Speech

Speech by SFST at 4th Asia-Pacific Pensions Forum (English only)

Tuesday, June 2, 2015

Following is the speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, at the 4th Asia-Pacific Pensions Forum today (June 2):

Pauline (Vamos) (Chief Executive Officer of ASFA), distinguished guests, ladies and gentlemen,

Good morning. It is my great pleasure to speak at the Asia-Pacific Pensions Forum again. A warm welcome to all of you, especially who are here to join us from other corners of the world.

I had the honour to speak at the inaugural forum in 2011 here in Hong Kong and thank you for inviting me back. Back then, I thought Hong Kong was not the most obvious location to host an inaugural forum on pensions. After all, our Mandatory Provident Fund (MPF) Scheme was only 11 years old then – very young indeed in the world of pensions. But certainly on that occasion, it was very interesting for us to share views and experiences on challenges that were facing our retirement systems.

The Hong Kong MPF Scheme to a certain extent exemplifies a global trend - that is, the transition from publicly-funded defined benefit schemes, to private retirement schemes without public contributions. I am not sure if I have anything new to say. What I can certainly tell is that over the last couple of years, perhaps the challenges are greater, same for the noise level. We are doing some work hopefully to improve the system and I am going to talk about them.

Like many other public policies, there is often a gap between the public's expectations and the reality of designing a retirement system. From a retiree's perspective, an attractive pension scheme should offer defined benefits. Employee's contribution should be low compared to the employer's or government's contribution. Some sort of guaranteed return would be nice too. For example, a guaranteed return tracing the global stock markets floored at the domestic inflation rate would not be bad. Management and administration fees should be low and preferably borne by the Government.

In many places the retirement age is extended along with growing life expectancies. As such the working population is also demanding more flexibility in withdrawing accrued benefits before retirement. Others believe that they are equipped to make their own investment decisions and the schemes should allow them to do that.

Many of these expectations could be accommodated in a well-designed private pension scheme. However, to be sustainable, such a scheme needs to contain certain key elements.

No. 1 is the understanding that saving for retirement is primarily a personal financial planning exercise without subsidies from others. That is why, I believe, public resources should be used to back a social security net but not to fund private pensions.

This is especially true in Hong Kong given our low and simple tax regime. The maths is very simple. In Hong Kong, nearly 60% of the working population does not pay salaries tax. And for the 40% who pays, effective tax rate is only 8% on average. As such, it is necessary for the MPF system to play the role as the privately-managed pillar in our retirement protection arrangements.

No. 2 is that saving for retirement calls for financial discipline. If you want more in the future, you have to save more now. It is as simple as that. At present, we require both employee and employer to contribute 5% of the employee's earnings respectively. A very low contribution rate. Of course they may choose to save more now by making voluntary MPF contributions, or make use of other financial products. The key is that the individual has to exercise financial discipline to save more and save early for retirement.

As we all know, applying strict financial discipline is easier said than done. Some may argue that we need a system to compel people to save at the expense of flexibility for the individual. In fact, the OECD Pension Outlook 2014 pointed out that people in many jurisdictions need to save more and save longer than they currently do in light of the improvement in life expectancy. This is especially true for Hong Kong where life expectancy is among the highest in the world. We will need some serious deliberations within the community on the optimal contribution rate for the MPF system.

Finally, it is fair for employees to expect reasonable return on their retirement savings. Ideally the return is consistently higher than inflation. However, the hard truth is that investment is difficult and returns are uncertain. That is why scheme members need to develop the right investment attitude. This includes the use of long-term investment strategies that allow them to grow their savings over successive business cycles. Many scheme members want to manage their investment actively. But they need to understand that while it is possible to pick some funds to beat the market, it is as likely to pick the funds that underperform. Market timing, by switching investments in response to changes in market cycles, may also underperform a buy and hold strategy, as the returns from good and bad years get averaged out over a long horizon.

The role of the Government and investor education agencies is to educate the public and help them understand these tradeoffs. The industry and the financial media play a key role too. It is, for example, not a good idea to encourage frequent trading in an effort to beat the market. They should know that many professionals who try to time the market ended up underperforming it.

The industry also runs the risk of overselling MPF products. By that I am referring to sales activities resulting in frequent switching between plans and funds due to revenue pressure. Here the regulators also have a role to play.

What I have talked about is the education work that we need to do in order to encourage a healthy and responsible saving strategy for retirement of our population. We are doing some specific work about the MPF system and we are trying to improve it to make it more acceptable to the population. One of the work that we are doing now is controlling the fees and charges of the MPF system because the perceived high cost of the system is the number one public concern. Our regulator, the MPF Schemes Authority, has been striving to cut down costs borne by scheme members through automation, administrative streamlining, reduction of regulatory burden and promotion of competition. In fact, the average FER (Fund Expense Ratio) of MPF funds has been reduced from 2.1% in 2007 to 1.62% in March 2015.

We are also trying to make it easier for scheme members to make investment choices. This is not a problem unique to Hong Kong. In the European Union, surveys found that people often make suboptimal investment decisions. Moreover, default investment options in private pension schemes might not be in line with the purpose of long-term investment for retirement.

In Hong Kong, about 20% of the MPF scheme members do not make any investment choices. They feel that there are so many funds and schemes available to them and they are not so sure about what to buy. They do not make any choices and in our system, the default choice is very suboptimal. In order to help protect their interests, we are going to introduce legislation to mandate the provision of regulated default investment strategy in each MPF scheme by 2016. The investment strategy will be statutorily required to be de-risking, meaning that the exposure to equities will be reduced gradually when a scheme member is approaching the retirement age of 65. This is similar to the approach adopted by many lifestyle or target date funds.

The law will also impose a management fee cap of 0.75%. We will review the fee level with a view to bringing the cap lower in future. We hope that the launch of the default investment strategy will have a benchmarking effect and help bring down the cost of the entire system.

The MPF system in Hong Kong has a history of only 15 years. Covering a working population of 2.77 million, it is an important pillar of our retirement system. We are working hard to improve the scheme so that it could better meet the expectations of the community. It is equally important that scheme members should develop the right investment attitude towards saving for retirement.

As I said earlier, we have a low contribution rate so they are not meant to replace the total income for retirement. In our community, people need to save in other ways. That's why even though we are trying to improve the MPF system, we should really encourage responsible saving and investment in the community.

Of course there are also cries from the public about how the Government should come in to support their retirement. It is very important for us not to mix up the government's role in providing a safety net and the private retirement system. Unfortunately I feel that in the discussion of the retirement system, there is always confusion about the different pillars for retirement protection.

MPF is a private retirement scheme which is meant to be market-driven and that it supplements individual savings. I think what we need to do is to go back to the basics so people understand what the MPF is; and to improve the transparency of the system so people understand better the adopted investment strategies. Effectively addressing the cost issue will also enhance the popularity of the system.

Once again I would like to thank the Association of Superannuation Funds of Australia for inviting me to speak to you today.

An aging population is a challenge but also a blessing. The forum is an excellent opportunity for regulators and industry players in the Asia-Pacific region to discuss the future of private pension funds. We greatly appreciate the opportunity to learn from all of you. I wish you all a fruitful discussion today.

Thank you.

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