such documents could readily be taken from the report). A list of further actions is given in Appendix 1. These documents are currently (June 1999) being drafted by the members of the Working Party.

1. WHAT ARE THE MFR AND SOLVENCY?

a) MFR

We start with a quote from William Hague MP during the committee stage of the Pensions Bill on 23 May 1995. Mr Hague said 'The MFR will provide members with a reasonable assurance that, should the sponsoring employer become insolvent, the scheme will be able to deliver the relevant accrued rights. If the scheme is at least 100% funded on the statutory basis, pensioners can expect their pensions to continue to be met in full while younger scheme members will be entitled to a fair actuarial value of their rights which they can transfer to another scheme or to a personal pension.'

In broad terms therefore the aim of the MFR test is to ensure a scheme has sufficient funds to keep paying benefits for members whose benefits are in payment and to pay minimum transfer values for other members.

For pensioners, the liability is calculated as, broadly, the amount required to buy out guaranteed benefits in payment (for small schemes) or to buy assets which closely match the benefits (for larger schemes).

For active and deferred members the liability is the transfer value of their guaranteed benefits on a pre-defined basis. The basis was chosen with the intention that if the transfer value was invested in a personal pension the probability of the benefits at least matching those available from the occupational scheme would be 50%. It is assumed that the transfer value will be placed in an equity invested personal pension (or simply invested in equities) until ten years before retirement and then gradually switched into suitable gilts.

The liabilities of the scheme calculated on the MFR basis represent the target minimum assets that a scheme should hold. It is, as the name indicates, relevant to the on-going funding of the scheme.

The MFR also provides a floor for future contributions and serves as a comparable measure between schemes of each scheme's funding position, thereby assisting communication with scheme members.

A scheme being 100% funded on the MFR basis is not an indication that there are sufficient assets to secure the accrued benefits on wind-up. It appears that this fact is not appreciated by the majority of scheme members or even trustees and administrators. This is a communication problem that needs to be addressed by the profession.

However, before we consider this issue further we must consider how the MFR relates to general perceptions of solvency?

b) Solvency

In order to understand solvency, it is useful to first consider its general meaning and then to extend this to apply to pension schemes in particular.

Solvency is a financial condition in which total assets exceed total liabilities. This can, however, be defined in different ways:

- Solvency can mean that a company is able to pay its debts as they fall due in the normal course of business (i.e. an ‘on-going’ basis).

- Alternatively, it can mean that, at a particular point in time, there are sufficient total assets to meet its liabilities (i.e. a ‘balance sheet’ basis).

The distinction between these two meanings is not widely understood.

It is useful to consider an analogy with an individual who has taken out a loan. Although they may be unable to repay the loan immediately, they will expect to be able to do so over an agreed period of time and will rely on future expected income to do so. The individual would be “solvent” on the first measure, but not on the second.

Extending this to a pension scheme, the first definition corresponds to the ongoing funding position where future contributions will balance further accrual of benefits, and the second to the ability to buy out benefits with an insurance company with due allowance for all the guarantees that this implies. However, we do not believe that the majority of scheme members appreciate the difference and to many a statement that their pension scheme is ‘solvent’ will be assumed to mean the second measure.

With an on-going pension scheme, members’ benefits may be secure even though, if the scheme discontinued, there would be insufficient funds to buy out those benefits. Reasons why there may be insufficient assets to buy out the benefits are:

i) the scheme’s assets are likely to be invested largely in equities, which are expected to give higher returns than the gilts on which the insurance company buy out costs are based

ii) insurance company buy out costs will include allowance for both the statutory prudential rules for insurance products and the company’s profits, which are not relevant to an on-going scheme.

For an on-going scheme, this is not of real concern if the employer is continuing in business and will continue to contribute to the scheme.

For the purposes of this report, we will define a pension scheme to be ‘solvent’ if there are sufficient assets to secure the liabilities with an insurance company.

2. WHERE ARE THE MFR AND SOLVENCY CURRENTLY CONFUSED?

Pension fund solvency is discussed in the following areas:

a) Various booklets issued to interested parties

- "A Guide for Pension Scheme Trustees" issued by the Occupational Pensions Regulatory Authority.

  This states "The MFR refers to the minimum amount of funds that should be in the scheme at any one time, in order to meet the scheme's liabilities if it were to be discontinued". Although this statement is factually correct, it is misleading.

- "The Role of your Actuary in your Pension Scheme" issued jointly by the Faculty and Institute of Actuaries and aimed at pension scheme trustees.

  This states more informatively that the MFR "will not necessarily mean that the scheme could fully meet its liabilities were it to wind-up …".

- "MFR made simple" issued by the National Association of Pension Funds as a guide for pension scheme trustees and members.

  The bulk of this booklet is concerned with the administrative detail of MFR. It does, however, clearly state that MFR is not a guarantee of solvency.

b) Actuarial advice

For ease of reference the certificates referred to below are attached as appendices.

- Triennial actuarial valuations (and other actuarial advice) issued to scheme trustees in accordance with Guidance Note 9.

  Valuation reports tend to focus on the on-going funding level and whether or not the MFR is met. However, GN9 does require the actuary to make a statement as to the current funding level if the scheme were to discontinue. The actuary is given a wide remit as to how this funding level can be measured. For example, it is permissible to measure this on the basis that active members and deferred members are provided with the cash equivalent transfer value in lieu of their benefits. Trustees may not appreciate that this does not necessarily mean that accrued liabilities could be fully secured in the event of the scheme winding-up.

