Full Range of Support for Retirement Protection

Press Briefing on
Progressive Abolition of MPF "Offsetting"

23 June 2017

GOVERNMENT'S PROPOSAL THE MOST OPTIMAL

- The Government's proposal has three main elements –
  - From a prospective date (the Effective Date), abolish "offsetting" of severance payment (SP)/long service payment (LSP) with employer's mandatory MPF contributions and put in place "grandfathering" arrangement whereby accrued benefits from mandatory contributions before the Effective Date can continue to be used for "offsetting"
  - The amount of SP/LSP payable for the employment period since the Effective Date will be adjusted downwards from the existing entitlement of two-thirds of the last month's wages to half of the last month's wages as compensation for each year of service (i.e. 75% of existing entitlement)
  - The Government will share part of the SP/LSP expenditure of employers in the ten years from the Effective Date (amounting to 7.9 billion). SP/LSP to be fully borne by employers from the 11th year

Government's Proposal the Most Optimal (Cont'd)

- It is a finely balanced tripartite solution whereby employers, employees and the Government each have to pay extra costs or make some concession, with the consequential impact expected to be largely bearable for all three parties. This "give and take" proposal has balanced the interests of employers and employees while keeping Government's financial involvement one-off and time-limited

- The "grandfathering" arrangement and ten-year government subsidy provide a sufficiently long buffer period for employers to adapt to the policy change. After the abolition of "offsetting", in addition to fully preserving employers' mandatory MPF contributions for retirement, employees will also receive a reasonable compensation in case of SP/LSP dismissals

GOVERNMENT'S PROPOSAL THE MOST OPTIMAL (CONT'D)

- The proposal is targeted, requiring only employers with SP/LSP dismissals to pay more while the majority of employers will be unaffected. In overall terms, the additional costs will be generally manageable for most sectors. By continuing to hold employers individually accountable for their own dismissal costs, it incurs little risk of moral hazard and deters irresponsible dismissal behaviour, offering better employment protection for workers
- The proposal is the most cost-effective option to settle the "offsetting" issue once and for all

GOVERNMENT'S PROPOSAL THE MOST OPTIMAL (CONT'D)

RESPONSE TO CONCERNS OF EMPLOYERS AND EMPLOYEES

- Rather complicated arrangement, with subsidy rate reduced every two years
  - Labour Department (LD) will mount large-scale promotion campaign, such as producing pamphlets with more specific examples and considering developing on-line, user-friendly tool to help employers and employees calculate SP/LSP and the government subsidy
  - In-person consultation services will be made available to employers and employees in the district offices of the Labour Relations Division under LD

GOVERNMENT'S PROPOSAL THE MOST OPTIMAL (CONT'D)

RESPONSE TO CONCERNS OF EMPLOYERS AND EMPLOYEES

- Government reneging on its promise to employers of not "paying twice"?
  - SP/LSP entitlement will be adjusted downward from existing 66.7% to 50%
  - At present, on average accrued benefits from employers' mandatory MPF contributions can only meet 83% of the SP/LSP payable. Employers are still required to pay the remaining 17%, equivalent to 11% of monthly wages, by their own funds
  - In other words, the net additional cost to employers would only be 39%, after deducting the 11% mentioned above from the 50%
  - According to MPFA's records, more than half of the employers who were involved in "offsetting" in 2015 only had one employee subject to "offsetting" and the "offsetting" amount per employee was about $90,000
  - "Grandfathering" arrangement and government subsidy will help employers adapt to the policy change. The additional cost should be largely manageable for most sectors

Government's proposal the most optimal (cont'd)

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Response to concerns of employers and employees

- SP/LSP rate reduced to 50%, a retrograde step in employment benefits?

Employees' benefits under existing arrangement and Government's proposal		
Example : An employee with monthly wage at $15,000, retrenched after 2 years of service, and eligible for SP		
Existing "offsetting" arrangement	**Item**	**Government's proposal to abolish "offsetting"**
$18,000 (all for "offsetting")	**Employer's MPF contributions**	$18,000 (fully preserved)
$20,000 ($18,000 from "offsetting"; remaining $2,000 paid by employer out-of-pocket)	**SP**	$15,000 (entire sum paid by employer out-of-pocket)
$0 + $20,000 = $20,000	**Employees' benefits**	$18,000 + $15,000= $33,000

ADDITIONAL MPF CONTRIBUTIONS

- Additional 1% contribution each from employers and Government
- Preserve "offsetting" arrangement for SP/LSP
- Keep the original SP/LSP rate but cap the amount that can be withdrawn upon "offsetting" at $30,000 or two months' wages, with the remaining balance retained until the employee reaches the age of 65

PROS AND CONS OF ADDITIONAL MPF CONTRIBUTIONS

- Employers and Government will make additional contributions to the MPF System, which is easy to understand by employers and employees and simple to administer
- Non-employees' MPF contributions will increase by 40% if taking into account the additional 2% contributions from employers and the Government
- For dismissed workers, the vast majority of their employers' contributions will continue to be used for offsetting their SP/LSP payment. "Offsetting" remains unresolved
- Government has reservation about making MPF contributions for employees on long-term basis

