Foreword

This consultation document sets out in main the consultants' recommendations on the proposed Civil Service Provident Fund Scheme for new recruits on permanent terms of appointment. The proposal involves a major change to the retirement benefits system for the civil service. The existing pension schemes have been in place for over fifty years. The time has now come for us to adopt a system which will enable us to better meet the needs of the community and better manage the civil service, while at the same time being transparent and predictable in terms of financial management.

We welcome comments and suggestions on the design of the proposed CSPF Scheme.

Joseph W P Wong
Secretary for the Civil Service
January 2001

CONTENTS

PROPOSAL ON THE CIVIL SERVICE PROVIDENT FUND SCHEME

1. INTRODUCTION

1.1 The Administration issued a Civil Service Reform Consultation Document in March 1999. Measures proposed included, among other things, the introduction of new entry terms for the civil service to replace the current permanent and pensionable terms of appointment and a more competitive appointment system to fill posts at supervisory ranks. As a complement to these proposals, we also proposed to study the feasibility of setting up a Civil Service Provident Fund (CSPF) Scheme for new recruits to the permanent terms of appointment. The main objective of these measures is to institute a more flexible appointment system while maintaining a structured career framework that provides stability and continuity.

1.2 As a follow up to these proposals, we commissioned in January 2000 a consultancy study on the civil service retirement benefits system. The objectives of the consultancy study are –

(a) to explore and propose options for the new retirement benefits system based on a provident fund scheme for recruits to the permanent terms of appointment under the new entry system;

(b) to formulate design variables and options, including the transfer arrangements for serving officers appointed on pensionable terms; and

(c) to formulate implementation plans and to undertake related preparatory work for implementing the CSPF Scheme.

The consultancy study is being carried out in two stages. A summary of the consultants' findings in Stage 1 of the consultancy study, which is on objectives (a) and (b) above, and their recommendations on the proposed CSPF Scheme is set out in the Executive Summary of their report, separate copies of which are available upon request.

Consultation Timetable

1.3 This document sets out the consultants' recommendations on the proposed CSPF Scheme. We welcome comments and views from staff at all levels, those recruited under the new entry system in particular, grade management, departmental management and concerned parties. We will take the views and suggestions collated in the consultation exercise into account in Stage 2 of the study, during which the detailed design of the CSPF Scheme and the implementation plans will be formulated.

1.4 If you have views and suggestions on this consultation document, please send them to the Appointments (Special Duties) Team of the Civil Service Bureau before 30 April 2001.

Address	:	Appointments (Special Duties) Team Civil Service Bureau Government Secretariat Central Government Offices, West Wing, 10/F Ice House Street, Central
Fax	:	2523 6416
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2. POLICY CONSIDERATIONS IN SETTING UP THE CSPF

2.1 The current civil service retirement benefits system for officers appointed on pensionable terms is in the form of pension schemes. The prevailing two schemes are the Old Pension Scheme (OPS) and the New Pension Scheme (NPS); the former applies to civil servants appointed before 1 July 1987 and the latter to those appointed on or after that date. On the introduction of the NPS, the then serving officers on OPS were offered an option to join the NPS. Both OPS and NPS are non-contributory, unfunded defined benefits pension schemes set up under the law.

2.2 Under the civil service pensionable terms of appointment, the entry and exit mechanisms were not designed to provide sufficient flexibility in respect of attracting inflow of outside talent at various levels. For example, the pension system is more attractive for staff to join at basic ranks and rise through the ranks with full security of tenure. Removal is limited to exceptional and specified circumstances such as serious misconduct, continued non-performance, poor health and redundancy.

2.3 Under the new entry system adopted since June 2000, new recruits to the civil service will in general be engaged on probation for three years, to be followed by appointment on three-year agreements before they progress to permanent terms. We also envisage more intake at supervisory ranks, whereby appointees would be appointed on agreement terms in the first instance before they are considered for appointment on permanent terms. The mechanism is designed to ensure that permanent terms are offered only to those with proven performance and potential.

2.4 In order to complement the more flexible entry system, we have introduced an initiative to revamp the existing retirement benefits system so that it is compatible with that in the private sector, hence encouraging the inflow of talent as they will be able to carry their retirement benefits when switching jobs between the private sector and the civil service. The implementation of the Mandatory Provident Fund (MPF) legislation provides the ready infrastructure for the adoption of a provident fund scheme in the civil service.

