

**For discussion on
2 March 2015**

Legislative Council Panel on Financial Affairs

**Review of the Adjustment Mechanism for
the Minimum and Maximum Levels of Relevant Income for
Mandatory Provident Fund Mandatory Contributions**

PURPOSE

The Mandatory Provident Fund Schemes Authority (“MPFA”) launched a public consultation on “Introducing an Automatic Mechanism for Adjustment of Minimum and Maximum Levels of Relevant Income” on 23 January 2015 (consultation paper at [Annex](#)). This paper seeks Members’ views on the proposal.

BACKGROUND

2. Introduced in December 2000, the Mandatory Provident Fund System (“MPF System”) is a mandatory system for assisting the working population in saving for retirement. It is the second pillar of Hong Kong’s multi-pillar retirement protection system according to the model advocated by the World Bank¹.

3. Under the MPF System, employers, employees and self-employed persons are each required to contribute 5% of the relevant

¹ The World Bank advocates a multi-pillar retirement protection model. The model originally had three pillars, but later developed into a five-pillar one, including (a) a non-contributory basic or social pension system as the “zero pillar”, (b) a mandatory public pension plan as the “first pillar”, (c) a mandatory occupational or personal pension plan as the “second pillar”, (d) a voluntary occupational or personal pension plan as the “third pillar” and (e) access to informal support such as family support and formal social programmes including medical care as the “fourth pillar”.

income of the employee or self-employed person concerned to MPF schemes. However, employees and self-employed persons are not required to make mandatory contributions if their income is lower than the minimum level of relevant income (“Min RI Level”), although in the case of employees, their employers are still required to contribute for their employees. On the other hand, neither employers, employees nor self-employed persons are required to make mandatory contributions in respect of income which exceeds the maximum level of relevant income (“Max RI Level”).

4. The purpose of setting a Min RI Level is to relieve the financial burden of mandatory contributions on lower income earners, while the purpose of setting a Max RI Level is to allow higher income earners the flexibility to meet their retirement savings needs by means other than mandatory contributions.

5. It is necessary to adjust the Min and Max RI Levels over time so that they can continue to achieve the purposes explained in paragraph 4 above. Section 10A of the Mandatory Provident Fund Schemes Ordinance (“MPFSO”) (Cap. 485) sets out the adjustment mechanism which provides that MPFA must, not less than once in every four years beginning with the commencement of that section on 19 July 2002, conduct a review of the Min and Max RI Levels to ascertain whether or not there are grounds for adjustment. It further provides that MPFA must take into account the following two adjustment factors in conducting the review –

- (a) for the Min RI Level – 50% of the monthly median employment earnings (“50% of Median Earnings”); and
- (b) for the Max RI Level – monthly employment earnings at 90th percentile of the monthly employment earnings distribution (“90th Percentile Earnings”),

prevailing at the time of the review², but does not prevent MPFA from taking into account other relevant factors.

6. We adopted 50% of Median Earnings for reviewing the Min RI Level in the 2002 and 2006 review exercises. However, in the 2010 and 2012 review exercises, in response to some Legislative Council (“LegCo”) Members’ suggestion, we adopted a formula with reference to the Statutory Minimum Wage (“SMW”) rate³, which was first introduced in May 2011, as the benchmark for adjustment and promised that MPFA would conduct a comprehensive review of the statutory adjustment mechanism after the effect of SMW became clearer.

PROPOSAL FOR CONSULTATION

7. MPFA has completed the review of the statutory adjustment mechanism which has been in place for over 12 years. In view of the operational experience, it proposes turning the existing discretionary adjustment mechanism into an automatic one with the following key features –

- (a) to determine the Min and Max RI Levels at the same time once every two years based on the benchmarks set out in subparagraphs (b) and (c) below;
- (b) to set the benchmark for determining the Min RI Level at 55% of Median Earnings of all employed persons (excluding foreign domestic helpers (“FDHs”) as their employment terms and conditions are different from those of the local working population and they are not covered by the MPF System) aged 18 to 64, rounded up to the next

² Both 50% of Median Earnings and 90th Percentile Earnings are compiled from the General Household Survey conducted by the Census and Statistics Department.

³ Based on the formula, the Min RI Level was the product of (i) the SMW hourly rate; (ii) the latest statistics on the median daily working hours of the four low-paying sectors available at the time of review; and (iii) the assumed number of working days per month (i.e. 26 days).

\$100. By adding a 5% factor to the existing benchmark of 50% of Median Earnings to ensure that, after having paid their own 5% mandatory contributions, the lower income earners will still have an amount of take-home pay equal to at least 50% of Median Earnings; and

- (c) to set the benchmark for determining the Max RI Level at 90th Percentile Earnings of all employed persons (excluding FDHs) aged 18 to 64, rounded to the nearest \$2,500 and subject to the magnitude of each increase not exceeding \$5,000.

8. The proposed mechanism will allow the Min and Max RI Levels to track the overall economic and employment conditions more closely, and trustees and employers will be able to plan for the adjustments as the outcomes of each review exercise will be more predictable. The proposed mechanism, being a refined version of the existing one in MPFSO, will also be easily understood by stakeholders.

