Retirement Protection Forging Ahead

Executive Summary

Commission on Poverty
December 2015

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This Executive Summary is extracted from the "Retirement Protection   Forging Ahead" Consultation Document to provide readers with a quick and handy reference of the key issues in this consultation. If readers are interested in the more detailed policy and data analyses, please refer to the Consultation Document.

Preface

Retirement protection was last widely debated by the Hong Kong community in the early 1990s. With the enactment of the Mandatory Provident Fund (MPF) Schemes Ordinance by the Legislative Council in 1995, a retirement savings system mandating employer and employee contributions was established in 2000. This was a milestone for the development of retirement protection in Hong Kong.

Given the existing contribution rates and scheme coverage, the MPF alone cannot fully address retirement protection for the elderly. In fact, Hong Kong has adopted a multi-pillar model advocated by the World Bank. Under this model, working people can use mandatory MPF contributions from employers and employees to prepare for their retirement. Elderly people also enjoy the protection offered by other pillars such as social security schemes funded by tax revenue, voluntary savings or family support, as well as various housing, healthcare and welfare services provided by the Government. Despite these, there have been repeated calls from the community over the years for a universal retirement protection system (i.e. a uniform monthly pension for all those aged 65 or above regardless of financial means).

Poverty alleviation and care for the elderly are key policy priorities of the current-term Government. Retirement protection and elderly poverty are closely linked. The Chief Executive stated in his Election Manifesto that the Government would study "how to introduce short, medium and long-term measures to solve the problem of elderly poverty and improve the present social security and retirement protection systems". While the Old Age Living Allowance introduced by this Government in 2013 already benefits over 420 000 people, we remain determined and committed to enhancing the well-being of our elderly people. As such, the Commission on Poverty (CoP) has been tasked to identify ways to enhance retirement protection in Hong Kong with a view to better addressing the financial difficulties facing elderly people. This is the background of this public consultation exercise.

This consultation on retirement protection has several unique features:

(1) The consultation is carried out under the name of the CoP. The stance and contents of this consultation document have been endorsed by CoP members from a diversity of backgrounds. As the Chairperson of the CoP, I have endeavoured to be objective and impartial throughout the deliberations, and guided discussion in a way to help members build consensus. Yet, there remain divergent views on some of the more controversial issues. These have been presented in full and truthful terms in this consultation document;

(2) Likewise, in handling social issues with such far-reaching implications, as a responsible government, we have to clearly explain the Government's position to Hong Kong people. In a nutshell, the Government has reservations about any options that are not means-tested and apply equally to all the elderly regardless of being rich or poor. Nonetheless, we agree that the existing retirement protection system has room for improvement. We naturally do not wish to see our retirement protection efforts coming to a standstill, and for Hong Kong, once again, to be paralysed by polarised views;

(3) As our retirement protection system will affect the interests of many generations, the consultation exercise has to penetrate deeply into all strata, sectors and age groups, in particular young students. Therefore, we have set aside a relatively longer period of six months to listen to a wide cross-section of public views. My government colleagues and I, together with CoP members, will reach out to the community and young people through various channels, including social media, with a view to stimulating public discussion of the issue in a rational and pragmatic manner; and

(4) On whether the "regardless of rich or poor" principle or the "those with financial needs" principle should be adopted to strengthen retirement protection, the consultation document provides simulated options to help make meaningful comparisons in terms of financial commitments and the impact on public finances. I hope that members of the public will find the detailed data useful when they discuss this controversial issue.

Another contentious issue which needs to be addressed is the "offsetting" arrangement of the MPF. The Chief Executive stated in his Election Manifesto that we should "adopt measures to progressively reduce the proportion of accrued benefits attributed to employer's contribution in the MPF account that can be applied by the employer to offset long service or severance payments". After detailed deliberations, the CoP considers that the complexity of the "offsetting" issue should not be underestimated. The CoP agrees that the community should make good use of this consultation to conduct thorough and in-depth discussion on the impact of feasible options to address the "offsetting" issue on employers and employees as well as the role of

the Government. We should strive to find an option that is acceptable to both employers and employees so as to protect the interests of low-income people and further strengthen the MPF pillar and retirement protection system as a whole.

Given their diverse backgrounds, it is understandable that CoP members have a particular stance on the above two highly controversial issues. The fact that the drafting of this consultation document could be completed in a timely manner owed much to the inclusiveness and commitment to Hong Kong of CoP members who tried to narrow differences and maximise common ground. I am greatly indebted to them in this respect. I would also like to extend my gratitude to the team led by Professor Nelson Chow for completing the research report on the future development of retirement protection, which has provided a useful basis for the preparation of this consultation document.

Lastly, I appeal to all members of the community to express your views through various channels over the next six months. Your input will help the Government and the CoP better address the issue of retirement protection.

Carrie Lam

Mrs Carrie Lam
Chairperson of the Commission on Poverty

Background

1. According to the latest population projections, the elderly population in Hong Kong will continue to grow over the coming some 40 years. By then, the elderly population will be more than doubled from the existing one million or so. Hong Kong people are also living longer. Among the elderly people now aged 65, 60% are expected to live to the age of 85 or above and 40% to over 90. Retirement protection is an essential element in providing security for the elderly people. It is an issue that the whole community has to face and tackle through shared responsibility.

2. Hong Kong's retirement protection system is still evolving. Major developments in the past include the introduction of the Mandatory Provident Fund (MPF) System 15 years ago and the launch of the Old Age Living Allowance (OALA) shortly after this Government started its term. There are constant calls for improving the retirement protection system, but views are divergent as to what improvements are needed and how the financial commitments arising from the improvement measures can be met. Some consider that the existing means-tested schemes should be enhanced to help the elderly in need (the "those with financial needs" principle). Others suggest that a non-means tested and uniform payment should be provided for all elderly people (the "regardless of rich or poor" principle).

3. Retirement protection and elderly poverty are inextricably linked. The Chief Executive stated in his Election Manifesto that the Government would "study how to introduce short, medium and long-term measures to solve the problem of elderly poverty and improve the present social security and retirement protection systems". The current-term Government has launched the OALA and enhanced a number of elderly services relating to welfare, healthcare and transport. Nevertheless, further improvement to the retirement protection system is still necessary to better prepare the Hong Kong community for the challenge of an ageing population.

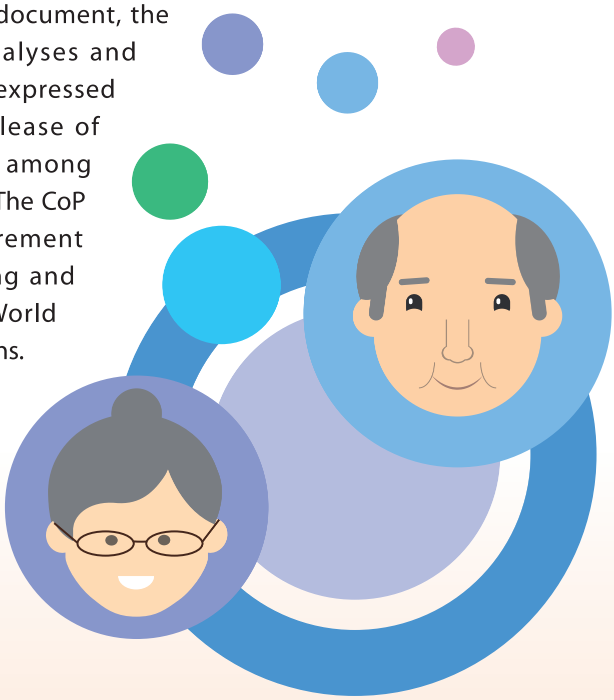
4. In May 2013, the Commission on Poverty (CoP) chaired by the Chief Secretary for Administration commissioned the team led by Professor Nelson Chow (the Research Team) to study the future development of retirement protection. In August 2014, the research report (the Report) was released for public discussion. In January this year, the Chief Executive stated in the Policy Address that the CoP would launch a public consultation on retirement protection in the latter half of 2015 and $50 billion would be set aside to demonstrate the Government's determination in and commitment to improving the protection for needy residents after retirement. The terms of reference and membership of the CoP are at Annex A.

Scope and purpose of the consultation

5. This consultation is conducted in the name of the CoP. The CoP, however, considers that the scope of consultation should not be limited to the pillar which covers the social security programmes provided by the Government (i.e. the zero pillar). As retirement protection covers different aspects, it would be difficult to address elderly poverty and other retirement protection problems through one single pillar. If other pillars (e.g. the MPF and voluntary savings) can assume stronger retirement protection functions, this can, in the long run, help reduce the retirees' reliance on the social security pillar, thus effectively alleviating the pressure imposed by an ageing population on public finances and maintaining the sustainability of the whole system. This is in line with the concept of the multi-pillar model advocated by the World Bank.

6. The CoP acknowledges that some elderly people are not adequately cared for under the existing retirement protection system. How better protection can be provided for these elderly people — whether to adopt the "regardless of rich or poor" principle or the "those with financial needs" principle — is the core issue to be dealt with in this consultation. Apart from income protection, the discussion should also cover protection in other aspects, like medical or long-term care services.

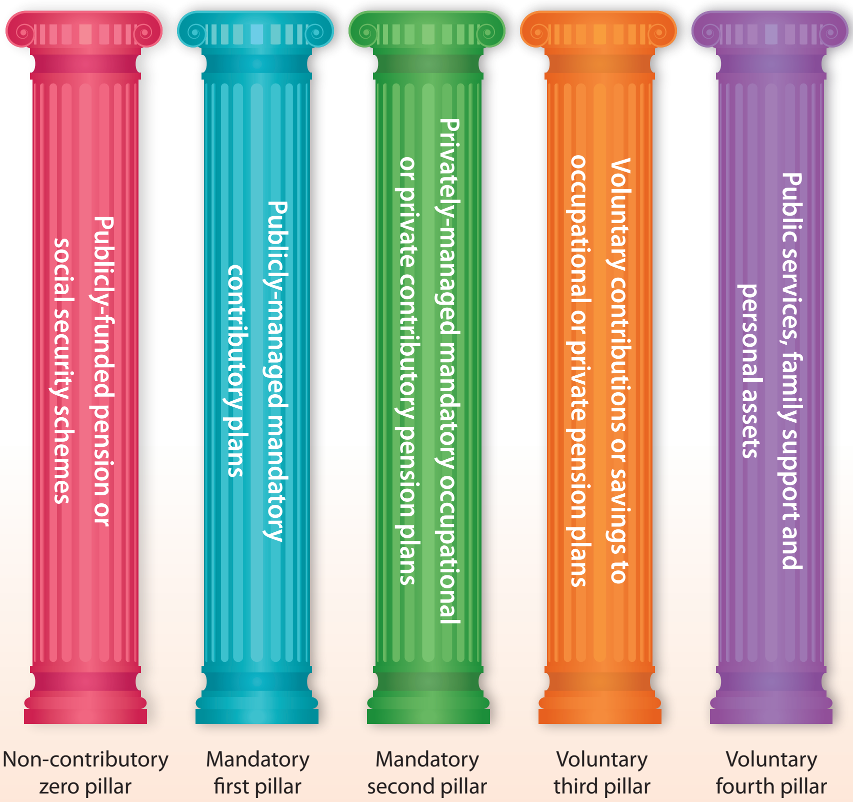
7. When drafting the consultation document, the CoP made reference to the analyses and proposals in the Report, views expressed in the community after the release of the Report, and the discussion among members of the CoP in the past. The CoP also reviewed the existing retirement protection system in Hong Kong and studied the experience of the World Bank and other overseas jurisdictions. Based on the latest population and labour force projection data, the CoP updated and projected the impact of different options on our public finances for the next 50 years, and estimated the additional burden to be borne by employers and employees.



World Bank's multi-pillar model

8. To help different places conduct systematic analyses and comparisons, the World Bank proposed a three-pillar retirement protection framework in 1994 and refined it in 2005 by proposing a more detailed classification of five pillars (see Diagram 1). According to the World Bank, the core objectives of pension systems are to protect people against the risk of poverty in old age and through savings to maintain a standard of living similar to that before retirement. The World Bank considers that accumulating enough reserves for retirement is a complex issue. Therefore, we have to adopt a multi-pronged approach and establish multiple sources of savings or income for retirement. As each pillar has its own purposes, target groups and financial sources, a multi-pillar model can better serve the needs of different elderly groups. At the same time, it is noteworthy that the World Bank does not indicate that a comprehensive retirement protection system should comprise all five pillars. On the contrary, the World Bank stresses that there is no single system that is suitable for all places. Each place should find its way forward in light of its inherited retirement protection system, the need for reform and whether the conditions are favourable for reform.

Diagram 1: World Bank's multi-pillar model



Source: World Bank

Hong Kong's multi-pillar system

9. Based on the multi-pillar model advocated by the World Bank, the retirement protection system in Hong Kong is made up of a number of schemes. It comprises four pillars. The system advocates that those who have the ability to work should become self-reliant, and the Government's role is to provide assistance for the elderly who cannot financially support themselves. In other words, the working population save and plan for their and their families' retirement life through mandatory contributions to MPF schemes, voluntary savings, retirement investments, etc. (i.e. the second, third and fourth pillars). The Government, on the other hand, redistributes wealth through tax receipts to finance social security schemes which serve as a social safety net or provide a supplement for the needy elderly (i.e. the zero pillar), and to heavily subsidise services like public housing, healthcare and residential and community care, etc. to meet the daily needs of the elderly (i.e. the fourth pillar). This arrangement can better ensure the long-term sustainability of the system in light of the ageing population and the need to maintain a simple tax regime with low tax rates (see Diagram 2).

Diagram 2: Multi-pillar system in Hong Kong

	Zero pillar	First pillar	Second pillar	Third pillar	Fourth pillar
Five pillars of the World Bank	Publicly-funded pension or social security schemes (non-means-tested or means-tested)	Publicly-managed mandatory contributory plans (largely financed on a pay-as-you-go (PAYG) basis)	Privately-managed mandatory occupational or private contributory pension plans	Voluntary contributions or savings to occupational or private pension plans	Public services, family support and personal assets
Retirement protection system in Hong Kong	Comprehensive Social Security Assistance (CSSA)*; OALA; Old Age Allowance (OAA); Guangdong Scheme; Disability Allowance (DA)	Nil	Mandatory contributions to MPF schemes; occupational retirement schemes; civil service pensions; Grant/Subsidised Schools Provident Funds	Voluntary contributions to MPF schemes; retirement savings-related insurance	Public housing; public healthcare; residential and community care services; elderly health care vouchers; public transport fare concession; family support; self-owned properties

Note: (*) Including the Portable CSSA Scheme.
Source: World Bank and relevant policy bureaux

10. The CoP considers that Hong Kong should continue to adopt the multi-pillar model in providing diversified sources to deliver retirement savings and income, to be complemented by a range of public services. To realise the established philosophy

behind our social welfare and public finance management policies, the CoP is of the view that the following inherited values and principles treasured by our community should be preserved in the retirement protection system of Hong Kong:

(a) Realising self-reliance through continuous employment and savings;

(b) Encouraging mutual support among family members; and

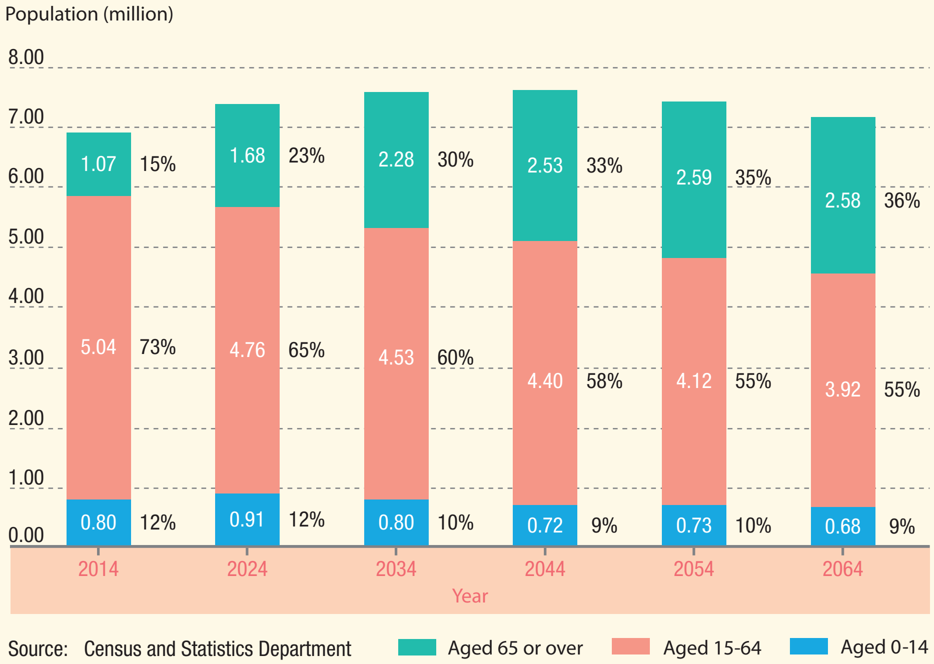
(c) Providing a social safety net for elderly people in need.

How to approach the issue

11. The CoP considers that the community can approach the issue of retirement protection from different perspectives. First, **concepts and principles**. Which direction should Hong Kong's retirement protection system continue to move towards? If providing better protection for the elderly in need is the goal of the reform, whether the "regardless of rich or poor" principle or the "those with financial needs" principle can better realise the concept of poverty alleviation? Which principle can better achieve the objectives, namely adequacy, sustainability, affordability and robustness, advocated by the World Bank? These are the questions that we cannot evade.

