

MANDATORY PROVIDENT FUND SCHEMES AUTHORITY

V.3 Guidelines on MPF Exempted ORSO Schemes - Treatment of Accrued Rights of Existing Members who Join MPF Schemes

INTRODUCTION

Pursuant to sections 4 and 15 of the Mandatory Provident Fund Schemes (Exemption) Regulation (“the Exemption Regulation”), existing members of an MPF exempted ORSO scheme¹ can opt for remaining in the ORSO scheme or MPF coverage. For an existing member who has decided to opt-out from an ORSO registered scheme and become a member of a registered MPF scheme (i.e. “opt-out members”), his benefits accrued under the ORSO registered scheme will need to be treated in the manner as stipulated in section 7 of Schedule 2 of the Exemption Regulation². This provision is not applicable to ORSO exempted schemes.

2. Subsection (1) of section 7 prescribed how an opt-out member’s benefits should be determined upon termination of service under a defined contribution scheme and a defined benefit scheme.

^Note 1: An MPF exempted ORSO scheme means a scheme in respect of which an exemption certificate has been issued under sections 5 or 16 of the Exemption Regulation.

^Note 2: All references to sections made in this document refer to sections under Schedule 2 of the Exemption Regulation except otherwise stated.

3. Subsection (2) further prescribed that if the ORSO registered scheme also provides death, disability or any other benefits in addition to termination of service benefits, an opt-out member's benefits accrued under these circumstances should be no less than the amount of benefits determined in accordance with subsection (1) upon termination of service.

4. The accrued rights of an opt-out member can be treated not in accordance with the above provisions provided the member's consent has been obtained and it is allowed under the governing rules of the ORSO registered scheme.

5. Subject to paragraph 4 above, the following paragraphs provide guidelines on how an opt-out member's benefits should be determined upon termination of service under a defined contribution scheme and a defined benefit scheme as prescribed in subsection (1) of section 7.

TREATMENT OF ACCRUED RIGHTS

Defined Contribution Schemes

6. A defined contribution scheme is a scheme where the contribution rates are defined and the amount of benefits accrued is based on the accumulated contributions with investment income. Members usually do not get the full benefits funded by their employers unless they meet certain criteria, such as age, years of service or a combination of the two.

7. In determining a member's benefits upon termination of service, these schemes usually will apply a vesting percentage on the accumulated account balance attributable to contributions made by the employer based on the member's age, years of service or a combination of the two.

8. As stipulated under section 7(1)(a), the accumulated balance under both the employer account and the employee account, if applicable, of an opt-out member should be retained in the existing scheme and continue to be credited with investment income until the member is entitled to receive any benefits from the scheme.

9. Upon termination of service, in determining an opt-out member's vesting percentage and thus his accrued benefits, his total years of service (i.e. his years of service under the scheme before he joined an MPF scheme plus his years of service after he joined an MPF scheme) and, if applicable, his age at the time of termination of service should be used.

10. The following illustration demonstrates how the mechanism would work :

Illustration 1

	<u>Employee</u>	<u>Employer</u>
Contribution Rate :	5%	7.5%
Vesting Scale :	<u>Years of service</u>	<u>Vesting percentage</u>
	less than 3	0%
	3	30%
	4	40%
	5	50%
	:	:
	:	:
	9	90%
	10	100%

Termination of Service Benefit =

$$\begin{aligned} & \text{Employee Account Balance} + \\ & \text{Employer Account Balance} \times \text{Vesting Percentage} \end{aligned}$$

For an employee who has 3 years of service at the time he opts out of the ORSO scheme, 5 years of total service at the time he leaves employment and his account balances are -

	<u>Employee Account</u>	<u>Employer Account</u>
as at date of opt-out :	\$20,000	\$30,000
investment income :	\$ 4,000	\$ 6,000
as at date of termination :	\$24,000	\$36,000

His termination of service benefits under the ORSO scheme would be :

$$\mathbf{\$24,000 + \$36,000 \times 50\% = \$42,000}$$

i.e. the vesting percentage is determined based on the total years of service.

Defined Benefit Schemes

Typical Defined Benefit Schemes

11. A defined benefit scheme is a scheme where the employer's contribution rates are not defined and the amount of benefits a member can get is based on a formula with reference to his age, years of service, final average salary etc.

12. A typical defined benefit scheme usually defines the amount of benefits in the following manner:

The Amount of Benefits =

Benefit Factor x Scheme Service x Final Average Salary [x Vesting Percentage]

where some schemes will have an explicit vesting scale and some schemes will embody the vesting scale in the scale of benefit factors. Both the benefit factor and the vesting percentage are usually determined based on years of service and/or age.

