Hong Kong

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Retirement Income Protection in Hong Kong

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Abstract

This paper gives background information on work, retirement, and labor force participation in Hong Kong. A brief development of social security is described followed by introducing the current retirement income protection programs in Hong Kong. The paper also discusses the financial disposition of current older adults and the soon-to-be old generation. These discussions raise the potential problems of the retirement income protection schemes. Finally, this paper provides recommendations for improving the existing schemes and proposes a study plan which tries to devise a sustainable financial support system for older adults in Hong Kong.

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Introduction

A longer life expectancy coupled with a low fertility rate has resulted in a rapidly aging population in most parts of the world (OECD, 1998; Peterson, 1999; Bernard & Philips, 2000; Zhang, 1999). Hong Kong is no exception to this global aging population transformation and age structure of the population which will change dramatically in the next three decades. The number of people 65 years old and above has increased from 150,000 in 1961 to 739,739 in 2001 (4.8% and 11.0% of total population, respectively), and it was expected to reach 2,093,160 in 2031 (24.0% of the total population) (Census & Statistics Department, 1997; 2002a). The rapid growth of the aging population presents a serious challenge to policymakers in respect of societal, economic and political issues related to the elderly people in Hong Kong (Task Force on Population Policy, 2003).

One key challenge posed by an aging society is achieving a proper balance between the amount of time spent in work and in retirement in the coming decades. This balance also will reflect on the accumulative and decumulative wealth in a life span perspective. The financial costs of an aging population can be seen as having two main dimensions: the costs involved in providing income support in terms of pensions and other benefits to the elderly population; and the cost of social support and health care provision (Johnson & Falkingham, 1992). Work and retirement inevitably loom large in any assessment of the economic impact of population aging. Retirement pattern will have dramatic implications for the productivity as well as economy of the society (Jackson, 1998; Peterson, 1999). Whether an older person is in work or retired, and whether extensive or minimal pension entitlements have been accumulated are key determinants of economic well-being. Any changes in employment and retirement patterns in the future will, therefore, have a direct impact on the welfare of future generations of older people.

According to the World Bank report "Averting the Old-Age Crisis: Policies to Protect the Old and Promote Growth", governments should use two overarching criteria for old-age programs: they should protect the old and they should promote economic growth. Old-age security programs will be best achieved by adopting a 'three-pillar' approach to provide comprehensive retirement protection (World Bank, 1994). The three pillars are:

1. Publicly managed, tax-financed social safety net for the old;
2. Mandatory, privately managed, fully funded contribution scheme; and
3. Voluntary personal savings and insurance.

With the implementation of Mandatory Provident Fund (MPF) Scheme on 1 December 2000, complemented by personal savings and the Comprehensive Social Security Assistance (CSSA) Scheme operated and funded by the Government, Hong Kong now has in place all the three pillars for old-age protection. However, in the coming three decades, Hong Kong Special Administration Region (HKSAR) Government will still face a serious challenge to provide financially sustainable and secured retirement for Chinese older adults in Hong Kong. HKSAR Government also acknowledges the fact that some problems related to population aging are due to outdated social policies which have not kept up with the changes in socio-economic development and thus calls for redefining the notion of retirement (Task Force on Population Policy, 2003).

The purpose of this paper is to give background information on work, retirement, and labor force participation in Hong Kong. A brief historical development of social security will be described followed by introducing the current old age income protection programs in Hong Kong. The paper will also discuss the financial disposition of current and next generation of older adults, the potential problems of the old age income protection schemes. Finally, this paper will propose a study plan which tries to devise a sustainable financial support system for older adults in Hong Kong.

Work, Retirement and Labor Force Participation

By examining retirement behavior of older adults in Hong Kong before 1990s, it is found that retirement was an unfamiliar concept to older adults due to the cultural and societal factors. Although Western culture is prevalent in Hong Kong, especially among the young people and the well-educated ones, Chinese culture is still dominated older adults because over 98 per cent of the population is ethnic Chinese. Most of the older adults came from an agrarian social and economic background and are now the first generation to grow old in a highly industrialized city (Chow, 1983). It is therefore not surprising to find that retirement is not a familiar concept to Hong Kong older adults because there is no such concept in an agricultural society. Specifically, farmers will not retire and they will only cease working until they were unable to do it physically. Another reason is the fact that retirement has not been institutionalized in Hong Kong because there was no mandatory retirement protection scheme for its residents until recent years. Before the implementation of the MPF Scheme, only about 30% of workers in Hong Kong were working in organizations such as the government, subsidized agencies, and large commercial firms, where pension or provident/retirement funds were provided to their employees (Siu, 2002). In addition, Hong Kong has no official or mandatory retirement age except for those who are civil servants or employees of a few large corporations. Due to these cultural and societal factors, retirement was not a formalized transition within institutionalized life course in Hong Kong before the 1990s. Nonetheless, as a civilized industrial and commercial society, retirement has gradually been accepted and institutionalized in Hong Kong in the last decade.

