

Legislative Council Panel on Financial Affairs

MPF System - Proposed Amendments to Legislation and Situation of Default Contributions

PURPOSE

This paper seeks Members' views on the proposed amendments to the Mandatory Provident Fund (MPF) legislation to further enhance the efficiency and effectiveness of the MPF System. It also provides information on the latest situation in respect of default contributions.

BACKGROUND

2. The MPF System was launched in December 2000. The System is entirely new to Hong Kong and it affects over two million employers, employees, self-employed persons as well as service providers. In the course of implementing the System and applying the provisions in the Mandatory Provident Fund Schemes Ordinance (MPFSO), the relevant parties have identified areas for improvement within the System. In view of the extensive impact of the System upon our community, we consider it prudent and appropriate to review the operational and administrative aspects of the System to ensure it is efficient, effective and user friendly.

3. The MPF Schemes Operation Review Committee (the Review Committee) was established by the Mandatory Provident Fund Schemes Authority (MPFA) in August 2001. It comprises representatives of employers and employees bodies, service providers, professional bodies and the Government. Membership of the Review Committee is at Annex A. The Review Committee is tasked to undertake a comprehensive review of the MPF legislation in relation to the administrative and operational aspects of MPF schemes and make recommendations to MPFA on amendments to the MPF legislation related to those aspects in order to further enhance the effectiveness and efficiency of the MPF System. The Review Committee has recently completed the first phase of its work. In the light of the recommendations put forward by MPFA, we intend to put forward proposals to amend the MPFSO in respect of the following areas-

- (a) Adjust the minimum level of relevant income for MPF contributions;
- (b) Enhance protection for scheme members;
- (c) Simplify MPF scheme administration;
- (d) Improve regulation of MPF schemes;
- (e) Improve regulation of MPF investment; and
- (f) Technical amendments.

PROPOSED LEGISLATIVE AMENDMENTS

(A) Adjust the minimum level of relevant income for MPF contributions

4. Under section 9 of MPFSO, a relevant employee or self-employed person (SEP) whose relevant income is less than the minimum level is not required to make MPF contribution. Under section 10, a relevant employee or SEP whose relevant income is more than the maximum level is not required to contribute to the MPF scheme in respect of the excess relevant income. The minimum and maximum levels are prescribed in Schedules 2 and 3 to the MPFSO respectively, and were set in 1995 when the MPFSO was enacted.

5. The intention of setting a minimum level of relevant income is to lessen the financial burden of MPF contributions on lower-paid employees or SEPs. The current minimum level of \$4,000 per month, as proposed in the Report of the Consultancy on the MPF System in 1995 and later adopted by the Government, was half of the then monthly median employment earnings (hereafter “median income”). Employees or SEPs earning an income less than the minimum level do not need to make MPF contribution, although their employers (if any) still have to pay their share of MPF contribution.

6. The rationale for setting a maximum level of relevant income is that the MPF System is intended to encourage the workforce to save for basic retirement needs. It is recognized that such a need is less likely to arise in the case of higher income employees or SEPs who could always have the choice of making additional MPF contributions on a voluntary basis or

pursuing other forms of investment arrangements to provide for their retirement needs above the basic level.

7. The maximum level of relevant income for MPF contributions is currently at \$20,000 a month, which according to the 1995 Consultancy Report, covered the entire earnings of nearly 90% of the working population at that time.

8. With the passage of time and changes in the economic conditions, these minimum and maximum levels need to be reviewed and it was indicated in 1995¹ that there would be a mechanism to adjust both the minimum and maximum income levels. In the light of the above, MPFA has proposed an adjustment mechanism to review the minimum and maximum levels of relevant income for MPF contributions. The main features of the review mechanism include –

- (a) A review would be conducted every four years;
- (b) 50% of the monthly median income would be adopted as the basis to adjust the minimum relevant income level; and
- (c) 90% of the scheme coverage would be adopted as the basis to adjust the maximum relevant income level.

— The details are at Annex B. It should be noted that MPFA also recommended –

- (a) that applying the principle of 50% monthly median income level, the minimum relevant income level should be raised to \$5 000 per month; and
- (b) The maximum relevant income level of \$20 000 per month would be retained.