NEXT STEPS

9. The consultation will end on 5 March 2015. MPFA is seeking the views of the industry, employer associations and labour unions. Subject to the views collected, MPFA will submit a concrete proposal for amending the statutory adjustment mechanism for the Min and Max RI Levels to the Government this year.

Financial Services and the Treasury Bureau
Mandatory Provident Fund Schemes Authority
18 February 2015



強制性公積金計劃管理局
MANDATORY PROVIDENT FUND
SCHEMES AUTHORITY

Introducing an Automatic Mechanism for Adjustment of Minimum and Maximum Levels of Relevant Income

Consultation Paper

January 2015

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FOREWORD

We invite interested parties to submit comments on a proposal to introduce an automatic mechanism for adjusting the minimum level of relevant income and the maximum level of relevant income. The automatic mechanism would keep contribution levels aligned with the earnings distribution of the working population and enhance the efficiency of the Mandatory Provident Fund (“MPF”) System.

Interested parties should submit comments to the Mandatory Provident Fund Schemes Authority (“MPFA”) on or before 5 March 2015.

Submissions will be received on the basis that MPFA may freely publish, reproduce, quote or summarize them in whole or in part, and in any form, without seeking permission from or providing acknowledgment of those who provide comments. Please note that the names of those who provide comments and the contents of their submissions may be posted on MPFA’s website or referred to in other documents published by MPFA. In this connection, please read the “Personal Information Collection Statement” attached to this Consultation Paper.

If you wish to make a submission but do not wish your name to be published by MPFA, please state that you wish your name to be withheld from publication when you make the submission. If you wish to make a submission as a representative of an organization, please provide details of the organization whose views you represent.

Comments may be sent through any of the following means:

By mail to: Policy Development & Research Department
Mandatory Provident Fund Schemes Authority
Units 1501A and 1508, Level 15
International Commerce Centre
1 Austin Road West, Kowloon
Hong Kong

Attention: Consultation on “Introducing an Automatic Mechanism for Adjustment of Minimum and Maximum Levels of Relevant Income”

By fax to: (852) 2259 8108
By email to: minmax@mpfa.org.hk
Via MPFA's website: <http://www.mpfa.org.hk>

Please note that MPFA will not issue acknowledgements, or reply to, individual submissions received.

A copy of this Consultation Paper is available on MPFA's website at <http://www.mpfa.org.hk>.

Mandatory Provident Fund Schemes Authority
Hong Kong

January 2015

PERSONAL INFORMATION COLLECTION STATEMENT

This Personal Information Collection Statement is made in compliance with the requirements of the Personal Data (Privacy) Ordinance (Cap. 486) (“PDPO”). This statement sets out the purposes for which your Personal Data¹ will be used following collection, what you are agreeing to with respect to the use of your Personal Data by the Mandatory Provident Fund Schemes Authority (“MPFA”) and your rights under the PDPO.

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- in exercising MPFA’s statutory functions under the Mandatory Provident Fund Schemes Ordinance (Cap.485);
- for the purpose of consultation for this Consultation Paper;
- for research and statistical purposes; and/or
- for any other purposes directly related to the above purposes.

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Personal Data provided in your submission may be disclosed by MPFA to members of the public (whether in Hong Kong or elsewhere), as part of the public consultation on this Consultation Paper. Your name together with the whole or part of your submission may be disclosed to members of the public. This may be done by publishing such information on MPFA’s website and in documents to be published by MPFA during the consultation period, or at, or following its conclusion.

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¹ Personal Data means personal data as defined in the PDPO.

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Retention

Your Personal Data provided to MPFA in response to this Consultation Paper will be retained for such period as may be necessary for the fulfillment of the purposes stated above.

Enquiries

You may make enquiries regarding the Personal Data provided in your submission on the Consultation Paper, or request for access to or correction of such Personal Data, by writing to:

The Personal Data (Privacy) Officer
Mandatory Provident Fund Schemes Authority
Units 1501A and 1508, Level 15
International Commerce Centre
1 Austin Road West, Kowloon
Hong Kong

GLOSSARY

CPI	Consumer Price Index
FDHs	Foreign domestic helpers
Max RI Level	Maximum level of relevant income specified in Schedule 3 to the Ordinance; currently at \$30,000 per month
Min RI Level	Minimum level of relevant income specified in Schedule 2 to the Ordinance; currently at \$7,100 per month
MPFA	Mandatory Provident Fund Schemes Authority
MPF scheme	Mandatory Provident Fund scheme
MPF System	Mandatory Provident Fund System
Ordinance	Mandatory Provident Fund Schemes Ordinance (Cap. 485)
SMW	Statutory Minimum Wage
SMW rate	Statutory Minimum Wage rate
Transport Subsidy Scheme	Work Incentive Transport Subsidy Scheme
50% of Median Earnings	50% of monthly median employment earnings as stipulated in section 10A of the Ordinance
90 th Percentile Earnings	Monthly employment earnings at 90 th percentile of the monthly employment earnings distribution as stipulated in section 10A of the Ordinance

EXECUTIVE SUMMARY

1. Launched in December 2000, the objective of the Mandatory Provident Fund System (“MPF System”) is to assist the working population of Hong Kong to accumulate retirement savings by means of mandatory contributions by both employers and employees, as well as self-employed persons.

