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Subcommittee on Retirement Protection (Membership)
Legislative Council
G/F, Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong



ACTUARIAL SOCIETY
of
H O N G K O N G
香 港 精 算 學 會

(By email: kyeung@legco.gov.hk)

Dear Sir,

Response to the Consultation relating to Public Engagement Exercise on Retirement Protection

We are writing to respond to the consultation relating to Public Engagement Exercise on Retirement Protection.

The Actuarial Society of Hong Kong (“ASHK”) is established with more than 1,000 qualified actuaries and to-be-qualified actuaries who are working in pension, insurance, academic and other areas. Actuaries are usually recognized as the engineer for defined benefit pension systems and actuaries’ expertise enables decision makers understand the financial sustainability and the underlying risks of a pension system.

We went through the list of questions in the consultation document and we do not have specific comments towards those questions. However, ASHK will like to express its views as follows:

1) All pension systems could be unsustainable under certain circumstances. The best-estimate scenario is not suitable to illustrate financial sustainability.

The key actuarial issue in this case is around the financial sustainability of the proposed retirement security program. The high level illustration of the two proposals as published by the Commission on Poverty easily leads to a conclusion that the universal pension proposal is not sustainable for a near term while the targeted pension gives a higher chance of sustainability. This easily gives a wrong perception for the user of the results that the projection gives a very accurate estimate of what will happen. Unlike the pre-retirement mortality which the actuaries are usually more comfortable that the correlation is low, and therefore the best-estimate is more reliable and relevant. The most sensitive assumptions for the actuarial projection of the financial sustainability are post-retirement mortality, birth rates, investment returns and price inflation. None of them could be well diversified to achieve higher degree of certainty. Hence, the actuarial question should not be around “what is the best estimate”, since we will not be able to give a narrower range of estimate anyway. The actuarial question should be what are the uncertainties and what elements in the program could “hedge” those uncertainties such that the proposal could be financially sustainable.

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2) When will the program be not sustainable?

This will happen when the post-retirement mortality is low, the birth rate is low, the investment return is bad and the price inflation is high. So what can we do at that time? Increase tax? Increase the employer contribution? Increase the employee contribution? Reduce the amount of retirement benefits? Extending the eligible retirement age for benefits? We may label these as "adjustment measures". All of them could help but it seems that, when referencing to other countries, there are always demonstrations and politics around the decision of what adjustment measure is taken. No one would like to suffer and therefore everyone is fighting for a better outcome for themselves. The program is not sustainable when there are no auto adjustment mechanism and when the outcome is worse than expected.

3) How could we make a retirement security program financially sustainable?

We propose to agree on a few principles before we start the program.

3.1) Separate fund. A separate fund should be set up for the retirement security program. This should not be mixed up with the government money otherwise the government (and the underlying tax payers) will be the "equity" player of the program and they will always be the last resort for the sustainability.

3.2) Pre-agreed funding allocation. The funding allocation among tax payers, employers, employees and other potential parties should be agreed in advance. This is a social question (but not an actuarial question) of what should be the allocation. For simplicity and illustration purpose, I will put 1/3 from tax payers, 1/3 from employers and 1/3 from employees. Hence, in the future, whenever there are changes of required contributions to the system, all parties are bearing the same outcome. The interests of all parties are better aligned and there is no need to regularly review this funding allocation.

3.3) Pre-agreed auto adjustment mechanism. A list of sequential auto adjustment mechanism should be agreed in advance before the system is set up. An example is shown below as an illustration:

Sample list

Extending benefit eligible age by 1 year to age of 66
Freezing the benefit increase due to inflation for 1 year
Increasing the contribution amount by 10%
And others ...

3.4) Regular Valuation. An actuary should carry out the valuation of the program regularly and assess the level of financial sustainability of the program. The financial sustainability should be well defined in advance and the results of such valuation should trigger the pre-agreed list of "auto adjustment mechanism". For illustration, say if we define the level of financial sustainability to be equal to:

Present value of future benefit payments / (present value of future contribution + current asset of the program)

When the level of financial sustainability is lower than a certain percentage (say 80%), then it will trigger the pre-agreed auto adjustment mechanism.

We hope the above comments contribute to the healthy debates for this topic and would be pleased to answer any questions or respond to any comments that you may have. Please feel free to contact us.

Yours sincerely,



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The Actuarial Society of Hong Kong



Billy Wong
Chairperson of Pension & Employee Benefits Committee
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