In the coming three decades, the demographic profile of the Hong Kong population will undergo a dramatic change. Local demographers predicted that labor shortage might occur given the aging population if current retirement patterns are allowed to continue (Task Force on Population Policy, 2003). Hong Kong has one of the highest life expectancies and at the same time it has one of the lowest birth rate in the world. According to the Census and Statistics Department (2002a), the average life expectancy for male at birth is 78.8 years and for female is 84.7 years in 2002. The birth rate is 0.9 which is under the replacement level. The proportion of the Hong Kong population aged 65 and above will increase from 11.2 % in 2001 to 24.3% by 2031. Retirement literatures emphasize the elderly dependency ratio – the ratio of those who aged between 15 and 64 to those who aged 65 and above. In Hong Kong this ratio was 6.45 to 1 in 2001 and it is estimated that this ratio will substantially drop to 2.63 to 1 by 2031 (Census & Statistics Department, 2002a; 2002b).

In 2001, there were about 1.9 million middle age people who aged between 35 and 49 (namely middle-aged adults) in Hong Kong constituting 28.3% of Hong Kong population (Census & Statistics Department, 2001). These middle-aged adults create the demographic bulge for the population pyramids. Moreover, these 1.9 million individuals made up approximately 55.1% of the Hong Kong population aged 25 to 54 – the ages when labor force participation rates are at their highest. Their enormity suggests that the impact on labor markets could be traumatic if this group of middle-aged adults could stay in workforce for a longer period of time than did the previous cohort. The number of Hong Kong residents aged 20 years or older will increase by 41% from 5.2 million in 2001 to 7.3 million in 2031 (Census & Statistics Department, 2002a). Over the same period of time, the number of adults aged 25 to 54 is projected to increase by only about 31,400 (0.9%) whereas, the number of persons aged between the ages of 55 and 64 is projected to increase by 669,000 or more than 132%. In other words, while the number of persons aged 25 to 64 is expected to increase by about 700,400 over the next 30 years; almost 95.5% of this increase is projected to occur among persons aged 55 to 64. Whether these middle-age adults could work until the age of 65 or even longer has a significant impact on the supply of the labor market in the coming ten years.

The labor force participation rate (LFPR) is defined as the percentage of a given population that is either working or unemployed but seeking for job. The LFPR is believed to be the best single indicator of workforce involvement, particularly in low unemployment rate era (Ruhm, 1996). The LFPR changes over time for a specified age and sex groups due to various socio-economic factors such as economic development, retirement planning of older workers, and women employment. Historical trends in the LFPRs show men aged between 45-49 and 50-54 are slightly decreased in the past two decades (2.5% and 3.7%, respectively). For men aged between 55 and 59, the LFPR falls moderately (7.4 %). Men aged 60 and older are much less likely to participate in the work force today than were their counterparts 20 years ago. In 1981, about two-thirds (67%) of men aged 60 to 64 participated in the labor force and by 2002, only 46% of men in that age group participated in the labor force. The rate of decline is about 31.2%. Among men 65 and older, the rate of decline was even greater i.e. 72.4%. The LFPR for men 65 years and older decreased from 35.2% in 1981 to about 9.7% in 2002. The LFPR for this age group of men is only about half of their counterparts in United States (17%) (Szafran, 2002).

Quite different pattern is observed for women. The LFPR for women aged 25 and 39 increased greatly from 53.5% in 1981 to 71.7% in 2002. The LFPR for women aged between 40 and 49 also augmented but in much more gradual way. Specifically, for women aged 40 to 44 years, the LFPR augmented from 54.1% in 1981 to 56.4% in 2001 whereas the LFPR of women aged between 45 and 49 rose from 49.2% to 54.1% in that period of time. For the older age women, all their LFPRs dropped over the last two decades. However, the rate of reduction was accelerated across these four older age groups, i.e. 12.8%, 43.2%, 65% and 94% in the age group 50-54, 55-59, 60-64, and 65+, respectively. Remarkably, the LFPR for older women aged 65 and above reduced from 35.2% in 1981 to 2.0% in 2002. In U.S., the LFPR for women aged 55-59 and 60-64 was about 60% and 40%, respectively (Clark & Quinn, 2002). Comparatively, the LFPR was much lower for Hong Kong older women than for American older women. In conclusion, working after age 65 is very uncommon in Hong Kong and most people stopped working at the age of 60 and 65.

The estimated average retirement age for men decreased from 67.76 in 1976 to 66.34 in 1991 whereas the estimated mean length of retirement life increased from 7.10 in 1976 to 12.95 in 1991 (Suen, 1997). Another measure of the average retirement age is the age at which half of the adult population is in the labor force and the other half is not. Using this measure, the average retirement age for men was dropped from 65 years old or above in 1981 to somewhere between 55-59, a dramatic decline of at least 6 years was shown in the average age of retirement over a period of two decades only. This trend is quite different from the retirement pattern in U.S. where the retirement age remained relatively stable even though fluctuated slightly over the last fifteen years (i.e. 1986 – 2000) after a long term trend to earlier retirement in the period between 1950 and 1985 (Clark & Quinn, 2002; Quinn, 2002). In presence of any changes in social policy, existing trends of retirement pattern in Hong Kong will point to the likelihood of even further decrease in retirement age and growth in the proportion of life spent in retirement (also because of longer life expectancy). Studies point to means of extending the period of labor force participation (Borus, Parnes, Sandell, & Seidman, 1988; Mitchell, 1993; Peterson, 1999). In other words, one viable solution to this problem is to postpone retirement as late as possible (Task Force on Population Policy, 2003).

