

Fidelity Workplace Consulting

# International Defined Contribution Newsletter

May 2019

Fidelity's international defined contribution newsletter focuses on key issues surrounding employer-sponsored defined contribution retirement plans globally.

This month's edition covers legislative updates requiring action as follows:

- In the Philippines, retirement contributions will increase in 2019.
- In India, there are changes in the covered pay definition for the Employee Provident Fund and a change in the eligibility for the Employee Pension Scheme, as well as a reduction in employer and employee contributions for Employees' State Insurance.

In addition there is an article which summarizes the Hong Kong retirement market as well as commentary on the opportunities for employer education following the introduction of tax effective voluntary contributions.

## What's Inside

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## Legislative Updates



### Brazil

The government has outlined proposals to reform the country's social security system. The key highlights are:

- An increase to the normal retirement age by six months each year until ultimately reaching 65 for men and 62 for women.
- Changes to employee contribution levels, which will be based on a progressive system (higher contributions for higher earners).
- Introduction of individual accounts within the social security system.
- Reductions to death benefits paid to survivors.

The proposals must now go through Brazil's legislative process which may result in alterations.

#### Action Required

Monitor – await further announcements.



### Philippines

The President signed into law Republic Act No. 11199, taking effect as of March 2019, to help ensure the long-term viability and sustainability of the social security system.

The combined employee/employer contribution has increased from 11% to 12% in 2019.

Year	Employee Contribution %	Employer Contribution %
Pre-2019	3.63%	7.37%
2019	4.00%	8.00%

The combined employee/employer contribution will increase to a total of 15% in 2025.

#### Action Required

Implement – take necessary actions.



### European Union

A regulation has been approved by the European Parliament on a Pan-European Personal Pension Product (PEPP).

PEPPs are designed to provide European citizens with a retirement vehicle which can operate sustainably across borders.

The text must now be submitted to the Council for official adoption, with second level legislation following that will include further details such as the cost and fee cap. The first PEPPs will likely only launch in late 2020/early 2021.

#### Action Required

Monitor – await further announcements.



### India

Legislative changes and court rulings impact social security and certain defined contribution arrangements, including:

- Increase to the tax free lump sum available to National Pension System (NPS) members from 40% to 60%.
- Reinstatement of the option for employees earning over the wage ceiling (INR 15,000) to join the Employees' Pension Scheme (EPS).
- Changes to the definition of covered pay (to include allowances) used to calculate contributions in respect to the Employees' Provident Fund (EPF); these are especially relevant for those earning under the wage ceiling.
- Contributions to Employees' State Insurance (ESI) are to be reduced from 4.75% to 4.00% and 1.75% to 1.00% of pay for employers and employees respectively.

These changes are effective as of April 2019. Further guidance is awaited to clarify if the changes will be retroactive or not; however, employers should assess, implement and communicate these changes going forward.

#### Action Required

Implement – take necessary actions.

## Hong Kong Retirement Savings Landscape Overview

Due to low birth rates and increased life expectancies, Hong Kong is facing the challenge of a rapidly ageing population. As the population collectively grows older, the working population will have a much larger number of retirees to support – projections developed by the World Bank show that the ratio of the older population (those over age 65) to the working population in Hong Kong will increase from 48% in 2015 to 101% in 2050<sup>1</sup>.

There are two forms of retirement plans, which cover 84% of the population:

	Number of Plans	Number of Employees (000's)	Assets (USD million)
Mandatory Provident Fund	290,000	2,841	103,570
Occupational Retirement Scheme Ordinance (DB+DC)	5,771	362	44,832
Total			148,402

Source: MPF Schemes Statistical Digest & ORSO Schemes Statistics, Dec 2018 (FX of US\$1 = HK\$7.85 applied)

A number of prescribed employment categories are exempt from MPF participation.

### ***The Mandatory Provident Fund ("MPF") System***

The MPF system, which was introduced in 2000, is a mandatory, privately managed, funded retirement system with both employee and employer contributions. Since its introduction, the proportion of the workforce covered by some form of retirement provision has increased from around 33% to 84% of the employed population, with 73% of the population covered under MPF schemes.

### ***Contributions***

Employees and employers who are covered by the MPF System are each required to make regular contributions as shown in the table below. For a monthly-paid employee, the minimum and maximum relevant income levels are HK\$7,100 and HK\$30,000 respectively.

Monthly Relevant Income	Amount of Mandatory Contributions Payable by Employer	Amount of Mandatory Contributions Payable by Employee
Less than HK\$7,100	Relevant income x 5%	No contributions required
HK\$7,100 to HK\$30,000	Relevant income x 5%	Relevant income x 5%
More than HK\$30,000	HK\$1,500	HK\$1,500

Any mandatory contributions paid for and in respect of an employee are fully and immediately vested in the employee once they are paid to the MPF trustee. Any investment return derived from the investment of the mandatory contributions is also fully and immediately vested.

