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LEGISLATIVE COUNCIL BRIEF

REFINEMENT OF GOVERNMENT SUBSIDY SCHEME FOR THE ABOLITION OF THE "OFFSETTING" ARRANGEMENT UNDER THE MANDATORY PROVIDENT FUND SYSTEM

INTRODUCTION

At the meeting of the Executive Council on 21 September 2021, the Council ADVISED and the Chief Executive ORDERED that –

(a) the refined Government subsidy scheme (paragraph 5 below), including the reimbursement approach for subsidy disbursement (paragraph 11 below), should be endorsed; and

(b) public bodies/subvented organisations whose employees' severance payment (SP) and long service payment (LSP) have been fully funded by the Government, as well as the Protection of Wages on Insolvency Fund (PWIF), should not be eligible for government subsidy (paragraph 12 below).

JUSTIFICATIONS

2. The Chief Executive announced in the 2018 Policy Address the enhanced arrangements for the abolition of using the accrued benefits of employers' mandatory contributions under the Mandatory Provident Fund (MPF) System to "offset" SP/LSP (the "offsetting" arrangement). The Government will legislate for employers to set up Designated Savings Accounts (DSAs) under their own names to save up for meeting their future SP/LSP liabilities after the abolition. At the same time, to help employers adapt to the policy change, the Government will provide a two-tier subsidy (hereafter referred to as "the original subsidy scheme") to share out their expenses on SP and LSP after the abolition for a period of 25 years. Under the original subsidy scheme, all employers[1] would be eligible for the first-tier subsidy lasting for 12 years. If, after netting the first-tier subsidy, an employer's DSA balance is insufficient to cover his/her SP/LSP liabilities, it will be eligible for the second-tier subsidy. Only employers with a DSA

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[1] Except for those whose employees are not covered by the MPF System (currently domestic employees, whether foreign or local, and employees aged below 18 or aged 65 or above) or other statutory retirement schemes. Their SP/LSP expenses are not affected by the abolition of the "offsetting" arrangement and therefore they will not be reimbursed with any subsidy from Government for payment of any SP/LSP.

would be eligible for the second-tier subsidy. The two-tier subsidy would last for a total of 25 years. The key features of the abolition of the "offsetting" arrangement and the DSA Scheme are at Annexes A and B respectively. A table showing the two-tier subsidy ratios under the original subsidy scheme is at Annex C.

A, B

C

3. While welcoming the sizable increase in Government subsidy under the original subsidy scheme, the business sector finds the calculation of second-tier subsidy, which is contingent on an employer's DSA balance in future and the remaining amount of SP/LSP expenses not covered by the first-tier subsidy, complicated and difficult to understand. Besides, as an employer's DSA balance at the time of dismissal of an employee is uncertain because the balance may vary from time to time depending on factors such as the number of employees engaged, the wages and length of service of employees, etc., employers could not readily ascertain their out-of-pocket payment for future SP/LSP liabilities. With limited capacity to plan and save ahead, micro, small and medium-sized enterprises (MSMEs) are particularly concerned about their ability in meeting their SP/LSP liabilities after the abolition of the "offsetting" arrangement.

Refined Government Subsidy Scheme

4. To address the concerns of the business sector and to lobby their support for the abolition of the "offsetting" arrangement, we propose to refine the original subsidy scheme while maintaining roughly the same amount of Government's financial commitment as earmarked for the original subsidy scheme as well as the 25-year subsidy period. The refined subsidy scheme is proposed based on the following principles –

(a) to assist employers to adapt to the policy change by front-loading the subsidy in the initial years and reducing it progressively afterwards;

(b) to enable MSMEs to generally benefit more from a higher subsidy ratio under the refined subsidy scheme;

(c) to simplify the subsidy formula to make it easier to understand; and

(d) to provide greater certainty to employers on the amount of subsidy to be received by employers.

5. Based on the above principles, we propose to revise the original subsidy scheme –

(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.

D

E

6. The proposed share ratios payable by an employer under the refined subsidy scheme are at Annex D. Illustrative examples showing the amount of SP/LSP payable by an employer are at Annex E.

