

For information on
15 December 2005

LegCo Panel on Manpower

Prevention of Abuse of the Protection of Wages on Insolvency Fund

Purpose

This paper briefs Members on the strategy and action adopted by the Administration since April 2005 to prevent abuse of the Protection of Wages on Insolvency Fund (the Fund).

Background

2. The Administration attaches great importance to protecting the Fund against any abuse. To this end, we have put in place a mechanism to forestall and combat fraudulent claims. We have introduced stringent vetting procedures for applications of ex-gratia payment from the Fund. An inter-departmental Task Force has also been set up since end-2002 to tackle suspected fraudulent cases.

3. The spate of restaurants going out of business without discharging their obligations on wage payments, thus shifting their liabilities to the Fund earlier this year has given rise to considerable public concern over possible abuse of the Fund. There have been calls on the Administration to take further measures to protect the Fund against abuse. This subject was discussed by the LegCo Panel on Manpower at its meeting on 26 April 2005. A motion debate on the same subject was also held by LegCo at its meeting on 4 May 2005. We have since conducted an in-depth study and come up with a multi-pronged strategy to safeguard the Fund from possible abuses.

Strategy to tackle abuse

4. The Fund has been set up to provide timely relief in the form of ex-gratia payment to employees of insolvent employers. As such, it is only meant to assist employees whose employers are “genuinely insolvent”. In tackling the problem of abuse of the Fund, two areas deserve special attention:

- (a) illegal transfer of assets and/or other acts on the part of the director or responsible persons of a company to defraud creditors before the closure of the company; and
- (b) unscrupulous employers shifting their liabilities under the Employment Ordinance (EO) to the Fund.

5. Illegal transfer of assets and/or fraudulent acts committed by the director/responsible person(s) before the closure of a company would have a direct adverse impact on the Fund. The reason is obvious as such action would drain the assets of the company and thus reduce the chance of the Fund Board, as a subrogated creditor¹, to recover the ex-gratia payment made to the employees.

6. To tackle effectively this kind of abuse, the Administration has set up an inter-departmental Task Force comprising representatives from the Commercial Crime Bureau of the Hong Kong Police Force, Official Receiver's Office, Legal Aid Department and Labour Department (LD). The Task Force has since its inception made vigorous efforts in taking concerted action on suspected fraudulent cases. Furthermore, there is a view that new legislative provisions on insolvent trading, if enacted, may help deter the directors and senior management of a company from acting irresponsibly while the company is insolvent, thereby helping to preserve the assets of those companies. Although the Administration considers that the impact of such provisions in practice may be limited, it would nevertheless continue to explore the feasibility of the idea as a longer-term option.

7. As regards the problem outlined in paragraph 4(b) above of unscrupulous employers shifting their liabilities under the EO to the Fund, this is essentially a problem of the employer's inability to honour wage payments. The most effective way to deal with this problem is to prevent cases of non-payment of wages from happening and festering into claims to the Fund in the first place. To tackle the problem at source, we have devised a proactive and pre-emptive strategy with the following focus:

- (a) Toughening the law
- (b) Stepping up prosecution
- (c) Targeting problematic establishments
- (d) Stepping up enforcement

¹ By virtue of section 24 of the Protection of Wages on Insolvency Ordinance, after payment is made from the Fund, the rights of the employees, to the extent of the payment, will be transferred to the Fund Board, which will become a subrogated creditor.

- (e) Strengthening intelligence gathering
- (f) Enhancing publicity and promotion

These measures are explained below.

(a) Toughening the law

8. In parallel with our all-out efforts to prevent non-payment of wages from happening and festering into claims to the Fund, we have proposed to raise the maximum penalty for wage offences under the EO to enhance the deterrent effect. With the support of the Fund Board, the Labour Advisory Board and this Panel, we shall introduce an amendment bill of the EO to raise the maximum penalty for wage offence from the existing fine of \$200,000 and imprisonment for one year to a fine of \$350,000 and imprisonment for three years, to make it on a par with the penalty for employment of illegal workers. We plan to introduce the bill into LegCo on 14 December 2005.

(b) Stepping up prosecution

9. The LD has stepped up prosecution of employers who wilfully and without reasonable excuse commit wage offences. As a result of such rigorous efforts, the number of convicted summonses on wage offences rose from 139 in 2002 to 445 in 2003 – registering a hefty increase of 220%. The figure increased to 504 in 2004, up 13% on 2003. In the first 10 months of 2005, there were 493 convictions against wage offences. Of these, 100 convictions were related to catering establishments, up by a significant 144% over the figure of 41 convictions in the same period last year.

10. The LD has also adjusted its enforcement strategies. If the employer committing a wage offence is a limited company, we will, apart from prosecuting the company, consider prosecuting the directors and other responsible persons of the company as well. We will make every effort to take out prosecution if there is sufficient evidence and the employees concerned are willing to testify in court. In July this year, a convicted restaurant director was imprisoned for one month for wage offences. This is considered an effective deterrent especially when the company concerned has already been wound up.

11. We also see more severe sentences imposed on convicted offenders. Apart from the restaurant director above, two other employers were given jail sentences for defaulting wage payments and an employer was fined \$120,000 for wage offences. In addition, two employers who committed wage offences were sentenced to jail after they failed to pay the court as ordered. These

verdicts should have sent a strong message to employers on the seriousness of wage defaults.

(c) Targeting problematic establishments

12. The LD has proactively approached restaurants with repeated records of labour disputes to assist them to improve their management practices with a view to preventing wage defaults. To this end, we have compiled a “Help List” which covers restaurants with three claim cases lodged within six months. Officers of the LD have actively approached these restaurants to offer consultation and advisory services to improve their management practices. Such proactive action helps engender a cultural change within the industry.

