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Chairman
Panel on Commerce and Industry
Legislative Council
Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

(Attn: Mr Desmond Lam, Clerk to Panel)

7 September 2018

Dear Mr Lam,

Government's reply to follow-up items raised at the meeting of the Panel on Commerce and Industry on 19 June 2018

At the meeting of the Legislative Council Panel on Commerce and Industry (the Panel) held on 19 June 2018 to discuss the Government's preliminary idea on abolishing the "offsetting" arrangement under the Mandatory Provident Fund System and the possible impact of the abolition on various industries, the Panel asked the Government to provide after the meeting information on the following two items:-

(i) the potential impact of abolishing the "offsetting" arrangement under the MPF System on various sectors, including small and medium-sized enterprises; and

(ii) the assumption adopted by the Government to come up with the various crude estimation regarding the key elements of the preliminary idea on abolishing the "offsetting" arrangement, including the estimated proportion that 79% of incident employers would have adequate funds in their designated saving accounts to meet the severance payment/long service payment payable in Year 20 after the abolition of the "offsetting" arrangement.

With the assistance of the Government Economist and the approval of the Secretary for Labour & Welfare, we are providing at Annex the Government's response to the two above-mentioned follow-up items for Members' reference, please.

Yours sincerely,

(Ms Melody Luk)
for Commissioner for Labour

Enclosure
Annex

Legislative Council
Panel on Commerce and Industry
Follow-up item from the meeting on 19th June 2018

Preliminary idea on abolishing the "offsetting" arrangement under the Mandatory Provident Fund System and the possible impact of the abolition on various industries

Purpose

In response to the request raised by the Panel on Commerce and Industry to the Administration at the meeting on 19th June 2018, this note provides information on (a) the potential impact of abolishing the "offsetting" arrangement under the Mandatory Provident Fund (MPF) System on various sectors, including small and medium-sized enterprises; and (b) the assumptions adopted to come up with various crude estimations regarding the key elements of the preliminary idea on abolishing the "offsetting" arrangement. Since the crude estimates referred to in item (b) above are based on administrative records of the Mandatory Provident Fund Schemes Authority (MPFA) on claims for "offsetting" severance payment (SP) and long service payment (LSP) in 2015, the analysis below also focuses on the corresponding figures in 2015 [(1)].

(a) The potential impact of abolishing the "offsetting" arrangement under the MPF System on various sectors, including small- and medium-sized enterprises

<u>Analysis of the employers involved in "offsetting"</u>

2. There were 13 419 employers involved in "offsetting" (hereinafter referred to as employers involved) [(2)] in 2015, representing 6.2% of the total

(1) According to the information on "offsetting" claims from MPFA, both the total "offsetting" amount and the number of involved employers increased in 2016, but the sectoral pattern of involved employers and the proportion of SMEs therein were broadly similar to the situation in 2015.

(2) In this note, information on the employers involved in "offsetting" is the administrative records provided by trustees of individual MPF schemes as compiled by MPFA. As an enterprise may participate in more than one MPF scheme and make claims under different schemes during the year, there may be double-counting of the number of employers involved. The MPFA re-collected the data for 2015 again in 2016 to address the double-counting problem. Hence, the total number of employers involved in 2015 as shown in this note (i.e. 13 419) is slightly less than that published by the MPFA (i.e. 14 400).

number of enterprises [3], at about 215 400, in Hong Kong. The numbers of employers involved in "offsetting" SP and LSP were 8 154 and 6 815 [4] respectively.

3. A majority of the employers involved were small and medium-sized enterprises (SMEs) with fewer than 50 employees. Among the employers involved in 2015, 10 751 (around 80%) were SMEs, representing 5.1% of the number of SMEs, at about 209 400, in Hong Kong. Analysed by the number of claims, almost 60% (26 906) of the 47 332 "offsetting" claims in 2015 were related to SMEs.

