

LEGISLATIVE COUNCIL BRIEF

CIVIL SERVICE RETIREMENT BENEFITS SYSTEM

INTRODUCTION

At the meeting of the Executive Council on 16 January 2001, the Council ADVISED and the Chief Executive ORDERED that the consultants' recommendation on the design options of the proposed Civil Service Provident Fund (CSPF) Scheme should be presented for consultation.

BACKGROUND AND ARGUMENT

General Background

2. The current civil service retirement benefits system 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 the date. On the introduction of NPS, the then serving officers were offered an option to join the NPS. Both OPS and NPS are non-contributory, defined benefits pension schemes for which funds are not specifically set aside to meet the government's commitments. The rules governing OPS and NPS are set out in legislation.

3. The Administration issued a Civil Service Reform Consultation Document in March 1999. Among other things, we proposed to introduce new entry terms for the civil service to replace the current permanent and pensionable appointment terms, to introduce a more competitive appointment system to fill posts at supervisory ranks, and to study the feasibility of setting up a CSPF Scheme for recruits on permanent terms. The main objective of these measures is to institute a more flexible appointment system while maintaining a structured career framework that provides stability, continuity and a high degree of integrity among civil servants.

4. A consultancy study was commissioned in January 2000. The consultancy is being carried out in two stages - Stage 1 on the surveys of current retirement benefits schemes in Hong Kong and in overseas civil services and possible design options for a CSPF; Stage 2 will be on implementation after consultation on the recommended design options.

Policy Considerations in Setting up the CSPF

5. One of the key elements of the Civil Service Reform is to facilitate the inflow of outside talent into Government at various levels. Retirement benefits in the private sector are mainly in the form of provident funds. It is therefore important to introduce a similar retirement benefits system in Government so that outside talent can carry their retirement benefits when switching jobs between the private sector and the civil service. In this way, they will not be inhibited from joining Government at various times of their career. The implementation of the Mandatory Provident Fund (MPF) legislation has also provided a ready infrastructure to support the use of a provident fund scheme in the civil service.

6. In addition, the introduction of a CSPF will have advantages in financial management terms. First this will entail a funded approach in respect of the provision of retirement benefits. Secondly, this will require payment of the retirement benefits throughout the active service of the staff whereas under the NPS, liabilities for retirement benefits of present day civil servants are deferred to the next generations. Thirdly, the commitment under a provident fund system is transparent and predictable whereas the liabilities under the pension schemes are open-ended in that they are subject to many uncertain factors such as inflation in the economy, changes in life expectancy, etc.

Summary of Findings in Stage I of the Consultancy

7. The consultants have completed their Stage 1 study. A summary of the findings from their background studies, namely, the survey on the civil service retirement benefits system in 10 overseas countries, the study on the retirement benefits systems in 50 local major corporations and organisations, the actuarial review of the civil service pension schemes and their recommendations on design options of the CSPF is set out in the Executive Summary of the consultancy report. The consultation document on the CSPF

proposal puts the consultants' recommendations on the design options more in focus. A copy each of the documents is attached.

Retirement System in Other Civil Service

8. It is difficult to draw a direct comparison between the civil service retirement benefits systems in overseas countries that the consultants have surveyed and that in Hong Kong because of the difference in the social security or insurance system. The findings also indicate that changes are being introduced to the traditional defined benefits systems. Among the countries surveyed, Singapore has moved from a defined benefits scheme to a defined contribution system and New Zealand does not offer a retirement benefit scheme to its newly hired civil servants. Seven civil service retirement schemes require contribution from the employees.

Local Retirement Benefits System

9. Locally, public organisations surveyed generally provide staff with retirement benefits in the form of a provident fund scheme (nine out of 10), with or without employees' contributions. The 40 private corporations surveyed all offer retirement benefits schemes for their employees, with two-thirds (25) providing a defined contribution scheme. Among the defined contribution schemes, 56% requiring employee contributions as well. On average, the provident fund schemes in the upper quartile (i.e. the third and the fourth quartiles) feature the following –

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

10. The survey findings reveal that the scheme with the best contribution rates is as follows –

Employer's Contribution Rate
as a Percentage of Basic Monthly Salary

Years 1 - 10	13%
Years 11+	20%

If the CSPF is modelled on the basis of such a scheme, the long-term cost to Government, including a Special Disciplined Services Contribution (see paragraph 14(c) below) at approximately 2.5% of payroll, would be 18.5% of basic salary.

Financial Commitment for Retirement Benefits

11. In the last major review of the civil service pension system, the NPS was introduced resulting in reduction in the Government on-cost from a weighted average of 27.59% under the OPS to 22.91% for serving officers under the NPS. In return, staff were given a higher commutation ratio for the lump-sum gratuity and an extension of the retirement age. The consultants have advised that the average pension on-costs for new recruits will be around 22% if the NPS remains open to them.

12. The level of retirement benefits under the NPS is noted for being higher than those offered in the private sector. However, it is the general view held by the civil service and the community that this is necessary to retain high calibre officers and to serve as an effective deterrent against malpractice and corruption because of the opportunity cost arising from loss of pension benefits. This has also contributed to the acceptance by the civil service as a whole of the requirement to comply with the highest standards of integrity and probity when compared with the private sector.

13. In the design of a CSPF, we are mindful of the need to maintain the on-cost for retirement benefits at a level which will retain the overall attractiveness of the civil service career. Taking into account these considerations, we consider the consultants' recommended design options appropriate and necessary to attract and retain good quality staff.

