Retirement Benefits in Hong Kong

Introduction

In Hong Kong, there are several types of retirement benefits sponsored by different parties as shown below.

Government-sponsor - Old Age Allowances from the Social Security Assistance (SSA) Scheme is a means-tested monthly income to elderly persons living in Hong Kong for 7 years and staying continuously for 1 year prior to the application. There are restrictions on the wealth and the monthly income. The current allowances are HK$625 per month for age 65 to 69 and HK$705 per month for age 70 or above.

ORSO Schemes – voluntary retirement schemes set up by employers under Occupational Retirement Schemes Ordinance. All retirement scheme arrangements (except MPF Schemes as mentioned below) must be registered or exempted under ORSO with the following requirements:

- Scheme assets must be separated from the employer
- No more than 10% of scheme assets invested in employer's business
- Defined Benefit Plans must be adequately funded
- Schemes must be governed by trust or insurance policy (but those schemes applying MPF exemption must be set up under trust)
- Scheme set up under trust must have at least one independent trustee
- Scheme must provide adequate disclosure to members
- Those schemes established before 15 October 1995 can apply for MPF exemption (deadline 3 May 2000)

MPF Schemes – mandatory defined contribution schemes set up under Mandatory Provident Fund Schemes Ordinance. All employers have to set up the MPF Schemes for their employees. The key characteristics are summarised below:

- Introduced on 1 December 2000
- Cover all employees aged over 18 and under 65 with exemptions
- Mandatory contributions of 5% of earnings each by employee and by employer
- Earnings subject to a current minimum limit of HK$5,000 p.m. and a current maximum limit of HK$20,000 p.m., and excludes housing allowances/benefits
- The minimum and maximum limits would be reviewed from time to time
- Mandatory contributions are immediately 100% vested with employees, portable on change of employment, preserved until retirement
- Full benefits paid on retirement, death, disability, permanent departure from Hong Kong
- Minimum of 30% of investments must be held in HKD denominated assets

Long Service Payment (LSP) – this is not a formal retirement scheme arrangement but this is an employer's obligation under Employment Ordinance to pay a lump sum benefit at employees' retirements (and upon some other events). The details are shown below:

- Service requirement : 5 years of continuous service

- Eligibility: ill-health, death, retirement after age 65, dismissal other than redundancy, layoff or summary dismissal or expiration of fixed term contract without renewal
- Benefit: 2/3 x final month wages (capped at HK$22,500 p.m.) x years of service, subject to an overall cap of HK$390,000
- Employer funded retirement scheme benefit (including ORSO or MPF) can be used to offset LSP payment

Legislation

Occupational Retirement Schemes Ordinance (ORSO), which governs
- Scheme operations
- Reporting requirements
- Funding requirements for defined benefit schemes
- Assets management

Mandatory Provident Fund Schemes Ordinance (MPFSO), which governs
- Scheme trustee assumes overall responsibility
- Scheme design
- Scheme operations
- Reporting requirements
- Service providers
- ORSO/MPF scheme interface

Employment Ordinance, which governs
- Long service payment / severance payment

Inland Revenue Ordinance, which governs
- Tax exemption for employer / employee contributions
- Tax rules on benefits including proportionate tax rule
  (there is a Departmental Interpretation No. 23 issued by Inland Revenue Department in September 2006 showing the details of the interpretation about tax rules on retirement scheme)

Discrimination Ordinance, which governs
- Sex discrimination

Type of Retirement Schemes in Hong Kong

Most of the employees in Hong Kong are covered under MPF Schemes. Under the ORSO environment, defined contribution plans are generally more common than defined benefit plans in Hong Kong. Below are the relevant statistics as at 31 December 2006:

	MPF Schemes	ORSO Schemes	Total
Number of Employees (HK$000)	2,071	512	2,583
Asset size (HK$ billion)	202	211	413
Annual contribution (HK$ billion)	28	15	43

	ORSO DC Schemes	ORSO DB Schemes	Total ORSO
Number of Employees (HK$000)	356	156	512
Asset size (HK$ billion)	122	89	211
Annual contribution (HK$ billion)	10	5	15

Source: MPFA website

Defined Benefit Plans in Hong Kong typically provide lump sum benefits upon termination of employment or retirement based on formulas linked to salary and year of service. Employer bears the investment risks. Pensionable salary may include basic monthly salary, overtime pay, allowances, commissions or bonuses.

Defined Contribution Plans in Hong Kong provide lump sum benefits upon termination of employment or retirement. Members bear investment risks. Employer contributions are generally expressed as a fixed percentage of salaries, depending on years of service and job grades.