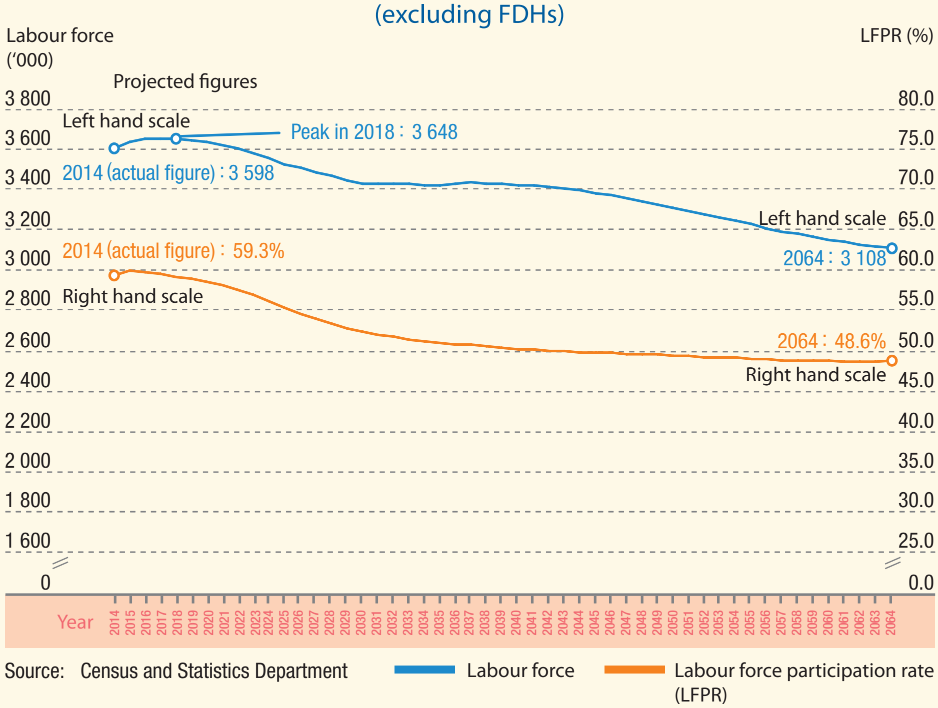
12. Second, **demographic changes**. The latest population projections reaffirm that the population ageing problem in Hong Kong is very acute. While the overall population is expected to decline from the mid-2040's onward, the trend of population ageing will persist. The share of elderly (aged 65 or above) in the total population will increase from 15.4% (or 1.07 million) in 2014 to 35.9% (or 2.58 million) in 2064. In contrast, the share of younger people (aged 15 to 64) will drop significantly from 73.0% (or 5.04 million) in 2014 to 54.6% (or 3.92 million) in 2064 (see Diagram 3). Younger people are the mainstay of the labour force. Along with the drastic reduction of people in this age group, the labour force, after a slight increase from 3.6 million in 2014 to a peak of 3.65 million in 2018, will decrease continuously and down to 3.11 million in 2064 (see Diagram 4). The dependency ratio will worsen further from 371 children and elderly people per 1 000 people of working age in 2014 to 831 in 2064 (see Diagram 5). With declining younger population and growing elderly population, as well as longer life expectancy of the elderly, a retirement protection system which relies heavily on future generations to support the elderly is difficult to maintain its financial sustainability. Having regard to the future demographics, how to ensure the sustainability of a retirement protection system; how to distribute the responsibility of supporting the elderly among individuals, families and the community in a fair and effective manner; and how to balance the interests across different generations are the issues that the community should examine collectively.

Diagram 3: Growing elderly population and declining younger population (excluding foreign domestic helpers (FDHs))



Source: Census and Statistics Department

Diagram 4: Labour force starts to shrink after reaching the peak in 2018 (excluding FDHs)



Source: Census and Statistics Department

Diagram 5: Worsening dependency ratio (excluding FDHs)

	Child dependency ratio	Elderly dependency ratio	Overall dependency ratio
2014	159	211	371
2024	192	353	546
2034	176	505	680
2044	163	574	738
2054	177	629	806
2064	173	658	831

= 100 children   = 100 elderly people

Notes : Child dependency ratio refers to the number of persons aged under 15 per 1 000 persons aged 15 to 64. Elderly dependency ratio refers to the number of persons aged 65 or over per 1 000 persons aged 15 to 64. Child dependency ratio and elderly dependency ratio may not add up to overall dependency ratio due to rounding.

Source: Census and Statistics Department

13. Third, **impact on public finances and utilisation of resources**. In 2014-15, the total government recurrent expenditure on the elderly (excluding public housing) was about $55.3 billion, accounting for about 20% of the total government recurrent expenditure. In other words, in every $5 of recurrent expenditure, about $1 was spent on helping the elderly. Such expenditure mainly included:

    (a) $24.1 billion on elderly social security programmes (an increase of 70% over 2010-11)[1];

    (b) $23.9 billion on public healthcare services for the elderly (an increase of 39% over 2010-11);

    (c) $6.2 billion on residential and community care services for the elderly (an increase of 57% over 2010-11); and

    (d) $1.1 billion on the Elderly Health Care Voucher Scheme and the public transport fare concession scheme (an increase of 846%[2] over 2010-11).

1 Excluding the one-off relief measures as announced in the Budget.

2 As the public transport fare concession scheme was not launched until June 2012, the percentage here only reflects the increase in expenditure of the Elderly Health Care Voucher Scheme over the period from 2010-11 to 2014-15.

14. Basing only on the growth of the elderly population, discounting the factor of inflation and assuming that there is no service improvement, the Government estimates that the elderly expenditure in 2064 will be two to four times the current expenditure (see Diagram 6). On the other hand, the shrinkage of the labour force will constrain the overall economic growth. It will adversely affect the Government's tax revenue and other incomes, increasing the risk of budget deficits. The Working Group on Long-Term Fiscal Planning released a report on fiscal sustainability assessment on public finances in March 2014. It anticipates that if government expenditure keeps growing faster than government revenue and economic growth for a long period, the Government may start facing a structural deficit problem around 2029-30 (i.e. within 14 years from now). Unless the expenditure on other public services and policy areas is reduced, it is highly likely that the Government will have to raise taxes or introduce new taxes to tackle the deficit problem. The implementation of any retirement protection proposal that involves extra public resources will surely bring additional pressure on public finances. How to avoid creating unbearable financial burden for the community while optimising the use of limited resources to help the elderly in need in a targeted and effective way is one of the key considerations in dealing with retirement protection.

Diagram 6: Elderly expenditure will be two to four times the current expenditure after several decades

($ billion; at 2015 price)	2014-15	2064-65
Social security benefits for the elderly (including CSSA, OALA, OAA, DA and allowance under the Guangdong Scheme)	24.1	doubled
Public healthcare services for the elderly	23.9	tripled
Residential and community care services for the elderly	6.2	tripled
Public transport fare concession scheme for the elderly	0.4	quadrupled
Elderly Health Care Voucher Scheme	0.7	quadrupled

Source: Relevant policy bureaux

15. Fourth, **needs of different elderly generations**. The MPF System was introduced in 2000. The accrued benefits accumulated by older age employees who joined the schemes at that time would be limited. However, as the MPF System matures, the contributions and benefits accrued will increase. Moreover, many Hong Kong people have relatively high saving rates. There are also about 250 000 elderly people residing in self-owned properties with no mortgage (including private properties and Home Ownership Scheme (HOS) flats). The future development of retirement protection should have full regard to these changes, helping those "asset-rich,

income-poor" elderly people convert their MPF benefits, retirement investment or personal savings, self-owned properties, etc. into cash flow to improve their financial position after retirement.

Enhancing existing system — our intended objectives

16. Our target is to establish a comprehensive, adequate, sustainable, affordable and robust retirement protection system, enabling in particular those elderly people who are unable to take care of themselves to maintain a reasonable standard of living. "Comprehensive" means that apart from income protection, support services in areas such as housing, healthcare and welfare should also be provided under the system. "Adequate" refers to the adequacy of income protection in supporting the elderly people in their twilight years. "Sustainable" means the financial sustainability of the system. "Affordable" means whether the additional expenditure will go beyond the affordability of the Government, employers and employees. "Robust" means the ability of the system to withstand economic fluctuations without the need for drastic reduction in pension benefits in face of economic instability. These five objectives can co-exist but interact with one another. For example, too much emphasis on adequacy will make the system difficult to sustain, while pursuing sustainability only may result in inadequate protection for the elderly. The CoP considers that the challenge before us is to identify the right balance among different these objectives that best suits Hong Kong's practical circumstances.

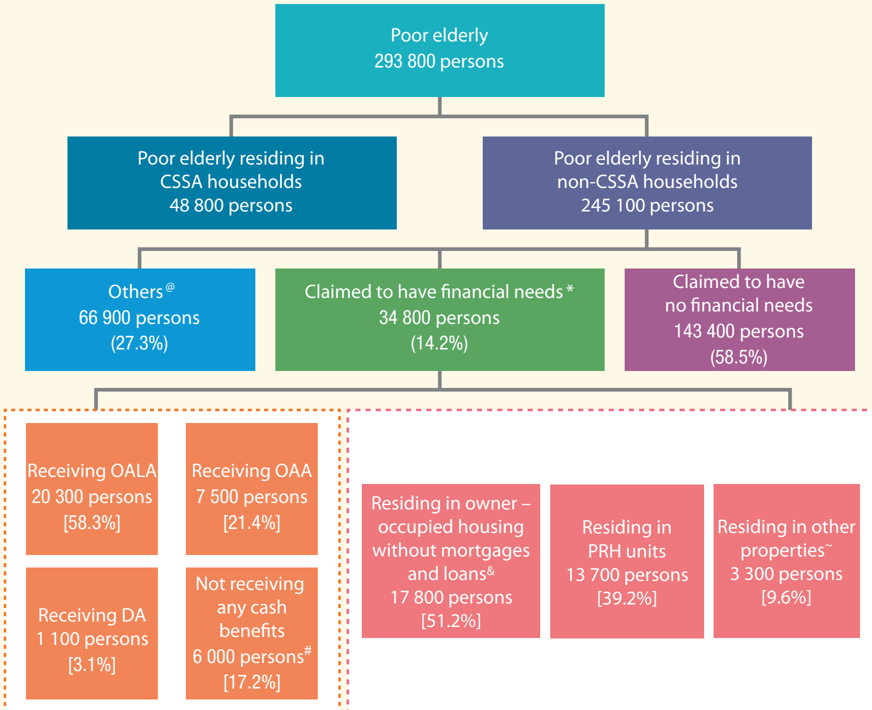
Elderly poverty situation

17. In 2014, about 290 000 elderly people were still living below the poverty line after recurrent cash intervention, representing 30% of the elderly population. Yet, among these 290 000 or so poor elderly people, 17% were living in CSSA households and their "recognised needs" were covered by the CSSA Scheme. Of the remaining 83% or about 245 000 poor elderly people who were not living in CSSA households, about 140 000 claimed that they did not have financial needs[3]. This indicates that not all elderly people living below the poverty line need support. They may be those "asset-rich, income-poor" elderly people.

18. As to the remaining 100 000 or so non-CSSA poor elderly people, only about 35 000 claimed that they had financial needs or were applying for CSSA. Among them, about 50% were living in self-owned properties with no mortgage, while another 40% were public rental housing (PRH) tenants. Their housing needs have largely been met. At the same time, among these 35 000 elderly people, 58% were receiving OALA, around 24% were receiving non-means tested DA or OAA, and

3 The data has been collected by the Census and Statistics Department's General Household Survey since 2010. When the monthly income of an interviewed household fell below a certain level, they would be asked "Why don't you apply for CSSA?" and would be given multiple answers to choose from. Some households chose to indicate that they did not have financial needs. Some said that they had financial needs but were ineligible or were applying for CSSA. There were also some households who refused to answer. Over the past five years, about 60% of non-CSSA households consistently claimed that they did not have financial needs.

Diagram 7: Distribution of the some 290 000 poor elderly in 2014



Notes: These are poverty statistics after recurrent cash intervention.
( ) The proportion in the total number of poor elderly residing in non-CSSA households.
[ ] The proportion in the total number of poor elderly residing in non-CSSA households who claimed to have financial needs.
(*) Including those who claimed to have financial needs and are applying for the CSSA.
(#) 700 (11.9%) of them are elderly people aged 70 or above.
(@) Including those who refused to reply.
(&) Including subsidised sale flats and owner-occupied private housing, both without mortgages and loans.
(~) Including subsidised sale flats (with mortgages or loans), temporary housing and private housing (including tenants and those owner-occupiers with mortgages and loans.

Source: Census and Statistics Department

17% were not receiving any social security benefits at all (see Diagram 7). From the above analysis, we can see that the number of elderly people who need further financial support should be much less than the number of elderly people living below the poverty line.

Groups requiring our attention

19. After examining the elderly poverty situation and the profile of elderly people that can be covered by each pillar under the existing retirement protection system, the CoP considers that the following groups deserve our attention:

(a) The elderly people who are still living below the poverty line and have financial needs after policy intervention.

(b) Low-income workers especially those who need not make MPF contributions by employees because of their low income and those who are affected by the "offsetting" arrangement[4].

(c) The non-working population not covered by MPF.

(d) Some elderly people who are not rich but have certain assets (such as self-owned properties).

Overseas experience

20. In recent years, many places have been making vigorous efforts to reform their retirement protection systems. At Annex 2 to the consultation document, the CoP has reviewed the reform trends in these places and two main observations have emerged –

(a) In the past many places have developed publicly-managed mandatory contributory systems under the first pillar which is financed mainly on a PAYG basis. However, against the backdrop of declining birth rates and longer life expectancies, when the number of retirees has grown faster than that of the working population, the first pillar in these places has experienced financial difficulties. One of the reform directions is to retain this pillar and fix its problems. Measures such as deferring the retirement age, revising the formula for calculating pension entitlements, etc. have been implemented to reduce pension expenditure or contain its rate of increase to improve the financial sustainability of the first pillar.

(b) Another reform direction is that more and more places have established the second pillar, mainly being privately-managed mandatory occupational contributory systems operated in the form of individual accounts. As these second pillars are fully funded, the pension schemes have accumulated adequate assets to meet current and future payment obligations. Hence such systems are more financially sustainable. However, same as the MPF in Hong Kong, the second pillars in these places have encountered challenges, including fee levels, inadequate protection as well as the investment and longevity risk borne by employees. These places have implemented improvement measures, such as introducing default pension products, to lower fees and better manage investment risks.

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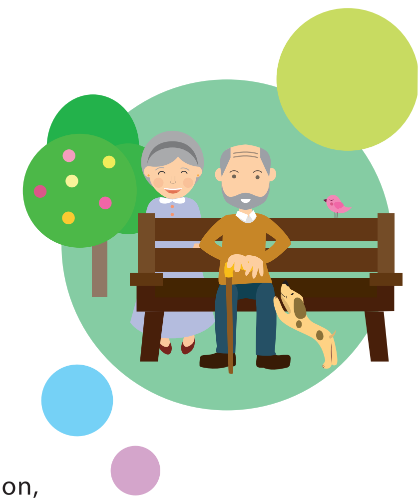
4 "Offsetting" is an arrangement that allows employers to use funds which include the MPF accrued benefits to offset severance payment or long service payment required under the Employment Ordinance.

"Regardless of rich or poor" or "those with financial needs"

21. The core issue of this consultation is whether the principle of "regardless of rich or poor" or "those with financial needs" should be adopted to strengthen the existing retirement protection system. To facilitate the public to understand and discuss this issue, this document will use a simulated option each from the "regardless of rich or poor" principle and the "those with financial needs" principle for comparison and analysis. Besides, as the CoP cannot reach broad consensus on this core issue, this document will present the different views of CoP members to help the community better understand the differences between the two options.

Simulated "regardless of rich or poor" option



22. The Report examines six proposals on improving retirement protection put forth by stakeholders. As the "Demo-grant" proposal is recommended by the Research Team after studying the stakeholders' proposals, the CoP agrees that the simulated "regardless of rich or poor" option should be modelled on the payment level and disbursement criteria (including its interface with other social security schemes) of the "Demo-grant" proposal.

23. Under the simulated "regardless of rich or poor" option, a monthly payment of $3,230 (based on the $3,000 as of 2013 price proposed by the Research Team and adjusted to 2015 price) will be paid to all elderly people aged 65 or above. In terms of interface with other social security schemes, the simulated option will adopt the same arrangements of the "Demo-grant" proposal, i.e. the payment of $3,230 from the simulated "regardless of rich or poor" option received by CSSA elderly recipients will be regarded as income, while elderly recipients with specific needs can continue to receive special grants to cover rent, dental and medical treatment expenses under CSSA. Hence, for CSSA elderly recipients, their overall financial support will remain the same as that under the existing system. OALA and OAA, however, will be replaced by the payment under the simulated "regardless of rich or poor" option. As DA is to meet special needs arising from disability and its intended function is different from retirement protection, eligible elderly people can receive both at the same time.