13. In addition, the LD has since August this year launched a pilot exercise codenamed Operation COMBAT which is aimed at proactively forestalling problematic restaurants from evading their wage liabilities and hence abusing the Fund. For the period of August to October 2005, 14 Chinese restaurants employing altogether over 1,000 employees were put under Operation COMBAT. Of these 14 restaurants, eight already ceased operation involving a total of 558 employees. After the intensive monitoring actions under Operation COMBAT, employees in seven of the eight restaurant closures had their wages and termination compensation payments cleared by their own employers. Hence, they would not need to resort to the Fund at all. The remaining six restaurants which are still in operation have also been put under surveillance and regular liaison with the management has been established.

(d) Stepping up enforcement

14. The LD has adjusted its enforcement strategies and stepped up inspection of catering establishments to clamp down on employers defaulting on wage payments at source. In the first 10 months of this year, Labour Inspectors inspected a total of 3,041 catering establishments, or more than one in four catering establishments in the territory. The stepped-up inspections aim to remind employers that we do not tolerate wage defaults. In-depth inquiries are made during the inspections with a view to collecting evidence for possible prosecution and creating a deterrent effect on unscrupulous employers. Labour Inspectors will take statements immediately if they detect any offences and if there are witnesses. They also distribute to employees a leaflet containing LD’s wage offence complaint telephone hotline and provisions on employees’ rights and benefits. This helps employees to lodge complaints when necessary.

(e) Strengthening intelligence gathering

15. The LD has employed seven veteran former police officers with criminal investigation experience to reinforce our capacity in intelligence gathering and evidence collection. Their assistance has enhanced our investigation work on suspected cases of wage offence. The deployment of this team of former police officers has aroused the attention of the catering industry and underlined our determination in clamping down on wage offences.

16. To facilitate reporting of non-payment of wages in the catering industry, we have also established an early warning system in collaboration with trade unions. A user-friendly report form has been put into use since May 2005 to facilitate speedy reporting of suspected cases.

(f) Enhancing publicity and promotion

17. The LD has made every effort in sending out the strong message to the community that the Government does not tolerate wage offences. To this end, we have solicited the full support of the Catering Industry Tripartite Committee in widely publicising the message. We have also accorded extensive publicity to both the enquiry hotlines of LD (i.e. 2717 1771 operating round-the-clock) and of the Mandatory Provident Fund Schemes Authority (i.e. 2918 0102). Employees are also encouraged to make prompt reports of wage defaults.

18. In targeting employers, LD has also distributed to them a new leaflet emphasising the seriousness of wage offences. Newspaper extracts on reported wage offence conviction cases are carried in these leaflets to reinforce the message. As for employees, we have tailor-made a new leaflet urging them to pursue wage claims promptly and come forward as prosecution witnesses to safeguard their rights. We have made use of all channels of distribution such as LD offices, district offices of the Home Affairs Department and the different tripartite committees. Our publicity leaflets for employers have been sent to all catering establishments whilst leaflets for employees have been disseminated to all trade unions in the non-government sector.

19. To promote the standard accounting practice that an enterprise has to recognise the contingent liability for severance payment, we have incorporated such a requirement into a guidebook on good management practices specially designed for the catering industry. We have also enlisted the support of the Hong Kong Institute of Certified Public Accountants in giving a talk on the

subject at a large-scale seminar on good people management for over 250 employers and human resources managers in the catering industry on 11 November 2005.

Improvements observed in the catering industry

20. There are encouraging signs that our multi-pronged strategy is beginning to pay off. In the first 10 months of this year, the Fund has received 9,060 applications, down 22% compared with 11,624 applications in the same period last year. In respect of the catering industry, as can be seen from the table below, while the first two quarters still saw increases in the number of applications, the situation in the third quarter improved notably. Indeed, the third quarter of 2005 recorded a sharp decrease of 34% compared with the same quarter last year. The declining trend continued in October, with only 100 applications from the catering industry, down 76% when compared with the same period in 2004.

Quarter	No. of applications from the catering industry		
	2004	2005	2005 vs. 2004
First Quarter	1,286	1,597	+ 24%
Second Quarter	1,245	1,308	+ 5%
Third Quarter	1,477	968	- 34%
October	410	100	- 76%

21. Apart from the drop in the number of applicants, it is encouraging to note that the length of period with wages in arrears has shortened, as shown in the table below:

Length of the period with wages in arrears (Month)	Percentage of employees involved in applications from the catering industry	
	2004	2005 (Jan – Oct)
Zero	7%	10%
More than 0 to 0.5	14%	15%
More than 0.5 to 1	23%	35%
More than 1 to 2	43%	34%
More than 2	13%	6%
Total	100%	100%

22. There has been continuous improvement in the financial position of the Fund in the past few months. In the first seven months of the 2005-06 financial year (i.e. April to October 2005), the Fund registered on average a surplus of \$22.3 million per month. As at October 2005, the accumulated surplus of the Fund stood at a healthy \$252.5 million.

Sustaining the momentum

23. In brief, our strategy has been to adopt a proactive and pre-emptive approach to clamp down on employers evading their wage liabilities at source, thus preventing wage defaults developing into claims on the Fund. We believe that the proposal to increase the maximum penalty for wage offences, if implemented, would complement our recent renewed efforts to combat wage defaults. Separately, we are reviewing the effectiveness of the current section 64B of the EO under which directors and other responsible persons of a company may be convicted of a like offence if the wage offence is committed with their consent or connivance or due to their neglect.

Consultation with the Fund Board and Labour Advisory Board

24. The Fund Board and the Labour Advisory Board were consulted on 8 December 2005 and both supported the latest strategy and measures adopted by the Administration as set out in paragraphs 7 to 19 above.

Economic Development and Labour Bureau
Labour Department
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