7. The $500,000 threshold is proposed to better assist MSMEs, which would likely have a lower amount of SP/LSP liabilities. According to the "offsetting" claims data provided by the Mandatory Provident Fund Schemes Authority (MPFA), the average amount of SP/LSP "offsetting" claims per employer in 2019 was $323,900. We estimate that close to 90% of MSMEs had no more than $500,000 SP/LSP liabilities in 2019. We thus propose to set the threshold at $500,000 as most MSMEs should be covered, thereby enabling them to benefit from a higher subsidy ratio. As previously committed by the Government, we will review the operation of the subsidy scheme five years after implementation of the abolition of the "offsetting" arrangement.

8. The above refinements will address the business sector's concerns –

(a) the calculation of subsidy will be simpler and easier to understand. For cases within the $500,000 threshold, the amount of SP/LSP to be paid by employers is clearly capped during the initial nine years, and a flat share ratio will be set from Year 10 onwards. As regards cases beyond the $500,000 threshold, a flat share ratio will be clearly set for SP/LSP to be paid by employers;

(b) the employers' DSA balance and the calculation of subsidy will be delinked so that employers can have greater certainty on the amount of subsidy to be received and can easily ascertain the expenses to be shouldered; and

(c) the SP/LSP expenses of MSMEs is generally lower. We estimate that the majority of MSMEs will have no more than $500,000 SP/LSP liabilities[2] and therefore propose the $500,000 threshold, which should cover the majority of MSMEs. MSMEs will generally benefit more from a higher subsidy under the refined subsidy scheme for each SP/LSP pay-out within the $500,000 threshold, compared to a SP/LSP pay-out exceeding the $500,000 threshold.

9. In addition, the refined subsidy scheme has the following benefits -

(a) employers will receive greater support during the initial transitional years when they are adapting to the post-abolition arrangements. The "capped amount" in the initial three years is as low as $3,000 per employee. This 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; and

(b) the subsidy level will be progressively reduced over the 25-year subsidy period as employers gradually adapt to the policy change and build up their DSA balances. This will better prepare employers for the eventual conclusion of the subsidy scheme.

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2 According to the set of "offsetting" claims data in 2019 provided by MPFA, the average SP/LSP "offsetting" claims amount for each employer is $323,900. Based on this, the proportions of employers having no more than $500,000 SP/LSP liabilities in Year 1, Year 10 and Year 20 after the abolition are estimated below -

Firm size	**Estimated proportion among employers having no more than $500,000 SP/LSP liabilities in Year 1, Year 10 and Year 20 after the abolition**		
	Year 1	**Year 10**	**Year 20**
MSMEs (1-49 employees)	Close to 100%	Around 90%	Around 85%
Large firms (50 or more employees)	Close to 100%	Close to 70%	Around 60%
All firms	Close to 100%	Close to 90%	Around 80%

10. The financial commitment for the original subsidy scheme was around $29.3 billion in 2016 prices[3] and $32.9 billion in 2021 prices[4]. Under the refined subsidy scheme, the financial commitment is estimated at $33.2 billion (in 2021 prices)[4], around 1% higher than the updated estimate for the original subsidy scheme.

Reimbursement Approach for Subsidy Disbursement

11. Since the timing of the employer's payment of SP/LSP to his/her employees should be in accordance with the law[5] and should not be affected by the timing of payment of government subsidy to the employer, an employer should first settle any SP/LSP that arises as soon as possible by first drawing on his/her DSA balance, and then out-of-pocket if necessary. The government subsidy will be calculated and disbursed upon application. We will put in place a one-stop system so that employers can submit the DSA withdrawal and subsidy application at the same time. When approved, the amount of subsidy will be paid into the employer's DSA[6]. This is in line with the policy intent of requiring an employer to set up a DSA, which is to save up for his/her SP/LSP liabilities.

Eligibility for Subsidy

12. We propose that the following organisations/parties should not be eligible for government subsidy -

(a) **public bodies/subvented organisations if their employees' SP/LSP has been fully funded by the Government -** this is in line with the practices of the Employment Support Scheme and the Reimbursement of Maternity Leave Pay Scheme. The principle is that there should not be any double financial benefits received from the Government, and doubtful cases will be handled on a case-by-

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[3] Based on the set of "offsetting" claims data for 2015 provided by MPFA.

[4] Based on the set of "offsetting" claims data for 2019 provided by MPFA.