Brief Historical Development of Social Security

As early as 1965, the Hong Kong Government had already included retirement income protection in its first social welfare white paper (Department of Social Welfare, 2003). However, the Government at that time considered older persons should be taken care of by their families. Therefore, there was no need for the Government to intervene in this issue. There is a Chinese saying, "to raise children to protect your old age." Similar to other Chinese communities, older persons in Hong Kong have been relying on their families as the main source of financial support. For those who do not have a family to rely on, or those families are not able to provide adequate support, they may have to continue to work beyond the normal retirement age. Consequently, a portion of the older adults, who had no family support, were living in poverty.

In 1971, the Hong Kong Government established its first cash benefit program - Public Assistance (PA) Scheme to help those who were poor and had no means. Even at the beginning stage of this new program, quite a number of the PA recipients were elderly people. Following the establishment of the public assistance program for the poor and unemployed, the second social welfare white paper published in 1973 recommended setting up Old Age Allowance (OAA) and Disability Allowance (DA) (Department of

Social Welfare, 2003). The purpose of these two programs was to provide financial assistance to those families who are taking care of frail elderly relatives or those family members who are severely disabled.

Since late 1970s to mid 1990s, the Hong Kong Government introduced several consultation papers for the public to discuss on the pension issues. For instance, a consultation green paper on social security was published in 1977. The decision was neither retirement nor unemployment insurance was urgently needed. Over these years, Hong Kong society has a lot of changes including rapid growth in economy and deterioration of family support. Quite a number of elderly people could no longer rely on their family to provide for their basic needs. The job market has become more competitive and a lot of older workers could not find jobs to maintain their old age. The general public also put pressure on the Government to take care of these poor elders as Hong Kong society is getting more affluent. Consequently, more and more older adults turned to PA and OAA as their source of income. Another consultation paper on a community-wide retirement protection system was then published in 1992 (Social Welfare Department, 2003). During that time, the public debate focusing on the role of the government – should the government act as an ultimate guarantor for the pension fund? Two issues related to this debate were: (1) investment risk for individual as it is not fair to require everyone to put his/her funds in items of a given risk level; (2) moral hazard for the government as people will choose higher return investments if government will be the guarantor. The Government, after serious consideration, was unwilling to take the risk to implement such system in Hong Kong.

With provident fund schemes growing popular in the stock market in early 90s, the Government has finally decided to establish a regulatory regime for retirement schemes. By October 15, 1993, the Government implemented the Occupational Retirement Schemes Ordinance and started to appoint consulting firms to study the feasibility of establishing MPF. The report was released in April 1995 and enacted the MPF Schemes Ordinance (MPFSO) in August 1995. The MPFSO was amended and enacted the subsidiary legislation in 1998. Eventually, a semi-independent Mandatory Provident Fund Schemes Authority (MPFA) was established in September 1998. By January 10, 2000, the MPFA took over the functions of the Registrar of Occupational Retirement Schemes from the Office of the Registrar of Occupational Retirement Schemes, which had been operating under the Financial Service Bureau of the HKSAR Government (Mandatory Provident Fund Scheme Authority, 2003).

Current Old Age Income Protection Schemes in Hong Kong

Currently there are two major old age income protection programs in Hong Kong, namely the public assistance program and job-related retirement program. The public assistance program includes CSSA, OAA and DA schemes. Job-related retirement program is compulsory privately managed pension plan for income maintenance which includes MPF Scheme, ORSO and Civil Servant Pension Scheme. As in 2003, Hong Kong has 3,400,000 working population and approximately 85% of them are having some types of retirement income protection, and 11% of workforce is exempted from retirement program. Sixty three percent has joined the MPF Scheme, 22% has joined other retirement programs, such as ORSO, Civil Servant Pension Scheme.

1. Compulsory Public Plan for Poverty Alleviation

The Public Assistance (PA) Scheme was first introduced in Hong Kong in 1965 with the goal "to make provision for minimum public assistance for those who are demonstrably unable to fend for themselves". In the early 90's, it developed into the present CSSA Scheme which offers assistance to different categories of people, namely the old aged, the disabled, the sick, the unemployed, the low income earners and single parents to meet their basic needs. Older persons have always been the main category of the CSSA recipients and they account for about 60% of all CSSA recipients. Due to many factors, there has been a rising reliance on CSSA by older persons. Throughout the 1980s, about 7-8% of older persons were on PA. However since 1993/94, the take-up rate rose steadily to the 15% in 2000, whereas the total number of old age CSSA recipients increased by 190% from 53,400 in 1993/94 to the 154,800 in 2000 (Department of Social Welfare, 2003).

In the early days of the PA Scheme, all categories of applicants were subject to very stringent eligibility criteria. As the circumstances of older persons are different from able-bodied recipients of CSSA, there has been increasing social sympathy to the financial position of some of the senior citizens. Consequently, the CSSA eligibility criteria for older persons have become more lenient than the able-bodied. For example, their asset limit is US$4,625 which is higher than the US$3,000 for the able-bodied. They are exempt from the requirement to sell their self-occupied properties in the assessment of assets. Their cases are reviewed only once every three years, compared with the biennial review cycle of the able-bodied (Department of Social Welfare, 2003).