24. The "Demo-grant" proposal and three other "regardless of rich or poor" proposals[5] covered in the Report have suggested their own financing arrangements. All of them involve tripartite contributions from the Government, employees and employers[6]. While endorsing the principle of sharing out the increased expenditure through additional contributions from parties concerned, the CoP considers that the community should discuss in this public consultation whether the increased expenditure under the "regardless of rich or poor" and "those with financial needs" principles is sustainable and affordable. Specific financing arrangements should not be the focus of this consultation. Retirement protection is only one of the many public expenditure items. When considering whether to raise tax rates or introduce new taxes as proposed by stakeholders, the Government must take into account the estimated spending needs in other policy areas, including whether there is a need to raise taxes to address the structural deficit problem which will probably surface in about 10 years or so. The Government would then be in a position to comprehensively assess the impact of tax hike on the community and economy and consider the matter in a holistic manner.

Simulated "those with financial needs" option

25. Borrowing the concepts of the two "those with financial needs" proposals in the Report[7], the Government has put forth a simulated option. Specifically, the option will provide a monthly payment which is higher than the current OALA payment of $2,390 to the elderly people with assets no more than $80,000 (single) or no more than $125,000 (couple) (which are approximately two times of the current CSSA asset limits of $43,500 (single) and $65,000 (couple)) and having made income declarations similar to that for OALA (i.e. monthly income no more than $7,340 (single) and monthly income no more than $11,830 (couple)). To facilitate comparison with the simulated "regardless of rich or poor" option, the Government proposes to adopt the same amount of payment, i.e. $3,230 per month (2015 price) for the simulated "those with financial needs" option. It is estimated that about 60% of the current OALA recipients (about 250 000) can receive further financial assistance under this simulated option.

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5 The other three "regardless of rich or poor" proposals are from stakeholders, viz. The Hong Kong Federation of Trade Unions, Alliance for Universal Pension and The Professional Commons respectively.

6 On government contribution, the four proposals have put forth very similar arrangements with two main sources, namely the transfer of elderly social security expenditure (excluding DA, the Guangdong Scheme, and special grants and supplements for rent and other items under the CSSA Scheme), and injection of extra funds. Suggestions involving employees and employers, however, are relatively diverse, including reducing MPF contributions to free up resources for funding the new option, collecting additional taxes (such as "payroll old age tax") from employees and employers, and levying additional profits tax on enterprises that have earned profits above a certain level.

7 The two "those with financial needs" proposals are from the New People's Party and the Democratic Alliance for the Betterment and Progress of Hong Kong.

It must be stressed that this simulated option is not a concrete policy proposal put forth by the Government. Rather, it is only an illustration to facilitate comparison with the simulated "regardless of rich or poor" option and to stimulate discussion.

Comparing and analysing the two simulated options

26. To facilitate comparison between the two simulated options, the CoP adopts a common basis to analyse the two options' increased expenditure over that of the "baseline scenario" (i.e. without any enhancement proposals) for the coming 50 years. To provide the public with a better idea of the magnitude of the increased expenditure, the CoP has quantified their impact on public finances by assuming that the increased expenditure will be met by different types of taxes. Details of the data analyses are provided in Annex 4 to the consultation document. With reference to the key data analyses of the two options, the different views of CoP members as to whether to adopt the "regardless of rich or poor" principle or the "those with financial needs" principle to strengthen the existing retirement protection system are summarised in the ensuing paragraphs.

Concepts and objectives

27. Members who support the "regardless of rich or poor" principle generally consider that retirement protection is a basic right, not a welfare benefit. Thus no means test should be imposed. There are members pointing out that with non-means tested benefits, elderly people can live with more dignity in their old age. They do not have to run down their assets to a very low level in order to pass the means test before receiving social welfare assistance. This principle can also assist elderly people to tackle longevity risk effectively. It provides basic income protection, thus offering a stronger sense of security in old age. With reference to the payment amount suggested in the "Demo-grant" proposal and other "regardless of rich or poor" proposals by stakeholders, a monthly payment of $3,000 or so appears to be adequate to provide basic living protection, apart from healthcare and housing. Some members also point out that there is no lack of precedents of livelihood measures in which benefits are provided on a universal basis, for example the 12-year free education.

28. On the other hand, members supporting the "those with financial needs" principle object to offering uniform assistance to all elderly people regardless of their financial status. They consider that the "those with financial needs" principle targets resources towards helping the needy elderly. It is consistent with the Government's policy belief of "putting in place a reasonable and sustainable social security and welfare system to help those who cannot provide for themselves"[8]. Some members point out that the "those with financial needs" principle represents Hong Kong's cherished core values of self-reliance and hard work.

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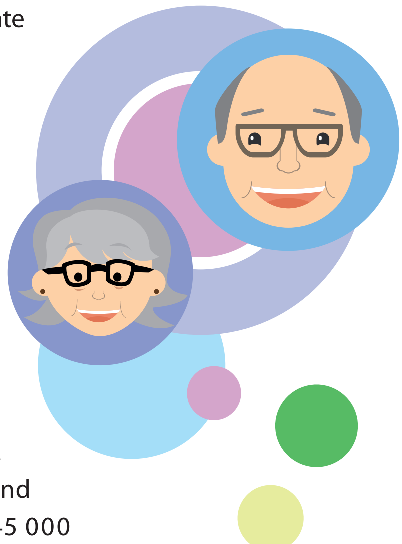
8 Please see paragraph 46 of the 2014 Policy Address.

29. There are opinions that the "regardless of rich or poor" principle deviates from the underlying concept of MPF of "one supporting one-self". Its nature is in essence PAYG or "one generation supporting another", meaning that contributions or taxes from employees and employers of the current generation would be used to pay for the pensions of the previous generation. When the current generation retires, it will be supported by the next generation[9]. Some members are concerned that such inter-generational retirement protection arrangement will increase the reliance of the future generation on the "regardless of rich or poor" benefits, thus reducing its saving incentive and changing the long-established belief of "one supporting one-self". This will have adverse impact on the future economic development, as well as the sustainability of both public finances and retirement protection.

Coverage

30. The "regardless of rich or poor" option can bring immediate benefits to all elderly people. Its full coverage can take care of those low-income and non-working elderly who are not adequately protected by other pillars. The stable income can provide the elderly people with peace of mind, while the design of this kind of option is generally simple and easy to implement.



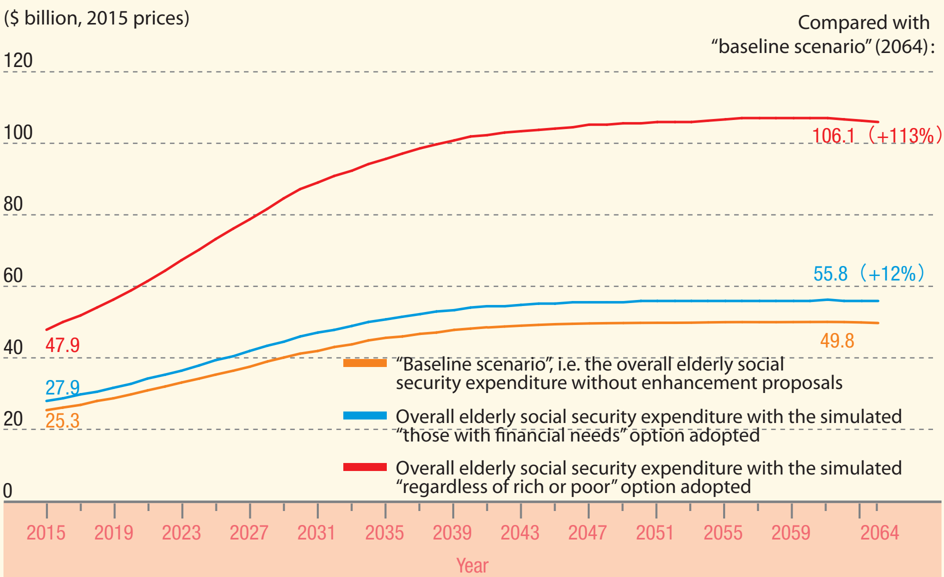
31. However, some members consider that given limited resources, we should assess the applicability of the "regardless of rich or poor" principle in light of the elderly poverty situation. We should not seek to attain full coverage through one single scheme. As mentioned in paragraph 17, against the background of having OALA in place since 2013, among the 245 000 poor elderly people who were not on CSSA, about 140 000 claimed that they did not have financial needs. This shows that offering assistance to everyone under the "regardless of rich or poor" principle would lead to resources mismatch. If resources are to be provided to all elderly people (including those who do not have financial needs), the overall expenditure will rise substantially. Even a slight upward adjustment to the amount of payment will involve substantial extra resources. As a result, such enhancement proposals are more likely to be shelved owing to financial consideration, and this, on the contrary, will not be to the advantage of those elderly in need.

9 Most of the "regardless of rich or poor" proposals from stakeholders seek to have some form of partially pre-funded arrangement by a one-off or phased injection from Government and early collective savings (i.e. accumulating as much reserves as possible before the peak of population ageing for meeting future outlay). However, Hong Kong's population is ageing fast and the labour force is expected to shrink in a few years. The "regardless of rich or poor" proposals will need to operate on a PAYG basis very soon. Hence, these proposals are, in essence, PAYG in nature.

"Who foots the bill?"

32. Diagram 8 shows the overall elderly social security expenditure in the 50-year projection period under three different scenarios, namely the "baseline scenario" (orange line) that represents the existing overall elderly social security expenditure prior to any enhancement proposals; the overall elderly social security expenditure with the simulated "those with financial needs" option adopted (blue line); and the overall elderly social security expenditure with the simulated "regardless of rich or poor" option adopted (red line). The gap between the red line and the orange line represents the increased expenditure (expressed at 2015 constant price) resulted from implementing the simulated "regardless of rich or poor" option. The increased expenditure will rise

Diagram 8: Overall elderly social security expenditure under the "baseline scenario", the simulated "regardless of rich or poor" option and the simulated "those with financial needs" option



Notes: The projection has adopted the social security take-up rates for the elderly under the framework of the "Report of the Working Group on Long-Term Fiscal Planning".

The overall elderly social security expenditure under the "baseline scenario" includes the CSSA, DA, OALA and OAA for the elderly aged 65 or above. Under the simulated "regardless of rich or poor" option, the overal elderly social security expenditure equals to the overall expenditure of the "baseline scenario", plus the increased expenditure resulted from the simulated "regardless of rich or poor" option (i.e. deducting from the payment expenses the part of payment which is regarded as income under the CSSA system, the OALA and OAA). Under the simulated "those with financial needs" option, the overall elderly social security expenditure equals to the overall expenditure of the "baseline scenario", plus the increased expenditure resulted from the new tier of financial assistance under the OALA. All expenditure does not cover the Guangdong Scheme.

( ) The percentage increase as compared with the "baseline scenario".

Source: CoP Secretariat

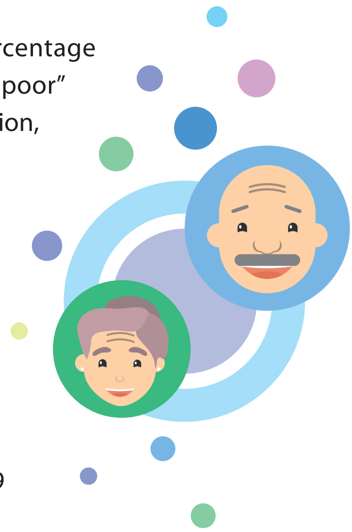
significantly from around $22.6 billion in 2015 to $56.3 billion in 2064, far exceeding the $2.5 billion (2015) and $6 billion (2064) (i.e. the gap between the blue line and the orange line) under the simulated "those with financial needs" option.

33. The total increased expenditure under the simulated "regardless of rich or poor" option for 50 years will amount to $2,395 billion (2015 constant price). This amount is almost 10 times the $255.5 billion required by the simulated "those with financial needs" option. It will advance the onset of structural deficit by six years to 2023-24 and the depletion of fiscal reserves by eight years to 2033-34. Under the simulated "those with financial needs" option, both situations will be advanced by one year.

34. If the increased expenditure is to be met by tax revenue[10], during the 50-year projection period the Government will be required to:

(a) raise the profits tax rate by about an additional 4.2 percentage points to 20.7% for the simulated "regardless of rich or poor" option. For the simulated "those with financial needs" option, the additional increase will be 0.4 percentage point; **or**

(b) raise the amount of salaries tax payable by about 55% for the simulated "regardless of rich or poor" option. In terms of the increase in tax rate, with the standard rate as an example, it will be an the additional increase of 8.3 percentage points to 23.3%. For the simulated "those with financial needs" option, the amount of salaries tax payable would need to be increased by 6% and the additional increase in standard tax rate will be 0.9 percentage point; **or**



(c) introduce goods and services tax (GST) and set the rate at around 4.5% for the simulated "regardless of rich or poor" option. For the simulated "those with financial needs" option, the rate will be 0.5%; **or**

(d) introduce the payroll old age tax as recommended in the Report and set the employer and employee tax rates in the range of 1.6% to 3.9% respectively for the simulated "regardless of rich or poor" option. For the simulated "those with financial needs" option, the tax rates will be 0.2% to 0.4%.

Diagram 9 summarises the above data analyses in the form of a table.

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10 Different types of tax will affect different groups of people. In the year of assessment 2013-14, for instance, 98 500 registered companies were required to pay profits tax (about 9% of the total number of registered companies), while 1.7 million working people were required to pay salaries tax (46% of the total working population). According to the "Demo-grant" proposal, all employers and employees will be required to pay the payroll old age tax (excluding employees with monthly income below $7,100). The GST base is assumed to cover food items, clothing and daily necessities, as well as healthcare, transportation, education, etc. services, and therefore will affect the largest number of persons (including those from the low-income group who are not required to pay salaries tax).

Diagram 9: Key data analyses of the simulated "regardless of rich or poor" option and the simulated "those with financial needs" option (2015 prices)

<table>
<tr><th colspan="2">Comparative indicators</th><th colspan="2">Simulated "regardless of rich or poor" option – $3,230 (maintained at 2015 constant price for the coming 50 years)</th><th colspan="2">Simulated "those with financial needs" option – $3,230 (maintained at 2015 constant price for the coming 50 years)</th></tr>
<tr><td rowspan="3">I</td><td colspan="5">As compared to the elderly social security expenditure of the "baseline scenario":</td></tr>
<tr><td>(i) Overall increased expenditure*</td><td colspan="2">From 2015 to 2064
$2,395.0 billion</td><td colspan="2">From 2015 to 2064
$255.5 billion</td></tr>
<tr><td>(ii) Annual average increased expenditure*</td><td colspan="2">$47.9 billion</td><td colspan="2">$5.1 billion</td></tr>
<tr><td rowspan="3">II</td><td colspan="5">If the Government has to meet all the increased expenditure* with the existing tax regime or tax rates remaining unchanged:</td></tr>
<tr><td>(i) Advancing the timing for the Government to have structural deficit</td><td colspan="2">6 years
(2023–24)</td><td colspan="2">1 year
(2028–29)</td></tr>
<tr><td>(ii) Advancing the timing for the Government to fully deplete its reserves</td><td colspan="2">8 years
(2033–34)</td><td colspan="2">1 year
(2040–41)</td></tr>
<tr><td rowspan="7">III</td><td colspan="5">If the increased expenditure* is to be met by tax revenue:</td></tr>
<tr><td rowspan="2">Option 1:
Raising the rate of profits tax</td><td>2015
2.8 percentage points</td><td>2064
4.6 percentage points</td><td>2015
0.3 percentage point</td><td>2064
0.5 percentage point</td></tr>
<tr><td colspan="2">Average increase for 2015-2064:
4.2 percentage points</td><td colspan="2">Average increase for 2015-2064:
0.4 percentage point</td></tr>
<tr><td rowspan="2">Option 2:
Raising the rate of salaries tax:
Increase in standard rate#</td><td>2015
4.9 percentage points</td><td>2064
9.1 percentage points</td><td>2015
0.6 percentage point</td><td>2064
1.0 percentage point</td></tr>
<tr><td colspan="2">Average increase for 2015-2064:
8.3 percentage points</td><td colspan="2">Average increase for 2015-2064:
0.9 percentage point</td></tr>
<tr><td rowspan="2">Option 3:
Introducing goods and services tax (tax rate)</td><td>2015
2.8%</td><td>2064
5.0%</td><td>2015
0.3%</td><td>2064
0.5%</td></tr>
<tr><td colspan="2">Average rate for 2015-2064:
4.5%</td><td colspan="2">Average rate for 2015-2064:
0.5%</td></tr>
</table>

Comparative indicators		Simulated “regardless of rich or poor” option – $3,230 (maintained at 2015 constant price for the coming 50 years)		Simulated “those with financial needs” option – $3,230 (maintained at 2015 constant price for the coming 50 years)	
Option 4: Introducing payroll old age tax (respective tax rates for employers and employees)**	Monthly income	2015	2064	2015	2064
	below $11,000[##]:	0.7%	2.0%	0.1%	0.2%
	$11,000 or above – below $22,000:	1.0%	3.1%	0.1%	0.3%
	$22,000 or above^:	1.6%	5.1%	0.2%	0.5%
	Monthly income	Average rate for 2015-2064:		Average rate for 2015-2064:	
	below $11,000[##]:	1.6%		0.2%	
	$11,000 or above – below $22,000:	2.4%		0.3%	
	$22,000 or above^:	3.9%		0.4%	

Note: (*) The increased expenditure under the simulated “regardless of rich or poor” option equals to deducting from the payment expenses the part of the payment which is regarded as income under the CSSA system, the OALA and OAA. The increased expenditure under the simulated “those with financial needs” option is the extra expenditure for providing a new tier of financial assistance under the OALA. With reference to the assumption in the Report that an investment return of 2% in real terms (i.e. after discounting inflation) can be earned by the funding balance for the retirement protection scheme, and assuming a similar discount rate, the total present value of the increased expenditure required by the simulated “regardless of rich or poor” option and the simulated “those with financial needs” option for the period 2015–2064 will be $1,442.0 billion and $154.0 billion respectively after taking into account the discount rate.