  Disclosure statements: issued to the trustees within one year of the date of the triennial actuarial valuation, to accompany the annual Trustee Report and Accounts. (Appendix 4.1)

  The funding level for these statements can be measured on the same basis as set out in the preceding paragraph and the same issues of communicating the meaning of this apply. However, we acknowledge that the form of disclosure statement will change as schemes undergo their first formal MFR valuation and this confusion will therefore disappear.

- Supplementary Certificate A and Certificate T: issued to the Contributions Agency for schemes contracted-out of the State Earnings Related Pension Scheme. Certificate T should be issued following the triennial valuation, within 1 month of the schedule of contribution certificate being submitted. The Supplementary Certificate A should be issued if the last Certificate A expires before Certificate T is signed. (Appendix 4.2 & 4.3).

  These certificates state that the scheme has sufficient assets to cover certain of its liabilities. Supplementary Certificate A will be replaced by Certificate T, which itself will no longer be required after the year 2007.

- Minimum Funding Valuation statement: this is issued to the Scheme trustees and must accompany the triennial valuation report. (Appendix 4.4)

  This statement states that it is not certification of adequacy for the purposes of securing the scheme's liabilities by the purchase of annuities, if the scheme were wound-up.

- Schedule of Contribution certificates: must accompany the schedule of contributions within 12 weeks of signing the valuation report and then within 21 days of the anniversary of the previous certificate in intermediate years. (Appendix 4.5 & 4.6)

  These certificates state that they are not certification of adequacy for the purposes of securing the scheme's liabilities by the purchase of annuities, if the scheme were wound-up.

- Debt on the employer certification in accordance with Guidance Note 19: issued to the scheme trustees, when a scheme is winding up, a participating employer becomes insolvent or an employer ceases to participate in a multi-employer scheme. (Appendix 4.7)

  The current certificate states that it is not certification of adequacy for the purposes of securing the scheme's liabilities by the purchase of annuities, if the scheme were wound-up.

  Version 3.0 of Guidance Note 19 is applicable where wind-up started before 19 December 1996 or where the deficiency is being calculated at a date before 6 April 1997. This states that the actuary should point out to the trustees that "this sum does not represent the amount of cash required by the scheme to secure the member's accrued entitlement by using non-profit insurance company rates at the date stated".

c) Press comment

For the most part, press comment has:

- Equated a funding level of 100% of the Minimum Funding Requirement with having sufficient assets to pay a scheme's liabilities in full in the event of a wind-up, despite the change of name from solvency requirement to funding requirement. It has not always distinguished between running the scheme as a closed fund and purchasing annuities and deferred annuities; and

- Suggested that high nominal investment returns will have improved the funding position of a scheme. Again press comment does not consider any compensating effects on the liabilities of a scheme.

d) Communication to members

There are other forms of communication which are more relevant to pension scheme members, scheme booklets and announcements for example. Scheme booklets do not generally cover solvency. In any announcements made to members which refer to solvency or the MFR, it is important that the meaning of these terms and their relevance is clearly explained.

3. WHERE ARE SOLVENCY AND THE MFR RELEVANT?

The relevance of each of these measures will be determined by whether the scheme is on-going, winding-up or closed.

a) On-going schemes

The majority of schemes are currently in this position and winding-up is not an immediate issue. The scheme may not have sufficient assets to buy out the accrued liabilities, but this is not currently relevant since the funding rate will be assessed in order that assets and liabilities balance in the long run.

Different parties will be concerned with different measures of the scheme's financial position:

- Employers will be concerned with on-going costs; the stability of these and whether extra contributions would be required if the scheme was discontinued.

- Trustees will be interested in whether there is sufficient money to pay benefits, i.e. they will be concerned with the funding position of accrued benefits; whether funds will be sufficient if the employer stops contributing andwhether future contributions will be sufficient.

- Members may be concerned that there is sufficient money to pay the promised benefits when they are due and what will happen if employer contributions stop.

Underlying the on-going funding of the scheme is the MFR, the minimum that employers are required to meet. This not only provides a minimum level for funding, but also for future contributions and cash equivalent transfer values.

In the private sector, the MFR basis, or the basis plus a margin, appears to be becoming the norm for calculating transfer values. It remains to be seen whether this will also happen to on-going funding bases.

b) Winding-up schemes

In these schemes, Trustees and members will be concerned that there is sufficient money available to secure the benefits. The cost of securing the benefits by way of a buy-out with an insurance company will bear little or no relation to their on-going or MFR value.

MFR may also be relevant to these schemes as this is the basis used to calculate any debt on the employer under certain circumstances.

A communication difficulty will arise where a scheme is 100% funded on the MFR basis but there is insufficient money to buy out the benefits with an insurance company.

c) Closed schemes

Immediately after closure funding is generally still the most relevant issue for such schemes. However, as time passes, it becomes increasingly likely that the scheme will eventually wind-up, so the financial position on the basis of buying out benefits with an insurance company is more important than for an on-going (open) scheme.

