For discussion on
20 November 2018

Legislative Council Panel on Manpower

Arrangements for the abolition of using employers' mandatory contributions under the Mandatory Provident Fund System to offset severance payment and long service payment

Purpose

This paper briefs Members on the arrangements announced by the Chief Executive in the 2018 Policy Address for the abolition of using employers' mandatory contributions under the Mandatory Provident Fund (MPF) System to offset severance payment (SP)/long service payment (LSP), and the preparatory work to be actively taken forward.

Background

The preliminary idea

2. In March 2018, the Government put forth a "preliminary idea" on abolishing the "offsetting" arrangement (key features at Annex A). Since then, we met with major stakeholders, including major employers' associations/business chambers, labour unions and political groups etc., and listened to their views on the preliminary idea. We consulted this Panel on 15 May and the Labour Advisory Board (LAB) on 13 June on the preliminary idea. The Legislative Council (LegCo) Panel on Commerce and Industry also discussed the issue on 19 June.

Views of major stakeholders on the preliminary idea

The labour sector

3 The labour sector in general welcomes the Government's preliminary idea, not least with regard to keeping the formula for calculating SP/LSP at two-thirds of the eligible employee's monthly wages for each year of service, as opposed to the previous-term Government's proposal to reduce the rate to one-half. On the other hand, some have continued to express concern that in certain extreme

circumstances, individual employees might receive less than what they do now notwithstanding the abolition of the "offsetting" arrangement[1]. Some have expressed reservation about the proposal of allowing employers to continue to use their MPF contributions made after the effective date of abolition (hereafter referred to as "effective date") to offset the pre-effective date SP/LSP.

The business sector

4. Most of the major business chambers understand the Government's determination to abolish the "offsetting" arrangement, but maintain that this policy change violates the Government's promise that employers would not be required to pay twice when soliciting their support for introducing the MPF System. They reiterate the need to address the overlapping functions among SP, LSP and MPF and consider that restoring the SP/LSP rate to two-thirds of the monthly wages unjustified. They remain highly concerned over the possible financial impact of discharging the SP/LSP responsibilities on cash-tight establishments, notably the micro-sized enterprises with less than ten employees or outsourcing contractors in the cleaning and security industries.

5. Many employers have accepted the need to save up in advance to meet their SP/LSP liabilities by way of the proposed designated saving account (DSA). However, they are concerned that the 1% saving under DSA would not be sufficient to meet their SP/LSP incidental liabilities in full. Such concern is particularly prevalent among micro-sized enterprises and establishments that have less control over their staff turnover (e.g. outsourcing contractors).

6. The increase in Government's financial commitment from the previous-term Government's $7.9 billion for ten years to $17.2 billion for 12 years under the preliminary idea has been considered inadequate to help enterprises meet their SP/LSP liabilities in the long run. The business sector is of the view that retirement protection is a matter for the

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[1] To guard against the risk of large-scale dismissals before the abolition of the "offsetting" arrangement, it was proposed under the preliminary idea to adopt the last month's wages before the effective date of abolition as opposed to the last month's wages at the time of dismissal (if the dismissal is after the effective date) for calculating the SP/LSP entitlement for the employment period before the effective date. This may result in some employees with relatively long employment period before the effective date and with substantial pay rise after the effective date receiving a smaller amount of aggregate benefits (SP/LSP entitlement together with the accrued benefits of their employers' mandatory contributions to their MPF accounts) than they would otherwise receive under the current "offsetting" regime.

employers, employees and Government to address together, and it is unfair to place the responsibility on employers alone. There is a strong demand from employer groups for the Government to play a longer-term or even perpetual role in sharing part of the SP/LSP responsibility following abolition of the "offsetting" arrangement. Some have requested the Government to review the subsidy scheme after its implementation. That said, many welcome the second-tier subsidy which is targeted more at the needs of micro, small and medium-sized enterprises (MSMEs) or establishments with problems in paying SP/LSP even with the help of DSA.

7 Some employer groups have expressed grave concern that abolition of the "offsetting" arrangement would hamper harmonious labour relations and increase disputes between employers and employees over SP/LSP entitlements. Some also consider the two-tier subsidy scheme too complicated to understand.

Others

8. LAB employer and employee representatives have reached a consensus that the employer representatives would not oppose to abolishing the "offsetting", and both sides urged the Government to come up with a revised proposal to provide long-term support to employers and address the concerns of MSMEs.