OAA is also a publicly funded scheme. When the OAA was introduced in 1973, it was designed to provide some form of financial assistance to older persons of 75 or above because they were considered in need of care and support. Their maintenance at home would probably place financial, physical and emotional strains on their families. It was a non-contributory scheme and it was decided to be non means-tested. The original objectives of the OAA were (1) to provide financial assistance to families partly to relieve their burden of caring for their older members; (2) to reduce the demand for institutional care by encouraging families to care for their older members; and (3) to enable older persons to contribute to the family budget so that they would feel less of a financial burden to their families. In 1978, the age limit was lowered to 70 as it was considered that most elderly would have already retired by this age, and did not have independent means of support. It was decided in 1987 that the age limit should be further lowered to 65 by phases. When lowering the age limit to 65, it was proposed at the same time to require all OAA recipients, except the existing ones, to declare their means. The rationale underlying the proposal was that many older persons would still be in gainful employment after reaching the age of 65. In addition, there was concern at the rising OAA expenditure which increased from US$2.25 million in 1973 to US$83.25 million in 1986 (Department of Social Welfare, 2003). The proposal nevertheless was met with adverse public reaction and subsequently modified for application to older persons aged between 65 and 69 only.

The objectives of OAA have become obscured overtime, partly due to (1) the lowering of the qualifying age from 75 to 70 and further down to 65. At such younger age, many older persons still possess strong self-care abilities; and (2) extension of the OAA to cover older persons receiving residential care services. Over the years, there have also been gradual but important changes in the social values and attitude towards social security benefits in our society. When the OAA was introduced, it was assumed that the prevailing attitudes towards charity would deter people without genuine financial need from applying for the allowance. However, many people now view OAA as a form of pocket money paid to the elders (as reflected in its popular naked name “money for buying fruit”) in recognition of their past contribution to society. Older persons now generally regard receiving OAA as a right. There has always been a high take-up rate of OAA, reflecting on the general public’s acceptance of the Scheme. In 1973/74 when the Scheme was introduced, the take-up rate was already around 50% and it rose steadily to 71.9% in 1994. In fiscal year 2003-04, social welfare expenses rank second (15.8%) in amount among all Government’s expenditures and over 70% of these expenses is pension related (Department of Social Welfare, 2003). Due to inadequate retirement income protection, more retirees in Hong Kong become welfare recipients. Over one fifth (21.5%) of middle-aged adults planned to rely on welfare as their way to maintain their living after retirement (Chou, Chow, & Chi, in press). Consequently, changes in the age profile of the population and the average retirement age have implications for both income as well as expenditure for the government.

2. Major Job-related Retirement Program – MPF

Mandatory retirement protection scheme called MPF was launched at the end of 2000. MPF is a system of mandatory personal savings accounts and 5% of workers’ pay of each worker (the maximum amount is about US$ 128) and an equal amount of contribution from their employers were deposited in an individualized saving account to accumulate income for one’s retirement. MPFA was established to regulate and monitor the operation of the MPF System. For details of the MPFA organization, please refer to the attachment. The mission of the MPFA is to ensure the provision of retirement protection for

Hong Kong's workforce through an effective and efficient system of prudential regulation and supervision of privately managed provident fund schemes under the MPF System. Its responsibilities as laid down in the Mandatory Provident Fund Schemes Ordinance (MPFSO) include:

- ensuring compliance with the MPFSO;
- registering provident fund schemes;
- approving qualified persons and companies as trustees of registered schemes;
- regulating the affairs and activities of approved trustees and ensuring that they administer the registered schemes in a prudent manner;
- making rules or guidelines for the payment of mandatory contributions and for the administration of registered schemes;
- exercising such other functions as are conferred or imposed on the Authority by or under the MPFSO or any other Ordinance;
- considering and proposing reforms of the law relating to occupational retirement schemes or provident fund schemes; and
- promoting and encouraging the development of the retirement scheme industry in Hong Kong, including the adoption of a high standard of conduct and sound prudent business practices by trustees and other service providers.

Since MPF will become the main Scheme for old age income protection in Hong Kong for the coming years, a more detailed description on the key features of the System are described as below.

Coverage

MPF is an employment-based retirement protection system. Except for exempt persons, employees and the self-employed aged between 18 and 65 are required to join MPF Schemes. Under the law, an employee is defined as any full-time and part-time employee who is employed for a continuous period of not less than 60 days under an employment contract. A self-employed person is a person who earns an income from his production of goods or services, or a trade in goods or services in a capacity not as an employee. A casual employee refers to a person employed in the catering or the construction industry by an employer on a day-to-day basis, or for a fixed period of less than 60 days. Employers are required to enroll casual employees in MPF Schemes regardless of the length of the employment period. A person who belongs to any one of the following categories is exempt from joining MPF Schemes:

- Domestic employees;
- Self-employed hawkers;
- People covered by statutory pension or provident fund schemes, such as civil servants and subsidized or grant school teachers;
- Members of occupational retirement schemes which are granted exemption certificates;
- People from overseas who enter Hong Kong for employment for less than 13 months, or who are covered by overseas retirement schemes; and
- Employees of the European Union Office of the European Commission in Hong Kong.

