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Panel on Manpower

Updated background brief prepared by Legislative Council Secretariat for the meeting on 20 April 2021

Offsetting arrangement under the Mandatory Provident Fund system

Purpose

This paper provides background information and summarizes discussions 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") by the Panel on Manpower ("the Panel") in the Sixth 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.

Abolition of the "offsetting" arrangement

8. The former Chief Executive ("CE") announced in the Policy Address delivered in January 2017 the proposal to progressively abolish the "offsetting" arrangement. In May 2018, the Panel was briefed on the Administration's preliminary proposals to, among others, require employers each to set up a designated saving account ("DSA") and contribute 1% of their employees' monthly income to the account until reaching 15% of the employees' annual income for payment of SP/ LSP; and to provide a two-tier Government subsidy up to 12 years to help share employers' expenses on SP/LSP within the 12-year transitional period. It was subsequently announced in the CE's 2018 Policy

Address that the Government would enhance the proposed abolition arrangement and extend the period of the second-tier subsidy from 12 years to 25 years. The estimated Government's total financial commitment is $29.3 billion.

Deliberations of the Panel

Enhanced abolition arrangements

9. The Panel was briefed on the enhanced abolition arrangements at the meeting on 20 November 2018. The Panel also received views from deputations on the subject at that meeting. As agreed at the meeting on 17 November 2020, the Administration was requested to provide the Panel with an update on the progress of the proposal to abolish the "offsetting" arrangement at each subsequent regular meeting. The major views and concerns of members on the latest enhanced abolition arrangements are summarized in the ensuing paragraphs.

Government subsidy

10. Some members welcomed the proposed increase in the Government's financial commitment to the two-tier subsidy scheme under the enhanced abolition arrangements from $17.2 billion under the preliminary proposal to $29.3 billion in the 25-year subsidy period. However, some members pointed out that the business sector remained concerned that the time-limited Government subsidy was insufficient for employers, in particular the micro-sized enterprises to discharge their full SP/LSP liabilities. There was a 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.

11. The Administration advised that the increase in the Government's financial commitment under the enhanced abolition arrangements aimed to help enterprises adapt to the policy change, particularly the micro, small and medium-sized enterprises ("MSMEs") which constituted 88% of the total establishments in Hong Kong. It would help employers meet their SP/LSP liabilities and in turn provide better employment protection for employees. Of the $29.3 billion committed under the two-tier subsidy scheme, the respective shares under the first-tier subsidy and the second-tier subsidy were $14.7 billion and $14.6 billion. It was envisaged that MSMEs or enterprises which were more prone to large-scale retrenchment would benefit most under the second-tier subsidy. In effect, most of the resources under the two-tier subsidy would be channelled to assisting MSMEs, particularly the micro-sized enterprises to cope with the policy change of abolishing the "offsetting" arrangement.

12. The Administration further advised that the suggestion of setting up a central fund pool to meet employers' SP/LSP liabilities might not be in the interests of employers as a whole because employers would still need to make provision to meet their substantial share of SP/LSP payment on top of the regular contributions to the central fund pool. The attention of members was also drawn to the unfairness of cross-subsidization from employers/sectors with fewer incidents of dismissals/retrenchments necessitating payment of SP/LSP to employers/sectors with more frequent incidents.

Impact on employment contractual arrangements

13. Some members were concerned that as the duration of the second-tier subsidy would be extended from 12 years to 25 years with the subsidy rate scaling back according to the specified schedule, some employers would offer employees with short-term employment contracts as a result of the policy change.

14. According to the Administration, while the policy change might give rise to behavioural change of both employers and employees, employers might not necessarily benefit from dismissing employees with long years of service and engaging new employees for replacement. Under the enhanced abolition arrangements, employers would continue to be allowed to use their MPF contributions made after the Effective Date to offset the pre-effective date SP/LSP and that 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) as presently provided under EO. As such, there was no justification for employers to dismiss their employees upon implementation of the abolition proposal. According to the statistics, around 60% of employees quitted their jobs on their own accord. Among employees not voluntarily leaving their jobs, around 70% were not entitled to SP or LSP for not yet having served the same employer for the requisite period of two or five years respectively.

15. Some members expressed concern about the 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 than the accrued benefits of their employers' mandatory contributions to MFP accounts) than what they would otherwise receive under the current "offsetting" regime.

16. The Administration advised that the Government would make up for the shortfall in case an employee received a smaller amount of aggregate benefits of SP/LSP entitlement and the accrued MPF benefits than what he/she would otherwise receive under the current "offsetting" regime so as to address the

labour groups' concern that no employees would be worse off after the abolition of the "offsetting" arrangement. That said, it was expected that there would not be many such cases and the number would be reducing over the time. The expenditure in this regard would be met separately from the funding earmarked for the two-tier subsidy scheme.