[5] Employers are required by law to settle their LSP liabilities within seven days of dismissal. An employee who wishes to claim for SP should serve a written notice to the employer within three months after the dismissal/lay off takes effect. The deadline for serving such notice may be extended if approved by the Commissioner for Labour. The employer shall grant SP to the employee not later than two months from the receipt of such notice.

[6] In the event an employer is not required to set up a DSA (such as when all employees of an employer are exempted employees and the employer is not required to make DSA contributions for them), the subsidy will be paid to the employer direct.

case basis; and

(b) **PWIF -** we recommend that PWIF[7] should not be eligible for government subsidy to recover the ex gratia payments in respect of SP paid to the employees. The aim of providing government subsidy is to relieve the financial pressure of employers in paying SP/LSP. It is not in line with our policy intent to allow PWIF, which grants ex gratia payments in respect of SP owed by an insolvent employer to the employees, to apply for government subsidy. We briefed the PWIF Board at its meeting in July 2021 and members did not express any special views on this.

IMPLICATIONS OF THE PROPOSAL

13. The proposal is in conformity with the Basic Law, including provisions concerning human rights. It has no environmental, gender or productivity implications. The sustainability, family, economic, financial and civil service implications are set out at Annex F.

F

PUBLIC CONSULTATION

14. We consulted the Labour Advisory Board on 6 October 2021 and will consult the Legislative Council (LegCo) Panel on Manpower on the refined scheme later in the month.

PUBLICITY

15. Apart from the issue of this LegCo Brief, a spokesman from the Labour Department (LD) will be available to handle press enquiries. We will also arrange a technical briefing for the media.

BACKGROUND

16. The Government is taking forward at full steam the preparatory work for abolishing the "offsetting" arrangement, including (a) drafting an amendment bill to amend eight pieces of legislation with provisions on the "offsetting" arrangement and make consequential amendments to related

[7] Under the Protection of Wages on Insolvency Ordinance, in the case of an employer's insolvency, the employee may apply for ex gratia payment from the PWIF in respect of, among others, outstanding SP owed to him. The PWIF is mainly financed by an annual levy (currently at $250) on each Business Registration Certificate. As at end of June 2021, the PWIF enjoyed a positive balance of $6,385.6 million.

legislation; (b) drafting a new bill to provide for the legal framework for the DSA Scheme and to make consequential amendments to ordinances that deal with matters related to the Scheme; (c) formulating details of the supporting infrastructure for the DSA Scheme, namely building DSA functionalities on the eMPF Platform being developed by MPFA, and developing a new DSA information technology system in LD for operating and managing the DSA Scheme; and (d) developing operational details for the Government subsidy scheme.

17. We have been working with relevant bureaux/departments to take forward the work above. We aim to introduce the two bills into LegCo in early 2022 as soon as the new LegCo is sworn in. Our plan is to abolish the "offsetting" arrangement and implement the DSA Scheme at the same time upon full implementation of the eMPF Platform in 2025.

ENQUIRIES

18. Enquiries on this brief can be addressed to Ms CHEUNG Hoi-shan, Assistant Commissioner for Labour (Policy Support), on 2852 3633.

Labour and Welfare Bureau
8 October 2021

Annex A

Major features of abolition of the "offsetting" arrangement

(a) The "offsetting" arrangement will be abolished as from a future effective date with no retrospective effect (the "grandfathering" arrangement), but the severance payment (SP)/long service payment (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 Mandatory Provident Fund (MPF) System made both before and after the effective date, as opposed to the present provision under the Employment Ordinance (EO) that employers can only use his/her contributions that relate to the employee's years of service for which SP/LSP is payable for "offsetting".

(b) The rate for calculating SP and LSP remains at two-thirds of the monthly wages of the employee for each year of service and the maximum payment of SP/LSP keeps at $390,000.

(c) Any SP/LSP payable for the employment period up to the day immediately before the effective date would be calculated on the basis of the monthly wages as at the day immediately before the effective date, as opposed to the last monthly wages at the time of dismissal (if the dismissal is after the effective date) presently provided under the EO.

(d) 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.

(e) The abolition of the "offsetting" arrangement should also be applicable to the schemes under the Occupational Retirement Schemes Ordinance 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 schemes.