9. We agree with the recommendations made by MPFA and propose to adjust the minimum level of relevant income for MPF contributions from \$4,000 to \$5,000 per month. An amendment to Schedule 2 of the MPFSO would be required. In addition, the gazette order on the

¹ In the Legislative Council Brief on the Main Features of the Mandatory Provident Fund System Legislation dated 9.5.1995.

scale of amounts of contribution for casual employees² who are members of industry schemes would need to be amended correspondingly, for example, by replacing the lowest income band of "less than \$130" with "less than \$160". Casual employees in industry schemes within such income band need not contribute, but their employers would still need to contribute.

(B) Enhance protection for scheme members

Monies-in-transit to be placed in interest-bearing accounts

10. Section 12(2) of the MPFSO stipulates that income derived from the investment of the accrued benefits of an MPF scheme member shall vest in the member as accrued benefits. Some approved trustees have expressed concerns that a strict interpretation of the section would require the allocation of the interest earned to each individual member strictly in accordance with the amount of his contribution and the period such contributions were held in the interest-bearing account pending processing. Such a requirement would entail a high administrative cost, probably outweighing the interest that may be earned. As a result, the trustee would have to hold MPF contributions pending processing in non-interest-bearing accounts. Similar problem exists in other cases of monies-in-transit³.

11. It is therefore proposed that section 12(2) be amended to put it beyond doubt that interest derived from monies-in-transit does not need to be vested in individual members' accounts. Instead, such income shall be credited to the schemes as scheme income to offset scheme expenses (such as legal fees and audit fees) or to enhance the returns of the schemes for the benefits of all scheme members.

Rectification of non-enrolment and non-payment of mandatory contributions

12. At present, MPFA is not empowered to issue statutory notices to an employer requiring him to enroll his employees into MPF schemes and to make mandatory contribution. Instead, MPFA can only prosecute the employer under section 43B(1) of the MPFSO. An employer found guilty

² Casual employees are defined in the MPFSO to mean those relevant employees who are –
 (a) engaged in an industry for which a provident fund scheme is registered as an industry scheme (currently either the construction or the catering industry); and
 (b) employed in that industry on a day-to-day basis or for a fixed period of less than 60 days.

³ Other types of monies-in-transit include benefits transferred to an MPF scheme pending investment into a constituent fund; benefits switched out of a constituent fund and pending investment into another constituent fund; and benefits redeemed from a constituent fund and pending withdrawal or transfer.

of the offences of non-enrolment and non-payment of mandatory contributions is punishable by a fine and / or imprisonment.

13. From the perspective of the employees, prompt enrolment and payment of mandatory contribution are of paramount importance. We propose to empower MPFA to serve a statutory notice on an employer who has failed to enroll his employees to require rectification by a specified date, as well as to impose a surcharge on the contributions in arrears. If the employer fails to act in accordance with the statutory notice, MPFA may take follow-up action. Compared with prosecution, the proposed statutory notice has the advantage of being administratively less costly and can be issued within a shorter period of time. Moreover, unlike the case of a fine, the surcharge will be vested with the employees concerned. We are also considering other amendments to enhance the enforcement against non-enrolment, such as making non-enrolment a continuous offence.

Benefit payment to unemployed scheme members on incapacitation

14. Under section 164 of the Mandatory Provident Fund Schemes (General) Regulation (the General Regulation), subject to certain criteria, a scheme member who was employed / self-employed immediately before his becoming totally incapacitated may claim his accrued MPF benefits. However, the provision does not provide for the occasion whereby the scheme member was unemployed / unengaged in work immediately before becoming totally incapacitated. We propose to amend section 164 to cater for such an occasion.

(C) Simplify MPF scheme administration

Setting the daily minimum and maximum levels of relevant income

15. The prorating of the minimum and maximum levels of relevant income based on \$4,000 (proposed to be adjusted to \$5,000) and \$20,000 per month respectively to suit the length of different payroll cycles (e.g. weekly) is administratively cumbersome and prone to errors. To address this issue, it is proposed that generic minimum and maximum levels at \$130 (proposed to be adjusted to \$160) and \$650 per day respectively be adopted for payroll cycle more frequent than monthly (e.g. weekly).

