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Legislative Council Panel on Welfare Services
Subcommittee on Retirement Protection

Follow-up to meeting on 2 June 2011

Purpose

This note provides information in response to the matters for follow up arising from the meeting of the Subcommittee on Retirement Protection (the Subcommittee) on 2 June 2011.

Studies of the Central Policy Unit

2. The Central Policy Unit (CPU) completed five studies concerning the retirement protection system in Hong Kong between 2007 and 2010. A brief summary of the five studies is at **Annex A**. Overall speaking, the findings of the five studies indicate that the three pillars under the current retirement protection model in Hong Kong are complementary to one another, and would continue to be so in future.

Retirement protection model promoted by the World Bank

3. The multi-pillar model has all along been the retirement protection model promoted by the World Bank (the Bank). Its purpose is to help different places, in responding to an ageing population, meet challenges in the financial and economic aspects of their retirement protection system, and at the same time provide better living security for the elderly through different types of support (commonly referred to as "pillars") that are complementary to each other. The Bank first introduced the three-pillar model of the retirement protection system in its report entitled "Averting the Old Age Crisis[1]" in 1994. The three pillars are -

Pillar I: a mandatory, non-contributory and publicly managed **defined-benefit system**;

[1] The World Bank (1994) '***Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth'***, Washington , D.C.: Oxford University Press.

Pillar II: a mandatory, contributory and privately managed **defined-contribution system**; and

Pillar III: voluntary occupational or personal savings.

4. Based on the experience of retirement system reforms in different places, the Bank proposed in 2005 to add the following two pillars[2], -

Zero pillar: a basic or social security system, which may be means-tested, financed by the Government. This pillar branches out of Pillar I with a view to alleviating poverty and extending protection to the entire elderly population; and

Pillar IV: informal income support involving a broad spectrum of measures other than financial support. Examples are family support, health care and housing benefits, etc.

5. The above five pillars together form a multi-pillar retirement system. The Bank considers that this system, comprising several elements with varying characteristics and with each pillar complementing one another, can result in better individual and societal benefits while minimising the relevant risks.

6. The Bank has also pointed out that the multi-pillar model is only a framework and not a "one-size-fits all" blueprint. Retirement protection systems in different places may be of various forms with different number of pillars. Different places have to make their own prudent choices to avoid conflict among the pillars which would affect expected outcomes. The choice would depend on the circumstances of different places, in particular with regard to factors such as the existing retirement protection scheme (and other related public policies), specific needs for reform, and the management capacity and development of the financial market, etc.

Model of the retirement protection system in Hong Kong

7. The retirement protection system in Hong Kong draws reference to the Bank's multi-pillar model. It consists of three pillars, namely the non-contributory social security system (comprising Comprehensive

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2 The World Bank (2005) ***'Old Age Income Support in the 21st Century: An International Perspective on Pension Systems and Reform'***, Washington, DC: The World Bank Publishing.

Social Security Assistance (CSSA), Old Age Allowance (OAA) and Disability Allowance (DA)), the Mandatory Provident Fund (MPF) system, and voluntary private savings. Each pillar targets different groups of people and addresses their different needs. The first pillar mainly aims to provide income relief for elders who are in financial hardship, and to provide some financial support for the elderly through the largely non-means-tested OAA and DA. The second pillar mainly provides income protection for the employed population (especially the future generations of retired persons) upon their retirement. Meanwhile, savings have all along been a way through which Hong Kong people prepare to meet living expenses upon retirement. In addition, most adult children follow the traditional value of filial piety and provide financial support for their parents. Therefore, the third pillar is also an important source of financial support for the elderly.

8. A greater proportion of the current generation of elders relies on the first pillar, savings and financial support from adult children to meet living expenses upon retirement. However, as the MPF system develops and matures, the accrued benefits will increase. Together with other sources of income such as investment returns, the future generations of retired persons will rely relatively less on the first pillar. As regards private savings, an individual can make arrangements for different savings and investment plans having regard to his own conditions and needs, such as living requirements upon retirement, financial (including assets) position, and whether they expect their children to support them, etc. The social security system provides the safety net of last resort for all. In other words, the three pillars can supplement the different financial needs of the current and future generations of retired persons. Retirement protection requires the three pillars to be supportive of and complementary to each other.

