



強制性公積金計劃管理局
MANDATORY PROVIDENT FUND
SCHEMES AUTHORITY

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Mr. Leung Chi-yan, John, JP
Deputy Secretary for Financial Services
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Financial Services and the Treasury Bureau
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Dear Mr Leung

Consultation on
“Review of Corporate Rescue Procedure Legislative Proposals”

Thank you for your letter dated 29 October 2009 to our Mrs. Diana Chan, Managing Director inviting the comments of the Mandatory Provident Fund Schemes Authority (the MPFA) on the consultation paper entitled “Review of Corporate Rescue Procedure Legislative Proposals” (the Consultation Paper). Mrs. Chan has directed me to reply on her behalf.

2. The MPFA is generally in support of the reform proposals which provide a statutory grace period for companies with long-term viability but facing short-term financial difficulty to restructure their business or debts, or seek capital injection with the hope to turn themselves around (the Proposals).

3. Having reviewed the Consultation Paper, we set out below our comments thereon for your consideration. We have also identified a number of issues relevant to MPF where we would be grateful for your clarification and advice.

Paragraph 2.1 of Chapter 2 of the Consultation Paper – Application of the Proposals

4. Paragraph 2.1 states that the Proposals will apply to both local and non-Hong Kong companies formed or registered under the Companies Ordinance,

except for the following regulated institutions:

- (i) authorized institutions within the meaning of the Banking Ordinance (Cap.155);
- (ii) authorized insurers within the meaning of the Insurance Companies Ordinance (Cap.41);
- (iii) certain entities in the securities and futures industries.

5. Subject to your advice, it appears that approved trustees within the meaning of the Mandatory Provident Fund Schemes Ordinance (Cap.485) (MPFSO) will not be treated as regulated institutions and hence the Proposals shall apply to them. This is our preferred position although it is contrary to the understanding given by your Bureau when the MPFA was consulted on the Proposals in August/September last year. As far as we understand, your Bureau was inclined at that time to exclude MPF trustees from the application of the Proposals on the reasoning that

- (i) MPF trustees were highly regulated by the MPFSO and the MPFA,
- (ii) the MPFA's oversight of MPF trustees was in line with the Hong Kong Monetary Authority (HKMA) overseeing banks and the Insurance Authority (IA) overseeing insurance companies and hence MPF trustees should be treated in the same manner as banks and insurance companies.

Given the peculiar nature of trust business which differs from that of the banking and insurance business, we support the, apparently modified, position the Proposals should apply to MPF trustees.

6. MPF trustees are in a very different position from banks and insurers in that an MPF trustee is only appointed to provide trust services to an MPF scheme. In the event of a liquidation of an MPF trustee, MPF assets that are held under trust by the trustee for scheme members will not be made available for repaying debts owed by the trustee to its creditors as MPF assets do not form part of a trustee's own assets. As such, how a trustee uses its own assets to meet creditors' claims is not an issue for the MPFA to direct. This is unlike the position for banks and insurers. Deposits of deposit-holders become assets of the banks, whilst premiums paid by policyholders become assets of the insurers, with corresponding liabilities. It is therefore understandable that the regulators of banks and insurers would therefore be concerned as to how these assets are dealt with to ensure that the interests of deposit-holders and policyholders are not necessarily prejudiced.

7. Apart from the above, the HKMA and the IA have the power to take over the operation of banks and insurers respectively and exercise control over them through the appointment of managers when an entity fails. The MPFA does not have any similar power to take over the operation of a trustee nor assume control of its business should it run into financial difficulty.

8. Unlike banks (which only do banking business regulated by HKMA) or insurers (which only do insurance business regulated by IA), trustees may well have other non-MPF trust business not regulated by the MPFA. Even where the MPFA has some power in relation to MPF scheme operations (in contrast to taking over the operation of a trustee) under sections 33A and 33B of the MPFSO, this will not cover the trustee's non-MPF business. Accordingly, neither the procedures in the Proposals nor the MPFA's powers would apply to the non-MPF trust business of a trustee in financial difficulty, if the Proposals were not to apply to trustees.

9. From the operational perspective, applying the Proposals to MPF trustees may have beneficial impact on MPF scheme members. The Proposals can keep a financially distressed trustee as a going concern as long as possible, thus allowing the trustee to continue to perform its MPF obligations. Such obligations include, for example, processing transfer-out of benefits for members and processing fund switching for members who wish to change their investment portfolio. The Proposals should also serve to enable the operations of the trustee in financial difficulty to be transferred to another party, including through the exercise of the MPFA's power under sections 33A or 33B of the MPFSO which takes time to complete.

Chapter 4 of the Consultation Paper – Employees' Outstanding Entitlements

10. We are pleased to note that the issues pertinent to outstanding employers' MPF contributions raised by us earlier in August/September last year are being considered by your Bureau under this Chapter, which proposes priority treatment for employee's arrears of wages and other entitlements under the Employment Ordinance (Cap.57) (the EO) owed by a financially distressed company to its employees *before* provisional supervision could be initiated. Employee's arrears of wages and other entitlements covered are those accrued *before* the commencement of provisional supervision.

11. Three options, namely, the 2003 Proposal, Alternative A and Alternative B, have been formulated by your Bureau based on the principle that employees should not be treated less favourably than in a winding up. One of the critical issues is

whether outstanding employers' MPF contributions should be treated in the same manner as employee's arrears of wages and other entitlements under the EO.