(#) The increased expenditure is assumed to be shared by all taxpayers (i.e. taxpayers who pay their taxes at progressive rate and standard rate) on a pro rata basis. However, as progressive rate ranges from 2% to 17% while the standard date is 15%, only the increase in standard rate is included here for simplicity.

(**) The payroll old age tax is a new tax proposed to be introduced as part of the income source for funding the “Demo-grant” proposal. The income bands are as suggested under the “Demo-grant” proposal with inflation adjustment to the level of 2015 price.

(##) Only the employer will pay the tax if the monthly income of the employee is below $7,100.

(^) The cap is at $129,000 (i.e. the limit of $120,000 proposed in the Report expressed at 2015 price level). In other words, based on the average tax rate between 2015 and 2064, the maximum tax to be paid by employer and the employee under the simulated “regardless of rich or poor” option will be $5,030 per month respectively, while the maximum tax payment under the simulated “those with financial needs” option will be $520 per month respectively.

Source: CoP Secretariat

Cost effectiveness in alleviating poverty

35. Diagram 10 attempts to compare the additional payment to be received by different groups of elderly people under the two simulated options. Those who benefit most from the simulated "regardless of rich or poor" option are mainly those who are receiving the OAA or the better-off elderly who have not been receiving any social security benefits. They represent 46% of the total elderly population. Each of them can receive an additional payment of about $2,000 to more than $3,000 per month. If analysed by the increased expenditure of $2,395 billion for the simulated "regardless of rich or poor" option during the 50-year projection period, only 18% can benefit those elderly people receiving OALA. Most of the remaining 82% are given to those elderly receiving OAA and those not receiving any social security benefits. For the simulated "those with financial needs" option, the main beneficiaries are those OALA recipients who can pass the proposed means test. This shows that the simulated "those with financial needs" option is targeted, and its cost-effectiveness in alleviating poverty is much higher than the simulated "regardless of rich or poor" option.

Sustainability of the schemes

36. Owing to an ageing population and a shrinking labour force, universal retirement protection schemes operating on a PAYG basis and relying on inter-generational support will face a huge challenge. Based on the suggested funding model of the "Demo-grant" proposal and the original projection framework in the Report, we have updated the financial assessment with the latest population and labour force projections. The updated assessment shows that the proposal will start to incur a deficit in the 10th year and the balance will turn negative in the 25th year after implementation. By 2064, the negative balance will grow to $541 billion. The timing of the first structural deficit and a negative fund balance will be advanced by three and four years respectively as compared to the original projection in the Report[11]. Unless there is a substantial increase in the proposed taxes or reduction in "Demo-grant" payment, the proposal will inevitably run into a persistent deficit. The situation will be even more acute under the latest population projections.

11 According to the original projections in the Report, it can be inferred that the "Demo-grant" proposal will record a negative balance in 2042.

Diagram 10: Comparison of additional payment to be received by different groups of elderly people under the simulated "regardless of rich or poor" and"those with financial needs" options

Groups of elderly people (classified by social security benefits)	Proportion in the elderly population aged 65 or above as at June 2015 (number)	Current payment received by each recipient per month* ($)	After adopting the simulated "regardless of rich or poor" option			After adopting the simulated "those with financial needs" option		
			Payment received by each recipient per month ($)	Additional payment received by each recipient per month ($)	Increased expenditure (share in overall increased expenditure) ($ billion)	Payment received by each recipient per month ($)	Additional payment received by each recipient per month ($)	Increased expenditure (share in overall increased expenditure) ($ billion)
CSSA#	13% (147 428)	5,548	5,548^	0^	0	5,548	0	0
OALA	37% (420 227)	2,390	3,230	840	426.4 (18%)	3,230~	840~	255.5 (100%)
OAA	19% (216 205)	1,235	3,230	1,995	587.4 (25%)	1,235	0	0
Higher DA	1% (14 079)	3,160	6,390@	3,230@	60.1 (3%)	3,160	0	0
Normal DA	2% (19 472)	1,580	4,810@	3,230@	76.1 (3%)	1,580	0	0
Not receiving any social security benefits	27% (305 889)	0	3,230	3,230	1,245.1 (52%)	0	0	0
Increased expenditure&	–	–	–	–	2,395.0 (100%)	–	–	255.5 (100%)

Notes: (*) The monthly payment of $3,230 under the two simulated options is at 2015 price level. For comparison, payments of all other social security benefits are also expressed at the same price level. The relevant payment level is adjusted in accordance with the prescribed mechanism on 1 February every year.

(#) Represented by the average monthly CSSA payment for elderly singletons (aged 60 or above).

(^) Elderly CSSA recipients under the simulated "regardless of rich or poor" option can receive a payment of $3,230 (at 2015 price) per month, as well as rent and other allowances under the CSSA. As the payment under the simulated option will be regarded as income of the elderly recipients under CSSA, receiving the payment of $3,230 will not change the overall financial support they have under the existing system.

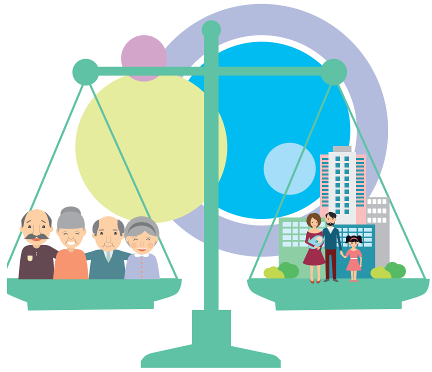
(~) Only applicable to those OALA recipients who can pass the means test of the simulated option.

(@) Elderly people receiving the DA can also receive the payment under the simulated "regardless of rich or poor" option.

(&) Numbers do not add up to total due to rounding.

Source: CoP Secretariat

Government's position



37. Since the release of the Report in August 2014, the Government has expressed reservations about the "regardless of rich or poor" principle on various occasions, including the Policy Address and Budget delivered in early 2015. This remains the Government's position.

38. The Government's main concern lies in four areas. First, under the prevailing tax regime and tax rates along with the scenario of having no service enhancement, the increased expenditure arising from the "regardless of rich or poor" options will undermine the long-term sustainability of public finances. This will not only reduce the financial capacity of the Government in handling other retirement protection initiatives (e.g. healthcare, long-term care and community care services), but will also inevitably compress the expenditure on other policy areas. Second, Hong Kong is entering an era of rapid population ageing. Any "regardless of rich or poor" option will, sooner or later, run into deficit and will not be financially sustainable. Should there be no alternatives by that time but to continue to support the scheme, the burden of taxation to be borne by the younger generations will be much heavier in the future. Third, implementing the "regardless of rich or poor" option will need to raise taxes substantially or even introduce new taxes. This will deviate from Hong Kong's long-established low tax regime. It will not only weaken our ability in attracting foreign investments, but also undermine the long-term economic development of Hong Kong. This, ultimately, will affect the competitiveness of Hong Kong. Fourth, the allocation of resources under the "regardless of rich or poor" principle is not targeted, rendering resources not being able to be deployed in the most effective manner to help the elderly in need.

39. It is worthy to mention that according to Article 107 of the Basic Law, the Hong Kong Special Administrative Region must follow the principle of keeping the expenditure within the limits of revenues in drawing up its budget, and strive to achieve a fiscal balance, avoid deficits and keep the budget commensurate with the growth rate of its gross domestic product.

40. The Government, however, acknowledges that there is room for improvement within the existing system and does not wish to see our retirement protection efforts coming to a standstill. Given that the collective retirement protection functions of the four pillars will be strengthened as the system becomes more mature, and enhancing the existing pillars will allow the four groups of people mentioned in paragraph 19 to have better retirement protection, the Government recommends that the community should focus our discussion on how to consolidate the existing system, improve and strengthen each pillar, and make good use of the $50 billion set aside by the Government with a view to providing better assistance to the elderly in need.

Updating financial projections of stakeholders' proposals

41. To facilitate comparison, we have updated the financial projections of the five proposals from stakeholders[12] and the "Demo-grant" proposal in the Report in the next 50 years based on the original projection framework in the Report, and the latest population and labour force projections. The updated projection results and related technical details are at Annex 5 to the consultation document. According to the updated projections, the financial situation of the "regardless of rich or poor" proposals will be even worse as compared to that analysed in the Report. The proposals will run into deficit or record a negative balance earlier than the projections stated in the Report. This indicates that the "regardless of rich or poor" proposals are even less sustainable under the latest population structure (see Diagram 11). The CoP took note of another "regardless of rich or poor" proposal put forth by a group of scholars in November 2015. The proposal is very similar to that from the Alliance for Universal Pension (AUP). After adjusting the payment level and

Diagram 11: Updated financial projections of three "regardless of rich or poor" proposals from stakeholders and the "Demo-grant" proposal

	Updated financial projection in 2015* (2015 price)			
	Timing of starting to have deficit after the implementation of the proposal[#]	Timing of starting to record negative balance after the implementation of the proposal[#]	Fund balance in 2041[~] ($ billion)	Fund balance in 2064 ($ billion)
Hong Kong Federation of Trade Unions	1 year (unchanged)	13 years (1)	-267.0 <-248.5>	-1,271.9
Alliance for Universal Pension	12 years (3)	29 years (-)[@]	37.6 127	-505.8
Professional Commons	6 years (1)	18 years (1)	-141.0 <-116.7>	-989.6
"Demo-grant"	10 years (3)	25 years (4)	-27.5 <13.5>	-541.0

Notes: (*) The updated financial projection is made on the following basis: (i) the latest population and labour force projections; (ii) the payments and income limits being adjusted to the price level of 2015; (iii) the ways of financing as proposed in each proposal; and (iv) all other assumptions, including assumptions on the elderly social security take-up rates being the same as that used in the projection framework in the Report.

(#) Figures in ( ) denote the number of years advanced when compared with the original projections in the Report.

(@) Comparison is not possible as the projections of the Report end in 2041.

(~) Figures in < > denote the original projections in the Report which are based on 2013 price.

Source: CoP Secretariat

12 Apart from those five proposals, the Report also includes a public annuity scheme proposed by Dr Law Chi-kwong. However, as the scheme involves a large amount of hypothetical data, the Research Team has not conducted projections for this proposal.

significantly increasing the Government's funding injection, the proposal has a net positive balance at the end of the projection period[13]. As regards the two "those with financial needs" proposals, the increased expenditure under the proposal from the Democratic Alliance for the Betterment and Progress of Hong Kong (DAB) will rise from $9.6 billion in 2015 to $20.9 billion by 2064[14], while the corresponding figures of the proposal from the New People's Party are $4.9 billion and $12.7 billion respectively.

Public annuity scheme

42. One of the proposals mentioned in the Report is the public annuity scheme proposed by Dr Law Chi-kwong. Under the proposed scheme, retirees and those who are going to retire may invest their capital (such as MPF accrued benefits and private savings, etc.) in an annuity scheme operated by the Government or a statutory body in exchange for a stable monthly income for the rest of their life (see Annex 6 of the consultation document). The CoP generally supports the concept of annuity. In particular, the MPF accrued benefits will increase with time and Hong Kong people are living longer. Thus, the community should have an early discussion on how to help retirees turn their MPF accrued benefits or private savings in the form of a lump sum into regular income for a long period of time or even for the rest of their life through annuity schemes or other financial instruments. This can properly manage the longevity risk such that elderly people will no longer have to worry about outliving their savings, or overly reduce their daily expenses to such an extent that will affect the quality of their retirement life and their spending pattern.

43. The CoP considers that the community should further explore the feasibility of a public annuity scheme. Issues to be examined include the roles of the Government and the private market, the Government's financial commitments involved in the annuity scheme, whether annuitisation should be mandatory or voluntary, whether there should be guaranteed returns for annuities, the role of the annuity scheme in the whole retirement protection system and its relationship with other pillars.

13 The scholars' proposal is very similar to that of the AUP. The differences are that the scholars' proposal proposes a lower retirement protection payment (scholars' proposal: $3,500; AUP's proposal: $3,690) and more fund injection from the Government (scholars' proposal: $100 billion; AUP's proposal: $53.8 billion). According to the scholars' projection, their proposal will start to have deficit by 2033 (i.e. the 17th year after implementation) and will have a net positive balance of $54.8 billion at the end of the projection period (i.e. 2064).

14 The increased expenditure of the DAB's proposal can be divided into three parts: adding one more tier of assistance (2015: $5.9 billion; 2064: $15 billion); relaxing the asset limit of OALA to $300,000 (2015: $1.8 billion; 2064: $3.3 billion); and lowering the age criteria of receiving OAA from 70 to 65 (2015: $1.9 billion; 2064: $2.6 billion).

Enhancing existing system

The zero pillar — social security

44. The zero pillar is a multi-tiered social security system. The main function of most of the schemes is to alleviate poverty by serving as a safety net for those elderly people who are unable to have adequate retirement protection under other pillars

Diagram 12: Details of various social security schemes for the elderly

<table>
<tr><th rowspan="2">Scheme*</th><th colspan="3">Income/asset limit and amount of monthly payment[#]</th><th rowspan="2">Number of recipients aged 65 or above (percentage of the elderly population aged 65 or above as at end June 2015)</th><th rowspan="2">Actual expenditure for 2014-15 ($ billion)</th></tr>
<tr><th>Income limit ($)</th><th>Asset limit ($)</th><th>Amount of monthly payment ($)</th></tr>
<tr><td>CSSA</td><td>Monthly payment to meet “recognised needs”[@]</td><td>43,500 (single elderly)</td><td>5,548[^]</td><td>147 428 (13%)</td><td>8.89</td></tr>
<tr><td>OALA</td><td>single persons: 7,340
couples: 11,830</td><td>single persons: 210,000
couples: 318,000</td><td>2,390</td><td>420 227 (37%)</td><td>11.34</td></tr>
<tr><td>OAA</td><td>N.A.</td><td>N.A.</td><td>1,235</td><td>216 205 (19%)</td><td>2.79</td></tr>
<tr><td>Guangdong Scheme**</td><td>single persons: 7,340
couples: 11,830</td><td>single persons: 210,000
couples: 318,000</td><td>1,235</td><td>16 776 (–)[##]</td><td>0.26</td></tr>
<tr><td>Normal DA</td><td rowspan="3">N.A.</td><td rowspan="3">N.A.</td><td>1,580</td><td>19 472 (2%)</td><td>0.33</td></tr>
<tr><td>Higher DA</td><td>3,160</td><td>14 079 (1%)</td><td>0.49</td></tr>
<tr><td>Elderly people who are not receiving social security benefits</td><td>N.A.</td><td>305 889 (27%)</td><td>–</td></tr>
<tr><td colspan="4">Total elderly population (as at end June 2015)</td><td>1 123 300 (100%)[~]</td><td>Total amount: 24.10[&]</td></tr>
</table>

Notes: (*) Different schemes have different age requirements. Under the CSSA system, elderly people are defined as persons aged 60 or above. OAA applicants must be aged 70 or above, while elderly people aged 65 or above can apply for OALA and the Guangdong Scheme. The eligibility for the DA is based on the degree of disability of the applicant. There is no age requirement under the DA.

(#) These are the current means test limits and payment levels effective since 1 February 2015. These limits and levels would be adjusted with effect from 1 February each year according to the established mechanism.

(@) The total assessable monthly income of the applicants and their family members must be lower than the monthly “recognised needs” under the CSSA Scheme.

(^) A rough estimation indicates that the average monthly CSSA payment for the elderly singletons aged 60 or above (excluding recipients of the Portable CSSA Scheme) is estimated to be $5,548.

(**) The income and asset limits for the Guangdong Scheme are applicable to applicants aged 65 to 69 only.

(##) The percentage is not available as most recipients of the Guangdong Scheme are not included in the Hong Kong resident population.

(~) Percentages may not add up to 100% due to rounding.

(&) If the one-off relief measures are included, the total amount of expenditure should be around $25.85 billion (CSSA: $9.39 billion; OALA: $12.29 billion; OAA: $3.01 billion; Guangdong Scheme: $0.28 billion; Normal DA: $0.36 billion; Higher DA: $0.53 billion). Numbers may not add up to the total due to rounding.

Source: Social Welfare Department

or by supplementing their living expenses. At present, the various assistance programmes under the zero pillar have benefited about 73% of elderly people in Hong Kong, comprising the CSSA (13%), OALA (37%), OAA (19%)[15] and DA (3%). The take-up rate of those aged 70 or above is even higher at 87%. All these four assistance programmes are non-contributory and funded by general revenue (see Diagram 12).

45. OAA and DA are designed to meet the special needs arising from old age and severe disabilities. As these two non-means tested allowances are not targeted at providing assistance for the poor elderly, the CoP agrees that the two allowances will not be included in the present review.

Elderly CSSA

46. Designed to help those who are unable to support themselves, the CSSA Scheme is subject to means-testing so as to ensure that our limited resources are targeted towards the most needy elderly. Higher standard rates, special grants and supplements are provided for elderly CSSA recipients to meet their basic needs and other special needs (such as special diet, medical items, etc.). CSSA recipients are also entitled to free services at public hospitals and clinics. Taking into account all CSSA cases involving elderly recipients, an elderly person may receive a monthly CSSA payment of about $5,100 on average whereas an elderly singleton may receive $5,548. The CoP considers that the comprehensive and targeted assistance available under the CSSA is tailor-made to meet the basic needs of individual elderly persons. The role of CSSA as a safety net cannot be replaced. Diagram 13 gives four examples to illustrate the monthly CSSA payments received by elderly singletons in different health and housing conditions.

