

**立法會**  
**Legislative Council**

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**Panel on Financial Affairs**

**Meeting on 7 July 2014**

**Background brief on Mandatory Provident Fund  
core fund proposal**

**Purpose**

This paper provides background information on the core fund proposal developed by the Mandatory Provident Fund Schemes Authority ("MPFA") for the Mandatory Provident Fund ("MPF") system, and summarizes the major concerns and views expressed by Members on related issues during relevant discussions at meetings of the Legislative Council ("LegCo") and its committees during the legislative sessions of 2012-2013 and 2013-2014.

**Background**

Measures to reduce MPF fees

2. Since implementation of the MPF system in 2000, there have been comments and criticisms from the public about the high level of fees. In 2004, MPFA introduced the fund expense ratio to provide a single indicator disclosed for all MPF funds, aggregating fees and other expenses charged to MPF funds and underlying investments.

3. In December 2011, MPFA engaged an independent consultancy firm to conduct a detailed study on the costs incurred by trustees in performing different MPF scheme administration functions ("the Cost Study"). The consultancy report released in November 2012 identified a number of factors contributing to the higher administration costs of the MPF system compared

with those of selected international pension systems (Australia, Chile, Mexico and the United States), including a higher percentage of manual and paper-based administration processing, process complexity, small scale of assets under management, as well as insufficient industry cooperation and pricing competition.

4. In response to the recommendations in the Cost Study, MPFA has adopted short to medium term measures to drive down MPF fees, including (a) urging trustees to provide various types of low-fee funds for each scheme and to promote these funds; (b) facilitating trustees in further automating and streamlining their administration processes, merging smaller scale or less efficient schemes/funds; (c) facilitating scheme members in consolidating their personal accounts; and (d) promoting index funds in the constituent fund approval process. MPFA also recommended the Government to make fundamental changes to improve the MPF system. Options that could be further explored included providing low-fee funds in all MPF schemes, considering the possibility of introducing a not-for-profit operator to operate a simple and low-fee MPF scheme (a public trustee), reviewing the feasibility of imposing a cap on fund fees, and providing a type of basic, low-fee, default fund arrangement.

#### Approval of MPF schemes and constituent funds

5. Pursuant to the Mandatory Provident Fund Schemes Ordinance (Cap. 485), new MPF schemes and constituent funds requires approval of MPFA. MPFA currently approves new funds only if applicants can demonstrate that the new addition is in scheme members' interests. MPFA will take into account factors such as whether the fund is sufficiently diversified and not having an excessively narrow focus on certain markets or industries, and fee levels.

6. The Mandatory Provident Fund Schemes (Amendment) Bill 2014 was introduced into LegCo in June 2014 to, amongst others, enhance MPFA's powers to approve constituent funds, i.e. to provide MPFA a clear legal basis to refuse applications for new MPF schemes and funds where the applicant cannot satisfy MPFA that the approval would be in the interests of scheme members. The Bill also includes a number of amendments to provide greater scope for fee reduction by trustees<sup>1</sup>.

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<sup>1</sup> Including amendments to facilitate the use of electronic means of communication (e.g. allowing electronic means for giving or sending of prescribed documents between trustees and scheme members) and removing overlapping or unnecessary certification requirements (e.g. combining the membership certificate with the notice of acceptance to scheme members).

## **Development of a core fund as a default fund in a MPF scheme**

7. Under the MPF system, if a scheme member does not select funds for investment, the scheme trustee will, by default, invest the scheme member's contributions in one or more of the funds as specified in scheme rules. At present, different MPF schemes have different default arrangements/default funds, and their risk and investment outcomes differ significantly. In connection with the Cost Study, MPFA has recommended to the Government the proposal to provide a basic, low-fee, default fund arrangement with a view to driving down MPF fees. For those employees who currently do not specify their investment options in the respective MPF schemes, the proposed fund will improve the default arrangements in the MPF system, with a view to facilitating MPF scheme members to make investment choices in MPF funds.

8. According to the Administration, the default/core fund will be designed with a long-term investment perspective and an investment strategy which balances investment risk and return over the long term, by using for instance, mixed asset funds or life-cycle/target-date funds. Fees of the fund will be controlled and monitored. The Administration will take into consideration factors such as the types of low-fee funds to be provided, benchmark for standardizing the provision if necessary, and the age of scheme members when determining the core fund proposal.

