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Panel on Manpower

**Updated background brief prepared by Legislative Council Secretariat
for the meeting on 15 May 2018**

Offsetting arrangement under the Mandatory Provident Fund system

Purpose

This paper summarizes Members' discussions on issues relating to the arrangement of offsetting severance payments ("SP") and long service payments ("LSP") against Mandatory Provident Fund ("MPF") accrued benefits (hereafter referred to as the "offsetting" arrangement) since the Fourth Legislative Council ("LegCo").

Background

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

SP and LSP under EO

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

4. The amount of SP and LSP is calculated by according two-thirds of the last month's wages, or two-thirds of the average monthly wages in the last 12 months, for every year of service of an employee with the employer (service of an incomplete year should be calculated on a pro rata basis). The monthly

wages for calculating SP or LSP is capped at \$22,500, while the maximum amount of SP or LSP payable to an employee is \$390,000. There is no limit on the number of reckonable years of service.

The MPF system

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

The "offsetting" arrangement

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

7. According to the Administration, over \$3 billion accrued benefits of employers' MPF contributions are used for offsetting SP and LSP each year. In 2016 alone, some 49 300 employees had the accrued benefits of employers' contributions in their MPF accounts totalling \$3.855 billion (including around \$3.4 billion of mandatory contributions and around \$0.4 billion of voluntary contributions) offset with SP or LSP. On average, each offsetting incident would reduce the MPF accrued benefits of the affected employee by some \$78,300.

Past discussions by members

Impact of the "offsetting" arrangement on the retirement protection for the workforce

8. Some Members expressed grave concern about the substantial reduction in the MPF accrued benefits of employees as a result of the "offsetting" arrangement, thereby defeating the purpose of the MPF system in providing

retirement protection for the workforce. These members had repeatedly urged the Administration to review the matter, with a view to abolishing the "offsetting" arrangement or removing it in phases.

9. The Administration explained that the MPF system aimed to assist the employed population in accumulating retirement savings through contributions by both employers and employees so as to enhance retirement protection for the employed population in Hong Kong. Before the implementation of the MPF system in 2000, only about one-third of the Hong Kong workforce had some forms of retirement protection. The MPF system had enabled more than 2.5 million employees to save for their retirement. The abolition of MPF "offsetting" was a matter of considerable public interest as the retirement protection of the over three million employees under MPF or other statutory retirement schemes, who might be subject to SP/LSP dismissals, would be at stake.

10. Some other Members, however, pointed out that employer groups generally considered that the "offsetting" arrangement was a consensus reached after extensive consultation in enacting the MPF legislation. The employer groups took the view that abolition of the "offsetting" arrangement would not only amount to a breach of such consensus, but would also increase employers' financial burden and impact significantly on the business environment of the small and medium enterprises ("SMEs") in particular. As SP and LSP provided certain protection to employees on account of their service with the same employer, the "offsetting" arrangement was reasonable, lest employees would be provided with "double benefit" for the same period of service. Some Members also considered it unfair to hold employers responsible for providing retirement protection for their employees, which was the responsibility of the Government.

11. The Administration advised that the "offsetting" arrangement actually predated the implementation of the MPF system. Before the implementation of the MPF system, employers were allowed to offset SP/LSP from the accrued benefits derived from their contributions to the occupational retirement schemes for employees. During formulation of the current framework for the MPF system and related legislation, there had been extensive consultation and discussion among stakeholders before a consensus was finally reached for the extension of the "offsetting" arrangement to apply to MPF benefits.

The last-term Government's proposal of progressively abolishing the "offsetting" arrangement

12. Members were advised that upon the completion of a six-month public consultation exercise on retirement protection conducted by the Commission on Poverty from December 2015, the Administration had thoroughly considered

how to tackle the "offsetting" arrangement. The former Chief Executive ("CE") subsequently announced in his Policy Address delivered in January 2017 a concrete proposal to progressively abolish the "offsetting" arrangement. The proposal contained the following three key elements:

- (a) the abolition would have no retrospective effect (i.e. employers' MPF contributions before the implementation date of the proposal would be "grandfathered");
- (b) the amount of SP or LSP payable for an employment period from the implementation date of the abolition would be reduced from the existing entitlement of two-thirds of one month's wages to half a month's wages as compensation for each year of service; and
- (c) the Government would share part of the expenses on SP or LSP of employers within 10 years after the implementation date of the abolition to help employers, especially SMEs.

13. Some Members and the labour sector expressed grave dissatisfaction that the labour rights and benefits were compromised under the Administration's proposal to adjust downward the entitlement of SP/LSP from two-thirds to one-half of the last month's wages before dismissal. Concern was also expressed that employers might only retain employees with less than five years' service so as to evade the statutory obligations to pay LSP to the employees concerned.

14. Some other Members and the business sector expressed grave reservations about the need for implementing the Administration's proposal, as employers would have to set aside dedicated fund for SP/LSP after the abolition of the "offsetting" arrangement. This would give a severe blow to the operation of SMEs and might result in immediate dismissal of employees for subsequent re-employment under new contracts. While noting that the Administration proposed to provide 10-year government subsidy for employers on a reimbursement basis in order to share part of the expenses on SP or LSP, some Members considered that the Government should instead set up a fund to help employers meet the long-term commitment for extra expenses on SP and LSP.