47. Some members suggest that the CSSA payment level should be reviewed. Some members also see the need for reviewing the arrangement of requiring family members to make a declaration if they are unable to provide for the daily needs of the elderly members concerned. The feasibility of income and assets declaration on an individual basis should be explored, and the impact of the relevant measures on family policies and public finances be assessed. On the other hand, some members note that in all types of households, the average allowance received by CSSA households is higher than the average expenditure of non-CSSA households in the lowest 25% expenditure group in Hong Kong. Given that CSSA for the elderly people is part of the CSSA system, we should consider whether any contemplated changes will adversely affect the well-established system and prudence must be exercised before deciding whether to introduce such changes.

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15 Excluding elderly beneficiaries of the Guangdong Scheme as most of them are not included in the Hong Kong resident population.

Diagram 13: Examples of monthly CSSA payments for elderly singletons aged 60 or above

	Example (1)	Example (2)	Example (3)	Example (4) (residing in non-subsidised residential care places)
(1) Standard rates	$3,200 (able-bodied elderly)	$3,200 (able-bodied elderly)	$3,870 (elderly with 100% disability)	$5,450 (elderly requiring constant attendance)
(2) Community living supplement/ residential care supplement	$300	$300	$300	$300
(3) Long-term supplement	$167 ($2,000/12 months)	$167 ($2,000/12 months)	$167 ($2,000/12 months)	$167 ($2,000/12 months)
(4) Rent allowance	No rent payable	Rent for public rental housing: $800	Rent for private housing: $1,640 (maximum rent allowance)	Rent for non-subsidised residential care places: $1,640 (maximum rent allowance)
(5) Special grants*	Not receiving any special grants	• Grant for service charges for emergency alarm system for elderly recipients: $100 • Grant for telephone charges: $128 • Grant to cover costs of dental treatment: $800 ($9,600/12 months) • Grant to cover costs of glasses: $21 ($500/24 months)	• Special diet allowance (lower rate): $530 • Grant for service charges for emergency alarm system for elderly recipients: $100 • Grant for telephone charges: $128 • Grant to cover costs of dental treatment: $800 ($9,600/12 months) • Grant to cover transport fares to and from hospital/clinic: $50	• Special diet allowance (higher rate): $1,005 • Grant to cover costs of medical items: – disposable diapers: $1,400 – nasal-gastric tubes and glucometers: $500
Total#	$3,667	$5,516	$7,585	$10,462

Notes: (*) Most special grants are payable to meet actual expenses on a reimbursement basis. Some are subject to grant ceilings.

(#) The one-off additional standard rate payments granted to CSSA recipients announced in the Budget in recent years are not included.

Source: Social Welfare Department

48. The CoP is also concerned that people who want to reduce the financial burden of taking care of their elderly parents would arrange for their parents to be admitted to residential care homes. The elderly parents would then be eligible to apply for CSSA as independent applicants. This would not only push up the institutionalisation rate of the elderly people, but also affect the living standards of the elderly people. There are about 25 000 elderly CSSA recipients residing in non-subsidised places. The Elderly Commission is studying the feasibility of introducing a voucher subsidy mode for residential care services for the elderly. The Government has earmarked about $800 million for providing a total of 3 000 service vouchers in a three-year pilot scheme. Moreover, elderly people who do not wish to apply for CSSA together with their families may consider applying for the OALA on an individual or couple basis.

49. Some members also propose exploring the possibility of consolidating the elderly CSSA and the OALA to provide a basic pension for able-bodied poor elderly people. For the poor elderly with special needs, these members consider that it might be better to continue assisting them through the current CSSA system. Others, however, consider that if the payment received by the elderly remains the same after consolidation, the change will have no practical significance and may cause confusion because when the health of the elderly people deteriorates, they will need to revert to the CSSA as safety nets of a final resort from the proposed consolidated scheme.

OALA

50. Launched in April 2013, the OALA is the first major poverty alleviation measure implemented by the current-term Government. This allowance is specially designed for those elderly people aged 65 or above who have financial needs but are not able or willing to apply for the CSSA. The OALA payment serves as a subsidy for their living expenses. OALA applications are made on an individual or couple basis and the means test for the OALA is more lenient than that for the CSSA.

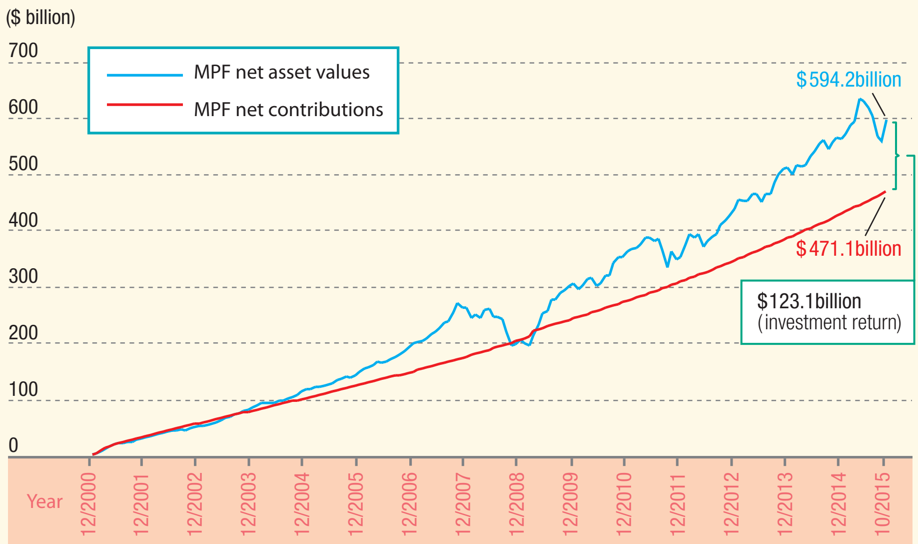
As the social security benefit with the largest number of elderly recipients, OALA benefited more than 420 000 elderly people or almost 40% of the elderly population as at end June 2015. It has proven to be effective in lowering the elderly poverty rate, in addition to strengthening the retirement protection function of the social security pillar.

51. According to the poverty data in 2014, about 20 000 elderly OALA recipients living below the poverty line indicated that they still had financial needs. Some members consider that the OALA should be enhanced to provide better support for these elderly people with financial needs. In fact, two of the six stakeholders' proposals in the Report involve enhancement of the OALA. The CoP generally agrees that using the OALA as a platform to strengthen support for the poor elderly is a policy direction worth exploring.

The second pillar — MPF

52. In Hong Kong, the second pillar takes the form of MPF schemes, MPF-exempted Occupational Retirement Schemes, Civil Service Pensions, Grant/Subsidised Schools Provident Fund, etc. In terms of the number of participating employees and accumulated total asset values, the MPF System ranks the highest among the

Diagram 14: MPF net asset values, net contributions and investment return over the past 15 years



Source: Mandatory Provident Fund Schemes Authority (MPFA) aforementioned schemes. The MPF System is an employment-based, privately-managed mandatory defined contribution system. As at end October 2015, MPF assets had increased to $594.2 billion, of which about $123.1 billion were investment returns (see Diagram 14). At present, about 2.55 million employees are enrolled in MPF schemes, representing 100% of the employees required by law to join the MPF schemes. This is a very high rate by international standards. In addition, another 210 000 self-employed persons are also scheme members.

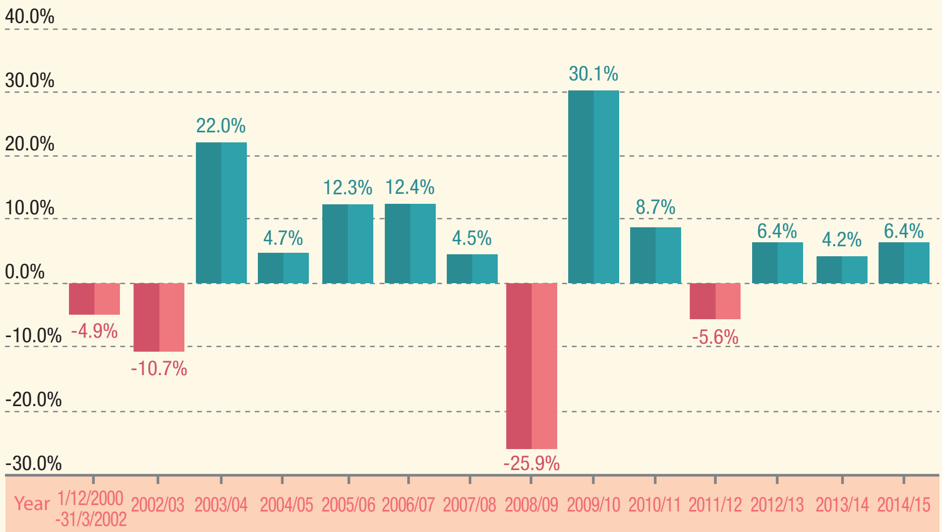
Contribution rates, maximum and minimum levels of relevant income and investment return

53. Whether MPF accrued benefits are enough to support one's retirement life is directly linked to the contribution rates, maximum and minimum levels of relevant income[16] and investment returns. An employer and an employee are each required to contribute 5% of the relevant employee's income, and a self-employed person is also required to contribute 5% of his/her income. At present, employees or self-employed persons earning less than the minimum relevant income level, i.e. $7,100 a month, do not need to contribute but employers still need to make their contributions for the employees. For employees or self-employed persons earning more than the maximum relevant income level, i.e. $30,000 a month, the employees and their employers or the self-employed persons do not need to make contributions for the part of income above this level.

54. Employers select MPF schemes from which scheme members can choose the constituent funds. The choices of constituent funds made by scheme members have an impact not only on the returns of their accrued benefits but also on the overall investment returns of the MPF System. Since its implementation, the entire MPF System has, as at end October 2015, achieved an annualised internal rate of return of 3.4% (net of fees and charges), which is higher than the inflation rate of 1.8% for the same period. As the portion of MPF accrued benefits investing in Hong Kong equities is rather high, driven by corresponding changes in the Hong Kong equity market, the yearly performance of the MPF System fluctuated, ranging from a negative annualised return of -25.9% to a positive annualised return of 30.1% for different years (see Diagram 15).

16 Section 9 of the Mandatory Provident Fund Schemes Ordinance (Cap. 485) stipulates that self-employed persons or employees whose monthly income is less than the minimum level of relevant income are not required to make mandatory contributions but relevant employers are not exempted. According to section 10 of the Ordinance, neither employers, employees nor self-employed persons are required to make mandatory contributions in respect of the wages in excess of the maximum level of relevant income. Section 10A of the Ordinance stipulates the adjustment mechanism for the minimum and maximum levels of relevant income, which includes conducting a review at least once every four years, and the adjustment factors that must be taken into account when conducting the review.

Diagram 15: MPF's annualised internal rate of return in the past 10 years or so



Source: MPFA

55. If an employee whose monthly salary is $15,000 (i.e. same as the median income of employed persons in 2014) makes contributions from the age of 25 to 65 during which there is no pay adjustment in real terms nor "offsetting" arrangement[17], his/her MPF benefits, estimated at an annualised internal rate of return of 1.6% after discounting inflation[18], will be around $1 million upon retirement at the age of 65. If we divide the amount into monthly payments based on the average life expectancy of persons aged 65 (85 years for male; 89 years for female), this person can receive a monthly income of about $4,200 (male) or $3,500 (female) upon retirement[19].

56. Given the current contribution rate, the MPF can only provide basic retirement protection for the working population making an average income, and should be complemented by income sources under other pillars (such as voluntary savings or family support). In fact, the MPF System is designed to be one of the income sources after retirement. There are views that the contribution rate or the maximum relevant income level should be raised to strengthen the retirement protection function of the MPF System. Others are of the opinion that maintaining

17 This is based on an example cited by the MPFA. By "no pay adjustment in real terms", it means the pay is only inflation-adjusted with no real growth.

18 Since the implementation of MPF System and up to end October 2015, the annualised internal rate of return is 3.4%. The inflation rate for the same period is 1.8%.

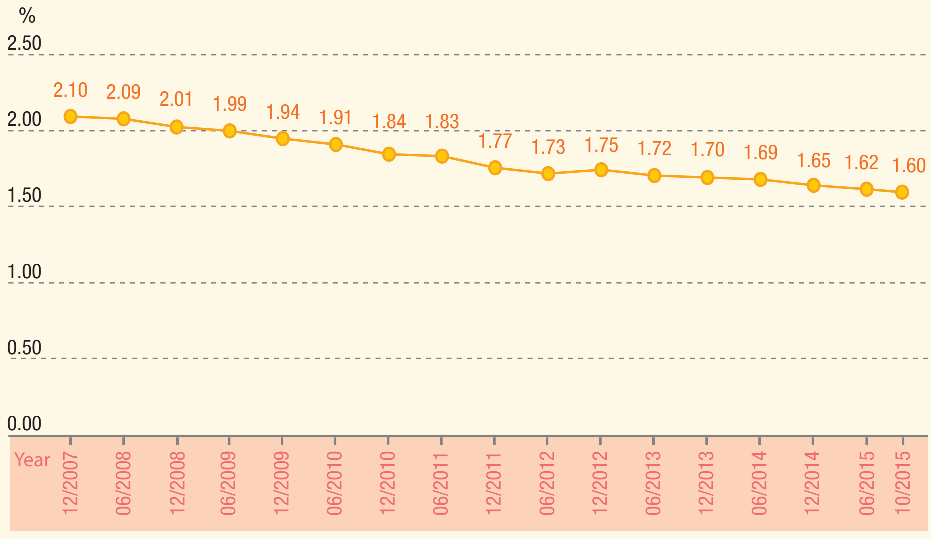
19 Assuming the rate of return of the MPF benefits withdrawn is the same as the inflation rate. All figures in this example are at 2015 price.

the contribution rate at a lower level can reduce the financial burden of monthly contributions borne by employees and self-employed persons (especially those with a low income). Employees will also be able to make other retirement financial planning with their other savings (e.g. taking out an endowment policy). To employers, increasing the contributions will mean higher operating costs. Besides, arrangements are already in place for employers or scheme members to make voluntary contributions under the MPF System.

Reduction of fees and other improvement measures

57. Through a series of fee reduction measures, including the introduction of the "semi-portability" in 2012, the average fund expense ratio (FER) of MPF constituent funds has dropped by about 24% from 2.10% in end 2007 to 1.60% in October 2015. This is a record low since the launch of the FER in 2007 (see Diagram 16). In addition, about 40% of the existing MPF constituent funds are low-fee funds, meaning an FER of not more than 1.30% or management fees not more than 1.00%.

Diagram 16: The average FER dropped by 24% since 2007



Source: MPFA

58. However, the CoP considers that the Mandatory Provident Fund Schemes Authority (MPFA) has to continue its efforts in reducing fees as there is still a gap between the existing fee levels and the general expectation of scheme members. Reducing fees must remain one of the priorities in the future. The CoP also considers that the primary objective of the MPF System is to safeguard scheme members' retirement benefits. Both the Government and the MPFA are obliged to take all practicable measures to reduce fees and streamline the administrative arrangements so that scheme members will be provided with maximum protection under the System.

Limited protection for low-income earners

59. As mentioned in paragraph 56, the MPF can only provide basic retirement protection for the working population earning an average income. The contributions made at the existing rate of 10% will not be sufficient for scheme members, especially the low and middle-income group, to accumulate adequate MPF benefits upon retirement. For employees who earn less than the minimum relevant income level, their MPF accrued benefits will be even less, as their benefits will only be derived from their employers' contributions (i.e. 5%). For self-employed persons who earn less than the minimum relevant income level, they need not make any contribution. This also applies to individuals without stable long-term employment. As their total years of service are shorter with fewer contribution periods, they will receive less MPF accrued benefits upon retirement. To them, the MPF System may not be a reliable pillar of retirement protection.

60. While a higher contribution rate may increase the retirement savings, the analysis in paragraph 56 indicates that we need to balance a number of factors such as the impact on employers, employees and self-employed persons. The CoP considers that the other pillars should be better used to enhance the protection of low-income earners or people without stable employment. For instance, we should consider the need to enhance the social security pillar which serves as a final safety net for those elderly people not having full retirement protection under the MPF System or other pillars.

Non-working population not covered

61. As an employment-based mandatory savings scheme, the MPF System is not intended to cover the non-working population, such as housewives. This is not unique to Hong Kong. The case is the same for the employment-related contributory pension plans in other places, where protection for the non-working population is provided under other pillars. Some members propose that we should consider providing tax concessions to incentivise married employees to make

MPF voluntary contributions for their non-working spouses. This would be in line with the policy of encouraging family support and would reinforce the retirement protection function of the third pillar. However, other members consider that this would require separate arrangement under the current tax regime and given our low tax rate, the measure might not be very effective.

Reduced protection due to "offsetting"

62. "Offsetting" is an arrangement that allows employers to use funds which include MPF accrued benefits to offset severance payments or long service payments required under the Employment Ordinance (Cap. 57). According to the information provided by the MPFA, between July 2001 and end 2014, MPF benefits withdrawn for "offsetting" amounted to $25 billion, representing 29% of the total benefits withdrawn during that period. The Chief Executive stated in his Election Manifesto that we should "adopt measures to progressively reduce the proportion of accrued benefits attributed to employer's contribution in the MPF account that can be applied by the employer to offset long service or severance payments".