13. Section 7(1)(b) requires the accrued rights of an opt-out member to be retained in the existing scheme until the member is entitled to receive any benefits from the scheme.

14. The policy intention under section 7(1)(b) is to determine an opt-out member's benefit entitlements in such a way that it has no funding implication to the relevant employer and is in line with generally accepted actuarial principles.

15. Based on the above typical defined benefit scheme, an opt-out member's benefit entitlement should be determined on the following basis :

- (a) years of scheme service up to the date he elected to opt out;
- (b) the relevant benefit factor and/or vesting percentage based on total years of service, i.e. his years of service under the scheme before he joined an MPF scheme plus his years of service after he joined an MPF scheme, and, if applicable, his age at the time of termination of service; and
- (c) final average salary determined as at the date of termination.

16. The following illustrations demonstrate how the mechanism would work in practice :

Illustration 2 :

Benefit Formula : $2.0 \times \text{Final Average Salary} \times \text{Scheme Service} \times \text{Vesting Percentage}$

Vesting Scale :	<u>Years of service</u>	<u>Vesting percentage</u>
	less than 3	0%
	3	30%
	4	40%
	5	50%
	:	:
	:	:
	9	90%
	10	100%

For an employee who has 3 years of scheme service at the time he opts out of the ORSO scheme, 5 years of total service at the time he leaves employment and his final average salary at that time is \$12,000, his termination of service benefits under the ORSO scheme would be :

$$2.0 \times \$12,000 \times 3 \times 50\% = \$36,000$$

Illustration 3 :

The following illustration is a variation of the above illustration where the benefit factors are defined with respect to years of service. There is no explicit vesting scale prescribed, however, vesting is implicitly applied through the design of the benefit factors.

Benefit Formula : Benefit Factor x Final Average Salary x Scheme Service

where the Benefit Factors are defined as follows -

<u>Total Service</u>	<u>Benefit Factor</u>
less than 3 years	0
3	0.6
4	0.8
5	1.0
6	1.2
7	1.4
8	1.6
9	1.8
10	2.0
:	:
:	:
20 or more years	3.0

For an employee who has 3 years of scheme service at the time he opts out of the ORSO scheme, 5 years of total service at the time he leaves employment and his final average salary at that time is \$12,000; his termination of service benefits under the ORSO scheme would be :

$$1.0 \times \$12,000 \times 3 = \$36,000$$

Hybrid Schemes

17. A hybrid scheme is a scheme which has both defined contribution and defined benefit characteristics and is classified as a type of defined benefit scheme for the purposes of the Occupational Retirement Schemes Ordinance. The amount of benefits a member can get is the greater of the benefit determined based on a defined benefit formula and the benefit generated by defined contributions.

18. In determining an opt-out member's benefits under a hybrid scheme upon termination of service, the mechanism prescribed above for defined benefit schemes and defined contribution schemes will apply to the respective parts of the hybrid scheme.

19. The following illustration demonstrates how the mechanism would work in practice :

Illustration 4:

Defined Contribution Part

	<u>Employee</u>	<u>Employer</u>
Contribution Rate :	5%	5% for the first 5 years 10% for the next 5 years 15% thereafter

Vesting Scale :	<u>Years of service</u>	<u>Vesting percentage</u>
	less than 3	0%
	3	30%
	4	40%
	5	50%
	:	:
	9	90%
	10	100%

Defined Benefit Part

Benefit Formula : $2.25 \times \text{Final Average Salary} \times \text{Scheme Service} \times \text{Vesting Percentage}$

Termination of Service Benefit = the greater of

- (a) Employee Account Balance +
Employer Account Balance x Vesting Percentage; and
- (b) $2.25 \times \text{Final Average Salary} \times \text{Scheme Service} \times \text{Vesting Percentage}$

For an employee who has 3 years of service at the time he opts out of the ORSO scheme, 5 years of total service at the time he leaves employment and his account balances are -

	<u>Employee Account</u>	<u>Employer Account</u>
as at date of opt-out :	\$20,000	\$20,000
investment income :	\$ 4,000	\$ 4,000
as at date of termination :	\$ 24,000	\$24,000

His final average salary at the time he leaves employment is \$12,000.

His termination of service benefits under the ORSO scheme would be :

The greater of

(a) $\$24,000 + \$24,000 \times 50\% = \$36,000$; and

(b) $2.25 \times \$12,000 \times 3 \times 50\% = \$40,500$

i.e. \$40,500.

Others

20. For a scheme with composite or complicated scheme arrangements, the employer/trustee of the scheme may consult the Authority on treatment of accrued rights.