Government's decision to enhance the arrangements for abolishing the "offsetting"

9. The Government has, after carefully considered the views expressed by the business and labour sectors, LAB and other stakeholders, decided to enhance the arrangements for abolishing the "offsetting" and significantly increase the financial commitment to strengthen the financial assistance to MSMEs so as to address the concerns of different sectors of the community. The Chief Executive announced in the 2018 Policy Address the enhanced arrangements as follows –

(a) the major features of the preliminary idea at Annex A would form the basis of the arrangements for abolishing the "offsetting";

(b) while keeping the first-tier of the Government subsidy scheme at 12 years, the duration of the second-tier subsidy would be extended from 12 years to 25 years with the rate of subsidy scaling back according to the schedule at Annex B. This would substantially increase the total Government commitment from $17.2 billion proposed in the preliminary idea to $29.3 billion[2] in the 25-year subsidy period;

(c) the Government would make up for the shortfall in case an employee receives a smaller amount of aggregate benefits (SP/LSP entitlement together with the accrued benefits attributable to the employer's mandatory contributions to his/her MPF account) than what he/she would otherwise receive under the current "offsetting" regime (see paragraph 13 below); and

(d) the enhanced Government subsidy scheme would be reviewed five years after abolition of the "offsetting" arrangement (see paragraph 14 below).

10. Our analysis shows that DSA would work better for employers with larger employment size. For micro-sized employers (i.e. employers with less than ten employees), should they need to initiate dismissals which necessitate SP/LSP payment in Year 20 after the abolition, more than half of them would have sufficient balance in their DSA to meet the SP/LSP expenses[3]. It is worth noting that, based on the "offsetting" claim data provided by the Mandatory Provident Fund Schemes Authority (MPFA), around 7 000 micro-sized enterprises were involved in "offsetting" every year in the past few years, representing only about 4% of all micro-sized enterprises with employees in Hong Kong.

11. To strike an appropriate balance between the two objectives of better helping enterprises adapt to the policy change of abolishing the "offsetting" arrangement and ensuring the proper use of public funds, the duration of the 12-year first-tier subsidy would not be extended under the enhanced government subsidy scheme as the majority of large enterprises should be able to accrue enough savings in their DSAs to cope with their

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2 The crude estimate is calculated based on an average saving balance in DSAs of incident employers which is less than 15% of the annual relevant income, having taken into account that in reality some incident firms would have operated for less than 15 years in Year 20 after the abolition.

3 The crude estimate has assumed that the incident employers have accumulated an amount up to the cap of 15% of the annual relevant income of their employees in their DSAs and has excluded closure cases of micro-sized firms.

SP/LSP liabilities. On the other hand, extending significantly the period of the second-tier subsidy from 12 years to 25 years could better focus the resources in assisting MSMEs or enterprises which are more prone to large-scale retrenchment as the chances of their having inadequate savings in their DSAs and hence requiring the second-tier subsidy is envisaged to be far greater than large enterprises. A comparison of the maximum subsidy rate under the enhanced subsidy scheme with that under the preliminary idea is set out at Annex C.

12. The enhanced second-tier subsidy would help alleviate the financial burden of micro-sized incident employers who have inadequate savings in their DSAs. A crude estimate is that the average amount of top-up to be made by these micro-sized employers for each incident employee would be reduced from $86,000 under the preliminary idea to $69,000 at Year 20 after the abolition while the total top-up amount for each incident employer would be lowered from $219,000 under the preliminary idea to $179,000. As noted in paragraph 10 above, statistics in past few years show that the number of micro-sized enterprises involved in “offsetting” accounted for a small proportion of all the micro-sized enterprises. Of these, only a proportion had to make top-up payments to incident employees.

Other implementation and technical details

Employees being worse off after abolition of the “offsetting” arrangement

13. As mentioned in paragraph 3 above, there is a possibility that some employees with relatively long employment period before the effective date and with substantial pay rise after the effective date might receive a smaller amount of aggregate benefits (SP/LSP entitlement together with the accrued benefits of their employers’ mandatory contributions to their MPF accounts) than what they would otherwise receive under the current “offsetting” regime. Taking heed of the concerns expressed by the labour sector, the Government would make up for the shortfall should such cases, which we do not expect to be many, arise so as to ensure that employees would not be worse off. Otherwise it would go against the policy objective of improving employees’ benefits by abolishing the “offsetting” arrangement. Details of the arrangement would be worked out in the implementation stage.