Simplification of 30-day contribution holiday

16. Section 7A of the MPFSO provides that employers must enroll their new non-casual employees into an MPF scheme within the permitted period of 60 days from the date of employment. When making the first MPF contribution after the permitted period, employers' contributions shall count from the first day of employment, but employees' contributions shall count from the 31st day of employment, i.e. employees enjoy a 30-day contribution holiday.

17. For a new employee, the 31st day of his employment would not, in most cases, fall on the first day of his regular payroll cycle. This would result in an incomplete initial employee contribution period for making mandatory contributions. The employer and trustee have to prorate for that incomplete period the amount of relevant income as well as the corresponding minimum and maximum levels of relevant income, and the process is often cumbersome.

18. To simplify the arrangement, we propose that for employees with monthly payroll or more frequent than monthly payroll (e.g. weekly), the employee contributions for the first incomplete employee payroll period should be waived. As for employees with less frequent than monthly payroll, their contributions would be waived for the incomplete calendar month immediately following the first 30 days of employment. The contribution period for employer remains unchanged, i.e. the employer has to start contribution on the first day of employment.

Regular contribution remittance arrangement

19. Under sections 122(1)&(3) of the General Regulation, employers are required to remit MPF contributions to the trustees by the 10th day after each contribution period (i.e. payroll cycle). For employees with more frequent than monthly payroll cycle (e.g. weekly), employers have to remit contributions several times during a single month. We propose to simplify the arrangement by allowing an employer to remit the contributions for his employees for all payroll periods ending in a calendar month by the 10th day of the following month. The above proposal would not apply to casual employees.

Notification of cessation of employment

20. If an employee ceased to be employed, under sections 145(6) and 146(8) of the General Regulation, the employer needs to notify the

approved trustee by a written notice within 30 days after the cessation. We propose to allow the employer to notify the approved trustee by means of the regular remittance statement and within 10 days after the calendar month during which the cessation of employment occurs. This would reduce administrative cost of MPF schemes. The above proposal would not apply to casual employee.

Publication of notices in search of lost members

21. Section 172(10) of the General Regulation requires approved trustees to publish annual notices in newspapers continuously to search for lost members (i.e. members with unclaimed MPF benefits) until the lost members, or their personal representatives, come forward to claim the benefits.

22. To streamline the administrative process, we propose a central register on lost members be set up by MPFA for the public's inspection. Approved trustees would be required to publish notice in newspapers to search for their lost members within 6 months after the financial year in which the benefit *first* became unclaimed, i.e. the name of a lost member would only be published once. Approved trustees would also be required to report relevant information to MPFA for the purpose of updating the proposed central register.

Extension of the first financial period of a scheme beyond 12 months

23. The approved trustee of an MPF scheme is obliged to appoint an auditor to audit the accounts of the scheme for each financial period of the scheme. Section 79 of the General Regulation provides that the first financial period of a scheme must cover a period not more than 12 months.

24. Where the first financial year-end is close to the scheme launch date, the first scheme audit may cover a very short period and a small number of transactions. In such a case it will not be cost-effective to require an audit report. We propose to amend section 79 to allow the approved trustee, with the prior approval of MPFA, to extend the length of the scheme's first financial period beyond 12 months.

(D) Improve regulation of MPF schemes

Intra-group transfer and change of ownership transfer

25. Section 12A of the MPFSO provides for an offsetting mechanism where an employer can get a reimbursement from his previous MPF contributions for his employee after paying the severance payment / long service payment (SP / LSP) to the employee. Section 12A (6) further provides that in the case of intra-group transfer or change of business ownership transfer, the offsetting mechanism also recognizes the employment periods with and contributions made by the relevant previous employers. Accordingly, all the contributions previously made to MPF schemes by the relevant previous employers may be used by the final group employer / the new owner to offset the SP / LSP. This is in line with the arrangements under the existing Employment Ordinance (EO).

