

Press Release

LCQ20: Fees and charges of the Mandatory Provident Fund schemes and the expenditure of the Mandatory Provident Fund Schemes Authority

Wednesday, July 9, 2014

Following is a question by the Hon Paul Tse Wai-chun and a written reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (July 9):

Question:

It has been reported that the net asset value of the Mandatory Provident Fund (MPF) schemes is estimated to be as high as \$550 billion at present and the average fund expense ratio for the MPF constituent funds in this year was as high as 1.69%. As such, it is estimated that the fees and charges charged by MPF trustees and fund managers are as high as \$9.2 billion per annum. The press report has cited an example of an employee and his employer making monthly contributions to an MPF scheme for 40 years, and it turns out that the fund management fees will account for as much as 39% to 52% of the employee's accrued benefits. The press report has also pointed out that four trustees are currently having a total market share of as high as 70% in the MPF market, thereby creating a quasi-monopolistic market situation, which is the main reason why the Mandatory Provident Fund Schemes Authority (MPFA) has been ineffective in pushing forward a reduction of the MPF fund management fees. The public's lukewarm response to the "MPF Semi-Portability" (i.e. the "Employee Choice Arrangement") is also related to the trustees' refusal to enhance their efficiency and their levying of additional fees and charges. In addition, some members of the public have relayed that MPFA has, on the one hand, requested the trustees to lower their fund management fees with a view to reducing MPF expenses, and on the other hand, it uses public funds to rent office accommodation at high rentals and employ many staff members with high salaries. Regarding the issue of lowering MPF fund expenses and the expenditure of MPFA, will the Government inform this Council:

(1) of the policies put in place by the authorities to tackle the quasi-monopolistic market situation of MPF trustees, for the purpose of urging trustees and fund managers to lower their fund management fees and to enhance their efficiency;

(2) given that some members of the public have pointed out that the MPF fund

investment companies have performed unsatisfactorily and that employees' contributions have been eroded by the fund management fees charged by them, and a negative rate of return has been recorded for some MPF schemes after deduction of the management fees, whether the authorities will conduct a study on amending the relevant legislation to allow contributors to directly invest, without involving any trustee, their monthly contributions in an amount not less than that required by the law, in index funds of which the management fees are lower (e.g. the Tracker Fund of Hong Kong), with a view to lowering the fund expenses payable by the employees; if they will conduct such a study, of the details and the time required to complete it; if not, the reasons for that;

(3) whether the authorities have reviewed whether the decision, made by the former Chief Secretary for Administration, who is suspected of having an interest related to the majority owner of the International Finance Centre (IFC), to renew the tenancy of MPFA's office at IFC was appropriate at that time; if they have, of the results; if not, the reasons for that;

(4) whether it knows the lease period and the monthly rental expenses of MPFA's existing office at the International Commerce Centre; of the actual needs for MPFA to rent space in a Grade A commercial building as its office; whether MPFA will relocate its office to office accommodation with a lower rental in order to reduce its expenditure;

(5) given that it has been reported that while MPFA employs almost 700 employees (their average annual salary is \$400,000 while the annual salaries of its five highest-ranking executives amount to over \$3 million each) and rents a total of four offices, MPFA has indicated that it would not, on grounds of effectiveness concerns, operate the "core fund" (i.e. a standardised, low fee default fund under all MPF schemes) proposed by it, whether the authorities have assessed if the salary and rental expenditures of MPFA is good value for money; whether they will request the Audit Commission to conduct a value-for-money audit on MPFA to ensure that it has not misused public funds; if they will, when they will make such a request; if not, of the reasons for that; and

(6) given that there are views that the existing MPF system is unreasonable because the system, which was proposed by the former Managing Director of MPFA who has the sobriquet of a resourceful man, can only "guarantee that banks and fund investment companies will make profits", but it "cannot force

trustees to lower the fees and charges of funds which have recorded losses for ten consecutive years" nor can it protect the employees' interests, and that some academics have proposed that the Government should take the opportunity of the introduction of the core fund to require MPF trustees to offer funds with a guaranteed rate of return of at least 4% to 5% per annum for employees to choose, otherwise the employees can switch to other trustees, or that the Government should offer a core fund with a guaranteed rate of return of 4% to 5% per annum, and that some academics have also proposed that public consultation should be conducted on the aforesaid proposals to reform the MPF system, together with the report of the study on a universal retirement protection scheme to be submitted to the Government by an honorary professor of the University of Hong Kong, whether the Government will study these proposals seriously and implement them as soon as possible for the purpose of reforming the MPF system?