2. The Mandatory Provident Fund Schemes Authority (“MPFA”) is the statutory body tasked with regulating and supervising the privately-managed Mandatory Provident Fund schemes (“MPF schemes”). The primary objectives of MPFA are to ensure compliance with the Mandatory Provident Fund Schemes Ordinance (Cap.485) (“Ordinance”) by employers, self-employed persons and MPF service providers. MPFA’s functions also include considering and proposing reforms of the laws relating to MPF schemes or occupational retirement schemes.

3. Employers and employees are each required to make mandatory contributions at 5% of the relevant income of the employees for the benefit of the employees. Self-employed persons are required to make mandatory contributions at 5% of their relevant income. The amount of mandatory contributions is subject to the minimum level of relevant income (“Min RI Level”) and the maximum level of relevant income (“Max RI Level”) which should be adjusted over time having regard to changing circumstances.

4. The purpose of setting a Min RI Level is to lessen the immediate financial burden of mandatory contributions on lower income earners. Below a certain earnings level, their immediate needs outweigh the need for them to put money aside for long-term retirement savings. The rationale for setting a Max RI Level is that the MPF System is to require the working population to set aside a moderate level of retirement savings during their work life. Beyond a moderate income level, mandatory contributions should not be required, as higher income earners should be allowed greater flexibility as to how to achieve their retirement savings needs.

5. Section 10A of the Ordinance provides that MPFA must, not less than once in every four years beginning on the commencement date of that section (i.e. 19 July 2002), conduct a review of the Min and Max RI Levels to ascertain whether or

not there are grounds to amend the levels. It further provides that MPFA must take into account the following two adjustment factors in conducting the review, i.e. –

- (a) for the Min RI Level – 50% of the monthly median employment earnings (“50% of Median Earnings”); and
- (b) for the Max RI Level – monthly employment earnings at 90th percentile of the monthly employment earnings distribution (“90th Percentile Earnings”),

both prevailing at the time of the review as compiled from the General Household Survey conducted by the Census and Statistics Department. The Ordinance does not prevent MPFA from taking other factors into account in conducting the review. After a review, actual adjustments to the Min and Max RI Levels require a legislative process during which stakeholders and legislators may put forward their views and suggestions, and strive for a solution that could balance different interests. Chapter 1 below provides more details of the current adjustment mechanism and the adjustments of the Min and Max RI Levels that were made following past reviews.

6. Based on the experience gained in previous rounds of adjustments, MPFA has conducted a review of the adjustment mechanism, including the benchmark factors and the adjustment frequency. Details of the review are set out in Chapter 2.

7. In this Consultation Paper, we put forward, for consultation, a proposal to replace the existing discretionary adjustment mechanism with an automatic mechanism. Key proposed changes are set out below. Further details are set out in Chapter 3.

- (a) The Min RI Level and the Max RI Level would be determined at the same time every two years based on the benchmark factors set out in (b) and (c) below;**
- (b) the benchmark factor for determining the monthly Min RI Level would be 55% of the monthly median employment earnings of all employed persons (excluding foreign domestic helpers (“FDHs”)) aged 18 to 64 rounded up to the next \$100; and**
- (c) the benchmark factor for determining the monthly Max RI Level would be 90th percentile earnings of the monthly employment earnings distribution of all employed persons (excluding FDHs) aged 18 to 64 rounded to the nearest \$2,500, subject to the magnitude of each increase not exceeding \$5,000.**

We expect the proposed mechanism would keep the contribution levels better aligned with the earnings distribution of the working population and enhance the efficiency of the MPF System.

8. We invite interested parties to submit to us comments on the proposed mechanism on or before 5 March 2015.

CHAPTER 1 CURRENT ADJUSTMENT MECHANISM

9. The Mandatory Provident Fund System (“MPF System”) is a mandatory system for assisting the working population to save for retirement. It is one of the pillars forming the retirement protection system as advocated by the World Bank. Understanding that members of the working population also have other needs and some may have preference for other saving or investment vehicles for accumulating retirement benefits, the contributions to the MPF System are kept at a reasonably low level. Employees, employers and self-employed persons are each required to contribute 5% of relevant income, subject to the minimum level of relevant income (“Min RI Level”) (where applicable) and the maximum level of relevant income (“Max RI Level”) prescribed under the Mandatory Provident Fund Schemes Ordinance (Cap.485) (“Ordinance”).

10. An employee or a self-employed person whose relevant income is less than the Min RI Level is not required to contribute to a Mandatory Provident Fund scheme (“MPF scheme”). This does not, however, affect the obligation of the employer to make employer mandatory contributions to the employee’s account under an MPF scheme. The Max RI Level is the level beyond which an employee or a self-employed person is not required to make any mandatory contributions in respect of the excess amount of relevant income. The employer is likewise not required to make any employer mandatory contributions for the employee in respect of such excess amount.