Before the implementation of the MPF System, only about one-third of the workforce of 3.4 million people had some form of retirement protection. Up to now, 63% of the working population has joined MPF Scheme while about 4% of the working population who should join the MPF Scheme but still has not done so. Specifically, up to October 31, 2003, Hong Kong has 228,000 employers and 95.2% (i.e. 217,000 employers) has join the MPF Scheme, among the 1,816,000 employees and 351,000 self-employed persons, the compliance rates are 95.9% and 85.3% respectively.

Contributions

Mandatory contributions are calculated on the basis of 5% of an employee's relevant income, with the employer matching the employee's contribution. Self-employed persons also have to contribute 5% of their relevant income. They can opt to make contributions on a monthly basis or a yearly basis. Relevant income includes wages, salaries, leave pay, fee, commission, bonus, gratuity, perquisite or allowance, but excludes housing allowance or housing benefits. It does not include severance payments and long service payments. Mandatory contributions are subject to the minimum and maximum levels of income, which are US$640 and US$2,570 respectively. Employees earning less than US$640 a month do not need to contribute but their employers have to contribute 5% of the employees' income. For employees earning more than US$2,570 a month, mandatory contributions are capped at US$128. The above minimum and maximum income levels also apply to self-employed persons. Employers, employees and self-employed persons can opt to make extra, voluntary contributions in addition to the mandatory contributions. The monthly total average contribution amount is about HK$20 billion and as on September 30, 2003, the total MPF net asset value was HK$787 billion.

Vesting, Withdrawal and Transfer of Accrued Benefits

Mandatory contributions made for an MPF member will be fully and immediately vested as his/her accrued benefits once they are paid to the MPF approved trustees. Investment income or profit derived from the investment of accrued benefits is also immediately vested in the scheme member. Scheme members can withdraw their accrued benefits in a lump sum under the following conditions: at the retirement age of 65, permanently leaving Hong Kong, disabled, or deceased. Before then, they may transfer their benefits from one scheme to another when changing jobs.

Types of MPF Schemes

There are three main types of MPF Schemes.

(1) Master Trust Scheme : Its membership is open to the relevant employees of more than one employer, self-employed persons and persons with accrued benefits transferred from other schemes. By pooling together contributions of small employer units, master trust schemes can enjoy a high degree of efficiency in terms of scheme administration and investment, resulting in economies of scale. This type of scheme is most suitable for small- and medium-sized companies.

(2) Employer-sponsored Scheme : Its membership is limited to the relevant employees of a single employer and its associated companies. With such limitation in membership, it is only cost-effective to run an employer-sponsored scheme if the number of employees is large enough.

(3) Industry Scheme : It is specially established for employees of the catering and construction industries with high labor mobility. An employee who is a member of an industry scheme does not need to change schemes if he or she changes employment within the same industry, so long as his or her previous and new employers are participating in the same industry scheme.

Currently, there are 19 trustees, 48 different schemes for employer and 319 funds for employee as their investment choices.

Four-tier Protection

To ensure that the interests of scheme members are adequately and properly protected, the MPFA has a comprehensive approval and monitoring system, which includes:

(1) Stringent approval and registration criteria

Only companies and individuals that meet the stringent criteria on capital adequacy, financial soundness, fitness and propriety as well as internal control standards can become approved trustees. Trustees are responsible for appointing fund managers and other service providers, and ensure their compliance with the requirements, standards and guidelines of MPF. All MPF Schemes must be managed under trust arrangements and governed by the law of Hong Kong. Scheme assets are held separate from the assets of trustees and other service providers.

(2) On-going monitoring

The MPFA is empowered to regulate and monitor the operation of the MPF System and MPF trustees' compliance with statutory requirements. Trustees are required to submit returns, financial statements and internal control reports on a regular basis. The MPFA may also conduct field inspections to ensure trustees comply with requirements and enable early detection of deficiencies. The MPFA will investigate cases of suspected non-compliance with requirements. For minor cases, the MPFA may issue warnings or impose financial penalties, and order the trustee to take remedial actions. For more serious cases, the MPFA may require a special audit to be conducted on the trustee. During the investigation, the MPFA may suspend the trustee from administration of an MPF Scheme, and appoint another trustee to administer the scheme on a temporary basis. Depending on the results of the investigation, the MPFA may revoke the approval of the trustee and terminate the trustee's administration of the scheme, as well as take prosecution action for serious non-compliance with regulations.

(3) Professional indemnity insurance

To provide scheme members with additional layers of protection, trustees are required to take out adequate insurance to indemnify scheme members for any losses of scheme assets caused by misfeasance or misconduct of the trustees or their service providers.

(4) Compensation fund

There is also a statutory Compensation Fund set up under the MPFSO to compensate scheme members should the indemnity insurance not fully cover those losses. The Government had injected US$78 million as the seed money of the Compensation Fund. When in need, the MPFA may apply to the court to use the Fund.

Investment Restrictions

To protect the interests of scheme members, there is a set of detailed and stringent guidelines governing MPF investments.

(1) Regulation of MPF intermediaries

MPF intermediaries are persons who sell MPF schemes, or advise clients on constituent funds or underlying approved pooled investment funds of MPF Schemes. MPF intermediary includes an individual (employee/agent/representative), a firm (sole proprietor), a partnership, or a corporation and its directors who are responsible for the supervision of the selling/advising activities of MPF Schemes. However, it does not include certain professionals (such as lawyers, professional accountants or actuaries) whose act of giving advice on MPF is wholly incidental to the practice of his profession.

