

**LegCo Panel on Manpower  
(Meeting on 31 October 2002)**

**Financial Assistance to the  
Protection of Wages on Insolvency Fund**

**Purpose**

This paper seeks Members' view on the Administration's proposal to extend a bridging loan to the Protection of Wages on Insolvency Fund Board (the Fund Board) to enable it to tide over its cash flow problem in meeting its financial commitments under the Protection of Wages on Insolvency Ordinance.

**Background**

The Protection of Wages on Insolvency Fund

2. The Protection of Wages on Insolvency Fund (the Fund) was set up in 1985 under the Protection of Wages on Insolvency Ordinance to provide timely relief in the form of ex-gratia payment to employees of insolvent employers.

3. The Fund is administered by the Fund Board and is mainly financed by a flat annual levy (currently at \$600) on each Business Registration Certificate (BRC). Other sources of income include money recovered from the remaining assets of insolvent employers through subrogation and returns from deposits of the Fund's balance. For 2001-02, the total income was \$201 million and the percentage accounted for by levy income was 85%, subrogation income was 10% and interest/investment income was 5%.

4. Since its establishment in 1985, the Fund has made significant contribution to maintaining Hong Kong's harmonious employer-employee relationship and social stability by providing timely relief to employees whose employers have become insolvent.

The case for a bridging government loan of \$695 million

5. The Fund has been suffering from annual deficits since the Asian financial crisis in late 1997. The sharp increase in claims payment has not

been matched by a similar increase in the Fund's income. As a result, the Fund's reserve dropped to a low of \$195 million at end-March 2002. In an attempt to restore the financial health of the Fund, the BRC levy has been increased from \$250 to \$600 per annum with effect from May 2002.

6. Whilst the curative process of putting the Fund back on an even financial keel began in May this year, the prevailing difficult economic climate has continued to exert great pressure on the Fund. Between June and August this year, the number of new applications rose to 7 660, an increase of 65% over the figure of 4 631 for the same period last year. The continuing increase in the number of applications received has pushed the number of outstanding applications at end-July and end-August 2002 to an all-time high figure of 14 000.

7. The collapse of the Treasure Restaurant Group (敦煌酒樓集團) involving 2 100 employees in June this year dealt a severe blow to the Fund. With forthcoming payments anticipated for the outstanding applications and with the reserve of the Fund falling to \$114.4 million at the end of August 2002, the Fund Board will be facing a serious cash-flow problem in the near future.

8. Under Section 4(2)(d) of the Ordinance, the Fund Board may, with the prior consent of the Financial Secretary, borrow money in such manner and on such securities or terms as it thinks expedient.

9. It is recommended that a **bridging government loan of \$695 million** be extended to the Fund Board between 2002-03 and 2005-06 (see [Annex 1](#)). The extension of a bridging loan is required and justified in the current circumstances because the sharp increase in the number of applications has pushed the Fund to the verge of depletion, despite the recent increase in levy. The Government has to provide the safety net by providing the bridging loan.

### **The Proposal**

10. The loan, at Government's "no-gain-no-loss" interest rate (currently at 3.125% per annum), will be in the form of a credit line so that funds would **only be drawn as and when necessary**. It is expected that the Fund should be able to repay the loan in full by 2015-16. Specifically, as the Mandatory Provident Fund (MPF) contribution builds up, a large part of the ex-gratia payment for severance payment, payable under the Fund, will be met by MPF savings. Besides, as the Hong Kong economy picks up over time, the number of insolvencies / bankruptcies is expected to taper off, thus improving the Fund's financial position. The

Administration, in conjunction with the Fund Board, will closely monitor the financial situation of the Fund to ensure its long-term financial viability and to review the need for adjusting the BRC levy in future years.

