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Panel on Manpower and Panel on Financial Affairs

**Report of Joint Subcommittee to Study the Arrangement of Offsetting
Severance Payments and Long Service Payments
against Mandatory Provident Fund Accrued Benefits**

Purpose

This paper reports on the deliberations of the Joint Subcommittee to Study the Arrangement of Offsetting Severance Payments and Long Service Payments against Mandatory Provident Fund Accrued Benefits ("the Joint Subcommittee").

The Joint Subcommittee

2. The Joint Subcommittee was appointed by the Panel on Manpower and Panel on Financial Affairs on 2 March 2015 to study and review the arrangement of offsetting severance payments ("SP") and long service payments ("LSP") against Mandatory Provident Fund ("MPF") accrued benefits ("the offsetting arrangement") and other related policy issues, and to make recommendations where necessary. The terms of reference of the Joint Subcommittee are in **Appendix I**. The Joint Subcommittee commenced work in January 2016.

3. Hon SIN Chung-kai and Hon TANG Ka-piu were elected as Chairman and Deputy Chairman of the Joint Subcommittee respectively. The membership list of the Joint Subcommittee is in **Appendix II**. The Joint Subcommittee held a total of four meetings, and received views from 32 deputations on issues relating to the offsetting arrangement at two of these meetings. A list of the deputations which have given views to the Joint Subcommittee is in **Appendix III**. A list of relevant questions raised and motions moved at Council meetings and relevant papers relating to the offsetting issue is in **Appendix IV**.

Background

4. At present, there are provisions under the Employment Ordinance (Cap. 57) ("EO"), Mandatory Provident Fund Schemes Ordinance (Cap. 485) ("MPFSO") and Occupational Retirement Schemes Ordinance (Cap. 426) ("ORSO") permitting employers to offset their SP or LSP payable against accrued benefits attributable to their contributions to MPF or ORSO schemes.

SP and LSP under EO

5. SP and LSP were introduced under EO in 1974 and 1986 respectively. They seek to provide compensation to employees dismissed owing to redundancy or other reasons after having served the same employer for a certain period of time so as to help alleviate an employee's short-term financial hardship caused by loss of employment.

6. The amount of SP and LSP is calculated by according two-thirds of the last month's wages, or two-thirds of the average monthly wages in the last 12 months, for every year of service of an employee with the employer (service of an incomplete year should be calculated on a pro rata basis). The monthly wages for calculating SP or LSP is capped at \$22,500, while the maximum amount of SP or LSP payable to an employee is \$390,000. There is no limit on the number of reckonable years of service.

The MPF system

7. MPFSO provides that, among others, unless exempted, an employer and an employee must each contribute 5% of the employee's relevant income to a registered MPF scheme, subject to the maximum and minimum levels of monthly income for contribution purposes, currently at \$30,000 and \$7,100 respectively, which also apply to self-employed persons who have to contribute 5% of his relevant income.

The offsetting arrangement

8. MPFSO also empowers the making of regulations to permit withdrawal of accrued benefits arising from an employer's contributions for the purpose of offsetting SP or LSP payable to an employee under EO. Following enactment of MPFSO and subsequent amendments to sections 31I and 31Y of EO, if an employee becomes entitled to SP or LSP and accrued benefits attributable to his employer's contribution are being held in an MPF scheme, his SP or LSP can be offset against the accrued benefits. As for MPFSO, section 12A prescribes the procedures for paying accrued benefits under an MPF scheme to an employer (if the employer has already paid SP or LSP to the employee) and the procedures for paying accrued benefits under an MPF scheme to an employee (if the employer has not yet paid SP or LSP to the employee).

9. The Chief Executive ("CE") stated in his election manifesto that he would progressively reduce the proportion of accrued benefits attributable to employers' contributions that can be applied for the offsetting arrangement.

