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REVIEW OF THE MFR BASIS

Thank you for your letter of 5 September 2001 about the Minimum Funding Requirement (MFR), in which you propose a lowering of the 'benchmark' dividend yield in the equity market-value adjustment (MVA) from 3.25% to 3%.

As you say in your letter, adjusting the equity MVA and changes to mortality assumptions formed part of the package of interim changes suggested by the Faculty and Institute in its review of the MFR published in September 2000. In March 2001, the Government decided not to make these changes in the light of its announcement at that time of its proposals to replace the MFR with a long-term scheme specific funding standard.

Implementing the Government's proposals in full requires primary legislation, and we recognise that some changes should be made to the way the current MFR works in advance of its replacement. That is why we are currently consulting on an interim package of measures that will enable pension schemes to start to move towards the position of more sustainable funding for the long-term. The consultation period ends on 10 December 2001 and we plan to implement these measures before April next year.

Our view is that we need to take a considered and balanced view as to the next stage of reform of the MFR, and that we should not make piecemeal changes. As such we would propose to give full consideration to your suggestion alongside others which we receive as part of the current consultation on the interim package of measures. Whilst we note the arguments you have put forward for an immediate change to the equity MVA we do not believe that such a change should be made in isolation, but should be considered as part of a coherent and balanced package arising out of the current consultation.

JOHN HUGHES