



吳亮星議員，銀紫荊星章、太平紳士
Hon. NG Leung Sing, SBS, JP

3rd Feb 2016

Hon TAM Yiu-chung, GBS, JP
Chairman
Mandatory Provident Fund Schemes (Amendment) Bill 2015

Dear Hon TAM

Comments on Mandatory Provident Fund Schemes (Amendment) Bill 2015

I have pleasure to attach herewith a letter from the Hong Kong Association of Banks relaying the comments from one of its members on the Mandatory Provident Fund Schemes (Amendment) Bill 2015.

Thank you for your attention.

Yours sincerely,

NG Leung-sing, SBS, JP

Encl.



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2 February 2016

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Hon. Ng Leung Sing, SBS, JP
Legislative Councillor (Finance)
Room 704, Legislative Council Complex
No. 1 Legislative Council Road
Central

Dear Hon. Ng

Mandatory Provident Fund Schemes (Amendment) Bill 2015

We have been asked by a member bank to convey to you its enclosed comments in relation to the captioned Bill for your perusal. Your attention in this regard is highly appreciated.

Yours sincerely

Doris Ma
Secretary

Enc.

Chairman Standard Chartered Bank (Hong Kong) Ltd
Vice Chairman Bank of China (Hong Kong) Ltd
The Hongkong and Shanghai Banking Corporation Ltd
Secretary Doris Ma

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Mandatory Provident Fund Schemes (Amendment) Bill 2015

Concerns and risks relating to the proposed opt-out approach for DIS

Executive Summary

Whilst we are supportive of the proposal overall in the Mandatory Provident Fund Schemes (Amendment) Bill 2015 (the “Bill”) with the introduction of a standardized Default Investment Strategy (“DIS”), we do have a concern with the “Opt-Out” approach (see below) that is being proposed, which involved transferring defaulted members’ pre-existing accrued benefits without their explicit consent to the new DIS arrangement. This may potentially lead to negative outcome for these members and therefore subsequent complaints, potentially harming the reputation of MPF system with a knock-on impact to the banking industry in Hong Kong, particularly for those who have been distributing MPF products. We recommend instead an alternative “Opt-In” approach where the Defaulters’ accrued benefits will continue to be invested in their existing funds after the implementation of the new DIS unless they have explicitly expressed that they would like to transfer their accrued benefits to the new DIS to avoid these issues.

Background

Under the current draft of the Bill, a standardized Default Investment Strategy (“DIS”) will be implemented across the whole MPF industry, which involved investments in funds that may have a high equity content (up to 60%, depending on their age profile). Members who do not elect their investment choices related to their MPF schemes (the “Defaulters”) will be subject to the DIS arrangement. Such members form a significant portion (~20%) of the entire MPF population in Hong Kong.

Currently, whilst different MPF providers in the market may have different default investment arrangements for such Defaulters, these arrangements are typically invested into low-risk asset classes such as money market funds, conservative funds, guaranteed fund etc. Most of these current default funds also have a management fee that is lower than the proposed annual fee cap of 0.75% for the DIS.

The Bill also sets out the transitional arrangement for the Defaulters, as set out in Sections 34DE to 34DL of the Bill (see Appendix A). In summary, under the proposed transitional arrangement, MPF trustees are required to identify the Defaulters in their schemes, **and have their accrued benefits automatically transferred to the DIS arrangement upon the implementation of DIS, unless the member explicitly expresses his / her wish not to have his / her benefits invested in the DIS arrangement.** Their future contributions will also be invested in accordance with the new DIS, instead of the existing default arrangement.

This approach is referred in the industry as the “Opt-Out” approach. If the Bill is passed in its current form, i.e. with the Opt-Out approach, we foresee members may complain about this arrangement even if this is written explicitly in the legislation, for the reasons as set out in the rest of this paper.

Main concerns over the Opt-Out approach and potential negative impact to the members

Our main concerns over the Opt-Out approach are based on:

- Best interests of the members;
- Potential losses that members may incur during and after the transition;
- Effectiveness of the communication to Defaulters.

More details are provided below.

Best interests of the members

One of the main concerns on the “Opt-out” approach is that members can have their accrued benefits moved from an existing investment fund to the DIS arrangement without their explicit consent (or even prior knowledge if the member has not received or read the communication materials that the MPF providers will be sending to them).

As a result of this, member's accrued benefits may end up being invested in a fund which is exposed to a higher-risk and/or with higher fees than their current default arrangement (e.g. when their funds are transferred from a money-market fund (low risk & low fees) to DIS (higher risk and likely to be higher fees than money-market funds and conservative funds as DIS can have up to 60% in equities).