26. However, apart from section 12A, other provisions of the MPFSO do not regard intra-group transfers and change of business transfers as “continuous employment”, but treat such transfers as a “change of employment”. Such treatment has resulted in problems. For example, upon “change of employment”, an employee is entitled to transfer the accrued MPF benefits derived from his previous employment to an individual preserved MPF account of his own choice. Within a preserved account, accrued benefits derived from the employee's former employment are commingled and not segregated. As a result, the amount of contributions made by the relevant previous employers cannot be readily ascertained for SP / LSP offsetting purposes. Another problem is the application of the 30-day employee contribution holiday to such intra-group and change of business ownership transfers, which will increase administrative workload and may lead to abuses.

27. To address these problems, it is proposed that where a “change” of employer (either in the case of intra-group transfers or change of ownership of business) does not break the continuity of the period of employment for the purposes of SP / LSP, the employment should be deemed to be continuous for the purposes of the MPFSO.

Issue of payment notice and simplification of surcharge calculation for default contribution

28. Under the current mechanism for recovery of default MPF contribution, trustees have to report to MPFA on non-payment of

contributions after the settlement period⁴, the first payment period⁵ and the second payment period⁶. MPFA may issue the first payment notice on receipt of the default report from trustees after the settlement period, and issue the second payment notice on receipt of the default report after the first payment period.

29. Besides, under section 134 of the General Regulation, MPFA may impose a surcharge based on a rate of 15% per annum when issuing the first payment notice and 20% per annum when issuing the second payment notice. In other words, the surcharge will accrue during the period the contributions remain in arrears. The calculation of the surcharge is administratively cumbersome.

30. To streamline the procedures in the recovery of default contribution, it is proposed that MPFA should serve only one payment notice. The notice would demand payment of contribution in arrears and impose contribution surcharge at a flat rate of 5% of the contribution in arrears (truncated to whole dollars). If the defaulter fails to pay the contribution in arrears and the contribution surcharge, the trustee would report to the MPFA within 10 days after the end of the payment period and MPFA would consider other follow-up actions including prosecution.

Restructuring of MPF schemes

31. Sections 34B and 34C of MPFSO provide for the merger and division of MPF schemes respectively. However, they do not provide for the situation in which trustees merge existing schemes into other existing ones instead of new ones, or trustees continue to operate part of a scheme whilst transferring other parts to another existing scheme or a new scheme. Besides, merger or division of industry schemes are not covered. We propose to introduce a new provision to cater for all these forms of restructuring.

⁴ The settlement period means the period of 30 days after the contribution day (i.e. contribution due date) for each contribution period.

⁵ The first payment period refers to the period specified in the first payment notice issued by MPFA requiring the defaulter to recover the contributions in arrears within the period.

⁶ The second payment period refers to the period specified in the second payment notice issued by MPFA requiring the defaulter to recover the contributions in arrears within the period.

Notification requirement on change of name of employer

32. To facilitate MPFA's enforcement action and communication with participating employers, we propose to require employers to report the change of their names (as appearing on the employer participation certificates) to the approved trustees, who would report the change to MPFA in their monthly return to MPFA. MPFA would issue a new participation certificate to the employers concerned.

Notification of events of significant nature

33. Under section 62 of the General Regulation, approved trustees are required to notify MPFA of events of significant nature not later than the third working day after becoming aware of the event. These include events that cause the approved trustee to contravene the legislation or governing rules of a scheme, as well as any material change to the approved trustee's capability to perform his duties. The existing provision does not, however, differentiate significant events by impact, and also covers events having limited impact on scheme members' interests, for instance, trivial breaches of investment restrictions as a result of external factors. To streamline operation without undermining the effectiveness of the monitoring of approved trustees, it is proposed that MPFA be empowered to issue guidelines setting out those events considered as having limited impact on scheme members' interests. Trustees shall keep records of details of those events (e.g. date of occurrence, remedial actions taken, indemnification to members, etc.) to be made available for MPFA's inspection.

