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Panel on Financial Affairs
Meeting on 6 July 2015

**Updated background brief on
adjustment mechanism for the minimum and maximum levels of relevant
income for Mandatory Provident Fund mandatory contributions**

Purpose

This paper provides background information on the adjustment mechanism for the minimum and maximum levels of relevant income ("Min RI" and "Max RI") for Mandatory Provident Fund ("MPF") mandatory contributions, the automatic adjustment mechanism proposed by the Mandatory Provident Fund Schemes Authority ("MPFA") in early 2015, and a summary of the major concerns and views expressed by Members on the subject when related matters were discussed by the relevant committees of the Legislative Council ("LegCo") after establishment of the statutory adjustment mechanism in 2002.

Background

Minimum and maximum levels of relevant income for MPF contributions

2. Under section 7A of the Mandatory Provident Fund Schemes Ordinance (Cap. 485) ("MPFSO"), each employee and employer has to contribute 5% of the relevant income as mandatory contributions, subject to the Min RI and Max RI levels as prescribed in Schedules 2 and 3 to MPFSO respectively. A relevant employee or self-employed person earning less than the Min RI level is not required to contribute to an MPF scheme while the employer of the employee still has to contribute for the employee. A relevant employee or self-employed person earning more than the Max RI level is not required to contribute to an MPF scheme in respect of the earnings in excess of that maximum level. The employer of the employee is also not required to contribute for the employee in excess of that maximum level.

Statutory adjustment mechanism for Min RI and Max RI levels

3. Section 10A¹ of MPFSO sets out the statutory adjustment mechanism which provides that MPFA must, not less than once in every four years, conduct a review of the Min and Max RI Levels. It further provides that MPFA must take into account the following two adjustment factors in conducting the review –

- (a) in respect of the Min RI level, 50% of the monthly median employment earnings ("50% of median earnings"); and
- (b) in respect of 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.

4. When the MPF System was first launched in December 2000, the statutory adjustment mechanism was not yet in place and the Min RI and Max RI levels were \$4,000 and \$20,000 per month respectively. With the establishment of the statutory adjustment mechanism (paragraph 3 above) through the enactment of the Mandatory Provident Fund Schemes (Amendment) (No. 2) Ordinance 2002 in July 2002, the Min RI was revised to \$5,000 per month, whereas the Max RI was retained at \$20,000 in view of the economic difficulties at the prevailing time.

Review of Min RI and Max RI levels

5. After establishment of the statutory adjustment mechanism in 2002, MPFA conducted the first and second reviews of the Min RI and Max RI levels in 2006³ and 2010⁴ respectively. During the second review in 2010, there were views that

¹ Introduced by the Mandatory Provident Fund Schemes (Amendment) Bill 2002, which was enacted as the Mandatory Provident Fund Schemes (Amendment) (No. 2) Ordinance 2002 in July 2002

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 statutory factors, MPFA proposed keeping the Min RI at \$5,000 per month and adjusting the Max RI from \$20,000 to \$30,000 under the first review in 2006. When the proposals were discussed at the meetings of the Panel on Financial Affairs on 5 January 2007 and 1 February 2007, views expressed by Panel members and the attending deputations were divergent. Having regard to all relevant factors and views, the Administration finally did not pursue any changes to the Max RI and Min RI.

⁴ For the second review in 2010, review findings showed that the Min RI should be increased from \$5,000 to \$5,500 per month, whereas the Max RI should be increased from \$20,000 to \$30,000 per month. MPFA did not make any recommendations to the Administration after the review but suggested consulting further with key stakeholders before arriving at policy decisions. Taking account of the views of members of the Panel on Financial Affairs and the community, the Administration finally put forward legislative proposals in 2011 to adjust the Min RI from \$5,000 to \$6,500, and the Max RI from \$20,000 to \$25,000. The Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 2) Notice 2011 and the Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 3) Notice 2011 were passed by LegCo on 30 June 2011 and 23 November 2011 respectively to give effects to the proposed adjustments.

the adjustment mechanism of the Min RI level should be updated having regard to the implementation of the Statutory Minimum Wage ("SMW") at the initial rate of \$28 per hour with effect from 1 May 2011. MPFA undertook to conduct a comprehensive review of the statutory adjustment mechanism when the actual impact of SMW became more evident.