Dedicated Fund for SP/LSP

- Based on three scenarios with different splits of SP/LSP rate between employers and the dedicated fund, the break-even levels of levy that can keep the dedicated fund financially sustainable are estimated –

	Share of 50% SP/LSP rate between employers/dedicated fund	
	Employers	Dedicated fund
Alternative 1	0%	50%
Alternative 2	25%	25%
Alternative 3	30%	20%

The estimation is made with the following assumptions —

- Same as the Government's original proposal, "grandfathering" arrangement before the Effective Date will be put in place, and the current "offsetting" arrangement and the SP/LSP regime remain unchanged. As from the Effective Date, "offsetting" will be abolished and the SP/LSP rate will be adjusted downwards to 50%
- The sources of funding for the dedicated fund include a one-off Government's injection of $6.2 billion and on-going levy from employers. The levy is payable by all employers at flat-rate per employee
- The dedicated fund has to be financially sustainable for 30 years. The dedicated fund balance would earn a real rate of return of 1% per annum. Employees' wage would rise at 1% in real terms per annum

DEDICATED FUND FOR SP/LSP (CONT'D)

- The SP/LSP caseload is estimated based on the number of "offsetting" cases in 2015 as reported by MPFA, with suitable adjustments to take into account around 20% cases which are currently not subject to MPF "offset", and the projected demographic profile of the labour force. The estimation also takes into account normal economic fluctuations ("Base Case"). The increased cases due to moral hazard risk or abuse are then added to the "Base Case"

	Share of SP/LSP rate between employers/ dedicated fund	Assumed increase in SP/LSP cases due to moral hazard risk or abuse (as compared to "Base Case")	Crude estimate of the annual flat-rate levy per employee to be paid by employer (in 2016 prices)
Alternative 1	0%/50%	50-100%	$3,000-3,900
Alternative 2	25%/25%	25-60%	$1,300-1,600
Alternative 3	30%/20%	20-40%	$1,000-1,100
Original proposal from employer proponent	0%/50%	this factor not taken into account	$1,200 (SP only) $2,400 (SP and LSP)

Pros and cons of Dedicated Fund for SP/LSP

- Full or partial payment of SP/LSP from the dedicated fund can lessen the financial burden of employers in having to pay a large amount of SP/LSP. It can also protect employees' statutory SP/LSP entitlement
- However, if SP/LSP is fully borne by the fund, the annual levy to be paid by a medium-sized enterprise with 40 employees can be as high as $156,000. This amount is significantly higher than the $48,000 ($1,200X40) or $96,000 ($2,400X40) per annum as originally estimated by the employer proponent
- Employers and industries which seldom initiate dismissals will cross-subsidise those employers and industries which initiate more dismissals. A flat-rate levy is disadvantageous to those small- and medium-sized enterprises which hire relatively more low to middle-income workers, or those employers and industries with high turn-over rate and most of their employees leaving their jobs voluntarily

PROS AND CONS OF DEDICATED FUND FOR SP/LSP (CONT'D)

- If SP/LSP is fully borne by the fund and individual employer is not required to shoulder any additional cost in dismissals, it may trigger irresponsible dismissal behaviour or incentivise employers to lay off employees. In addition to undermining the stability of labour relations, this will also increase the number of claims and thus the level of levy
- Setting up the fund is an administratively complex task. Apart from legislating for the arrangement, it also requires manpower for collecting levy contributions, processing and verifying SP/LSP claims, taking monitoring and enforcement measures to guard against abuse, etc. The operating cost is substantial

Comparison across options

Cost

Assuming that the employee's monthly wage in real terms remains unchanged at $15,000 throughout the 6-year employment period and the SP/LSP rate is 50%, the SP/LSP payable is $45,000 —

Unit additional cost to employer per employee (2016 prices)	Dedicated fund for SP/LSP			Additional MPF contributions	Government's proposal (after the mitigating effect of Government's subsidy and "grandfathering" arrangement has fully subsided)
	Alternative 1 Employer 0%; Fund 50%	Alternative 2 Employer 25%; Fund 25%	Alternative 3 Employer 30%; Fund 20%		
Employer who dismisses employee	$18,000 (1.7%)	$30,300 (2.8%)	$33,000 (3.1%)	$10,800 (1%)	$45,000 (4.2%)
Employer who has not dismissed employee	$18,000 (1.7%)	$7,800 (0.7%)	$6,000 (0.6%)	$10,800 (1%)	No additional cost

Notes: The above figures are the additional cost to employers during the 6-year employment period, including levy to the dedicated fund, additional MPF contributions, and/or the SP/LSP payable under different proposals

Figures in brackets represent additional cost to employers per month as % of monthly wage

COMPARISON ACROSS OPTIONS (CONT'D)