11. It is necessary to adjust the Min and Max RI Levels over time so that they reflect changes in the income distribution of the working population. Section 10A of the Ordinance sets out the adjustment mechanism which provides that Mandatory Provident Fund Schemes Authority (“MPFA”) must, not less than once in every four years beginning with the commencement of that section on 19 July 2002, conduct a review of the Min and Max RI Levels to ascertain whether or not there are grounds to amend the levels. It further provides that MPFA must take into account the following two adjustment factors in conducting the review, i.e. –

- (a) for the Min RI Level – 50% of the monthly median employment earnings (“50% of Median Earnings”); and
- (b) for the Max RI Level – monthly employment earnings at 90th percentile of the monthly employment earnings distribution (“90th Percentile Earnings”),

both prevailing at the time of the review as compiled from the General Household Survey conducted by the Census and Statistics Department. The Ordinance does not prevent MPFA from taking other factors into account in conducting the review.

12. The monthly employment earnings distribution obtained through the General Household Survey which is used for compiling 50% of Median Earnings and 90th Percentile Earnings covers all employed persons aged 18 to 64.

History of Adjustments of Min and Max RI Levels

13. The history of the adjustments made to the monthly Min and Max RI Levels is set out in the table below –

Effective Date	Min RI Level	Max RI Level
1 December 2000	\$4,000	\$20,000
1 February 2003	\$5,000	\$20,000
1 November 2011	\$6,500	\$20,000
1 June 2012	\$6,500	\$25,000
1 November 2013	\$7,100	\$25,000
1 June 2014	\$7,100	\$30,000

14. As a result of the recovery of the economy after the severe acute respiratory syndrome epidemic and the 2008 global financial crisis as well as the enactment of the Minimum Wage Ordinance (Cap. 608), more frequent adjustments to the Min and Max RI Levels have been made in recent years.

15. The initial Max RI Level of \$20,000 reflected 90th Percentile Earnings in 1994. When the current adjustment mechanism was introduced in 2002, the prevailing 90th Percentile Earnings had increased to \$30,000. In the light of the poor economic conditions at that time, however, no adjustment was made to the Max RI Level. For the reviews conducted in 2006 and 2010, 90th Percentile Earnings still pointed to \$30,000. MPFA suggested that a staggered approach be adopted to gradually bring the Max RI Level to \$30,000 by two increases of \$5,000 at a time. The adjustments eventually became effective in 2012 and 2014 respectively.

CHAPTER 2 REVIEW OF CURRENT ADJUSTMENT MECHANISM

16. In reviewing the adjustment mechanism, the following inter-related key components have been considered –

- (a) extent of automation of adjustments (see paragraphs 17 to 18 below);
- (b) adjustment benchmarks (see paragraphs 19 to 27 below);
- (c) frequency of reviews and adjustments (see paragraphs 28 to 30 below);
- (d) limits on adjustment magnitude (see paragraphs 31 to 33 below); and
- (e) rounding mechanism (see paragraphs 34 to 36 below).

(a) Extent of Automation of Adjustments

17. The current adjustment mechanism for the Min and Max RI Levels is a mechanism that lies between a fully-automatic mechanism² and a fully-discretionary mechanism³ – the reference benchmarks and review frequency for MPFA to conduct a review are prescribed in the Ordinance, but the outcome of each adjustment exercise requires the community to come to a broad consensus and a formal legislative process. Factors not explicitly set out in the legislation are also taken into account during the process.

18. A mechanism such as the current one can provide flexibility. However, the outcome is highly uncertain which can increase administrative uncertainty and operating costs. The current mechanism may be most appropriate during an initial phase for building consensus for the benchmarks and review frequency. If consensus can be reached on the benchmarks and review frequency, switching to a fully-automatic mechanism may be considered as it will produce a highly predictable outcome and ensure that adjustments can be made promptly in line with economic developments to better achieve the objectives of the MPF System.

(b) Adjustment Benchmarks

Min RI Level

19. The current statutory adjustment factor for the Min RI Level is 50% of

² The Min and Max RI Levels are adjusted strictly based on the key components as prescribed.

³ None of the key components is prescribed and adjustment is on a completely discretionary basis.

Median Earnings which is compiled from the employment earnings distribution of all employed persons (including foreign domestic helpers (“FDHs”)) aged 18 to 64. In considering the appropriate benchmark for the Min RI Level, MPFA has taken into account a number of other possible indicators, including, for example, a higher percentage of Median Earnings, the Consumer Price Index (“CPI”), the Statutory Minimum Wage (“SMW”) rate, the monthly income limit for a one-person household for the Work Incentive Transport Subsidy Scheme (“Transport Subsidy Scheme”) and the Poverty Line set by the Commission on Poverty.

20. The use of Median Earnings as a Min RI Level benchmark has the advantages of being easily understood, relatively objective and should, in the long run, reflect changes in economic conditions. Median Earnings reflect not only the effect of price changes but also the overall wage trend. In view that employees may be more concerned about their net take-home pay after the deduction of 5% mandatory contributions, a refinement may be considered to provide for an extra 5% in the calculation formula (i.e. using 55% of Median Earnings as the benchmark).