4. CONSEQUENCES OF CHANGING THE STRENGTH OF THE MFR

The complexity of the MFR test means that few people understand it fully. This means that if changes go beyond simple adjustments to the specific actuarial assumptions, the consequences are likely to be difficult to understand. Even simple adjustments to the specific actuarial assumptions might mean that the MFR test is strengthened for some schemes and weakened for others. If the methodology and actuarial assumptions are altered it may be difficult to generalise about whether the test is stronger or weaker. There is also the likelihood that in some possible future conditions a revised MFR test will be weaker, but in other conditions it will be stronger.

Any changes to the strength of the MFR bring into question the level at which it was previously set and may undermine the public's (including trustees', employers' and members') faith in those who set the MFR. In addition, given the lack of understanding of the background to the MFR, some actuaries may be confused by the change.

There will be immediate consequences of any changes. These include:

- the creation or abolition of an underfunding position,
- higher or lower transfer value payments between schemes after the date of change,
- higher or lower contribution requirements over the few years (i.e. short-term) following the date of change, and
- a scheme which was winding-up and where a GN19 Certificate was requested by the trustees may have a debt/no debt on the employer, whereas prior to the change the opposite could have been the case. In any event the size of any existing debt will alter.

Longer term consequences may include:

- changes to the balance between DC and DB provision,
- changes to the overall amount of occupational pension provision in the UK,
- changes to the security of benefits promised from occupational pension schemes, not always in obvious ways, e.g. if the MFR was strengthened, (i.e. by increasing the value of assets needed to stay 100% MFR funded), then schemes may be more inclined to simply adopt the MFR as a target rather than fund for a margin above it, and so actually reduce their absolute funding level, whereupon the security of benefits may reduce.
- changes to the way companies account for their occupational schemes, including the actuarial basis underlying the cost disclosed in companies' accounts, and
- changes to future investment returns (If there is less overall occupational pensions provision, or if schemes are funded to a lower level, the total investment in UK assets may reduce and this may reduce future investment returns, and vice versa.)

If the MFR test is weakened, then:

- for a member leaving service with a deferred pension the amount available as a transfer value payment (as an alternative to leaving the benefits deferred in the scheme until retirement) would be likely to fall. This could lead to criticism of the actuarial profession, as happened following the change in June.

- a scheme which was winding up and which had a 100% MFR funding level after the weakening would be able to provide less by way of deferred annuities than one which had exactly the same liabilities and which had a 100% MFR funding level before the weakening.

If the MFR test is strengthened, then:

- some schemes would switch to a defined contribution basis and may reduce benefits for future service,

- other schemes would remain as defined benefit, but again with reduced benefits for future service,

- some schemes would wind up and many would be unlikely to provide the full promised benefits by way of insured deferred annuities,

- the result of these changes would be that total pensions provided by occupational pension schemes would reduce and more reliance would be placed on the other forms of retirement income. This is already a concern as the State wishes to reduce people's reliance on it for retirement income (e.g. later State pension age, SERPS benefits reduced by method of applying LEL deduction, stakeholder pensions).

Although it should be obvious, it is worth stating that if the MFR is to be changed, the reason for the changes should be given. However, before we can do this, there needs to be a greater understanding of what the MFR is and what it is not. If we can achieve this then changes to the MFR, whether fundamental or not, should be much easier to communicate and should be much more readily understood and accepted.

5. WHAT NEEDS TO BE COMMUNICATED?

We believe based on the analyses discussed in previous sections that there are fundamental misunderstandings of the MFR throughout the pensions industry. The MFR is universally confused with the concept of a solvency guarantee. People do not understand exactly what it is (largely because it is often discussed in very technical terms), and changes to it are treated with a great degree of suspicion. As a result, the credibility of the actuarial profession (which is closely identified with the creation and monitoring of the MFR) is undermined.

To address these problems, we must consider how ingrained misunderstandings can be systematically corrected. Not all actuaries will agree with the concept or the detail of the MFR, but it is a legal requirement, and we can certainly improve its perception and consequently the image of the profession. To do this, we believe there are four key concepts that need to be addressed. If these can be carefully communicated to all interested parties, a lot of the problems we have described should be reduced or even eliminated.

These concepts are:

- The MFR does not guarantee solvency.
- The purpose and nature of the MFR.
- Why the MFR changes, and the consequences of any change.
- The MFR is set by the Government (albeit after consultation with interested parties)

To whom they should be communicated and how are discussed in Section 6.

a) MFR and Solvency

As described in Sections 1 and 2, passing the MFR test is frequently confused with a guarantee of solvency in the minds of trustees, scheme members, the press and even many pension professionals. No doubt part of the reason for this was the publicity surrounding the original concept of the Minimum Solvency Standard first discussed in the Goode Committee Report. Also, the Pensions Act 1995 which introduced the MFR was consistently presented as a series of measures to protect members' benefits, and the MFR was one of the key tenets of this piece of legislation.

Arguably, the various parties involved with the creation and operation of the MFR have failed to address the confusion that has arisen since the idea was first proposed. From a simple concept, we now have a very complex test understood, in the main, only by actuaries, and therefore likely to produce suspicion. The failures of legislators, regulators and the profession to address growing signs of misunderstanding and dissatisfaction have undoubtedly allowed them to become more ingrained.

The complexity of the MFR creates serious communication problems. We believe that it would be counter-productive to try to explain this complexity as such an effort is doomed to failure and would probably exacerbate the problem. Instead we believe communication efforts should concentrate on the MFR concept rather than the detail. If people understand the concept and are comfortable with the profession's role, the detail is of less importance to them.