(f) Voluntary MPF contributions made by an employer in excess of the mandatory contributions of 5% of an employee's relevant income and the accrued benefits derived therefrom can continue to be used for "offsetting" SP/LSP. Likewise, contractual gratuity based on length of service made by employers to employees can also continue to be used to "offset" SP/LSP.

Annex B

Major features of the Designated Savings Accounts Scheme

(a) The Designated Savings Accounts (DSA) Scheme is a compulsory and dedicated saving scheme to assist employers to save up to meet their future severance payment (SP)/long service payment (LSP) obligations after the abolition of the Mandatory Provident Fund (MPF) "offsetting" arrangement.

(b) Employers are required to set up DSAs under their own name and contribute an amount equivalent to 1% of their employees' monthly relevant income (subject to the same monthly relevant income cap for MPF contributions, which is currently set at $30,000) to their own DSAs. Employers may stop making contributions to their own DSAs when the savings in their DSAs have reached 15% of the annual relevant income of all their employees.

(c) Employers could withdraw monies from the savings of their DSAs for payment of SP/LSP. The monies in an employer's DSA cannot be used for other purposes.

(d) Employers are exempted from making DSA contributions for certain employees. For example, in order not to discourage employers from making voluntary MPF contributions for their employees, employers making voluntary MPF contributions at 1% or above of the employees' relevant income in addition to the 5% mandatory MPF contributions would be exempted from making DSA contributions. Besides, employers whose employees are currently not covered by the MPF System, including persons covered by statutory retirement schemes or provident fund schemes (e.g. civil servants or teachers of grant/subsidized schools), members enrolled in occupational retirement schemes with MPF exemption certificate, domestic employees, employees aged under 18 or aged 65 or above, etc. would also be exempted.

(e) Government would make use of the eMPF Platform of the Mandatory Provident Fund Schemes Authority for the collection of employers' contributions to their respective DSAs and for subsequent payment of SP/LSP from the DSA monies for more cost-effective administration. To facilitate employers in calculating and making DSA contributions, the definition of relevant income for calculating DSA contributions and its ceiling, as well as the contribution period and contribution day would be the same as those for mandatory contribution under the MPF System. The daily operating expenses of the DSA Scheme, including the additional cost of the eMPF Platform arising from the DSA operation, would be recovered from employers.

Government would explore the feasibility of placing DSA monies, together with Government monies, with the Exchange Fund.

(f) Currently, provision made for LSP and SP obligations in accordance with the Hong Kong Accounting Standards can be deducted in calculating employers' chargeable profits. Tax deduction would be provided for DSA contributions made by employers. To avoid double tax deductions, employers could only deduct the excess of the accounting provision over the DSA contributions previously allowed for deduction.

Annex C

Original Government Subsidy Scheme for Post-abolition Severance Payment/Long Service Payment (SP/LSP)

Year after the abolition	**First-tier subsidy ratio (as % of SP/LSP payable)** *(per employee)*	**Second-tier subsidy ratio (as % of remaining SP/LSP after netting (i) first-tier subsidy and (ii) accrued balance of Designated Savings Accounts)** *(per employee)*
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	-	-

Annex D

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)	
	First $500,000 of all SP/LSP paid by an employer in a year	**Beyond the first $500,000 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%

Annex E

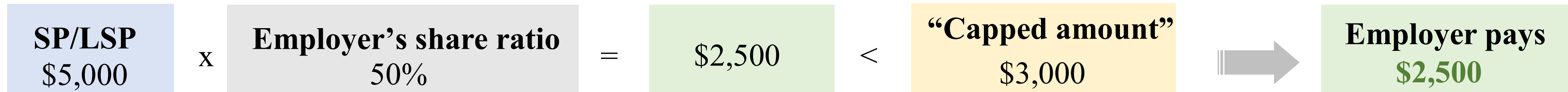
Illustrative Examples of Employer's Share (Per Employee) Within the $500,000 Yearly Threshold under the Refined Subsidy Scheme

<u>First nine years after abolition</u>

Employer's share per employee = Amount of SP/LSP x employer's share ratio, or "capped amount", **<u>whichever is lower</u>**