(2) Eligibility requirements for MPF intermediaries

Corporate and individual intermediaries must register with the MPFA. To meet basic registration requirements, an applicant must:

(a) be supervised by one or more of the three financial regulatory regimes, namely the Monetary Authority regime, the Insurance Authority regime and the Securities and Futures Commission regime;

(b) pass an MPF intermediaries examination recognized by the MPFA (see MPF Intermediaries Examination below); and

(c) satisfy the MPFA that his is fit and proper to be registered as an MPF intermediary.

(3) Proof of qualification

MPF intermediaries are issued with "MPF cards" as evidence that they are qualified to sell/advise on MPF Schemes. The MPFA keeps a register of all registered MPF intermediaries. The public can verify the registration status of an MPF intermediary by calling the MPFA hotline, checking the MPFA website or visiting the MPFA office.

(4) Code of Conduct for MPF intermediaries and examination

MPF Intermediaries must comply with Code of Conduct for MPF Intermediaries when conducting MPF business. The Mandatory Provident Fund Schemes Examination (under the Insurance Intermediaries Quality Assurance Scheme conducted by the Vocational Training Council) and the MPF Intermediaries Examination (conducted by the Hong Kong Securities Institute) are based on the same syllabus and are recognized by the MPFA as meeting the examination requirement to be an MPF intermediary. The examination syllabus covers the regulatory framework and key features of the MPF System, functions of MPF trustees, MPF Schemes and investments, interface arrangements for ORSO Schemes and the MPF System and the regulation of MPF intermediaries.

(5) Continuing professional development for MPF intermediaries

All MPF intermediaries are required to comply with the Continuing Professional Development (CPD) requirement with effect from January 2002. The objectives of the CPD program are to enhance the technical knowledge and professional expertise of individual intermediaries about the MPF System and related areas, and to assure that individual intermediaries remain fit and proper to be registered. An individual intermediary is required to undertake a minimum of 10 hours of CPD activities in each calendar year, with at least 20% of the minimum CPD hour devoted to core subject areas. Core subject areas include MPF or related legislation, relevant codes and guidelines, and the latest developments of the MPF System.

<u>Enforcement</u>

The overriding objective of the MPFA's enforcement policy is to ensure that scheme members' interests are duly protected. Depending on the circumstances of each case, the MPFA takes different enforcement measures in the handling of complaints. Factors to be considered include whether the interests of scheme members have been protected, and whether the enforcement measures have an adequate deterrent effect. Measures adopted by the MPFA include reminders, warnings, surcharge notices, and the pursuance of claims on behalf of employees. Blatant offenders would be prosecuted.

The MPFA conducts investigations into all complaints received. Complainants' identities and information provided are kept confidential. The MPFA will notify complainants of the results upon completion of the investigations. Employees are encouraged to report to the MPFA as early as practicable when suspecting that their MPF rights are infringed upon. Apart from acting on complaints, the MPFA also conducts proactive on-site inspections. Legal actions will be taken against those non-compliant employers to protect the interests of scheme members.

To summarize, the MPF Scheme had just implemented at the end of 2000. The operation and supervision of the MPF System is governed by the existing MPF legislation. Owing to the tight schedule and the lack of precedents at the time of enactment, there are plenty of rooms for improvement in the legislation. Prior to the formal implementation of the MPF System, MPFA had already initiated a process of legislative review, with amendments to several ordinances proposed and passed since then. Since August 2001, the MPF Schemes Operation Review Committee was established within MPFA and the Committee has recommended three MPFS amendment bills in the past two years to enhance the System (MPFA, 2003).

Since MPF is mandatory in nature, MPFA attaches great importance to the monitoring of investment products. While it is necessary to protect the interests of the investors against risky investments, MPFA also has to consider the rate of investment returns. One of the major tasks for MPFA is to continue the discussion with the trade to improve the operation of the MPF System. MPFA will focus its future efforts on the monitoring and regulation of investment product. There have been quite a number of investment funds for MPF in Hong Kong since the MPF enactment. Basically MPFA holds that allowing free competitions in the market would result in more products and funds, hence more competitions and better prices. Therefore, MPFA has not acted to restrict the number of investment funds. Nevertheless, MPFA finds that the present rate of fund consolidation is quite slow, probably because the current trustees are mostly banks or insurance companies which continue their MPF business out of other commercial considerations.

The “5%+5%” contribution rate was set after long deliberation by various parties and approved by the Legislative Council. It was insufficient to meet the needs of retirement living. People not employed, such as housewives, are not covered by MPF Scheme. At the same time, the low-income group is exempted from MPF Scheme while the retirement protection afforded by the Scheme to the middle and high-income groups is limited because of the ceiling on their mandatory contribution. In this light, MPF seems to be of limited effectiveness in retirement income protection. According to overseas studies, it is estimated that retired persons had to secure around 60% of their working income in order to maintain a certain standard of living after retirement. When the economic climate takes a turn for the better or the operation of the MPF System is up and running, MPFA will consider proposing to revise upward the ratio of savings/investments. However, as this involves policy change, it will be up to the HKSAR Government to propose legislative changes and seek the Legislative Council's endorsement.

