

**For discussion on
4 February 2022**

Legislative Council Panel on Manpower

Proposed abolition of the offsetting arrangement under the Mandatory Provident Fund System

Introduction

The Chief Executive (CE) in Council approved on 4 January 2022 that the Employment and Retirement Schemes Legislation (Offsetting Arrangement) (Amendment) Bill 2022 (the Bill) be introduced into the Legislative Council (LegCo) for abolishing the use of accrued benefits¹ derived from employers' mandatory contributions under the Mandatory Provident Fund (MPF) System (ERMC) to offset severance payments (SP) and long service payments (LSP) (the offsetting arrangement). Since it is a new LegCo term, the Government considers it appropriate to brief this Panel at a special meeting on the legislative proposals before introducing the Bill.

Background

2. Currently, employers are allowed to use ERMC to offset SP/LSP. Likewise, benefits of employers' contributions to other occupational retirement schemes can also be used to offset SP/LSP. The community, in particular the labour sector, has been pressing for years for the abolition of such practice to improve employees' retirement protection. Abolishing the offsetting arrangement would also help strengthen the retirement protection function of MPF as an important pillar of Hong Kong's retirement protection system.

3. Given the far-reaching consequences of the abolition and the diverse opinions of employers, employees and different sectors in the community, various proposals were put up throughout the years spanning two terms of government to explore feasible and practical options to abolish the offsetting arrangement. After years of extensive consultation and major revisions to proposals, CE

¹ Under the Mandatory Provident Fund Schemes Ordinance, "accrued benefits", in relation to a registered scheme, means the amount of each scheme member's beneficial interest in the registered scheme at any time, including sums derived from the contributions made by or in respect of that scheme member together with the income or profits arising from any investments of the contributions, but taking into account any losses in respect of the investments and any amounts paid in respect of the scheme member.

announced in the 2018 Policy Address an enhanced package for abolishing the offsetting arrangement. This includes legislative amendments to give effect to the abolition, introducing a Designated Savings Account (DSA) Scheme through a new legislation to assist employers to save up after the abolition to meet their future SP/LSP liabilities, and a Government subsidy scheme to alleviate financial pressure of employers after the abolition. The current-term Government has been taking forward the above work in full steam. A background note on the history leading to the current abolition package is at **Annex**.

Legislative Proposals

4. It is necessary to make amendments to the following eight pieces of ordinance/subsidiary legislation, which currently provide for the offsetting arrangement or contain provisions that need to be consequentially amended upon the abolition of the arrangement –

- (i) Employment Ordinance (Cap. 57) (EO);
- (ii) Mandatory Provident Fund Schemes Ordinance (Cap. 485) (MPFSO);
- (iii) Mandatory Provident Fund Schemes (Exemption) Regulation (Cap. 485B) (MPFS (Exemption) Regulation);
- (iv) Occupational Retirement Schemes Ordinance (Cap. 426) (ORSO);
- (v) Grant Schools Provident Fund Rules (Cap. 279C);
- (vi) Subsidized Schools Provident Fund Rules (Cap. 279D);
- (vii) Protection of Wages on Insolvency Ordinance (Cap. 380) (PWIO); and
- (viii) Inland Revenue Ordinance (Cap. 112) (IRO).

(a) Abolition of offsetting arrangement under MPF System and “grandfathering” arrangement

5. The offsetting arrangement will be abolished starting from a date to be appointed after the enactment of the Bill (the transition date). Thereafter, employers can no longer use ERMC to offset the SP/LSP entitlement under EO in respect of an employee’s employment period starting from the transition date (post-transition employment period) (post-transition portion of SP/LSP).

6. The abolition will have no retrospective effect. Employers may continue to use the accrued benefits derived from their MPF contributions (irrespective of whether the contributions are made before, on or after the

transition date, and irrespective of whether the contributions are mandatory or voluntary) to offset an employee's SP/LSP entitlement in respect of the employment before the transition date (pre-transition employment period) (pre-transition portion of SP/LSP). This "grandfathering" arrangement helps reduce the risk of large-scale dismissals before the transition date, or else some employers may dismiss employees (particularly those with long years of service) before the abolition takes effect in order to use ERM to offset SP/LSP. The arrangement of allowing employers to use contributions made before, on or after the transition date to offset pre-transition portion of SP/LSP can also obviate the need to segregate an employee's MPF account into separate accounts to record pre- and post-transition date MPF contributions (and the returns derived therefrom), which would lead to a proliferation of accounts and a high administrative cost².

