

For discussion on
3 July 2006

**LEGISLATIVE COUNCIL
PANEL ON FINANCIAL AFFAIRS**

Review of Mandatory Provident Fund Schemes Compensation Fund

PURPOSE

This paper sets out the results of the review of the optimum level and the levy rate of the Compensation Fund under the Mandatory Provident Fund (“MPF”) System (“the Compensation Fund”).

BACKGROUND

2. The Compensation Fund is established under section 17(1) of the Mandatory Provident Fund Schemes Ordinance (Cap. 485) for the purpose of compensating scheme members (and other persons who have beneficial interests in the schemes) for losses of accrued benefits that are attributable to misfeasance or illegal conduct determined by the Court of First Instance on the application of the Mandatory Provident Fund Schemes Authority (“MPFA”) committed by the approved trustees or by other persons concerned with the administration of the schemes. It covers all losses in accrued benefits arising from both mandatory and voluntary contributions without any limit.

3. Section 188 of the Mandatory Provident Fund Schemes (General) Regulation prescribes that the rate of the Compensation Fund levy is 0.03% of the net asset value of the scheme assets. The levy applies from the commencement of the MPF System so as to build up a reasonably large reserve and hence a more sizeable protection cover.

4. In 1998, in recognition of the fact that the Compensation Fund would take time to build up its reserve, the Government originally undertook to provide a grant or loan of HK\$300 million as seed money for the Compensation Fund. Having received suggestions from Members of the Provisional Legislative Council that the Government should provide a greater financial commitment to support the setting up of the Fund, the

Government eventually provided a one-off grant of HK\$600 million as seed money when the Compensation Fund was established in 1999.

5. On the basis of the projections at that time, it was envisaged that the Compensation Fund could cease to collect levies once the level of the accumulated reserve reached HK\$900 million. The MPFA would keep under constant review the optimum level of the Fund's reserves, in the light of the total accrued benefits and other prevailing factors.

6. The HK\$900 million level was set arbitrarily, given that there were no such claims in overseas countries such as Australia and Canada, and there were no statistics overseas that could be used to estimate the size of the Compensation Fund required. Unknown variables included the number, frequency and size of possible claims.

PRESENT POSITION

7. The Compensation Fund stood at HK\$895 million as at 31 May 2006 and is expected to reach HK\$900 million by the end of June 2006. The MPFA has been closely monitoring developments, and has conducted and completed a review on the Compensation Fund.

8. Based on the estimates made in 1997, it would take 8 to 10 years for the Compensation Fund to build up the proposed reserve of HK\$900 million, provided there were no claims during the period. During that period of time, the MPF System was expected to have gone through an implementation phase and settled into a more mature phase. However, in reality the Compensation Fund will reach the HK\$900 million level in five and a half years, much earlier than originally envisaged.

9. The reason for the Compensation Fund to reach the HK\$900 million level much quicker is mainly because the growth of MPF scheme assets has substantially exceeded initial estimates. Initially it was expected that contributions to the MPF System in the first year of System implementation would amount to HK\$10 billion, and accumulated assets after the System had been implemented for five years would reach HK\$70 billion. However, as at 31 December 2005, the aggregate net asset values of all MPF schemes amounted to HK\$ 151 billion, more than doubled the original projection.

10. We have conducted a review of the Compensation Fund and our findings are as follows:

- (a) As elaborated in paragraph 9 above, MPF assets have been growing at a significantly faster rate than initially projected, so it would be prudent to keep a larger pool of reserves for protection coverage.
- (b) Having been implemented for only five years, the MPF System is still in a phase of rapid development. For example, some approved trustees have launched “special voluntary contribution” arrangements¹ to attract more voluntary contributions into the System in the past year. In the last quarter of 2005 and the first quarter of 2006, HK\$30 million and HK\$48 million of special voluntary contributions were made into the MPF System respectively. We reckon that it will take at least another three to five years to observe the development of the market both in terms of the growth of assets and the risks involved, as well as to refine and improve the System to a more mature stage.
- (c) No claim has been made to the Compensation Fund so far. Regulators in other sectors or jurisdictions usually determine the optimum level of a compensation fund based on claims experience. Without any claims experience, we do not have sufficient information to build a suitable model to determine the optimum level of the Compensation Fund.
- (d) The levy is still an insignificant amount on a per member basis. The average assets per enrolled scheme member amount to about HK\$72,000 as at 31 March 2006. The average impact of the levy on each per enrolled scheme member is therefore only about HK\$22 this year.

RECOMMENDATION

11. In the light of prevailing factors, we consider it prudent to retain the current levy rate of 0.03%. While doing so, we are mindful of the need to continue to keep the issue under constant review so as to ensure

¹ “Special voluntary contribution” arrangements allow an employee to directly make voluntary contributions to an MPF scheme of his own choice. These special voluntary contributions are remitted to the trustee by the employee, without going through his employer. The making of contributions and withdrawal of benefits under such an arrangement are not tied to the employee’s employment. Arrangement details vary among trustees and depend solely on the terms and conditions of the scheme.

that the cost impact of the levy is minimised whilst the reserve of the Compensation Fund is kept at an optimum level. In this connection, we propose that the issue be reviewed again in 36 months' time.

Mandatory Provident Fund Schemes Authority
June 2006