

MANDATORY PROVIDENT FUND SCHEMES AUTHORITY

V.5 Guidelines on MPF Exempted ORSO Schemes - Illustrative Examples

INTRODUCTION

Section 15(1) of the Mandatory Provident Fund Schemes (Exemption) Regulation (“the Exemption Regulation”) requires employers who have made an application for exemption under section 16 in respect of their relevant ORSO registered schemes to provide the information specified in Part 2 of Schedule 1 to the Exemption Regulation to existing members and new eligible employees of the schemes within the prescribed period.

2. Paragraph 5 of Part 2 of Schedule 1 requires the provision of illustrative examples to demonstrate the differences in benefits between the relevant ORSO registered scheme and the mandatory provident fund scheme (“the MPF scheme”) selected or proposed to be selected by the employer.

3. The Mandatory Provident Fund Schemes Authority (“the Authority”) hereby issues guidelines relating to the illustrative examples to be provided by employers.

ILLUSTRATIVE EXAMPLES

Minimum number of illustrative example per scheme

4. Employers should at least provide a set of illustrative example for new eligible employees not later than 10 days after the employees became such an employee.

5. If the relevant ORSO registered scheme or the MPF scheme provides different benefit terms and conditions to different classes of members, different sets of illustrative examples should be provided for each class of members.

6. Each set of illustrative examples should demonstrate at least the differences in benefits upon termination of service and retirement and both the projected values of benefit payments (or accruals) and employee own contributions should be shown. Other auxiliary benefits, such as death and disability benefits should also be disclosed in the illustrative examples if they are material.

Illustration Period

7. As ORSO schemes usually have vesting scales spanning over 10 years whereas the MPF mandatory contributions are fully and immediately vested with members, the comparison period should start from an age which reflects the average membership characteristics of the scheme or of the relevant member class and all the way up to age 65 in order to assist new eligible employees to understand how the benefits of the two schemes may differ over their career life spans.

8. In each set of illustrative examples, the termination of service benefits/retirement benefits are required to be shown at:

- (a) each of the first 5 years;
- (b) year 10; and
- (c) every 10 years thereafter up to age 65.

Assumptions

9. Each illustrative example needs to disclose the assumptions used to carry out the projection, in particular the following:

- (a) rates of gross investment return (i.e. before levies, administrative and asset management expenses);
- (b) rate of salary inflation; and
- (c) rates of administrative expenses.

10. In order for new eligible employees to gain a feel on how investment return may affect their future benefit entitlements, the illustrations should include two gross investment return rates. One of the gross rates should be higher than the assumed rate of salary inflation and the other one should be lower than or at most equal to the assumed rate of salary inflation. The gross yield gaps chosen (i.e. the gap between the gross investment return rate and salary inflation rate) should take into account the risk/return profiles of the underlying scheme investments and it must be within the range of $\pm 3\%$ per annum.

11. It should be mentioned in every illustrative example that the benefits which one will eventually receive upon termination of service or retirement may be higher or lower than those being illustrated depending upon the actual experience over the period.

12. According to Schedule 3 to the Mandatory Provident Fund Schemes Ordinance (“the Ordinance”), the amount of monthly relevant income is capped at \$20,000 for contribution periods commencing on or before 31 May

2012 and \$25,000 for contribution periods commencing on or after 1 June 2012¹ for the purposes of making mandatory contributions. Even though there is no automatic index mechanism being built in the legislation to adjust it periodically, for illustration purposes, this maximum level of monthly relevant income should be assumed to increase in line with the salary inflation assumption being adopted in the illustration.

13. If all of the administrative expenses incurred with respect to the ORSO or the MPF scheme are to be borne by the relevant employers, there is no need to incorporate any assumption on administrative expenses in the illustrations. Otherwise, an assumption should be made on administrative expenses and it should approximate the actual charges levied by all relevant parties who administer or regulate the schemes.

14. With respect to the assumptions on the current or entry level of salary (as defined in the terms of the ORSO scheme) and relevant income (as defined in the Ordinance) to be used in the examples, they should reflect the average profile of members of the scheme or of the relevant member class.