Hybrid Plans are not very common in Hong Kong. The benefits may be the sum of 2 types of formula (e.g. sum of 1.2 x years of service x monthly salary and Member balance + Company balance) or the greater of 2 types of formula (e.g. greater of 1.5 x years of service x monthly salary and Member balance + Company balance)

Considerations in setting up Retirement Plans

Below are the general considerations in setting up the employer sponsored schemes

- Desire to provide some form of benefit in retirement for long serving employees
- Preferential tax treatment
- Benefit forfeited if employees leave prior to retirement
- Death and disability benefits set in response to perceived needs of employees
- Defined contribution plans vesting scale usually provide better benefits to shorter service employees
- Help to attract (and retain?) talents

- While plan offering may be a necessity, the overall generosity of benefits offered varies considerably
- Traditional defined benefit plans are well-suited to long serving employees
- Defined contribution plans viewed as more effective for mobile workers
- With the pressure of ageing population, employers may have to rely increasingly on retirement plan incentives to maintain the orderly retirement of older workers (defined benefit plans easier to augment)

Arguments in favour of setting defined contribution plans
- Concept relatively easy to understand and tends to be readily accepted by employees - operation similar to bank accounts
- Employer contribution level fixed - can accurately predict current and future obligations
- Employer contributions to individual accounts - readily integrated with salary packaging
- Member investment choice more readily incorporated into a defined benefit plan

Arguments against defined contribution plans
- Amount received at retirement (and hence standard of living) depends on salary over work life rather than salary near retirement
- Benefit level critically dependent on level of investment returns
- Inflation may erode the real value of benefit payable at retirement
- Difficult for employees to estimate what their benefit at retirement worth in real terms
- Employee bears the investment risk

Arguments in favour of setting defined benefit plans
- Level as a percentage/multiple of salary known in advance
- Level independent of investment return
- Benefits could be augmented more easily
- If benefit linked to salary near retirement => some protection against inflation
- Employer bears the investment risk – may need to meet any funding shortfall but may also take “contribution holiday”

Arguments against defined benefit plans
- Pooled assets and defined benefit concepts more difficult for members to understand
- Amount paid into the scheme by the employer in respect of a particular employee not defined and not readily measurable
- Difficult for employer to budget for future contribution obligations
  - Cost escalates at times of high inflation and vice versa
  - Required to increase funding in times of poor investment return
- When surplus arises, there can be disagreement about the ownership

Argument for Lump Sum
- Flexible for members to utilize their retirement benefits. May use to meet any capital needs or can use the money to purchase an annuity and structure the timing of payments to suit their needs and circumstances
- Human preference - may “lose out” if take a lifetime pension and then die soon afterwards

- Hong Kong taxation is favouring lump sums
- Pensions without indexation quickly lose their purchasing power while many believe they can invest their lump sum to counter inflation

ORSO Interface

ORSO is not removed in the implementation of MPF. Employers also wish to keep ORSO. However, ORSO sponsors are required to provide choice to employees to join MPF scheme upon the following events:

- on 1 December 2000 for all members
- If the ORSO schemes are open to new employees, upon joining
- Reduction in future service benefits

Sufficient documentation has to be provided to employees in making the scheme choice

- Statement – details covered in MPFSO
- Benefit projection
- ORSO and MPF scheme rules

Scheme choice election forms have to be kept in personnel files

Employees opting for ORSO

- For existing employees: business as usual
- For new employees: Minimum MPF Benefits (“MMB”) must be preserved
- MMB = 1.2 x MPF Relevant Income x Service or leaving service benefit under the ORSO if lower

Employees opting for MPF

- Past service retained and frozen in the ORSO (i.e. Benefit accrual rate x years of service (frozen) x scheme salary)
- Or other arrangement acceptable to employees like transfer value
- Future service benefit will be accrued in MPF
- Upon termination of employment : ORSO (Frozen) + MPF

ORSO requirement

Actuary is defined to be the fellow member of one of the following representative bodies

- Society of Actuaries (US)
- Institute of Actuaries of England
- Institute of Actuaries of Australia
- Faculty of Actuaries of Scotland

Actuarial investigations

- Key activity of a pension actuary
- Conduct regular actuarial investigations of defined benefit scheme required by law
    - To examine how well the scheme is being funded (i.e. adequacy of current assets)
    - To calculate future employer contribution rates necessary to secure member’s expected benefits

