Research Office
Legislative Council Secretariat

Information Note

Severance and long service payments in selected places

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1. Introduction

1.1 In Hong Kong, severance payment ("SP") was introduced under the *Employment Ordinance* (Cap. 57) in 1974 to provide compensation to an employee who is dismissed or his or her contract is not being renewed by reason of redundancy, and has not less than 24 months of continuous services with the same employer prior to the termination.

1.2 In 1986, the *Employment Ordinance* was amended to introduce long service payment ("LSP") compensating an employee who is dismissed by reason other than redundancy after serving the same employer for a long period of time. An employer should pay LSP to an employee who has been employed under a continuous contract for not less than five years if the employee (a) is terminated by reasons other than redundancy or summary dismissal due to serious misconduct, (b) resigns on ground of ill health or old age (aged 65 or above), or (c) dies during employment.

1.3 When the Mandatory Provident Fund ("MPF") system came into operation in December 2000, the *Mandatory Provident Fund Schemes Ordinance* (Cap. 485) allows employers to offset the accrued benefits arising from their contributions under the MPF schemes against SP or LSP ("offsetting arrangement"). Before that, *the Employment Ordinance* already allowed employers to use contributions made to a retirement scheme or the end of contract gratuity to offset SP and LSP.

1.4 At its meeting on 18 November 2014, the Panel on Manpower requested the Research Office to provide information on the arrangement of SP and LSP in selected places. This information note first highlights the findings of a comprehensive report published by the World Bank in 2012 on the SP arrangement in 183 places around the world. It then discusses the specific SP arrangements in five Asia-Pacific economies, followed by a discussion of the LSP and offsetting arrangements in overseas places.

2. World Bank report

2.1 According to the World Bank report, "severance pay is quite likely the most widely applied compensation or income support program in the world – it exists in almost all countries across income levels in either mandated or voluntary form." Among the 183 places studied, 152 had mandated SP schemes (83%), 18 (10%) had quasi-mandated SP schemes through comprehensive collective agreements[1], and 13 (7%) had neither.

Eligibility requirement

2.2 SP scheme requires employers to make payments to workers upon separation from the firm. According to the World Bank report, some countries mandated SP for all types of separations. In other countries, some types of separation might disqualify workers. For example, workers dismissed as a result of misconduct (separated by their own fault) and those who voluntarily quit typically did not qualify for the entitlement. Other countries provided mandatory SP only to workers who were discharged for redundancy (economic) reasons but not for other valid reasons (dismissal); yet others mandated SP only for cases of collective dismissals or for certain groups of workers (such as white collar workers).

Benefit type and benefit level

2.3 Among the places studied by the World Bank, SP usually depended on years of service and last wage, and usually had a vesting period (i.e. a minimum number of months of employment were required for eligibility). Typically, each year of service was rewarded in proportion to the person's wage; for example, half of the monthly wage for each year of service.[2] More complex formulas existed in which compensation was adjusted according to years of service or age tiers. Under such structures, older workers or those with long service records were usually entitled to more generous SP.

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1 These places included developed economies such as the United States and New Zealand where there were no legal provisions for SP. Instead, SP was usually governed by the terms of collective agreement.

2 In Hong Kong, the amount of SP is two-thirds of last month's wage for each year of employment or two-thirds of HK$22,500, whichever is less, subject to a maximum payment not exceeding HK$390,000.

2.4 In some countries, the generosity of SP might differ by the type of separation (e.g. dismissal, redundancy, collective redundancy and end of service); between white and blue collar workers; between permanent and fixed-term workers; or between those covered by collective agreement and those not covered. In some countries, workers received a seniority premium depending on the reason for separation (usually in cases of non-fault dismissal). Some countries did not have explicit benefit formulas and left determination of SP, as well as the authorization to lay off workers, to special government bodies or court decisions.

Funding

2.5 In general, SP was financed by employers. In countries with individual accounts[3], workers might also contribute. In some countries, the government provided financial assistance, particularly for large-scale restructuring operations that involved worker retrenchment in mass layoffs.

3. Severance payment in selected Asia-Pacific economies

3.1 Five Asia-Pacific economies are selected for further analysis in this information note. Except Japan, all of them have mandatory SP system for dismissal or redundancy.

South Korea

3.2 In South Korea, an employee who has worked continuously for an employer for at least one year is entitled to SP under the mandatory SP system introduced in 1961.[4] SP is financed entirely by employers and given to those who have worked at least one year in the company, regardless of the reason for separation[5]. The statutory benefit of SP is at least one month of wage per year of service.

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3 In some countries, the World Bank report observed that firms (and sometimes workers themselves) were obliged by law to deposit SP contributions in individual savings accounts. These deposits then earned interests and were paid out either as a lump sum or in monthly payments.

4 According to the World Bank (2012), the SP system in South Korea, often called the retirement allowance system, was first introduced under Article 28 of the *Labor Standards Act* of 1953 as a way of guaranteeing income for the unemployed as well as retirees. The system was voluntary at first and has become mandatory after 1961.

5 The reasons for separation can be redundancy, resignation, retirement, closure of the company, dismissals (including disciplinary dismissal), and death of the employee during employment.