6. In the light of adjustment of the SMW rate to \$30 per hour from 1 May 2013, MPFA conducted an interim review of the Min RI and Max RI levels in 2013, ahead of the third statutory review due in July 2014. Following the interim review, the Min RI and Max RI levels were adjusted to \$7,100 and \$30,000 per month respectively⁵, which are the Min RI and Max RI levels at present. A summary of statutory review results and past adjustments on the Min RI and Max RI levels is in **Appendix I**.

Public consultation in early 2015 on an automatic mechanism for adjusting Max RI and Min RI levels

7. Upon completing a review of the mechanism for adjusting the Max RI and Min RI levels, MPFA launched a public consultation⁶ from 23 January 2015 to 5 March 2015 on its proposals, among others, to introduce an automatic mechanism under which the Min RI and Max RI levels would be determined at the same time every two years in strict accordance with the proposed benchmarks and other components to be prescribed in MPFSO ("the proposed automatic adjustment mechanism"), set the benchmark for determining the Min RI Level at 55% of median earning of all employed persons (excluding foreign domestic helpers ("FDHs")) aged 18 to 64 (i.e. 55% of median earnings benchmark) rounded up to the next \$100, and 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. The key components of the proposed mechanism for public consultation are in **Appendix II**.

Concerns and views expressed by Members

8. MPFA consulted the Panel on Financial Affairs ("FA Panel") on the proposed automatic adjustment mechanism at the latter's meeting on 2 March 2015. Besides, Members have expressed views on issues relating to the Min RI and Max RI levels adjustment mechanism at meetings of FA Panel on 5 January and 1

⁵ The Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 2) Notice 2013 and the Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 3) Notice 2013 were passed by LegCo on 17 July 2013 to give effect to the proposed adjustments.

⁶ The consultation paper is hyperlinked in **Appendix III**.

February⁷ 2007, 21 February and 20 April⁸ 2011 and 4 March 2013; and during the scrutiny of the Mandatory Provident Fund Schemes (Amendment) Bill 2002, the Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 2) Notice 2011, the Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 3) Notice 2011, the Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 2) Notice 2013 and the Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 3) Notice 2013. The major views and concerns are summarized in the ensuing paragraphs.

Determination of the Min RI and Max RI levels

9. During previous reviews of the Min RI and Max RI levels, some LegCo Members expressed concerns about the difficulties faced by low income earners in making ends meet and the inadequacy of the MPF System in providing retirement protection to the workforce as a whole. While noting that raising the Min RI level would reduce the number of employees making MPF contributions and the accrued benefits available to scheme members upon retirement, these Members stressed the priority to address the immediate financial hardship of lower income earners. They called on MPFA/the Administration to review the adjustment mechanism, including examining whether 50% of median earnings was an appropriate threshold for determining the Min RI level, having regard to inflation, changes in employment earnings, introduction of SMW and the monthly income threshold or other criteria adopted for government schemes for low-income people. There was a suggestion that not less than 60% of the monthly median income should be adopted for the Min RI level so as to relieve the financial burden on low-income earners in making MPF contributions and enable them to have more disposable income for improving their immediate livelihood.

10. Given that the underlying premise of setting Min RI was to relieve employees or self-employed persons whose income was below a certain threshold from significant financial difficulties if they were required to make MPF contributions, and SMW was implemented to ensure the wages of the workforce in Hong Kong would not be too low, some LegCo Members opined that SMW should form the basis for determining Min RI. They considered that Min RI should be linked with SMW by working out a suitable methodology (like the use of median or a certain percentile) for translating SMW into a monthly income. There was also a suggestion that employees receiving SMW should be exempted from making MPF contributions.

⁷ Special meeting of FA Panel to receive views from deputations on the 2006 review of the Min RI and Max RI levels.

⁸ Special meeting of FA Panel to receive views from deputations on the 2010 review of the Min RI and Max RI levels.

11. Some other LegCo Members expressed concern that the financial burden on employers and employees would further increase if other contribution schemes (e.g. mandatory medical insurance scheme) were introduced in future. They opined that factors which might affect the operating costs of the business sector should also be taken into account when considering upward adjustment of the Max RI level, in particular, the impacts of implementation of SMW on the small and medium enterprises.

12. The Administration stressed that apart from the statutory adjustment factors, other relevant factors could also be taken into account when determining the Min RI and Max RI levels. During past reviews of the Min RI and Max RI levels, both the views of employees and employers were gauged through the Labour Advisory Board and other channels. The Administration was mindful of the need to give due regard to the prevailing economic situations and avoid additional burden on employers and employees. The Administration further pointed out that it was necessary to strike a balance between the short-term impact of complying with the statutory contribution requirements and the long-term retirement protection of MPF scheme members, and any change to the adjustment mechanism would require community-wide consultation and must not be resorted to lightly. The Administration also pointed out that MPFA had considered the SMW factor in its review after implementation of SMW.

