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Panel on Financial Affairs

Meeting on 1 December 2008

**Background Brief on
Enhancing employee control over Mandatory Provident Fund investment –
proposed legislative amendments**

Purpose

This paper sets out the background of the proposal of increasing employees' control over Mandatory Provident Fund (MPF) investment. It also summarizes the views and concerns expressed by Members in respect of the proposal at previous meetings of the Legislative Council (LegCo) and its committees.

Background

2. The Mandatory Provident Fund Schemes Ordinance (Cap. 485) (MPFSO) was enacted in 1995 to provide a statutory framework for the establishment of mandatory, privately managed retirement schemes for the retirement protection of the general workforce. It is supplemented by subsidiary legislation passed in 1998, 1999 and 2000. The MPF System was launched in December 2000. The MPF System is subject to review from time to time to ensure that it continues to serve the needs of existing and potential scheme members. For this purpose, the Mandatory Provident Fund Schemes Authority (MPFA) set up the MPF Schemes Operation Review Committee (the Review Committee) in August 2001¹.

3. Under the existing MPF System, an employee can choose from the funds offered by the MPF scheme 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. The employees, however, are not allowed to choose the MPF scheme for the accrued benefits derived from their contributions. This has

¹ The Review Committee comprises representatives of employer and employee bodies, MPF service providers, professional organizations, the Government and MPFA.

given rise to concern about the rights of employees to control the accrued benefits derived from MPF contributions to enhance retirement protection, particularly in light of the high management fees and unsatisfactory investment returns.

4. Based on the recommendations of the Review Committee, the Administration has introduced amendments to MPFSO to improve the operation and enforcement of the MPF System. The Mandatory Provident Fund Schemes (Amendment) Bill 2007 and the Mandatory Provident Fund Schemes (Amendment) (No.2) Bill 2007 were passed in January 2008 and June 2008 respectively. Among other issues of concerns raised during the scrutiny of the legislative amendments, Members have expressed concern about the need to allow employees to choose their preferred MPF trustees. Members have been advised that MPFA has completed consultation with the industry and relevant stakeholders on the development of a proposal to increase employees' control over their MPF investment.

5. On 27 June 2007, a motion on "Lowering the Mandatory Provident Fund management fees" moved by Hon Miriam LAU as amended by Hon SIN Chung-kia and Hon Andrew LEUNG was passed. Amongst other measures to lower the MPF management fees and improve the investment returns, the Council urged the Administration to allow employees to choose their own MPF trustees for their own contributions. The wording of the motion passed is at **Appendix I**.

The proposal to increase employees' control over MPF investment

Key considerations

6. In developing the current proposal to increase employees' control over MPF investment, MPFA has taken into account the following key considerations to ensure acceptance of any new arrangement by key stakeholders and to facilitate early implementation of the proposed changes –

- (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 MPFSO should be minimized.

Key features

7. MPFA proposes that legislative amendments be made to MPFSO 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 in an MPF scheme of their own choice (the Proposal). According to the Administration, the Proposal has been considered and endorsed by the Review Committee and the MPF Schemes Advisory Committee (the Advisory Committee). The key features of the Proposal are as follows-

- (a) 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 year². 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.
- (b) 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.
- (c) The same requirement under the existing legislative provision 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, would apply to transfers of employee mandatory contributions under the Proposal.
- (d) MPFA will rename "preserved accounts" as "personal accounts" which will instill a greater sense of ownership of MPF accounts by the employees. The definition of personal accounts will 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.

Alternative arrangements examined

8. In formulating the Proposal, MPFA has examined the following options-
- (a) to allow employees to also transfer all the accrued benefits derived from employer mandatory contributions from the employer-chosen schemes to MPF schemes of their own choice; or
 - (b) to allow employees to choose the trustees for making contributions in respect of both the employers' and the employees' portions.

² Trustees are at liberty to provide more flexible services to their scheme members by allowing transfer more frequently than once a year in their schemes rules.

9. According to MPFA's assessment, both alternatives will increase the complexity of the offsetting of Severance Payment (SP) and Long Service Payment (LSP), and will need to impose an obligation on the employees to keep their employers informed of all transfers of the employers' portion of mandatory contributions. Alternative (a) will require more record keeping by employers and trustees. Alternative (b) will bring about a fundamental change to the MPF System, increase the workload of employers substantially, and make enforcement of default contributions by MPFA more difficult, more costly and less effective.

Major views and concerns expressed by Members

10. The Administration and MPFA briefed the Panel on Financial Affairs (the FA Panel) on the Proposal at the meeting on 8 April 2008. The FA Panel discussed the Proposal again on 30 June 2008 and received views from the public and relevant stakeholders. The views and concerns expressed by Members are summarized in the following paragraphs.