<sup>1</sup> US Census Bureau, International Populations Reports, An Aging World: 2015, US Government Publishing Office

## Payment of Benefits

Since the MPF System was introduced to help the workforce save for old age, withdrawal of accrued benefits derived from mandatory contributions and tax deductible voluntary contributions is only allowed when scheme members reach the age of 65.

However, there are circumstances under which accrued benefits may be paid before members reach the age of 65, provided that specified conditions can be met. These would include provisions for early retirement, disability and permanent departure from Hong Kong.

## Occupational Retirement Scheme Ordinance ("ORSO")

ORSO schemes are a retirement scheme which can be set up on a voluntarily basis by employers, as an alternative to MPF schemes, to provide retirement benefits for their employees; as such the governing rules are drawn up by individual employers. This enables the company to determine the eligibility, contribution and vesting requirements beyond the minimum MPF requirements.

Since the launch of the MPF System in 2000, MPFA has exempted a number of ORSO schemes that meet the relevant requirements in accordance with the Exemption Regulation (i.e. MPF-exempted ORSO schemes). Employers of these MPF-exempted ORSO schemes are required to give new eligible employees a one-time option to choose between joining an MPF scheme or the MPF-exempted ORSO scheme.

The setup of new ORSO schemes have become increasingly rare given the cost of set up is significantly higher compared to the MPF. When participating in the MPF system, the employer bears little to no cost as all fees are embedded into the fund choices within an individual MPF master trust.

## Encouraging Retirement Saving

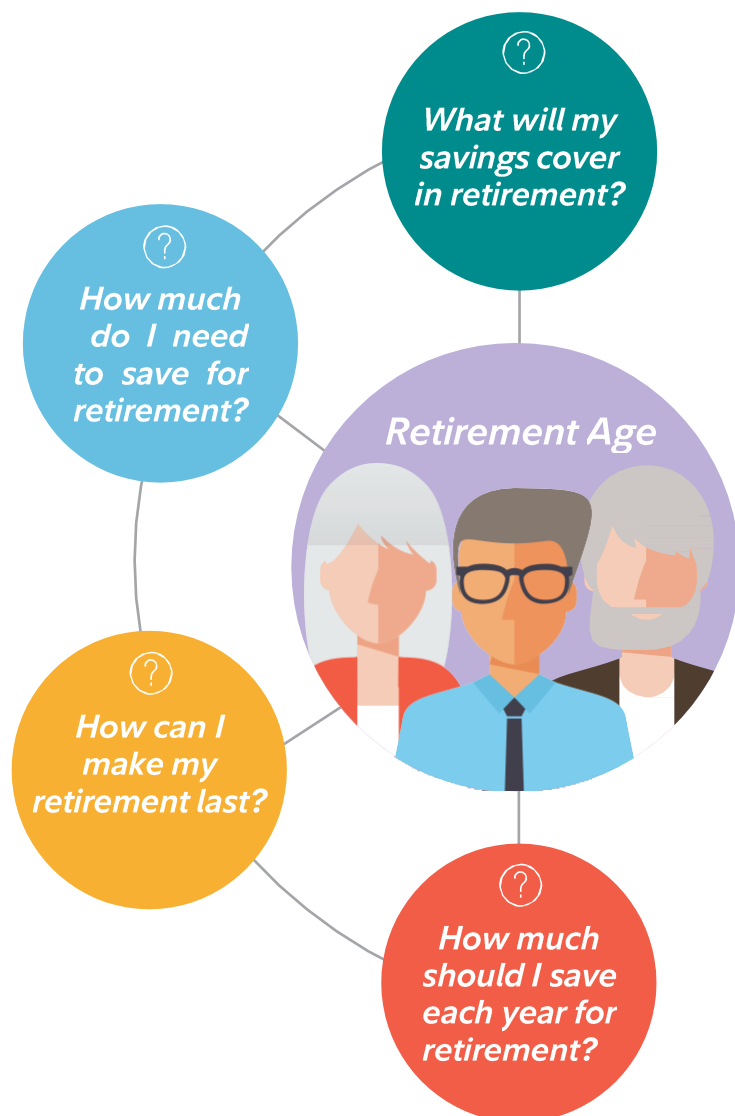
The government is looking at new ways to increase levels of retirement savings and it has recently increased the amount which individuals can save tax effectively. These changes are providing employees with an incentive to better provide for their financial future.

## Introduction of Tax Effective Voluntary Contributions

Until 2019, the limit on tax deductible contributions was HK\$18,000 (US\$2,300); there was also no tax deduction for voluntary contributions. Effective April 1, 2019, all employees will now have the option to make tax-deductible voluntary contributions ("TVCs") of up to HK\$60,000 per year, in addition to the previous limit of HK\$18,000. TVCs enable better scope for individuals to make tax effective provision for their retirement needs.

## Retirement Education

There is also a growing focus on retirement education, promoted by the Mandatory Provident Scheme Authority ("MPFA"). The MPFA provides wide access to a range of useful information including details on fund choice, performance, charges and associated calculators.