In amending the MPF legislation, the Government's current emphasis is on enhancing flexibility in administration and investment, and protecting participants of MPF Schemes. The first step is to improve and streamline the administrative system and this involves a quadrennial review of the legislation relating to the contribution rate, and the minimum and maximum levels of income. This will be followed by enhancing the existing supervisory power and allowing investment products a higher degree of flexibility with a view to striking a better balance between risk and return.

3. Other Job-related Retirement Schemes

There are two other types of retirement scheme which are also linked up with the employment. One is ORSO and another one is Civil Servant Pension Scheme. The ORSO is commenced on 15 October 1993. It is a voluntary scheme that governed by trust. The contribution of ORSO varies depending on different individual plans. Workers who have joined ORSO Scheme on or before 3 May 2000 may have the exemption to MPF. The total number of registered schemes is 8,000 and cover over 600,000 workers as on 31 October 2003. The total asset size of ORSO is US$17,462 million and the annual contribution amount of ORSO registered schemes is US$2,207 million (Mandatory Provident Fund, 2003).

The Civil Servant Pension is a non-contributory and life time program. It covers 162,000 civil servants including the retired magistrates. The payment is based on their highest pension emoluments which is determined with reference to their highest substantive salary before retirement. There are two types of pension, specifically for those who were appointed on or before 1 July 1987 remain in the Old Pension Benefit (OPB) and those who were appointed after 1 July 1987 belong to the New Pension Benefit (NPB). The NPB compares with the OPB has more flexibility except on the voluntary early retirement age and the pension grant date. Since it is a public funded program, the long term burden on public expenditure has become an issue in recent years. Therefore, a major change was taken place in 1998. Instead of hiring civil servants on a substantive term, majority of the civil servants are now being hired on contract basis and these contract staff will join the MPF scheme as their job-related retirement income protection.

Financial Disposition of Current and Next Generation of Older Persons

Hong Kong Government has conducted a survey on the current generation (aged 60 and above) and the next generation (aged 45 to 59) of older persons in Hong Kong in the summer of 2000 to obtain a better understanding of their financial disposition (Census and Statistics Department, 2002b). Altogether 2,180 respondents of age 60 or above and 1,867 of age 45 to 59 were surveyed. A summary of the findings is presented in this paper.

As for the income of the current generation of older adults, the survey results show that family is till the main provider, with 58% of older persons receiving a family contribution, averaged at US$800 a month. However, it is noted that the importance of the role of the family seems to have been diminishing as a survey conducted in 1996 showed that 71% of older persons back then received financial support from family members. Only a small percentage of older adults have a formal source of income like salary (12%) and retirement benefits (15%). Those still in employment earn a median monthly income of US$750. For those enjoying retirement benefits, most of them only received a lump sum on retirement. Very few receive regular monthly payments. The lump sum amounts received have a medium of US$8,125 and would not enable the elders to support themselves for long. Older persons of this generation do not own much asset in general. About 24% own self-occupied properties and 4% have investments such as stocks and bonds. Although the great majority has cash deposits, the value involved should not be very high as the amount of interest reported to have been received is small.

Although the older adults surveyed had limited income, most of them considered their income as sufficient in meeting their expenses except a certain proportion of older adults live in financial hardships. About 10% of older adults actually relied on OAA as their main source of income despite its modest payment rates. Among this group of elders, about one-third received financial contribution from their families, and had a total average monthly income of US$140. For the remaining two-thirds, they did not receive any family contributions and had to rely on an average monthly income of US$95. Furthermore, according to the General Household Survey in the second quarter of 2000, 74% of the households in the lowest income bracket involved elder family members, and most of these households in fact comprised single elders or elder couples.

As for the next generation of older adults, we do not know their income post retirement but 30% are working/have worked with employers who provide retirement benefits to their employees. With the introduction of the MPF Scheme, most of them should enjoy retirement benefits in one form or another when they retire. They are also richer in assets. 37% have self-occupied properties; 11% invest in shares, bonds or unit trusts; and 96% have bank deposits. Judging from the dividend and income from investment reported, it is estimated that the average value of their assets, not including properties, should be in excess of US$12,960. In summary, a proportion of the next generation of elders will have an improved financial standing post retirement compared to the current cohort. Nevertheless, it seems that the majority of them may not be adequately protected.

The Potential Problems

Although the next generation of elders appears to be financially better off at present, the majority of them (around 67%) have not made any arrangement to meet their future financial needs. While 58% of them indicated that they would rely on financial support from their children after retirement, the actual family size of the next generation of older adults is getting smaller. 55% of them have only one or two children and 12% have no child at all. The reduction in family size is expected to have implications on how the soon-to-be old are going to finance their post-retirement living. We are concerned that there may be a group of the next generation of older adults who are currently on low income and have few or even no child to support them. After retirement, they may exhaust their savings or retirement benefits in a short time period and subsequently fall into the welfare safety net.

The MPF will take some 30-40 years to mature and will have limited effect in the interim. For those of low income, the benefits of MPF are limited even in the longer term. For example, a person earning a monthly income of US$650 will have accumulated after 30 years an amount that can give him support for around three years before meeting the CSSA asset limit of US$4,800 if the individual has no other assets or income. Even for those earning US$1,165 a month, the amount will be depleted in about five years after which they become eligible for CSSA if they have no other source of savings or retirement provision.

