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RE : New Law on Social Insurance of Vietnam

This memo compares, analyzes and discusses the impact of the new Law on Social Insurance (“LSI”). The LSI will come into effect on January 1, 2007. The unemployment insurance provisions will come into effect on January 1, 2009.

Generally speaking, the new social insurance (“SI”) regime will have a more significant impact on employees, than on employers. Initially, for many employers, the cost of SI will decrease. However, over time, the cost to the employer will increase. In addition, the LSI will require employers to readjust in order to establish a more effective personnel strategy.

In this memo, we do not discuss the voluntary contributors to social insurance. We discuss only persons who are involuntarily within the scope of the system. Also note that no implementing regulations have been issued yet, so our analysis of the LSI is limited to the contents of the LSI itself.

1. Maximum salary on which contributions to social insurance is based.

One significant change relates to the quantum of salary on which contributions will be based to determine the amount that both employers and employees will contribute, and to determine SI benefits to the employees.

SI contributions and payment of SI benefits are based on three main elements: (1) contribution rate and level of benefits, (2) base salary (the salary on which contributions are based and minimum wage) and (3) period during which SI contributions or payment of benefits are made. Change of any element will affect the SI contribution as well as the employee’s SI benefits.

Under current regulations, contributions are based on the entire salary. That is, the entire contracted salary that an employee receives is the basis on which SI contributions and SI benefits are calculated.

The LSI changes this. It sets a ceiling on the salary on which contributions will be calculated, and beyond which no contribution need be made. Employees’ monthly salary is the basis on

which contributions will be made and on which SI benefits will be paid. If total salary on which contributions are based is higher than twenty times the Government's minimum wage, then, for the purposes of calculating SI contributions/benefits, salary will be deemed to be fixed at twenty times the minimum wage ("**maximum contribution salary**"). Therefore, SI maximum contributions and benefits will depend on the minimum wage fixed by the Government from time to time. The current legal minimum wage is VND350,000¹, and twenty times the minimum wage is VND7,000,000.

a) Effects on SI contributions

SI contribution rates are fixed by the LSI and the rates will be gradually increased until they reach a maximum rate of 18% by the employer and 8% by the employees in 2014. That is a huge 26%, but it is on a potentially lower salary. As you can see, the increase will pass a large part of the cost to the employer. However, the employer will not be affected immediately by the increase. During the next three years -- from January 2007 to December 2009 -- contribution rates remain unchanged at 15% by the employer and 5% by the employee.

Employers who use a large number of white-collar workers, specialists or professionals will be favored by the new LSI. Salaries paid for white-collar workers or specialists are usually high, while the salary on which contributions will be based is capped. As a result, and in any case, SI contributions for an employee will not exceed a percentage of the maximum contribution salary, i.e. 15% of VND7,000,000 or VND1,050,000, as of January 1st.

b) Effects on employees' SI benefits

As mentioned above, under current regulations, the salary on which SI contributions are based is the employee's contracted salary and there is no limit on that salary.

Under the LSI, employees who have a contracted salary that exceeds the maximum contribution salary on which SI benefits will be calculated will be adversely affected. To understand the difference, consider the following example.

Employee A is an executive assistant. A's net contracted salary is US\$1,000/month, or about VND16,000,000. Under current regulations, her maternity benefits will be as follows:

Salary for 4 months maternity leave = 4 x VND16,000,000	VND64,000,000
One-off maternity allowance = one monthly salary	VND16,000,000
Total benefit	VND80,000,000

¹ Art. 1 Decree 118/2005/ND-CP regarding adjustment of minimum wage.

Under the LSI², as her salary is higher than the maximum contribution salary, to calculate her maternity benefits, the effect of the maximum contribution salary will be as follows:

Salary for 4 months maternity leave = 4 x VND7,000,000	VND28,000,000
One-off maternity allowance = two months of minimum wage	VND700,000
Total benefit	VND28,700,000

Maternity benefits are short-term. What about her long term benefits -- pension benefits? Suppose that A's period of SI contribution is twenty-eight years. Under current regulations, her pension benefits upon retirement will be as follows:

Monthly pension salary (paid until death) = 75% x VND16,000,000	VND12,000,000
One-off pension allowance = 0.5 x three months salary	VND24,000,000

Under the LSI, her pension benefits upon retirement will be:

Monthly pension salary (paid until death) = 75% x VND7,000,000	VND5,250,000
One-off pension allowance = 0.5 x three months salary (maximum contribution salary)	VND10,500,000

It is clear from the examples that the SI benefits of the employee are substantially changed. This will be the common situation for highly-paid employees. Overall, because of the cap and because of the current low minimum wage, SI benefits of certain employees under the LSI will be adversely affected.

2. How the changes in SI benefits under the LSI will affect current employers and employees?

Up to now, we have discussed the situation in which an employee is either wholly under the current SI regime or wholly under the new SI regime. However, what about employees whose benefits straddle both regimes? This Part will discuss how the new LSI will affect employers and employees after it comes into full force on January 1, 2007.

