

CHAPTER 10

RETIREMENT BENEFITS

10.1 INTRODUCTION

Proposal in Report No. 7

10.1.1 In Report No. 7, we recommended that retirement benefits should be included in total packages and that these benefits should be valued by applying an appropriate set of actuarial assumptions.

10.2 WORKING GROUP'S VIEW

10.2.1 The Working Group was unable to recommend whether or not retirement benefits should be taken into account in total packages. Some of its members saw difficulty in doing so for the following reasons :

- (a) civil service pensions were only payable on retirement under very strict rules and represented no immediate benefit to the employees concerned;
- (b) civil service pensions were not granted as of right, but at the discretion of the Crown;
- (c) retirement benefits were a form of social security and in most advanced societies would be available to all citizens. It would not be fair to take these benefits into account in comparisons of total packages because only the more enlightened employers in the private sector in Hong Kong provided them to their employees;
- (d) contract gratuities were granted to make total packages more attractive for the purpose of recruitment. To take them into account for the purpose of pay level comparisons would tend to defeat the purpose for which contract gratuities were paid; and
- (e) it was difficult to put a value on retirement benefits as perceived by the employee, as distinct from their actuarial value which, in effect, represented the cost to the employer.

10.3 PAY RESEARCH ADVISORY COMMITTEE'S PRELIMINARY VIEW

Inclusion of Retirement Benefits

10.3.1 The Pay Research Advisory Committee felt that the reasons stated in paragraph 10.2.1 were invalid because :

- (a) although it was stated in the Pensions Ordinance that civil service pensions and gratuities were not granted as of right, there had not been any instances where the payment of retirement benefits had been withheld from officers eligible for them;
- (b) irrespective of the purpose for which retirement benefits were given, they formed a significant part of employees' total packages. For example, in a situation where two jobs were exactly the same in all respects in so far as remuneration etc. were concerned, the job with retirement benefits would be more attractive than the one without;
- (c) for the purpose of comparing total packages between the public and private sectors, the actual level of total packages currently offered by employers in Hong Kong should be considered. What the public or private sectors should be offering, having regard to the practice of employers in other territories, was irrelevant;
- (d) using an appropriate set of actuarial assumptions, the amount of pension payments which employees were likely to receive calculated on a present value basis could be the method for arriving at a reasonable estimate of the value of these benefits to employees; and
- (e) although the valuation of pensions would vary according to the actuarial assumptions used, pay comparisons were more concerned with the relative rather than the absolute value of total packages. Provided that the same assumptions were used for both the private and the public sectors, the method of valuation used should not affect the validity of pay comparisons.

10.3.2 In the light of these considerations and the increasing importance which both employers and employees attached to retirement benefits, the Pay Research Advisory Committee considered that retirement benefits should be included in total packages.

Valuation of Civil Service Pensions

10.3.3 The Pay Research Advisory Committee considered that civil service pensions should be valued on the basis of :

- (a) the actual pensions to which officers were entitled, rather than hypothetical contract gratuities. For this purpose it would be necessary to :
 - (i) calculate the weighted average age of officers in the rank under comparison;
 - (ii) assume an average rate of salary increase up to the date of retirement;
 - (iii) assume an average discount rate for the entire period from the date of pay comparison to the date when the final pension payment was likely to be made; and
 - (iv) assume an average rate at which pension payments were increasing annually, from the date of retirement throughout the period of life expectancy. This, together with the assumed discount rate, would enable the appropriate capitalization factor for civil service pensions to be worked out; and
- (b) the option to commute 25% of the annual pensions.

The above method of valuation should also be used in the case of civil service annual allowances, except that their value should be taken as 75% of the value assigned to civil service pensions.

Valuation of Private Sector Retirement Benefits

10.3.4 Retirement benefits in the private sector could be broken down into two major categories : lump sums paid to employees on retirement, and pensions. The Pay Research Advisory Committee considered that these should be dealt with according to the methods described in the following two paragraphs.

10.3.5 In the case of lump sum payments, the total lump sum entitlement payable on retirement, discounted to its present day value and averaged over the employee's entire period of service in the company, should be taken as the value of the benefit.