## **Discussions by Members on related issues**

### Meetings of the Panel on Financial Affairs and Finance Committee

9. The Administration/MPFA briefed the Panel on Financial Affairs ("FA Panel") the results of the Cost Study and MPFA's proposed reform directions to lower MPF fees at the meeting on 7 January 2013. Issues relating to reduction of MPF fees and the core fund proposal were also discussed at meetings of the FA Panel on 29 January 2014, and at the special meetings of the Finance Committee on 8 April 2013 and 31 March 2014 for the examination of the Estimates of Expenditure 2013-2014 and 2014-2015 respectively. The major views and concerns expressed by Members at these meetings are summarized in the ensuing paragraphs.

10. Noting that there have been concerns from the community about the high fees and low investment returns of MPF schemes, Members generally supported MPFA's proposed reform directions to improve the MPF system fundamentally and lower MPF fees.

### *Introducing the core fund*

11. Members expressed concerns whether the proposed core fund would help reduce MPF fees and ensure stable returns for MPF investment. There was a view that the returns from a basic, low-fee core fund in the MPF system might not be better than placing fixed deposits at banks. Members also enquired about the principles to be adopted for setting fee ceilings for the core fund and whether the fund would be operated by the Government (e.g. Hong Kong Monetary Authority ("HKMA")) or the industry.

12. The Administration advised that the preliminary thinking was that each MPF scheme would be required to include a core fund as the default fund which would make long-term and diversified investment that balanced investment risks and returns. The major purposes of the core fund proposal were to enhance transparency of operation of MPF schemes to facilitate scheme members in making investment choices suitable for their needs, as well as highlight to them the importance of making long-term investments instead of short-term returns under the MPF system. The Administration considered that the standardized arrangement of the core fund would enhance market competition as well as facilitate fee control. The public would be consulted on the core fund proposal and its fee control mechanism.

### *MPF investment*

13. With a view to lowering MPF fees and improving investment returns, Members have suggested the Administration to consider entrusting HKMA to act as a public trustee and take up the investment of all MPF funds, and providing Exchange Fund ("EF")-linked MPF products for selection by scheme members. Other suggestions included mandating the MPF core fund to invest in public debts, stepping up the promotion of index funds taking into account their lower administration cost and fees, mandating trustees to provide lower risk funds like the Tracker Fund of Hong Kong, as well as providing scheme members with the choice to put their MPF accrued benefits on bank deposits.

14. The Administration pointed out that there were a number of factors relating to system features and industry practices that had contributed to the relatively high fees under the MPF system of Hong Kong (e.g. large number of trustees and schemes, and complex operation of the MPF system). Hence, focus should be placed on improving the system in these areas instead of mandating a particular investment tool for MPF schemes. Regarding the suggestion for HKMA to take up the role of a public trustee, the Administration explained that HKMA was responsible for maintaining currency stability and integrity of the financial system of Hong Kong, and the suggestion could undermine HKMA in discharging its statutory functions.

The Administration further pointed out that the industry could make reference to HKMA's investment strategies and EF's investment portfolio in devising similar MPF products.

15. On the promotion of index funds, the Administration advised that since 2011, MPFA has been promoting index funds in the constituent fund approval process. For every application for approval of launching a new constituent fund, the applicant was required to provide reasons as to why the index fund option was not used for obtaining the proposed investment exposure. The Administration would also study the role of index funds in the design of the core fund arrangement.

*Fee control on MPF funds*

16. As regards imposing fee control on MPF funds, while some Members supported the proposal, some Members expressed reservation and considered that attempts should first be made to enhance automation in the management of MPF funds and streamline the administration processes so as to reduce administration costs and drive MPF fees down. The consultation on proposal to cap MPF fees should not be undertaken prematurely lest it might give the wrong impression that a fee cap would be a panacea for solving all problems associated with the MPF system. Moreover, capping MPF fees could dampen the incentive of the industry and other stakeholders to reduce fees through other means.

17. The Administration advised that the complicated administration processes and overlaps in the MPF schemes/funds were among the major reasons contributing to the high MPF fees. The Administration was working closely with MPFA and the industry in implementing various measures to streamline operation of the MPF system. Given the complexity of the existing MPF system, it would take time for these measures to take effect and it would be difficult to predict when MPF fees could be reduced. The fee cap proposal which was a fundamental and long-term measure for achieving reduction in MPF fees should be considered in parallel as an alternative in case of market failure. The Administration would assess the effectiveness of the measures and monitor market developments before considering the next step forward.