7. Currently, some employers are making MPF contributions in excess of the mandatory requirement of 5% of the relevant income³ for their employees (i.e. MPF voluntary contributions). These voluntary contributions and the returns derived therefrom (ERVC) can continue to be used to offset both pre- or post-transition portion of SP/LSP. Likewise, gratuities based on length of service as contractual payment of employers to employees can continue to be used to offset SP/LSP. These arrangements will remain unchanged after the abolition of the offsetting arrangement.

(b) Calculation of SP/LSP

8. The current rate for calculating SP/LSP is two-thirds of the last monthly wages (or the average monthly wages over the period of the last 12 months before the termination of employment, if the employee elects so), subject to a maximum of \$22,500, for each year of service; and the maximum payment of SP/LSP is \$390,000. The rate and maximum payment of SP/LSP will remain unchanged after the abolition of the offsetting arrangement. If an employee has worked for a long period such that the aggregate sum of his/her pre- and post-transition portion of SP/LSP exceeds \$390,000, post-transition portion will be the remainder of \$390,000 after first deducting pre-transition portion.

² In the short run, this arrangement may benefit employers as they could use ERM made after the transition date to offset pre-transition portion of SP/LSP in the event that ERM made before the transition date are not sufficient for offsetting. In the long run, ERM made before the transition date would grow due to investment returns and would likely outgrow the "offsettable" pre-transition portion of SP/LSP. Hence, it is likely in the long run that there would be no need to use ERM made after the transition date to offset pre-transition portion of SP/LSP.

³ "Relevant income" is defined in MPFSO and is subject to the maximum level of \$30,000 as specified in Schedule 3 to MPFSO for the purpose of making mandatory contributions.

9. Pre-transition portion of SP/LSP would be calculated on the basis of the monthly wages immediately preceding the transition date. This aims to contain the SP/LSP liability of an employer in respect of the pre-transition employment period of his/her employees, so as to guard against the risk of deliberate dismissals that may otherwise take place before the abolition should the last monthly wages before the termination of employment be used for calculating pre-transition portion of SP/LSP.

10. Currently, a monthly rated employee may choose to calculate his/her SP/LSP on the basis of his/her last monthly wages before the relevant date of dismissal or elect to have his/her wages averaged over the period of 12 months immediately preceding the relevant date⁴. The same options will be provided to employees in calculating his/her pre-transition portion of SP/LSP.

11. After the abolition, there could be cases where an employee, while fulfilling the requisite years of service for entitlement to SP/LSP upon termination of employment⁵, only has less than 12 months' service before the transition date. The employee would be given the option of having his/her wages averaged over the pre-transition employment period for the purpose of calculating pre-transition portion of SP/LSP.

12. There may also be cases where the pre-transition employment period of a monthly rated employee is less than a month, or the pre-transition employment period of a non-monthly rated employee is less than 30 days. In such cases, the pre-transition portion of SP/LSP of the employee concerned would be calculated based on his/her first month's wages (for monthly rated employees), or any 18 days' wages chosen by the employee during the first 30 normal working days⁶ (for non-monthly rated employees) after commencement of employment.

13. To facilitate calculation of pre-transition portion of SP/LSP, employers will be required to keep wage and employment records of the employees covering the 12 months of the employees' employment (or a shorter period for an employee

⁴ Where the employee so elects, in the case of a monthly rated employee, the monthly average shall not exceed \$22,500. For non-monthly rated employees, the total wages for the period of 12 months shall, for the purpose of calculating the daily average, not exceed 12 times \$22,500.

⁵ The minimum requirements for entitlement to SP and LSP are having worked under a continuous contract for two years and five years respectively as counted from the date of commencement of employment of an employee to the relevant date of termination of the employment contract.

⁶ Under EO, an employee who is not monthly rated may choose 18 days' wages based on any 18 days occurring during his/her last 30 normal working days, or two-thirds of \$22,500, whichever is less, to calculate the amount of SP/LSP that he/she is entitled to.

who has worked for less than 12 months) immediately preceding the transition date. Where a monthly rated employee has less than a month's service, or a non-monthly rated employee has less than 30 days of service preceding the transition date, the employer will be required to keep wage and employment records of the monthly rated employee's first month of employment, or those of the non-monthly rated employee's first 30 normal working days.