13. At the FA Panel meeting on 2 March 2015, Panel members expressed support in general to adopt the proposed 55% of median earnings benchmark for determining the Min RI level as the proposed benchmark would be in line with the overall wage trend including changes to SMW rate. As regards the proposal to determine the Max RI level in strict accordance with the 90th percentile earnings, some Panel members conveyed the serious concern of the business sector that the proposal would reduce MPFA's flexibility to take into account other factors not explicitly set out in the legislation in determining the Max RI level. These members urged that MPFA and the Administration should consult the business sector, labour unions and the employees in the relevant groups on the proposal.

14. MPFA stressed that the consultation on the proposed automatic adjustment mechanism aimed to seek the views of the public and LegCo. If a consensus could be reached on the proposed automatic adjustment mechanism, including the parameters such as the benchmark factors, review frequency and the commencement date, the proposed mechanism would operate in a mechanical way and MPFA would administer the mechanism fully based on the relevant statistics and calculation formula without discretion. An automatic adjustment mechanism would facilitate prompt adjustment in the RI levels in line with economic development and would avoid delay which might be caused by lengthy debate after each review on whether the adjustments should be implemented fully. MPFA further advised that there were public comments in favour of a fully-automatic

adjustment regime in accordance with the proposed adjustment benchmarks as the resulting prompt adjustment would better follow the overall wage trend. On the other hand, in the absence of a consensus, the proposed mechanism would not be taken forward. While under the current proposal the adjustments in the Min and Max RI levels would be made automatically according to the proposed benchmarks, it was envisaged that changes to the Min RI and Max RI levels after implementation of the proposed mechanism would be subject to negative vetting procedures of LegCo.

15. As regards the proposal of capping each increase on the Max RI level at \$5,000, at the FA Panel meeting on 2 March 2015, some Panel members expressed concern that the cap would "suppress" the Max RI level resulting in a continued gap between the proposed benchmark and the Max RI level. On the other hand, some Panel members noted that based on the relevant data for the third quarter of 2014, it was envisaged that the Max RI level would be adjusted upward by the prescribed limit of \$5,000 in two successive reviews to reach the 90th percentile earnings of \$40,000. These members were concerned that given the unsatisfactory performance of MPF investments and that there could be better investment return if the employees were allowed to invest their earnings outside the MPF System, increase in the Max RI Level would not benefit employees.

16. MPFA advised that some members of the community considered that the proposed limit on the increase magnitude for the Max RI level acceptable as it would avoid substantial adjustment at a time. As regards concerns about investment returns from MPF schemes, MPFA pointed out that the returns would depend on factors including the investment options chosen by individual scheme members and the scheme/fund structure. MPFA further clarified that the adjustment magnitude of the Max RI level would depend on the data of the prevailing 90th percentile earnings at the time of the review. The situation referred to by members in paragraph 15 above was only based on the relevant data for the third quarter of 2014 provided by the Census and Statistics Department.

Review cycle

17. Noting that the existing MPFSO only required MPFA to review the Min RI and Max RI Levels at least once in every four years but did not prescribe the frequency of the review, some LegCo Members opined that the Administration should conduct the review more frequently, say, once every two to three years, to enable more timely adjustments to the relevant income levels. There was also a view that the timing of review should synchronize with that of the SMW rate which was currently reviewed every two years.

18. On MPFA's proposal put forward in early 2015 of reviewing the Min RI and Max RI levels once every two years, at the FA Panel meeting on 2 March 2015,

some Panel members expressed support for the proposal as it would enable the reviews/adjustments to be made in a more disciplined manner. On the other hand, some Panel members urged that MPFA should pursue annual review. These members were of the view that conducting annual review of the Min RI and Max RI levels would not only ensure the levels could track changes in the economic conditions and wages more closely, but also have positive impact on the ongoing efforts of the labour sector in fighting for annual review of the SMW rate.

19. MPFA advised that the proposal of adjusting the Min RI and Max RI Levels once every two years was put forward after striking a balance between tracking socio-economic conditions and the administrative/operational work required of service providers and employers. Annual review would create more administrative work and hence increase the costs of the MPF System. MPFA also pointed out that the review/adjustment frequency for the Min RI and Max RI Levels and that for the SMW rate were different matters and their adjustment mechanisms were prescribed in separate legislation.