- In Hong Kong, every 3 years if the scheme is solvent (i.e. vested benefits fully covered by assets); otherwise annual valuations
- Trust deed usually specifies the need for such investigations
  - Duties imposed by ORSO
  - Carry out an actuarial valuation and issue a certificate in respect of the scheme
  - Actuarial Certificates prescribed under ORSO
    - Scheme solvent: Full Actuarial Certificate
    - Scheme insolvent: Qualified Actuarial Certificate
  - Vested Liability is defined to be the value of benefits assuming member leaves the scheme as at the valuation date (no actuarial assumptions)
  - Past Service Liability is defined to be the value of member's projected benefits in respect of service completed assuming he remains as active member of the scheme
  - Solvency is a measure of whether value of assets sufficient to meet total vested liability (leaving service benefits) if all members leave service. Solvency ratio is the asset divided by the solvency liability.
  - On-going funding is a measure of whether value of assets sufficient to meet value of members projected benefits assuming the scheme continues in operation. Past Service Funding Ratio is the asset divided by the past service liability. Funding objective is to have assets at least equal to past service liability.
  - Attained Age Cost Method is typically used in Hong Kong. Under the method, past service liability of the scheme is determined using the Projected Unit Credit Cost Method
  - Future service liability is the present value of the projected benefits based on service after the valuation date
  - Company normal contribution rate is equal to future service liability divided by the present value of members' projected future salaries
  - Scheme asset value is compared with past service liability to determine surplus or deficit. Surplus or deficit is amortized as prescribed by ORSO

Certification under "Full Actuarial Certificate"

- As at the Date of Actuarial Review the Scheme's assets were sufficient to meet the Scheme's Aggregate Vested Liability
- Following the review I have made recommendations as regards funding of the Scheme for [date] to [date] as follows :
  - Executive: x%
  - General Staff: y%
- Provided the Scheme is funded in accordance with those recommendations, I would expect that :
  - the Scheme's assets would continue to be sufficient to meet the Scheme's Aggregate Vested Liability throughout the period of 3 years from the date of the review; and
  - the Scheme's assets would continue to be sufficient to meet the Scheme's Aggregate Past Service Liability.

Certification under "Qualified Actuarial Certificate"

- As at the Date of Actuarial Review the Scheme's assets were not sufficient to meet the Scheme's Aggregate Vested Liability and the amount of deficit as at that date was HK$xxx.
- Following the review I have made recommendations as regards funding of the Scheme for [date] to [date] as follows :
  - Executive: x%
  - General Staff: y%
- Provided the Scheme is funded in accordance with those recommendations, I would expect that :
  - the estimated amount of deficit between the Scheme's assets and the Scheme's Aggregate Vested Liability as at the expiry of 12 months from the date of Actuarial Review would be HK$xxx
  - Within three years, the Scheme's assets would be sufficient to meet the Scheme's Aggregate Vested Liability.
  - I would expect that on the expiration of xx years, the Scheme's assets would be sufficient to meet the Scheme's Aggregate Past Service Liability.

ORSO requires that the actuarial valuation has to comply with the Professional Standard 2 – Actuarial Reports and Certification issued by Actuarial Society of Hong Kong.

Accounting for Defined Benefit Plans in Hong Kong

The accounting standard governing the accounting for companies operating defined benefit plans are Hong Kong Accounting Standard 19 – Employee Benefits. This standard is basically the same as the International Accounting Standard 19.

Companies are required to book an expense (or income) under its Profit or Loss Account in accordance with HKAS 19 and this expense is generally independent of the actual cash contributions made to the scheme which are recommended by the Actuary in accordance with ORSO.

Companies are also required to book a pension liability (or asset) under its balance sheet to reflect the actuarial deficit (or surplus) of the scheme subject to various deferred recognition rules.

Regulations on Investment of Retirement Scheme

- Management of retirement scheme assets is subject to regulatory requirements
- Investment earnings are tax exempt in HK
- ORSO
  - Scheme assets must be kept separate from the employer's assets
  - No more than 10% of the scheme assets shall consist of shares or securities of the participating employers of the scheme or their associates
  - No scheme assets acquired on or after 15 October 1993 shall consist of shares of a body corporate not listed in a recognised stock exchange
  - Investment in shares of a body corporate listed on a recognised stock exchange is limited to a maximum of 15% of the total scheme assets

- MPF
  - An MPF fund may generally invest in fully paid-up shares listed on recognised stock exchanges, investment grade debt securities, or some types of convertible debt securities, and to a limited extent, listed warrants
  - The fund may, within limits, engage in security lending and repurchase agreements, and hedging through certain financial derivatives
  - The fund may be deposited with eligible banks, provided the amount of deposits avoid over-concentration
  - Total amount invested in securities and permissible investments issued by any one person may not generally exceed 10% of the total assets of an MPF fund
  - For employer-sponsored schemes, may not have more than 10% of assets in shares or securities of, or issued by, participating employers or associated companies

Disclaimer

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