18. The Administration further pointed out that the proposal of imposing fee control on the core fund was expected to be controversial and extending the proposal to other MPF funds would likely arouse more controversies. Given that the design of MPF funds varied widely as compared to the core fund, there would be practical difficulties in extending the fee control proposal to non-core funds. Hence, the Administration would focus on the core fund proposal first and review the option of fee capping for other MPF

funds in the light of implementation of the core fund proposal and when the market failed in lowering MPF fees.

### Council meetings

19. At the Council meeting of 1 December 2010, Members passed a motion on "Comprehensively reviewing the Mandatory Provident Fund Scheme" which urged the Government to review the MPF scheme covering aspects including to lower MPF management and administration fees, allow full portability of MPF benefits, and implement universal retirement protection, etc. Another motion on "Comprehensively reforming the Mandatory Provident Fund Scheme" was passed at the Council meeting of 2 November 2011 urging the Government to conduct a comprehensive review of the MPF scheme and examine the feasibility and impact of measures, including to press MPF scheme trustees to lower their fees, enact legislation to specify fee ceilings for different types of investment funds and fee types, require MPF scheme trustees to provide contributors with products resembling bank deposits that charged no management fees, and introduce fund products operated by the Government at low management fees, etc.

### **Latest Development**

20. On 24 June 2014, the Administration and MPFA launched a public consultation on the proposal to enhance the regulation of default arrangements in MPF schemes by introducing a "core fund" as the standardized low fee default fund of all MPF schemes which will be subject to fee control. The Panel will be consulted on the core fund proposal at the meeting on 7 July 2014.

### **Relevant papers**

21. A list of relevant papers is in the **Appendix**.

Council Business Division 1  
Legislative Council Secretariat  
4 July 2014

List of relevant papers

Date	Event	Paper/Minutes of meeting
11 November 2009	Council meeting	<p>Written question raised by Hon Federick FUNG on "Review of the Mandatory Provident Fund Scheme"</p> <p><a href="#">Hansard</a> (pages 152 – 155)</p>
1 December 2010	Council meeting	<p>Motion on "Comprehensively reviewing the Mandatory Provident Fund Scheme" moved by Hon WONG Kwok-kin</p> <p><a href="#">Hansard</a> (pages 136 – 234)</p>
2 November 2011	Council meeting	<p>Motion on "Comprehensively reforming the Mandatory Provident Fund Scheme" moved by Hon TAM Yiu-chung</p> <p><a href="#">Hansard</a> (pages 251 – 319)</p>
6 June 2012	Council meeting	<p>Written question raised by Hon Paul TSE on "Charging rates of Mandatory Provident Fund Schemes"</p> <p><a href="#">Hansard</a> (pages 140 – 143)</p>
7 January 2013	Meeting of the Panel on Financial Affairs ("FA Panel")	<p><a href="#">Administration's paper</a> (LC Paper No. CB(1)358/12-13(03))</p> <p><a href="#">MPFA's paper</a> (LC Paper No. CB(1)358/12-13(09))</p> <p><a href="#">Minutes</a> (LC Paper No. CB(1)782/12-13) (paragraphs 16 to 45)</p>

<b>Date</b>	<b>Event</b>	<b>Paper/Minutes of meeting</b>
8 April 2013	Special meeting of Finance Committee ("FC") for examination of Estimates of Expenditure 2013-2014	<a href="#">Minutes</a> (paragraphs 3.4-3.5)
6 November 2013	Council meeting	Written question raised by Hon CHAN Kin-por on "Measures to improve MPF Scheme"  <a href="#">Hansard</a> (pages 100 – 104)
31 March 2014	Special meeting of FC to examine the Estimates of Expenditure of 2014-2015	<a href="#">Written questions raised by Members and Administration's replies for the session on "Financial Services"</a> (Reply serial numbers: FSTB(FS)007, 008, 025, 044, 050, 097 and 118)
24 June 2014	The Mandatory Provident Fund Authority launched a public consultation on "Providing Better Investment Solutions for MPF Members"	<a href="#">Press release</a>  <a href="#">Consultation paper</a>