➔ If lower than "capped amount" ➔ Employer pays according to the share ratio

<u>Example 1 (in Year 3)</u>



<u>Example 2 (in Year 6)</u>

➔ If higher than "capped amount" ➔ Employer only pays the "capped amount"

<u>Example 3 (in Year 3)</u>

<u>Example 4 (in Year 6)</u>

From Year 10 onwards

Employer's share per employee = Amount of SP/LSP x employer's share ratio

Example 5 (in Year 10)

SP/LSP $36,000	x	**Employer's share ratio** 80%	=	**Employer pays** **$28,800**

Example 6 (in Year 15)

SP/LSP $36,000	x	**Employer's share ratio** 90%	=	**Employer pays** **$32,400**

Abbreviations:

SP: Severance Payment

LSP: Long Service Payment

Annex F

Implications of the Proposal

Sustainability and Family Implications

The abolition of the "offsetting" arrangement, including the Government subsidy scheme as part and parcel of the proposal, though may slightly increase the operation costs on employers, can help preserve the accrued benefits in the Mandatory Provident Fund (MPF) System for retirement protection for employees, thus making MPF a more sustainable pillar of Hong Kong's retirement protection system. It will also have positive implications on families facing financial difficulties in case of redundancy in terms of assisting employers to pay the affected employees their entitled severance payment/long service payment (SP/LSP).

Economic Implications

2. Compared with the original subsidy scheme, the refined subsidy scheme would put more resources in the initial years after the abolition of the "offsetting" arrangement. This should better help employers adjust to the policy change. On the other hand, the levels of subsidies relative to employers' SP/LSP payable under the refined subsidy scheme would be lower in the later years after the abolition. Nonetheless, considering that employers should have adopted different strategies to absorb or mitigate the rise in costs over the years, the cost impact should be generally manageable by most employers. Mandatory contributions to Designated Savings Accounts (DSAs) saved up over time should also help employers pay for the additional SP/LSP expenses. Meanwhile, delinking the balances in employers' DSAs from the calculation of government subsidy would provide greater certainty to employers on the amount of subsidy that they can receive when they need to pay any SP/LSP. Separately, with a higher subsidy for each SP/LSP pay-out within the $500,000 threshold, micro, small and medium-sized enterprises will generally benefit more under the refined subsidy scheme.

3. The total ex gratia payment in respect of SP by the Protection of Wages on Insolvency Fund (PWIF) should increase after the abolition, as the payment amount would then be calculated based on the SP owed by an insolvent employer without "offsetting" of the accrued benefits derived from the employer's mandatory MPF contributions. With the proposed ineligibility of PWIF for government subsidy, whether there will be any upward pressure on the annual levy on the Business Registration Certificate would depend on various factors, including the balance of PWIF. Nonetheless, the potential impact on firms should be insignificant, considering that the annual levy only constitutes a tiny fraction of the revenue of most firms. Separately, there should be no

economic implications in relation to the ineligibility of public bodies/subvented organisations for government subsidy on the condition that their employees' SP/LSP are fully funded by the Government.

Financial and Civil Service Implications

4. The financial commitment of the Government under the original subsidy scheme was $29.3 billion (in 2016 prices)[1]. Following the adoption of the 2021 prices[2], the financial commitment would increase by $3.6 billion from $29.3 billion to $32.9 billion. The refinements of the subsidy scheme as outlined in paragraph 5 of this Brief are estimated to further increase the financial commitment by $0.3 billion (i.e. from 32.9 billion to $33.2 billion (calculated also in 2021 prices). Depending on the actual implementation date of the subsidy scheme, the overall financial commitment may further increase due to the changes in the price level.

5. It is estimated that substantial manpower would be required for administering the abolition arrangements[3], including the Government subsidy scheme. The proposed refined subsidy scheme would not incur additional staff costs on top of the costs required for the original subsidy scheme.

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[1] Based on the set of "offsetting" claim data for 2015 provided by the Mandatory Provident Fund Schemes Authority (MPFA).

[2] Based on the set of "offsetting" claim data for 2019 provided by MPFA.

[3] Recurrent provision of $5.1 million was approved in 2017 and further recurrent provision of $13.5 million was approved in 2019 for the creation of additional posts in the Labour Department. In addition, non-recurrent provision of $447.2 million was approved in 2020 for system development and meeting the operating costs of the DSA Scheme.