21. Since 2012, the Census and Statistics Department has published two sets of statistics on monthly median employment earnings of employed persons, the standard set including all employed persons and the refined set excluding FDHs. MPFA has considered which set of statistics will be more appropriate for purposes related to MPF contributions. As the monthly earnings, working patterns and entitlements to in-kind benefits of FDHs are quite different from those of local workers, **the refined data set excluding FDHs may better reflect the earnings distribution of local workers who are covered by the MPF System.**

22. On CPI, experience shows that it tends to increase more slowly than earnings. If adopted as the benchmark for adjusting the Min RI Level, it may result in an increasing proportion of the low income earners being required to make contributions.

23. As regards SMW, its main objective is to maintain an appropriate balance between forestalling excessively low wages and minimizing the loss of low-paid jobs; and to sustain Hong Kong’s economic growth and competitiveness. The setting of SMW draws reference to a basket of indicators which fall into different

categories⁴. While some of the indicators, such as average monthly employment earnings and CPI, can be considered as relevant in determining the Min RI Level, there are also less relevant indicators in the basket, such as those on the relative economic freedom and competitiveness of Hong Kong. In addition, the Minimum Wage Commission undertakes analysis and impact assessments based on wage distribution data and findings of other relevant surveys, and considers views from various sectors of the society in order to develop its recommended SMW rate. This recommendation is then considered by the Government before a proposal is deliberated by the Legislative Council. As such, the outcome is a negotiated one which may not necessarily reflect any particular criteria in an objectively ascertainable way.

24. The SMW rate directly affects the earnings of employees with low hourly wage. It would also likely affect indirectly the earnings of the remainder of the working population through its ripple effects on wage rates. Overall, the effects should be fully reflected in the earnings distribution of the working population and, as such, would be reflected in the Median Earnings in any event.

25. The Transport Subsidy Scheme aims to relieve the burden of travelling expenses commuting to and from work on low-income households with employed members and to promote sustained employment, which are quite different from the objective of setting the Min RI Level. Using the Transport Subsidy Scheme income limit for setting the Min RI Level has an additional drawback of the potential lack of permanence as the Scheme is an administrative arrangement not backed by legislation.

26. The Poverty Line was first set for Hong Kong in 2012 at 50% of the median monthly household income before tax and welfare transfers. The 2013 Poverty Line for one-person households was set at \$3,500, and at \$8,300, \$12,500, \$15,400, \$16,000 for two, three, four and five-person households, and \$17,100 for households with six or more people. While it is typical to use household income to measure poverty, extending its application to adjustment of the Min RI Level for MPF which is employment and individual-based is difficult and somewhat arbitrary. When compared with the current statutory adjustment factor for the Min RI Level of 50% of Median Earnings (i.e. an individual-based statistical data point), it seems

⁴ There are four main categories of indicators for SMW setting purposes: (1) general economic conditions; (2) labour market conditions; (3) competitiveness; and (4) social inclusion.

difficult to justify why the Poverty Line of 50% of median monthly household income (i.e. a household-based statistical data point) (which will need to be converted to an individual-based benchmark based on arbitrary assumptions) could reflect better low income earners' affordability to make mandatory contributions.

Max RI Level

27. On the Max RI Level, the current statutory adjustment factor is 90th Percentile Earnings. It is easy to understand and aligns with the policy objective. Due to non-adjustment of the Max RI Level from implementation till 2012, there has been a quite significant difference between the Max RI Level and 90th Percentile Earnings benchmark. In 2012 and 2014, the Max RI Level was increased by \$5,000 each time to bring it closer to the benchmark.

(c) Frequency of Reviews and Adjustments

28. The Ordinance requires MPFA to conduct a review of the Min and Max RI Levels at least once in every period of four years. The period was set taking into account, among others, that such timeframe can cater for the administrative and operational work required of service providers and employers, and without requiring them to adjust their computer systems at intervals that are too frequent.

29. Less frequent reviews and adjustments can reduce the work and costs, particularly for employers, self-employed persons and service providers involved in implementing the adjustments. However, less frequent adjustments may mean more significant adjustments to the Min and Max RI Levels following each review and less sensitivity to changing socio-economic conditions in between the adjustments.

30. More frequent reviews and adjustments, such as annually, will allow the Min and Max RI Levels to more closely track socio-economic conditions but create more administrative work and consequently increase the costs of the MPF System. The adjustment amounts will likely be smaller each time.

(d) Limits on Adjustment Magnitude

31. Allowing the Min and Max RI Levels to be fully adjusted in accordance with the benchmarks will most closely track changes that the benchmarks reflect. However, to avoid adjustments to the Min and Max RI Levels being too substantial,

and to remove the need to make relatively small adjustments, consideration can be given to imposing limits on the adjustment magnitude. For example, the phased adjustments of the Max RI Level in 2012 and 2014 were, in effect, equivalent to the imposition of a \$5,000 limit on the magnitude of increase for the Max RI Level.

32. In respect of the Min RI Level, a full increase in line with the benchmark will provide relief from contributions for those employees who may otherwise experience difficulties in meeting their immediate needs. Imposition of a limit on the magnitude of increase may therefore not be so appropriate. There also appears to be no strong justification for the imposition of any limit on the magnitude of decrease in the less likely scenario when the benchmark sees a fall in value.