Deliberations of the Joint Subcommittee

Impact of offsetting arrangement on the workforce

10. Members note from the information provided by the Mandatory Provident Fund Schemes Authority ("MPFA") that between July 2001 and end-2014, MPF accrued benefits attributable to employers' contribution withdrawn for offsetting SP and LSP amounted to \$25 billion. In 2014, the relevant figure was \$3 billion¹. Of this amount, \$1.66 billion was for offsetting SP and \$1.35 billion for offsetting LSP, involving 15 600 employers (or 5.7% of all enrolled employers) and 43 500 employees (or 1.7% of all enrolled employees). The average offsetting amounts per employer and per employee were \$192,800 and \$69,200 respectively.

11. Some members note with concern that for those 43 500 employees affected by the offsetting arrangement in 2014, about 94% of the relevant employer's contributions were withdrawn for offsetting purposes. Moreover, a majority of the employees affected were elementary workers aged 48 to 54 and who were not required to make their own contributions for earning less than \$7,100 a month. These members have expressed grave concern about the substantial reduction in the MPF accrued benefits of these employees as a result of the offsetting arrangement. They consider the remaining accrued benefit insufficient for retirement protection.

12. Some members have pointed out that the purpose of MPF is to assist the working population to save for retirement, while SP and LSP are intended for meeting the short-term financial needs of employees who become unemployed under specific circumstances. As the purposes of SP and LSP are different from that of MPF, it is not appropriate to offset SP or LSP against accrued benefits arising from employers' contribution to MPF. Moreover, employers should be aware of the requirements regarding SP and LSP from the time they start the businesses. These members have strongly urged the Government to review the existing arrangement, with a view to abolishing the offsetting arrangement or removing it in phases so as to strengthen retirement protection for low-income employees.

¹ According to information on the MPFA website, the relevant figure was \$3.355 billion in 2015. Of this amount, \$1.779 billion was for offsetting SP and \$1.576 billion for offsetting LSP.

13. The Administration has advised that the MPF system aims to assist the employed population in accumulating retirement savings through contributions by both employers and employees so as to enhance retirement protection for the employed population in Hong Kong. Before the implementation of the MPF system in 2000, only about one-third of the Hong Kong workforce had some forms of retirement protection. The MPF system has enabled more than 2.5 million employees to save for their retirement. Together with other retirement protection schemes, around 90% of the working population has participated in a retirement protection scheme. In addition, scheme members may decide whether to top up retirement savings for better protection through voluntary contributions or other investments. As of May 2015, the annualized internal rate of return (net of management fees) of the MPF system since its inception was 5.1%² and the annualized change of the Consumer Price Index for the same period was 1.7%, reflecting the role of the MPF system in providing retirement protection for scheme members.

14. Some other members, however, have strong reservations against abolishing the offsetting arrangement. They have pointed out that the offsetting arrangement was a consensus reached after extensive consultation in enacting the MPF legislation. Employer groups agreed to support implementation of the MPF system on the understanding that the law would clearly permit offsetting between MPF accrued benefits and SP/LSP so that employers would not need to pay twice.

15. These members share the employer groups' concern that abolition of the offsetting mechanism would increase employers' financial burden and impact significantly on the business environment of the micro, small and medium enterprises ("SMEs"). The employer groups have advised the Joint Subcommittee that as a matter of fact, some employers adopt the offsetting arrangement to make provisions for SP and LSP. If the offsetting arrangement is abolished, enterprises will need to make additional reserve to meet financial accounting requirements. This may affect the cash flow and business operation of the enterprises. To evade the statutory obligations under EO to pay LSP to employees concerned if the offsetting arrangement is abolished, it is pointed out that some employers may only retain employees with less than five years' service. These employer groups consider it unfair to hold employers responsible for providing retirement protection for their employees, which is the responsibility of the Government. Instead, the Government should consider establishing a fund to assist SMEs to meet the extra payments of SP and LSP arising from the abolition. There is also a view submitted to the Joint Subcommittee that the abolition of the offsetting arrangement can be explored, if there is no retrospective effect on the MPF benefits accrued before the new law coming into operation.

² According to the information on the MPFA website, the relevant figure as of March 2016 was 2.6 %.