9. Moreover, the Government has over the years been playing an active role in providing diversified and low-cost community support, health care and residential care services for the elderly. It has also implemented measures such as the priority allocation of public housing for the elderly and the dependent parent tax allowance. All these to a certain degree subsidise the daily living and personal care expenses of the elderly, and may be regarded as another important pillar for retirement protection for the elderly.

10. In conclusion, elders in Hong Kong are not dependent solely on a particular pillar for retirement protection, but both financial and non-financial support from various sources.

Sustainability of each pillar by income level

11. According to the definition of the Bank, a sustainable system refers to one which has sound financial position and can continue to operate in the foreseeable future after taking account of various assumptions. To reliably assess the financial sustainability of a system, one must provide a convincing projection of the revenues and expenditures of the system, including the short- and long-term capital flow projections, and an assessment on the cumulative amount and the use of funds.

12. Making an accurate assessment of the financial sustainability of the three pillars according to the above criteria is not easy. In the light of the many social changes in Hong Kong during recent years, some of the new developments (including the increase in the rates of OAA, the implementation of the Statutory Minimum Wage, proposed amendments to the minimum and maximum relevant income levels for MPF contribution, and the proposed healthcare financing scheme requiring individual contributions, etc.) have certain degree of implications for the financial income of the elderly. CPU is refining its studies on the retirement protection system in Hong Kong having regard to the latest developments, for the purposes of assessing the sustainability of the existing system and considering ways to improve and enhance each pillar. To this end, CPU will organise a series of focus group meetings to listen to the views of experts, scholars, think tanks and concern groups. It will also conduct a new round of territory-wide household survey to obtain up-to-date data for use in scientific simulations and projections.

13. According to CPU's rough estimate, the financial burden on the first pillar will increase in the next 30 years owing to the increase in the elderly population. However, as MPF schemes under the second pillar mature with more accrued benefits, this pillar will become more and more robust and will play an increasingly important role. As regards the third pillar, personal savings are projected to increase with economic development, a rise in income and the development of a savings habit by more people. This will make up for the possible reduction in family support; and, in the long run, this pillar will also be sustainable. On the whole, the three-pillar system of Hong Kong should therefore be financially sustainable.

Social security

OAA

14. The Administration increased the rates of Normal OAA and Higher OAA to $1,000 across-the-board in 2009 and has, in accordance with the established mechanism, continued to adjust the rates of the allowances on an annual basis taking into account inflation/deflation reflected by the Social Security Assistance Index of Prices[3]. The most recent adjustment was the increase of the rates by 3.4% to $1,035 in February this year.

CSSA

15. The CSSA Scheme is designed to provide financial support to needy families for meeting basic needs. Applications are made on a household basis because family members should render assistance and support for each other. Where a household meets the asset test, and the household's total income is also assessed to be insufficient to meet its total recognised needs under the CSSA Scheme, CSSA is provided to the household to make up the deficiency.

16. Regardless of whether they are living with family members, elders who apply for CSSA on their own must submit a declaration on their financial position for the Social Welfare Department (SWD) to verify, for the purpose of assessing their financial needs, whether they have other sources of income or any financial link with other family members. Under special circumstances, for example, where an elderly applicant has poor relationship with his family members or there are special reasons for which his children cannot provide financial support for him, SWD will consider on a case-by-case basis and may allow a needy elder to apply for CSSA on his own.

17. At present, the asset limits for elderly CSSA applicants are already higher than those for normal able-bodied adults (e.g. $36,000 for singleton elders, which is much higher than the $23,000 for singleton able-bodied adults). Furthermore, where a CSSA household has old age members, the value of the owner-occupied residential property is totally disregarded in asset calculation.

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[3] The Social Security Assistance Index of Prices is compiled by the Census and Statistics Department (C&SD) on a monthly basis to reflect the impact of price changes on CSSA recipients. It consists of all items covered in other Consumer Price Indices compiled by C&SD, except those which are covered by CSSA special grants or provided free by the Government.

