Long Service Payment and Severance Payment in Hong Kong - Abolishment of Offsetting Arrangement

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The Government passed the Employment and Retirement Schemes Legislation (Offsetting Arrangement) (Amendment) Bill 2022 on 9 June 2022 to abolish the use of the accrued benefits of employers' mandatory contributions under the Mandatory Provident Fund ("MPF") System to offset severance payment ("SP") and long service payment ("LSP").

While this development is welcome by employees, certain preparation should be made by Hong Kong employers especially for those whose workforce experiences low turnover.

LSP and SP

It is important for each Hong Kong employer to first understand the application of LSP and SP to its workforce.

LSP is payable to an employee who has been employed continuously for at least 5 years and fulfils one of the following conditions:

- is dismissed but not due to redundancy or serious misconduct
- resigns on ground of ill health
- resigns at the age of 65 or above
- dies
- if the employment contract is of a fixed term and expires, but is not renewed by the employer

That essentially means, if a Hong Kong employer sets a retirement age of say 62 and the employee (having been employed for 5 years or longer before the retirement) is required to retire, it is very unlikely that the employee will resign. Then, the employer has to end the employment contract which technically constitutes a dismissal, and therefore must pay the LSP to the retired employee.

The definition of SP is more straight-forward. SP is required to be made to an employee who has been employed continuously for at least 24 months but is dismissed due to redundancy or laid off.

The calculation of the LSP and SP is subject to the statutory formula: last full month wages X 2/3 (capped at HK$22,500 X 2/3) X years of service. The overall maximum amount of either LSP or SP is HK$390,000 (i.e. US$50,000). The new law will have an implication on the reference to "last full month wages" as explained below.

Current offsetting arrangement

An employer is required by law to make a monthly contribution to a MPF scheme of 5% of each employee's monthly income, capped at HK$1,500 (i.e. US$193) per month. The employer may also make additional contributions, on a voluntary basis, for the benefit of the employees.

Currently under the Employment Ordinance, when the employer is required to make LSP/SP, it may reduce the payable amount by the value of benefits paid to an employee derived from the employer's contributions to an MPF scheme (both mandatory and voluntary contributions) and an occupational retirement scheme ("ORSO").

Removal of the offsetting arrangement

The new law abolishing the offsetting will come into effect in 2025 on an exact date to be announced by the Hong Kong Government ("Effective Date").

The removal of the offsetting arrangement will not have retrospective effect. Where the employment commenced before the Effective Date, an employer can continue to offset the LSP/SP earned before Effective Date.

After the Effective Date, an employer can no longer use any part of its mandatory contributions to MPF or contributions to an ORSO scheme to reduce the LSP/SP payable to an eligible employee. However, the employer still reduce the LSP/SP by:

i. its voluntary contributions to MPF,

ii. its contributions to an ORSO scheme that is greater than a reference amount calculated at final average monthly income (currently capped at HK$30,000) × years of service (pro rata for incomplete year) to which the MPF-exempted ORSO scheme benefits are attributable × 5% × 12, and

iii. any contractual gratuity paid to an employee.

Different treatments before and after the Effective Date

Not only the offsetting arrangement, the "last full month wages" is also different before and after the Effective Date.

The portion of LSP/SP prior to the Effective Date is to be calculated on the basis of the monthly wages immediately preceding the Effective Date and the years of service before the Effective Date. The portion of LSP/SP after the Effective Date is to be calculated on the basis of the last monthly wages immediately before the termination of employment and the years of service at that time.

For example, if the employee started the employment in 2020 and becomes entitled to LSP in 2027, and her monthly wages immediately preceding the Effective Date is

HK$21,000 and her monthly wages immediately before the employment termination in 2027 is HK$23,000, then:

- The portion of LSP before the Effective Date = HK$21,000 X 2/3 X 5 years = HK$70,000, which can be offset by the value of benefits paid to the employee derived from the employer's contributions to the MPF scheme and the relevant ORSO scheme (if any).
- The portion of LSP after the Effective Date = HK$22,500 X 2/3 X 2 years = HK$30,000, which may not be offset by the value of benefits paid to the employee derived from the employer's mandatory contributions to the MPF scheme and the relevant ORSO scheme.

The aggregate amount of LSP/SP earned before and after the Effective Date remains capped at HK$390,000.

Government support for employers

The Hong Kong Government has pledged HK$33.2 billion (i.e. US$4.26 billion) to help employers bear part of their LSP/SP costs after the Effective Date, by way of a subsidy scheme over a period of 25 years. Details of the subsidiary scheme will be announced by the Government.

Nevertheless, the Government will make law to require employers to set up designated savings accounts for their future LSP/SSP obligations.

Key Takeaway

With the removal of the offsetting arrangement, Hong Kong has taken a great step forward towards better employee protection. Employees' benefits in their MPF/ORSO schemes will not decrease after the Effective Date even if they are dismissed or laid off.

While the removal will take effect in 2025, employers are encouraged to avoid large-scale dismissals of employees (especially those who are eligible to receive LSP) before the Effective Date in 2025, because employers will be partially subsidized by the Government in respect of LSP/SP payable after the Effective Date.

In any event, Hong Kong employers should familiarize themselves of their contingent obligations to make LSP/SP, specifically when they have long-serving employees or have mandatory retirement policies. It is also essential to keep track of developments in terms of the Effective Date, the forthcoming statutory designated account requirement and the Government subsidy scheme.

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