

**立法會**  
***Legislative Council***

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**Panel on Financial Affairs**

**Meeting on 6 July 2015**

**Background brief on Mandatory Provident Fund Core Fund**

**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 at meetings of the Legislative Council ("LegCo") and its committees during the legislative sessions of 2012-2013 to 2014-2015.

**Background**

2. The MPF system was implemented in December 2000 as a mandatory, privately-managed, defined contribution, employment-based and fully-funded pension system. Since its implementation, there have been comments and criticisms from the public about the high level of MPF fees. In 2004, MPFA introduced the fund expense ratio ("FER") 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 commissioned an independent consultancy 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). These factors included 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. In response to the recommendations in the Cost Study, MPFA adopted a range of short to medium term measures to drive down MPF fees<sup>1</sup>. Furthermore, the Mandatory Provident Fund Schemes (Amendment) Ordinance 2015 was enacted by LegCo on 21 January 2015. The purposes of the Amendment Ordinance, among others, are to enhance the powers of MPFA to approve constituents funds ("CF") and facilitate trustees' compliance with statutory obligations to provide greater scope for MPF fee reduction.

### **MPFA's proposal to develop a core fund as a default fund in an MPF scheme**

4. Under the existing arrangements of 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 the Government to consider the proposal requiring all MPF schemes to offer the same type of low-fee investment fund or funds, i.e. the core fund.

5. On 24 June 2014, the Government and MPFA jointly published a consultation paper on "Providing Better Investment Solutions for MPF Members" and launched a three-month consultation to seek views from the public and the industry on the details of the core fund proposal. The major features of the core fund arrangement are highlighted below –

- (a) design of the core fund will be based on a standardized default fund. The contributions of scheme members who have not made a choice will be invested in the core fund automatically;
- (b) investment approach of the core fund is to balance long-term risks and returns in a manner appropriate for retirement savings. A "life cycle" or "target date" investment approach that reduces exposure to risky assets in the period before a member reaches the age of 65 may be adopted;

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<sup>1</sup> The measures include (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, and 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.

- (c) core fund will be subject to fee control. The fees for the core fund should be 0.75% of assets under management ("AUM") per annum or less. This fee level should be reduced further over the longer term. The use of passive investment strategies will help make low cost and low fee outcomes more achievable;
- (d) all MPF scheme members are free to choose the core fund, if they consider that the investment strategy and the low fees of the core fund suit their personal needs; and
- (e) the core fund should be operated by the market instead of a public trustee operated by the Government, a public organization or a non-profit-making organization.

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

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

6. The Government and 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, and further consulted FA Panel on the core fund proposal on 7 July 2014. Issues relating to the core fund proposal were also discussed at meetings of FA Panel on 29 January 2014, and at the special meetings of the Finance Committee on 8 April 2013, 31 March 2014 and 30 March 2015 for the examination of the Estimates of Expenditure 2013-2014, 2014-2015 and 2015-2016 respectively. The major views and concerns expressed by Members at these meetings are summarized in the ensuing paragraphs.

#### *Introducing the core fund*

7. Some Members were concerned that the core fund proposal could not address the problem of continued increase in MPF fees. They questioned whether the yield from a basic, low-fee core fund could be better than the interest return from fixed deposits placed with banks. There was also concern about how the availability of the core fund could offer a genuine additional choice for scheme members.

8. The Government advised that the preliminary proposal was to require each MPF scheme to include a core fund as the default fund which would make long-term and diversified investment with the aim to balance 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 standardized arrangement of the core fund would enhance market competition as well as facilitate fee control.

*Operator of the core fund*

9. Some Members considered that it might not be necessary for every trustee to operate a core fund as various MPF schemes might share the same core fund. The Government should also explore inviting MPF trustees to operate a central core fund through tender. On the other hand, some Members suggested that the Government should consider introducing a public trustee (e.g. the Hong Kong Monetary Authority ("HKMA") or a non-profit making organization) to operate the core fund. They pointed out that a core fund operated by a public trustee would have benefits including lower fees and better protection of scheme members' interests. They further noted that collaboration between the public and private sectors in setting up public trustees had been successful in some overseas pension systems. However, some other Members took the view that even if the core fund was operated by the Government or a public trustee, administrative costs would still be incurred and the fee level might not necessarily be lower than those charged by private trustees.

10. The Government stressed that similar to other CFs under MPF schemes, the core fund should be operated by the market. The suggestion of operating the core fund through a public trustee would require the establishment of a new operating system and replication of the administrative tasks handled by private trustees, and would involve a long period of preparation and development. The Government emphasized that the core fund proposal was not meant to be an ultimate solution for resolving all issues related to the MPF system. As such, the Government and MPFA would continue to implement other measures to enhance the MPF system.

11. As regards Members' suggestion for HKMA to take up the role of a public trustee, the Government explained that HKMA was responsible for maintaining currency stability and integrity of the financial system of Hong Kong. The suggestion could undermine HKMA's capability in discharging its statutory functions.

