Consultancy Study on the Proposed Civil Service Provident Fund Scheme

19 March 2001

Objectives of the CSPF Scheme

- *Modernise* the retirement benefit system in the civil service
- *Comparable* with the practice in the private sector in Hong Kong
- *Attractive* to new recruits
- Design which contains *retention incentives*
- Characteristics that allow for greater *flexibility* in the Civil Service appointment system
- *Predictable and transparent* Government cost and liability

Existing Pension Costs- New Pension Scheme (NPS)

- Average long-term cost for new recruits, as a % of payroll:
  - About 22% of payroll, including all benefits
  - Non-disciplined services officers: 20.4%
  - Disciplined services officers, all benefits: 26.4%
  - Disciplined services officers, without special benefits : 23.6%

Contributions in Local Provident Fund Schemes

- Normally in the range of 5% to 15% of basic salary
- Some provide uniform rates; others rates based on service
- Median about 10%-13% of salary
- Upper quartile 13%-15% of salary
- Best practice: initial contribution 13% of salary, after 10 years 20% of salary

Legal Framework

- Recommendation: Set up under the Mandatory Provident Fund Scheme Ordinance (MPFSO)
- Can be Employer Sponsored Scheme or Master Trust Scheme - no recommendation yet
- Details of scheme design and administration to be considered in Stage 2

Design Options for Disciplined Services Officers

- To account for shorter careers, longer retirement periods, and enhanced benefits at age 55
  - Recommend additional contribution to CSPF of 2.5% of salary per year (SDSC)
  - Based on estimated average value to typical new recruit to disciplined services under NPS
  - Two vesting options:
    - Full vesting at 55; no partial vesting
    - Partial vesting from 10-30 years of service; full vesting at age 55 or 30 years of service

Government Contribution Rates Considered

- Uniform rate for all staff
- Varying contributions rates based on service
- Varying contributions rates based on service and salary band

Government Contribution Rates Considered

- Uniform rate for all staff
  - Simple to understand and administer
  - Equitable
  - High recruitment value
  - Low retention value (could be enhanced with vesting schedule)

Fixed Rate Option

- Basic Tier: MPF mandatory contribution
- Voluntary Tier: 17% of basic salary minus Basic Tier
- Special Disciplined Services Contribution (SDSC): 2.5% of basic salary
- Voluntary Tier and SDSC subject to different vesting schedules
- Government commitment or long term cost = 17.7% of payroll, including SDSC

Service Based Options

- Varying contributions based on service
  - Rates start at 5% of basic salary
  - Rates increase periodically, up to a maximum of 25%
  - High retention effect, enhanced by vesting schedule
  - Will discourage moves to second career employment by experienced officers with high value to the civil service
  - Government commitment = 18% of payroll, including SDSC

Options Based on Service and Salary Band

- Different levels for Lower Band, Middle Band, and Upper Band and Directorate
  - Pros:
    - High recruitment and retention value for senior officers
  - Cons:
    - May be controversial
    - Higher percent of pay compensation costs for senior officers
    - Different from existing strategy under NPS
- Not recommended

Vesting

- Basic MPF amount immediately vested
- Voluntary Tier:
  - a: 10 year (graded or cliff): Higher retention with cliff vesting
  - b: 20 year graded : not commonly seen
- SDSC: 100% at age 55, or graded with 100% at age 55 or 30 years of service
- Forfeitures of voluntary tier benefits due to misconduct, etc.

Design Options for Other Special Benefits

- Special benefits at duty death and incapacity
  - Amounts and frequency are minimal
  - Recommend benefits for duty death and incapacity comparable to those provided under the NPS
  - Recommend benefits be paid outside of CSPF

Transfer Options

- Proposal allowing existing serving officers to transfer from pension schemes to CSPF investigated
- Not recommended due to legal, financial, design and administrative complications

Transfer Options

- Legal: Legislation required, would distract from bigger issues
- Financial: Significant potential cash requirement
- Design: Disconnect between benefit accruals of pension and provident fund scheme
- Administrative: Assumptions and eligibility issues

Summary of Recommendations

- CSPF covered by MPFSO
- Special contributions for disciplined services-SDSC
  - Rate set at 2.5% of basic salary
  - One of 2 vesting options, full vesting at 55
- Voluntary Tier
  - uniform rate
  - service-based rates

Summary of Recommendations

- 10 year vesting for Voluntary Tier; maximum retention value with 10 year cliff vesting
- Benefits over mandatory MPF amount paid immediately at leaving service
- No transfer option offered to existing serving officers
- Special benefits paid outside of CSPF

Financial Argument in Support of the CSPF

- Under the pensions system, retirement benefits for today's civil servants not funded before their retirement. They are paid from the general revenue as and when necessary. (In other words, the financial commitments in respect of the present generation is passed onto future generations.)
- Under the CSPF, retirement benefits are funded during the active service of the civil servants.
- Financial commitment : 22% of the payroll under the NPS; 18% of the payroll under the proposed CSPF.
- Current civil service payroll in 2000-01: $55 billion

Advantages of CSPF Design to Staff

- Total benefit paid as lump sum at retirement
- Lump sum in excess of mandatory MPF amount paid at leaving service prior to retirement
- Individual account balances
- Employee choice of investments
- Portability

Questions?