The MPF Scheme is defined contribution in nature and many large corporations have shifted their original defined benefit plans to defined contribution plans in recent few years. As a result, Hong Kong workers covered by defined benefit plan such as Civil Servant Pension will be decreased whereas employees under the defined contribution plan will be predominant in the long run. This trend is consistent with what happened in U.S. over the past thirty years since mid-1970s (Clark & McDermed, 1990; PBGC, 1999). The proportion of U.S. pension participants covered by defined-benefit was decreased from 83% in 1979 to 50% in 1996. Yet even among those workers who remain in the highly age structured defined benefits pension plan, age structuring may decline because of early retirement pension incentives, especially in current economic downturn in Hong Kong. Many large corporations in Hong Kong and even HKSAR Government continually launch these early retirement schemes to their soon-to-be old employees in recent years in order to cut labor cost and budget deficits.

Devising a Sustainable Financial Support System for Older Adults in Hong Kong

In order to find out the policy options for the future, the Hong Kong SAR Government has commissioned the Sau Po Centre on Ageing at the University of Hong Kong to conduct a study to review the social security schemes for older adults. The ultimate goal is to devise another public pillar which is financially sustainable in the long run given the simple and low taxation system. The objectives of the review are:

1. To assess the distribution of income and asset possession among older adults in the coming three decades;

2. To examine the public expenditure of the social security system including old-aged category of CSSA Scheme and OAA Scheme in the coming three decades;

3. To estimate the benefits to be received from the retirement income protection schemes including the MPF Schemes, the voluntary Occupational Retirement Schemes Ordinance (ORSO), and civil servant pension scheme for the aged in the coming thirty years;

4. To review and evaluate the roles of the existing pillars in old age income security;

5. To propose a number of financial sustainable schemes for the next 30 years that may change or replace the current social security system for older adults;

6. To project the impact of these schemes on the distribution of income and asset possession in the future cohort of older adults in the coming three decades e.g. to what extent these schemes may prevent or reduce the poverty or income inequality in old age;

7. To assess the impact of these schemes on family support, saving behavior, labor participation incentives, retirement decision and local economy in the coming three decades; and

8. To evaluate these schemes by taking into account of results obtained in (2), (3), and (4) and social (attitude to poverty in old age, concept of equity), economic and political (feasibility) circumstances of Hong Kong and guidelines proposed by World Bank (1994) as well as Holzmann, MacArthur, & Sin (2000).

Conclusion

The main objectives of retirement income protection are protecting against income drop after retirement and preventing poverty in old age. HKSAR Government follows closely to World Bank's three-pillar approach for retirement income protection without questioning its adequacy while the pension scholars in the world are debating on whether or not the proposal of the World Bank is really advisable (Beattie-McGillivray, 1995; James, 1996). Nonetheless, it is recognized by some scholar of the efforts that HKSAR Government had made in setting up the MPF Scheme as a way to increase level of investment and may improve efficiency; would get possible economic benefits for the whole society; introduces market disciplines and in some cases competition exists; and makes pensions less political (Daykin, 2003). In Hong Kong, the SAR Government is duty-bound to provide for the first pillar recommended by the World Bank for retirement income protection. However, the financial burden has become unbearable and it is also threatening the low taxation policy which Hong Kong Government considers as the cornerstone of the prosperous society (i.e. to maintain Hong Kong the best investment city in the world).

The problem of adopting World Bank's three-pillar approach in Hong Kong is how the balance these three pillars. While you have too many people relying on welfare as their retirement income protection and the coverage of compulsory privately managed pension plan is insufficient, some adjustments need to be taken place for improvement. A new public-funded retirement scheme is recommended with following features:

- means-tested with an indexed flat rate;

- universal minimum pension guarantee scheme with an indexed flat rate;
- schemes may be funded by general revenue and an additional funding source such as earmarked taxes, consumption tax, payroll contribution (PAYGO), or combination of these options; and
- may be publicly or privately managed.

MPFA oversees the operation of the second pillar. As discussed in the earlier section, quite a few areas have been identified for MPFA and HKSAR Government to make policy and Ordinance changes in order to improve the Scheme. The following recommendations are also suggested as further enhancement:

- defer the retirement age for the middle aged population;
- allow the non-working population to join the Scheme and encourage personal savings; and
- encourage the development of annuities program to act as an effective decumulation vehicle for the MPF benefits. Specifically, the annuities can ensure a dependable flow of post-retirement income, provide a smooth consumption profile throughout the remaining lifetime, and avoid the prospect of outliving resources.

Regarding to the third pillar, the introduction of MPF has brought about a change in the public mindset in that people began to realize that they should be responsible for their own retirement income. According to Nobel Laurent, Professor Franco Modigliani, people save only for themselves. From the postulate of utility maximization it follows that consumption is evenly distributed over time and this, in turn, implies that the individual during active period, builds up a stock of wealth for consumption during old age. However, given the weak sense of retirement preparation among the Hong Kong people, education in personal wealth management is an important component in retirement income protection. Both the Government and MPFA are urged to promoting public education to raise community awareness of retirement income protection and the importance of private saving.

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