4. Analysed by sector, among the 13 419 employers involved, 4 572 (around 34%) were from wholesale/retail/manufacturing & import/export trades (***Table 1***). This to some extent reflected the large number of enterprises in this sector, accounting for around 48% of all enterprises in Hong Kong. Nevertheless, analysed by the enterprises' incidence rate of "offsetting", these 4 572 employers involved only represent around 4% of all enterprises in that sector. In contrast, the incidence rate of "offsetting" for enterprises in the security guard sector was notably higher, reaching 14%.

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(3) The total number of enterprises is obtained from the Census and Statistics Department (C&SD)'s Annual Survey of Economic Activities for 2015 ("2015 ASEA") and only includes enterprises with employees. As the MPFA and C&SD employ different methods to collect and compile data on sectoral classification and the number of employees, and as the MPFA's data, unlike those of the C&SD, may include public organisations, caution should be exercised when analysing and comparing the data from these two sources.

(4) Among the 13 419 employers involved in 2015, 1 550 employers were involved in "offsetting" both SP **and** LSP.

Table 1：Number of employers involved and claims in 2015 analysed by sector and employment size of employers involved

Sector	Overall employers involved			SMEs involved		Number of claims		
	Number	As % of total employers involved in all sectors	As % of total enterprises in the sector	Number	As % of total SMEs in the sector	Overall	As % of total claims of all sectors	SMEs involved
Catering	859	6.4%	7.0%	634	5.4%	4 313	9.1%	2 563
Cleaning	39	0.3%	3.3%	19	1.9%	329	0.7%	63
Community/Social/ Personal Services	597	4.4%	-	413	-	2 969	6.3%	960
Construction	565	4.2%	3.7%	362	2.4%	3 901	8.2%	1 303
Financing/Insurance/ Real Estate/Business Services	598	4.5%	1.6%	414	1.1%	2 149	4.5%	909
Wholesale/Retail/ Manufacturing & Import/Export Trades	4 572	34.1%	4.4%	4 112	4.0%	11 415	24.1%	9 108
Transport	676	5.0%	7.2%	478	5.4%	1 908	4.0%	1 174
Security Guard	49	0.4%	14.3%	16	6.8%	887	1.9%	28
Hairdressing and Beauty	19	0.1%	0.4%	9	0.2%	34	0.1%	24
Others	2 521	18.8%	-	2 099	-	7 134	15.1%	4 662
Unknown	2 924	21.8%	-	2 195	-	12 293	26.0%	6 112
All Sectors	**13 419**	**100.0%**	**6.2%**	**10 751**	**5.1%**	**47 332**	**100.0%**	**26 906**

Notes: - Not available.

Information on the number of enterprises is obtained from the 2015 ASEA and only includes enterprises with employees.

Sources: MPFA and 2015 ASEA.

Analysis of the "offsetting" amount

5. The total "offsetting" amount was $3.36 billion in 2015, with the "offsetting" amount related to SMEs higher than that of large enterprises both in terms of the total amount ($2.07 billion vs 1.27 billion) and the percentage of their wage bills [(5)] (0.7% vs 0.3%). Analysed by sector, the employers in wholesale/retail/manufacturing & import/export trades (30%) took up the largest share in terms of total "offsetting" amount.

6. On the average "offsetting" amount per enterprise involved, the SP and LSP "offsetting" amounts for SMEs involved averaged at about $183,000 and $172,000 respectively in 2015, as compared to the respective amounts of $388,000 and $393,000 for large enterprises given their larger employment size. Although the average "offsetting" amounts for SMEs involved were smaller than those for large enterprises, the amounts represented a larger proportion of their average wage bill. For SMEs involved in either SP or LSP "offsetting" in 2015 and all sectors taken together, the average amount in "offsetting" SP was equivalent to around 13% of the average wage bill per SME, while that in "offsetting" LSP was around 11% [(6)]. Corresponding figures for large enterprises were only around 0.4% and around 0.3% respectively.