Irrespective of the reasons for the confusion between the MFR and solvency, we believe it is incumbent on the profession who are seen as the “guardians” of the MFR to act to correct the confusion. All parties involved with pensions need to understand that the usual concept of solvency is not directly addressed by the MFR. A scheme 100% funded on the MFR basis does not necessarily have sufficient assets at any point in time to secure all guaranteed benefits. It is therefore not necessarily “solvent” as most people would understand the concept and as we have previously defined it.

b) What is the MFR?

If we can correct the confusion between the MFR and a solvency guarantee, we should at the same time address exactly what the MFR really is, and what it is designed to do. Inevitably the two topics are very closely linked.

We need to ensure that relevant parties understand that:

- The MFR provides no guarantees on the payment of benefits so that if an individual scheme is unable to meet its guaranteed benefits on winding up, this is not a sign of the failure of the MFR or of the profession

- That because it is possible to satisfy the MFR as an ongoing scheme but be mismatched so that there is a deficit on wind up, such a failure is not the fault of the MFR.

- That it is not definitive and immovable – it is simply a “line in the sand”. As such, it is a pragmatic approach to a problem that has no correct answer, which attempts to balance members’ security with the desire of employers to avoid tying up working capital in a pension scheme. It is simply a value placed on the liabilities of a pension scheme using a prescriptive set of assumptions and method

- That it is one of a package of protections introduced by the Pensions Act 1995, and it cannot do the job on its own

- That by taking a pragmatic approach to improving security as measured by scheme funding levels, the risk that final salary benefit provision will not be able to continue as a viable option in the face of competition from defined contribution alternatives is minimised

- That it is a complex calculation overseen as a result by the relevant body of experts: the actuarial profession

The MFR was introduced to raise the minimum permissible funding position of schemes to a universally agreed level. A clear understanding of this should avoid a lot of the criticism, based on lack of knowledge, directed at the MFR and therefore at the profession

c) Changing the MFR

If the MFR is perceived as a rigid standard, changes to the basis or method of calculation are open to misinterpretation. Again, as actuaries are inextricably linked with the MFR in most observers’ eyes, criticism of such changes will tend to reflect badly on the profession.

When the MFR basis is changed, it is important that:

- The reasons for the change are clearly explained and quantified
- The implications for solvency are also explained
- The effect on MFR positions is described in broad terms, and extreme results are avoided or allowed for by transitional provisions (to the extent allowed by legislation)
- The knock-on effects in particular situations are dealt with
- A sensible timescale, of say 1 - 2 weeks, is allowed for the implementation of procedural changes
- It is clearly understood that responsibility for the change rests with the Government

If changes to the MFR are instead presented as a “decree from on high”, with no thought to their impact, or at least to how people will react to them, they will devalue the MFR concept further.

6. COMMUNICATION: HOW AND TO WHOM?

In this Section, we consider how the four concepts introduced in Section 5 should be communicated. For simplicity we will refer to these concepts as C1, C2, C3 and C4:-

C1 The MFR is not a guarantee of solvency
C2 The purpose and nature of the MFR
C3 Why the MFR changes, and the consequences of any change
C4 The MFR is set by the Government.

The first stage in this discussion is to identify the parties who need to be involved in this communication process. These are as follows:

- The actuarial profession
- Pension scheme trustees
- Pension scheme members
- Sponsoring employers
- Trade unions
- Regulators
- Other professions
- The press
- The Government

The method of communication appropriate for each of these parties is dependent on the purpose of the communication, the logistics of a communication process, the level of detail deemed appropriate, the concepts to be addressed and the ability of certain parties to act as a conduit of information. We consider each of the parties in turn.

a) The Actuarial Profession

The profession performs a key role in monitoring the MFR. We believe that more education of actuaries about the MFR is desirable. Looking outwith the profession, we believe that actuaries have a key role to play in explaining the MFR, its nature and implications. Guidance Note 27 provides all the technical information necessary for Scheme Actuaries to understand the MFR, but GN27 being written for actuaries is fairly technical and is therefore little use as a communication tool. Other tools are needed, and we suggest these should include in terms agreed by the profession:

- a simple summary of the rationale for the MFR
- a very broad description of the calculations underlying the MFR
- an explanation of the difference between the MFR and a solvency guarantee.

Armed with these texts (which could be combined into a single communication to all Fellows and Students), the profession can present a consistent and united face when describing or justifying the MFR and our important role in it.

b) Pension Scheme Trustees

The best and most efficient way to communicate with scheme trustees is through Scheme Actuaries. It is incumbent on Scheme Actuaries to ensure that trustees understand the MFR and the extent of the protection it provides so that, in turn, they can appreciate the effects of the MFR position of the scheme on the sponsoring employer and on the members.

We would suggest redrafting the relevant text contained within the booklet “The Role of your Actuary in your Pension Scheme” to avoid any ambiguity about the MFR. We also believe the profession should take the lead in drafting two Factsheets written in clear and simple English (one factsheet for C1, C2 and C4, and a separate one for C3). It would then be up to the trustees to decide what use to make of these Factsheets in communicating the MFR to their scheme members.