12. Under the priority rules in section 265 of the Companies Ordinance, which apply when a company is placed into liquidation, both the employers' MPF contributions and any employees' MPF contributions deducted but not paid to the trustees of the MPF scheme enjoy priority. Treating outstanding employers' MPF contributions in the same manner as employee's arrears of wages is in line with the principle adopted by your Bureau in formulating the three options, i.e. employees should not be treated less favourably than in a winding up.

13. We note one of your concerns is treating outstanding employers' MPF contributions in the same manner as employees' arrears of wages will raise the trust fund amount under the 2003 Proposal and the employees' protected debt amount under Alternative B by the amount of those contributions, thereby raising the threshold for triggering provisional supervision and making it more difficult for financially distressed companies to make use of the procedure. Please note that employers' MPF contributions in general represent only 5% of the wage income of an employee. If an employee is owed both wages and employers' contributions, the amount of employers' contributions should be relatively small, unless in a case where an employer has failed to pay wages for only a few months but with outstanding employers' MPF contributions accumulated for years. Besides, as employers' MPF contributions are of the same nature as wages in the sense that they are both benefits payable by employers for the benefits of their employees, we consider that they should be treated in the same manner.

14. From the regulatory perspective, the MPFA has to ensure that employers comply with the MPFSO, including the obligation to make contributions. If employees are owed employers' MPF contributions by a company in financial difficulty, it is appropriate to treat such contributions in the same manner as arrears of wages so that the contributions can be accorded priority treatment, therefore protecting the interests of the employees.

15. In view of the above, subject to your clarification on certain issues raised below, we are inclined to the view that employers' MPF contributions should be treated in the same way as employee's arrears of wages and other entitlements under the EO, independent of which option is adopted. Such priority treatment is of paramount importance given that during the moratorium there would be a stay of legal action, including civil action to recover outstanding contributions, against the company.

16. In addition to the issue of whether outstanding employers' MPF contributions should be treated in the same manner as employee's arrears of wages and other entitlements under the EO, the powers of the MPFA under the three options – the 2003 Proposal, Alternative A and Alternative B – also need to be clarified. This is discussed in the ensuing paragraphs.

17. Under the MPF regime, if an employer fails to pay MPF contributions for its employee, the MPFA can take civil action to recover the contributions as a debt due to the MPFA on behalf of the employee under section 18 of the MPFSO or can initiate prosecution action against the employer under section 43B of the MPFSO. In this connection, we are concerned whether the MPFA can still exercise its powers under sections 18 and 43B of the MPFSO under the three options and if so, when and how.

18. We use the 2003 Proposal to illustrate our concerns. Under the 2003 Proposal, a trust account is required to be set up to cover all arrears of wages and other statutory entitlements owed by a company to its former employee before the commencement of provisional supervision and all arrears of wages owed to its existing employees up to the commencement of provisional supervision, subject to the Protection of Wages on Insolvency Fund (PWIF) cap. The voluntary arrangement proposal would be required to contain terms for paying the company's employees any outstanding amounts above the PWIF cap within 12 months of the approval of the proposal by the creditors. In this regard, if employers' MPF contributions were to be treated in the same manner as arrears of wages and other entitlements under the EO, we would be interested to know, for example,

- (i) If the outstanding amounts (which include employers' MPF contributions) above the PWIF cap are not settled in accordance with the approved voluntary arrangement within the 12 months, can the MPFA take civil action against the company (and/or the provisional supervisor and/or the supervisor of voluntary arrangement) for recovery of the outstanding employers' MPF contributions under section 18 of the MPFSO or prosecution action under section 43B against any one of them for such failure during that 12 month period?
- (ii) As the 2003 Proposal deals with employee's arrears of wages and outstanding employees' entitlements accrued before the commencement of provisional supervision, whether the MPFA can take any civil action / prosecution action against the company (and/or the provisional supervisor

and/or the supervisor of voluntary arrangement) if the employees of the company are owed employers' MPF contributions which are accrued after the commencement of provisional supervision?

19. Of the three options, we consider the 2003 Proposal as providing better protection to employees' retirement benefits, and hence that is our preferred option.

Other Comments

20. If the Proposals were to apply to MPF trustees, we are concerned that the scheme administration work of a trustee in financial difficulty and dealings in MPF trust assets should not be disrupted whilst the trustee is undergoing the corporate rescue process. For example, an MPF trustee in financial difficulty undergoing the corporate rescue process will need to be able to continue to administer scheme assets by receiving contributions and paying out accrued benefits and to manage the investment of scheme assets. Moreover, the MPFA will need to be able to continue to exercise its regulatory powers over the MPF trustee under the MPF legislation such as suspending and terminating the trustee's administration of MPF schemes under sections 33A and 33B of the MPFSO.

21. Given that issues raised herein are to be clarified, upon receipt of your clarification, we may identify further issues with possible implications on MPF.

22. Thank you again for inviting the comments of the MPFA on the Proposals. As the Proposals are relevant to MPF, we would be grateful if you could kindly keep us posted of any development.

23. If you have any questions on the above, please do not hesitate to contact Ms. Gabriella Yee, Chief Manager on

Yours sincerely



(Darren McShane)
Executive Director
Regulation and Policy