3.3 In December 2005, the South Korea government passed the *Employee Retirement Benefits Security Act* to provide an option for employers to convert their existing SP system into a corporate pension system[6]. The difference between the two systems is that the SP system is unfunded (even though it is supposed to be funded by employers from their current revenues) and involves lump-sum payments to separated workers, while the corporate pension system is funded by employers and involves annuity payments to retired workers.

3.4 In August 2014, the South Korea government announced to make corporate pension plans mandatory for bigger companies with at least 300 employees by January 2016. The requirement will gradually be extended to all companies by January 2022 at the latest. According to the government, the mandatory arrangement is to "allow employees to enjoy the superior benefit of retirement protection plans, compared to the severance pay they are receiving now."[7]

Taiwan

3.5 In Taiwan, dismissed employees are entitled to SP irrespective of the length of service. For those employees who have joined the labour pension scheme after the implementation of the *Labor Pension Act* in July 2005[8], they are entitled to both pension payment and SP. The latter is calculated at a rate of half-a-month wage for each year of service, subject to a payment ceiling equivalent to six months' wage. However, for those who have joined the "old pension scheme" before the implementation of the *Labor Pension Act*, the SP benefit is calculated at one month's wage for each year of service. In addition, they are entitled to receive either the pension contributions from their employer or SP upon termination of service.

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6 Nevertheless, Clause (3) of Article 4 of the *Employee Retirement Benefit Security Act* provides that "[i]f an employer intends to choose a type of retirement benefit scheme or change the chosen type into a different one, the employer shall, if there is a trade union composed of a majority of workers, obtain the consent of the trade union, and if there is no such trade union, obtain the consent of the majority of workers".

7 See Ministry of Strategy and Finance (2014).

8 A major pension reform took place in 2005 when Taiwan introduced the New Labor Pension System as a defined contribution scheme. The scheme is meant to solve the portability and underfunding problems of the old pension system.

Singapore

3.6 In Singapore, an employee who has worked continuously for an employer for at least 24 months is entitled to SP, or called "retrenchment benefits" in Singapore, as stipulated under the *Employment Act* enacted in 1968. However, the law does not lay down the exact amount of retrenchment benefits, which is subject to the negotiations between employer and employees. The prevailing norm in practice is to pay a retrenchment benefit varying between two weeks to one month's wage per year of service.

Australia

3.7 In Australia, the *Fair Work Act* enacted in 2009 stipulates that an employee who (a) has worked for an employer of a company with at least 15 employees; and (b) has at least one year of continuous service is eligible for redundancy payment if dismissed. SP entitlement varies with the length of service, starting from a total of four weeks of wage for employees having one to less than two years of continuous services to a maximum total of 16 weeks of wage for nine to less than 10 years of continuous service. However, for those workers who have continuous service of 10 years or more, SP entitlements are reduced to 12 weeks of wage when dismissed.[9]

Japan

3.8 In Japan, there is no mandatory legislation on SP. Yet it was reported that "almost all enterprises" in Japan still pay SP at the time of job termination, in accordance with employment contract or work rules.[10] According to a recent enterprise survey conducted in 2012, among the firms which offered SP to dismissed workers, 47% of them paid "six months or less" in their redundancy pay based on bilateral agreement, while 41% paid "six months or more".[11]

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9 Depending on the relevant State/Territory law, an employee may be entitled to long service leave after providing a period of continuous service of between seven and 15 years for the same employer. After working for the employer for 10 years, the employee is entitled to a payment in lieu of accrued long service leave in addition to SP when dismissed. To avoid the double counting, the Australian Industrial Relations Commission has made a decision to reduce the rate of SP to 12 weeks of wage for employees who have at least 10 years' continuous service. The Australian Industrial Relations Commission is an independent national tribunal dealing with employment issues. See Australian Industrial Relations Commission (2004).

10 See Japan External Trade Organization (2015).

11 See Sugeno and Yamakoshi (2014).

4. Long service payment in overseas places

4.1 The International Labour Organization conducted a study in 2013 on employment protection legislation in selected countries. Among the 95 countries studied, Switzerland and Indonesia were the only countries with statutory LSP.

4.2 In Switzerland, there is no general statutory SP or redundancy payment scheme. However, upon termination of the employment contract by either parties, a worker who is aged 50 or above and has 20 or more years of service with the same employer is entitled to LSP. The maximum amount of LSP payable to an employee is based on the bilateral agreement, ranging from two to eight months' wage. However, it may be reduced in part or cancelled if (a) the employee terminates his or her contract without proper justification, (b) the employer summarily dismisses him or her for valid reasons, or (c) the payment of this amount would result in difficulties for the employer.

4.3 In Indonesia, SP amounts to one month's wage for each year of service, up to a maximum of nine months' pay. In addition, there is LSP for reward of service equal to two months' pay for the first completed three years of service plus an additional one month's pay for each three completed years of service thereafter. For 24 or more years of service, the payment is capped at 10 months' pay.

5. Offsetting arrangement in overseas places

5.1 In the study conducted by the International Labour Organization in 2013, there was no discussion of offsetting arrangement between SP/LP and retirement benefits in the countries covered[12]. Likewise, this information note has not observed similar offsetting arrangement in the five Asia-Pacific economies studied based on the information available.

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[12] The Research Office has written to the International Labour Organization requesting for information about the availability of offsetting arrangement between SP/LP and retirement benefits in its member countries. As at the publication of this information note, the International Labour Organization has not responded to the request.

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