Trustees could use text from the Factsheets as input to the Annual Report to Members. We would also suggest a review of the text in all standard actuarial certificates to ensure that the four key concepts are covered appropriately in all circumstances. GN9 should also be reviewed regarding the standard text to be included when commenting on the scheme's MFR position so that the implications for solvency and ongoing funding are properly understood.

c) Pension Scheme Members

It would be very difficult for the profession to communicate directly with scheme members in a systematic manner. Therefore, Scheme Actuaries should encourage trustees to provide members with the information necessary to address any incorrect perceptions of the MFR. This task is an onerous one for trustees, unless they can be provided with the material they require. It should always be borne in mind that all parties have an interest in ensuring that scheme members fully understand and appreciate their pension schemes.

The material covered in a) and b) above should be sufficient for this purpose if accompanied by clear instructions on the course recommended by the actuary. Members will also have access to the actuarial valuation, actuarial certificates and Annual Report as well as their Scheme Booklet.

d) Sponsoring Employers

The information we suggest providing to trustees should be equally helpful to employers in clarifying the aims of the MFR and its effects on employer commitments. Efforts to communicate with employers will be particularly important when changes are made to the MFR which have direct financial consequences. An alternative route worth exploring is to use organisations such as the NAPF or the CBI as a conduit for conveying information to their members.

e) Trade Unions

Trade unions have particular concerns about the security of members' benefits. The provisions of the Pensions Act 1995 have gone some way to improving this security, but it is important that Trade Unions understand the nature of the protection provided by the MFR. The materials discussed above should provide trade unions with the necessary information. However, a more direct approach to the TUC offering briefings to specialist pensions staff and assistance in preparing advice to their members may pay dividends.

f) Regulators

The various regulatory and supervisory bodies involved with pensions should have communication objectives similar to those of the profession when considering the MFR. We recommend that approaches are made by the profession to promote co-ordinated action to address the problems we have identified. These should allow agreement of a course of action to address these problems, and to ensure a consistent and clear message is presented. The profession should not shoulder the entire burden for correcting misunderstandings of the MFR and concerted action will be more powerful anyway.

The OPRA booklet "A Guide for Pension Scheme Trustees" will need to be revised to avoid any ambiguity. However, we feel that the MFR is a sufficiently problematic subject that it warrants treatment in a separate OPRA booklet that could back up the forms of communication suggested above. In fact, we understand that such a project is underway, and, although we understand that the profession has been consulted, we feel that further involvement would ensure the message provided is consistent with the aims we have set out. To this end we have sent a draft copy of this report to OPRA to give them the opportunity to take our views into account. We have also offered to give comments on their document.

g) Other Professions

Other professions, particularly the accountancy and legal professions should also be involved in discussions. The messages we wish to see disseminated have to be understood by other professionals who provide advice on pension matters. Also other professionals will come into frequent contact with trustees and employers, and can therefore reinforce the messages.

The same arguments apply to pension organisations such as the Pensions Management Institute and the Society of Pension Consultants.

h) The Press

Along with other major stakeholders, the press has been partly responsible for creating the misunderstandings we have to correct. However, given their key role in informing public opinion, it is extremely important that we work with them to help them get a correct message across. An education process is therefore required, stressing the incorrect interpretations that have arisen in the past and providing the information necessary to correct them.

We believe that press comment on the MFR should be monitored by the profession, and action taken to respond to any misconceived criticism or incorrect facts.

Press releases, particularly those relating to changes in the MFR, need to take account of the possibility of misinterpretation. Standard Editor's Notes that leave no room for incorrect reporting would be beneficial.

i) Government

The situation with Government requires sensitive handling. On the one hand we need to make it clear that the ultimate responsibility for the existence, shape and strength of the of the MFR lie squarely with the Government. On the other hand we want to influence them in order that the MFR works to best effect and to ensure that we continue to be consulted by them in advance of any changes to it. Given the heavy workload of relevant Government ministers, and the fact that they may not be technical experts in the Pensions arena, we suggest that regular briefings on relevant topics are the best approach. These could be built up from the Factsheets referred to earlier.

7. Summary

Although there are a number of problems with the current understanding of solvency vis-à-vis the MFR and funding we do not think that they are, in any way, insoluble. While Pensions in general, and Final Salary/Defined Benefit Pensions in particular, will never be easy to understand we do not believe that the situation is hopeless either. If the Recommended Actions listed in Appendix 1 are followed we feel that this important topic will be clearer to all concerned and the debate about funding of pensions will be a more informed one as a result.

APPENDIX 1

RECOMMENDED ACTIONS

Action	**To**	**Reference**
Summary of rationale for MFR	Profession	6(a)
Broad description of calculations	Profession	6(a)
Explanation of MFR vs. Solvency Guarantee	Profession	6(a)
Redraft relevant text in "the Role of Your Actuary" booklet	Trustees/Members/Employers	6(b)
Factsheets on MFR vs. Solvency, and Nature and Role of MFR	Trustees/Employers	6(b)
Standard text for inclusion in Annual Report	Trustees	6(b)
Review of text in actuarial certificates	Trustees/Employers	6(b)
Review of GN9	Profession	6(b)
Trade Union briefings	Trade Unions	6(e)
Co-ordination with legislators and regulators	Government (DSS) and OPRA	6(f)
Revise OPRA "Guide for Scheme Trustees"	OPRA	6(f)
Participate in OPRA MFR booklet	OPRA	6(f)
Co-ordination with other Professions	APL, PRAG, PMI, SPC etc.	6(g)
Standard format for MFR press releases	Press	6(h)
Systematic correction of incorrect press comment	Press	6(h)
Government Briefings	Government	6(i)

APPENDIX 2

MEMBERS OF WORKING PARTY

• Simon Shearer (Chairman)	-	Standard Life Assurance Company
• Ben Brown		HSBC Gibbs Benefit Consultants Ltd
• Steve Button	-	William M Mercer
• Debbie Evans		William M Mercer
• Steve Holt		Barclays Global Investors
• Audra Windley		HSBC Gibbs Benefit Consultants Ltd

APPENDIX 3

TERMS OF REFERENCE

General

The general aim of this project is to consider how best to communicate to relevant parties, how solvency should be assessed including the role of the MFR in this process. The work will therefore extend beyond the MFR to consider other aspects of communicating solvency and other aspects of communication in general.

