Press Release

LCQ20: Monitoring the performance of the Mandatory Provident Fund Schemes Authority and fund managers

Wednesday, November 2, 2016

Following is a question by the Hon Paul Tse and a written reply by the Acting Secretary for Financial Services and the Treasury, Mr James Lau, in the Legislative Council today (November 2):

Question:

A number of academics have repeatedly stated that the Mandatory Provident Fund (MPF) Schemes are full of drawbacks and completely worthless as their high fees and low returns have gnawed retirement fund contributions for a long time. Another academic has recently pointed out that the expenditure of the Mandatory Provident Fund Schemes Authority (MPFA) increased sharply by 36% in the past five years. Apart from its rental expenses which are as high as $70 million per annum, MPFA's previous managing directors were even offered huge amounts of emoluments, with the incumbent managing director having received a total of about $70 million over the past 13 years. In the year ended March this year, MPFA incurred a deficit as high as $510 million, and recorded losses for six consecutive years. MPFA has not only failed to monitor MPF Schemes properly, but has also failed to make ends meet for a long time, not practising what it preaches. Also, the aforesaid academic has cited various profiteering tricks deployed by fund managers who act in disregard of contributors' interests, resulting in the long-term underperformance of most of the equity funds. Such tricks include: charging fund fees up to 2% and engaging in frequent trading of shares, thereby gnawing MPF contributions for a long time; embezzling dividends payable to clients; charging fund switching fees under all sorts of pretexts; buying investment products at high prices even when the market is overheating on the excuse that fund accounts cannot hold too much cash; and selling investment products at low prices during market downturns for fear that clients may make redemption and switch positions. Furthermore, in the past 10-odd years, fund managers often bought stocks at high prices based on rumours, leading to the underperformance of fund investments and incurring huge losses to clients. Those fund managers, however, were awarded large sums of bonuses or exercised warrants, with their affiliated financial institutions even gaining huge profits from such acts. In this connection, will the Government inform this Council:

(1) given that the average annual return of MPF equity funds in the past 15 years was less than 4%, lagging substantially behind the rate of increase of the Hang Seng Index in the same period, whether the Financial Services and the Treasury Bureau (FSTB) and MPFA have studied the reasons, other than the exorbitant fund fees charged by fund managers, that lead to the long-term underperformance of MPF equity funds in terms of investment return; if they have, of the study findings; if not, whether a study can be conducted immediately;

(2) of the policies in place to regulate and monitor various acts disregarding clients' interests committed by equity fund managers, or even their undesirable investment habits which enable them to profiteer from such acts;

(3) whether the Government, in the past 15 years, raised questions or issued warnings to fund managers alleged of having engaged in misconduct or acts disregarding clients' interests; if it did, of the number of cases and details of such acts, and the outcome of follow-up actions; if not, the reasons for that; whether it has reviewed the circumstances under which MPFA has not monitored MPF Schemes sufficiently or has not monitored at all, and whether it will expeditiously establish a new regime to regulate fund managers or tighten the existing regime;

(4) as there are views that MPFA has failed to monitor MPF Schemes properly, has completely no knowledge of the total amount of management fees received by fund managers in the past 15 years, and such fees are of an exorbitant level, whether the Government has regularly reviewed the performance of MPFA, and what policies are in place to impose strict control on MPFA's expenditure; and

(5) as an academic has pointed out that "the financial sector and the so-called governing elites have been targeting at the general public for making every possible gain and, if this situation goes on, there will be increasing calls for the abolition of MPF Schemes" and that "after the abolition of MPF Schemes, the problems associated with the offsetting arrangement will be gone", whether the Government will, in response to the concerns over the problems of "high fees and low returns" and the offsetting arrangement of MPF Schemes raised by the

academic and more and more members of the public, conduct an objective value-for-money assessment on MPFA and the entire MPF system to study if public funds (the Government allocated $5 billion of public money to fund the operation of MPFA in 1998) and MPF contributions are used properly and, at the same time, consider whether MPF Schemes should be abolished so as to completely solve the problems associated with the offsetting arrangement; if it will, of the details; if not, the reasons for that?

