Speech

Speech by SFST at ASFA - Asia-Pacific 2011 Pensions Forum (English only)

Tuesday, September 27, 2011

Following is the speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, at the Asia-Pacific 2011 Pensions Forum organised by the Association of Superannuation Funds of Australia today (September 27):

Ladies and gentlemen,

Good morning. I am honoured to open the first Asia-Pacific Pensions Forum organised by the Association of Superannuation Funds of Australia. A pension is a form of retirement protection that every working person looks forward to. Today, we have among us a broad spectrum of professionals including trustees, fund managers, securities and investment practitioners, lawyers, accountants and other related professionals. You are all tasked with the heavy responsibility of managing the wealth we intend to enjoy after we retire.

This forum is a great opportunity for the distinguished experts among us to exchange ideas on the latest pension trends, be they regional or global, and to facilitate dialogue on the future landscape of pension regulation and policies.

Hong Kong's Asset Management Centre

The organiser's choice of Hong Kong for staging its inaugural forum has a special meaning to us. You have given Hong Kong a strong vote of confidence as an asset management centre for pension funds, and I can assure you we will not let you down.

After the great financial crisis, there is a perception of a shift of the economic centre of gravity from the West to the East.

Situated at the heart of Asia and as the gateway to Mainland China, Hong Kong has established itself as an ideal platform for overseas fund managers to access the Asian markets, and our fund management businesses have scaled new heights in recent years. The combined fund management business of Hong Kong amounted to over HK$10 trillion (over US$1,200 billion) as at end 2010, up 19 per cent from 2009's figure.

Hong Kong's development into a major asset management centre in the region is premised on our fundamental strengths as an international financial centre, including our having the world's freest economy, a stable currency, free flow of capital, a rich pool of talent and a low and simple tax regime.

You may all know that China's National 12th Five-Year Plan, our national economic blueprint running up to 2015, explicitly supports the development of Hong Kong into an international asset management centre. It affirms for the first time the function and role played by Hong Kong's asset management industry, and incorporates the objective to support its sustainable development into the comprehensive plan for the overall development of the nation.

The Plan also emphasises the Central Authorities' support to develop Hong Kong into an offshore Renminbi (RMB) centre.

The Vice-Premier of the State Council, Mr Li Keqiang, announced last month a series of measures to further support the development of Hong Kong as the offshore RMB business centre.

The latest measures cover a number of aspects, including further expansion of the RMB trade settlement scheme, support for the use of RMB for foreign direct investment in the Mainland, introduction of the RMB Qualified Foreign Institutional Investors (RQFII) scheme for investing in the Mainland's securities markets, the pilot arrangement for foreign banks to increase capital in their Mainland subsidiaries using RMB, and expansion of issuance of RMB bonds in Hong Kong by Mainland entities (including financial institutions and corporations).

All these exciting developments would only bring more liquidity to Hong Kong, leading to rapid growth of our asset management business.

The Retirement Protection System in Hong Kong

Now turning to retirement protection in Hong Kong. Hong Kong has adopted the retirement protection model advocated by the World Bank: the non-contributory social security system, the Mandatory Provident Fund (MPF) system and voluntary private savings. While none of these can solve all the problems related to an ageing population, together they reinforce each other and lay the foundation for retirement protection infrastructure in Hong Kong.

Let me give you some facts about our MPF system so you have a better picture of its coverage. As at the first quarter of 2011, Hong Kong had an employed population of 3.58 million, of which 71 per cent were covered under MPF schemes. The rest of the population was covered under other retirement schemes, such as the Civil Service Pension Scheme or Occupational Retirement schemes, or they fell under a category of employees not required by law to join any retirement scheme - domestic employees or employees aged above 65 or below 18. The enrolment rates of employers and employees stand impressively high at 98 per cent and 99 per cent respectively. The contributions received in the second quarter of this year totalled HK$10.2 billion (US$1.3 billion).

At the end of the first half of this year, we had 19 approved MPF trustees and 41 MPF schemes. Particularly impressive is the cumulative net asset value of all the MPF schemes. The total contributions into the MPF system after deducting the amount of benefits paid stood at a net total of HK$277.52 billion (US$35.59 billion).

In terms of asset allocation, 66 per cent was in equities, 22 per cent was in debt securities and 12 per cent was in deposits and cash.

There has been considerable market volatility since the inception of the system in 2000. We experienced the technology bubble, SARS and more recently the global financial tsunami. As a result, the rate of return on a year-by-year basis saw similar fluctuations.

Once the ups and downs are ironed out, we have seen an average annualised internal rate of return for MPF (net of fees and charges) of 5.5 per cent over the past 10 years.

This is substantially higher than both the annualised one-month Hong Kong Dollar fixed deposit rate (1 per cent per year) and the inflation rate (0.7 per cent per year) for the same period. It is a very respectable return when compared to the yield of MPF's international counterparts.

However, public views are mixed as to whether 5.5 per cent represents a reasonable average return. Questions have been raised about the leakages due to fees and administrative expenses.

Governance of Pension Funds

Ladies and gentlemen, we have established that our MPF system is no small business!