Objectives

- To prepare advice to members of the profession on the importance of communicating clearly to pension scheme members trustees and sponsors about pension scheme solvency especially in relation to the MFR.

- To consider what means should be used for communicating the solvency position of a scheme and solvency issues in general (e.g. actuarial certificates, members booklets etc).

- To consider the terms and language which should be used to describe the solvency position of a scheme.

- To consider whether a general communication about the issues surrounding pension scheme solvency and the MFR is required and, if it is, who it should be addressed to (the Government, consumer bodies, the media etc) and what it should say.

- In the light of actual or proposed changes in the MFR to consider what general communication should be issued, in conjunction with the "change in conditions" Working Party.

Scope

The scope of the project will cover all issues relating to communications about solvency including communications about the solvency position of individual schemes and general communication about issues surrounding solvency and the MFR and the relation between them. It will include communications with all interested parties including:-

- Pension scheme members
- Trustees
- Government
- Consumer bodies
- Media
- Pension Scheme Sponsors
- Actuaries
- Government agencies
- Pension Providers

Deliverables

- A report setting out the conclusions of the Working Party

- Drafts of any general communications which the working party thinks should be issued. This could include (but is not limited to) draft professional guidance and/or a draft press release and/or a draft letter to Government.

- A note of the terms which should be used in giving information about the solvency position of a scheme.

Timescales

The project should be completed by the end of October 1998.

Dependencies

This project should take particular account of the work of the Working Party considering the MFR and changes in conditions.

APPENDIX 4.1 (a)

ACTUARIAL STATEMENT MADE FOR THE PURPOSES OF REGULATION 8 OF THE OCCUPATIONAL PENSION SCHEMES (DISCLOSURE OF INFORMATION) REGULATION 1986

Name of scheme:

Effective date of valuation and statement :

1. Security of accrued rights

In my opinion, the scheme's assets existing on the effective date fully cover its liabilities as at that date, including liabilities arising in respect of the service of pensioners and deferred pensioners prior to the effective date on the basis that the service of active members terminates on that date, with the following exceptions:

Description of liability	Percentage covered
Liabilities In Excess of GMP For Members Not Yet Retired.	%

The measure(s) to be taken to bring these to 100% and the date by which it is expected that this will be achieved are as follows:

Contribution rate is designed to meet the shortfall by the normal retirement date of each member.

2. Security of prospective rights

In my opinion, the resources of the scheme are likely in the normal course of events to meet in full the liabilities of the scheme as they fall due. In giving this opinion, I have assumed that the following amounts will be paid to the scheme:

Description of contributions

Contributions at the rate of % of pensionable payroll, including the contribution for Disability Benefit, subject to review at future actuarial valuations.

3. Summary of methods and assumptions used

The scheme has been valued by the projected unit method.

The principal assumptions were that investments would yield an % pa rate of return, salaries would increase at % pa and each year approximately 10% of younger members will withdraw from service prior to retirement.

Further details of the methods and assumptions and a summary of the data used are set out in the actuarial valuation addressed to the trustees dated .

Signature: Date:

Name: Qualification: FFA

Address: Name of Employer:

APPENDIX 4.1 (b)

ACTUARIAL CERTIFICATE MADE FOR THE PURPOSES OF REGULATION 30 OF THE OCCUPATIONAL PENSION SCHEMES (MINIMUM FUNDING REQUIREMENT AND ACTUARIAL VALUATIONS) REGULATIONS 1996

Name of Scheme:

Effective date of valuation:

Security of prospective rights

In my opinion, the resources of the scheme are likely in the normal course of events to meet in full the liabilities of the scheme as they fall due. In giving this opinion, I have assumed that the following amounts will be paid to the scheme:

Description of contributions

Contributions at the rate of XXX% of pensionable payroll inclusive of members' contributions, subject to review at future actuarial valuations.

Summary of methods and assumptions used

The scheme has been valued by the projected unit [attained age] method

The principle assumptions were that investments would yield a XXX% pa. rate of return, salaries would increase at XXX% pa. and no members will withdraw from service prior to retirement or each year approximately 10% of younger members withdraw from service prior to retirement.

Further details of the methods and assumptions used are set out in my actuarial valuation, addressed to the trustees dated XXXXX

Signature	
Date	
Name	
Qualification	FFA
Address	

APPENDIX 4.2

Supplementary Certificate A

Northern Ireland has its own body of law relating to pensions, and in relation to Northern Ireland, references to Great Britain legislation contained in this certificate should be read as including references to corresponding Northern Ireland legislation.

This certificate must be completed by an actuary appointed under section 47 of the Pensions Act 1995, where applicable.