33. In respect of the Max RI Level, if the benchmark has increased substantially, full adjustment in line with the benchmark implies that employers, employees and self-employed persons have to make substantially more contributions. By imposing a limit on the increase magnitude, the increase of the Max RI Level is in effect phased in more gradually. The drawback is that the accrued retirement savings will be smaller compared with those under the full adjustment approach. If the limit needs to be consistently applied, then the gap between the benchmark and the Max RI Level will not be closed, rendering the benchmark less effective. As regards a decrease in value of the benchmark, there appears to be no strong justification for the imposition of any limit on the magnitude of decrease of the Max RI Level.

(e) Rounding Mechanism

34. Where the benchmark does not always produce figures that are easy to apply, a rounding mechanism may be adopted. Such figures can be rounded down, up or to the nearest unit. Rounding practices may also help mitigate the need for more frequent adjustments. The current statutory adjustment mechanism sets no rounding requirements.

35. On the Min RI Level, if the benchmark is viewed as the level below which mandating contributions will make it difficult for scheme members to meet immediate needs, then only rounding upwards will be appropriate. Given the current Min RI Level is at \$7,100, rounding upwards to the next \$100, \$250 or \$500 may be reasonable options. The choice of the unit for rounding represents a balance between accruing more benefits and the work and costs involved in making

adjustments. If the unit for rounding is a small amount, then it is more likely that each review will result in an adjustment, thus causing more work and costs. This approach will exempt low income earners from contributions more gradually, meaning that system-wide, more benefits will be accrued for retirement. On the other hand, if the unit for rounding is a larger amount, not every review may result in an adjustment, thereby saving adjustment work and costs. However, in this case, for each adjustment, a larger number of scheme members will be affected.

36. On the Max RI Level, all three rounding approaches are possible options. Rounding up will produce a higher amount of accrued benefits; rounding down may be more easily accepted by employers, employees and self-employed persons; and rounding to the nearest unit may be perceived as a fairer and more neutral approach. As the current Max RI Level is at \$30,000, potential units for rounding may be \$1,000 and \$2,500.

CHAPTER 3 PROPOSED MECHANISM FOR CONSULTATION

37. Having considered various factors, including the experience of operation of the current adjustment mechanism, MPFA has drawn up a proposed mechanism for consultation.

38. **The key features of the proposed mechanism are –**

- (a) the Min RI Level and the Max RI Level would be determined at the same time every two years based on the benchmark factors set out in (b) and (c) below;**
- (b) the benchmark factor for determining the monthly Min RI Level would be 55% of the monthly median employment earnings of all employed persons (excluding FDHs) aged 18 to 64 rounded up to the next \$100; and**
- (c) the benchmark factor for determining the monthly Max RI Level would be 90th percentile earnings of the monthly employment earnings distribution of all employed persons (excluding FDHs) aged 18 to 64 rounded to the nearest \$2,500, subject to the magnitude of each increase not exceeding \$5,000.**

Each key component of the proposed mechanism is further discussed below.

(a) Full Automation

39. The proposed mechanism is a fully-automatic one under which the Min and Max RI Levels would be determined at the same time in accordance with the proposed adjustment benchmarks and other key components to be prescribed in the Ordinance. Accordingly, relatively prompt adjustment and implementation of the two levels to more closely reflect economic conditions should be feasible. Stakeholders, such as trustees and employers, will also be able to plan for adjustments with more certainty than is possible under the existing mechanism.

(b) Adjustment Benchmark

40. There would only be two simple and objective adjustment benchmarks –

- (a) for the Min RI Level – 55% of the monthly median employment earnings of all employed persons (excluding FDHs) aged 18 to 64

compiled from the General Household Survey conducted by the Census and Statistics Department; and

- (b) for the Max RI Level – 90th percentile earnings of the monthly employment earnings distribution of all employed persons (excluding FDHs) aged 18 to 64 compiled from the General Household Survey conducted by the Census and Statistics Department.

41. The above proposed adjustment benchmarks are refinements of the current statutory adjustment factors of 50% of Median Earnings for the Min RI Level and 90th Percentile Earnings for the Max RI Level, and hence should be relatively easy to understand. Moreover, having considered the fundamental principles of the MPF System, it is considered that the existing employment earnings distribution (and accordingly the existing adjustment benchmarks)⁵ can be refined by **excluding** the earnings data of FDHs for setting the Min and Max RI Levels.

42. In Hong Kong, a prospective employer intending to recruit an FDH must enter into an employment contract as specified by the Director of Immigration and must pay salary of no less than the Minimum Allowable Wage⁶ announced by the Government and prevailing at the date of signing the employment contract for employing the FDH. This way of setting the monthly earnings at a standard level at the Minimum Allowable Wage differentiates FDHs from the local working population whose earnings is usually set by agreement, subject to the requirements in the labour legislation in Hong Kong. Moreover, there are significant differences between FDHs and the local working population in other aspects such as working patterns and entitlements to in-kind benefits (e.g. free accommodation). There are over 300 000 FDHs working in Hong Kong and they are exempted from the MPF System. As such, including the earnings of FDHs in the employment earnings distribution may unintentionally distort the distribution of earnings for setting the appropriate Min and Max RI Levels for contribution purposes. The proposed

⁵ The existing benchmarks for the Min and Max RI Levels are compiled from the employment earnings distribution which covers all employed persons (i.e. including FDHs) aged 18 to 64 (see paragraph 5 above).