Eligibility of delegate of custodian

34. According to section 71 of the General Regulation, eligible delegates of custodians (i.e. subcustodians) include authorized financial institutions, registered trust companies incorporated in Hong Kong, approved overseas banks and approved overseas trust companies, meeting the relevant eligibility requirements. They also include overseas banks or overseas trust companies that are wholly-owned subsidiaries of approved overseas banks and approved overseas trust companies. However, wholly-owned subsidiaries of Hong Kong incorporated authorized financial institutions and registered trust companies are not covered by the existing provision. To ensure level playing field, we propose to amend section 71 to allow such wholly-owned subsidiaries to be eligible to be subcustodians, subject to meeting other eligibility requirements.

(E) Improve regulation of MPF investment

Spread of investments for index funds

35. Schedule 1 of the General Regulation limits the investment of a constituent fund (CF) in securities and other permissible investments issued by any one person to 10 per cent of its total funds. This is to ensure a spread of investments to avoid excessive risks. However, the restriction is considered generally unnecessary in the case of index funds, given the sheer number of constituent stocks involved in such funds which effectively result in a spread of investment. It is proposed that MPFA may waive the current restriction in the case of CFs with the sole investment objective of tracking a particular market index.

Admissibility of index-tracking collective investment schemes

36. An index-tracking collective investment scheme (CIS) has the primary objective of tracking or replicating the investment performance of an index. The General Regulation contains restrictions that in general would hinder investments in such schemes. It is considered that some of those restrictions should be relaxed.

37. We propose that, with the prior approval of MPFA, the funds of a CF should be permitted to invest up to 100% in an index-tracking CIS that is either authorized by the Securities and Futures Commission or listed on a recognized stock exchange approved by MPFA. The Authority would issue guidelines to prescribe what constitutes a CIS and the criteria it would adopt in considering the granting of approval. Furthermore, it is proposed that section 8(1) of Schedule 1 should be amended to exclude shares of investment companies (vis-à-vis ordinary companies), which in effect are a type of CIS and should be governed separately.

Convertible debt securities

38. Section 9 of Schedule 1 of the General Regulation requires a convertible debt security and its underlying share to be listed on the same recognized stock exchange. The same exchange requirement is unintentional and unnecessary. We propose to rectify the unintentional restriction by requiring convertible debt securities and their underlying shares to be both listed on recognized stock exchanges, but not necessarily the same exchange.

Spread of deposit

39. Section 11(3) of Schedule 1 of the General Regulation requires that funds of a CF deposited with an authorized financial institution or an eligible overseas bank must not exceed a certain proportion of the total market value of the CF. For a CF with a small asset size (total market value less than HK\$8,000,000), a restriction of 25% maximum exposure to a single institution is imposed. The reason behind the restriction is to limit the exposure of CFs to failure of individual institutions. However, in the case of small CFs, such restriction is considered not practicable. We therefore propose to empower MPFA to exempt a CF from the restriction where the total market value of the CF is less than HK\$8,000,000.

Unwinding currency forward contracts

40. Section 15(3) of Schedule 1 of the General Regulation restricts a CF from entering into currency forward contracts to sell Hong Kong dollars unless it is for the purpose of settling a transaction in the acquisition of securities denominated in a foreign currency already committed. This restriction may at times unduly limit the ability of investment managers to unwind either wholly or partially currency forward contracts previously entered into to hedge the currency exposure of investments denominated in foreign currencies, leaving the CFs concerned over-hedged. We propose that a CF should be permitted to enter into currency forward contracts to sell Hong Kong dollars in order to reduce the over-hedged position on the market value of the foreign currency investments to comply with the minimum Hong Kong dollar currency exposure requirement.

(F) Technical amendments**Serving notices or documents by post**

41. Section 206 of the General Regulation stipulates that if notices or documents to be given or served for the purposes of MPFSO are to be sent by post, it must be sent by "registered post". We propose to amend the section so that apart from the documents as currently specified in section 206(3) such as MPF membership certificate, other notices and documents, if sent by post, may be sent by ordinary post. The proposed amendment will reduce the administrative cost of a scheme.

