Press Release

LCQ22: Investment arrangements under the Mandatory Provident Fund schemes

Wednesday, November 18, 2015

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 (November 18):

Question:

Standard Chartered Bank has recently announced a substantial loss in the third quarter of this year, causing the Singaporean sovereign wealth fund Temasek Holdings (Temasek), one of its major shareholders, to suffer huge losses. The Exchange Fund (EF) of the Hong Kong Monetary Authority (HKMA) recorded a loss of $63.8 billion in the third quarter of this year. Amid the downturn of the international investment environment, the investment returns of the Mandatory Provident Fund (MPF) schemes have fallen accordingly. Employees not only suffer the losses from the MPF investments but also have to pay exorbitant management fees. There are comments that while EF recorded the highest ever loss in the third quarter of this year, the losses from the MPF investments for the same period are far more substantial, with the loss of the former representing about 1.9 per cent of its total fund size, while the losses of the latter as high as 12 per cent. In this connection, will the Government inform this Council:

(1) whether it knows the total amount of contributions made to the MPF schemes, the fund investment performance, the average rate of investment returns, the total amount of fees charged and the average percentage of such fees in the total amount of contributions, since January this year;

(2) given that the share price of Standard Chartered Bank, one of the note-issuing banks of Hong Kong, has recently fallen by nearly two-thirds as compared to the level in 2010, causing losses to the long-term investment of national sovereign wealth funds like Temasek, and that EF which has engaged many investment experts has also failed to withstand fluctuations in the investment market, whether the Government has reviewed if the following practice is still appropriate: mandating employees to make contributions to the

MPF schemes and transferring their contributions to fund managers for investment in the hope that the returns can provide retirement protection for the employees; if it has, of the details; if not, whether it will conduct such a review expeditiously;

(3) given that some members of the public have all along criticised that fund managers charge excessively high fees which have gnawed the investment returns of the MPF schemes, whether the Government will conduct studies on allowing employees to make their own investment arrangements for their contributions, such as employees using their contributions to subscribe directly for passively managed funds which charge lower administration fees (such as the Tracker Fund of Hong Kong), so that they are not required to pay the fees of funds under the MPF schemes;

(4) as some members of the public have queried that the Government's purpose of implementing the MPF schemes is to protect the income of fund managers but not to provide retirement protection for employees, how the Government removes such a perception among members of the public, so that they are willing to make contributions on a long-term basis; and

(5) given that the Commission on Poverty will launch a six-month public consultation on retirement protection in December this year and will, at that time, also consult the public on the arrangement under which an employer may use the accrued benefits derived from the contributions he made for an employee to an MPF scheme to offset the severance payment or long service payment payable to the employee under the Employment Ordinance (Cap. 57) (commonly known as "the offsetting arrangement"), whether the Government will consider including in the scope of consultation the proposal of completely abolishing the MPF schemes to enable members of the public to make their own saving and investment arrangements for retirement?

Reply:

President,

(1) According to information received by the Mandatory Provident Fund Schemes Authority (MPFA) from approved trustees, net contributions received during the period from January to September 2015 is $34.9 billion, and as a

result of recent market volatility, the annualised internal rate of return (net of fees and charges) during the period from January to October 2015 is -1.7 per cent, and the latest average Fund Expense Ratio (FER) at 1.60 per cent. We have to emphasise that MPF, as one of the sources of retirement savings, is a long-term investment. As the investment period will span across a period of more than 40 years, returns during this period will inevitably fluctuate with economic cycles, global economic growth and short-term market volatility. Scheme members should not focus on short-term market fluctuations.

(2) and (3) After almost thirty years of deliberation on the design of Hong Kong's retirement protection system, the MPF System was eventually introduced in the form of mandatory private retirement schemes. The MPF System aims to assist the working population in saving for retirement by mandating them and their employers to make contributions during employment, such that public resources can be focused on assisting those in need.

Under the System, MPF schemes are established as trusts and run by professional approved trustees which are responsible for handling administrative tasks, such as collecting employers' and employees' mandatory contributions from employers, recovering default contributions, making regular reports to MPFA and scheme members, appointing investment managers, managing accrued benefits and assisting scheme members in withdrawing accrued benefits. To safeguard scheme members' accrued benefits, approved trustees must appoint investment management companies that are registered with the Securities and Futures Commission as investment managers to manage the investment in the schemes.

The MPF schemes are composed of constituent funds (CFs) and designed as pooled (or collective) investment structures, which are efficient for amassing small contributions for investment. Compared with individual investments, the pooled investment model of MPF reduces the administrative burden and costs for small and medium-sized enterprises for participating in the MPF schemes, achieves better economies of scale, have lower investment costs, and better protect scheme members' interests.

If individual scheme members make their own investment instead of joining an MPF scheme through approved trustees and having their accrued benefits managed by qualified investment managers, they would have to take up the aforementioned administrative tasks and investment work which would not be economically efficient. In addition, the pooled investment model can also better diversify investment risks.

At present, scheme members may invest their accrued benefits in dedicated MPF CFs that track a particular index. As of September 2015, there are 27 CFs that are index funds, including 12 that invest in the Tracker Fund of Hong Kong.

The MPFA has been striving to drive down the MPF fees. Since 2007, the average FER has already been reduced by more than 20 per cent. Among all existing approved CFs, some 40 per cent are low-fee funds (i.e. with FER≦1.3 per cent, or management fees≦1 per cent).

(4) To protect scheme members' accrued benefits more directly, we and MPFA will introduce an amendment bill into the Legislative Council on November 25, mandating each approved trustee to provide a regulated, highly-standardised and fee-controlled Default Investment Strategy (DIS)(formerly called "Core Fund") that is consistent with the objective of long-term retirement savings. The proposed fee cap level of 0.75 per cent of the net asset value of each DIS CF will be further lowered in the long run. On the whole, we envisage that the DIS will become a benchmark for CFs to drive competition and fee reduction so as to further strengthen the role of the MPF System as one of the pillars of retirement protection in Hong Kong.

(5) The Commission on Poverty will launch a six-month public consultation on retirement protection in December this year. The scope of the consultation covers how to strengthen the functions of each pillar in our retirement protection system.

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