Analysis of "offsetting" amount versus the median profits level of SMEs

7. The average "offsetting" amount of enterprises involved as a percentage of their average wage bill shown above indicates that the impact of abolishing the "offsetting" arrangement will likely be larger for SMEs, especially taking into account that they are in general less able to cope with additional cost. Nevertheless, as pointed out in paragraph 3, SMEs involved in "offsetting" constituted only around 5% of all SMEs [(7)] in 2015. Since the operating environment and the employees' turnover situation differ across sectors, abolishing the "offsetting" arrangement would conceivably bring about a varying degree of impact to different sectors. In general, the impact on sectors with

(5) Wage bill in this note refers to the wages and salaries (excluding employers' contributions to MPF, provident funds and retirement funds) paid by enterprises. The figures are from 2015 ASEA and only enterprises with employees are included.

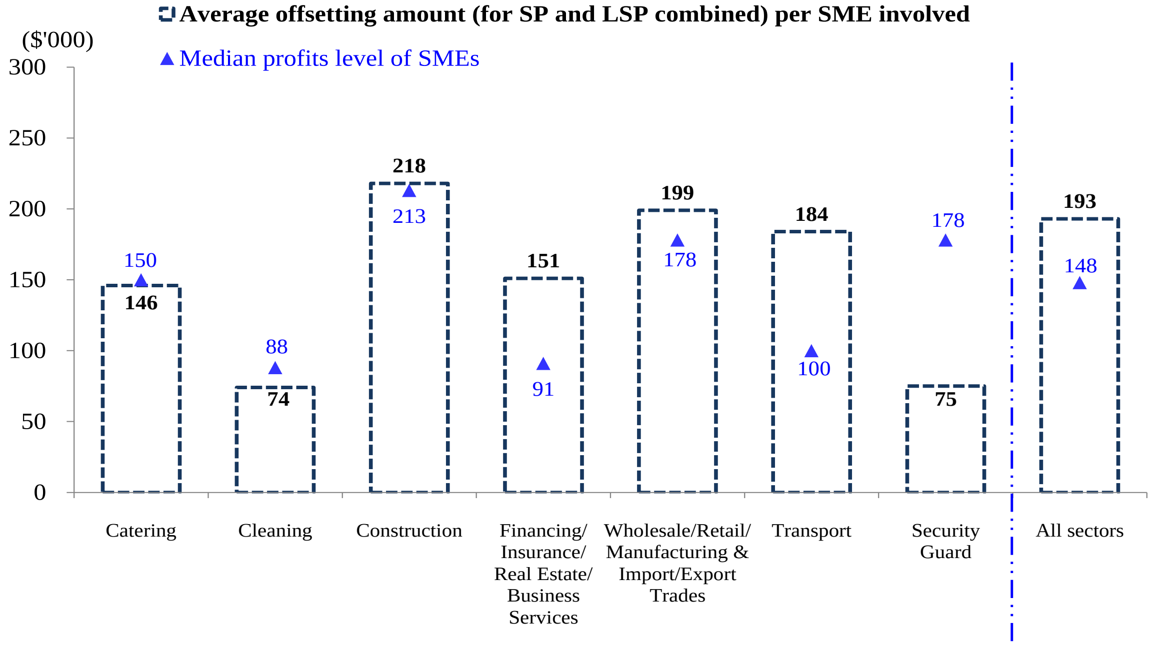
(6) For SMEs involved in "offsetting" both SP and LSP in the year, the average "offsetting" amount was equivalent to around 35% of the average wage bill per SME. The corresponding figure for large enterprises was around 1.3%.

(7) Large enterprises involved in "offsetting" represented over 40% of all large enterprises in 2015, but their average "offsetting" amount as a percentage of the average wage bill was generally far less than the that of SMEs.

higher incidence of triggering SP/LSP and enterprises with thinner profits is expected to be larger.

8. Although MPFA cannot provide detailed information on the operations of the employers involved, a broad-brush comparison of the 2015 sectoral data from the MPFA and C&SD may help shed some lights on the affordability of SMEs involved in "offsetting" in different sectors in case the "offsetting" arrangement is abolished. It is evident from ***Figure 1*** that for most sectors, the average "offsetting" amount per SME involved represented a rather large portion of the median profits level [8] of the SMEs concerned. For sectors such as transport, financing/insurance/real estate/business services, wholesale/retail/ manufacturing & import/export trades, and construction, the average "offsetting" amount of SMEs involved even exceeded the median profits level of SMEs therein.

