

Background and Relevant Information on Severance Payment, Long Service Payment and “Offsetting” Mechanism

Eligibility for severance payment

1. Severance payment was introduced under the Employment Ordinance in 1974 to provide compensation for an employee who is dismissed by reason of redundancy and has no less than 24 months of continuous services with the same employer prior to the termination, so as to help alleviate his/her financial hardship caused by loss of employment.
2. According to the existing Employment Ordinance, an employer should pay severance payment to an employee who has been employed continuously for no less than 24 months if:
 - (a) the employee is dismissed by reason of redundancy;
 - (b) his/her fixed term employment contract expires without being renewed by reason of redundancy; or
 - (c) he/she is laid off under the circumstances as specified in the Employment Ordinance.

Eligibility for long service payment

3. Long service payment was introduced under the Employment Ordinance in 1986 to provide compensation for older employees dismissed by reason other than redundancy after serving the same employer for a long period of time. When long service payment was first introduced, it was targeted at older employees. As such, in calculating the amount of long service payment, younger employees would receive a smaller amount than older ones, and were required to have a longer service period in order to be eligible for long service payment. After a number of subsequent amendments were made to the Employment Ordinance, the provisions for long service payment have progressively evolved into the current version, where the amount payable to employees is calculated by the same formula irrespective of their age, and the protection coverage is extended to include employees who resign under certain special circumstances.
4. According to the existing Employment Ordinance, an employer should pay long service payment to an employee who has been employed continuously for no less than five years if:
 - (a) the employee is dismissed other by reasons of redundancy or serious misconduct;
 - (b) his/her fixed term employment contract expires without being renewed;
 - (c) he/she is permanently unfit for his/her present job due to health reasons;
 - (d) he/she resigns at the age of 65; or
 - (e) he/she dies during employment.

Calculation of severance payment and long service payment

5. For each dismissal incident an employee may only receive either severance payment or long service payment. Both payments are calculated by the same formula as shown below:

(Last month's wages* x 2/3)# x years of service

* An employee may elect to use his/her average wages in the last 12 months for calculation.

The monthly wage cap is \$22,500, i.e. maximum payment of \$15,000 (\$22,500 x 2/3) for each year of service. Service of an incomplete year should be calculated on a pro rata basis.

The maximum amount of severance payment or long service payment is \$390,000.

"Offsetting" arrangement

6. When severance payment and long service payment were introduced under the Employment Ordinance in 1974 and 1986 respectively, employers were allowed to use the gratuity based on the length of service paid to employees or provident fund to offset severance payment and long service payment (the so-called "offsetting" arrangement). Several amendments were made subsequently to the "offsetting" provisions. The "offsetting" arrangement is also applicable to the retirement protection schemes registered under the Occupational Retirement Schemes Ordinance and the Mandatory Provident Fund Schemes Ordinance.

7. The following table provides a summary of the Legislatures discussion on the introduction of and subsequent amendments to the "offsetting" provisions having regard to the legislation for severance payment and long service payment, including the Government's response to the motion debate held in the Legislative Council in 1995 on the establishment of the MPF. It seeks to facilitate public understanding of the policy intent of the "offsetting" arrangement, as well as the interface of severance payment and long service payment with the MPF and other retirement protection schemes:

Year	Details of Event
1974	<p>The arrangement of severance payment under the Employment Ordinance came into effect. It provided compensation for employees dismissed by reason of redundancy to alleviate their financial hardship caused by loss of employment. The amendments to the ordinance also allowed employers to use gratuities based on length of service or their contributions made to provident fund schemes to "offset" the severance payment.</p> <p>According to the Official Report of Proceedings of the Legislative Council (when moving the Second Reading of the amendment bill on 3 July 1974), the Government said that the introduction of severance payment aimed to provide compensation for employees dismissed by reason of redundancy to alleviate their financial hardship caused by loss of employment. It also served to reduce labour disputes concerning redundancy and provide a framework for the making of severance payments (please refer to the extract of the original report: "Severance payment on redundancy is the means whereby an employee may be compensated for loss of employment through no fault of their own...The bill has three main aims. It will serve to protect employees against possible hardship arising from redundancy and, with Hong Kong's present system of social security, it seems important that this form of protection should be available to all employees who come within the scope of the Employment Ordinance. Second, it should serve to reduce the incidence of labour disputes concerning redundancy by introducing a minimum legal obligation in all cases. Third, it should help to clear up much of the existing confusion by confirming the practice, and regulating the method, of making severance payments."). Moreover, the Government expressed that as a number of firms in Hong Kong had been for many years providing long service gratuities or redundancy compensation under employment contracts, it was considered that severance payment should be alternative and not additional to such schemes and that employees should be given the option of choosing the most favourable arrangement. Severance payment was intended to provide compensation for employees who lost employment and did not operate as an additional benefit where such protection was already available ("As a number of firms in Hong Kong have for many years included long service gratuities or redundancy provisions in the terms of their contracts of employment, which adequately protect employees against the adverse effects of redundancy, it was concluded that severance pay should be alternative and not additional to such schemes and that employees should be given the option of choosing which was the more favourable. Severance pay is intended to provide compensation for loss of employment and not to operate as a bonus where such protection is already available").</p>