Inconsistency in English and Chinese description of listed debt securities

42. It is proposed to amend the Chinese version of section 7(2)(d) of Schedule 1 to the General Regulation to remove the inconsistency with the English version. The amendment aims to make it clear that the funds of a CF may be invested in a debt security listed on a recognized stock exchange (but need not be on the same stock exchange where the company issuing the debt security is listed).

Transfer of existing members between MPF exempted ORSO schemes

43. Under section 2 of the MPFS (Exemption) Regulation (the Exemption Regulation), if a member of an MPF exempted ORSO registered scheme became a member of the scheme before or on 1 December 2000, he is deemed to be an “existing member” under the Exemption Regulation. Otherwise, he shall be treated as a “new member”. A new member of an MPF exempted ORSO registered scheme will be subject to the minimum MPF benefits⁷ (MMB) requirements, i.e. requirements such as those on benefit preservation, portability and withdrawal.

44. At present, under certain circumstances such as intra-group transfer amongst associated companies or the restructuring of a company group, an “existing member” of an “MPF exempted ORSO scheme” may be transferred to another “MPF exempted ORSO scheme”. Upon the transfer, an “existing member” will become a “new member”, and thus making his accrued benefits subject to the MMB requirements. We propose to allow an “existing member” to retain his status after such transfer subject to certain requirements.

Portability and transferability of minimum MPF benefits

45. Section 5(1) of Schedule 2 of the Exemption Regulation provides that where a new member of an MPF exempted ORSO registered scheme is entitled to receive benefits under the scheme, the MMB must be transferred to an MPF scheme and preserved until the circumstances for withdrawal of benefits (e.g. retirement) arise. The MPF scheme in this case, however, only covers an employer-sponsored scheme and a master trust scheme. We propose to also allow MMB to be transferred to an industry scheme.

⁷ MMB is the portion of benefits held in an MPF exempted ORSO registered scheme which is broadly equivalent to the accumulated mandatory contribution made by or on behalf of the employee if he participates in an MPF scheme.

Clarification on indemnification of “losses” in custodian agreement

46. The indemnification requirement of custodian and that of its subcustodian is different under section 5(a) and (b) of Schedule 3 of the General Regulation. We propose to remove the inconsistency by amending section 5(b) of Schedule 3 to make reference to “direct losses” only.

LEGISLATIVE TIMETABLE

47. It is expected that an amendment bill on the proposed amendments will be introduced into the Legislative Council in the second quarter of 2002.

SITUATION OF DEFAULT CONTRIBUTIONS

48. At the Legislative Council Panel on Financial Affairs meeting on 3 December 2001, the Administration was requested to provide information on MPF default contributions and enforcement measures taken by MPFA.
—— The relevant information is provided at Annex C.

**MEMBERSHIP OF MPF SCHEMES OPERATION REVIEW COMMITTEE
(as at 1 January 2002)**

Chairman

Mr. Ronald ARCULLI

MPFA

Non-Executive Director

Mr. LEE Kai-ming

Chief Operating Officer

Mrs. Diana CHAN

(Corporate Affairs)

Executive Director

Mr. Raymond TAM

(Policy and Development)

Representative

Alternate

Employee Representatives

The Federation of Hong Kong
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Mr. LEE Kai-ming

Mr. SIN Kai Ming

Hong Kong Federation of
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Mr. TING Kam Yuen

Mr. C.K. KWONG

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Ms. CHEUNG Lai Ha

Mr. WONG Ying Yu

Employer Representatives

Employers' Federation of
Hong Kong

Ms. Mary TUNG

Mrs. Jackie MA

Hong Kong Institute of
Human Resource Management

Mr. LAI Kam Tong

Ms. Edith LEE

MPF Industry

Hong Kong Trustees'
Association

Mr. Nick CROUCH

Mr. Alastair MURRAY

The Hong Kong Association
of Banks

Mr. Mark BAIN

Mr. Sean FRASER

The Hong Kong Federation of
Insurers

Mr. Edward LAU

Mr. Terry LO

Hong Kong Investment Funds
Association

Mr. Douglas NAISMITH

Ms. Edith NGAN

The Law Society of Hong
Kong

Mr. Duncan ABATE

Mr. Paul TAN

HKSAR Government
Financial Services Bureau

Miss Susie HO

Miss Patricia SO

Labour Department

Mrs. Jennie CHOR

Secretary

Ms. Gabriella YEE
(Senior Manager, MPFA)

