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For discussion
on 7 February 2017

LEGISLATIVE COUNCIL
SUBCOMMITTEE ON RETIREMENT PROTECTION

2017 Policy Address

Full Range of Support for Retirement Protection

PURPOSE

This paper briefs Members about the Government's response to the "Retirement Protection Forging Ahead" public engagement exercise set out in the 2017 Policy Address.

"RETIREMENT PROTECTION FORGING AHEAD" PUBLIC ENGAGEMENT EXERCISE

2. Commenced in December 2015, the six-month public engagement exercise entitled "Retirement Protection Forging Ahead" ended in June last year. During this period, the Government and the Commission on Poverty (CoP) organised or took part in 110 public engagement activities of different types, including public forums, meetings of the House Committee and other sub-committees of the Legislative Council (LegCo), 18 District Councils, etc. We received a total of 18 365 written submissions by the close of the public engagement exercise. Of these, 16 830 were submitted in the form of templates that allowed respondents to provide supplementary views; all were from supporters of universal pension. An independent consultant was commissioned to collate and analyse the public views. The consultant's report, following discussion by the CoP, was released in December 2016.

GOVERNMENT'S COMPREHENSIVE POLICY RESPONSE

3. This is the first time since 1997 the community has studied this important subject of retirement protection. After taking into account public

views received and ensuring the sustainability of our financial commitment, we have devised a package of measures to strengthen each of the existing pillars. This is in line with the commitment of this term of the Government to build a just and compassionate society and represents our comprehensive response to the public aspiration for enhancing retirement protection for elderly persons.

Reinforcing the multi-pillar system

4. Adopting the World Bank's multi-pillar approach, Hong Kong's retirement protection system has four pillars, comprising a multi-tiered social security system (pillar 0), the Mandatory Provident Fund (MPF) and other occupation-based retirement savings schemes (pillar 2), voluntary savings (pillar 3), as well as public services, family support and personal assets (pillar 4). The design is underpinned by the principles of sharing the responsibility of retirement protection amongst individuals/families, employers and Government, as well as addressing the varying needs of elderly persons through multiple channels. We consider that Hong Kong should continue to adopt a multi-pillar retirement protection model. We should strengthen each of the existing pillars while maintaining the sustainability and financial viability of the system. The directions for making enhancements comprise –

(a) enhancing the social security pillar so that it can perform well the function of a safety net;
(b) improving the public services pillar, in particular to help elderly persons meet their medical expenses;
(c) enhancing the MPF pillar to maximise the protection for employees; and
(d) making the voluntary savings pillar more assured by exploring financial products to help elderly persons make good use of their assets to increase the stability of their post-retirement investment income.

Enhancing the social security pillar

Providing additional targeted support for elderly persons under Old Age Living Allowance (OALA)

5. The social security pillar currently covers over 70% of our elderly population. The take-up rate of those aged 70 or above is even higher at 87%. We have chosen OALA as the platform for enhancing the social security pillar

because OALA is the most effective recurrent cash policy for tackling elderly poverty. OALA, relative to Comprehensive Social Security Assistance (CSSA), is simple in design and more relaxed in terms of income and asset requirements, particularly the arrangement of allowing applications to be made on an individual or couple basis.

6. We propose to enhance OALA in two aspects:

(a) adding a higher tier of assistance for elderly persons with more financial needs who are eligible for the allowance, i.e. elderly singletons with assets not exceeding $144,000 or elderly couples with assets not exceeding $218,000, by providing a higher monthly allowance of $3,435 per person (about one-third more than the existing OALA payment ($2,565 with effect from 1 February 2017)); and

(b) relaxing the existing asset limits for OALA, from $225,000 (with effect from 1 February 2017) to $329,000 for elderly singletons and from $341,000 to $499,000 for elderly couples, to benefit more elderly persons with financial needs.

The higher tier of assistance of $3,435 per month is pegged to the standard rate for able-bodied/50% disabled CSSA elderly singleton recipients. The OALA income limits (i.e. $7,750 per month for singletons and $12,620 per month for couples with effect from 1 February 2017) will remain unchanged. The two measures could benefit about 500 000 elderly persons (or around 40% of the elderly population) in the first year of implementation, comprising about 81% of existing OALA recipients (or 365 900) who have more financial needs based on the Social Welfare Department's administrative records, and another 127 400 elderly persons who would likely become eligible for OALA under the relaxed asset limits. Each of these 500 000 elderly persons will receive more than $30,000 to $40,000 each year. Counting in CSSA and non-means tested Old Age Allowance and Disability Allowance, the social security pillar could cover about 910 000 or around 74% of elderly in the first year of implementation.

Enhancing the CSSA application arrangement for elderly persons

7. CSSA has been providing appropriate assistance to individuals with the most financial needs (including elderly persons). Having regard that CSSA is designed to be the safety net of last resort and that members of the

same family should support one another, we will maintain the requirement for elderly persons living with their families under the same roof to apply on a household basis. Having examined the application process, we nevertheless recommend abolishing the arrangement for the relatives concerned to make a declaration on whether they provide the elderly persons who apply for CSSA on their own (e.g. an elderly person who does not live with his children) with financial support (the so-called "bad son statement"). The information should be submitted by the elderly applicants only.

