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Panel on Manpower

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Offsetting arrangement under the Mandatory Provident Fund system

Purpose

This paper summarizes discussions of various committees on issues relating to using employers' mandatory contributions under the Mandatory Provident Fund ("MPF") System to offset severance payments ("SP") and long service payments ("LSP") 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.

<u>SP and LSP under EO</u>

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, expressed the view that under the long-established "offsetting" arrangement, employees were allowed to receive prematurely the MPF accrued benefits from employers' contribution for the purpose of alleviating their short-term financial hardship caused by loss of employment. It was the high administration cost for fund management under various MPF schemes that had undermined the retirement protection function of the MPF System. Employer groups generally considered that the "offsetting" arrangement was a consensus reached after extensive consultation in enacting the MPF legislation. The "offsetting" arrangement was a prerequisite for employers' support for enacting the MPF legislation years ago. 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.

<u>The previous-term Government's proposal of progressively abolishing the "offsetting" arrangement</u>

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.

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.

<u>The current-term Government's preliminary idea to abolish the "offsetting" arrangement</u>

17. In her Policy Address delivered 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. At the meeting of the Panel on Manpower ("the Panel") on 15 May 2018, members were advised of the current-term Government's preliminary idea on abolishing the "offsetting" arrangement under the MPF System. According to the Administration, as a key element of the preliminary idea, the Government would assist employers in setting up designated saving accounts ("DSAs")[1] under their own name to prepare in advance for their potential SP or LSP expenses in future. The Government would also increase its financial commitment from $7.9 billion to $17.2 billion and provide a two-tier subsidy with duration extended to 12 years to mitigate the impact of the abolition on enterprises, in particular micro-, small- and medium-sized enterprises ("MSMEs").

18. Some members were pleased to note that the Administration had taken into account the strong objection of the labour sector to the last-term Government's proposal of adjusting downwards the SP/LSP rate to half of the employee's wages and proposed to maintain the calculation of the SP/LSP entitlement at two-thirds of an employee's monthly wages. They strongly called on the Administration to take forward the proposal and expedite the relevant legislative process. Some other members, however, considered that the proposal of abolishing the "offsetting" arrangement had not fully taken into account the affordability of MSMEs. Moreover, it was unfair for the business sector to shoulder all the responsibility of providing retirement protection for their employees. In these members' view, the Administration should rationalize the relationship between SP/LSP and MPF before putting forth a better option to abolish the "offsetting" arrangement.

19. The Administration advised that retirement protection was a shared responsibility of individuals, employers, the Government and family members. As a matter of fact, the Government's annual financial expenditure on the various pillars of the existing retirement protection system, including the Old Age Living Allowance and Comprehensive Social Security Assistance Scheme, was substantial. Given that the "offsetting" arrangement had greatly weakened the retirement protection function of the second pillar of the existing retirement protection system i.e. the MPF System, it was necessary to abolish the arrangement. After the abolition of the "offsetting" arrangement, the respective functions of MPF and SP/LSP would be reinstated.

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[1] Employers would contribute 1% of their employees' monthly relevant income to their DSAs until reaching 15% of the annual relevant income of all their employees.

Designated saving account

20. Some members expressed concern that according to the Administration's estimation, the proportion of incident employers (i.e. employers who had initiated dismissals that necessitated SP/LSP) of micro-sized firms with inadequate funds in their DSAs to meet SP/LSP payable to their employees would be 51% and 44% at year 10 and 20 respectively after the abolition. On average, employers of micro-sized firms who did not have adequate funds in their DSAs would need to top up some $219,000 after exhausting their savings accrued in their DSAs. These members were gravely concerned that employers of micro-sized firms could not discharge their full SP/LSP liabilities after exhausting their savings accrued in their DSAs and thus might result in business closure.

21. The Administration advised that by way of DSAs, the impact of the abolition of the "offsetting" arrangement would be manageable for most of the medium- and large-sized enterprises. As for the challenges to be faced by the micro-sized firms and those medium-sized firms in the case of their dismissing a higher proportion of workers, the Administration would explore how to improve the preliminary idea and would continue to exchange views with stakeholders on how to refine the preliminary idea to devise a more practical and acceptable proposal to both the business and labour sectors.

Government subsidy

22. Some members pointed out that the provision of time-limited subsidy was insufficient for employers of the micro- and small-sized enterprises to discharge their full SP/LSP liabilities, and these employers would still need to make top-up payment for paying SP/LSP after netting the accrued benefits of their MPF contribution and the Government subsidy. Some members also considered the formula for calculating the two-tier subsidy too complicated. These members took the view that the Administration should instead set up a central fund pool to help employers meet the long-term commitment for extra expenses on SP and LSP when such need arose after the abolition of the offsetting arrangement.

