20 December 2011

ACTUARIAL SOCIETY of HONG KONG
香港精算學會

Dear Members,

Actuarial Society of Hong Kong
Review of Professional Standard 2
Occupational Retirement Schemes - Actuarial Reports and Certification ("PS2")
Exposure Draft

Professional Standard 2 of the Actuarial Society of Hong Kong ("ASHK") provides guidance for the preparation of actuarial report and certificates for occupational retirement schemes as required under the Occupational Retirement Schemes Ordinance. PS2 has not been revised since its original issuance but the retirement scheme landscape in Hong Kong has changed very significantly since PS2 was first issued in 1994. A review project of PS2 was carried out by the Retirement Scheme Committee ("RSC") of the ASHK in the last two years, and I am glad that we have now completed an Exposure Draft as enclosed.

The attachment to this letter summarises the key amendments introduced to PS2.

The Exposure Draft has already been approved by the Professional Matters Committee. Pursuant to the ASHK By-law on the Due Process for the Development of Professional Standards/Guidance Notes, members of the ASHK are now being given one month to provide any written comments to Council on the enclosed Exposure Draft. The Retirement Scheme Committee will aim at presenting a summary of the resulting comments and a subsequent version of the Exposure Draft early next year. The Exposure Draft will also be submitted to the Mandatory Provident Fund Schemes Authority ("MPFA") for their comments.

Subject to the comments received from the members and the MPFA, the Exposure Draft will be submitted to the ASHK Council for final approval.

Please address all feedback to Ms. Pat Kum (email: patkum@netvigator.com) by close of business day on **31 January 2012**.

Thank you for your time and support.

Yours sincerely,

Jack Mak

Jack Mak
Chairperson
Retirement Scheme Committee

Encl.

Attachment – summary of key changes

Some of the changes in this Exposure Draft ("ED") are intended to tighten up certain wordings such that they are more consistent with the Occupational Retirement Schemes Ordinance (the "Ordinance"). However, there are a few more significant changes, as summarised in the paragraphs below.

<u>Valuation assumptions</u>

The Retirement Scheme Committee ("RSC") believes that whilst the current version of PS2 requires the Actuary to direct attention to those assumptions to which the contribution rate is sensitive, it does not give enough information to the reader of the valuation report regarding the risks and the impact of changes to the financials of the scheme.

The ED suggests that explicit comments are made regarding how changes in key assumptions will impact the scheme's funding position and recommended employer contributions.

<u>Amortisation of funding deficit</u>

The current version of PS2 caused some confusion as to whether any shortfall between a scheme's assets and its Aggregate Past Service Liability has to be amortised over the "average period to full vesting" of the membership. (The "average period to full vesting" is generally interpreted as the weighted average of the periods of the existing members' future memberships during which their benefits become fully vested, based on individual members' past service liability in the scheme.)

It is in the RSC's opinion that the initial intention of the current version of PS2 is not to impose this amortisation period to all schemes, even though it may suggest that such an amortisation period is appropriate, with consideration of the balance between benefit security of the scheme members, and affordability of the resultant employer contributions.

At the time when the current version of PS2 was drafted, most defined benefit ("DB") schemes were still opened to new entrants and hence the "average period to full vesting" for most schemes was relatively long. However, since 1994, most DB schemes in Hong Kong have closed to new entrants and hence the "average period to full vesting" has become extremely short, and in some cases, benefits for all members in the scheme can be fully vested. The usage of this period to amortise any funding deficits will no longer achieve the balance between benefit security and affordability of the employer contributions.

Given the above consideration, the RSC proposes that the relevant paragraphs in PS2 be amended such that a suitable amortisation period is to be agreed between the employer and the trustee with the Actuary's recommendation, and should be confirmed by the Actuary as consistent with the funding objectives of the scheme.

<u>Post-valuation events</u>

The current version of PS2 has not provided any guideline on allowance for material post-valuation events. ("Post-valuation events" refer to significant events that have happened between the valuation date and the date on which the valuation of a scheme is completed and signed off.) Significant market movements are now observed more frequently than ever and such post-valuation events can have a significant impact to the scheme's funding status. If they are not allowed for in the valuation, the results disclosed in the valuation report (and hence the contribution rates certified in the actuarial certificate) may not reflect the true financial state of the scheme.

In the ED, the RSC proposes that when signing off an actuarial report, the Actuary should disclose in the report, whether in his or her opinion, any significant post-valuation events have occurred that will have a material impact on the scheme's financial health. The Actuary can choose to allow for such significant event in the valuation results. Otherwise, a statement should be made in the valuation report stating how he/she expects such post-valuation events may put a limitation on the advice that the Actuary has given in the report.

<u>Comments on investment policy</u>

The current version of PS2 requires the Actuary to comment on whether a scheme's investment policy is appropriate to the form and incidence of the liabilities.

The RSC has concluded that the Actuary is often not in the best position to comment whether a scheme's investment policy is appropriate, without qualifying other factors such as the scheme's financial strength, the trustee's attitude to risk, the sponsoring employer's covenant and their tolerance towards volatility in contribution level, etc.

As such, this requirement is removed from the ED. The Actuary should highlight any specific investment-related risks that are considered relevant.