

Mr J Hughes
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5 September, 2001

Dear John

Review of the MFR basis

As part of its role in continually reviewing the actuarial basis for the Minimum Funding Requirement (MFR), the Pensions Board has been considering the changes that should be made to the MFR to ensure that its strength under current economic conditions remains consistent with the original intentions. Although we understand the reasons why the proposed interim measures we proposed earlier are not to be implemented, we feel that a change should nevertheless be made in the near future in order to return the MFR to the level originally envisaged when it was first introduced. We have aimed at making the proposed change as simple as possible in view of the intention to abolish the MFR in its current form.

Currently two main factors affecting the MFR basis have changed - the reduced level of or the non-payment of dividends and the expected mortality rates in future. The changes needed to the MFR in the light of these two factors work in opposite directions in terms of the financial impact. On the one hand the lack of any dividend from companies such as British Telecom would indicate that some change should be made to the MVA factor which produces a weakening of the basis at the point it is changed. Note however that this is aimed at bringing its strength back to that originally intended rather than an actual weakening. On the other hand, improvements in longevity would indicate a strengthening of the basis.

The extent to which these two effects cancel each other out in terms of the total for the MFR liabilities will depend on the maturity of each particular scheme. We are of the view, however, that the overall position has changed sufficiently to require a lowering of the dividend yield in the MVA from 3.25% to 3%. If we had considered more detailed changes in the form of our earlier proposals we would now be proposing a larger change to the MVA factor, to something of the order of 2.75% rather than 3%. However, in order to keep the proposal simple and to take some account of the underlying need for a change to the mortality assumption, we are suggesting that a smaller change is made which implicitly can be taken as making some allowance for the mortality change.

In recommending this change to the MFR we would point out that it is a change that could be introduced immediately through a Technical Amendment to GN27 following agreement by the Secretary of State.

As before, we shall, in due course, be informing our members that we have made this proposal.

Yours sincerely

Peter Tompkins
Chairman
Pensions Board

Please reply to:
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