COST

2016 prices (in billion)	Dedicated fund for SP/LSP			Additional MPF contributions	Government's proposal
	Alternative 1 Employer 0%; Fund 50%	Alternative 2 Employer 25%; Fund 25%	Alternative 3 Employer 30%; Fund 20%		
Additional cost to employers in the next 30 years (a)	\$258.8	\$228.3	\$220.7	\$162.0*	\$183.0
Additional cost to Government in the next 30 years (b)	\$6.2	\$6.2	\$6.2	\$162.0*	\$7.9#
Additional cost to society in the next 30 years ((a) + (b))	\$265.0	\$234.5	\$226.9	\$324.0*	\$190.9
Tax forgone in the next 15 years	\$15.7	\$26.1	\$28.3	\$10.3	\$30.8

Notes: (*) The cost is crudely estimated based solely on employers' mandatory MPF contributions in 2016, i.e. \$5.4 billion X 30 years (corresponding figures for 2014 and 2015 are \$4.7 billion and \$5.2 billion). If factors such as wage increase and changes in labour force, etc. are taken into account, the cost may be higher

(#) This is the revised estimate of additional cost to Government, after taking into account normal economic fluctuations. It is higher than the previously announced \$6.2 billion

Comparison across options (Cont'd)

Employee's benefit

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2016 prices	Dedicated fund for SP/LSP			Additional MPF contributions	Government's proposal (after the mitigating effect of Government's subsidy and "grandfathering" arrangement has fully subsided)
	Alternative 1 Employer 0%; Fund 50%	Alternative 2 Employer 25%; Fund 25%	Alternative 3 Employer 30%; Fund 20%		
Dismissed employee					
SP/LSP	$45,000 Receivable upon dismissal			$30,000 Receivable upon dismissal ($45,000 entirely offset by employer's contributions, with withdrawal cap upon dismissal)	$45,000 Receivable upon dismissal
Employer's MPF contributions	$54,000 Fully preserved for retirement			$34,800 Preserved for retirement (Original contributions of $64,800 minus $30,000 withdrawn upon dismissal)	$54,000 Fully preserved for retirement
Actual benefits	$45,000 + $54,000			$30,000 + $34,800	$45,000 + $54,000
Employees not dismissed					
SP/LSP	$0			$0	$0
Employer's MPF contributions	$54,000 Fully preserved for retirement			$64,800 Fully preserved for retirement	$54,000 Fully preserved for retirement

COMPARISON ACROSS OPTIONS (CONT'D)

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KEY OBSERVATIONS

- The Government's proposal will cost the most to employers who need to pay SP/LSP, but it will entail no additional cost for other employers (according to MPFA's data for the past three years, only about 5-6% or 15 000 employers involved in "offsetting")
- For all employers, the Government's proposal costs less than the dedicated fund, because the former will not incite moral hazard risk or abuse
- For society as a whole (i.e. the cost to the Government and all employers altogether), the Government's proposal costs the least

SPLIT APPROACH

- To abolish the "offsetting" of SP first and keep the SP formula at two-thirds, with LSP continuing to be subject to "offsetting" until the issue would be resolved at a later date
- Employers generally suggested that more time was needed for studying the impact of the option on businesses and did not want to rush through any decision without properly and fully consulting their member organisations
- Many unionists rejected an open-ended review. Instead, they pressed for a clear commitment by the Government and the business sector to the effect that two or three years after the abolition of SP "offsetting", the LSP "offsetting" should also be abolished while preserving the LSP formula at two-thirds

SPLIT APPROACH (CONT'D)

- Some do not agree that this split approach would be more beneficial to employees when compared with the Government's proposal, as businesses generally see that LSP and MPF have highly similar functions and that the former should be redefined with a much narrower scope or even scrapped
- There are concerns that if only SP is not subject to the "offsetting" arrangement, dismissed employees may attempt to claim SP in all dismissal cases with employers arguing the other way round, and it will likely lead to more disputes between employers and employees

CONCLUSION

- In the past few months, the Government put in the best efforts to seek support from employers and employees on the Government's proposal. We have also conducted studies and analyses into alternative proposals from various parties and discussed our findings with stakeholders. Regrettably, the business and labour sectors so far cannot reach consensus on any proposal

- However, the Government fully acknowledged efforts made by various parties (including employer and employee representatives of the Labour Advisory Board). Both employers and employees have become more proactive in the past few months, from holding on to one's principles in the past to acceptance by major employers' groups that doing nothing is not an option, and display of goodwill by agreeing to pay more and putting forth specific proposals in order to create room for negotiation with trade unions. These hard-earned interim achievements can lay down a solid foundation for resolving this highly complex problem

CONCLUSION (CONT'D)

- The abolition of MPF "offsetting" is a matter of considerable public interest. Having examined carefully views received during the consultation exercise, we consider that the Government's proposal remains the most optimal and should be adopted as the basis for taking the matter forward
- We hope that the constructive and rational discussions as well as the huge volume of policy analyses done by the Government over the last few months could facilitate continued positive exchanges between employers and employees, eventually leading to consensus and concrete results

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