# Something Keeps Employers Up at Night – Taiwan DB Pension Risk

*More companies are seeking solutions in reducing their pension liabilities in regards of Taiwan's Labor Standards Law (LSL)*

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# What is the current situation?

In Taiwan, employees who joined a company before 1 July, 2005 would be automatically enrolled in the Labor Standards Law (LSL) retirement scheme, which is a mandatory Defined Benefit plan that employers need to carry the liability for until employees terminate service with the company. Different from other countries in the world, there are not many choices in regards of funding vehicles for LSL; the employer must do monthly contributions to the Bank of Taiwan (BoT) (with a legal contribution requirement from 2%~15% of salary) while these savings would only be able to be withdrawn for employee's severance (only if the business entity is suspended) or retirement.

In early 2015, a new amendment of LSL took effect which required companies to annually review its BoT fund and make sure the money is enough for those who will be eligible for retirement within a year. If there is any insufficiency, the employer needs to make up the shortfall by the end of the next March each year. The additional contributions have stretched companies' cash flow and bring inefficiency to the utilization of resources.

According to the Taiwan Ministry of Labor, the total number of qualified DB employers by the end of December 2019 is 98,672 where 99% (97,765) of them have made up the differences in BoT. The accumulated total contribution has reached NTD 2,009 bn (approximate USD 67 bn)[1] by 2019.

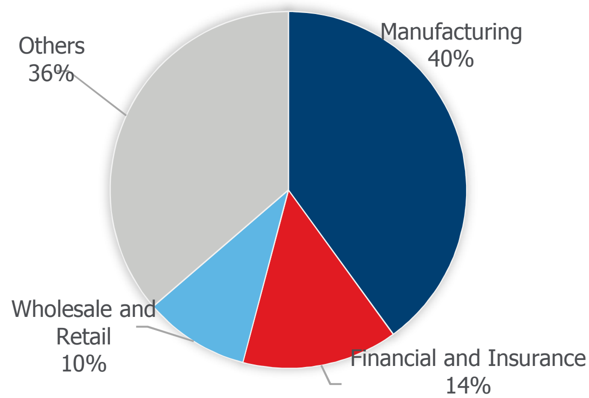



Figure 1. Retirement fund contribution by industry and scale in 2019

If we take a closer look, it's not hard to find that with manufacturing as Taiwan's largest industry, it takes up 40% of 2019 contributions with a total of NTD 338 bn (USD 11 bn). Financial and wholesale industries are listed in second and third with a total of NTD 119 bn (USD 4 bn) and NTD 81 bn (USD 3 bn) respectively.

Such contributions for pension liabilities not just puts pressure on employer's shoulders but also reduces companies' flexibility in the use of funds.

[1] Newsletter from Ministry of Labor. Retrieved February 5, 2020 from the Web: https://www.mol.gov.tw/announcement/2099/42860/

# Is it possible to transfer this risk?

Based on our observations in recent years, there has been an upsurge among MNCs in seeking solutions in reducing their DB liabilities but only a select few are putting this into action. The most common concerns are coming from first, LSL is a mandatory benefit which requires government's approval for doing so. Second, employees' backlash on cutting off the possibilities of their future benefit accrual before retirement and most importantly, the company might need to offer additional incentives to be able to settle this liability.

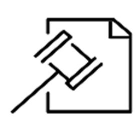
Indeed, according to the Ministry of Labor, a company cannot force employees to give up their current entitlement rather than "encouraging" them to transfer to mandatory DC scheme (LPA). From our experiences, the most common ways in doing so is either by introducing an early retirement option with some compensation or a replication plan with an individual contract.

Under the **early retirement** method, the company will need to re-evaluate its current demographic distribution with winner/ loser assessment and cost analysis on the compensating level that the employer is willing to make. Most of the time, additional compensation would be made as a one-time addition rather than pushing the gap into salary. The company will no longer carry the liability forward and can retrieve money from BoT, however, there will be a one-time expense to pay up.