14. There may be a scenario in which some employees will be worse off after the abolition of the offsetting arrangement than what they would be entitled to under the current offsetting regime, i.e. the total amount of SP/LSP entitlement plus ERMC left in their MPF accounts after offsetting is smaller than that under the existing regime⁷. The Government has undertaken to make up for the shortfall by way of an administrative scheme should any such case arise.

(c) Adapted abolition arrangements

15. The abolition of the offsetting arrangement will also be applicable to –

- (a) Occupational retirement schemes under ORSO which are exempted under section 5 of MPFSO (MPF-exempted ORSO schemes) in relation to employers' contributions made to those occupational retirement schemes.
- (b) The two school provident funds under the Grant/Subsidized Schools Provident Fund Rules (G/SSPF Rules) in relation to Government/school donations made to those school provident funds.

The abolition of the offsetting arrangement for the above schemes/funds will take effect on the same date as the abolition of the offsetting arrangement for MPF schemes.

- (c) Cases where an employer is exempted from making mandatory MPF contributions for an employee pursuant to section 4(3)(b) of MPFSO⁸

⁷ Under some special circumstances, the amount of aggregate benefits received by an employee could be less than under the current offsetting regime. For example, if (a) the employee has a substantial pay rise after the transition date, and thus a much lower wage level (i.e. the monthly wages immediately preceding the transition date) is used to calculate pre-transition portion of SP/LSP; (b) the employee's pre-transition employment period is long, and thus the above effect is amplified; and/or (c) the employee's post-transition employment period is short, and thus the employee's benefits gained from the abolition are relatively small.

⁸ Section 4(3)(b) of MPFSO exempts any person entering Hong Kong for the purpose of being employed or self-employed if that person is a member of a provident, pension, retirement or superannuation scheme (however described) of a place outside Hong Kong

but the employer has nonetheless made contributions to a provident, pension, retirement or superannuation scheme (however described) in a place outside Hong Kong. Such cases are rare but should they happen, we propose to apply the same adapted abolition arrangements as set out in the ensuing paragraphs.

16. Since employers' contributions under the MPF-exempted ORSO schemes and Government/school donations under the school provident funds (ORS benefits) are not differentiated into mandatory and voluntary contributions, the following adapted abolition arrangements will be put in place to calculate and carve out a portion of "non-offsettable benefits" from ORS benefits by using the formula below. The "non-offsettable benefits", which is akin to ERMC, cannot be used to offset the post-transition portion of SP/LSP for the scenarios described in paragraph 15 above—

$$\begin{aligned} & \textit{Final average monthly relevant income (capped at \$30,000)} \times \\ & \textit{Years of service with ORS benefits} \times 5\% \times 12 \end{aligned}$$

The formula is modelled on the calculation for minimum MPF benefits (MMB)⁹ under the MPFS (Exemption) Regulation. MMB refers to the minimum amount of ORS benefits (comprising accrued benefits derived from the employee's contributions plus, if any, the benefits derived from the employer's contributions under the vesting scale prescribed by the relevant ORSO scheme rules) that must be transferred from an employee's account when the employee changes from an MPF-exempted ORSO scheme to an MPF scheme. The "non-offsettable benefits" as calculated by the formula above is akin to ERMC (5% of relevant income of the employee).

17. For cases with only post-transition portion of SP/LSP, the "non-offsettable benefits" cannot be used for offsetting. After deducting the amount of "non-offsettable benefits", the remaining amount (akin to ERVC) can be used for offsetting. For cases with both pre- and post-transition portion of SP/LSP, the "non-offsettable benefits" can only be used to offset pre-transition portion. The remaining amount can be used to offset both pre- and post-transition portion.