Merits of the Proposal

11. At the FA Panel meeting, some Members expressed dissatisfaction about the Proposal as it would not give the employees full control of their MPF investment. They were of the view that employees should be allowed to transfer all the accrued benefits derived from both the employer and employee mandatory contribution to MPF schemes of employees' own choice.

12. Some other Members supported the Proposal and considered it a pragmatic approach which could balance the interests of different stakeholders. These Members considered that a fair and reasonable proposal should take into account both the demand of employees to increase control over their MPF benefits and the right of employers to offset SP/LSP with the accrued benefits attributable to the employer mandatory contributions. There was also the view that if alternatives to allow employees full control of their MPF investment would increase the complexity of offsetting SP/LSP, the offsetting arrangement should be abolished altogether.

Fees and charges of MPF funds and management of accounts

13. Some Members opined that as individual employees might not possess the expertise and the bargaining power in negotiating with scheme trustees the terms and fees of MPF funds, allowing employees full control of their MPF investment might not necessarily increase investment returns or drive down fees of MPF funds. If an employee chose to invest all the contributions in highly risky investment and sustained losses, employers would have to top up the shortfall in the offsetting of SP/LSP.

14. Some other Members recalled that one of the major reasons underlying the proposal to increase employees' control over their MPF investment was the need to lower exorbitant fees and charges of MPF funds. They were concerned

whether this intended purpose could be achieved through the Proposal. Noting the new portable personal accounts to be created under the Proposal, a Member called on MPFA to require scheme trustees to facilitate scheme members' checking the account balance by using account passbooks.

Latest position

15. The Proposal is included as one of the initiatives in the Chief Executive's 2008-2009 Policy Address. A Member reiterated the request for giving employees full control over their MPF investment during the policy briefing for the FA Panel on 17 October 2008. The Administration is drafting the legislative amendments in relation to the Proposal. It will consult the FA Panel on the proposed legislative amendments at the meeting on 1 December 2008.

Relevant papers

16. A list of relevant papers is at **Appendix II**.

Council Business Division 1
Legislative Council Secretariat
26 November 2008

(Translation)

**Motion on
“Lowering the Mandatory Provident Fund
management fees”
moved by Hon Miriam LAU Kin-ye
at the Legislative Council meeting
of Wednesday, 27 June 2007**

**Motion as amended by Hon SIN Chung-kai and Hon Andrew LEUNG
Kwan-yuen**

“That, in view of the current relatively high management fees charged under the Mandatory Provident Fund (MPF) schemes and their less than satisfactory investment returns, this Council urges the Government to immediately adopt relevant measures and create favourable conditions, including changing the practice of employers selecting the MPF trustees to allowing employees to choose their own MPF trustees for their own contributions, and adding new provisions to the Code on Disclosure for MPF Investment Funds to require MPF trustees to further disclose the levels of fees and charges for various constituent funds, so as to promote competition in the MPF management market and facilitate comparison by employees participating in the MPF schemes, thereby effectively lowering the management fees of the MPF schemes, and appropriately increase the variety and flexibility of their investments as well as strengthen the monitoring of their investment performance, with a view to preventing the erosion of the hard-earned money contributed to the MPF by both employees and employers, and enhancing the effectiveness of the MPF in providing protection to employees’ retirement life.”

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proposed legislative amendments**

List of relevant papers

| Committee | Paper | LC Paper No. |
|--|---|--|
| Council Meeting on 27 June 2007 | ✧ Motion on "Lowering the Mandatory Provident Fund management fees" (Hansard, page 301 to 375) http://www.legco.gov.hk/yr06-07/english/counmtg/hansard/cm0627-translate-e.pdf | -- |
| Meeting of the Panel on Financial Affairs (the FA Panel) on 8 April 2008 | ✧ Administration/Mandatory Provident Fund Schemes Authority's paper on increasing employees' control over Mandatory Provident Fund investment http://www.legco.gov.hk/yr07-08/english/panels/fa/papers/fa0408cb1-1163-4-e.pdf ✧ Minutes of meeting (paragraphs 22 to 44) http://www.legco.gov.hk/yr07-08/english/panels/fa/minutes/fa080408.pdf | CB(1)1163/07-08(04) CB(1)1381/07-08 |
| Meeting of the FA Panel on 30 June 2008 | ✧ Minutes of meeting (paragraphs 1 to 32) http://www.legco.gov.hk/yr07-08/english/panels/fa/minutes/fa080630.pdf | CB(1)2317/07-08 |
| Meeting of the FA Panel on 17 October 2008 | ✧ Administration's paper on policy initiatives of the Financial Services and the Treasury Bureau (paragraphs 28-30) http://www.legco.gov.hk/yr08-09/english/panels/fa/papers/fa1017cb1-53-1-e.pdf | CB(1)53/08-09(01) |