The MPF system

18. The MPF system aims to assist the working population to accumulate retirement savings. Its core design includes a mandatory contribution rate of 5% of the relevant income each from employees and their employers, and also 5% from self-employed persons (SEPs), subject to the Minimum Relevant Income Level (Min RI) and the Maximum Relevant Income Level (Max RI)[4]. The arrangements have taken into account the policy objective of encouraging the workforce to save for basic retirement needs, and the policy consideration of lessening the financial burden of MPF contributions on lower paid employees and SEPs. The current contribution rate reflects the above factors and the general community consensus. Scheme members may decide whether to top up retirement savings for better protection through voluntary contributions or other investments. In this connection, the amount of voluntary contributions made directly by employees recorded a 48% increase from $552 million in 2008 to $816 million in 2010.

19. As mentioned in paragraph 12 above, CPU is refining its study on the subject of retirement protection. The study covers, among other things, the sustainability of the existing retirement protection system and possible improvements to individual pillars. The Administration and the Mandatory Provident Fund Schemes Authority (MPFA) will make reference to the findings of CPU's studies and introduce improvements to the MPF system as appropriate.

20. Other information requested by the Subcommittee at its meeting on 2 June 2011 is set out below –

(a) The analysis by age group and income level of the employed population[5] as at Q1 2011 as compiled by the Census and Statistics Department is at **Annex B**.

(b) According to the data collected from trustees by MPFA, the total amount of MPF accrued benefits used to offset severance payments (SP) or long service payments (LSP) during the period between 1 July 2001 and 31 March 2011 was $15,289 million,

[4] The Mandatory Provident Fund Schemes Ordinance provides that unless exempted, an employer and employee must each contribute 5% of the employee's relevant income to an MPF scheme as mandatory contribution, while an SEP must similarly contribute 5% of his relevant income. However, if the relevant income of the employee or SEP concerned is less than Min RI, he is not required to make MPF contribution himself, although his employer still has to make MPF contribution for him. For an employee or an SEP whose relevant income is above Max RI, both he and his employer are not required to make mandatory contribution in respect of the excess relevant income.

[5] Excluding foreign domestic helpers but including other exempt persons (e.g. civil servants on pension schemes).

whilst the aggregate net asset values of all MPF schemes as at 31 March 2011 was $378.2 billion.

As MPFA collects the above information for the purpose of monitoring the withdrawal of benefits from MPF schemes from an overall perspective, MPFA does not have the withdrawal record of individual accounts nor data on the number of scheme members whose accrued benefits have been withdrawn by their employers for offsetting SP or LSP.

(c) MPFA does not have information on the number of scheme members who have made voluntary contributions. As set out in paragraph 18 above, the amount of voluntary contributions made directly by employees was $816 million in 2010. This represented 2.16% of the total MPF contributions of $37,792 million in that year.

(d) The amount of accrued benefits for scheme members at different income levels at the age of 65 projected by MPFA, based on a set of assumptions (and the scenario that the employee concerned has worked under 15 three-year contracts with the portions of accrued benefits from employers' contribution used for offsetting SP or LSP), is at **Annex C**.

(e) According to data provided by MPFA, the number of participating members in registered Occupational Retirement Schemes (ORSO) schemes as at 31 May 2011 was 420 296. As MPFA does not have the vesting information of individual ORSO schemes, it is unable to project the retirement scheme benefits available to members of those schemes.

Labour and Welfare Bureau
Financial Services and the Treasury Bureau
Central Policy Unit
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Annex A

A summary of the five studies on the retirement protection system in Hong Kong conducted by the Central Policy Unit