⁹ For an employee who joined an MPF-exempted ORSO scheme after 1 December 2000, MMB must be calculated upon termination of employment, and transferred from the ORSO scheme to (a) an MPF scheme in which the member's new employer is a participating employer or (b) an MPF scheme, nominated by the member, that accepts transfers of MMB. MMB means the lesser of –

- (i) the member's benefits accrued and held under the scheme during the course of employment, i.e. benefits derived from the employee's contributions, plus the benefits derived from the employer's contributions under the vesting scale; or
- (ii) $1.2 \text{ (i.e. } 5\% \times 2 \times 12) \times \text{ final average monthly relevant income (capped at \$30,000, same as the maximum level of relevant income as specified in MPFSO)} \times \text{ years of post-MPF service.}$

(d) Application of the abolition arrangement

18. Employees who are currently not covered by the MPF System (e.g. domestic helpers) or other statutory retirement schemes are not affected by the offsetting arrangement. Hence, the abolition of offsetting will have no impact on them. Their SP/LSP, if eligible, will continue to be calculated on the basis of the last monthly wages (or the average monthly wages of the 12-month period) before the termination of employment.

(e) Ex gratia payment from Protection of Wages on Insolvency Fund (PWIF)

19. Currently, PWIF may grant an ex gratia payment for SP to an employee upon the latter's application. If an applicant (i.e. an employee) has received such an ex gratia payment from PWIF, the applicant's rights to the accrued benefits in an MPF scheme or ORS benefits (which are "offsettable" items for SP) attributable to the employer's contributions (up to the amount of SP paid from PWIF) would be transferred to and vested in the PWIF Board. This means that the PWIF Board is entitled to recover the amount of ex gratia payment on SP from MPF/ORS benefits attributable to contributions by the employer (i.e. the so-called "subrogation" right of the PWIF Board). Upon the abolition of offsetting, ERMC or the "non-offsettable benefits" of an employee's ORS benefits can no longer be used to offset post-transition portion of SP, and thus should not be included in the MPF/ORS benefits to be recovered by the PWIF Board. Legislative amendment will be made to reflect the above.

20. The second amendment concerns the scenario involving wage reduction of an employee. Under section 16 of PWIO, for situations involving wage reduction, the ex gratia payment from PWIF is calculated on the basis of an employee's wage level before wage reduction, or a wage level in between the employee's reduced wages and his/her pre-reduction wages, whichever is less, on the conditions that (a) if his/her employer has undertaken to pay SP on the basis of the pre-reduced wage level in writing before the wage reduction, and (b) the wage reduction took place within 12 months immediately before the date of termination of employment. The purpose is to allow for calculation of the ex gratia payment in a more favourable manner to the employee. Under the "grandfathering" arrangement for the abolition of the offsetting arrangement, the amount of pre-transition portion of SP should be calculated on the basis of the monthly wages immediately preceding the transition date (please refer to paragraph 9 above) unless otherwise provided for. Therefore, legislative amendment is necessary to expressly provide for the wage reduction scenario in order to continue to apply the above practice.

(f) Salaries tax treatment for LSP and SP

21. LSP is prima facie an income from employment assessable to salaries tax under IRO. Since LSP can be offset by non-taxable ERMC under the current offsetting arrangement, it is the established practice of the Inland Revenue Department not to tax LSP paid in accordance with EO. After the abolition of the offsetting arrangement, LSP cannot be offset by ERMC and the said established practice of not taxing LSP will no longer apply. Therefore, it is necessary to amend IRO to stipulate that LSP paid in accordance with EO is not chargeable to salaries tax.

22. SP paid in accordance with EO is generally regarded as a compensation for loss of employment and should not be taxable as an income from employment. But to avoid doubt, it is also necessary to amend IRO to make clear that SP paid in accordance with EO is not chargeable to salaries tax upon the abolition of the offsetting arrangement.

Supporting Measures

23. The Government will achieve the stated policy objective of abolishing the offsetting arrangement under the MPF System once the Bill is passed into law. Bearing in mind that the new regime would incur additional financial burden on employers, the Government will put in place supporting measures to facilitate the transition. Such support is helpful in particular to micro, small and medium-sized enterprises (MSMEs). First and foremost, to assist employers to adapt to the policy change, the Government will introduce a 25-year subsidy scheme totalling \$33.2 billion at 2021 prices. As announced in the Policy Address Supplement published in October 2021, the Government subsidy scheme has been refined to provide targeted assistance to employers, especially MSMEs, in the initial years after the abolition.¹⁰

24. Another supporting measure is the introduction of a DSA Scheme¹¹ under which employers will be mandated to save up for meeting their future SP/LSP liabilities after the abolition. A new piece of legislation will be enacted to implement the Scheme. The DSA Scheme will ride on the eMPF Platform being developed by the Mandatory Provident Fund Schemes Authority, which is expected to be fully implemented in 2025 at the earliest. We plan to introduce the bill for the DSA Scheme into the LegCo in Q2 2022. Prior to that, we plan

¹⁰ The LegCo Brief on the refined Government subsidy scheme was issued on 8 October 2021.

