For discussion on
8 April 2008

LEGISLATIVE COUNCIL PANEL ON FINANCIAL AFFAIRS

Increasing Employees' Control over Mandatory Provident Fund Investment

Purpose

The paper seeks Members' views on a proposal by the Mandatory Provident Fund Schemes Authority ("MPFA") to increase employees' control over their investment in MPF funds by allowing employees to transfer accrued benefits derived from employee mandatory contributions from the employer chosen scheme to an MPF scheme of their own choice at least once per calendar year.

Background

2. Under the existing MPF system, an employee can choose from the funds offered by the MPF scheme[1] selected by his employer. The employee may also on cessation of employment with his employer open a preserved account to hold all the accrued benefits relating to his past employment(s) in any one of the master trust schemes[2].

3. As part of the MPFA's on-going efforts to enhance the efficiency of the MPF system, the MPFA has examined if there are feasible ways to increase employees' control over their MPF investment. The proposal set out in this paper will be a positive response to the motion passed by the Legislative Council ("LegCo") in June 2007 which inter alia urged that the existing practice of employers selecting the MPF trustees to be changed to allow employees to choose their own MPF trustees for their own contributions.

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[1] The number of constituent funds offered by MPF schemes ranges from 2 to 26. On average, an MPF scheme offers 8 different types of fund choices for selection by scheme members.

[2] Or industry schemes for the catering and construction industries if the employee is eligible to join.

The Proposal

Key Considerations

4. To ensure acceptance of any new arrangement to all key stakeholders viz. the employees, the employers and the trustees, and to facilitate early implementation of the proposed changes, the MPFA has taken into account the following key considerations in formulating its proposal –

(a) the proposal should increase employees' control over their mandatory MPF contributions made during their current employment;

(b) the proposal should not create cumbersome procedures which would significantly add to the administrative burden and operating costs of the stakeholders (including employers and trustees); and

(c) the scope of legislative changes to the Mandatory Provident Fund Schemes Ordinance ("the MPF Ordinance") should be minimized.

Key Features

5. The MPFA proposes that legislative amendments be made to the MPF Ordinance to allow employees to decide whether they would transfer all accrued benefits derived from their employee mandatory contributions from the relevant employer chosen schemes to an employee's personal account opened in an MPF scheme of their own choice ("the Proposal").

6. Under the Proposal, the MPF Ordinance will be amended to stipulate that an employee may on a lump-sum basis transfer all the benefits derived from his employee mandatory contributions to an MPF scheme of his own choice at least once a year. It will be a statutory obligation of the trustees to transfer the accrued benefits derived from employee contributions to another scheme as requested by the employees. In this connection, there is already an existing provision in the MPF Ordinance whereby trustees cannot refuse enrolment by employees to set up preserved accounts.

7. The proposed transfer procedures will be very similar to the

existing transfer mechanism upon cessation of employment. The employee would only be required to give a written notice of election (in a standard form) to the transferee trustee concerned. The transferee trustee will then follow up with the transferor trustee to effect the transfer.

8. The Proposal will benefit the employees, whilst avoiding proliferation of transfers and small-balance accounts. The risk of possible errors due to frequent transfers could be minimized.

9. As regards possible transfer fees, there is an existing legislative provision in the MPF Ordinance which stipulates that trustees can only charge the actual and reasonable expenses incurred as a result of redeeming funds in connection with the transfer from a unit trust or similar type of investment and of purchasing units in another such investment (i.e. the bid and offer spread). The same requirement would apply to transfers of employee mandatory contributions under the Proposal[3].

10. As a corollary of the Proposal, the MPFA will rename "preserved accounts" as "personal accounts" which would instill a greater sense of ownership of MPF accounts by the employees. Compared to preserved accounts[4], the definition of personal accounts would be expanded to cover MPF benefits derived from employee contributions made during a member's current employment which are transferred from the relevant employer chosen scheme, as well as MPF benefits derived from the voluntary contributions of the member concerned.

<u>Assessment</u>

11. In terms of the key considerations set out in para. 4 above –

(a) the Proposal would allow employees access to a broader spectrum of MPF service providers, schemes and investment funds for investment of mandatory contributions made by them during their

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[3] Apart from disclosure of transfer fees in accordance with the Code on Disclosure for MPF investment Funds issued by the MPFA, the annual benefit statements sent to scheme members would be enhanced starting from financial periods ending after 1 September 2009 to show the actual amount of fees deducted from members' accounts in respect of each transfer / transaction.

[4] At present, preserved account holds MPF benefits derived from former employment / self-employment and benefits transferred from ORSO schemes.

current employment. Upon implementation, the Proposal will result in around 60% of MPF benefits being portable between trustees;

(b) the proposed new arrangement would not add undue burden on the trustees' administrative duties, whilst the transfer of employee mandatory contributions would not require employers to change their administration system. Same as before, new contributions made by the employer on behalf of both the employer and the employee would continue to be made to the relevant employer chosen scheme; and

(c) taking into account the lead time required by trustees to make necessary adjustments and other preparations e.g. system enhancements and conducting familiarization programs for scheme members, the MPFA hopes that the Proposal would be implemented within one year after completion of the necessary legislative exercise.