⁶ The current Minimum Allowable Wage is \$4,110 per month.

mechanism therefore adopts benchmarks using the refined employment earnings distribution that covers all employed persons aged 18 to 64, but excluding FDHs.

43. The proposed Min RI Level adjustment benchmark of 55% of Median Earnings is also relatively objective. The median earnings distribution (excluding FDHs) reflects not only the effect of price changes but also the overall wage trend of the local working population. Compared with the existing benchmark of 50% of Median Earnings, the “5% gross up” factor ensures that, after having paid their own 5% mandatory contributions, these workers would still have take-home pay equal to at least 50% of Median Earnings.

44. On the Max RI Level, the proposed adjustment benchmark is similar to the current statutory adjustment factor of 90th Percentile Earnings. The adoption of the proposed benchmark of 90th Percentile Earnings based on the employment earnings distribution but excluding the earnings data of FDHs would be consistent with the intended scope of coverage of the MPF System.

(c) **Frequency of Reviews and Adjustments**

45. An automatic adjustment mechanism makes more frequent reviews and adjustments of the Min and Max RI Levels feasible. Hence, the proposed mechanism is that the review and adjustment frequency for the two levels be set at once every two years. Too frequent reviews and adjustments of the two levels (e.g. once a year) would likely add work and costs to the MPF System and its stakeholders.

(d) **Limits on Adjustment Magnitude**

46. If there is a downward movement of 55% of Median Earnings, under the proposed mechanism, the Min RI Level will be adjusted downwards accordingly. There is no strong justification for forbidding or limiting downward adjustments.

47. If there is an upward movement of 55% of Median Earnings, under the proposed mechanism, the Min RI Level will be adjusted upwards accordingly. Full

adjustment upwards will provide relief from making contributions for those employees and self-employed persons who may otherwise experience difficulties in meeting their immediate needs.

48. If there is a downward movement of 90th Percentile Earnings, under the proposed mechanism, the Max RI Level will be adjusted downwards accordingly. There is no strong justification for forbidding or limiting downward adjustments. This means that if the benchmark decreases, employers, employees and self-employed persons would pay less contributions. Those individuals who like to maintain the same level of contributions as before could make voluntary contributions or use other vehicles to invest the difference to better provide for their retirement.

49. If there is an upward movement of 90th Percentile Earnings, employers, employees and self-employed persons will have to pay more contributions. There will be financial impact on these parties, and a very substantial increase may need to be phased-in. From past experience, \$5,000 may be a realistic limit on the magnitude of an increase, beyond which a one-off increase may impose too heavy an impact. The proposed mechanism therefore includes a limit of \$5,000 on the magnitude of an increase in the Max RI Level in order to strike a balance between helping the working population accumulate more retirement benefits whilst not seriously aggravating the financial burden of the business sector and the working population at a single point in time.

(e) **Rounding Mechanism**

50. As explained in paragraph 35 above, only rounding upwards will be appropriate for the Min RI Level, and the remaining component to be considered is the rounding unit. If there is only a small change in the benchmark, the work and costs associated with effecting a small corresponding adjustment to the Min RI Level may outweigh any benefit resulting from the adjustment. On the other hand, smaller adjustments can track changes in the benchmark more closely. In the past (see paragraph 13 above), rounding up to the next \$100 multiple has been adopted and it is proposed to maintain this practice.

51. On the rounding mechanism for the Max RI Level, rounding to the nearest rounding unit will be a fair mechanism to employers, employees and self-employed persons. As the current Max RI Level stands at \$30,000, the proposed mechanism suggests adopting a rounding unit of \$2,500.

Implications of Implementation of the Proposed Mechanism

52. Based on the statistics from the General Household Survey conducted by the Census and Statistics Department (for the third quarter of 2014), the Median Earnings and 90th Percentile Earnings of the monthly employment earnings distribution of all employed persons (excluding FDHs) aged 18 to 64 are at \$15,000 and \$40,000 respectively. In other words, if the proposed mechanism is implemented today, the Min RI Level will be adjusted to \$8,300 (55% of \$15,000 rounded up to the next \$100) while the Max RI Level will be adjusted to \$35,000 (the current Max RI Level of \$30,000 increased by \$5,000, being the limit on the magnitude of each increase).