¹¹ A new bill, namely the Designated Savings Accounts for Severance Payment and Long Service Payment Bill, will need to be introduced into LegCo to implement the Scheme.

to consult key stakeholders (including this Panel) on the implementation details. As the DSA Scheme will only be implemented when the eMPF Platform is fully operational, we can afford the time to consult stakeholders without delaying passage of the Bill for abolishing the offsetting arrangement or its eventual implementation in 2025 at the earliest.

Public Consultation

25. Following CE's announcement of the enhanced proposal for the abolition of the offsetting arrangement in October 2018, the Labour and Welfare Bureau/Labour Department met with major business chambers, employers' associations, labour groups, etc. to explain the enhanced proposal. We also briefed the Labour Advisory Board (LAB) and this Panel¹² in October and November 2018 respectively, and on the further details of the abolition arrangement in April 2021. Upon the announcement of refinement of the Government subsidy scheme to provide more targeted assistance to employers in October 2021, we met with and explained the refined scheme to stakeholders including this Panel, LAB, employers' associations, labour unions and political parties to foster their understanding.

Way Forward

26. To take forward the abolition of the offsetting arrangement, the Government plans to introduce the Bill into LegCo in the latter half of February 2022.

27. Members are invited to note the content of this paper.

Labour and Welfare Bureau
Labour Department
January 2022

¹² Members of the Panel on Commerce and Industry and the Panel on Financial Affairs as well as other LegCo members were invited to join the discussion.

Abolition of the Offsetting Arrangement – Background Note

The offsetting provisions were introduced into the Employment Ordinance (EO) when severance payment (SP) and long service payment (LSP) were put in place in 1974 and 1986 respectively. The provisions allow employers to use gratuities attributable to employees' years of service or contributions made for employees under retirement schemes to offset SP and LSP payable. Following the enactment of the Mandatory Provident Fund Schemes Ordinance (MPFSO) in 1995, an employer is allowed to offset his/her SP/LSP payment against the accrued benefits from his/her MPF contributions.

Proposal of the previous-term Government

2. The former Chief Executive pledged in his election manifesto in 2012 to adopt measures to progressively reduce the proportion of accrued benefits attributed to employer's contribution in the MPF account that could be applied to offset long-service or severance payments. As one of the measures to enhance retirement protection, including the MPF pillar, the previous-term Government made the first proposal on the abolition of the offsetting arrangement in early 2017. Taking into account the historical background of SP/LSP and offsetting, the previous-term Government recommended that the abolition of the offsetting arrangement should be subject to the following guiding principles –

- (a) the abolition of offsetting should have no retrospective effect;
- (b) to balance between employers' affordability and employees' benefits;
- (c) the Government should have a visible role to play in terms of financial commitment but any payment from the public purse should be finite in quantum and duration;
- (d) employees currently not covered by MPFSO or other statutory retirement schemes and hence not affected by the abolition of the offsetting arrangement would continue to have their SP/LSP entitlements dealt with and calculated in accordance with the existing provisions of the law; and
- (e) any unintended policy consequences in terms of creating moral hazards, souring labour relations, massive lay-offs, etc. should be minimised.

3. Based on the above principles, the previous-term Government proposed the following abolition package –

- (a) from a prospective date (the Effective Date), abolish the offsetting arrangement with no retrospective effect and put in place a “grandfathering” arrangement. Under the “grandfathering” arrangement, as and when an employer needs to pay SP/LSP, he/she can use the accrued benefits from his/her MPF contributions before the Effective Date and the returns derived therefrom to offset against SP/LSP payable for the employment period before the Effective Date. This part of SP/LSP would be calculated according to the existing statutory formula, i.e. –

last month’s wages before Effective Date x 2/3 x years of service;

- (b) the SP/LSP payable for the employment period from the Effective Date cannot be offset by accrued benefits from MPF contributions. The calculation of this part of SP/LSP would be adjusted downwards as follows –

last month’s wages x 1/2 x years of service; and

- (c) the Government would provide subsidies for employers on a reimbursement basis in the ten years from the Effective Date in order to share part of the SP/LSP expenditure in the absence of the offsetting arrangement, until the 11th year when the cost would be fully taken up by employers. The estimated one-off expenditure was \$7.9 billion (in 2016 prices). The proposed Government subsidy during the ten-year transitional period is at **Appendix 1**.