2.5 In addition to the human resource management considerations, the pension system also has a major drawback in financial management terms because no funds are specifically set aside on an annual basis to meet the Government's future commitments as civil servants start to retire and draw pensions. This means that in practice, pension liabilities incurred today are met from future annual recurrent accounts. The introduction of a CSPF Scheme will entail a funded approach in respect of the provision of retirement benefits. The Government's commitment in this regard will also become transparent and predictable. Payments for the retirement benefits will be spread evenly throughout the staff's active service and the year-to-year impact on government expenditures will be contained within a narrower margin proportionate to the changes in the size and profile of the current civil service.

3. THE PROPOSED CSPF SCHEME

3.1 A summary of the consultants' recommendations on the design options for the proposed CSPF Scheme are set out in the following paragraphs.

Legal Framework for the CSPF Scheme

3.2 The consultants recommend that the proposed CSPF Scheme should be set up under the Mandatory Provident Fund Schemes Ordinance (Cap. 485) (MPFSO). This means that the proposed Scheme would have to meet the requirements set out in the legislation.

Retirement Age

3.3 The normal retirement age should remain the same as in the NPS, i.e. 60 for the civilian grades and 55 for members of the disciplined services except those officers whose prescribed retirement age is 57 in the legislation.

Contribution Rates

3.4 The consultants have examined the following three contribution rate options for all staff –

(a) Uniform Contribution Rate, which is simple to administer and easy to understand, but the retention incentive within the scheme would depend solely on the vesting schedule;

(b) Different Contribution Levels for Different Salary Bands, i.e. varying contribution levels with higher rates for staff in senior ranks. This option will have the major advantage of enhancing the attractiveness of senior salary band posts for staff retention and for higher competitiveness in direct outside recruitment. This is practised in the private sector although most companies do not disclose full details of the remuneration packages (especially for senior appointees) due to commercial and data privacy reasons; and

(c) Different Contribution Levels Based on Service, i.e. contribution level increases as an officer's length of service increases. This option allows for higher contribution levels at the latter part of an officer's career and enhance the retention incentive for that period.

3.5 The consultants also made reference to their survey findings on the defined contribution schemes in the local private sector. On average, schemes in the upper quartile (i.e. the third and fourth quartiles) feature the following –

	Employer's Contribution Rate as a Percentage of Basic Monthly Salary
Management Staff	
Year 1 - 5	10%
Year 6 - 10	12%
Thereafter	13%
General Staff	
Year 1 - 5	9%
Year 6 - 10	11%
Thereafter	12%

The scheme with the best contributions features the following –

	Employer's Contribution Rate as a Percentage of Basic Monthly Salary
Year 1 - 10	13%
Thereafter	20%

Special Arrangements for the Disciplined Services

3.6 If the retirement ages are to remain unchanged under the proposed CSPF Scheme, staff of the disciplined services would have a shorter span of career when compared with civilian staff. Therefore, in addition to the rate of contribution that the Government will make towards staff in general, the consultants recommend a "Special Disciplined Services Contribution" (SDSC) for members of the disciplined services at a level broadly comparable to that of the value of the enhancement of benefits on retirement at the prescribed age under the NPS. (The additional value of the associated pension benefits for members of the disciplined services who are required to retire at the prescribed ages of 55 to 57 with enhancement of their pensionable service under the NPS is approximately 2.5% of salary.)

Government Contribution Rates

3.7 Unlike the civil service pay policy, the Administration does not have a policy of linking the level of retirement benefits with those in the private sector. In the last major review of the civil service pension system, the NPS was introduced resulting in a reduction in the Government on-cost from a weighted average of 27.59% under the OPS to 22.91% for serving staff under the NPS. However, staff under the NPS are given a higher commutation ratio for the lump sum gratuity.

3.8 Having regard to the survey findings of the retirement schemes in the private sector and with reference to the objectives of maintaining the attractiveness of the civil service as a career and ensuring a high degree of integrity and probity among civil servants, the consultants have drawn up design options as follows –

Option 1 - Uniform Contribution Rate

Basic Tier Mandatory contribution under the MPF legislation
Voluntary Tier Equal to 17% of basic salary when added to the Basic Tier contribution
Special Disciplined Services Tier
Comparable to 2.5% of basic salary