*Fee control for the core fund*

12. Some Members considered that the proposed fee cap for the core fund at 0.75% of AUM per annum was on the high side as compared to those of other pension systems, and enquired if the cap could be further lowered.

Some other Members however pointed out that MPF funds with low FERs were already available in the market. The Government should study why scheme members did not choose these low-fee funds before introducing a fee cap for the core fund. They also stressed the need for the Government and MPFA to strengthen public education on fee issues relating to the MPF system so as to enhance public understanding. For instance, the fees of the pension systems of some overseas jurisdictions were much lower because they had been operating for a much longer period and enjoyed a greater economy of scale due to the substantial fund size accumulated. It would be inappropriate to make a direct comparison between the MPF system of Hong Kong and the more mature pension schemes overseas.

13. The Government advised that the fees of less than 20 existing approved CFs (out of some 477 approved CFs as at July 2014) were lower than 0.75% of AUM. Therefore, setting the fee cap at 0.75% of AUM with the expectation that FER for the core fund would be under 1% in the medium term was already an aggressive proposal. It was envisaged that the fee level would be reduced further over the longer term. As regards the principles to be adopted for setting fee ceilings for the core fund, the Government advised that the public would be consulted on the core fund proposal and its fee control mechanism.

#### *Investment strategy for core fund*

14. In response to some Members' concern about the complicated operation of the proposed life cycle/target date approach, MPFA advised that there was established methodology in the industry to operate pension funds that automatically reduced risks over time in accordance with scheme members' age. This approach had fewer drawbacks as compared with other investment approaches in terms of cost and operation.

15. During past discussions, there were suggestions from Members for the Government to mandate CFs and core fund of MPF schemes to invest in instruments such as iBonds, bonds issued by large corporates (e.g. bonds to be issued the Airport Authority Hong Kong to finance the three-runway system), Exchange Fund-linked investment products ("EF-linked investment products"), and fixed bank deposits (in particular for scheme members approaching retirement age), etc. Members were of the view that these investment products, which involved relatively lower risks and lower administrative fees, as well as more stable investment return, would generate better accrued benefits for scheme members.

16. The Government advised that a host of factors relating to system features and industry practices 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, the focus should be placed on improving the system in these areas instead of mandating a particular investment tool for MPF schemes. Moreover, it should be for the MPF trustees and fund managers to consider the components of CFs and core fund. MPFA opined that the core fund should not adopt the most conservative investment approach, and the optimal approach should have regard to the need to balance long-term risks and returns in a manner appropriate for retirement savings, and operational efficiency compared to other options. As regards returns for EF-linked investment products, the Government pointed out that as the primary objective of EF was to provide full backing to the Monetary Base and stabilize the Hong Kong Dollar, its investment portfolio was unique with heavy investment in bonds. EF-linked investment products might not necessarily guarantee good returns. Nonetheless, trustees could offer MPF funds that mirrored the investment strategies of EF. It was observed that there were MPF products in the market with investment exposure mainly to bonds.

### Council meetings

17. At the Council meeting of 1 December 2010, Members passed a motion on "Comprehensively reviewing the Mandatory Provident Fund Scheme" which called on 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**

18. The consultation conclusions on the core fund proposal were released in March 2015. The Government and MPFA will brief FA Panel on the consultation results and the way forward at the meeting on 6 July 2015. The Government's target is to introduce the relevant Bill into LegCo in the 2015-2016 session. Subject to the progress of the legislative processes and the preparation work, it is anticipated that the core fund proposal will be implemented by the end of 2016.

**Relevant papers**

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

Council Business Division 1  
Legislative Council Secretariat  
30 June 2015

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>



Date	Event	Paper/Minutes of meeting
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 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 ("MPFA") launched a public consultation on "Providing Better Investment Solutions for MPF Members"	<a href="#">Press release</a>  <a href="#">Consultation paper</a>
7 July 2014	Meeting of the FA Panel	<a href="#">Administration's paper</a> (LC Paper No. CB(1)1668/13-14(06))  <a href="#">Minutes</a> (LC Paper No. CB(1)1998/13-14) (paragraphs 57 to 76)
21 January 2015	The Legislative Council passed the Mandatory Provident Fund Schemes (Amendment) Bill 2014	<a href="#">Hansard</a> (page 4894 - 4991)  <a href="#">The Bill passed</a>  <a href="#">Report of the Bills Committee</a> (LC Paper No. CB(1)444/14-15)

<b>Date</b>	<b>Event</b>	<b>Paper/Minutes of meeting</b>
12 March 2015	MPFA released the consultation conclusions of the public consultation on "Providing Better Investment Solutions for MPF Members"	<a href="#">Press release</a> <a href="#">Consultation conclusions</a>
30 March 2015	Special meeting of Finance Committee ("FC") for examination of Estimates of Expenditure 2015-2016	<a href="#">Written questions raised by Members and Administration's replies for the session on "Financial Services"</a> (Reply serial numbers: FSTB(FS)019, 040, 084 and 110)