1974	<p>According to the Official Report of Proceedings of the Legislative Council (when the debate on Second Reading of the amendment bill resumed and the Committee Stage Amendments to the bill were handled on 14 August 1974), the Government also considered that there was another section under the same bill excluding pensionable civil servants from the right to severance payment. Therefore, a similar principle should be applied in the private sector whereby employers could use gratuity or their contributions to provident funds to offset severance payment (...civil servants as a class of employee are excluded from the right to severance payment because of their entitlement under the Pension Ordinance. It is considered that a similar principle should be applied in the private sector whereby entitlement to gratuity or the employers contribution to a provident fund should be offset against entitlement to severance pay...").</p>
1986	<p>The arrangement of long service payment under the Employment Ordinance came into effect. The initial aim was to provide compensation for older employees who were dismissed by reason other than redundancy after serving the same employer for a long period of time.</p> <p>According to the Official Report of Proceedings of the Legislative Council (when moving the Second Reading of the amendment bill on 4 December 1985), the Government expressed that "...Since 1974 employees dismissed by reason of redundancy have been eligible for a severance payment from their employer, currently set at two thirds of a month's wages for each completed year of service. In the case of employees whose contract of employment is terminated under other circumstances, the Employment Ordinance merely requires the service of an agreed or statutory period of notice or the payment by the employer of wages in lieu of such notice. This disparity in the treatment of a dismissed employee has been often criticised as unfair, and especially unfair to ageing employees dismissed through no fault of their own who have served the same employer for several decades. Many older employees after dismissal find it especially difficult to secure alternative employment, in particular manual workers... Instead, the present long service payment proposals have been developed as a practical alternative to unfair dismissal legislation, based on the premise that the dismissal of an elderly long service employee without some form of provision for his future is itself unreasonable. A statutory requirement for an employer to make a payment to a dismissed employee, based on his age and length of service, would achieve much the same result as an employee's entitlement to monetary compensation under unfair dismissal legislation while avoiding the need for complex and expensive procedures to establish that the dismissal had been unreasonable in the circumstances". The amendments to the ordinance also allowed employers to use their contributions to provident fund schemes or gratuities based on length of service to offset long service payment. The relevant provisions were similar to those "offsetting" provisions applicable to severance payment.</p> <p>According to the Official Report of Proceedings of the Legislative Council, government officials and Members did not discuss about the "offsetting" provisions during the resumption debate of Second Reading of the amendment bill (on 18 December 1985).</p>
1992	<p>The Employment (Amendment) Bill was passed to amend the provisions on severance payment and long service payment, including clarifying some ambiguities relating to the "offsetting" arrangement'. According to the Official Record of Proceedings of the Legislative Council (when moving the Second Reading of the amendment bill on 13 May 1992), the Government indicated that "we propose to remove the ambiguities in the existing provisions on setting off of retirement scheme payment against severance or long service payment. To ensure that employers will not have to pay double benefits, clauses 7 and 11 put it beyond doubt that payment of severance or long service payment can be set off by retirement scheme payment and vice versa".</p>
1993	<p>The Occupational Retirement Schemes Ordinance came into effect, providing a legal basis for the regulation of voluntary occupational retirement schemes. No discussion was held on the "offsetting" arrangement during the legislative process, and no provision was made for the "offsetting" arrangement under the Occupational Retirement Schemes Ordinance. However, it was stipulated in the Employment Ordinance that employers could reduce severance payment or long service payment by their contributions to retirement schemes. Therefore, the "offsetting" arrangement is also applicable to the retirement protection schemes registered under the Occupational Retirement Schemes Ordinance.</p>
1995	<p>In March 1995, the Legislative Council debated the following motion on retirement protection moved by the Secretary for Education and Manpower (SEM): "That this Council urges Government to introduce as expeditiously as possible a mandatory, privately managed occupational retirement protection system with provision for the preservation and portability of benefits."</p> <p>When talking about the interface of severance payment and long service payment with the MPF in his opening speech, the SEM pointed out that the "offsetting" arrangement was to ensure that "Employers do not pay twice. Severance payments and long service payments are not designed as supplementary retirement schemes. They are intended to be alternatives to these retirement schemes. That is why the offsetting provisions exist under the present voluntary system of occupational retirement schemes. We do not intend to change it under the MPF, although we will need to consider very carefully the effect of the MPF on both schemes".</p> <p>In his concluding remarks, the SEM said that "these were designed at a time when there was little retirement protection. We were concerned about the difficulties that workers, especially elderly ones, might face in finding another job. These measures were introduced to help them over such difficulties. At the same time, we tried to encourage the provision of voluntary occupational retirement schemes. There is already provision in the Employment Ordinance to allow for the setting off of an employer's benefit payments under a retirement scheme by the amount payable for severance payments or long service payments".</p>