As the system grows and matures, we have the Mandatory Provident Fund Authority (MPFA) to regulate and supervise the operations of all MPF schemes.

(a) Stringent Approval and Registration Criteria

All approved MPF trustees must meet the stringent criteria on capital adequacy, financial reliability, fitness and propriety as well as having internal controls in place.

(b) Ongoing Monitoring

Yet, getting the approval of the MPFA is only the beginning. All MPF trustees are required to submit returns, financial statements and internal control reports to the MPFA on a regular basis. MPFA officers, on the other hand, conduct field inspections to ensure the trustees put their control mechanism and compliance into practice. When there is a suspected case of non-compliance, the MPFA will investigate.

Another one of the MPFA's main goals is to enhance the clarity, range and accessibility of information about the various MPF funds and the companies that run them.

In 2004, it introduced a Code on Disclosure for MPF Investment Funds, which required trustees to improve the standards of their disclosure of fund information to members, especially with regard to fees and charges.

(c) Professional Indemnity Insurance and Compensation Fund

MPF trustees are required to be insured against any losses caused by misfeasance or misconduct of the trustees or their service providers. There is additional protection from a statutory Compensation Fund should the insurance fall short of the scheme members' losses.

(d) Strict Investment Management

The governance of the investment managers is equally important. That's why investment of any MPF scheme assets can only be done by managers registered with the Securities and Futures Commission (SFC), our securities regulator.

The rules on scope of investment are based on the prevailing pension funds management standards. Managers need to be particularly careful with liquidity risks, valuation, counter-parties risks and diversification.

Reforms of the MPF System

Looking ahead, the Government, the MPFA and the industry will continue to work together to ensure the success of the MPF system. We will make refinements to the system like we have done in the past to adapt to changes in our lifestyles and the economic and social environment. We have enacted eight amendment ordinances since the system's inception - they range from deterring default contribution and streamlining regulatory requirements to promoting greater market competition.

A reform focus in the coming months will be on the fees and charges of the MPF system. Despite the average Fund Expense Ratio having been reduced from 2.1 per cent in January 2008 to 1.82 per cent today, we believe there is still room for further reduction given the increase in the scale of MPF assets.

The MPFA plans to commission an independent consultancy study on trustees' administration costs later this year. The study will seek to identify possible simplification in the administrative processes of the MPF system with the ultimate goal of reducing costs for members.

The MPFA is also studying the grounds for early withdrawal and the method for withdrawals, and is expected to submit the proposals to the Government next year.

Portability of the MPF System

Another initiative that is coming up and may lead to fees reduction is the Employee Choice Arrangement. The Arrangement seeks to promote market competition by allowing employees to transfer accrued benefits derived from their contribution from one scheme to another at least once a year. It is expected that the portable MPF assets will jump from 39 per cent to 67 per cent. A bill is being prepared to enhance the regulation of MPF intermediaries' activities. We plan to introduce the bill in the last quarter of this year and, subject to its passage within the current legislative year, we aim to implement the Arrangement in the second half of next year. Mr Darren McShane from the MPFA will touch upon the different facets of portability in greater detail in the breakout session later this afternoon.

Conclusion

How best to take care of the financial needs of our retirees has always been a controversial subject. We debated socially and politically for three decades before the MPF system framework was drawn up in 1995. Then it took another five years of intense discussion both inside and outside the legislature before consensus and compromises could be reached.

December 2000 was the beginning of a new chapter for retirement protection in Hong Kong. Our MPF system was rolled out and was widely recognised as a successfully implemented retirement scheme. Improvements and refinements have been continuously made ever since.

The public knows well that we need to save for the betterment of our future, to plan well ahead before retirement. However, from Day One, there has been a cultural indifference, if not resistance, in Asian society toward putting savings in a centrally co-ordinated retirement protection scheme. Our community has seen prolonged discussions of how to implement the MPF system and I am glad to say the success of our MPF system is self-evident. The past decade saw the steady growth of the system, with an almost full enrolment rate among employers and employees.

Nonetheless, there are public concerns that must be addressed: that the management fees should be lowered, that the performance of returns should be further improved and that employees should be allowed choices of MPF trustees are some examples. We also need to address the question, "Are we saving enough for our retirement?" Everyone knows a current monthly contribution capped at HK$1,000 will not be enough to allow the majority of MPF members to enjoy a comfortable retirement. Only after trust and confidence in the system is built would the public be willing to contribute more to the system - the Government, the MPFA and the industry need to work together to make this happen.

Superannuation is one of Australia's greatest public policy success stories. It is the envy of many advanced economies. It has an accumulated asset value of AUD1.34 trillion. The fact that the Australian public has been willing to increase the contribution from 3 per cent at the inception of the system nearly 20 years ago to 9 per cent today shows that superannuation must have done an excellent job and earned the trust of the public. We have much to learn from the Australian model.

Ladies and gentlemen, let me thank the Association of Superannuation Funds of Australia once again for organising this forum. This forum is an excellent opportunity for regulators and industry players in the Asia-Pacific region to discuss the future of pension funds. I hope you will all enjoy your stay in Hong Kong, and I am sure that your presence will make the forum a resounding success.

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