16. The Administration has explained that the offsetting arrangement actually predated the implementation of the MPF system. Before the implementation of the MPF system, employers were also allowed to offset SP/LSP from the accrued benefits derived from their contributions to the occupational retirement schemes for employees. During formulation of the current framework for the MPF system and related legislation, there had been extensive consultation and discussion among stakeholders before a consensus was finally reached for the extension of the offsetting arrangement to apply to MPF benefits. The Administration has stressed that the offsetting arrangement against the MPF accrued benefits is adopted after extensive consultation and balancing all relevant considerations, which is complicated and controversial, and there are still divergent views among different stakeholders on the matter.

17. The Administration has pointed out that while the impact of the offsetting arrangement on low-income employees is acknowledged, the impact of its abolition on the operation and affordability of enterprises should not be underestimated. In this regard, some members have requested the Administration to conduct the related impact assessment.

18. According to the Administration, the Labour Advisory Board exchanged views on the subject of offsetting arrangement at its meeting in December 2013, with employer and employee representatives holding widely divergent views. Given that the offsetting arrangement is a complicated issue which can be dealt with in different ways gradually and that different approaches would have varying impact on employers and employees, the Administration would need to continue to listen to the views of various sectors of the community through the existing platforms. It would consider and examine the issue in a holistic and careful manner before deciding on the way forward.

Refinement to the existing arrangements for SP/LSP and MPF

19. Having regard to the divergent views on the offsetting issue and the overlapping of SP/LSP and MPF for the purpose of retirement protection, some members take the view that instead of abolishing the offsetting arrangement, a review should be conducted to rationalize the relationship between SP/LSP and MPF. There is a view that the monthly cap for calculating SP/LSP should be raised from \$22,500 to \$30,000 in order to bring it in line with the maximum level of relevant monthly income for mandatory MPF contribution. The Administration has, however, advised that before the offsetting issue is tackled, an increase in the wage cap for calculating SP or LSP would result in an increase in the amount of accrued benefits in the employees' account subject to offsetting.

20. Some members have expressed concern that the management fees of the MPF schemes are generally on the high side, which would further erode the

retirement benefits of employees. They consider that the Government should introduce measures to refine the MPF system including reducing the fund management fees and administration cost so as to enhance the system for the purpose of providing better protection for retirement life.

21. Members are advised that since the inception of the MPF system, MPFA and the Administration have been pursuing various measures and planned initiatives to lower MPF fees and increase employees' control on investment made. Notably, following the implementation of the Employee Choice Arrangement in November 2012, which provides employees with greater autonomy in choosing MPF schemes, a number of funds have reduced their management fees. Currently, there are more than 170 low-fee funds available in the market and the average Fund Expense Ratio of all funds have dropped from 2.10% in 2007 to 1.65% in February 2015. Some members consider that the implementation of "full portability" in the long run will give scheme members full control over their MPF benefits, including their own contributions and those of their employers. This will facilitate further reduction of fees by market forces.

22. The Administration has advised that to facilitate greater scope for fee reduction, the Mandatory Provident Fund Schemes (Amendment) Bill 2015, which aims to introduce a highly standardized and fee-controlled Default Investment Strategy (previously called the "core fund") into the MPF system, was introduced into the Legislative Council on 25 November 2015 and passed at the Council meeting of 25 May 2016.

Way forward for dealing with the offsetting issue

23. Referring to CE's pledge in his election manifesto to progressively reduce the proportion of accrued benefits attributable to employers' contributions that can be applied for the offsetting arrangement, some members are of the view that CE should honour his pledge. Expressing strong disappointment and dissatisfaction at the Administration's failure to follow up the matter, these members have strongly called on the Administration to devise a concrete work plan and timetable for implementation.

