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Panel on Financial Affairs

Meeting on 6 July 2009

**Background brief on review of the
Mandatory Provident Fund Schemes Compensation Fund**

Purpose

This paper provides background information on the establishment and review of the Mandatory Provident Fund Schemes Compensation Fund (the Compensation Fund). It also summarizes Members' views and concerns on the review.

Background

Establishment of the Compensation Fund

2. The Compensation Fund was 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 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. The claim for compensation shall be determined by the Court of First Instance on the application of the Mandatory Provident Fund Schemes Authority (MPFA).

3. The Compensation Fund was established in 1999 with a one-off grant of HK\$600 million from the Government as seed money. As prescribed under section 188 of the Mandatory Provident Fund Schemes (General) Regulation, the rate of levy payable by the approved trustee of a registered scheme for the purpose of the Compensation Fund is 0.03% of the net asset value of the scheme assets. The levy applies from the commencement of the MPF System in 2000 to build up a reserve of reasonable size for the protection of scheme members' interests.

4. 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. As advised by MPFA, the HK\$900 million level was set arbitrarily, given that there were no such claims in overseas countries and there were no statistics overseas that could be used to estimate the size of the Compensation Fund required.

Review of the Compensation Fund

5. At the meeting of the Panel on Financial Affairs on 3 July 2006, MPFA briefed the Panel on the review on the Compensation Fund. As advised by MPFA, while it was estimated in 1997 that it would take eight to ten years for the compensation Fund to build up the proposed reserve of HK\$900 million, the Fund reached this level on 30 June 2006. The major reason for this development was that the growth of MPF schemes assets had substantially exceeded the initial estimates. In this connection, MPFA had conducted a review of the Compensation Fund, and the findings were as follows:

- (a) As MPF schemes assets had been growing at a significantly faster rate than initially projected, it would be prudent to keep a larger pool of reserves in the Compensation Fund for protection coverage.
- (b) The MPF System was still in a phase of rapid development after implementation for only five years. It would take at least another three to five years to observe the development of the market as well as to refine and improve the System to a more mature stage.
- (c) The Compensation Fund had not received any claim so far. Without any claims experience, there was not sufficient information to build a suitable model to determine the optimum level of the Compensation Fund.
- (d) The levy was an insignificant amount on a per member basis, with an annual average impact of the levy on each enrolled scheme member at about HK\$22 in 2006.

6. In the light of the findings of the review, MPFA considered it prudent to retain the current levy rate of 0.03% and proposed that the issue be reviewed again in 36 months' time.

Members' views and concerns

7. At the Panel meeting on 3 July 2006, some members queried the justifications for the continued collection of levy given that the Compensation Fund had already reached the level of HK\$900 million. Panel members also expressed the following views on the level of the Compensation Fund and collection of levy:

- (a) It was unfair to the registered MPF schemes members if they were required to pay the levy continuously without having a target level of reserves to be maintained for the Compensation Fund.
- (b) Given the expected growth of the asset value of MPF schemes alongside with the development of the MPF System, the size of the Compensation Fund would have to be increased if a certain percentage of the total asset value of MPF schemes had to be maintained.
- (c) MPFA should actively explore and identify objective means of determining the optimum level of the Compensation Fund, preferably with reference to relevant statistics. MPFA should consider pitching the reserves level of the Compensation Fund at a certain percentage of the total asset value of all MPF schemes.

8. Pursuant to the request of Panel members, MPFA undertook to work out a model/mechanism for determining the optimum level of the Compensation Fund and provide a progress report to the Panel in 18 months' time. The progress report provided by MPFA was issued to Panel members in December 2007 (LC Paper No. CB(1)497/07-08(01)).

9. During the scrutiny of the Mandatory Provident Fund Schemes (Amendment) (No.2) Bill 2007, some members of the Bills Committee raised concern about the difficulties in recovering outstanding mandatory contributions owed to employees if the employer companies became insolvent. A member suggested that to better protect the interest of employees, consideration could be given to extending the coverage of the Compensation Fund to include default mandatory contributions when the employer company became insolvent.

Recent development

10. MPFA will brief the Panel on Financial Affairs on the progress of the review of the Compensation Fund at the meeting on 6 July 2009.

Relevant papers

11. The relevant papers are available at the following links:

MPFA's paper for the FA Panel meeting on 3 July 2006
<http://www.legco.gov.hk/yr05-06/english/panels/fa/papers/fa0703cb1-1848-8e.pdf>

Minutes of FA Panel meeting on 3 July 2006 (paragraphs 50 to 67)
<http://www.legco.gov.hk/yr05-06/english/panels/fa/minutes/fa060703.pdf>

The MPFA's progress report on review of the Compensation Fund
<http://www.legco.gov.hk/yr05-06/english/panels/fa/papers/fa0703cb1-497-1-e.pdf>

Report of the Bills Committee on Mandatory Provident Fund Schemes
(Amendment) (No. 2) Bill 2007
<http://www.legco.gov.hk/yr07-08/english/bc/bc03/reports/bc030618cb1-1834-e.pdf>

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