Review of the subsidy scheme

14. To allay the concerns of some employers that the subsidy scheme is too complicated and may not render adequate assistance to MSMEs, we plan to review the operation of the subsidy scheme five years after implementation of the abolition of the "offsetting" arrangement.

DSA

15. There is a need for the collection of funds from employers and their disbursement from DSA. We would make use of the e-MPF platform for the collection of employers' contributions to their respective DSAs and for subsequent payment of SP/LSP for more cost-effective administration.

16. As for employers' savings in DSAs, we will explore the feasibility of having them, together with the Government's possible financial commitment to the scheme, placed with the Hong Kong Monetary Authority (HKMA). This should enable the funds to be treated in the same manner as other government or public placements, which share the return of the Exchange Fund without any charge or management fees. Details of the arrangement will be worked out with HKMA later.

Preparatory work

17. This Panel apart, we are also conducting briefings for major business chambers/employers' associations and labour groups on the above-mentioned enhanced arrangements for abolishing the "offsetting" arrangement.

18. Taking into account the complexities of the legislative amendments involved, the Government will strive to introduce the enabling bill into the LegCo in 2020 with a view to securing its passage by 2022. In the interim, we will work out the implementation details of the supporting measures including setting up of DSA and the disbursement of Government subsidy with relevant parties including MPFA. Our target is to implement the abolition two years after passage of the enabling legislation.

Advice sought

19. Members are invited to give their views on the content of this paper.

Labour and Welfare Bureau
Labour Department
November 2018

Annex A

Major Features of the Preliminary Idea Proposed in March 2018 on the Abolition of Using Employers' Mandatory Contributions under the Mandatory Provident Fund System to Offset Severance Payment and Long Service Payment

(a) The rate for calculating SP and LSP reverts to two-thirds of the monthly wages of the employee for each year of service (as opposed to 50% under the previous-term Government's proposal), and the maximum payment of SP/LSP keeps at $390,000;

(b) Each employer sets up a DSA under his/her own name and contributes 1% of his/her employees' monthly income to the DSA until reaching 15% of the employees' annual income for payment of SP/LSP. Employers making voluntary MPF contributions at 1% or above, in addition to the 5% mandatory contribution stipulated by the Mandatory Provident Fund Schemes Ordinance may be exempted from setting up their DSAs. Likewise, employers with contributions in excess of 5% under the Occupational Retirement Schemes Ordinance (ORSO) and school provident funds under the Grant/Subsidized Schools Provident Fund Rules of the Education Ordinance would also be exempted;

(c) Government provides a two-tier subsidy with duration extended to 12 years and the quantum increases to $17.2 billion to help share employers' expenses on SP/LSP in respect of the employment period after the effective date of abolition within the 12-year transitional period. The first-tier subsidy is available for all incident employers (i.e. those who need to pay SP/LSP to their employees). The maximum rate of subsidy would be pitched at 50% of the SP/LSP payable in the first three years after abolition of the "offsetting" arrangement and reduced progressively thereafter until it is diminished to 5% in the 12th year. Should an employer's DSA accrued balance be insufficient to pay SP/LSP after netting the first-tier subsidy, the second-tier subsidy would kick in to share the outstanding amount at the same rate as the first-tier in the relevant year. Government's share of SP/LSP in the 12-year subsidy period is as follows–

Year after the abolition	Government's share of SP/LSP in respect of the employment period after the abolition of the "offsetting" arrangement	
	First-tier subsidy (as % of SP/LSP payable)	Second-tier subsidy (as % of outstanding SP/LSP payable after netting first-tier subsidy and accrued balance of DSA)
1	50%	50%
2	50%	50%
3	50%	50%
4	45%	45%
5	40%	40%
6	35%	35%
7	30%	30%
8	25%	25%
9	20%	20%
10	15%	15%
11	10%	10%
12	5%	5%
13	-	-

(d) The "offsetting" arrangement will be abolished as from a future effective date with no retrospective effect (the "grandfathering" arrangement), while the SP/LSP entitlement for an employee's employment period before the effective date of abolition could continue to be offset by the employer's contributions under the MPF System made both before and after the effective date; and

(e) Other technical features as embodied in the previous-term Government's proposal should remain. These include–

(i) the abolition of the "offsetting" should also be applicable to the occupational retirement schemes under the ORSO and the two school provident funds under the Grant/Subsidized Schools Provident Fund Rules governed by the Education Ordinance with the same effective date set for the MPF System;