Name of Scheme	

Scheme Contracted-out number (SCON)	S						

I HEREBY CERTIFY that, in my opinion, in the event of the aforementioned scheme being wound up at any time during:

the period 6 April 1997 to (date)*, (Note 1)

the next three years*, (Note 2)

The resources of the scheme are likely, in the normal course of events (including events which might normally precede a winding up), to be sufficient to meet in full the scheme's liabilities specified at 1(a) and, (if appropriate) 1(b) below, after payment of expenses of administration so far as these expenses would be payable out of the resources of the scheme if it were to be wound up.

The liabilities to be met are:

those specified in section 73(3)(a) to (e) of the Pensions Act 1995, as amended by the Occupational Pension Schemes (Winding Up) Regulations 1996 (SI 1996/3126), and

if appropriate, payment of State Scheme Premiums under section 55 of the Pension Schemes Act 1993. (Note 3)

Taking into account the nature of the scheme's financial arrangements and the provisions of the trust documents, it is my opinion that the liabilities covered by 1 above will be capable of being wholly met for each individual with rights in the scheme, by one, or a combination, of the following methods.

in the case of a scheme that holds, or has previously held, a contracting-out certificate and which retains contracted-out rights within the scheme, by:

annuities secured under present or future contracts of insurance with one or more insurance companies, so that the annuities in total meet the conditions set out in Parts I and II of The Occupational Pensions Schemes (Discharge of Liability) Regulations 1997 (SI 1997/784) and section 19 of The Pension Schemes Act 1993; or (Note 4)

cash equivalent transfer values calculated in accordance with The Occupational Pension Schemes (Transfer Values) Regulations 1996 (SI 1996/1847).

In the case of a scheme which has ceased to contract-out and where arrangements have not been granted approval under section 50(1) of the Pension Schemes Act 1993, by the payment of an accrued rights premium or a pensioner's rights premium, where appropriate.

Overseas schemes only: by the following method(s):

as stated in paragraph 2(i)(a) above;**

as stated in paragraph 2(i)(b) above;**

as stated in paragraph 2(ii) above;**

by the method specified below, which has been approved by the Commissioners of Inland Revenue**

For the purpose of this certificate:-

I have assumed that the following amounts will be paid to the scheme:-

a) by members	-	contributions at the rate provided in the rules**
	-	contributions at the rate of........**
b) by the employer	-	contributions at the rate provided in the rules**
	-	contributions at the rate of inclusive of members' contributions**
c) this is a non-contributory scheme		

The amounts are based on a funding rate which, in my opinion, is satisfactory for the scheme as a whole.

I undertake to notify the Inland Revenue National Insurance Contributions Office of any occurrence of significant events of which I become aware during the currency of this certificate if, after investigation, I consider that the certificate may be invalidated as a result.

Signature of Scheme Actuary:	
Name:	
Date of signing: (effective date of certificate, unless note1 applies)	
Address:	
Qualification:	
Name and address of employer (if applicable)	

(Note 1) If the certificate is submitted with the re-election package, it will be valid from 6 April 1997 until the expiry of the Certificate A that was issued prior to that date.

(Note 2) In all other cases, the Supplementary Certificate A should be dated the day after the expiry of the previous actuarial certificate.

(Note 3) Only applicable to schemes that cease to contract-out on or before 5 April 1997 that are awaiting approval of arrangements to secure their GMP liabilities, or schemes that are subject to non-approval before that date.

(Note 4) The expression "annuities" includes an annuity where there is only one annuity contract in respect of any individual member.

* Delete paragraph 1(i) or 1(ii).
** Delete if inapplicable

APPENDIX 4.3

Statutory authority: Pension Schemes Act 1993, Pension Schemes (Northern Ireland) Act 1993 and Pensions Act 1995.

Certificate T

Name of Scheme	

Scheme Contracted- out Number (SCON)	S						

This certificate shall be effective for a period of 3 years from the date of signing.

I hereby certify that I carried out a valuation in accordance with section 57(1)(a) of the Pensions Act 1995 on (note 1) and that, in my opinion on that date, the aforementioned scheme either:

Met the minimum funding requirement imposed by section 56(1) of the Pensions Act 1995 or ✓ *(Note 2)*

(i) had sufficient assets to satisfy the liabilities:

Mentioned in section 73(3)(a) to (e) of the Pensions Act 1995, as modified by regulation 3 of the Occupational Pension Schemes (Winding-up) Regulations 1996 (SI 1996/3126); and

If appropriate, payment of State Scheme Premiums under section 55 of the Pension Schemes Act 1993.

The scheme is likely, in the normal course of events (including events which normally precede a winding-up), to continue to meet the liabilities specified in 1(b)(i) above for the next 3 years, after payment of expenses of administration so far as these expenses would be payable out of the resources of the scheme if it were to be wound up. ✓ *(Note 2)*

I have certified a schedule of contributions to the scheme for the purpose of section 58 of the Pensions Act 1995 and in accordance with regulations 16 and 17 and Schedule 2 of the Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996. ✓

I am unaware of the occurrence of any significant event since the effective date of the valuation under section 56(1) of the Pensions Act 1995 resulting in the scheme now having insufficient assets to meet the liabilities specified in paragraph 1(b)(i). ✓

I undertake to notify the Inland Revenue National Insurance Contributions Office of any occurrence of significant events of which I become aware during the currency of this certificate if, after investigation, I consider that the scheme has insufficient assets to meet the liabilities specified in paragraph 1(b). ✓

Note 1: Enter effective date preceding MFR valuation.