10.3.6 As regards pensions, the Pay Research Advisory Committee considered that there were three main types of pension schemes in the private sector, each of which should be treated differently, as follows :

- (a) Where the amounts of pension payable were calculated on the basis of final salaries, the pensions should be valued on the same basis as those in the civil service. Similar assumptions regarding the discount rate, weighted average age of employees in a rank and average annual general salary adjustments should be used;
- (b) Where the amounts of pension payable were dependent upon provident fund contributions, the benefits should be valued on the basis of the amounts of employers' contributions to the funds concerned, as these indicated the cost to employees of replacing the benefits provided by their employers. As these contributions were made at current values, there was no need to use the discounted cash flow method for valuation purpose; and
- (c) Where companies offered a combination of both (a) and (b), the value of retirement benefits should be calculated as follows :
 - (i) the combined value of the two schemes, if employees were entitled to receive benefits from both simultaneously; and
 - (ii) the greater of the two values, if employees were required to select only one of the two schemes.

10.3.7 In view of the fact that the valuation of retirement benefits was a very complex subject, the Pay Research Advisory Committee decided that the consultants to be engaged should be asked to examine in detail how retirement benefits in the public and private sectors could best be valued for the purpose of pay level surveys. Furthermore, as the value of retirement benefits depended very much on the actuarial assumptions to be used, the consultants were also asked to examine and establish a set of realistic and appropriate actuarial assumptions.

10.4 CONSULTANTS' ADVICE

10.4.1 TPF & C considered that the formula to be used for determining the value of retirement benefits for both sectors should be :

$$\frac{\text{The sum of (Amount of Benefit X Discount Factor)}}{\text{Spreading Factor}}$$

where the amount of benefit would be derived from the retirement scheme formula, the discount factor by combining the probability of reaching an age at which a retirement or termination benefit was payable, with an assumed rate of investment earnings and the spreading factor by calculating the value of the employee's earnings during his career. This general formula was based on actuarial assumptions and an illustration of its application was at Appendix A of TPF & C's Report at Appendix VIII. Definitions of the terms used in the formula will be found on pages 2, 3, A2 and A3 of their Report.

10.5 PAY RESEARCH ADVISORY COMMITTEE'S RECOMMENDATION

10.5.1 The Pay Research Advisory Committee recommended that retirement benefits should be included in total packages for the purpose of pay level comparisons, and that they should be valued in accordance with TPF & C's recommendations in paragraph 10.4.1. The value of annual allowances in the civil service should be calculated in accordance with the same formula used in the valuation of pensions.

10.6 VIEWS EXPRESSED AT PAY LEVEL SURVEY ADVISORY COMMITTEE MEETINGS

10.6.1 The Hong Kong Chinese Civil Servants' Association objected to the inclusion of retirement benefits in total packages because these benefits were not regarded as a legal right and people of different ages had different expectations of the retirement benefits they might receive. Moreover, inclusion of retirement benefits might inflate the civil service total packages and therefore gave an inaccurate picture of the pay level of the civil service. This view was supported by the Model Scale 1 Staff Consultative Council which pointed out that employees in the private sector enjoyed some retirement benefit after they had completed a number of years of service but civil servants leaving the service before retirement age would get nothing. The Senior Non-Expatriate Officers' Association also objected to the inclusion of retirement benefits in total packages but

requested that the results of the valuation of these benefits be shown separately. (Paragraph 4.1 of the PLSAC's Report Part II at Appendix X refers).

10.7 STANDING COMMISSION'S RECOMMENDATION

10.7.1 In considering the recommendation for retirement benefits we thought that certain points need to be clarified. Firstly, TPF & C's formula in paragraph 10.5.1 has already taken into account the probability of individuals reaching retirement age by the use of the "discount factor". Secondly, although the formal retirement age of civil servants is 55, civil servants are able to draw pensions from the age of 50 onwards if they choose to retire and the sum will be calculated proportionately according to their years of service. Whilst the civil service pensions scheme is non-contributory, most private sector retirement schemes or provident fund schemes are contributory and employees will get the amount they have contributed to the scheme, plus interest, if they retire or terminate their service before the normal retirement age set by the company concerned.

10.7.2 We also note that retirement benefits in the civil service are provided at the discretion of the Crown, but given that civil servants have a reasonable expectation in receiving the benefit and that there have been no past instances where such benefits were withdrawn apart from those cases which involved disciplinary action, we consider that retirement benefit should be taken into account in total packages in the civil service. In arriving at this conclusion, we have taken note of the fact that retirement benefits constitute a substantial amount of the fringe benefits received both in absolute and actuarial terms. We therefore recommend that retirement benefits should be included in total packages in the public and private sectors. We also recommend that the method of valuation should be in accordance with TPF & C's recommended formula in paragraph 10.4.1.