24. According to the Administration, the offsetting arrangement is a very complicated issue which involves the interests of various stakeholders. Members are advised that the Commission on Poverty ("CoP") has launched a six-month public consultation exercise on retirement protection from 22 December 2015. Apart from addressing the retirement protection option to be adopted, the consultation document also reviews the operation of other pillars of retirement protection, including the offsetting arrangement. Purely from the perspective of retirement protection, CoP considers that the offsetting arrangement will undoubtedly give rise to benefits leakage from the MPF system, weakening its retirement protection function. The Administration has further advised that the offsetting issue is not simply a choice between

"keeping" or "abolishing" the arrangement. When reviewing the offsetting issue, it will also consider ways to rationalize the relationship between SP/LSP and MPF. The community should take the opportunity offered by the consultation to conduct thorough and in-depth discussions on the feasible options for addressing the offsetting issue.

25. The Administration has stressed that it is important to strike a balance between the interests of employers and employees. While it has a role to play in taking the issue forward, it maintains an open mind towards the offsetting issue. The views received in the public consultation exercise would be collated and analyzed to facilitate thorough and in-depth discussions on the feasible options and the way forward in respect of the offsetting issue, which is expected to be announced in the CE's 2017 Policy Address.

26. Some members have expressed grave concern that there would be insufficient time left for implementation by the current term Government, and there is no guarantee that the Government of the next term would continue with the work concerned. Some members have called on the Administration to abolish, as a first step, the offsetting arrangement for employees of government outsourced contractors and non-civil service contract staff as well as elementary workers. The Administration considers that as the offsetting issue should be considered holistically, it is inappropriate to abolish the offsetting arrangement for certain groups of employees at the moment.

Recommendations

27. The Joint Subcommittee urges the Administration to take into account the views and concerns expressed by members on all relevant issues raised by the Joint Subcommittee. Some members of the Joint Subcommittee recommend that, in taking forward the offsetting issue, the Administration should consider:

- (a) abolishing the offsetting arrangement or removing it in phases so as to strengthen retirement protection for low-income employees, say, by
 - (i) abolishing the offsetting arrangement for either SP or LSP; and
 - (ii) reducing the proportion of the offsetting amount;
- (b) as a first step, abolishing the offsetting arrangement for employees of government outsourced contractors and non-civil service contract staff as well as elementary workers;

- (c) establishing a fund to assist SMEs to meet the extra payments of SP and LSP arising from the abolition of the offsetting arrangement; and
- (d) conducting an impact assessment of abolishing the offsetting arrangement on the business environment.

28. Of the above recommendations, some members have reservations on items (a), (b) and (c).

29. Some members consider that there should be an alternative option in place when the offsetting arrangement is abolished and the Administration should shoulder certain responsibility in the matter.

30. The Joint Subcommittee also recommends that both Panels should consider to follow up the above issues with the Administration in the next term of the Legislative Council.

Advice sought

31. Members are invited to note the work and support the recommendations of the Joint Subcommittee.

Council Business Division 2
Legislative Council Secretariat
8 June 2016

Panel on Manpower and Panel on Financial Affairs

Joint Subcommittee

to Study the Arrangement of Offsetting Severance Payments and Long Service Payments against Mandatory Provident Fund Accrued Benefits

Terms of reference

To study and review the arrangement of offsetting severance payments and long service payments against Mandatory Provident Fund accrued benefits and other related policy issues, and to make recommendations where necessary.

Panel on Manpower and Panel on Financial Affairs

Joint Subcommittee

to Study the Arrangement of Offsetting Severance Payments and Long Service Payments against Mandatory Provident Fund Accrued Benefits

Chairman Hon SIN Chung-kai, SBS, JP

Deputy Chairman Hon TANG Ka-piu, JP

Members Hon LEE Cheuk-yan
Hon LEUNG Yiu-chung
Hon Abraham SHEK Lai-him, GBS, JP
Hon Tommy CHEUNG Yu-yan, GBS, JP
Hon Vincent FANG Kang, SBS, JP
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon Andrew LEUNG Kwan-yuen, GBS, JP
Hon WONG Ting-kwong, SBS, JP
Hon CHEUNG Kwok-che
Hon WONG Kwok-kin, SBS
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Hon LEUNG Kwok-hung
Hon CHAN Yuen-han, SBS, JP
Hon LEUNG Che-cheung, BBS, MH, JP
Hon Kenneth LEUNG
Dr Hon KWOK Ka-ki
Hon KWOK Wai-keung
Hon Christopher CHEUNG Wah-fung, SBS, JP
Hon POON Siu-ping, BBS, MH
Dr Hon CHIANG Lai-wan, JP
Hon CHUNG Kwok-pan