Legislative timeframe for revising the Min RI and Max RI levels

20. Some LegCo Members enquired about the basis for determining the implementation dates for adjusting the Min RI/Max RI levels, and raised concern whether the timeframe to enact revised Min RI could be shortened so that workers whose income had been increased resulting from implementation of SMW would not be required to make MPF contributions if their income did not exceed the Min RI level. Moreover, expediting the implementation of Min RI would help lessen the financial burden of MPF contribution on low-paid employees. Some LegCo Members also questioned the rationale for implementing revised Max RI in phases while implementing revised Min RI in one-go when adjustments were made to both the Min RI and Max RI levels in past reviews. They also urged the Administration to consult relevant stakeholders as to whether a one-off or phased approach should be made when adjusting the Max RI level. Furthermore, Members noted that while some employees might be against early implementation of revised Max RI as they needed to pay extra contribution if the implementation schedule for Max RI was advanced, some employees saw the merit of accumulating more retirement benefits in the longer term as there would also be a corresponding increase in MPF contributions from their employers.

21. The Administration responded that adjustment of the Min RI and Max RI levels had to go through necessary legislative procedures, and the proposed implementation dates for adjustment aimed to allow reasonable time for employers and trustees to adjust the payroll systems and MPF scheme administration systems, and for MPFA to publicize such arrangements, regardless of whether the adjustments involved were simple or complicated in nature. While a staggered implementation schedules for Min RI and Max RI might necessitate extra efforts in

changing the systems and procedures concerned, the Administration considered it a reasonable arrangement to address employees' concern about reduction of disposable income and employers' concern on increased business cost arising from upward adjustment of Max RI.

Latest developments

22. The Administration and MPFA will brief FA Panel on the outcome of the public consultation on the proposed automatic adjustment mechanism and the recommended way forward at the meeting on 6 July 2015.

Relevant papers

23. A list of relevant papers is in **Appendix III**.

Council Business Division 1
Legislative Council Secretariat
30 June 2015

Summary of statutory review results and past adjustments to the minimum and maximum levels of relevant income

Year	Event	Monthly relevant income			
		Review results		Implementation	
		Minimum level	Maximum level	Minimum level	Maximum level
2000	Inception of the MPF System	-	-	HK\$4,000	HK\$20,000
2002	Review of the levels of relevant income and incorporation of section 10A to Mandatory Provident Fund Schemes Ordinance ("MPFSO") through enactment of Mandatory Provident Fund Schemes (Amendment) Ordinance 2002	HK\$5,000	HK\$30,000	HK\$5,000 (implemented in 2003)	HK\$20,000 (no change)
2006	First statutory review pursuant to section 10A of MPFSO	HK\$5,000	HK\$30,000	HK\$5,000 (no change)	HK\$20,000 (no change)
2010	Second statutory review pursuant to section 10A of MPFSO ^(Note)	HK\$5,500	HK\$30,000	HK\$6,500 (implemented in 2011)	HK\$25,000 (implemented in 2012)
2013	Interim review in light of the new Statutory Minimum Wage rate	HK\$7,100	HK\$30,000	HK\$7,100 (implemented in 2013)	HK\$30,000 (implemented in 2014)

Note: In this statutory review, the Mandatory Provident Fund Schemes Authority did not make recommendations to the Administration but suggested consulting the stakeholders on their views taking into account the introduction of the statutory minimum wage regime.

[Source: Adapted from Table 2 of Information note on "Minimum and Maximum levels of relevant income for Mandatory Provident Fund contributions" prepared by the Legislative Council Secretariat for the meeting of the Panel on Financial Affairs on 4 March 2013 (LC Paper No. IN09/12-13).]

Key components of the automatic mechanism for adjustment of minimum and maximum levels of relevant income ("Min RI" and "Max RI") proposed by Mandatory Provident Fund Schemes Authority ("MPFA")

1. Adjustment approach & review/adjustment frequency

- The proposed adjustment mechanism is an automatic one under which the Min RI and Max RI would be determined at the same time every two years in strict accordance with the proposed adjustment benchmarks and other components to be prescribed in the Mandatory Provident Fund Schemes Ordinance (Cap. 485).

2. Adjustment benchmarks

Min RI Level

- The proposed adjustment benchmark would be 55% of the monthly median employment earnings of all employed persons (excluding foreign domestic helpers) aged 18 to 64.
- Compared with the existing adjustment benchmark of 50% of the monthly median employment earnings, the new adjustment benchmark would incorporate a 5% gross up to ensure that after paying the 5% employee mandatory contributions, lower income workers would still have take-home pay equal to at least 50% of the monthly median employment earnings.