53. If the Min RI Level is increased from the current level of \$7,100 to \$8,300, employees and self-employed persons earning \$7,100 or above but below \$8,300 will be exempted from making mandatory contributions. The estimated impact of the increase is set out in the table below –

Employees (“EE”) / Self-employed Persons (“SEP”) monthly earnings	\$7,100 – <\$8,300
(a) Number of relevant EEs and SEPs affected	
No. of relevant EEs affected (% of total no. of relevant EEs covered by MPF schemes (i.e. 2 543 500))	125 400 (4.9%)
No. of SEPs affected (% of total no. of SEPs covered by MPF schemes (i.e. 287 800))	11 100 (3.9%)
(b) Total monthly mandatory contributions	
Decrease in total monthly EE contributions	(\$48.93 million)
Decrease in total monthly SEP contributions	(\$4.38 million)
Total decrease in monthly contributions	(\$53.31 million)

Employees (“EE”) / Self-employed Persons (“SEP”) monthly earnings	\$7,100 – <\$8,300
(c) Accrued benefits upon retirement per member ⁷	
Decrease in accrued benefits upon retirement per EE member	(\$271,600)
Decrease in accrued benefits upon retirement per SEP member	(\$275,300)

54. If the Max RI Level is increased from the current level of \$30,000 to \$35,000, employees and their employers, as well as self-employed persons earning more than \$30,000 will have to make extra mandatory contributions of not more than \$250. The estimated impact of the increase is set out in the table below –

EE/ SEP monthly earnings	\$30,001 – \$35,000	>\$35,000	>\$30,000
(a) No. of relevant EEs and SEPs affected			
No. of relevant EEs affected (% of total no. of relevant EEs covered by MPF schemes (i.e. 2 543 500))	73 700 (2.9%)	268 300 (10.5%)	342 000 (13.4%)
No. of SEPs affected (% of total no. of SEPs covered by MPF schemes (i.e. 287 800))	8 200 (2.8%)	43 000 (14.9%)	51 200 (17.8%)
(b) Total monthly mandatory contributions			
Increase in total monthly employer (“ER”) contributions	\$13.39 million	\$67.06 million	\$80.45 million
Increase in total monthly EE contributions	\$13.39 million	\$67.06 million	\$80.45 million
Increase in total monthly SEP contributions	\$1.52 million	\$10.75 million	\$12.27 million
Total increase in monthly contributions	\$28.30 million	\$144.87 million	\$173.17 million
(c) Accrued benefits upon retirement per member ⁸			
Increase in accrued benefits upon retirement per EE member			
- ER contributions	\$126,500	\$174,100	\$163,800
- EE contributions	\$126,500	\$174,100	\$163,800
Total	\$253,000	\$348,200	\$327,600

⁷ The estimations are based on the assumption that the member is at the age of 35 and makes mandatory contributions for 30 years and the investment return is at 4.0% per annum (i.e. the same rate as the annualized internal rate of return of the MPF System for the period from 1 December 2000 to 30 September 2014).

⁸ The estimations are based on the assumption that the member is at the age of 35 and makes mandatory contributions for 30 years and the investment return is at 4.0% per annum (i.e. the same rate as the annualized internal rate of return of the MPF System for the period from 1 December 2000 to 30 September 2014).

EE/ SEP monthly earnings	\$30,001 – \$35,000	>\$35,000	>\$30,000
Increase in accrued benefits upon retirement per SEP member	\$128,800	\$174,100	\$166,800

Consultation Questions

1. *Do you support replacing the current discretionary adjustment mechanism with the proposed automatic mechanism for adjusting the Min RI Level and the Max RI Level?*
2. *If you support only some of the features (extent of automation, adjustment benchmarks, review and adjustment frequency, limits on adjustment magnitude and rounding mechanism) of the proposed mechanism, please explain your views in respect of those features that you do not support and suggest how and / or what modifications should be made.*

RESPONSE TO CONSULTATION QUESTIONS

1. Do you support replacing the current discretionary adjustment mechanism with the proposed automatic mechanism for adjusting the minimum level of relevant income (“Min RI Level”) and the maximum level of relevant income (“Max RI Level”)?

Yes

No

Please explain your views:

2. If you support only some of the features of the proposed mechanism, please explain your views in respect of those features that you do not support and suggest how and / or what modifications should be made.

Min RI Level

Please indicate which key features you support.

- (a) Automatic adjustment Support Not support
- (b) Adjustment benchmark (55% of the monthly median employment earnings (Foreign Domestic Helpers (“FDHs”) excluded)) Support Not support
- (c) 2-year review and adjustment frequency Support Not support
- (d) No limit on adjustment magnitude Support Not support
- (e) Round up to next \$100 Support Not support

In respect of those features that you do not support, please explain your views and suggest how and / or what modifications should be made:

Max RI Level

Please indicate which key features you support.

- (a) Automatic adjustment Support Not support
- (b) Adjustment benchmark (90th percentile earnings of the monthly employment earnings distribution (FDHs excluded)) Support Not support
- (c) 2-year review and adjustment frequency Support Not support
- (d) \$5,000 limit on increase magnitude Support Not support
- (e) Round to nearest \$2,500 Support Not support

In respect of those features that you do not support, please explain your views and suggest how and / or what modifications should be made:

3. Do you have any additional comments on the proposed mechanism for the Min RI Level or the Max RI Level?

Yes

Please explain your views:

No

Information of Respondent

(Please refer to the Personal Information Collection Statement on pages 4 and 5 of this Consultation Paper.)

Name (optional):

Organization (where applicable, optional):

Address (optional):