(Total : 24 members)

Clerk Miss Betty MA

Legal adviser Miss Joyce CHAN

Date 20 January 2016

Panel on Manpower and Panel on Financial Affairs

**Joint Subcommittee
to Study the Arrangement of Offsetting Severance Payments and
Long Service Payments against Mandatory Provident Fund Accrued Benefits**

List of organisations/individuals which/who have given oral representation to the
Joint Subcommittee

1. Kowloon Truck Merchants Association Ltd.
2. Labour Party
3. Mr Joseph CHAN, Member of Central and Western District Council
4. 公屋被迫遷戶關注組
5. The Democratic Party
6. Liberal Party
7. 前線員工權益關注組
8. Mr LAU Tak-ching, Lecturer, Department of Economics and Finance, Hang Seng Management College
9. Mr TAM Chiu-yin, Lecturer, Department of Economics and Finance, Hang Seng Management College
10. The Hong Kong Federation of Trade Unions Social Affairs Committee
11. The Hong Kong Federation of Trade Unions Rights & Benefits Committee
12. Federation of Hong Kong Industries
13. Hong Kong Small and Medium Enterprises Association Committee on Youth

14. Hong Kong Department Stores and Commercial Staff General Union
15. Hong Kong Taxi Owners' Association Ltd.
16. Hong Kong Air Cargo Terminals Employees Union
17. Hong Kong Construction Industry Employees General Union
18. Hong Kong Container Tractor Owner Association Ltd.
19. Hong Kong Catering Industry Association
20. Business and Professionals Alliance for Hong Kong Committee on Youth
21. Dr YUEN Wai-kee, Associate Head and Assistant Professor, Department of Economics & Finance, Hong Kong Shue Yan University
22. Dr POON Che-cheong, Associate Professor, Department of Economics & Finance, Hong Kong Shue Yan University
23. Hong Kong Federation of Restaurants & Related Trades
24. Association of Restaurant Managers
25. The Federation of Hong Kong & Kowloon Labour Unions
26. Neighbourhood and Worker's Service Centre
27. The Lion Rock Institute
28. Lok Ma Chau China-Hong Kong Freight Association
29. Kwai Chung Estate Labour Rights Concern Group
30. Kwai Chung Standard Working Hours Concern Group
31. Institution of Dining Art

32. Money, Power, and Fame

List of organisations/individual which/who have provided written views to the Joint Subcommittee

1. Pension without Desolation
2. The Chinese Manufacturers' Association of Hong Kong
3. The Chinese General Chamber of Commerce
4. Hong Kong Professional Teachers' Union
5. Hong Kong Blind Workers' Union
6. Hong Kong Confederation of Trade Unions
7. Miss LUK Wai-sum

Relevant papers on the arrangement of offsetting severance payments and long service payments against Mandatory Provident Fund accrued benefits

Committee	Date of meeting	Paper
Legislative Council	20.2.2013	Official Record of Proceedings (Question 15)
Legislative Council	22.1.2014	Official Record of Proceedings (Question 5)
Legislative Council	2.7.2014	Official Record of Proceedings (Question 4)
Legislative Council	27.5.2015	Official Record of Proceedings (Question 10)
Legislative Council	28.10.2015	Official Record of Proceedings (Questions 3 and 9)
Legislative Council	3.2.2016	Official Record of Proceedings (Question 18)
Legislative Council	4.5.2016	Official Record of Proceedings (Question 1)
Joint Subcommittee to Study the Arrangement of Offsetting Severance Payments and Long Service Payments against Mandatory Provident Fund Accrued Benefits	---	CB(2)923/15-16(01) CB(2)1595/15-16(01)