The LSI retains the same basic principles that apply under current regulations, on how to determine SI benefits. In order to calculate SI short-term benefits, such as sick leave or maternity benefits, the employee's salary immediately before payment of sick leave or maternity benefits will be used. That means the salary will be governed by the new "maximum contribution salary" rule.

² In our examples, we merely analyze the situation where the contribution period of employee A falls entirely within the period before or after the effective date of the LSI. If an employee has a period of SI contribution before the effective date of the LSI, the salary on which contributions are based will be defined differently. Please see more in Part 2.

Consider the situation regarding Employee A, who takes her maternity leave from April 1, 2007, i.e. three months after the effective date of the LSI. She will be entitled to:

- Monthly salary, equivalent to 100% of the average salary on which contribution is made during the six months prior to the maternity leave (note, salary for months which after the effective date of the LSI is capped by maximum contribution salary), for four months; and
- One-off allowance, equivalent to two months of minimum wages, instead of one month salary on which contribution is based under current regulations.

Particularly, her maternity benefits will be as follows:

Salary for 4 months maternity leave = $4 \times [(3 \times \text{VND}16,000,000) + (3 \times \text{VND}7,000,000)]/6$	VND46,000,000
One-off maternity allowance = two months of minimum wages	VND700,000
Total benefit	VND46,700,000

In comparison with total benefit under current regulation (see above), her benefits under the LSI are VND33,300,000 lower than the VND80,000,000 she would receive now. If she is entirely under the new SI regime, her benefits would be VND51,300,000 lower. The new rule on maximum contribution salary will have an immediate effect on SI short-term benefits.

It will also have an effect when considering SI long-term benefits, such as monthly pension or a one-off SI allowance under the LSI. However, unlike SI short-term benefits, benefits under the pension regime or one-off allowance are not based on the salary of certain months before retirement or one-off allowance payment. They are based on the average salary during the whole contribution period of an employee. The cap imposed by the maximum contribution salary will generally reduce the average salary; therefore, reduce the benefits that are calculated on the basis of an employee's average salary.

It is still not known whether any special consideration will be given to an employee who has spent most of his/her work life within the current system and who is about to retire after January 1, 2007. Employers have contributed large amounts to the SI on behalf of the employee, in expectation of a larger retirement benefit, and the question is whether the employee will enjoy the benefits of those contributions made on the basis of a different plan and certainly different expectations. It is possible that implementing regulations will address this, but there is no indication that this will be treated as a special situation.

It is hard to say how employees will react in this situation. But it is clear that the benefits of employees under the new LSI will only be guaranteed at a specific level. For well-paid employees, that level will be lower than at present.

3. Unemployment insurance in connection with severance/redundancy allowance.

For the first time ever, the LSI has introduced unemployment insurance. It will apply to most employers and employees as from January 1, 2009, i.e. two years after the effective date of

the LSI. It may be too early to make comments on how this new kind of insurance will be implemented. Yet it will certainly affect both employers and employees.

Unemployment insurance provides unemployment compensation to an employee when s/he loses his/her job or terminates his/her labor contract with the employer. Employers who employ ten or more employees and their employees will be obligated to participate in the unemployment insurance regime. The contribution rate is small, which reflects the limited benefits of the program: the employer, employees and the State, will each contribute 1% of the salary on which contribution is based and which does not exceed the maximum contribution salary.

The characteristics of the unemployment compensation are somewhat similar to those of the severance or redundancy allowance that an employer pays to an employee upon his/her termination of employment. On closer look, the unemployment compensation will partly replace the severance/redundancy allowance regime that exists under the labor law. The LSI says that the period for which an employee contributes unemployment insurance under the LSI will not be counted for the purpose of determining the severance/redundancy allowance of employees under the labor law and the law regarding public servants. This seems to mean that, in the future, upon termination of employment with the employer, an employee will be entitled either to a severance/redundancy allowance or to unemployment insurance.

Historically, the purpose of a severance/redundancy allowance (which is not so common when compared to other countries) is to help an employee during the period after he/she loses his/her job and is looking for a new job. The intention seems to be, as in many other countries, to provide benefits if one is not able to obtain a new job. Entitlement to the payment, however, is not related just to unemployment -- a person may leave a job to take another job and still receive a severance/redundancy allowance.

It is possible that Vietnamese law makers are going to amend regulations regarding severance/redundancy allowance. It would seem that current regulations would not be totally abolished, because unemployment insurance is compulsory only for an employer who employs ten or more persons. If an employer employs fewer than ten people, he may still have to pay severance/redundancy allowances to his employees. Or, if an employee is not eligible for unemployment insurance benefits, s/he may be entitled to the severance/redundancy allowance. The relationship between unemployment insurance and the severance/redundancy allowance is still to be defined.

What are the differences between these two regimes? For an employee to receive unemployment insurance benefits under LSI, s/he will have to fulfill many conditions. It is quite different from requirements to receive severance/redundancy allowance under the Labor Code, which accrue based on time in the job. The benefits under the two regimes are also different. The table below compares unemployment compensation and severance/redundancy allowance of the employees upon termination of employment:

	Unemployment compensation	Severance/redundancy allowance
Conditions for	Employees who³:	Employees who:

³ We do not include requirements regarding administrative formalities.