A **replication plan** on the other hand, is an individual promised agreement needed to be signed with each employee that guarantees to pay the DB benefit while legally transferring to LPA for the government's records. Under this method, the company will not need to dig into the numbers on the fairness between different group of employees but please do keep in mind that pension risk is still on the employer's shoulders until the employee service is run off.

**Early Retirement**

- No more DB liability going forward.
- Easier to handle for HR admin.
- More cost.



**Replication Plan**

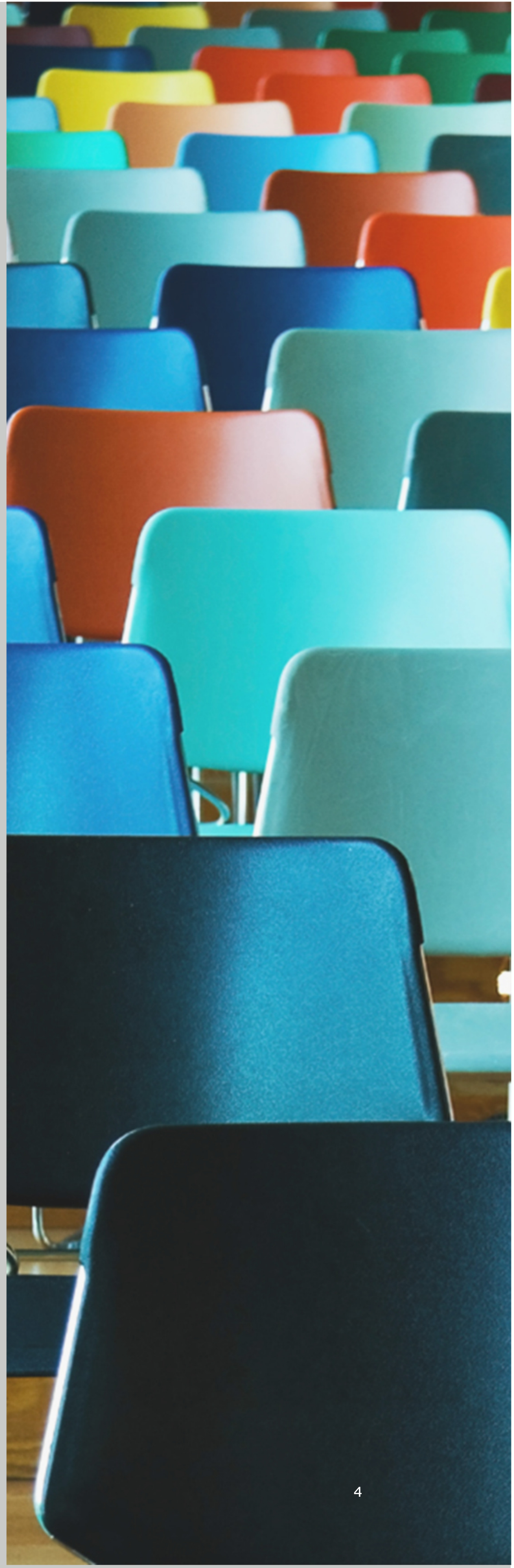
- Remaining DB liability until employee's service runs off.
- Easier employee communication.
- Less cost.

Figure 2. Possible options of DB de-risking in Taiwan

# Getting started

Given a rapid and diverse change in economy and global environment, companies are facing a more dynamic and challenging market in growing its revenue and adopting changes. How to be more effective allocating resources to achieve and exceed enterprise’s goals has become more essential than ever. As employers explore possibilities to de-risk pension liability, we believe there are two points employers should consider:

- **The current percentage mix of pure LSL and LPA employees with LSL years of service** – with less pure LSL employees, a company would find it easier in closing out the liability and with less additional cost.
- Measure **current talent pool** and compare the treatment between **company’s HR strategy** and the **cost** to terminate the DB liability.



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