4. However, no consensus could be reached on the abolition package between employers, who continued to oppose to the abolition of offsetting, and employees who opposed to adjusting downwards the calculation of post-Effective Date SP/LSP.

The “preliminary idea” in March 2018

5. The current-term Government made clear its stance in the 2017 Policy Address that the offsetting arrangement should be abolished. Having regard to the community’s views, the current-term Government would increase its financial commitment to mitigate the impact of the abolition on enterprises, in particular micro, small and medium-sized enterprises (MSMEs).

6. The Government sounded out the stakeholders on a “preliminary idea” to abolish the offsetting arrangement in March 2018, the major features of which were as follows –

- (a) the offsetting arrangement will be abolished as from a future effective date (Effective Date) with no retrospective effect (the “grandfathering” arrangement), while the SP/LSP entitlement for an employee’s employment period before the Effective Date could continue to be offset by the employer’s contributions under the MPF System made both before and after the Effective Date;
- (b) the rate for calculating SP and LSP will remain at two-thirds of the monthly wages of the employee for each year of service (as opposed to 1/2 under the previous-term Government’s proposal), and the maximum payment of SP/LSP will remain at \$390,000;
- (c) any SP/LSP payable for the employment period up to the Effective Date will 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 EO;
- (d) each employer is required to set up a Designated Savings Account (DSA) under his/her own name and contribute 1% of his/her employees’ monthly income to the DSA until reaching 15% of all his/her employees’ annual income for payment of SP/LSP; and
- (e) the Government provides a two-tier subsidy with the duration extended from ten years under the previous-term Government’s proposal to 12 years. The amount of financial commitment would be increased from \$7.9 billion to \$17.2 billion (in 2016 prices) to help share employers’ expenses on SP/LSP in respect of the employment period after the Effective Date within the 12-year transitional period. Details of the two-tier subsidy scheme are at **Appendix 2**.

7. The labour sector in general welcomed the Government’s commitment to abolish the offsetting arrangement and the proposals in the “preliminary idea”. Some expressed concern that in certain special circumstances, individual employees might receive less than what they do under the current offsetting regime. Others harboured reservation about allowing employers to continue to use their MPF contributions made after the Effective Date to offset the pre-Effective Date SP/LSP.

8. The business sector remained highly concerned over the possible financial impact of the abolition on cash-tight establishments, notably MSMEs. While many employers had accepted the need to save up to meet their SP/LSP liabilities, they pointed out that even with the DSA, the savings might not be sufficient for meeting some employers' SP/LSP expenses in full, particularly MSMEs and establishments that have less control over their staff turnover. 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" was still considered inadequate to help enterprises meet their SP/LSP liabilities in the long run. Employer groups called for the Government to play a longer-term or even perpetual role in sharing out part of the SP/LSP liabilities following the abolition of the offsetting arrangement. Some proposed to set up a "central fund pool" to be financed by mandatory levy contributions from all employers, under which the dismissal cost of individual employers would be borne, in full or in part, by the central risk pool. However, a "central fund pool" would involve significant issues of moral hazard and abuse, as well as cross-subsidisation between different employers.

The enhanced arrangements announced in the 2018 Policy Address

9. Having considered the stakeholders' views, the Chief Executive announced in the 2018 Policy Address the enhanced arrangements for abolishing the offsetting arrangement, with significant improvements built in to provide employers, especially MSMEs, with greater and longer-term financial support. The major features of the proposal are as follows –

- (a) the major features of the "preliminary idea" would form the basis of the final package for abolishing the offsetting arrangement;
- (b) the duration of the second-tier subsidy be extended from 12 years to 25 years in accordance with the schedule at **Appendix 3**. The total Government financial commitment would increase substantially from \$17.2 billion to \$29.3 billion (in 2016 prices); and
- (c) the Government would undertake to 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 accounts) than what he/she should otherwise receive under the current offsetting regime.