**MINIMUM AND MAXIMUM LEVEL OF RELEVANT INCOME FOR
MANDATORY PROVIDENT FUND CONTRIBUTION**

Review and Proposals by the MPFA

The Mandatory Provident Funds Scheme Authority (MPFA) has considered the matter and made the following proposals :-

- a) to review the minimum and maximum relevant income levels for MPF contribution concurrently every four years;
- b) to adopt 50% of the monthly median income as the basis to adjust the minimum relevant income level;
- c) to adopt 90% of scheme coverage as the basis to adjust the maximum relevant income level; and
- d) to raise the minimum relevant income level to \$5,000 per month in accordance with (b) above, and given the current economic conditions, to retain the current maximum relevant income level of \$20,000 per month until the next review.

The proposals are set out in greater detail in the following paragraphs.

Frequency of review

2. Adjustments to the minimum and maximum relevant income levels for MPF contributions will affect the level of retirement benefits ultimately enjoyed by employees and SEPs. Frequent and ad-hoc revisions would result in disruptions to the smooth operation of the MPF System, as all the payroll and MPF-related systems operated by trustees and employers etc. will have to be adjusted every time. Furthermore, they have cost implications and such costs are likely to be passed on to employees and SEPs as well as employers.

3. On balance, MPFA has proposed that both the minimum and maximum relevant income levels be reviewed concurrently, and revised as appropriate, at intervals of four years.

Adjustment basis for the minimum and maximum relevant income levels

4. Objective benchmark indicators reflecting changes in the price or wage levels can be used in adjusting the minimum and maximum relevant

income levels. Indicators such as consumer price index, nominal wage index, scheme coverage, median income, projected median income have been considered by MPFA. For consumer price index, past experience shows that it tends to increase more slowly than earnings. If adopted as the adjustment basis, it would result in an increasing proportion of the lower income workers being required to make contributions. The nominal wage index covers wage movement of sample employees in selected industries only, instead of the entire working population. For projected median income, it would be difficult to make accurate projection.

5. After careful consideration, the adjustment bases recommended are -

(a) Minimum relevant income level

The setting of the minimum relevant income level should strike a reasonable balance between the need to reduce the financial burden on lower income workers, and the need for accruing financial benefits for retirement protection. MPFA proposed to continue to adopt 50% of the median income as the minimum relevant income level. The use of median income is easily understood and relatively more objective, and will, in the long run, be more resilient to changes in economic conditions. Besides, the median income reflects not only the effect of price changes but also the overall wage trend.

(b) Maximum relevant income level

MPFA has recommended to continue to set the maximum level in order to cover the income of 90 percentile of the working population. Such basis has the advantage of being easier to understand. Moreover, it has not led to any problems since its adoption in 1995.

Recommended adjustment to the minimum level of relevant income

6. According to the latest statistics and following the mechanism referred to in paragraph 5(a) above, the minimum level of relevant income is proposed to be adjusted from the existing \$4,000 to \$5,000 per month.

7. The maximum level of relevant income should be increased to \$30,000 per month, if the adjustment mechanism referred to in paragraph 5(b) above were to be strictly followed. However, given the current economic situation and to avoid imposing additional burden on employers / employees, MPFA has proposed to maintain the maximum level at \$20,000 per month. In

fact, many employees in the income bands between \$20,000 and \$30,000 per month are members of MPF schemes receiving voluntary contributions on top of mandatory contributions. Some are exempted from the MPFSO altogether (e.g. teachers of subvented schools, civil servants on pension terms, overseas employees having joined other retirement schemes, members of exempted retirement schemes, etc.). Therefore, keeping the maximum level of relevant income at \$20,000 per month would unlikely affect the retirement protection for this group. The matter will be re-considered in the next review of the concerned income levels.