15. The Administration advised that its proposal to revise the SP/LSP rate to one-half of the last month's wages was justifiable in view of the partial overlap between the functions of SP/LSP and the MPF system. This adjustment was not a retrograde step in employment benefits because SP/LSP receivable would be additional to employers' mandatory MPF contributions which would be fully preserved for retirement. The overall monetary amount most employees could obtain under the Administration's proposal would be notably higher than the

existing arrangement. The Administration also acknowledged that abolishing the "offsetting" arrangement would bring additional costs to employers, in particular SMEs. The Administration had therefore proposed in an unprecedented move to provide 10-year subsidy amounting to \$7.9 billion to assist employers to adapt to the change. The maximum tax forgone arising from LSP provisions which were tax deductible was about \$18 billion in the 10 years.

16. Members were further advised in June 2017 that the Administration had since the announcement of the Administration's proposal engaged major employers' groups and trade unions in active dialogue. However, both employers and employees were not receptive to the proposal. Nor could they agree among themselves on any alternative that was acceptable to both sides. After considering in details the views and alternative proposals from employers' and employees' groups in the past few months, the Administration considered that its proposal remained the most optimal option and recommended its original proposal be adopted as the basis for taking the matter forward. In the view of the Administration, its proposal was a finely balanced tripartite solution whereby employers, employees and the Government each had to pay extra costs or make some concession, with the consequential impact expected to be largely bearable for all three parties, while keeping Government's financial involvement one-off and time-limited.

Recent development

17. In her Policy Address announced on 11 October 2017, the incumbent CE stated that the Administration hoped to come up with a proposal of abolishing the "offsetting" arrangement that took into account the interests of both the labour and business sector in the coming months.

18. At the policy briefing cum meeting of the Panel on Manpower ("the Panel") on 17 October 2017, members were advised that one of the priority tasks of the current-term Government was to abolish the "offsetting" of the accrued benefits of employers' MPF contributions with SP and LSP. According to the Administration, since July 2017 it had been actively engaging the business and labour sectors to explore a feasible option to resolve the issue. The Administration had made it clear to all the stakeholders that it was fully committed to abolishing the "offsetting" arrangement and was willing to enhance its financial commitment to providing financial subsidy for employers, in particular those from the micro, small and medium-sized establishments, to alleviate the impact on their businesses. To address employers' concern over their inability to meet their potential SP or LSP obligations as they came due, the Administration was considering the option of developing a mechanism to assist employers to save up designated saving accounts to meet their potential SP or LSP obligations towards their employees in future.

19. At its meeting on 21 November 2017, the Panel was consulted on the Administration's proposal to create a Chief Labour Officer post in the Labour Department to assist in the various duties in relation to the abolition of the "offsetting" arrangement, including the preparatory work in respect of policy formulation, legislative amendments and thrashing out the framework for implementation. In the course of deliberations, members expressed grave concern about the timeline for the Administration to put forth a finalized proposal for the abolition of the "offsetting" arrangement. Members were advised that one of the priority tasks of the current-term Government was to abolish the "offsetting" arrangement. According to the Administration, the implementation of the proposal would necessitate highly complicated and controversial amendments of different pieces of legislation including but not limited to MPFSO, EO and ORSO, as well as formulation of meticulous implementation arrangements for taking forward the proposal. It was estimated that at least three years would be required for the enabling legislation to be enacted.

20. Some members considered that the lead time of three years required for enacting the enabling legislation for the abolition of the "offsetting" arrangement was too long. The Administration assured members that it was committed to completing the entire exercise, including the legislative proposal, as soon as practicable. It was hoped that if the necessary legislative procedures for abolition of the "offsetting" arrangement could be completed before expiry of the Sixth LegCo by July 2020, the implementation details of a new "no-offsetting" regime, including the possible Government subsidy scheme and the relevant procedures and rules, would then be worked out by end of 2020.

21. The Administration will brief the Panel on the preliminary idea on abolishing the "offsetting" arrangement under the MPF system at its forthcoming meeting on 15 May 2018.

Relevant papers

22. A list of the relevant papers on the LegCo website is in the **Appendix**.

Appendix

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

Committee	Date of meeting	Paper
Panel on Financial Affairs ("FA Panel")	17 October 2008	Minutes
FA Panel	1 December 2008	Minutes
Legislative Council	8 July 2009	Report of the Bills Committee on Mandatory Provident Fund Schemes (Amendment) Bill 2009
Subcommittee on Retirement Protection	19 July 2011	Minutes
Subcommittee on Retirement Protection	8 May 2012	Minutes
FA Panel	7 January 2013	Minutes
Panel on Manpower ("MP Panel")	25 January 2013	Minutes
MP Panel	19 February 2013	Minutes
FA Panel	4 March 2013	Minutes
Special meeting of the Finance Committee for examination of Estimates of Expenditure 2013-2014	April 2013	Report on examination of the Estimates of Expenditure 2013-2014
FA Panel	3 May 2013	Minutes
FA Panel	29 January 2014	Minutes

Committee	Date of meeting	Paper
FA Panel and MP Panel	18 March 2014	Agenda Minutes
Report of Subcommittee on Retirement Protection		LC Paper No. CB(2)1871/15-16
Report of Joint Subcommittee to Study the Arrangement of Offsetting Severance Payments and Long Service Payments against Mandatory Provident Fund Accrued Benefits		LC Paper No. CB(2)1684/15-16
MP Panel	17 October 2017	Agenda Minutes
MP Panel	21 November 2017	Agenda Minutes

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