1995	<p>In July 1995, the Legislative Council passed the Mandatory Provident Fund Schemes Bill. During the debate on Second Reading of the bill, the SEM made the following response on the “offsetting” arrangement: “This is in line with our policy intent to enable the long-established set-off procedure under the Employment Ordinance in respect of schemes under ORSO to continue for MPF schemes. We have made it very clear that employers are not expected to pay twice under this new system... We do, of course, realize in the longer term the interface of long service payments and severance payments with the MPF need to be examined...”</p> <p>At the Committee stage, some Members proposed an amendment to abolish the “offsetting” arrangement. In response to the amendment, the SEM said: “At present, the employers’ contributions to a retirement scheme may be set off against any amount paid out for severance payments or long service payments. It is not appropriate to expect employers to pay twice”.</p>
2001	<p>The Legislative Council passed the Employment (Amendment) Ordinance 2001. Technical amendments were made to the “offsetting” provisions applicable to severance payment and long service payment under the Employment Ordinance, allowing employers to reduce severance payment or long service payment payable to employees by MPF scheme benefits already paid to the employees, so as to reflect the policy intent of the provisions more accurately.</p>

Long service payment and retirement protection

8. Apart from the above discussions held during the legislative process, it is also worth mentioning that the Government established a Working Group on Retirement Protection comprising government officials and representatives of outside bodies, in November 1991. The Working Group, was responsible for reviewing the various options of enhancing retirement protection for working persons. A consultation paper entitled “A Community-wide Retirement Protection System” was issued by the Working Group in October 1992, proposing the establishment of a mandatory system linked with occupation, under which both employers and employees were required to make contributions. The role of long service payment in the retirement protection arrangement was mentioned in the paper. The relevant parts are summarised below:

“The Government had preferred an alternative strategy. This was

- (a) to encourage the establishment of private retirement schemes on a voluntary basis; and
- (b) to tighten control over the operation of those schemes already in existence; while
- (c) enhancing the provision of social welfare and improving the Long Service Payment Scheme (LSPS) established under the Employment Ordinance.” (paragraph 1.3 of the consultation paper)

“The proposed retirement protection system has to be seen in the light of -

- (a) current retirement schemes;
- (b) social security schemes;
- (c) the Long Service Payment Scheme (LSPS).” (paragraph 7.1 of the consultation paper)

“There are two possible options for the LSPS in future. Under the first option, the LSPS would remain in place and run in parallel with the retirement protection system. The existing provision would be maintained whereby LSP may be reduced by that part of the retirement scheme or provident fund payments contributed by the employer in relation to the years of service for which LSP is payable. As all employers will be required to set up retirement

¹ The major amendments were to clearly specify that gratuity or retirement scheme payment for an employee could be reduced by severance payment or long service payment already paid to the employee, or severance payment or long service payment for an employee could be reduced by gratuity or retirement scheme payment already paid to the employee.

protection schemes, then their liability for LSP will decrease, and eventually disappear. Under this option, the LSPS cannot be abolished in the near future because there will inevitably be many workers who will still receive more under it than they would in the form of retirement benefits.” (paragraph 7.8 of the consultation paper)

“The second option would be to amend the LSP provisions so as, in effect, to turn the LSPS into a retirement protection scheme...” (paragraph 7.9 of the consultation paper)

“The practicalities of adopting a retirement protection scheme based on amending the Long Service Payment Scheme should be examined further at a later date.” (paragraph 10.1(38) of the consultation paper)

Overseas experience

9. In April this year, the Research Office of the Legislative Council prepared an information note on severance payment and long service payment in various places. The information note quoted the findings of a report published by the World Bank in 2012 on the severance payment arrangement in 183 places around the world, as well as the findings of a study conducted by the International Labour Organization in 2013 on the employment protection legislation in 95 countries. Some noteworthy points include:

- (a) Among the 183 places studied by the World Bank, 152 (83%) had mandated severance payment schemes, 18 (10%) had quasi-mandated severance payment schemes, and 13 (7%) had neither; and
- (b) Among the 95 countries studied by the International Labour Organization, Switzerland and Indonesia were the only countries with statutory long service payment.