Study title	Brief information
1. Household survey on financial disposition and retirement planning of current and future generations of retired persons	To understand the financial position and retirement plans of the current and future generations of retired persons.
2. A study on sustainability of three pillars of retirement protection in Hong Kong	To project the financial position and the financial sustainability of the three pillars from 2006 to 2036 through macro and micro-simulations.
3. A study on the intergenerational transfers between elderly parents and adult children	To study intergenerational mutual support in Hong Kong families, and factors affecting such support. Some of the findings were presented at the Conference on "Strengthening Hong Kong's Families: Obligation and Care Across the Generations" held on 9 June 2010. The presentation materials are available on the following website: http://www.cpu.gov.hk/tc/documents/conference/20100609%20Chou%20Kee-lee.pdf
4. The meaning and practice of filial piety in Hong Kong	To examine the meaning of filial piety, as well as the views on and practice of filial piety of the two generations (adult children and their parents). The study report points out that the young generation nowadays is more flexible in the practice of filial piety. While the provision of financial support for parents is still regarded as an important conduct of filial piety, it carries more a symbolic meaning than material support. The two

	generations place heavier emphasis on love and respect. The study report is available on the following website: http://www.cpu.gov.hk/tc/documents/new/press/Filial%20Piety.pdf Some of the findings were presented at the Conference on "Strengthening Hong Kong's Families: Obligation and Care Across the Generations" held on 9 June 2010. The presentation materials are available on the following website: http://www.cpu.gov.hk/tc/documents/conference/20100609%20Ting%20Kwok-fai.pdf
5. Private saving in Hong Kong: implications for retirement protection	To understand the savings situation of employees (including individual and families). Some of the findings were presented at the Conference on "Strengthening Hong Kong's Families: Obligation and Care Across the Generations" held on 9 June 2010. The presentation materials are available on the following website: http://www.cpu.gov.hk/tc/documents/conference/20100609%20Chou%20Kee-lee.pdf

Annex B

The number of employees aged between 18 and 65 with monthly employment earnings of less than $5,000

Age group	**No. of employees* with monthly employment earnings of less than $5,000 as at Q1 2011** **(A)**	**Total no. of employees* as at Q1 2011** **(B)**	**% of total no. of employees* in respective age group** **(C) = (A/B)X100%**
18-29	40 200	635 300	6.3%
30-39	25 900	749 200	3.5%
40-49	45 100	814 200	5.5%
50-65	58 200	726 400	8.0%
Total	**169 400**	**2 925 100**	**5.8%**

* Excluding foreign domestic helpers but including other exempt persons (e.g. civil servants on pension schemes).

Annex C

Projected accrued benefits

The Mandatory Provident Fund Schemes Authority has made the following assumptions in arriving at the projected accrued benefits set out in the table below –

(a) the annualised internal rate of return after deductions of fees and charges is 5.5%;
(b) the employee concerned has worked under 15 three-year contracts, with the portions of accrued benefits from employers' contribution made available for offsetting severance payments (SP)/long service payments (LSP);
(c) monthly relevant income remains unchanged for the entire employment period;
(d) the employer and employee mandatory contribution is calculated as 5% of an employee's relevant income over the entire employment period;
(e) the minimum and maximum levels of relevant income remain unchanged over the entire employment period at $6,500 and $25,000 per month respectively; and
(f) the calculation of and eligibility for SP/LSP under the Employment Ordinance (Cap. 57) remain unchanged over the entire employment period.

Monthly income (Min RI assumed at $6,500 and Max RI assumed at $25,000) **(A)**	**Estimated amount of accrued benefits at age 65 (mandatory contribution only, and assuming accrued benefits from employers' contribution are used for offsetting SP/LSP)** ***** **(B)**
$5,000 (assuming Min RI at $5,000)	$0 $592,597
$6,500	$770,376
$7,000	$829,636
$8,000	$948,155
$9,000	$1,066,675
$10,000	$1,185,194
$11,000	$1,303,713
$20,000	$2,370,388

Monthly income (Min RI assumed at $6,500 and Max RI assumed at $25,000)	**Estimated amount of accrued benefits at age 65 (mandatory contribution only, and assuming accrued benefits from employers' contribution are used for offsetting SP/LSP) ***
$25,000 (assuming Max RI at $20,000)	$3,206,407 $2,370,388

* Excluding SP/LSP. Employees concerned may make investments using their SP/LSP received for preparation of their retirement life.

Based on Q4 2010 data –

If Min RI is set at $5,000, 156 400 employees/SEPs will be excluded from making mandatory contributions; if Min RI is set at $6,500, 337 300 employees/SEPs will be excluded from making mandatory contributions. With the implementation of the Statutory Minimum Wage, the actual figure is expected to be smaller.