Reply:

President,

(1) Currently, the 15 trustees approved under the Mandatory Provident Fund (MPF) System offer a total of 41 schemes. Employers can choose among them for MPF contributions in respect of their employees. Scheme members may also transfer accrued benefits from their portion of MPF contribution in their contribution accounts to a scheme of their choice under the Employee Choice Arrangement (ECA), as well as the whole of the accrued benefits in their personal accounts to any of the 41 schemes. Over the years, the Government and the Mandatory Provident Fund Schemes Authority (MPFA) have pursued a host of measures to further promote competition, including (a) the introduction in 2007 of a Fund Expense Ratio (FER) as a common measure for comparing fees and charges of MPF constituent funds, and its publication alongside with the return and services of each fund on the website of the MPFA to facilitate comparison by scheme members; (b) the publication of a low-fee fund list on MPFA's website in 2012; and (c) implementing ECA in 2012.

In the period from July 2007 to May 2014, MPF fees and charges as measured by FER dropped from 2.1% to 1.69%, representing a reduction of some 20%. Going forward, we will pursue major reforms to achieve a more substantive reduction of MPF fees. In particular, we are consulting the public on the proposed

"Core Fund" which will be subject to a fee control and is expected to become a benchmark to drive competition and further fee reduction (see reply to part (6) of the question), in parallel the MPFA has embarked on a study on the Implementation of Full Portability.

(2) The MPF System, as a mandatory, privately-managed and defined contribution pension system, is consistent with the second pillar of the retirement protection system recommended by the World Bank. Its key objective is to assist the working population in saving for their retirement. Essential features of the System include, among other things, collection from employers their portion of MPF contributions in respect of their employees, and the MPF contributions of the working population themselves; as well as preservation of such contributions in the System until the scheme members concerned reach 65. Against this background, the Mandatory Provident Fund Schemes Ordinance (Cap. 485) (MPFSO) provides for a system for approval of MPF trustees which are entrusted with the indispensable role of dealing with collection of MPF contributions, their investment and withdrawal in accordance with the law.

On access to index funds, the MPFA has taken proactive measures to encourage the use of such funds in recent years. Currently, there are 25 index funds within the MPF System including 10 that invest directly into the Tracker Fund of Hong Kong. In addition, the proposed "Core Fund" (see reply to part (6) of the question) will adopt a passive, index-based investment strategy and provide MPF scheme members with more access to low fee index tracking funds.

(3) In view of the current legal proceedings, it is not appropriate for us to comment on the issue raised in the question, lest affecting the conduct of the legal proceedings concerned.

(4) and (5) The MPFA is a statutory body established under the MPFSO. A wide range of safeguards have been specified in the Ordinance to ensure accountability and transparency of the MPFA during the performance of its statutory functions. They include the appointment by the Chief Executive (CE) of independent non-executive directors to the MPFA, one of whom also assumes the role of the Chairman. An Administration Committee under the chairmanship of a non-executive director has been set up specifically to deal with the human resources and general administration matters, including appointment matters concerning executive directors, manpower plan, remuneration matters and office

accommodation arrangements. In the process, the Administration Committee will take into account the operational needs of the MPFA, prevailing market pay and rental, among other factors, and make recommendations to the full MPFA board accordingly. Under the MPFSO, the appointment of the executive directors and their employment terms and conditions are subject to the approval of the CE, while the budget of the MPFA requires the approval of the Financial Secretary. Moreover, the MPFA publishes its annual reports, including the audited financial statements, to enhance the transparency of its operation.

Specifically on rental expenses, the four offices of the MPFA are currently located in Kowloon West, Central, Kwun Tong and Kwai Fong to meet its operational needs and to provide convenient services to the community. For the year of 2012-13, the expenses in relation to office accommodation (including office rental, rates and Government rent, management fees, electricity expenses, etc.) were around \$65 million, representing about 13.6% of MPFA's total expenditure in that year.

Both the Government and the MPFA are mindful of the need of efficient use of public money and expenditure control. The headcount of the MPFA for 2014-15 has been reduced by 4% as compared with the previous year. Moreover, the MPFA is currently reviewing its accommodation strategy, including the location of its various offices.

(6) As mentioned in the reply to (2), the MPF System, consistent with the multi-pillar model recommended by the World Bank, is designed to assist the working population to save for their retirement, while public resources will continue to focus on those in need. As a major reform to enhance the MPF System, the Government and the MPFA launched a joint consultation on the proposed Core Fund on June 24, 2014. Under the proposal, all MPF scheme members will have access to a standardised investment product that is subject to a fee cap of 0.75% and is designed in a manner consistent with the overall objective of retirement savings. While saving for retirement typically involves some 40 years, exposing investments to multiple market investment cycles and a guaranteed return by trustees is not feasible, the proposed Core Fund will be required to balance investment risks and return, including the reduction of exposure to risky assets in the period before a scheme member reaches 65.

The consultation period on the proposed Core Fund will end on September

30, 2014. The Government and the MPFA will press ahead with the necessary legislative processes and operational arrangements for early introduction of the proposed Core Fund.

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