Actuarial Society of the Philippines

Building On Strong Foundations

PRIVATE RETIREMENT PLANS IN THE PHILIPPINES

Presentation by the Employee Benefits Committee

HISTORICAL BACKGROUND

Enactment of Republic Act 4917 (RA 4917) in 1967 spurred the establishment of private retirement plans in the Philippines by providing tax incentives to private companies to put up retirement plans and set aside retirement funds.

In 1992, RA No. 7641 was signed and provided further motivation to set-up retirement plans by mandating the compulsory payment of a minimum retirement benefit to employees.

TYPES OF RETIREMENT PLANS AND MARKET PRACTICE

three main categories of retirement plans :

- ⇨ defined benefit
- ⇨ defined contribution, or
- ⇨ hybrid (combination of defined benefit and defined contribution).

Most retirement plans :

- are of the defined benefit type
- are funded solely by the employer

Most retirement plans :

- cover all regular, full-time permanent employees

- reckon service from the date of hire

Most retirement plans :

- set normal retirement eligibility at age 60.
- allow early retirement at age 50 with at least 10 years of service.

Most retirement plans :

- offer a retirement benefit equal to a multiple of monthly salary per year of service, payable in lump sum

- use the final basic monthly salary as the pay basis for benefit computations

Most retirement plans :

- also offer death or total and permanent disability (TPD) benefits
- give the accrued retirement benefit as the death or TPD benefit

Most retirement plans :

- also offer benefits upon voluntary resignation

- provide for partial vesting starting at either five or ten years of service and full vesting at 20 years of service

Most retirement plans :

- also offer benefits upon involuntary separation
- give the greater of the accrued retirement benefit or the amount mandated by the Labor Code based on the circumstances of termination.

LEGAL AND TAX ISSUES

- The minimum benefit prescribed by R.A. 7641 is “one-half month salary per year of service”

- “One-half month salary” is not 50% of the monthly salary

The law defines "one-half month salary" as the sum of :

- **15 days salary based on the latest salary rate;**
- **cash value of 5 days service incentive leave;**
- **1/12 of the thirteenth month pay; and**
- **all other benefits agreed upon to be included.**

Because of the legal minimum, defined contribution plans still face a contingent liability for retirement benefits even if they have been funding their retirement plans regularly.

- Effective January 1, 1998, retirement benefits paid in compliance with RA 7641 were exempted from income tax.

- Prior to this date, only retirement benefits coming out of tax-qualified plans were tax-exempt

Retirement benefits are considered as welfare benefits just like health and life insurance, hence, employer contributions to the retirement fund are also exempt from fringe benefits tax

A tax-qualified plan :

- exempts the retirement benefits of an employee from income tax
- allows companies to deduct their contributions to the retirement fund from their taxable income
- exempts the earnings of the retirement trust fund from all taxes

FUNDING A RETIREMENT PLAN

- Republic Act #7641 or subsequent accounting standards did not require the actual setting aside of funds to ensure the payment of benefits promised.

- Companies actually have a choice as to the funding scheme that they prefer, ranging from “no funding” to “complete funding”

1. No funding or “pay-as-you-go”
2. Terminal funding
3. Level contributions from plan entry age
4. Immediate funding of initial accrued liability with annual contributions for future service benefits

5. Funding of initial accrued liability in annual installments, together with contributions for future service benefits.
6. Full funding at plan entry age
7. Complete funding

- Retirement funds are usually trusteed.
- A “trust” or “trustee” may be a natural person(s), or a corporation. “Any person of legal age and sound mind can serve as a trustee, but only corporations whose charters bestow trust powers upon them may act in that capacity.”

Some plan administrators prefer to place the funds with an insurance company instead of a trustee. Insurance companies usually provide services which otherwise would be separately contracted for by the plan administrator.

ACCOUNTING OF RETIREMENT BENEFIT COSTS

In retirement benefit accounting, there are two basic concerns :

- the periodic cost or the expense that should be reflected in the income statement; and,
- the liability that needs to be recognized in the balance sheet.

- Locally, IAS 19 has been adopted effective for reporting periods beginning on or after January 1, 2005

- The standard is known as PAS 19

PAS 19 prescribes :

- the use of the Projected Unit Credit method
- that Plan assets should also be measured at fair value.

PAS 19 prescribes :

disclosure of the periodic cost components:

- the current service cost,
- the interest cost on the present value of obligation
- the amortization of the actuarial gains and losses,
- the amortization of the transition liability, if any
- the amortization of the past service cost

PAS 19 prescribes :

that the discount rate to be used in the calculation of the present value of benefit obligation and the current service cost should be based on the yield of long-term corporate or government bonds with maturity period approximating the expected payout of benefits.

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There are two sources of actuarial gains and losses – the liability and the asset. A gain or loss arises when the expected accrued liability or asset is different from the actual liability or asset as of the valuation date.

- Actuarial gains and losses could also be due to changes in the actuarial assumptions.

- Usually, these gains and losses are amortized because of the expectation that in the long run, the assumptions will hold and the gains and losses will offset each other.

- A transition liability or asset arises when at the adoption of the accounting standard, the prescribed accrued liability or asset is different from the corresponding amount recorded in the books of the company.

- A transition asset is recognized immediately as a prior period adjustment or retained earnings adjustment while a transition liability may be recognized immediately or amortized up to five years.

- Past service cost strictly refers to the increase in the present value of the benefit obligation due to plan amendment or plan establishment.

- PAS 19 recognizes past service cost on a straight-line basis over the average period until the amended benefits become vested.

THANK YOU AND HAVE A NICE DAY !

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