17. Noting that contractual gratuity could continue to be used to offset SP/LSP following the abolition of the "offsetting" arrangement, some members also expressed concern that employers would offer their employees with contractual gratuity in future so as to evade their SP/LSP liabilities. These members were particularly concerned as to whether the MPF accrued benefits of non-skilled employees engaged under government service contracts would be offset by the contractual gratuity.

18. The Administration advised that contractual gratuity had been and would continue to be allowed to be used to offset SP/LSP. While government outsourced service contractors would be required to pay contractual gratuity to their non-skilled employees engaged to work for government outsourced service contracts tendered from 1 April 2019 onwards, they were still required under the law to contribute an amount equivalent to 5% of their employees' relevant income to their employees' MPF accounts. There was no question of offsetting the employers' MPF contributions with the contractual gratuity.

Legislative and implementation timetable

19. Some members stressed that the labour sector raised no objection to the Administration's latest proposal and strongly called for early implementation of the abolition of the "offsetting" arrangement on the premise that employees' rights and benefits under EO would not be undermined. These members also expressed grave concern about the Government's determination to take forward the proposal for abolishing the "offsetting" arrangement and whether the proposal would be further revised in face of the business sector's opposition.

20. The Administration advised that the framework for the abolition proposal was finalized, while the Government would continue to listen to the views of various sectors on the detailed implementation arrangements. The Administration further advised that the implementation of the abolition proposal would necessitate highly complicated and controversial amendments of various pieces of legislation, as well as formulation of meticulous implementation arrangements for taking forward the proposal. Taking into account the complexities of the legislative amendments involved, the Government would strive to introduce the enabling bill into LegCo in the 2021-2022 legislative session with a view to securing its passage within the current term of the Government, and to implement the abolition of "offsetting" arrangement in tandem with the full implementation of the eMPF Platform in around 2025 at the earliest.

Development of the eMPF Platform and the Designated Savings Account Scheme[1]

21. As part of its proposal to enhance the abolition arrangement, the Administration would assist employers to set up DSAs under their own names to save up in advance to meet the potential SP and LSP expenses with a view to alleviating their financial pressure when such payment arises. Members were advised that in order to assist employers to set up their DSAs, the Administration would need to collect regularly contributions from over 300 000 employers to DSAs, and disburse monies in their DSAs to them when the need to pay SP/LSP arose. Hence, the Administration planned to ride on the eMPF Platform, which was to be built by the Mandatory Provident Fund Schemes Authority and aimed to provide a centralized electronic platform to support comprehensive information enquiry and MPF-related account management functions, to achieve better cost-effectiveness and facilitate employers to handle MPF and DSA matters on one single platform.

22. The Panel was briefed at the meeting on 19 January 2021 on the funding proposal for building the functionalities on the eMPF Platform to support the DSA Scheme, and the development and management of the DSA Information Technology System ("DSA System") in the Labour Department. Some members expressed concern that the eMPF Platform would be fully implemented only until around 2025 at the earliest. Some members also expressed grave concern about the extended period of time to be taken for the development of the DSA System and interfacing with the eMPF Platform for implementing the DSA Scheme after passage of the enabling legislation. Members called on the Administration to compress the timetable for the development of the DSA Scheme for early implementation of the abolition proposal.

Relevant papers

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

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[1] Under the DSA Scheme, unless exempted, each employer will be required to make contribution equivalent to 1% of the monthly relevant income of his/her employees to his/her DSA after the abolition of the "offsetting" arrangement. The mandatory contributions in DSA can only be withdrawn for the purpose of paying SP/LSP.

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
Subcommittee on Retirement Protection	24 June 2017	Agenda Minutes
Panel on Manpower	17 October 2017 (Item III)	Agenda Minutes
Panel on Manpower	21 November 2017 (Item IV)	Agenda Minutes
Panel on Manpower	15 May 2018 (Item VI)	Agenda Minutes
Panel on Manpower	16 October 2018 (Item III)	Agenda Minutes
Panel on Manpower	20 November 2018 (Item IV)	Agenda Minutes
Panel on Manpower	7 January 2021 (Item III)	LC Paper No. CB(2)618/20-21(01)
Panel on Manpower	19 January 2021 (Items III & V)	Agenda
Panel on Manpower	18 February 2021 (Item III)	LC Paper No. CB(2)787/20-21(01)
Panel on Manpower	16 March 2021 (Item III)	LC Paper No. CB(2)888/20-21(01)

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