THE PROPOSED CSPF – Design Options

14. Having regard to our policy objectives and with reference to the survey findings, the consultants have developed a range of design options (summarised in the consultation document) with the following key features –

- (a) the CSPF is to be governed by the Mandatory Provident Fund Schemes Ordinance;
- (b) Government's contributions could be at –
 - (i) a uniform rate for all staff which can better achieve the effect of encouraging inflow of outside talent in the early years of their career; or
 - (ii) different contribution rates based on different length of service. The consultants has pointed out that progressive contribution rates based on length of service would better reflect the current principle for retirement benefits under the civil service pension schemes. If this option is adopted, certain flexibility will be required to determine the contribution rates based on relevant years of experience in facilitating intake of talent at senior levels;
- (c) A Special Disciplined Services Contribution (SDSC) for members of the disciplined services should be introduced to bring the retirement benefits level for disciplined services to a broadly comparable level with those of civilian grades despite their earlier retirement ages (i.e. at 55 or 57 as compared with 60);
- (d) Government's voluntary contributions will be subject to a vesting schedule to achieve retention effect. The consultants recommend full vesting after 10 years. It is for consultation whether the usual 10-year vesting schedule in the private sector is appropriate or whether the schedule should be longer to help maintain stability of the civil service;
- (e) transfer option should not be offered to serving officers on pensionable terms; and

- (f) special benefits provided under the pension schemes related to death and incapacity, etc., should be provided through payment outside the CSPF Scheme.

Transfer Option for Serving Pensionable Officers to the CSPF

15. The consultants have advised that a transfer option for serving pensionable officers is not desirable in view of the complications arising from the negotiations with the staff sides on the transfer value, and the likely financial implications and administrative burdens. It is relevant to note that the pension system and a provident fund scheme operate on completely different funding principles and design logic, and this will make transfer of serving staff's accrued benefits exceedingly problematic. The transfer of the then serving officers from OPS to NPS was relatively straightforward as the two pension schemes operate on the same design principles and contain very similar features. It is therefore not a relevant factor in this case.

Withholding, Forfeiture, Cancellation and Reduction of Retirement Benefits

16. The pension schemes provide for the cancellation, suspension and reduction of pension payments under certain circumstances such as disciplinary cases resulting in dismissals. It is appropriate to provide a mechanism in the CSPF Scheme for withholding and forfeiture, in whole or in part, of the accrued benefits related to Government's contributions above the MPF requirements to continue to act as a deterrent against misconduct. Such arrangements are common practice in private sector MPF agreements where employers make payments in excess of the statutory minimum.

FINANCIAL AND STAFFING IMPLICATIONS

17. Unlike pensions which are not separately funded and are paid as and when needed directly out of general revenue each year, the CSPF will require on-going funding for the employer's contributions during the active service of the officer. As set out in the Executive Summary, the consultants have recommended the following employer contribution options –

- (a) Option 1 – a uniform contribution rate of 17% across the board (and an additional Special Disciplined Services Contribution at a rate of 2.5%); and
- (b) Option 2-A – progressive contribution rates based on service, ranging from 5% to 25% for more than 20 years of service (and an additional Special Disciplined Services Contribution at a rate of 2.5%).

Depending on the design to be adopted, the cashflow to meet provident fund contributions will range from 5% of the salary for the new recruits to a larger percentage of the payroll for the affected staff in accordance with the contribution schedule. On the basis of the consultants' proposals on the scheme design with an underlying financial commitment of 18% of salary, there will be savings in the long-term when compared to the 22% on-cost under the NPS for new recruits.

18. Running two systems in parallel (i.e. the pension schemes for existing staff and pensioners and the CSPF Scheme for new recruits) will increase government expenditure in the short to medium term. However, for prudent fiscal management reason, we strongly support putting new recruits on a CSPF Scheme instead of NPS. The essence of a CSPF Scheme is that it is operated on a defined contribution basis, under which liability is discharged immediately when it is incurred. In addition, a CSPF Scheme will entail a defined and more even cashflow throughout the active service years of new recruits and so is easier to plan and manage in terms of control over government expenditure.

19. Depending on the mode of operation of the CSPF and the investment mechanism, the development of a computer system to cater for its implementation and additional staffing may be required.

BASIC LAW IMPLICATIONS

20. The provisions of the Basic Law governing the appointment of public servants ensure the continuity of the public service following reunification, and are not intended to stifle the introduction of reform measures or changes in the civil service for the good governance of Hong Kong. Since the

proposed CSPF Scheme is intended for officers who are offered the civil service permanent terms after May 2003 and does not affect the previous system of employment, the proposal is consistent with the Basic Law provisions and in particular Article 103.

ECONOMIC IMPLICATIONS

21. Like the MPF, the amount of assets built up under the proposed CSPF Scheme can be expected to stimulate the demand for, and hence the supply of long-term financial instruments to match the maturity structure of the CSPF liabilities corresponding to the retirement benefit pay-outs. There will be added demand for a wide range of professional support services such as fund managers, credit analysts, investment advisers, etc. All these will be conducive to the further development of Hong Kong's capital market and its role as a major financial centre.

PUBLIC CONSULTATION & PUBLICITY

22. Public consultation on the consultants' recommendations for the proposed CSPF Scheme will last till 30 April 2001. During this period, we will consult staff appointed under the new entry system since June 2000, departmental and grade management, as well as other stakeholders. We will also actively consult the staff sides.

23. We are issuing a press release on the subject. Apart from hard copies, the consultation document and the Executive Summary are being made available in the Civil Service Bureau web site. Briefings on the consultants' recommendations are also being arranged for various parties. We will brief the Legislative Council Panel on Public Service on the consultants' recommendations and keep it informed of the feedback received during the consultation period.