Figure 1: Average "offsetting" amount per SME involved versus the median profits level of SMEs in selected sectors in 2015



Notes: Respective figures of the hairdressing and beauty, community/social/personal services and other sectors are included in the overall figure.
Data on profits only pertain to enterprises with employees and business receipts, and do not include local representative offices of overseas companies.

Sources: MPFA and 2015 ASEA.

(8) Data are obtained from the 2015 ASEA, which only pertain to enterprises with employees and business receipts, and do not include local representative offices of overseas companies. Profit refers to profit before deducting tax; gain/loss on disposal of property, machinery and equipment; bad debts/write-off; provisions, etc.

9. It should be noted that the preliminary idea proposed by the Government on abolishing the "offsetting" arrangement allows the SP/LSP entitlement for an employee's employment period before the effective date to be offset by the employer's MPF contribution made both before and after the effective date (i.e. the "grandfathering" arrangement). Together with the two-tier subsidy provided by the Government during the 12-year transitional period, the average additional cost borne by the affected employers in the first few years after abolishing the "offsetting" arrangement should generally be lower than the average "offsetting" amount mentioned above.

Caveats

10. The analysis above is conducted mainly based on the MPFA's information on the "offsetting" claims in 2015. The then macroeconomic environment was largely stable, and the labour market was relatively tight with no massive lay-offs at the time, but changes in economic situation could cause year-to-year fluctuations in the relevant figures. In particular, in the case of an economic downturn, cases of retrenchment and dismissal will be higher than the level in 2015. Similarly, the analysis on different sectors in this note is conducted based on the sectoral statistical figures on "offsetting" in 2015, and the related sectoral distribution is likely to evolve over a longer period of time in the future. Hence, the analysis presented in this note must be interpreted with extreme caution and be read in conjunction with the abovementioned caveats and assumptions deployed.

(b) the assumptions adopted by the Administration to come up with various crude estimations regarding the key elements of the preliminary idea on abolishing the "offsetting" arrangement, including the estimated proportion that 79% of incident employers would have adequate funds in their designated saving accounts to meet the severance payment / long service payment payable in Year 20 after the abolition of the "offsetting" arrangement.

11. The crude estimates regarding the key elements of the preliminary idea on abolishing the "offsetting" arrangement are based on the MPFA's administrative records on claims for "offsetting" SP/LSP in 2015, and are reckoned in 2016 prices.

12. The labour market was in full employment in 2015, with the unemployment rate staying low. If the estimation of additional cost on employers in the medium to long term were to be solely based on the number of SP/LSP cases for one single year in 2015, the estimates would likely be on the low side. In fact, statistics on the number of SP/LSP claims and disputes handled by the Labour Department over the past 20 years reveal that the number of such cases was noticeably higher during economic downturns. To pay due regard to the ups and downs in economic cycle, the crude estimates under the Government's preliminary idea are based on the assumptions that the number of SP caseloads in the estimation time frame would on average be 50% higher than that under the state of full employment, and that the Hong Kong economy would experience cyclical slowdown for two years out of every ten years during the estimation period. The estimates have also taken into account the structural change of our labour force in the years to come, in particular that with population ageing and more workers reaching the retirement age, the LSP incidence may trend up. In addition, as some SP/LSP cases are not subject to MPF "offsetting", corresponding adjustments have been made to the crude estimates.

13. In estimating whether the incident employers have adequate funds in their designated saving accounts (DSAs) to meet the SP/LSP payable in Year 20 after the abolition of the MPF "offsetting" arrangement, it is assumed that employers have accumulated saving in their DSAs up to the cap of 15% of the annual relevant income, and closure cases for micro-sized firms (1-9 employees) are excluded. In coming up with the crude estimates, it is further assumed that there would be an average real investment return of 1% per annum to the savings in the DSAs and an average real growth at 1% per annum in employees' wages.