8. Besides, in view of our improved life expectancy and the policy of encouraging young-olds to join the workforce, we recommend raising the eligibility age for elderly CSSA from 60 to 65. Elderly persons aged between 60 and 64 who are receiving CSSA before the new policy takes effect will not be affected, except when they re-apply for CSSA after having left the CSSA net, in which case the revised definition of old age will apply.

<u>Improving the public services pillar</u>

Extending the coverage of the medical fee waiver system

9. Notwithstanding that the public healthcare services are heavily subsidised by the Government, CSSA recipients (including elderly persons) can receive free medical treatment at public hospitals and clinics without the need for further assessment. Non-CSSA patients who come within the asset and income limits would be qualified for full or partial waivers. The existing utilisation rate of the medical fee waiver mechanism by non-CSSA elderly patients is low. To alleviate the financial burden of non-CSSA poor elderly persons in medical expenses, we recommend extending the automatic medical fee waiving arrangement to older and more needy OALA recipients (i.e. aged 75 or above and with assets not exceeding $144,000 for singletons or not exceeding $218,000 for couples), to be on par with the provision for CSSA recipients in terms of access to free public hospital and clinic services. We expect that about 140 000 OALA recipients will benefit in the first year of implementation.

Enhancing the Elderly Health Care Voucher (EHCV) Scheme

10. To instil a stronger sense of health promotion and better primary care amongst elderly persons, as well as to relieve the pressure on the public healthcare system, we recommend lowering the EHCV's eligibility age from 70 to 65. About 400 000 additional elderly persons are expected to benefit from

the EHCV of $2,000 per annum for receiving private primary care services in the first year of implementation.

Enhancing the MPF pillar

Abolishing the "offsetting" arrangement progressively

11. "Offsetting" provisions originated in the Employment Ordinance when severance payment (SP) (1974) and long service payment (LSP) (1986) were introduced and before the MPF System was put in place, allowing employers to use gratuities attributable to employees' years of service or contributions made for employees under retirement schemes to offset SP and LSP payable[1]. The Mandatory Provident Fund Schemes Ordinance (MPFSO) enacted in 1995 allows an employer to offset his SP/LSP payment against the accrued benefits from his MPF contributions. For employees subject to "offsetting", on average about 94% of their employers' accrued benefits were withdrawn. About 67% of the affected employees had employers' accrued benefits completely withdrawn.

12. In many "offsetting" cases, the accrued benefits from employers' MPF contributions are not enough to settle the SP/LSP in full, and the shortfall has to be met by employers out-of-pocket. According to the 2014 and 2015 information from the MPF Authority, accrued benefits from employers' contributions on average can "offset" 83% of the total SP/LSP payable, with the remaining 17% paid by employers out-of-pocket. Furthermore, according to accounting standards, provisions should be recognised for the LSP liability in financial statements. Such provisions will be recognised as an expense in the profit and loss account and are tax deductible, but there is no need to set aside assets to back up the recognised liability.

13. Taking into account the historical background of SP/LSP and "offsetting", we recommend that the arrangement for the abolition of "offsetting" should be subject to the following guiding principles –

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[1] SP/LSP have the following four major functions –
(a) financial relief for loss of employment caused by dismissals;
(b) compensation for long-term service in case of dismissals not because of redundancy nor employees' own fault and three "involuntary" resignations (old age, ill health and death in service);
(c) protection against dismissals; and
(d) retirement protection.

(a) the abolition of “offsetting” should have no retrospective effect;
(b) to balance between employers’ affordability and employees’ benefits;
(c) Government should have a visible role to play in terms of financial commitment but any payments from the public purse should be finite in quantum and duration;
(d) employees currently not covered by MPFSO or other statutory retirement schemes and hence not affected by the abolition of the “offsetting” arrangement would continue to have their SP/LSP entitlements dealt with and calculated in accordance with the existing provisions of the law; and
(e) any unintended policy consequences in terms of creating moral hazards, souring labour relations, massive lay-offs, etc. should be minimised.

14. Based on the above principles, we recommend that the “offsetting” package should have three main components –

(a) from a prospective date (the Effective Date), abolish “offsetting” arrangement with no retrospective effect and put in place a “grandfathering arrangement. Under the “grandfathering” arrangement, as and when an employer needs to pay SP/LSP, he can use accrued benefits from his MPF contributions before the Effective Date and the returns derived therefrom to “offset” against SP/LSP payable for the employment period before the Effective Date. This part of SP/LSP will be calculated according to the existing statutory formula, i.e. –

    last month’s wage before Effective Date × 2/3 (i.e. 66.7%) × years of service;

(b) the SP/LSP payable for the employment period from the Effective Date cannot be “offset” by accrued benefits from MPF contributions, and has to be paid by employers out-of-pocket. This part of SP/LSP will be adjusted downwards and its formula will be revised as –

    last month’s wage × 1/2 (i.e. 50%) × years of service
    (i.e. a dismissed employee with two years of service can receive compensation equivalent to one month’s wage); and