23. Some other members were concerned that given the subsidy rate would progressively reduce following the abolition of the "offsetting" arrangement, some employers would dismiss their employees in the first few years of subsidy period and re-employ them for the same posts. Some of these members considered that it would be more reasonable to provide subsidy on a sliding scale for enterprises, on a need basis, to mitigate the impact of the abolition on them.

24. The Administration advised that the design of the preliminary idea had the effect of reducing the risks of massive dismissals upon the abolition.

These included the Government's provision of two-tier subsidy, the progressive reduction of the subsidy rate and requiring employers each to set up a DSA under his/her own name and contribute 1% of their employees' monthly income to the DSA until reaching 15% of the employees' annual income for payment of SP/LSP. The Administration further advised that setting up of a central fund pool was not the best solution to address the concerns of the business sector over the abolition of the "offsetting" arrangement, which would be most costly to the employers amongst various options. Under the Government's proposed two-tier subsidy, it was expected that the accrued balance of most enterprises in their DSAs would be sufficient to pay SP/LSP after discounting the first-tier subsidy. The Administration assured members that the concerns of micro- and small-sized enterprises about the special subsidy arrangement were well noted. It would continue to exchange views with major stakeholders to develop a more practical and acceptable proposal in taking the matter forward.

Offsetting SP/LSP for employment period before the Effective Date

25. Some members expressed concern that under the "no retrospective effect" principle, 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 was after the Effective Date). This would impose additional financial burden on the employers. The Administration should actively consider the proposal of setting up a central fund pool, such that employers' expenses on pre-Effective Date SP/LSP would be met by the central fund pool and the employers concerned. Some other members, however, were concerned that employers were still allowed to offset the pre-Effective Date SP/LSP of employees with long years of service with their MPF contributions made after the Effective Date.

26. According to the Administration, if employers were not allowed to offset the pre-Effective Date SP/LSP with their MPF contributions made after the Effective Date, it would necessitate the setting up of some three million new MPF accounts, which would result in high operation cost as well as much technical difficulties and disputes in the calculation of the value of the accrued benefits from employers' MPF contributions before the Effective Date.

Legislative timetable

27. Members were advised that the abolition of the "offsetting" arrangement involved technical complexities in mapping out the scheme and preparing the enabling legislation. The Government hoped to finalize the abolition proposal for consideration by CE in Council within 2018 and to introduce the enabling legislation into LegCo before the end of 2019. If the necessary legislative procedures for the abolition of the "offsetting" arrangement could be completed before the 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 rolled out by 2022.

Recent development

28. In the CE's 2018 Policy Address, the Government announced that having carefully considered the views of various parties, it decided to further enhance the Government's support for employers. In gist, the Government would extend the period of the second-tier subsidy from the originally proposed 12 years to 25 years. The estimated Government's total financial commitment is $29.3 billion.

29. At the policy briefing-cum-meeting of the Panel on 16 October 2018, some members reiterated the concern of the business sector that the time-limited Government subsidy remains insufficient for employers, in particular the micro-sized enterprises to discharge their full SP/LSP liabilities. Some other members, however, stressed that the labour sector raised no objection to the Administration's proposal and strongly called for early implementation of the abolition of the offsetting arrangement. These members also expressed concern that the Administration had deferred its implementation target for the abolition offsetting arrangement to 2024.

30. The Administration explained that taking into account the lead time for drafting the legislative proposal and the fact that the Sixth LegCo would expire by July 2020, LegCo might not have sufficient time to study the legislative proposal even if it was introduced by 2019. The Administration therefore considered it prudent to secure the passage of the enabling legislation by LegCo within the current-term of the Government, i.e. by mid 2022 or earlier, and fully implement the abolition of the offsetting arrangement two years later in 2024. The Administration assured members that one of the priority tasks of the current-term Government was to abolish the MPF offsetting arrangement.

31. The Panel would receive public views on the latest proposal of abolishing the "offsetting" arrangement at its forthcoming meeting on 20 November 2018.

Relevant papers

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

Council Business Division 2
Legislative Council Secretariat
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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

Committee	Date of meeting	Paper
FA Panel	29 January 2014	Minutes
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
Subcommittee on Retirement Protection	24 June 2017	Agenda Minutes
MP Panel	17 October 2017	Agenda Minutes
MP Panel	21 November 2017	Agenda Minutes
MP Panel	15 May 2018	Agenda Minutes
MP Panel	16 October 2018	Agenda

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