11. To ensure that the Fund is not subject to abuse, we have put in place stringent vetting mechanisms. The Fund screens out unqualified cases and on average 12% of the applications are so screened out. Even for applications screened in, the amount of payments approved represent only 64% of the claimed amount. There are also provisions in the Companies Ordinance to guard against employers taking refuge under limited liability and dishonestly shifting their wage liability to the Fund. At the same time, the Labour Department is stepping up prosecution against wage offences and enhancing public education on the early reporting of non-payment of wages. A note on the existing safeguards against possible abuse of the Fund is at Annex 2. The Administration, together with the Fund Board, will continue to consider further measures to reduce possible abuse.

### **Consultation**

12. The Fund Board has been consulted and endorsed the proposal on 22 October 2002. We have also informed the Labour Advisory Board and will seek the approval of the Finance Committee of the Legislative Council on 8 November 2002.

### **Financial Implications**

13. The proposal to grant a one-off bridging loan at Government's "no-gain-no-loss" interest rate will not have additional financial implications for Government.

### **Economic Implications**

14. As the proposed bridging loan will come from the Government and the BRC levy will be kept unchanged, there should be no cost impact on the business sector.

**Protection of Wages on Insolvency Fund Board  
Cash Flow Projection for 2002-03 to 2015-16**

**Cash flow (\$M)**

	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>	<u>2007-08</u>	<u>2008-09</u>	<u>2009-10</u>	<u>2010-11</u>	<u>2011-12</u>	<u>2012-13</u>	<u>2013-14</u>	<u>2014-15</u>	<u>2015-16</u>
<b>Income</b>														
Levy income on BRC	383.9	414.0	414.0	414.0	414.0	414.0	414.0	414.0	414.0	414.0	414.0	414.0	414.0	414.0
Subrogation income	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0
Other income	2.7	5.8	5.9	5.9	6.2	4.2	3.7	3.7	3.7	3.7	3.8	3.8	3.8	3.9
<b>Total</b>	<b>406.6</b>	<b>439.8</b>	<b>439.9</b>	<b>439.9</b>	<b>440.2</b>	<b>438.2</b>	<b>437.7</b>	<b>437.7</b>	<b>437.7</b>	<b>437.7</b>	<b>437.8</b>	<b>437.8</b>	<b>437.8</b>	<b>437.9</b>
<b>Expenditure</b>														
Claims payment	660.0	660.0	607.2	554.4	475.2	396.0	356.4	356.4	356.4	356.4	356.4	356.4	356.4	356.4
Less: Estimated MPF savings	-	(30.5)	(56.1)	(76.8)	(76.8)	(64.0)	(57.6)	(57.6)	(57.6)	(57.6)	(57.6)	(57.6)	(57.6)	(57.6)
	660.0	629.5	551.1	477.6	398.4	332.0	298.8	298.8	298.8	298.8	298.8	298.8	298.8	298.8
Administrative expenses	24.3	24.3	24.3	24.3	24.3	24.3	24.3	24.3	22.2	22.2	22.2	22.2	22.2	22.2
<b>Total</b>	<b>684.3</b>	<b>653.8</b>	<b>575.4</b>	<b>501.9</b>	<b>422.7</b>	<b>356.3</b>	<b>323.1</b>	<b>323.1</b>	<b>321.0</b>	<b>321.0</b>	<b>321.0</b>	<b>321.0</b>	<b>321.0</b>	<b>321.0</b>
<b>Net operating cash flow</b>	<b>(277.7)</b>	<b>(214.0)</b>	<b>(135.5)</b>	<b>(62.0)</b>	<b>17.5</b>	<b>81.9</b>	<b>114.6</b>	<b>114.6</b>	<b>116.7</b>	<b>116.7</b>	<b>116.8</b>	<b>116.8</b>	<b>116.8</b>	<b>116.9</b>
<b>Loan from Government</b>	<b>280.0</b>	<b>215.0</b>	<b>135.0</b>	<b>65.0</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Repayment of loan and interest</b> [Note]	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(115.7)</b>	<b>(115.7)</b>	<b>(115.7)</b>	<b>(115.7)</b>	<b>(115.7)</b>	<b>(115.7)</b>	<b>(115.7)</b>	<b>(115.7)</b>	<b>(115.7)</b>
<b>Net cash flow</b>	<b>2.3</b>	<b>1.0</b>	<b>(0.5)</b>	<b>3.0</b>	<b>17.5</b>	<b>(33.8)</b>	<b>(1.1)</b>	<b>(1.1)</b>	<b>1.0</b>	<b>1.0</b>	<b>1.1</b>	<b>1.1</b>	<b>1.1</b>	<b>1.2</b>
<b>Accumulated funds brought forward</b>	<b>194.9</b>	<b>197.2</b>	<b>198.2</b>	<b>197.7</b>	<b>200.7</b>	<b>218.2</b>	<b>184.4</b>	<b>183.3</b>	<b>182.2</b>	<b>183.2</b>	<b>184.2</b>	<b>185.3</b>	<b>186.4</b>	<b>187.5</b>
<b>Accumulated funds carried forward</b>	<b>197.2</b>	<b>198.2</b>	<b>197.7</b>	<b>200.7</b>	<b>218.2</b>	<b>184.4</b>	<b>183.3</b>	<b>182.2</b>	<b>183.2</b>	<b>184.2</b>	<b>185.3</b>	<b>186.4</b>	<b>187.5</b>	<b>188.7</b>