In addition, multinationals continue to expand Financial Wellness activities to better educate their workforce. Fidelity International and Fidelity Investments have been developing international retirement guidelines to support employees with their financial planning. As it applies to retirement, they have focused on helping individuals make plans for retirement by answering four questions, as shown in the table below.

Helping individuals understand the answer to these questions is increasingly forming the basis for retirement education. Broad advice and guidance for individuals have been developed and is summarized as follows:

- It is estimated that the required income in retirement for an individual at the age of 65 is approximately 48% of their earnings prior to retirement.<sup>2</sup>
- To provide that income, the estimated savings goal at a retirement age of 65 equates to approximately 12 times annual income, including income derived from MPF and ORSO benefits.
- It is estimated that individuals should aim, on average, to save around 20% of pre-tax income. This is well below typical contributions currently being made.

These estimates are being built into retirement modeling tools, to enable individuals to plan different retirement scenarios:

### How your retirement age impacts savings and withdrawals in retirement

	62	65	67	70
Income replacement rate	50%	48%	47%	45%
Savings milestone	 13x	 12x	 11x	 10x
Yearly savings rate <sup>3</sup>	26%	20%	17%	13%
Probable sustainable withdrawal rate	3.8%	4.1%	4.3%	4.8%

Income replacement rate: The percentage of pre-retirement income that an individual/household should target to replace annually from their personal savings (including workplace savings) in retirement in order to maintain pre-retirement lifestyle.  
Savings milestones: Age-based savings targets expressed as multiples of current income.  
Yearly savings rate: The suggested annual rate of (pre-tax) savings over a full working lifetime.  
Possible sustainable withdrawal rate: The real (inflation-adjusted), annual withdrawal amount expressed as a percentage of the initial (at retirement) asset balance.

The key takeaway from this analysis is that even with a new tax effective savings limit of HK\$60,000 (US\$7,700) there is a need to help individuals to understand the need to supplement their retirement savings over and above the typical mandatory contributions. Employers have an important role here to help employees achieve their retirement goals through targeted education. The recent introduction of TVCs provides a wonderful opportunity for employers to reach out to their employees to encourage sufficient retirement savings beyond the mandatory minimum amounts.

Hong Kong Retirement Savings Landscape Overview was authored by Louis Li, CFA; Associate Director, Hong Kong DC of Fidelity International and can be reached at +852 2629 2415 or louis.li@fil.com.

<sup>2</sup> Census and Statistics Department (Censtatd). Quarterly Report on General Household Survey 2016. Data from Household Expenditure Survey 2014-15.  
<sup>3</sup> Excludes 10% (5% employer, 5% employee) annual Mandatory Provident Fund (MPF) contributions.

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***About Fidelity International Workplace Consulting***

Fidelity's International Workplace Consulting team is independent and focuses on supporting clients in meeting their business objectives through the provision of impartial, but tailored, advice reflecting market trends and best practice.

Global Benefits Governance	International DC Governance	International Retirement & Financial Wellbeing	International Health care & Wellness	International Miscellaneous
<p>Design/ implementation of a tailored global benefits governance structure</p> <p>International audit and compliance review of overseas plans</p> <p>Benchmarking and development of global policies and standards</p> <p>Independent ongoing support to global benefits committees</p> <p>Advice on global financing opportunities, including risk financing</p> <p>Training on best practices in international benefits management</p>	<p>Developing fiduciary and compliance oversight and policy for international DC plans</p> <p>Cross border implementation of best practice and group policy</p> <p>Development of preferred provider arrangements to drive operational and financial efficiency</p> <p>Support on enhancing employee experience through developing &amp; implementing communication best practice</p> <p>Ongoing support to global benefits committees</p>	<p><b><i>Financial Wellbeing</i></b></p> <p>Benchmarking/ implementation of global best practice</p> <p>Design/ implementation of programs to support financial well-being</p> <p>Vendor selection and oversight for globally consistent local implementation</p> <p><b><i>International Retirement</i></b></p> <p>Benchmarking/ setting of globally consistent financing assumptions</p> <p>Advice on opportunities for de-risking in respect of retirement plans</p> <p>Consolidation of financial reporting &amp; budgeting</p>	<p><b><i>International Health care</i></b></p> <p>Vendor selection for international health care policies</p> <p>Advice on strategies to improve employee behaviors and reduce health care costs</p> <p>Development of health care policies to improve financial/ operational efficiency</p> <p><b><i>Wellness</i></b></p> <p>Global wellness education strategies &amp; programs</p> <p>Benchmarking and deployment of global wellness programs</p> <p>Vendor selection for International providers</p>	<p>Development of global insurance programs to reduce costs/commissions and improve operational efficiency</p> <p>Advice on country benefits practice (both Mandatory and typical practice)</p> <p>Support for benefit aspects on mergers, acquisitions and divestitures/splits</p> <p>Independent second opinions on local advice</p> <p>Strategy to respond to legislative changes</p> <p>Facilitation of global stock plan advice</p> <p>On-site support and benefits leadership</p>