Reply:

President,

The main duties of the Mandatory Provident Fund Schemes Authority (MPFA) include:

(a) regulating the approved trustees of registered mandatory provident fund (MPF) schemes to ensure that they administer the registered schemes in a prudent manner;
(b) registration of MPF schemes and occupational retirement schemes (ORSO schemes);
(c) monitoring compliance with relevant legislation by approved trustees and intermediaries, investigating suspected breaches and non-compliance, and taking enforcement actions;
(d) providing employees and employers with guidelines for the payment of mandatory contributions, and recovering outstanding contributions from employers on behalf of employees and instituting prosecutions against employers who fail to fulfil their obligation of making contributions;
(e) considering and proposing reforms of the law relating to MPF schemes and ORSO schemes; and
(f) implementing public education so as to enhance public understanding of the MPF System and their knowledge of financial planning for retirement.

The replies to the questions raised by Hon Paul Tse are as follows:

(1) As at August 2016, the annualised internal rates of return (net of fees and charges) of MPF equity funds and all MPF constituent funds since the inception of the MPF System in December 2000 were 4.2% and 3.2% respectively, broadly comparable to the overall investment returns of similar

retail funds.

(2) and (3) The MPF legislation requires all MPF schemes to be administered by approved trustees. To ensure that the accrued benefits of scheme members are adequately protected, approved trustees are required to administer and deal with scheme assets as trust property. Also, they are required to arrange for the scheme accounts to be audited; appoint investment managers to invest scheme members' contributions and accrued benefits; and ensure that all investments of the scheme are in the interest of scheme members. Fund managers are not allowed to charge scheme members any fees for fund switching. The MPF System is designed in such a way that the MPFA would approve and regulate the approved trustees who would proactively supervise their fund managers to enhance the performance of MPF constituent funds.

Furthermore, investment managers of all MPF constituent funds must be licensed by the Securities and Futures Commission (SFC) under the Securities and Futures Ordinance (SFO). The fund managers shall observe and comply with all the relevant provisions in the SFO and its subsidiary legislation, and the relevant codes and guidelines issued by the SFC. Operation and conduct of fund managers are under the ongoing supervision of the SFC.

Under the existing mechanism, when the MPFA is aware of any non-compliance relating to fund managers' misconduct or reckless disregard for members' interests, it would refer the cases to the SFC for follow-up. Up till now, no fund managers have been questioned or warned for misconduct involving MPF constituent funds or inappropriate investment practices that have undermined the interests of the clients.

(4) The operations of the MPFA are mainly financed by the investment income generated from a one-off Capital Grant of $5 billion from the Government in 1998. The MPFA's accounting records and financial statements must be audited by its auditor. In addition, the MPFA's annual reports, together with its financial statements, are available to the public on its website.

The MPFA has all along exercised stringent financial discipline and made efforts in controlling its expenditure. Along with various cost-saving measures, the MPFA consolidated its offices in early 2016 to maximise the efficient use of office space, and also relocated its offices away from prime commercial districts to reduce rental expenses. Efforts have also been made to reduce headcount to strictly contain the rise in staff costs. The Government and the MPFA review the income and expenditure of the MPFA regularly and explore options to ensure its long-term financial sustainability to support its regular duties and the launch of new regulatory measures.

(5) The MPF System is an integral part of Hong Kong's retirement protection system. It plays the role of Pillar Two under the retirement protection framework advocated by the World Bank. Before the MPF System was implemented, only one-third of Hong Kong's employed population had retirement protection. Now 85% of Hong Kong's employed population (i.e. over 3.2 million employees and self-employed persons) are covered by the MPF System or some other form of retirement scheme, enjoying varying degrees of retirement protection. MPF assets have been growing since the inception of the System, and as at August 2016, MPF contributions together with investment returns reached $646.6 billion. The annualised internal rate of return (net of fees and charges) of the System was 3.2%, higher than the annualised growth rate of the Consumer Price Index for the same period at 1.8%. This shows that the System has added value to scheme members' assets. Nevertheless, the Government and the MPFA have been refining the MPF System, for example, by introducing a fee-controlled Default Investment Strategy (DIS). The DIS will provide a better investment solution for scheme members who have not made or do not want to make investment choices, and will directly reduce MPF fees.

We must point out that the operations of the MPFA are mainly financed by the investment income from the Capital Grant of $5 billion from the Government in 1998. The contributions of MPF scheme members and the investment income derived therefrom will not be used to finance the MPFA's operations.

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