10. The labour sector in general welcomed the enhanced arrangements and pressed for early implementation to avoid further depletion of employees' retirement savings in their MPF accounts. The business sector, while welcoming the sizable increase in Government subsidy, had expressed concern about the complexity of the two-tier subsidy scheme and the lack of certainty on their out-of-pocket payment. MSMEs were particularly concerned about their ability in meeting their SP/LSP liabilities after the abolition of the offsetting arrangement.

The refined Government subsidy scheme

11. To address the concerns of the business sector, the Government announced in the Chief Executive's 2021 Policy Address Supplement a refined Government subsidy scheme. While maintaining roughly the same amount of Government's financial commitment as well as the 25-year subsidy period, the subsidy scheme is refined as follows (please refer to **Appendix 4** for details) –

- (a) For the first \$500,000 of the total amount of SP/LSP payable by an employer in a year –
 - (i) specify a share ratio payable by an employer per employee for each year; and
 - (ii) for the initial nine years, cap the maximum amount of SP/LSP (i.e. the “capped amount”) payable by an employer per employee. If the shared amount payable by an employer exceeds the “capped amount”, the employer only needs to pay the “capped amount”.

The rest of the amount of SP/LSP will be subsidised by the Government.

- (b) For the total amount of SP/LSP beyond the first \$500,000, specify a share ratio payable by an employer per employee for each year from Year 1 to Year 12. No subsidy will be provided from Year 13 onwards.

12. The business sector in general welcomed the refined subsidy scheme. The subsidy calculation is simpler and easier to understand, and employers could readily ascertain how much they would have to shoulder for their future SP/LSP liabilities after the abolition. To provide more targeted assistance to MSMEs, employers will enjoy a higher subsidy rate for dismissal cases falling within a yearly threshold of \$500,000, as compared to the subsidy rate for cases beyond the threshold. Employers will also receive a higher subsidy rate during the initial transitional years when they are adapting to the post-abolition arrangements. This front-end loaded arrangement would allow more time for employers to save

up in the initial years and get prepared to shoulder their SP/LSP liabilities in the long run.

13. The financial commitment for the original subsidy scheme was around \$29.3 billion (in 2016 prices) or \$32.9 billion (in 2021 prices). Under the refined subsidy scheme, the financial commitment is estimated at \$33.2 billion (in 2021 prices), around 1% higher than the updated estimate for the original subsidy scheme.

**Government Subsidy Scheme Proposed by the
Previous-term Government in 2017**

Year after the abolition	Employers' net SP/LSP payment as % of SP/LSP payable	Government's subsidy to employers as % of SP/LSP payable
1	50%	50%
2	50%	50%
3	60%	40%
4	60%	40%
5	70%	30%
6	70%	30%
7	80%	20%
8	80%	20%
9	90%	10%
10	90%	10%
11	100%	-

**Government Subsidy Scheme under the
“Preliminary Idea” proposed in March 2018**

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	-	-

**Refined Government Subsidy Scheme
Announced in the 2018 Policy Address**

Year after the abolition	Government's share of SP/LSP in respect of the employment period after the abolition	
	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 - 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 - 15	-	30%
16 - 18	-	25%
19 - 21	-	20%
22 - 23	-	15%
24 - 25	-	10%
26	-	-

**Employer's Share under
the Refined Government Subsidy Scheme for
Post-abolition Severance Payment/Long Service Payment (SP/LSP)**

Year after the abolition	Employer's share per employee (as % of SP/LSP payable)	
	<u>First \$500,000</u> of all SP/LSP paid by <u>an employer</u> in a year	<u>Beyond the first \$500,000</u> of all SP/LSP paid by an employer in a year
1 - 3	50%, capped at \$3,000	50%
4	55%, capped at \$25,000	55%
5	60%, capped at \$25,000	60%
6	65%, capped at \$25,000	65%
7	70%, capped at \$50,000	70%
8	75%, capped at \$50,000	75%
9	80%, capped at \$50,000	80%
10	80%	85%
11	80%	90%
12	85%	95%
13	85%	100%
14 - 19	90%	100%
20 - 25	95%	100%