63. Based on the more detailed information provided by MPFA for the first time, of the $3 billion MPF benefits withdrawn in 2014 for "offsetting" purposes, $1.66 billion was for offsetting severance payments and $1.35 billion for offsetting long service payments, 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 (see Diagram 17).

Diagram 17: Claims related to "offsetting" in 2014

Type of claims	MPF benefits withdrawn for "offsetting"	Number of claims#	Number of employers involved@	Average "offsetting" amount per employer	Number of employees involved@	Average "offsetting" amount per employee
Severance payment	$1.656 billion	30 900	9 100	$182,100	29 700	$55,800
Long service payment	$1.351 billion	14 500	7 200	$187,500	13 800	$98,000
Overall	$3.006 billion	45 400	15 600 (5.7%)*	$192,800	43 500 (1.7%)*	$69,200

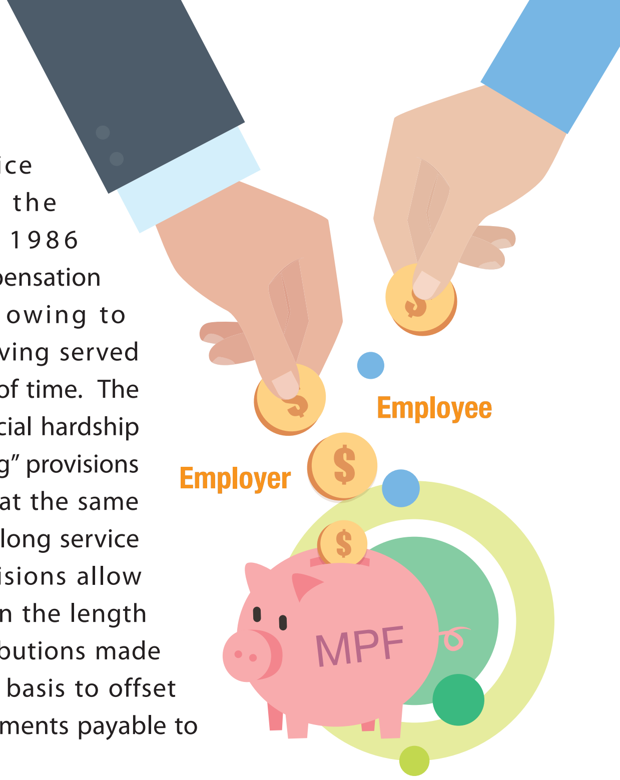
Notes: (#) Since a claim case may involve more than one claimant (e.g. both the employer and the employee can make claims with trustee(s) for the same claim case), the number of claims refers to the number of claims made by the claimants but not the unique number of claim cases in 2014.

(@) The respective numbers of employers and employees involved are only the aggregate of the relevant figures of all schemes without taking into account any multiple claims involving the same employer/employee made in different schemes in 2014.

(*) Figures in ( ) denote the percentage of enrolled employers and employees subject to the "offsetting" arrangement.

Source: MPFA

64. Severance payment and long service payment were introduced under the Employment Ordinance in 1974 and 1986 respectively. They seek to provide compensation for employees who are dismissed owing to redundancy or other reasons after having served the same employer for a certain period of time. The compensation helps alleviate their financial hardship caused by loss of employment. "Offsetting" provisions were incorporated into the Ordinance at the same time when the severance payment and long service payment were introduced. The provisions allow employers to use the gratuity based on the length of service paid to employees or contributions made to retirement schemes on a voluntary basis to offset severance payments or long service payments payable to their employees.



65. Annex B lists in chronological order the introduction of severance payment, long service payment and the relevant "offsetting" provisions, as well as the subsequent amendments made to the "offsetting" provisions. In CoP's discussion about this issue, some members consider that at the time when severance payment and long service payment were introduced, the Government had not stated explicitly that these two compensation measures for employees would carry the function of retirement protection. However, other members point out that on subsequent occasions, the Government had explained to the Legislative Council that severance payment and long service payment were introduced as alternatives to retirement protection. Based on the Government's speech on "offsetting" arrangement delivered in the Legislative Council and the contents of the consultation document on retirement protection published in 1992 about long service payment, it was difficult to say categorically that these two measures were totally unrelated to retirement protection.

66. No matter how the relationship between severance payment/long service payment and retirement protection should be interpreted, the fact is that prior to the establishment of the MPF System, there were no mandatory retirement protection schemes in Hong Kong. In order to encourage employers to set up voluntary pension plans, the Government at that time proposed the "offsetting" arrangement so that employers would not need to pay twice. There might be good reasons for putting forth this arrangement when the voluntary pension plans were introduced, but some members of the community have questioned the decision to keep this arrangement after implementation of the MPF System.

67. Trade unions and organisations have all along requested the Government to abolish the "offsetting" mechanism. Judging from the amount of MPF benefits withdrawn for "offsetting" over the years, "offsetting" will, no doubt, reduce employees' retirement savings. For the 43 500 employees affected by the "offsetting" arrangement in 2014, on average, about 94% of the relevant employers' contributions were withdrawn for "offsetting" purposes. This has weakened the retirement protection function of the MPF System. Apparently, employees earning less than $7,100 a month who are not required to make their own contributions are most affected.

68. There are views that the impact of changes to the "offsetting" arrangement on employment relationship, terms of employment and job opportunities should be handled cautiously. Employer groups point out that the "offsetting" arrangement was a prerequisite for their support for establishing the MPF System and endorsing the Mandatory Provident Fund Schemes Ordinance so that employers would not need to pay twice. They consider that abolition of the "offsetting" arrangement would not only be a breach of the consensus reached, but also an increase in their financial burden, especially the small and medium enterprises (SMEs). Employers generally share the view that severance payment/long service payment and the MPF overlap in the purposes of retirement protection. Some enterprises now adopt the "offsetting" arrangement to make provisions for severance payment and long service payment. If the "offsetting" arrangement is abolished, enterprises will need to make additional reserves to meet financial accounting requirements. This may affect the cash flow and business operation of the enterprises. We therefore need to further assess the related implications.

69. On the other hand, some are of the view that "offsetting" may impede the implementation of "full portability". Some employers may not be willing to support "full portability" as they want to retain their contributions for "offsetting". "Full portability" helps enhance market competition and further reduce fee levels.

70. Purely from the perspective of retirement protection, the CoP considers that the "offsetting" arrangement will undoubtedly give rise to benefits leakage from the MPF System, weakening its retirement protection function. This notwithstanding, the CoP emphasises that in dealing with the "offsetting" issue, we should not simply resort to a choice between "keeping" or "abolishing" the arrangement. When reviewing the "offsetting" arrangement, we also need to consider ways to rationalise the relationship between severance payment/long service payment and the MPF.

71. The CoP also considers that the complexity of the "offsetting" issue should not be underestimated and is aware of the concern of employers about rising operating costs. If the Government considers it appropriate to abolish the "offsetting" arrangement progressively, the community should be allowed to fully discuss when and how to abolish the arrangement so that the impact on employers can be minimised. The CoP is of the view that the community should make good use of the opportunity offered by this consultation to conduct thorough and in-depth discussion on the impact of the feasible options to address the "offsetting" issue on employers and employees, as well as the role of the Government. The community should endeavour to find a way acceptable to both employers and employees. By so doing, we will be able to safeguard the interests of low-income earners and further strengthen the MPF pillar and the entire retirement protection system. The community should also consider ways to rationalise the relationship between severance payment/long service payment and the MPF System, and discuss mitigation measures which can reduce the impact of any changes on the business sector (especially the SMEs) and the labour market[20].

Short, medium and long-term strategies

72. The CoP considers that the long-term goal should be strengthening the MPF pillar. In this connection, the CoP agrees with the Government and the MPFA in adopting the following strategies:

    (a) Implementing the Default Investment Strategy (DIS) within 2016 to tackle the issues of "high fees" and "difficulty in making fund choices".

    (b) Stepping up publicity efforts to broaden the employees' understanding and acceptance of the MPF System, including the importance of active management of one's own account.

    (c) Pursuing the setting up of a centralised electronic platform eMPF based on the outcome of the consultancy study engaged by MPFA.

    (d) Implementing "full portability" in the long run to give scheme members full control over their MPF benefits (including their own contributions and those of their employers).

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20 Though one of the members, Hon Michael Tien, agrees that the community should commence discussion on the "offsetting" issue, he does not think that this consultation is the right platform for doing so. As the consultation will deal with the core issue of the "regardless of rich or poor" and "those with financial needs" principles, opening up discussion on the "offsetting" arrangement concurrently will complicate the exercise. Besides, changing the "offsetting" arrangement will impact on the business environment, the working class, etc., and does not fall squarely within the purview of retirement protection or poverty alleviation. The Hon Tien considers that Government should, as soon as possible, deal with this important issue through a separate mechanism.

73. The CoP also agrees to the following two measures:

(a) properly address the "offsetting" issue – The community should make good use of the opportunity offered by this consultation to conduct thorough and in-depth discussion on the impact of the feasible options to address the "offsetting" issue on employers and employees, as well as the role of the Government. The community should endeavour to find an option acceptable to both employers and employees. In addition, we should consider ways to rationalise the relationship between severance payment/long service payment and the MPF System, and discuss mitigation measures which can reduce the impact of any changes on the business sector (especially the SMEs) and the labour market.

(b) explore the feasibility of raising the contribution rate at an opportune time – Now may not be the right time for raising the contribution rate. However, upon the full implementation of the DIS, which will help boost the confidence of MPF scheme members in the System, the feasibility of raising the contribution rate should be examined.

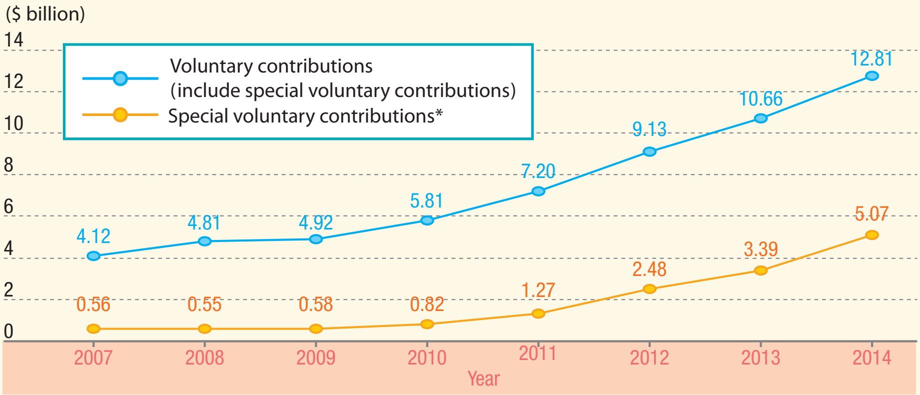
The third pillar — voluntary savings

74. In Hong Kong, the third pillar covers mainly MPF voluntary contributions, investments in retirement savings-related insurance or other financial products, etc.

75. The CoP has noticed the substantial rise in MPF voluntary contributions in recent years from $4.1 billion in 2007 (13% of the total contributions in the same year) to $12.8 billion in 2014 (21% of the total contributions in the same year), representing a 200% increase (see Diagram 18). This shows that the MPF's voluntary contribution arrangement has provided an additional option for making voluntary savings. This will help strengthen the retirement protection function of the third pillar.

76. For the year of assessment 2013-14, about 54% of the working population are not required to pay salaries tax. For the remaining 46% who need to pay the tax, the effective tax rate is only 8%. As there is neither capital gains tax nor estate duty in Hong Kong, our tax environment is favourable for voluntary savings and investments. Moreover, Hong Kong has a well-developed financial market. Apart from making voluntary contribution to MPF schemes, people can choose to invest in stocks, unit trusts, bonds or foreign exchange as they prepare for their retirement income. There are also a number of wealth management products on the market that are specifically designed for retirement savings, such as endowment policy.

Diagram 18: Substantial rise in MPF voluntary contributions



Note: (*) Voluntary contributions include general voluntary contributions and special voluntary contributions. Special voluntary contributions refer to voluntary contributions paid directly by a relevant employee to the trustee. Unlike general voluntary contributions, these contributions are non-employment related, i.e. contributions do not go through the employer, and withdrawal of accrued benefits is neither tied to employment nor subject to preservation requirements.

Source: MPFA

77. The CoP is of the view that the Government can further encourage voluntary savings through various means. First, the Government can strengthen its publicity and promotion efforts to enhance public understanding of different kinds of insurance and financial products that will help people plan their retirement life or manage their wealth. Second, the Government can create a favourable policy environment that will encourage the market to develop more financial products suitable for retirement investment and wealth management (e.g. issuing more retail bonds with longer term to maturity, and encouraging the private market to develop more financial products that comprise the element of long-term or life annuity plans). This will help people convert their savings into a continuous and steady stream of income after retirement, thereby facilitating an effective management of the longevity risk. Third, the Government can provide tax concessions to incentivise people to increase voluntary retirement savings for themselves and their family members. Possible measures include providing tax concessions for voluntary contributions under MPF schemes, or voluntary MPF contributions by employed persons for their non-working spouses.

The fourth pillar — public services, family support and personal assets

78. The CoP considers that in addition to income protection, publicly-funded services such as housing, healthcare, elderly care, transportation and other public services are also indispensable for enhancing the support for the elderly. These public services, family support and personal assets form the fourth pillar.

Public housing and self-owned properties

79. At present, more than half of the elderly people in Hong Kong live in subsidised housing units (including PRH and subsidised sale flats). With various housing priority schemes for the elderly people implemented by the Housing Authority, the waiting time for an elderly household to be allocated a public housing flat has been reduced. As of end September 2015, the average waiting time for the elderly singleton was 2.0 years, shorter than the average waiting time of 3.6 years for ordinary applicants. Besides, the Hong Kong Housing Society implements the Senior Citizen Residences Scheme which integrates purpose-built housing for the elderly with comprehensive health and care facilities. The housing units are leased out to eligible middle-income elderly under a "lease for life" arrangement.

80. In Hong Kong, properties are valuable assets. The CoP has taken note that there are more and more elderly singletons and two-person elderly households residing in self-owned properties with no mortgage (including private housing and HOS flats). The proportion of these households has increased from 60 000 or so in 2004 to about 120 000 in 2014. The CoP considers that given the trend of population ageing and longer average life expectancy, the reverse mortgage market in Hong Kong has great potential for development. Diagram 19 depicts the key statistics related to the Reverse Mortgage Programme launched by the Hong Kong Mortgage Corporation (HKMC) in 2011. The CoP recommends that HKMC should improve the operational details of reverse mortgage, and enhance publicity and supervision to make it more appealing to the elderly.

Diagram 19: Key statistics on the Reverse Mortgage Programme
(as at end October 2015)

Cumulative number of applications	1 034
Type of application	One borrower: 65% Two borrowers: 34.8% Three borrowers: 0.2%
Payment term	10-year: 30% 15-year: 16% 20-year: 13% Life: 41%
Age of borrower	69 on average (from 55 to 95)
Appraised property value*	$4.9 million on average (from $800,000 to $45 million)
Monthly payout	$14,700 on average (from $0 to $160,000)
Age of property	30 years (from 1 to 61 years)

Note: (*) A discount will be applied to any property valued over $8 million or any refinancing property under the reverse mortgage arrangement in computing the property value for payout calculation. The maximum property value for payout calculation is capped at $15 million for any property valued at $25 million or above.

Source: HKMC

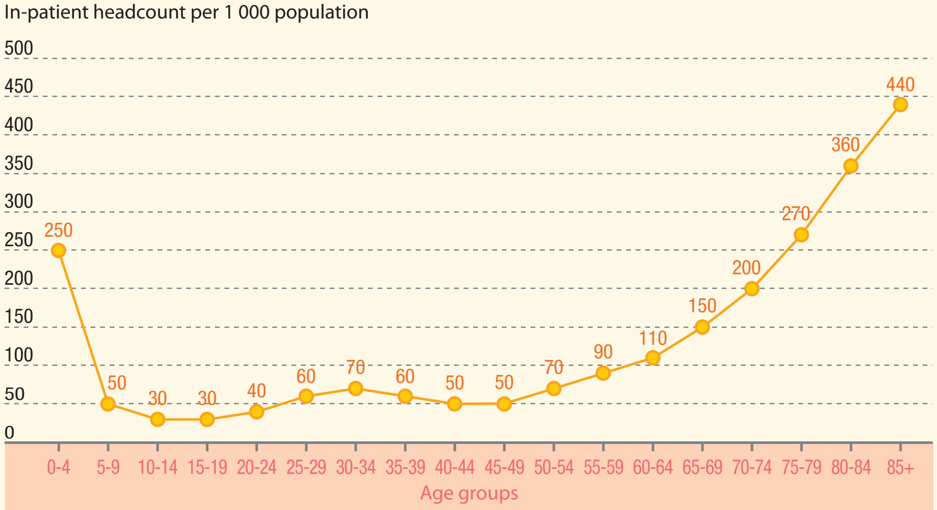
81. The CoP is also aware that the tradition of passing on property ownership to one's own children or relatives is still common in the elderly community. To meet the wish of these elderly people, the CoP proposes integrating the efforts of other sectors (such as social enterprises) to help elderly people let out the whole or part of their properties. This will release the value of the properties and bring rental income to the elderly while enabling them to attain ownership. The housing resources could also be better utilised to address the housing needs of other households.