Retirement Age		**Benefit as a Multiple of Final Month's Salary**					
	Hire Age	**25**	**30**	**35**	**40**	**45**	**50**
45		37.2	28.9	19.7	9.9	0.0	N/A
50		48.9	40.2	30.6	20.5	10.1	0.0
55		63.2	53.8	43.4	32.4	21.3	10.3
60		80.8	70.4	58.8	46.6	34.2	22.0

Note *The table above reflects the equivalent benefit levels for staff in general from the proposed Government contributions.*

Option 2 - Progressive Contribution Rates based on Service

Option 2-A:

Basic Tier Mandatory contribution under the MPF legislation

Voluntary Tier	Up to 5 years of service	)		)	5%	)	
	6-10 years of service	)		)	10%	)	of basic
	11-15 years of service	)	equal	)	15%	)	salary when
	16-20 years of service	)	to	)	20%	)	added to
	21-25 years of service	)		)	25%	)	the Basic Tier
	Thereafter	)		)	25%	)	contribution

Special Disciplined Services Tier
Comparable to 2.5% of basic salary

Retirement Age		**Benefit as a Multiple of Final Month's Salary**					
	Hire Age	**25**	**30**	**35**	**40**	**45**	**50**
45		28.1	17.2	8.7	2.9	0.0	N/A
50		44.2	29.8	18.0	9.0	3.0	0.0
55		63.0	47.4	31.6	18.8	9.3	3.0
60		85.5	68.2	50.6	33.3	19.6	9.6

Note *The table above reflects the equivalent benefit levels for staff in general from the proposed Government contributions.*

Option 2-B:

This is a variation of Option 2-A to better align with the new entry system whereby recruits normally would have to complete a 3-year probation followed by a 3-year period on agreement terms before being offered permanent terms of appointment.

Y1 - 3	**Y4 - 6**	**Y7 - 10**	**Y11 - 15**	**Y16 - 20**	**Y21 - 25**	**Thereafter**
5%	7.5%	10%	15%	20%	25%	25%

Retirement Age		**Benefit as a Multiple of Final Month's Salary**					
	Hire Age	**25**	**30**	**35**	**40**	**45**	**50**
45		27.6	16.6	8.1	2.9	0.0	N/A
50		43.7	29.2	17.4	8.4	3.0	0.0
55		62.4	46.8	30.9	18.2	8.7	3.0
60		84.9	67.5	49.9	32.6	18.9	8.9

Note *The table above reflects the equivalent benefit levels for staff in general from the proposed Government contributions.*

Option 3 – Varying Contribution Rates based on Salary Bands

The consultants have also examined this option, which is also practised in the private sector. However, the consultants do not recommend this for the proposed CSPF Scheme. This option would provide a more valuable compensation package to officers of management and directorate ranks for staff retention and for higher competitiveness in direct outside recruitment. However, it would also mean a drastic departure from the spirit of the existing pension schemes where the cost as a percentage of pay is the same for all ranks within the same normal retirement age group. The consultants pointed out that Option 2, i.e. progressive contribution rates based on service, which more closely reflects the benefit accrual patterns of the existing pension schemes, also has an enhanced staff retention value.

3.9 The consultants have adopted the following assumptions in projecting the benefits derived from the various options of Government contribution rates as set out in the tables at paragraph 3.8 above –

(a) an average long-term rate of return of 7.5% per year. This is a reasonable estimate of the long-term average investment return that CSPF Scheme members could earn on their accounts and is supported by experience in other provident fund schemes where long-term experience data are available; and

(b) members' salary would increase with inflation (assumed to be 2.5% in 2000-2003 and 4% per year thereafter), productivity (0.9% per year) and promotion (6.75% at Age 20; 4.625% at Age 30; 2.75% at Age 40; 1.25% at Age 50; and 0.25% at Age 59). The latter two components are based on historical data.

Employee Contributions

3.10 New recruits to be covered by the CSPF Scheme are required to contribute to the Scheme as prescribed in the MPF legislation.

Vesting

3.11 Under the MPFSO, the MPF mandatory contributions of 5% of relevant income (with a cap at $1,000 per month) from both the employer and the employee are immediately vested in the employee. However, vesting or entitlement to future possession of an officer's accrued benefit in the CSPF Scheme due to Government's voluntary contributions upon leaving service can be used as a retention tool.

3.12 In the local defined contribution schemes surveyed, the most common vesting rule provides full vesting after 10 completed years of service. These schemes also usually require a minimum of one to three years of service for partial entitlement to leaving service benefits.