(ii) voluntary contributions under the MPF System in excess of the mandatory 5% and the accrued benefits can continue to be used for offsetting SP/LSP. Likewise, gratuity based on length of service as voluntary payment of employers to employees can also continue to be used to offset SP/LSP;

(iii) for employees not covered by the MPF System (currently domestic helpers, whether foreign or local, and employees aged below 18 or aged 65 or above) or other statutory retirement schemes, their employers will not be reimbursed with any subsidy from Government for payment of any SP/LSP; and

(iv) any SP/LSP payable for the employment period up to the effective date would be calculated on the basis of the monthly wages as at the effective date, as opposed to the last monthly wages at the time of dismissal (if the dismissal is after the effective date) as presently provided under the Employment Ordinance.

Annex B

Further Enhanced Government Subsidy for Sharing Employers' Expenses on SP/LSP

Year after the abolition	Government's share of SP/LSP in respect of the employment period after the abolition of the "offsetting"	
	First-tier subsidy (as % of SP/LSP payable)	Second-tier subsidy (as % of outstanding SP/LSP payable after netting first-tier subsidy and accrued balance of DSA)
1	50%	50%
2	50%	50%
3	50%	50%
4	45%	45%
5	40%	45%
6	35%	45%
7	30%	40%
8	25%	40%
9	20%	40%
10	15%	35%
11	10%	35%
12	5%	35%
13	-	30%
14	-	30%
15	-	30%
16	-	25%
17	-	25%
18	-	25%
19	-	20%
20	-	20%
21	-	20%
22	-	15%
23	-	15%
24	-	10%
25	-	10%
26	-	-

Annex C

A Comparison of the Government's Maximum Subsidy to Employers under the Enhanced Abolition Arrangements and the Preliminary Idea

Year after the abolition	Government's maximum(Note 1) subsidy to employers as % of SP/LSP payable in respect of the employment period after the abolition of the "offsetting"					
	Government subsidy under the enhanced abolition arrangements			Government subsidy under the preliminary idea		
	First-tier subsidy	Second-tier subsidy (Note 2)	Total (First-tier + Second-tier)	First-tier subsidy	Second-tier subsidy (Note 2)	Total (First-tier + Second-tier)
1	50%	25%	**75%**	50%	25%	75%
2	50%	25%	**75%**	50%	25%	75%
3	50%	25%	**75%**	50%	25%	75%
4	45%	24.75%	**69.75%**	45%	24.75%	69.75%
5	40%	27%	**67%**	40%	24%	64%
6	35%	29.25%	**64.25%**	35%	22.75%	57.75%
7	30%	28%	**58%**	30%	21%	51%
8	25%	30%	**55%**	25%	18.75%	43.75%
9	20%	32%	**52%**	20%	16%	36%
10	15%	29.75%	**44.75%**	15%	12.75%	27.75%
11	10%	31.5%	**41.5%**	10%	9%	19%
12	5%	33.25%	**38.25%**	5%	4.75%	9.75%
13	-	30%	**30%**	-	-	-
14	-	30%	**30%**	-	-	-
15	-	30%	**30%**	-	-	-
16	-	25%	**25%**	-	-	-
17	-	25%	**25%**	-	-	-
18	-	25%	**25%**	-	-	-
19	-	20%	**20%**	-	-	-
20	-	20%	**20%**	-	-	-
21	-	20%	**20%**	-	-	-
22	-	15%	**15%**	-	-	-
23	-	15%	**15%**	-	-	-
24	-	10%	**10%**	-	-	-
25	-	10%	**10%**	-	-	-
26	-	-	**-**	-	-	-

Notes:

1. This shows the maximum Government subsidy share. As most employers would probably have savings accrued in their DSAs, it is likely that in most cases requiring the second-tier subsidy, the Government only needs to share part of the employer's remaining SP/LSP after discounting the first-tier subsidy.

2. The figure of Government's maximum share of SP/LSP payment under the second-tier subsidy in the relevant year is calculated by multiplying the remaining percentage of SP/LSP after netting the first-tier subsidy in that year by the sharing percentage of the second-tier subsidy in the same year. For example, under the enhanced abolition arrangements, in the fifth year after the abolition of the "offsetting", the Government's shares in the first-tier subsidy and the second-tier subsidy are 40% and 45% respectively (see Annex B). The second-tier subsidy is derived by [100% - 40% (the first-tier subsidy)] x 45%, i.e. 27% of the SP/LSP payment of the incident employer.