Public healthcare for the elderly

82. The CoP recognises that the elderly are particularly concerned about their health conditions and the availability of appropriate healthcare services when they are sick. As the healthcare safety net for Hong Kong people, the public healthcare system provides the elderly and other members of the public with access to healthcare services at highly subsidised rates (at present, the Government's overall subsidisation rate is as high as 97%). Besides, the Hospital Authority (HA) has a medical fee waiver mechanism to assist the elderly and other patients who cannot afford the public healthcare service charges owing to financial difficulties and who can meet the eligibility assessment. In addition, all CSSA recipients (including the elderly people) are entitled to free public medical services. With such financial assistance, no elderly people will be denied adequate medical care due to lack of means.

83. Given the trend of ageing population, elderly people will remain the major users of public healthcare services. The elderly's utilisation rate of healthcare services rises almost exponentially as they get older (see Diagram 20). It is worth noting that longer average life expectancy will cause the proportion of elderly people aged 75 or above to increase from 7.6% in 2014 to 22.6% in 2064. In 2014, the proportion of elderly population in Hong Kong was about 15%, but elderly people accounted for 38% of the general out-patient clinic visits and their share of patient days in all HA's hospitals was 50%. The risk of hospitalisation for the elderly is about four times that for the non-elderly (see Diagram 21). In addition to the rising number of elderly in-patients, elderly people also suffer from more complicated diseases. For example, chronic diseases such as hypertension, stroke, diabetes and dementia are becoming more prevalent among elderly people. This will impose a heavier burden on the public healthcare system. It is estimated that the costs of healthcare services for the elderly will be tripled after 50 years[21].

Diagram 20: Healthcare service utilisation rate rises sharply for the elderly aged 65 or above (2010)

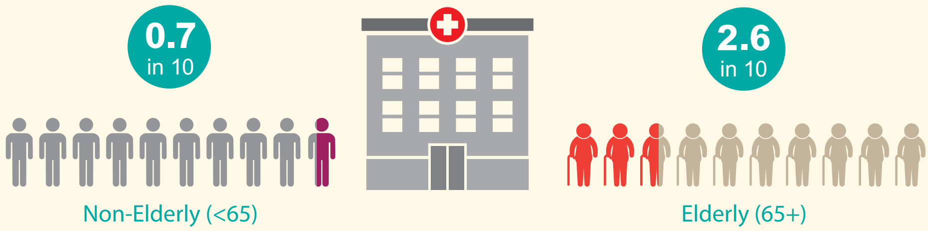


Source: HA I.T. System

21 This estimate is purely on account of the growth of the elderly population, discounting the factor of inflation and assuming that there is no service improvement.

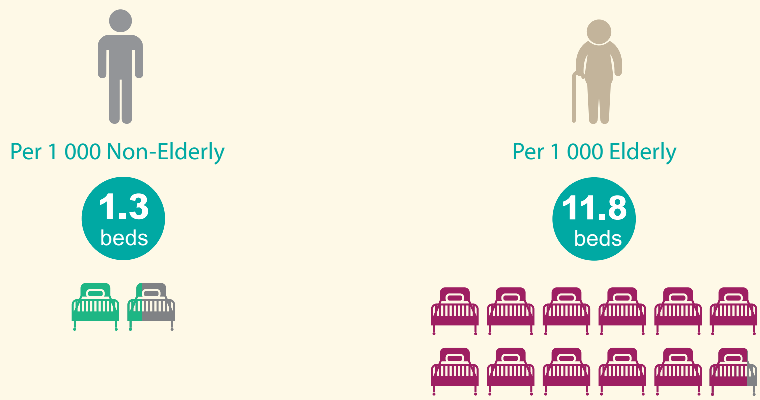
Diagram 21: Risk of hospitalisation for the elderly (in comparison with the non-elderly)

Ever admitted to any HA hospital *(General specialty)



Remarks: * Figures in 2010.
Age 0 are excluded in the calculation of hospital service utilisation.

Hospital Bed Requirement* (General specialty)



Note: (*) Figures in 2010.
Age 0 are excluded in the calculation of hospital service utilisation.

Source: HA I.T. System

84. The HA currently has about 27 600 beds. As the population is increasing and ageing, it is estimated that about 5 000 additional general beds will be needed by 2025-26. Hospital development or redevelopment projects which are being carried out or in the pipeline should be able to handle this extra demand. To meet the challenges of population ageing, the Food and Health Bureau is formulating a long-term hospital development blueprint. In addition, the Steering Committee on Strategic Review on Healthcare Manpower Planning and Professional Development is considering ways to cope with the anticipated demand for healthcare manpower and promote professional development, and will put forth recommendations in the first half of 2016.

85. The CoP has also expressed concern that the waiting time for some specialist out-patient services (e.g. orthopaedics and psychiatry) is too long for the elderly. In October this year, the HA launched an Action Plan in response to the Report of the Steering Committee on Review of Hospital Authority published earlier. As part of this Action Plan, HA will implement a series of measures within the next three years to shorten the waiting time of specialist out-patient clinics (SOPCs). However, the CoP considers that the HA still needs to take further action to shorten the waiting time for SOPCs for the elderly.

86. The CoP is of the view that the HA should, apart from increasing its service capacity and shortening the waiting time, further improve the mode of service delivery. This includes enhancing co-operation with other sectors (e.g. the Department of Health, the welfare sector and private medical sector) in the provision of primary care and rehabilitation services to reduce the risk of hospitalisation for elderly people or their re-admission to hospital. This will relieve the burden on the public medical sector.

87. The CoP is of the view that the manpower problem in the public healthcare system also calls for our immediate attention. While recognising the efforts of the Government and the medical sector in the past few years to address the issue, the CoP sees the need for a more thorough revamp, which includes more vigorous effort to attract medical professionals from abroad, especially Hong Kong students and the second generation of Hong Kong emigrants who have completed medical studies overseas.

Community and residential care services

88. About 6% of the elderly people in Hong Kong are living in residential care homes for the elderly (RCHEs). This percentage is higher than the 1% to 5% in many countries or places. The CoP considers that the Government should pursue the policy of "ageing in place as the core, institutional care as back-up" more vigorously. On the one hand, the Government should strengthen the development of community care services so as to help the elderly people age at home as far as practicable. On the other hand, the Government should adopt a multi-pronged approach to increasing the residential care places and building more contract homes for the elderly in need of residential care services.

89. In face of keen demand for residential care places, merely relying on the current funding mode to increase the provision of service places may not be able to meet the demand. As mentioned in paragraph 48 above, the Government has commissioned the Elderly Commission to conduct a feasibility study of a voucher scheme on residential care services for the elderly with a view to better utilising the non-subsidised vacancies of RCHEs to meet service demand.

90. At present, the average waiting time for subsidised care and attention home places is about 20 months, and that for subsidised nursing homes is 28 months. The waiting time for subsidised day care and home care services is seven and five months respectively. The CoP considers that there has been a shortfall in the supply of elderly services over the years. As the problem will be aggravated by population ageing, the Government should look into ways to reduce the waiting time. The CoP's proposals include stepping up efforts to achieve the objective of ageing in place by substantially increasing the provision of community care services,

better coordination between the Housing Department and the Social Welfare Department in considering the allocation of spaces for RCHEs or day care centres in public housing development, and exploring ways to make better use of private or self-financing RCHEs. The CoP also thinks that the Government should take action to address such issues as the service quality, manpower shortage and conditions of service in the elderly care service industry.

Family support

91. About 76% of the elderly are currently living with their families or relatives. This reflects the importance attached to family values in our community. The CoP has taken note that there are various policy initiatives in place to encourage support and care for elderly family members. These measures include the Dependent Parent and Dependent Grandparent Allowance, various schemes operated by the Housing Authority that encourage PRH tenants to live with or move closer to their elderly family members, as well as support for carers to take care of the elderly people living in the community.

92. Besides, the Census and Statistics Department conducted a Thematic Household Survey on “Retirement Planning and Financial Situation in Old Age” in 2012. The result showed that nearly 80% of the respondents opined that they themselves, their children/grandchildren and their spouse should be most responsible for providing their financial protection after retirement/in old age whereas less than 10% considered the Government should be the most responsible party. Separately, around 70% of the current generation (at the time of survey) of retired persons indicated that their family members provided financial support for them. The median amount of monthly financial support provided by family members was $4,000 (at 2012 price).

93. The CoP reaffirms the important role of the family in caring for the elderly, and the need to encourage and facilitate family support for the elderly people through public policy measures.

Other topics

Public education

94. Notwithstanding the above, more than 40% of the respondents have not made preparation for their own retirement according to the survey mentioned in paragraph 92 above. The CoP considers it necessary to step up promotion and publicity with a view to increasing public understanding and acceptance of the MPF System, and enhancing public awareness of the importance of retirement planning and the advantages of early savings, including how to calculate one’s financial needs after retirement and accumulate sufficient retirement income.

Express your views

95. Retirement protection forms a core part of our preparation for an ageing society. There is much to do and we need to move faster. The CoP is of the view that the community should weigh all considerations and make the right choices in enhancing retirement protection in a pragmatic and sustainable manner. On the other hand, we should avoid passing unbearable burden to future generations. In charting our way forward, views of the public are very important to us. The CoP hopes that you will express your views in particular on the issues listed below.

"Regardless of rich or poor" or "those with financial needs" principle

(a) With limited resources, addressing elderly poverty is one of the primary objectives of enhancing retirement protection. To effectively improve the poverty situation of the elderly and ensure the sustainability of the system, should we adopt the "regardless of rich or poor" principle to provide a uniform payment for all elderly people irrespective of their financial status? Or should we continue to use the "those with financial needs" principle targeting resources towards increased assistance for the elderly in need, with a view to providing them with adequate protection? What are the justifications? The substantial expenditure required by the "regardless of rich or poor" option will render tax hike or new taxes inevitable. Are you willing to pay the additional taxes?

Groups deserving attention

(b) The CoP has identified four groups which deserve further attention, namely:

(i) the poor elderly people who are receiving assistance such as the OALA and still claim to have financial needs;

(ii) the low-income workers, especially those who need not make MPF employee contributions because of their low income and those who are affected by the "offsetting" arrangement;

(iii) the non-working population; and

(iv) the elderly people who are "asset-rich, income-poor".

Do you think there are other groups which need our further attention?

Enhancing existing pillars

The zero pillar — social security

(c) At present, 73% of the elderly population are beneficiaries of various social security schemes, including the CSSA, OALA, DA and OAA. To strengthen the poverty alleviation function of the zero pillar, should we offer an additional tier of financial assistance under the OALA for the needy elderly by adopting the "those with financial needs" option? How can we identify these needy elderly? At what level should the asset limit be set? What subsidy level is regarded as adequate?

The second pillar — MPF

(d) The CoP agrees that the MPF pillar should be strengthened by introducing three key measures:

(i) Launching the DIS in 2016;

(ii) Putting in place a centralised electronic portal to facilitate the standardisation, streamlining and automation of the MPF scheme administration; and

(iii) Implementing "full portability" in the long run.

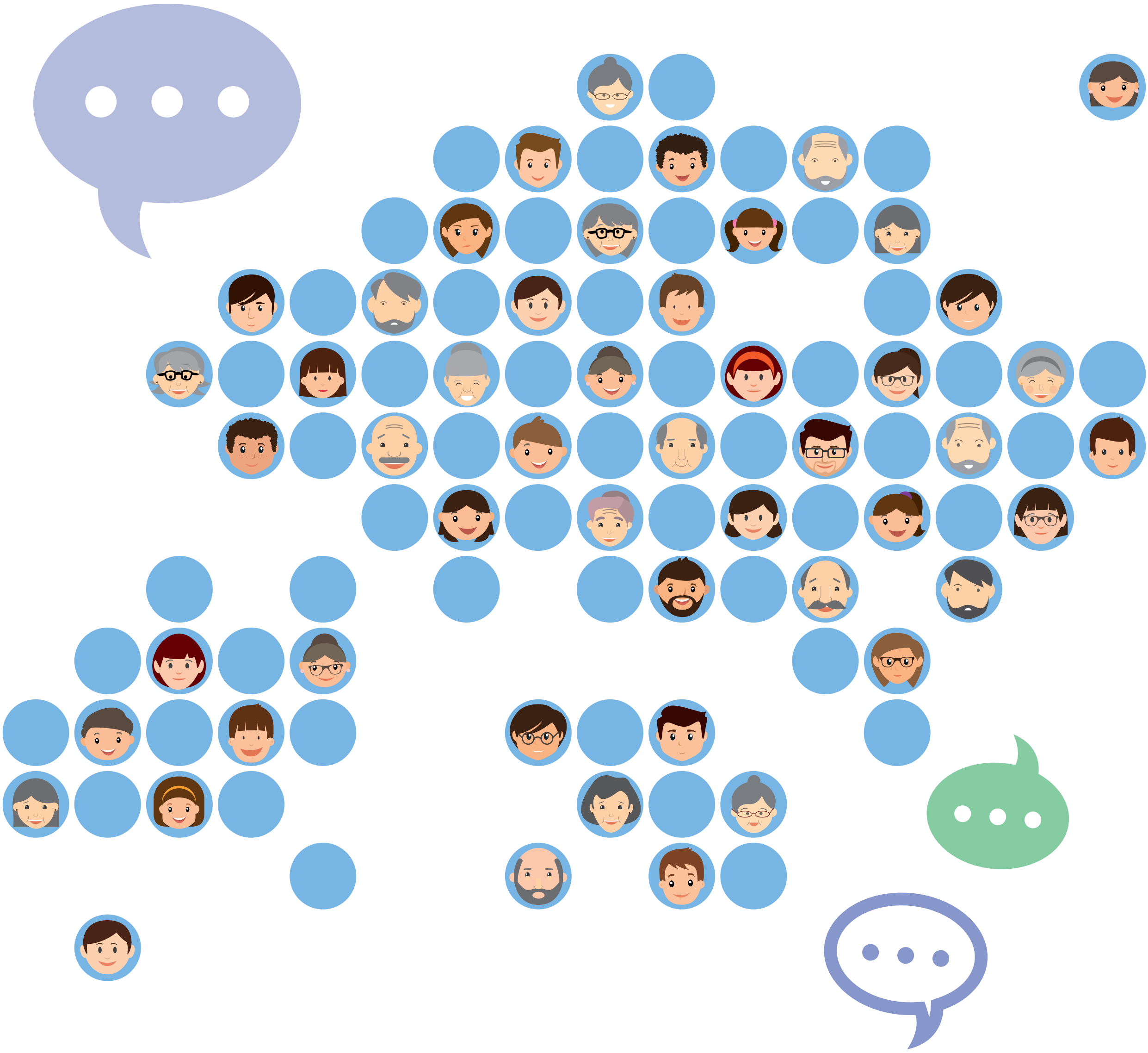
The CoP also thinks that the community should make good use of the opportunity offered by this consultation to conduct thorough and in-depth discussion on the impact of the feasible options to address the "offsetting" issue on employers and employees, as well as the role of the Government. The community should endeavour to find an option acceptable to both employers and employees. In addition, the community should consider ways to rationalise the relationship between severance payment/long service payment and the MPF, and discuss mitigation measures which can reduce the impact of any changes on the business sector (especially SMEs) and the labour market. The CoP also proposes to further consider the feasibility of raising the contribution rate upon full implementation of the DIS.

Do you agree with these reform directions? In particular, do you have any specific proposals to properly address the "offsetting" issue?

The third pillar — voluntary savings

(e) The CoP considers that a three-pronged approach may be adopted to further encourage voluntary savings:

(i) Strengthening publicity and promotion efforts to enhance public understanding of different kinds of insurance and financial products that will help people plan their retirement life or manage their wealth;



(ii) Creating a favourable policy environment to encourage the market to develop more financial products for retirement investment and wealth management (such as annuity plans or retail bonds with longer term to maturity); and

(iii) Providing tax concessions to incentivise people to increase voluntary retirement savings for themselves and their families.

Do you agree that these proposals would be effective in encouraging voluntary savings? Do you have other ideas?

(f) The CoP considers that the community should further explore the viability of the public annuity scheme. Do you agree with this proposed direction?

The fourth pillar — public services

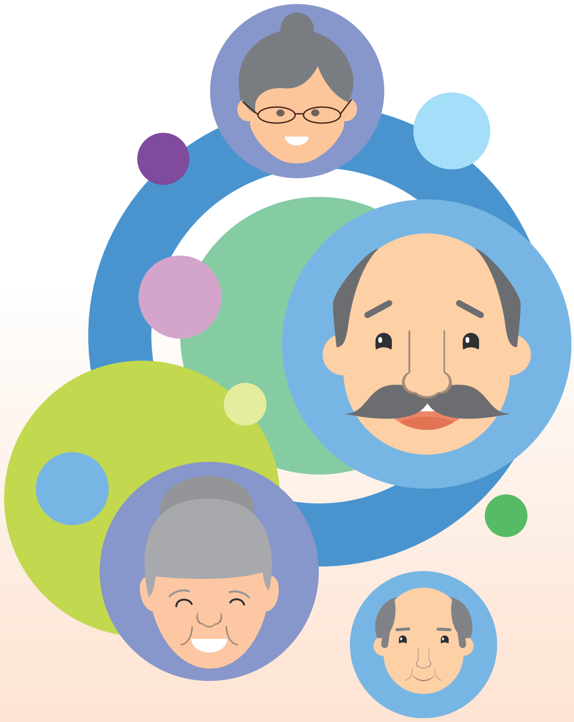
(g) An ageing population will lead to a drastic increase in demand for healthcare and elderly services. How should we ensure the sustainability of this pillar and plan the software and hardware facilities (including land, manpower and service delivery) for various services to meet future needs?