Other Alternatives

12. The MPFA has also examined the following alternative arrangements but considered that both are problematic and not recommended -

(a) to allow employees to also transfer all of the accrued benefits derived from employer mandatory contributions under the Proposal; or

(b) in addition, to allow employees to choose the trustees for making contributions in respect of both the employer's and the employee's portions.

MPFA's assessment is set out in the ensuing paragraphs.

(a) Transfer of employer mandatory contribution

13. The arrangement described in para. 12(a) above would place a new

responsibility on an employee to inform his employer of each transfer that involves the employer contributions. On cessation of employment, the employee would also need to notify and provide documentation obtained from his employer to each trustee holding his employer contributions in order for the benefits to be treated as former employment benefits after offsetting of Severance Payment/Long Service Payment (SP/LSP) is completed.

14. Implementation of such arrangement would also substantially slow down the SP/LSP offsetting process. Under the SP/LSP offsetting arrangement, an employer is required to know the whereabouts of the benefits derived from employer contributions and be able to ascertain from the trustees concerned the amount of accrued benefits that could be used to offset SP/LSP. However, if the employer mandatory contribution is allowed to be transferred out of the employer chosen scheme, the employer concerned would no longer be able to trace the whereabout of the said contribution in the absence of an elaborate communication arrangements between the employers and all their employees and trustees concerned, and an accurate account-keeping system for keeping track of all transfers made by his individual employees[5], as there would be no statutory restrictions on further transfers of benefits in an employee's personal account from one scheme to another should the employee prefer another service provider to handle his personal account. Noting that the majority of employers in Hong Kong are running only small to medium sized companies, they would have difficulties in putting together and maintaining such elaborate arrangements.

15. The trustees would also need to revamp their record-keeping systems which would become very complicated. They would need to keep employee contributions and employer contributions in separate sub-accounts under each member's account. For those transferee trustees, they would also need to keep all relevant information pertaining to the employer that is passed from the transferor trustee and to keep track of the movement of the employer contributions.

[5] To reimburse the SP/LSP, an employer would need to first apply to the trustee of the employer chosen scheme for reimbursement. If the accrued benefits in that account are not sufficient to cover the total amount of SP/LSP paid to the member, the employer would need to approach the trustees to whom transfer of employer contributions have been made by the employee. Due to the forward pricing nature of MPF funds, the actual amount of benefits is not known until the investment units are sold. As such, the employer would need to lodge a claim for reimbursement with each trustee in sequence until the full amount of SP/LSP has been offset.

(b) Employees' choice of MPF scheme for making contribution and for transfer of accrued benefits

16. Under the arrangement described in para 12(b), an employee would need to take on the new role as the principal point of liaison between the employer and trustees(s) involved. In particular, the employee would need to keep the employer informed of his personal account to which the mandatory contributions should be made and the whereabouts of the employer contributions for the SP/LSP offsetting purpose.

17. There would also be substantial additional workload on the employers. Apart from the issues raised in paras.13-15 above, an employer would need to work with multiple trustees (up to 19 trustees at present) for payment of the monthly mandatory contributions to the individual accounts of each of his employees as well as other on-going exchanges of relevant information.

18. The above represents a fundamental change to the current set-up of the MPF system. The MPFA is particularly concerned that enforcement of default contribution cases would become substantially more difficult than is the case in the current system which is built around trustees reporting defaults based on a comprehensive set of information obtained from each employer about his employees. The current system allows the MPFA to rely on one trustee's reporting of default contributions to identify a list of employees affected by the employer's default contribution and deal with the employer in relation to all the affected employees in one go. On recovery of arrears, the MPFA can also pass the recovered amount to the trustee concerned for allocating to the relevant individual employee accounts. However, under the arrangement described in para. 12(b), since an employee may request the employer to make contributions to a different scheme at different times, this would increase the risk of false alarms in default contribution reports and thus the MPFA may, as a safeguard measure, have to rely on default contribution reports from more than one trustee so as to identify all the default contribution periods in respect of a single employee. It would then become very difficult and time-consuming for the MPFA to get a full picture of the seriousness of any non-compliance by an employer.

Proposed Way Forward

19. Taking into account all relevant considerations, we agree with the MPFA's assessment that their proposal would present a practicable improvement to the existing arrangement. It would help promote greater market competition which would have a positive effect on keeping fees and charges at a reasonable level.

20. The proposal has been considered and endorsed by the MPF Schemes Operation Review Committee and the MPF Schemes Advisory Committee, both of which are represented by the stakeholders concerned including employer and employee bodies.

21. Subject to Members' views on the proposal, we will proceed with law drafting of the legislative amendments with a view to introducing the bill into LegCo in the next legislative session.

Mandatory Provident Fund Schemes Authority
Financial Services and the Treasury Bureau
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