3.13 The consultants recommend 100% vesting of the Government's voluntary contributions after 10 completed years of service. Interim vesting can be at the rate of 10% per year, or with no vesting until 10 years of service; the latter would fulfill the retention objective of the CSPF Scheme and is in line with the general 10-year qualifying service requirement under the NPS for pension benefits eligibility in the event of resignation before reaching normal retirement age.

3.14 The consultants also suggest that consideration may be given to extending the vesting schedule for the Government's voluntary contributions to 20 years with progressive vesting from the 11th year and 100% vesting on 20 completed years of service. This option, although not common in local provident fund schemes, would result in an even greater retention effect.

3.15 The consultants further recommend that benefits accrued under the SDSC arrangement should be subject to one of the following two vesting options –

(a) 0% vesting until reaching the prescribed retirement ages when 100% vesting will take effect, i.e. mirroring the arrangement under the NPS; or

(b) 0% up to 10 years of service, 5% per year from 11 to 30 years of service (i.e. 50% after 20 years and 100% after 30 years).

In all cases, the amount will be fully vested at the prescribed retirement age with 10 years of service (which is the minimum qualifying service for the existing enhancement) or with 30 years of service at any age.

3.16 Related to the issue of the vesting schedule is the withdrawal or encashment of the accrued benefits. It is common practice in the private sector to let employees encash what is vested in them on their departure from the company. The consultants recommend a common schedule for both vesting and encashment purposes and consider that the vesting schedule should count from the time that the staff join the civil service. This is simpler to administer.

Withholding, Forfeiture or Cancellation of Benefits arising from the Employer's Voluntary Contributions

3.17 The consultants recommend that to help maintain high standards of integrity and probity in the civil service, provisions to deal with withholding, forfeiture, cancellation, or reduction of benefits arising from the Government’s voluntary contributions should be included. Such provisions should, however, be subject to the rule that mandatory MPF benefits cannot be withheld or forfeited as prescribed under the MPF legislation.

Transfer Option for Serving Pensionable Officers

3.18 Issues that would need to be addressed for provision of a transfer option from the existing pension schemes to the proposed CSPF include, among other things –

(a) the appropriate method and assumptions for determining the transfer value;

(b) the availability of resources for funding the transfer values since there are no assets set aside for the pension schemes; and

(c) the treatment of pensionable officers who have yet to become eligible for any pension benefits.

Taking all factors into consideration, the consultants do not recommend allowing transfers from the pension schemes to the CSPF Scheme -

(a) pension schemes and provident fund schemes work on different design logic. The pension schemes provide a certain level of benefits that is accrued over the career of the officer. Allowing a mid-career transfer to the CSPF Scheme will disrupt the flow of benefit accruals, and result in difficult settlement as to the appropriate transfer value;

(b) the cash flow impact of allowing transfers of past service benefits might be significant. Cash would have to be provided up-front by the Government as part of the transfer; and

(c) the administrative and legislative requirements of allowing transfers could be burdensome, and would be a distraction from the objectives that the CSPF Scheme is trying to accomplish.

Provision of Enhanced Benefits

3.19 Under the existing civil service pension schemes, enhanced benefits, by means of enhancing an officer's length of pensionable service or provision of a guaranteed amount of benefit, will be granted on occasions including death in service, invaliding, duty-related injury or death, and abolition of office. The consultants point out that it is not possible for a defined contribution provident fund scheme, which is simply based on the accumulated value of contributions made by the employer and the employee, if any, and the return on investments, to provide these special enhanced benefits.

3.20 To address this problem, the consultants recommend that such benefits, where provided, should be paid through a supplementary defined benefit scheme or through payments outside of the CSPF Scheme.

4. LOOKING AHEAD

4.1 The Civil Service Reform aims to modernise the civil service management system in order to make it more flexible and better meets the needs of the community through a clean, trusted, respectable and fulfilled workforce. The proposed CSPF Scheme is one of the key measures to fulfill these aims.

4.2 Over the next three months, we look forward to receiving constructive comments and suggestions from all relevant sectors. We would strongly urge officers appointed under the new entry system to consider the proposal in depth and give us their feedback.

4.3 We will engage in active exchange of views with staff, grade management and departmental management, in order to collate views and suggestions on various aspects of the proposed CSPF Scheme during the consultation period. After that, we will work out the details of the Scheme and the implementation plans with the consultants in Stage 2 of the consultancy study. Preparatory work for implementation of the scheme will commence thereafter.