The fourth pillar — self-owned properties

(h) The CoP considers that innovative approaches should be identified to help the "asset-rich, income-poor" elderly increase their retirement income. As properties are valuable assets, the reverse mortgage market in Hong Kong has great potential for development. The CoP proposes improving the operational details of the Reverse Mortgage Programme and strengthening publicity to make it more appealing to the elderly. The CoP also proposes integrating the efforts of various sectors (such as social enterprises) to help elderly people let out the whole or part of their properties to supplement their retirement income with rental. Do you support these proposals?

The fourth pillar — family support

(i) The CoP sees the need to explore further how we can encourage and facilitate family support for the elderly through public policy measures. Do you have any specific proposals?



Public education

(j) The CoP considers it necessary to step up promotion and publicity with a view to increasing public understanding and acceptance of the MPF System, and enhancing public awareness of the importance of retirement planning and the advantages of early savings, including how to calculate one's financial needs after retirement and accumulate adequate retirement income. Do you agree with these ideas? What specific proposals do you have?

96. Please send your comments on the consultation document to us on or before 21 June 2016 through the following means. Your comments and proposals may be published and please specify so if you request anonymity in your submission.

Email: views@rp.gov.hk

Website: rp.gov.hk

Fax: 3904 5996

Mailing Address: Labour and Welfare Bureau
(Retirement Protection Public Engagement Exercise),
10/F, Central Government Offices (West Wing),
2 Tim Mei Avenue, Tamar, Hong Kong

Enquiries: 3142 2303

Annex A — Commission on Poverty's Terms of Reference and Membership

Terms of reference

(1) Update the poverty line analysis on a yearly basis and refine its analytical framework as appropriate to review the poverty situation and the effectiveness of poverty alleviation measures in Hong Kong;

(2) Review existing policies and explore new measures and through the work of the Task Forces to achieve the objectives of preventing and alleviating poverty for facilitating the grass-roots (especially the younger generation) to move upwards along the social ladder, providing appropriate support to target groups with special needs, as well as plugging the gaps in the existing system and promoting social innovation to tackle poverty through the Community Care Fund and the Social Innovation and Entrepreneurship Development Fund;

(3) Explore options to enhance retirement protection to improve the situation of elderly poverty in light of the actual situation in Hong Kong with reference to the study report on retirement protection conducted by Professor Nelson Chow and his team;

(4) Keep track of the feasibility study on establishing a central benefits service in Hong Kong and advise on future directions having regard to the results of the feasibility study; and

(5) Promote cross-sector collaboration in poverty alleviation work and engage other government advisory committees on poverty alleviation work.

Membership

Chairperson

Chief Secretary for Administration

Non-official members

Ms Amy Chan Lim-chee
Ms May Chan Suk-mei
Dr Henry Cheng Kar-shun
Professor Stephen Cheung Yan-leung
Dr Stephen Frederick Fisher
Mr Ho Hei-wah
Mr Lau Ming-wai
Mr Leung Che-cheung
Ms Li Fung-ying
Ms Yvonne Sin
Ms Sylvia Chan May-kuen
Mr Clement Chen Cheng-jen
Mr Cheung Kwok-che
Mr Chua Hoi-wai
Mr Frederick Fung Kin-kee
Ms Lam Shuk-yee
Dr Law Chi-kwong
Mr Clarence Leung Wang-ching
Professor Francis Lui Ting-ming
Mr Michael Tien Puk-sun

Ex-officio members

Secretary for Labour and Welfare (or his representative)

Secretary for Food and Health (or his representative)

Secretary for Education (or his representative)

Secretary for Home Affairs (or his representative)

Annex B — Background and Relevant Information on Severance Payment, Long Service Payment and "Offsetting" Mechanism

Eligibility for severance payment

1. Severance payment was introduced under the Employment Ordinance in 1974 to provide compensation for an employee who is dismissed by reason of redundancy and has no less than 24 months of continuous services with the same employer prior to the termination, so as to help alleviate his/her financial hardship caused by loss of employment.

2. According to the existing Employment Ordinance, an employer should pay severance payment to an employee who has been employed continuously for no less than 24 months if:

   (a) the employee is dismissed by reason of redundancy;

   (b) his/her fixed term employment contract expires without being renewed by reason of redundancy; or

   (c) he/she is laid off under the circumstances as specified in the Employment Ordinance.

Eligibility for long service payment

3. Long service payment was introduced under the Employment Ordinance in 1986 to provide compensation for older employees dismissed by reason other than redundancy after serving the same employer for a long period of time. When long service payment was first introduced, it was targeted at older employees. As such, in calculating the amount of long service payment, younger employees would receive a smaller amount than older ones, and were required to have a longer service period in order to be eligible for long service payment. After a number of subsequent amendments were made to the Employment Ordinance, the provisions for long service payment have progressively evolved into the current version, where the amount payable to employees is calculated by the same formula irrespective of their age, and the protection coverage is extended to include employees who resign under certain special circumstances.

4. According to the existing Employment Ordinance, an employer should pay long service payment to an employee who has been employed continuously for no less than five years if:

(a) the employee is dismissed other than by reasons of redundancy or serious misconduct ;

(b) his/her fixed term employment contract expires without being renewed;

(c) he/she is permanently unfit for his/her present job due to health reasons;

(d) he/she resigns at the age of 65; or

(e) he/she dies during employment.

Calculation of severance payment and long service payment

5. For each dismissal incident an employee may only receive either severance payment or long service payment. Both payments are calculated by the same formula as shown below:

   (Last month's wages* x 2/3)# x years of service

   *An employee may elect to use his/her average wages in the last 12 months for calculation.

   # The monthly wage cap is $22,500, i.e. maximum payment of $15,000 ($22,500 x 2/3) for each year of service. Service of an incomplete year should be calculated on a pro rata basis.

   The maximum amount of severance payment or long service payment is $390,000.

"Offsetting" arrangement

6. When severance payment and long service payment were introduced under the Employment Ordinance in 1974 and 1986 respectively, employers were allowed to use the gratuity based on the length of service paid to employees or provident fund to offset severance payment and long service payment (the so-called "offsetting" arrangement). Several amendments were made subsequently to the "offsetting" provisions. The "offsetting" arrangement is also applicable to the retirement protection schemes registered under the Occupational Retirement Schemes Ordinance and the Mandatory Provident Fund Schemes Ordinance.

7. The following table provides a summary of the Legislature's discussion on the introduction of and subsequent amendments to the "offsetting" provisions having regard to the legislation for severance payment and long service payment, including the Government's response to the motion debate held in the Legislative Council in 1995 on the establishment of the MPF. It seeks to facilitate public understanding of the policy intent of the "offsetting" arrangement, as well as the interface of severance payment and long service payment with the MPF and other retirement protection schemes:

Year	Details of Event
1974	The arrangement of severance payment under the Employment Ordinance came into effect. It provided compensation for employees dismissed by reason of redundancy to alleviate their financial hardship caused by loss of employment. The amendments to the ordinance also allowed employers to use gratuities based on length of service or their contributions made to provident fund schemes to "offset" the severance payment. According to the Official Report of Proceedings of the Legislative Council (when moving the Second Reading of the amendment bill on 3 July 1974), the Government said that the introduction of severance payment aimed to provide compensation for employees dismissed by reason of redundancy to alleviate their financial hardship caused by loss of employment. It also served to reduce labour disputes concerning redundancy and provide a framework for the making of severance payments (please refer to the extract of the original report: "Severance payment on redundancy is the means whereby an employee may be compensated for loss of employment through no fault of their own… The bill has three main aims. It will serve to protect employees against possible hardship arising from redundancy and, with Hong Kong's present system of social security, it seems important that this form of protection should be available to all employees who come within the scope of the Employment Ordinance. Second, it should serve to reduce the incidence of labour disputes concerning redundancy by introducing a minimum legal obligation in all cases. Third, it should help to clear up much of the existing confusion by confirming the practice, and regulating the method, of making severance payments."). Moreover, the Government expressed that as a number of firms in Hong Kong had been for many years providing long service gratuities or redundancy compensation under employment contracts, it was considered that severance payment should be alternative and not additional to such schemes and that employees should be given the option of choosing the most favourable arrangement. Severance payment was intended to provide compensation for employees who lost employment and did not operate as an additional benefit where such protection was already available ("As a number of firms in Hong Kong have for many years included long service gratuities or redundancy provisions in the terms of their contracts of employment, which adequately protect employees against the adverse effects of redundancy, it was concluded that severance pay should be alternative and not additional to such schemes and that employees should be given the option of choosing which was the more favourable. Severance pay is intended to provide compensation for loss of employment and not to operate as a bonus where such protection is already available."). According to the Official Report of Proceedings of the Legislative Council (when the debate on Second Reading of the amendment bill resumed and the Committee Stage Amendments to the bill were handled on 14 August 1974),

Year	Details of Event
	the Government also considered that there was another section under the same bill excluding pensionable civil servants from the right to severance payment. Therefore, a similar principle should be applied in the private sector whereby employers could use gratuity or their contributions to provident funds to offset severance payment (…civil servants as a class of employee are excluded from the right to severance payment because of their entitlement under the Pension Ordinance. It is considered that a similar principle should be applied in the private sector whereby entitlement to gratuity or the employers contribution to a provident fund should be offset against entitlement to severance pay…").
1986	The arrangement of long service payment under the Employment Ordinance came into effect. The initial aim was to provide compensation for older employees who were dismissed by reason other than redundancy after serving the same employer for a long period of time. According to the Official Report of Proceedings of the Legislative Council (when moving the Second Reading of the amendment bill on 4 December 1985), the Government expressed that "…Since 1974 employees dismissed by reason of redundancy have been eligible for a severance payment from their employer, currently set at two thirds of a month's wages for each completed year of service. In the case of employees whose contract of employment is terminated under other circumstances, the Employment Ordinance merely requires the service of an agreed or statutory period of notice or the payment by the employer of wages in lieu of such notice. This disparity in the treatment of a dismissed employee has been often criticised as unfair, and especially unfair to ageing employees dismissed through no fault of their own who have served the same employer for several decades. Many older employees after dismissal find it especially difficult to secure alternative employment, in particular manual workers…Instead, the present long service payment proposals have been developed as a practical alternative to unfair dismissal legislation, based on the premise that the dismissal of an elderly long service employee without some form of provision for his future is itself unreasonable. A statutory requirement for an employer to make a payment to a dismissed employee, based on his age and length of service, would achieve much the same result as an employee's entitlement to monetary compensation under unfair dismissal legislation while avoiding the need for complex and expensive procedures to establish that the dismissal had been unreasonable in the circumstances". The amendments to the ordinance also allowed employers to use their contributions to provident fund schemes or gratuities based on length of service to offset long service payment. The relevant provisions were similar to those "offsetting" provisions applicable to severance payment. According to the Official Report of Proceedings of the Legislative Council, government officials and Members did not discuss about the "offsetting" provisions during the resumption of Second Reading debate of the amendment bill (on 18 December 1985).

Year	Details of Event
1992	The Employment (Amendment) Bill was passed to amend the provisions on severance payment and long service payment, including clarifying some ambiguities relating to the "offsetting" arrangement*. According to the Official Record of Proceedings of the Legislative Council (when moving the Second Reading of the amendment bill on 13 May 1992), the Government indicated that "we propose to remove the ambiguities in the existing provisions on setting off of retirement scheme payment against severance or long service payment. To ensure that employers will not have to pay double benefits, clauses 7 and 11 put it beyond doubt that payment of severance or long service payment can be set off by retirement scheme payment and vice versa".
1993	The Occupational Retirement Schemes Ordinance came into effect, providing a legal basis for the regulation of voluntary occupational retirement schemes. No discussion was held on the "offsetting" arrangement during the legislative process, and no provision was made for the "offsetting" arrangement under the Occupational Retirement Schemes Ordinance. However, it was stipulated in the Employment Ordinance that employers could reduce severance payment or long service payment by their contributions to retirement schemes. Therefore, the "offsetting" arrangement is also applicable to the retirement protection schemes registered under the Occupational Retirement Schemes Ordinance.
1995	In March 1995, the Legislative Council debated the following motion on retirement protection moved by the Secretary for Education and Manpower (SEM): "That this Council urges Government to introduce as expeditiously as possible a mandatory, privately managed occupational retirement protection system with provision for the preservation and portability of benefits." When talking about the interface of severance payment and long service payment with the MPF in his opening speech, the SEM pointed out that the "offsetting" arrangement was to ensure that "Employers do not pay twice. Severance payments and long service payments are not designed as supplementary retirement schemes. They are intended to be alternatives to these retirement schemes. That is why the offsetting provisions exist under the present voluntary system of occupational retirement schemes. We do not intend to change it under the MPF, although we will need to consider very carefully the effect of the MPF on both schemes".

Notes: (*) The major amendments were to clearly specify that gratuity or retirement scheme payment for an employee could be reduced by severance payment or long service payment already paid to the employee, or severance payment or long service payment for an employee could be reduced by gratuity or retirement scheme payment already paid to the employee.

Year	Details of Event
	In his concluding remarks, the SEM said that "these were designed at a time when there was little retirement protection. We were concerned about the difficulties that workers, especially elderly ones, might face in finding another job. These measures were introduced to help them over such difficulties. At the same time, we tried to encourage the provision of voluntary occupational retirement schemes. There is already provision in the Employment Ordinance to allow for the setting off of an employer's benefit payments under a retirement scheme by the amount payable for severance payments or long service payments".
1995	In July 1995, the Legislative Council passed the Mandatory Provident Fund Schemes Bill. During the debate on Second Reading of the bill, the SEM made the following response on the "offsetting" arrangement: "This is in line with our policy intent to enable the long-established set-off procedure under the Employment Ordinance in respect of schemes under ORSO to continue for MPF schemes. We have made it very clear that employers are not expected to pay twice under this new system…We do, of course, realize in the longer term the interface of long service payments and severance payments with the MPF need to be examined…". At the Committee stage, some Members proposed an amendment to abolish the "offsetting" arrangement. In response to the amendment, the SEM said: "At present, the employers' contributions to a retirement scheme may be set off against any amount paid out for severance payments or long service payments. It is not appropriate to expect employers to pay twice".
2001	The Legislative Council passed the Employment (Amendment) Ordinance 2001. Technical amendments were made to the "offsetting" provisions applicable to severance payment and long service payment under the Employment Ordinance, allowing employers to reduce severance payment or long service payment payable to employees by MPF scheme benefits already paid to the employees, so as to reflect the policy intent of the provisions more accurately.

Long service payment and retirement protection

8. Apart from the above discussions held during the legislative process, it is also worth mentioning that the Government established a Working Group on Retirement Protection, comprising government officials and representatives of outside bodies, in November 1991. The Working Group was responsible for reviewing the various options of enhancing retirement protection for working persons. A consultation paper entitled "A Community-wide Retirement Protection System" was issued by the Working Group in October 1992, proposing the establishment of a mandatory system linked with occupation, under which both employers and employees were required to make contributions. The role of long service payment in the retirement protection arrangement was mentioned in the paper. The relevant parts are summarised below:

“The Government had preferred an alternative strategy. This was -

(a) to encourage the establishment of private retirement schemes on a voluntary basis; and

(b) to tighten control over the operation of those schemes already in existence; while

(c) enhancing the provision of social welfare and improving the Long Service Payment Scheme (LSPS) established under the Employment Ordinance.” (paragraph 1.3 of the consultation paper)

“The proposed retirement protection system has to be seen in the light of -

(a) current retirement schemes;

(b) social security schemes;

(c) the Long Service Payment Scheme (LSPS).” (paragraph 7.1 of the consultation paper)

“There are two possible options for the LSPS in future. Under the first option, the LSPS would remain in place and run in parallel with the retirement protection system. The existing provision would be maintained whereby LSP may be reduced by that part of the retirement scheme or provident fund payments contributed by the employer in relation to the years of service for which LSP is payable. As all employers will be required to set up retirement protection schemes, then their liability for LSP will decrease, and eventually disappear. Under this option, the LSPS cannot be abolished in the near future because there will inevitably be many workers who will still receive more under it than they would in the form of retirement benefits.” (paragraph 7.8 of the consultation paper)

“The second option would be to amend the LSP provisions so as, in effect, to turn the LSPS into a retirement protection scheme...” (paragraph 7.9 of the consultation paper)

“The practicalities of adopting a retirement protection scheme based on amending the Long Service Payment Scheme should be examined further at a later date.” (paragraph 10.1(38) of the consultation paper)

Overseas experience

9. In April this year, the Research Office of the Legislative Council prepared an information note on severance payment and long service payment in various places. The information note quoted the findings of a report published by the World Bank in 2012 on the severance payment arrangement in 183 places around the world, as well as the findings of a study conducted by the International Labour Organisation in 2013 on the employment protection legislation in 95 countries. Some noteworthy points include:

    (a) Among the 183 places studied by the World Bank, 152 (83%) had mandated severance payment schemes, 18 (10%) had quasi-mandated severance payment schemes, and 13 (7%) had neither; and

    (b) Among the 95 countries studied by the International Labour Organisation, Switzerland and Indonesia were the only countries with statutory long service payment.

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