(c) to assist employers, in particular small and medium-sized enterprises, the Government will provide subsidies for employers on a reimbursement basis in the ten years from the Effective Date in order to share part of the SP/LSP expenditure in the absence of the "offsetting" arrangement, until the 11th year when the cost will be fully taken up by employers. Details are as follows –

Year after the Effective Date	Employers' net SP/LSP payment (as % of monthly wage)	Government subsidy reimbursed to employers (as % of monthly wage)	Total SP/LSP (as % of monthly wage)
1	25%	25%	50%
2	25%	25%	50%
3	30%	20%	50%
4	30%	20%	50%
5	35%	15%	50%
6	35%	15%	50%
7	40%	10%	50%
8	40%	10%	50%
9	45%	5%	50%
10	45%	5%	50%
11	50%	--	50%

15. The "grandfathering" arrangement and government subsidy will mitigate the impact on enterprises. In the first few years after the policy change, the additional financial burden on affected enterprises will be notably smaller. On a broad-brush estimation, the estimated additional expenditure on employers in selected years is as follows –

Year after the Effective Date	Estimated overall additional expenditure on employers	Estimated additional expenditure as percentage of total wage bill
1	$111 - $147 million	0.01-0.02%
5	$1.4 - $1.9 billion	0.2%
11	$4.0 - $4.9 billion	0.5-0.6%

Enterprises would adopt different coping strategies, having taken into account their specific circumstances. With "grandfathering" arrangement and government subsidy, the additional cost should be largely manageable for most sectors.

Developing the eMPF platform

16. In addition to launching the Default Investment Strategy (DIS) in April this year, the MPF Authority is contemplating to develop the eMPF which seeks to streamline and automate the MPF scheme administration. The objectives of the eMPF are to lower the operating costs of MPF trustees so as to drive fees further down. We recommend that the MPF Authority should be tasked to take forward such deliberations. The Government will render full support to these efforts.

Government's vision for MPF

17. Notwithstanding its room for much improvement, the MPF System has been in existence for some 16 years covering 2.8 million workers. We should take bold steps to enhance the MPF pillar, so as to make it more effective and more robust, with a view to maximising the protection for employees and rebuilding public confidence. After making sustained efforts in driving fees down through launching the DIS and developing the eMPF, as well as abolishing the "offsetting" arrangement progressively, we will implement the MPF "full portability" in the long term with the ultimate aim of attaining "one member, one account" so that each employee can centralise his MPF accrued benefits in one MPF account to effectively manage his retirement savings.

Making the voluntary savings pillar more assured - supporting elderly persons in investment management

18. Increasing life expectancy comes with the risk of outliving one's resources. However, the local financial market lacks products which can help elderly persons effectively insure against their longevity and investment risks. Life annuities are particularly rare. Some industry practitioners consider that this is due to the lack of financial tools for hedging the longevity risk and very long-term inflation risk. The Government will study the feasibility of a public annuity scheme and explore whether we can have life annuity plans run by the public sector, so as to help elderly persons annuitise lump-sum assets into a steady stream of monthly income to reduce uncertainty. We will also consider issuing larger volumes of Silver Bond, which is popular amongst elderly persons, and setting the term longer. We will also encourage the financial sector to develop more retirement-related investment products.

Preliminary estimate on Government's financial commitment under the package

19. In the coming ten years, the package will involve an additional average recurrent government expenditure of over $9 billion per year, a one-off expenditure of $6 billion, as well as maximum tax forgone of $18 billion. Details are as follows –

Measures	Preliminary estimated expenditure or income forgone for next ten years ($ billion)	Preliminary estimated number of beneficiaries in the first year of implementation
Add a higher tier of allowance and relax the existing asset limits under OALA	75.57	Around 500 000 elderly persons
Lower the eligibility age for Elderly Health Care Voucher	11.86	Around 400 000 elderly persons
Automatic medical fee waiver for older and more needy OALA recipients in receiving public medical services	3.13	Around 140 000 elderly persons
Government subsidy during the transitional period of abolishing "offsetting"	6.22	---
Maximum tax forgone related to making LSP provisions which are tax deductible	17.96	---

NEXT STEP

20. Subject to LegCo's funding approval, the Government will put in place the enhancements to the OALA and healthcare services as soon as possible. We will in next three months engage the business and labour sectors, MPF trustees and relevant advisory boards in thorough discussions, explain to them our proposal of abolishing "offsetting" and listen to their views. Our aim is to revert to the Executive Council for decision on the finalised proposal before end June this year. We will also commence the study on the public annuity scheme, etc. with a view to building a more robust voluntary savings pillar.

21. In a publication entitled “Poverty Alleviation and Retirement Protection: Progress and Vision” released on 19 January, the Government has elaborated the retirement protection package in detail. We have distributed the publication to Members via the LegCo Secretariat.

ADVICE SOUGHT

22. Members are invited to comment on the issues covered in the paper.

Chief Secretary for Administration's Office
January 2017