Implications of the Proposed Adjustment to the Minimum Level of Relevant Income

8. It is estimated that adjusting the minimum level of relevant income from \$4,000 to \$5,000 per month will exclude about 49 500 relevant employees and 7 300 SEPs¹ from the requirement of contributing 5% of their relevant income into MPF schemes. The reduction in MPF contributions in the first year would amount to less than 1%, or some \$145 million per year.

9. Upon implementation of the new minimum income threshold, those employed persons (including both employees and SEPs) with monthly earnings between \$4,000 and less than \$5,000 will be exempted from making contribution to the MPF System. Their disposable income will henceforth be increased by an amount equivalent to 5% of their respective employment earnings. This is likely to boost consumer spending, yet the effect is expected to be small in overall terms. An estimate puts the lift in private consumption expenditure and in GDP at less than 0.01 of a percentage point in the year of incidence. The employment impact thus entailed is also likely to be small in overall terms. As to business operating cost, there should be virtually no new impact as the employers concerned will still have to provide the 5% MPF contribution, as is required under the existing minimum income threshold.

¹ The two figures refer to employees and self-employed persons aged between 18-65, and exclude persons estimated to be exempted under the MPFSO in accordance with the latest statistics from the Census and Statistics Department and estimation of MPFA.

Enforcement Actions taken by MPFA to Tackle Default Contributions

Enforcement actions taken by MPFA

As far as default contribution is concerned, the MPFA enforces the law in two aspects. First, complaints by employees about non-payment of mandatory contributions are investigated. In substantiated cases, the employers would be required to pay the contributions in arrears and a contribution surcharge, failing which prosecution under the MPFSO may be instituted. In parallel, employers whose contributions are reported by trustees to be in arrears are served payment notices by the MPFA, demanding settlement of the outstanding contributions plus a surcharge at 15% per annum. If the payment is not received within a prescribed period, the MPFA will serve them a second notice, and increase the surcharge to 20% per annum. Non-complying employers may be prosecuted. Alternatively, MPFA may, on behalf of employees concerned, pursue the recovery of outstanding contribution in arrears by civil means, such as through the Small Claims Tribunal, or by civil proceedings.

Statistics on default contributions

2. The prosecution of offence under MPFSO (including default contribution) is undertaken by the Department of Justice and the Police. Prosecution for some cases could not be pursued because the offences had past the limitation of time (i.e. 6 months) imposed under the Magistrates Ordinance¹. As at 28 December 2001, a total of 156 summons applications (involving 25 employers) relating to contributions in arrears had been made to the Police for prosecution. Out of these summonses, 74 were found guilty, 5 were withdrawn² and results for 77 summonses were not yet available³.

3. As at end December 2001, 48 000 first payment notices (with surcharge of 15% per annum) and 21 000 second payment notices (surcharge of 20% per annum) had been served on defaulting employers. This involved 10 000, or 4.8% of the participating employers per month. As a result of the

¹ The Magistrates Ordinance imposes a requirement that information or summons in respect of an offence must be laid within 6 months of the occurrence of that offence. Some non-enrolment complaints were launched to MPFA months after their occurrence, making it impossible to issue the summons within the 6 months period.

² Reasons include companies have closed, Police or bailiffs could not effectively serve summonses, or employers have rectified before summonses were served.

³ Cases awaiting plea, or under trial.

efforts of MPFA and trustees in recovering the default contributions, about 4 300 of the employers have settled the outstanding contributions. The overall default rate of employers is about 2.7% of the total enrolled employers. The proceeds receivable will be credited into the employees' MPF scheme contribution accounts.

Future plans by MPFA to tackle the issue

4. The MPFA will, through their publicity and public education efforts, continue to appeal to the public to report their complaints as soon as possible. Furthermore, the MPFA has proposed to simplify the two-step surcharge calculation for default contributions (please refer to the proposed legislative amendments in the main paper) to issuing only one payment notice stipulating a flat surcharge rate of 5%. We will also consider ways to tackle the constraints caused by the time limit for prosecution.