Note 2: One of the two boxes must be completed for the Certificate T to be valid.

Signature of Scheme Actuary	
Date	
Name	
Qualification	FFA
Address	

APPENDIX 4.4

ACTUARIAL STATEMENT MADE FOR THE PURPOSES OF REGULATION 14 OF THE OCCUPATIONAL PENSION SCHEMES (MINIMUM FUNDING REQUIREMENT AND ACTUARIAL VALUATIONS) REGULATIONS 1996

Name of Scheme:

Effective date of valuation:

Compliance with minimum funding requirement

In my opinion, on the effective date the value of the assets of the scheme is XXXX per cent of the amount of the liabilities of the scheme.

Security of preferential liabilities

In my opinion, on the effective date the assets of the scheme were sufficient to satisfy the liabilities of the scheme mentioned in section 73(3) of the Pensions Act 1995 (which lists the liabilities of schemes in the order in which they are to be met on a winding up) to the following extent:-

Description of liability within section 73(3)	Percentage satisfied
....	....
....	....
....	....
....	....

Valuation principles

The scheme's assets and liabilities are valued in accordance with section 56(3) of the Pensions Act 1995, the Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996 and the mandatory guidelines on minimum funding requirement (GN 27), prepared and published by the Institute of Actuaries and the Faculty of Actuaries.

Signature	
Date	
Name	
Qualification	FFA
Address	

Note:
The valuation of the amount of the liabilities of the scheme does not reflect the cost of securing those liabilities by the purchase of annuities, if the scheme were to have been wound up on the effective date of the valuation.

APPENDIX 4.5

ACTUARIAL CERTIFICATE GIVEN FOR THE PURPOSES OF SECTION 58 OF THE PENSIONS ACT 1995 (CERTIFICATION OF SCHEDULE OF CONTRIBUTIONS)

Name of Scheme:

Adequacy of rates of contributions

I hereby certify that, in my opinion, the rates of the contributions payable in accordance with this schedule of contributions are adequate for the purposes of securing that throughout the period it covers, the scheme will meet the minimum funding requirement imposed by section 56(1) of the Pensions Act 1995.

In forming this opinion, I have complied with the requirements imposed by sections 56(3) and 58 of the Pensions Act 1995, the Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996 and the mandatory guidelines on minimum funding requirement (GN 27), prepared and published by the Institute of Actuaries and the Faculty of Actuaries, and have made the assumptions prescribed by them.

Signature	
Date	
Name	
Qualification	FFA
Address	

Note:

The certification of the adequacy of rates of contributions for the purpose of securing the meeting of the minimum funding requirement is not a certification of their adequacy for the purpose of securing the scheme’s liabilities by the purchase of annuities, if the scheme were wound up.

APPENDIX 4.6

ACTUARIAL CERTIFICATE GIVEN FOR THE PURPOSES OF SECTION 57(1)(b) OF THE PENSIONS ACT 1995 (OCCASIONAL OR PERIODICAL CERTIFICATION OF CONTRIBUTIONS)

Name of scheme:

1. Adequacy of rates of contributions

I hereby certify that, in my opinion, the rates of the contributions payable in accordance with the schedule of contributions dated are adequate for the purpose of securing that the minimum funding requirement imposed by section 56(1) of the Pensions Act 1995 will continue to be met throughout the remainder of the period covered by the schedule of contributions.

In forming this opinion I have complied with the requirements imposed by sections 56(3) and 57 of the Pensions Act 1995, the Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996 and the mandatory guidelines on minimum funding requirement (GN 27), prepared and published by the Institute of Actuaries and the Faculty of Actuaries, and have made the assumptions prescribed by them.

2. Relevant changes since last actuarial valuation

delete as appropriate

Since the last actuarial valuation of the scheme was prepared under section 57 of the Pensions Act 1995 there have been no relevant changes.

Since the last actuarial valuation of the scheme was prepared under section 57 of the Pensions Act 1995 the following changes which are relevant have occurred:-

....

Signature:	....	Date:	....
Name:		Qualification:	
Address:		Name of Employer:	

Note:

The certification of the adequacy of rates of contributions for the purpose of securing the meeting of the minimum funding requirement is not a certification of their adequacy for the purpose of securing the scheme's liabilities by the purchase of annuities, if the scheme were wound up.

APPENDIX 4.7

To: The Trustees of the Scheme Named below

Name of Scheme: ....

PSO Reference No (if any): ....

This certificate is given having regard go the Occupational Pension Schemes (deficiency on Winding-up etc.) Amendment Regulations 1996 and has been prepared in accordance with Guidance Note GN19 issued jointly by the Institute of Actuaries and the Faculty of Actuaries and must be read in conjunction with the notes listed overleaf.

I hereby confirm that in my opinion, as at ....

* The value of the liabilities of the scheme did not exceed the value of the assets of the scheme.

* The value of the liabilities of the scheme exceeded the value of the assets of the scheme by £ ....

The values of the liabilities and assets have been determined in accordance with the principles and requirements of Guidance Note GN19.

Signature .... Date ....

Name .... Qualification ....

Address .... Name of Employer ....
(if applicable)

....

- Delete as appropriate

11 November, 1999
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