Specific illustration

15. A specific illustration is set out in the Annex to illustrate the projection of benefits for a new eligible employee under a typical MPF scheme. Employers shall use the basic framework provided in the Annex for the purpose of comparing their own ORSO scheme with an MPF scheme.

¹ The Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 3) Notice 2011 (L.N. 167 & 168 of 2011) amending the maximum relevant income level was approved by the Legislative Council on 23 November 2011 and becomes effective on 1 June 2012.

16. The illustration specified in the Annex is for illustrative purposes only and is not intended to be strictly followed. Employers should make appropriate illustrations based on their own situation.

DEFINITION OF TERMS

17. Where a term used in the Guidelines is defined in the Ordinance or the subsidiary legislation then, except where specified in the Guidelines, that term carries the meaning as defined in the Ordinance or the subsidiary legislation.

Illustration

New eligible employee :

- Age 40 at the Date of Employment
- Belongs to the Managerial Staff Grade in both ORSO and MPF Schemes
- Salary of \$25,000 per month
- Annual Remuneration = 12 months pay + bonus

The MPF Scheme :

- Employee Contribution : 5% of Relevant Income
(up to \$20,000 on or before 31 May 2012; and \$25,000 on or after 1 June 2012 increasing each year in line with the salary inflation assumption)
- Employer Contribution : 5% of Relevant Income
(up to \$20,000 on or before 31 May 2012; and \$25,000 on or after 1 June 2012 increasing each year in line with the salary inflation assumption)
- Relevant Income : \$25,000 per month increasing each year with the salary inflation assumption

Benefit Illustration :

The calculations are based on the following assumptions:

- (i) The new eligible employee joined the company on 1st January 2013
- (ii) The birthday of the new eligible employee is also 1st January
- (iii) Salary increment takes effect on 1st January each year
- (iv) Contributions are made on last day of each month
- (v) The annual rate of return and administrative expenses are applied on a monthly basis

(a) *Higher Investment Return Scenario*

Projection Assumptions

Rate of Gross Investment Return	:	7% p.a.
Rate of Salary Inflation	:	4% p.a.
Rate of Administrative Expenses	:	2% p.a.

At the beginning of	Projected Benefit under the MPF Scheme			Projected Benefit under the ORSO Scheme		
	Value of Employee Contributions \$	Value of Employer Contributions \$	Total Value of Contributions \$	Value of Employee Contributions \$	Value of Employer Contributions \$	Total Value of Contributions \$
Age 41	15,349	15,349	30,698			
Age 42	32,096	32,096	64,192			
Age 43	50,339	50,339	100,678			
Age 44	70,180	70,180	140,360			
Age 45	91,726	91,726	183,452			
Age 50	229,317	229,317	458,634			
Age 60	717,131	717,131	1,434,262			
Age 65	1,121,320	1,121,320	2,242,640			

(b) *Lower Investment Return Scenario*Projection Assumptions

Rate of Gross Investment Return : 4% p.a.

Rate of Salary Inflation : 4% p.a.

Rate of Administrative Expenses : 2% p.a.

At the beginning of	Projected Benefit under the MPF Scheme			Projected Benefit under the ORSO Scheme		
	Value of Employee Contributions \$	Value of Employer Contributions \$	Total Value of Contributions \$	Value of Employee Contributions \$	Value of Employer Contributions \$	Total Value of Contributions \$
Age 41	15,138	15,138	30,276			
Age 42	31,188	31,188	62,376			
Age 43	48,191	48,191	96,382			
Age 44	66,192	66,192	132,384			
Age 45	85,238	85,238	170,476			
Age 50	197,899	197,899	395,798			
Age 60	534,612	534,612	1,069,224			
Age 65	777,555	777,555	1,555,110			

Warning: *The amount of benefits one will eventually receive upon termination of service or retirement may be higher or lower than those being illustrated depending upon the actual experience over the period.*