Max RI Level

- The proposed adjustment benchmark would be the 90th percentile of the monthly employment earnings distribution of all employed persons (excluding foreign domestic helpers) aged 18 to 64.
- The exclusion of the earnings of foreign domestic helpers from the earnings data for the determination of the two proposed benchmarks is expected to better reflect the earnings distribution of local workers who are intended to be covered by the Mandatory Provident Fund System.

3. Limit on adjustment magnitude

Min RI Level

- The Min RI Level would be adjusted downwards or upwards in strict accordance with the adjustment benchmark.

Max RI Level

- The Max RI Level would be adjusted downwards in strict accordance with the adjustment benchmark. However, every upward adjustment would be subject to a \$5,000 limit on the magnitude of the increase, thereby striking a balance between helping the working population accumulate more retirement savings and not seriously aggravating the financial burden on employers and employees at any single point in time.

4. Rounding mechanism

Min RI Level

- The adjustment benchmark is proposed to be rounded up to the next \$100.

Max RI Level

- The adjustment benchmark is proposed to be rounded to the nearest \$2,500.

[Source: Extracted from the press release entitled "MPFA to consult the public on introducing an automatic adjustment mechanism for relevant income levels" issued by MPFA on 23 January 2015.]

List of relevant papers

Date	Event	Papers/Minutes of meeting
12 July 2002	The Legislative Council ("LegCo") passed the Mandatory Provident Fund Schemes (Amendment) Bill 2002	Hansard (page 39 - 105) The Bill passed Report of the Bills Committee (LC Paper No. CB(1)2114/01-02)
5 January 2007	Meeting of the Panel on Financial Affairs ("FA Panel")	Discussion paper (LC Paper No. CB(1)602/06-07(03)) Background brief (LC Paper No. CB(1)603/06-07) Minutes (paragraphs 7 - 42) (LC Paper No. CB(1)976/06-07)
1 February 2007	Special meeting of the FA Panel	Updated background brief (LC Paper No. CB(1)820/06-07) Minutes (paragraphs 1 - 40) (LC Paper No. CB(1)1231/06-07)
21 February 2011	Meeting of the FA Panel	Discussion paper (LC Paper No. CB(1)1291/10-11(01)) Background brief (LC Paper No. CB(1)1290/10-11) Minutes (paragraphs 33 - 58) (LC Paper No. CB(1)1853/10-11)
2 March 2011	Council meeting	Hon Mrs Regina IP LAU Suk-ye raised a written question on "Minimum level of relevant income for Mandatory Provident Fund contributions"

Date	Event	Papers/Minutes of meeting
20 April 2011	Special meeting of the FA Panel	Administration's paper (LC Paper No. CB(1)1291/10-11(01)) Minutes (paragraphs 1 - 45) (LC Paper No. CB(1)2871/10-11)
June 2011	The relevant subcommittee studied the Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 2) Notice 2011	Report of the Subcommittee (LC Paper No. CB(1)2599/10-11)
30 June 2011	LegCo approved the Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 2) Notice 2011	Hansard (page 56 - 103)
June to October 2011	The relevant subcommittee studied the Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 3) Notice 2011	Report of the Subcommittee (LC Paper No. CB(1)241/11-12)
23 November 2011	LegCo approved the Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 3) Notice 2011	Hansard (page 133 - 195)
4 March 2013	Meeting of the FA Panel	Administration's paper (LC Paper No. CB(1)599/12-13(05)) Information note (LC Paper No. IN09/12-13) Minutes (paragraphs 21 - 30) (LC Paper No. CB(1)1131/12-13)

Date	Event	Papers/Minutes of meeting
June 2013	The relevant subcommittee studied the Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 2) Notice 2013 and the Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 3) Notice 2013	Report of the Subcommittee (LC Paper No. CB(1)1478/12-13)
17 July 2013	LegCo approved the Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 2) Notice 2013 and the Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 3) Notice 2013	Hansard (page 249 - 305)
23 January 2015 to 5 March 2015	The Mandatory Provident Fund Schemes Authority launched a public consultation on the proposal to introduce an automatic mechanism for adjusting the minimum and maximum levels of relevant income	Press release Consultation paper
2 March 2015	Meeting of the FA Panel	Administration's paper (LC Paper No. CB(1)567/14-15(05)) Minutes (paragraphs 32 - 45) (LC Paper No. CB(1)844/14-15)