**Note:**

**Safeguards Against Possible Abuse of  
Protection of Wages on Insolvency Fund (PWIF)**

*Employers taking refuge under limited liabilities and shifting wage liabilities to PWIF*

Safeguards under the Companies Ordinance (Cap 32)

- Under Section 275 of the Companies Ordinance, the court may, in the course of a company's winding up, declare a person personally responsible, without any limitation of liability, for all debts and liabilities of the company if he has an intent to defraud creditors (including employees who are owed wages) when carrying on any business of the company. The criminal liability under this section is a maximum penalty of unlimited fine and five years' imprisonment if prosecuted on indictment and a fine of \$150 000 and twelve months' imprisonment if prosecuted summarily.
- Section 273 of the Companies Ordinance provides that any person who conceals or removes any of the company's property before the winding-up with intent to defraud creditors shall be guilty of an offence. The maximum penalty is a fine of \$150 000 and two years' imprisonment if prosecuted on indictment and a fine at level 5 (\$25 001 - \$50 000) and six months' imprisonment if prosecuted summarily.
- The court is empowered under Section 168H of the Companies Ordinance to make disqualification orders against any person to act as company director if it is satisfied that the person is or has been a director of a company which has at any time become insolvent and that his conduct as a director of that company, either taken alone or taken together with his conduct as a director of any other company, makes him unfit to be concerned in the management of a company. The maximum period of disqualification is fifteen years. (Since 1994, the Official Receiver has obtained more than 260 disqualification orders and the average length of disqualification is 3.2 years. The Labour Department is in close touch with the Official Receiver's Office on directors involved in serial insolvencies.)

***Applicants colluding with employers in making claims and applicants falsifying claims***

Safeguards under the Protection of Wages on Insolvency Ordinance (PWIO) (Cap 380)

- Applicants applying for ex-gratia payment from PWIF must provide truthful information. It is an offence under Section 26 of PWIO to make false statements or provide false information. The maximum penalty is a fine of \$50,000 and three months' imprisonment.

Stringent vetting mechanism for applications for PWIF

- There must be a presentation of winding-up or bankruptcy petition against the employer. PWIF screens out unqualified cases and on average 12% of the applications are so screened out. Even for applications screened in, approved payments represent only 64% of the claimed amount.

***Vigorous prosecution against wage offences***

- Under Sections 23 and 25 of the Employment Ordinance, an employer must effect wage payments not later than seven days when wages become due. Penalty for the offence is a fine of \$200,000 and imprisonment for one year.
- Vigorous prosecution against wage offence can nip potential problems in the bud by reducing recourse to and liability on the PWIF. The number of summons taken out by the Labour Department has increased from 58 in 1999 to 97 in 2001 and 138 in the first nine months of this year.
- The Labour Department has mounted a promotion campaign to encourage early reporting of non-payment of wages. This includes TV and radio messages and special site visits.