⁴ Art. 2(3) and 2(4) LSI

<p>entitlement</p>	<ul style="list-style-type: none"> • work for an employer that has ten or more employees⁴; and • have labor contracts with terms equal to twelve months⁵ or more; and • have contributed to the unemployment insurance fund for at least twelve months within a period of twenty-four months before being unemployed⁶. 	<ul style="list-style-type: none"> • work for an employer for a period of twelve months or more; and • are not dismissed under Article 85(a) and 85(b) of the Labor Code, or do not illegally, unilaterally terminate the labor contract with the employer.
<p>Who pays?</p>	<p>SI Agency, on the basis of unemployment insurance contributions made by the employees, employer and the State</p>	<p>The employer</p>
<p>What are the allowances?</p>	<p>Monthly unemployment compensation⁷, equivalent to 60% average salary during the last six months before being unemployed in:</p> <ul style="list-style-type: none"> • Three months, if the period of contribution to unemployment insurance is from one year to three years; or • Six months, if the period of contribution to unemployment insurance is from three years to six years; or • Nine months, if the period of contribution to unemployment insurance is from six years to twelve years; or • Twelve months, if the period of contribution to unemployment insurance is twelve years or more. 	<p>One-off <u>severance</u> allowance, one-half of one-month's salary for each year of employment; or</p> <p>One-off <u>redundancy</u> allowance, one-month's salary for each year of employment</p>

⁵ Art. 2(3) LSI

⁶ Art. 81(1) LSI

⁷ Art. 82 LSI

Following is an example of the specific differences between these two regimes. Employee A has worked for her employer for ten years; if she terminates her labor contract, what is she entitled to:

Under unemployment insurance regime:	Under severance/redundancy regime:
Monthly unemployment compensation = 60% x VND7,000,000 = VND4,200,000 (one month benefit) Her maximum unemployment compensation is for twelve months : = 12 x VND4,200,000 = VND50,400,000	One-off <u>severance</u> allowance = 0.5 x 10 x VND16,000,000 = VND80,000,000

Severance/redundancy regime provides a one-time payment; unemployment compensation is paid for a period of time. The LSI provides that an unemployed employee will cease to receive unemployment compensation⁸:

- Whenever the period of entitlement to unemployment compensation expires;
- When the employee has a new job;
- When the employee has twice refused a job recommended by the SI Agency without good reason.

After receiving unemployment insurance benefits, the period of contribution and entitlement to unemployment compensation will recommence.

The new unemployment insurance regime will not have any obvious unfavorable consequences on employers. In the future, employers may not need to pay severance/redundancy allowance to their employees when an employment relationship is terminated. The unemployment insurance will replace these allowances.

What will happen to current employees if they want to terminate a labor contract after they involuntarily participate in the unemployment insurance program in January 2009? We must wait for the implementing regulations. It is possible that employees will be entitled to a severance/redundancy allowance for the period before the date they participate in the unemployment insurance program. At the moment this is still speculative. For the period after their participation of the unemployment insurance program, they will not be entitled to severance/redundancy allowance, but they may be entitled to unemployment compensation, as long as they are eligible for that compensation.

4. New obligation of the employer to pay sick and maternity SI benefits.

⁸ Art. 87 LSI

According to the LSI, the Employer -- not the SI Agency, as now -- will pay the employees their SI benefits in case of sickness and maternity leave⁹. How exactly payment will be made and finalized with the SI Agency remains an open question. We assume these questions will be resolved by implementing regulations. This has the potential to create a new administrative burden on the employer.

5. Penalties for delay in SI contribution.

The LSI has set out strict penalties against employers who fail to fulfill or who delay making their SI contribution. If an employer fails to fulfill or delays for 30 days, it must pay interest on the amounts due. Employers' deposits at banks or credit organizations may be seized to pay for unpaid SI contributions¹⁰.

6. Conclusion.

The foregoing is our comparison and analysis of SI regimes under current law and under the new LSI. Briefly, the new LSI will have a significant impact on both employer and employee.

The employer will not be adversely affected by the LSI during the next three years. The employer's SI contribution rate remains unchanged at 15%. However, SI contributions by the employer will tend to be reduced, as the result of the cap imposed by the maximum contribution salary on which SI contribution is based. Of course, if the minimum wage increases, the costs will increase accordingly. However, it is not likely that the Vietnamese Government will significantly increase the minimum wage in the short term.

On the other hand, obviously, SI benefits of employees will change under the LSI. Employees with high incomes especially will be affected. Employers will want to examine the impact of the change.

There are also other things that an employer must prepare, in order to reflect the new SI regulations into its personnel/labor administrative policies. The employer will need to re-check provisions in its internal labor regulations that relate to SI. It will also want to look at personnel policies in light of the new LSI.

We hope this memo is helpful. If you have questions, please don't hesitate to contact us.

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⁹ Art. 92 LSI

¹⁰ Art. 138 LSI