Furthermore, these members may have been happy with the low-risk default funds that they are currently investing in and moving them to DIS without their explicit consent will be against the member's true wishes and risk appetite. These members may have actually understood the default arrangement of their MPF scheme (prior to DIS) and have therefore “chosen” to invest in such default funds by not electing any investment choices when they joined the MPF scheme. Whilst the member is comfortable with doing that, he / she may not be comfortable with the default arrangement anymore under the DIS arrangement where the risk level, investment objectives, fee level, etc. have all changed.

For new contributions, it may still be argued that with the new implementation of DIS, we have informed them as such, but applying it to the accrued benefits could be a real stretch as it actually could be applied to a real major portion of the member's existing MPF holdings. It may not be fair to do so without any explicit positive confirmation that he/she has understood the new position and risks associated with DIS, and this does not seem to be consistent with DIS's intended objective of better protecting the interests of the scheme members¹.

Potential losses members may incur

With the Opt-Out approach, there is a chance that there will be a significant (or even substantial) number of individuals that can suffer investment losses due to the move into the DIS. This is especially the case given the short-term volatility observed in the market currently. For example, if the equity market drops drastically following the switch of the members' benefits from a money market fund into the DIS (which contains up to 60% equities), the member will suffer substantial losses, due to the fund switch which was performed without their explicit consent.

This will likely raise complaints by the customers, especially after the fact, not only to the MPF providers but will also further damage the reputation of the MPF system and also of the banks which sold them the MPF products. This will further jeopardize the public's faith in the MPF system and potentially the banking system.

The Government and the MPFA may also run a risk of being accused of mandating an unfair and unjust arrangement.

Effectiveness of communication to Defaulters

The implementation of DIS requires MPF providers to inform and explain to the Defaulters of the transitional arrangement of DIS, and give them a chance to opt-out of the DIS.

Whilst the MPF industry can try its best to educate the customers regarding DIS and its associated impact to them, the DIS arrangement may not be easy to understand for the mass public. We feel that it may be

¹ See paragraph 3 of the Legislative Council Brief (reference MPF/2/1/39C(2015) Pt.2)

unrealistic to expect all the customers to understand the arrangement and be able to make an informed decision to opt-out of DIS pro-actively.

Another point to consider is that the members who are Defaulters are likely to be those who have been rather passive with their own MPF - it seems difficult to expect them to suddenly become active in understanding the DIS arrangement thoroughly to opt-out. Given the busy lifestyle of Hong Kong people, a lot of these members may simply ignore or overlook the communication materials, and they will miss the chance of making a very important decision regarding their MPF.

Recommendations

In summary, we do not believe moving a member's assets without their explicit consent is a fair way to treat a member, and may not be in a member's best interest as it can potentially lead to substantial financial losses to the members and their exposure to higher risks and fees.

Our recommendation is to adopt an alternative "Opt-In" approach where the Defaulters' pre-existing accrued benefits will continue to be invested in their existing funds after the implementation of the DIS unless they have explicitly expressed that they would like to transfer their accrued benefits to the new DIS. We believe this approach will largely eliminate the potential issues/concerns as set out in this paper. This will also enable the members to make an informed decision after taking time to consider all the pros and cons of DIS.

savings provisions that are necessary or expedient in consequence of an amendment made by the notice.

**Division 3—Transitional and Savings Provisions for
Pre-existing Accounts Wholly Invested according to
Default Investment Arrangement**

34DE. Interpretation

In this Division—

default investment arrangement (預設投資安排) means a default arrangement—

- (a) provided before the commencement date in the governing rules of a registered scheme; and
- (b) under which the accrued benefits in an account of a scheme member who has not given any specific investment instructions for those benefits are invested;

DIA account (預設投資安排帳戶) means a pre-existing account of an existing member that meets the description of section 34DF(b);

existing member (現有成員) means a scheme member of a registered scheme to whom this Division applies under section 34DF;

reply period (回覆期), in relation to a specified notice, means 42 days after the date of the notice;

specified notice (指明通知) means a notice that is approved, or in the form specified, by the Authority for the purposes of this Division.

34DF. Scheme members to whom this Division applies

This Division applies to a scheme member of a registered scheme, if—

- (a) the member is below 60 years of age, or becomes 60 years of age, on the commencement date;
- (b) immediately before the commencement date, all of the accrued benefits in a pre-existing account of the member have been invested according to a default investment arrangement of the scheme; and
- (c) the approved trustee of the scheme reasonably believes that the trustee has not received specific investment instructions from the member for those benefits.

34DG. Accrued benefits in pre-existing account

- (1) Unless the approved trustee of a registered scheme has received specific investment instructions from an existing member for the accrued benefits in the member's DIA account, the trustee must continue to invest those benefits according to the default investment arrangement of the scheme.
- (2) Subsection (1) does not limit the operation of sections 34DH, 34DI and 34DJ.

34DH. Approved trustee to give specified notice to scheme member

- (1) The approved trustee of a registered scheme must, within 6 months after the commencement date—
 - (a) give a specified notice to each existing member in respect of the DIA account, or each of the DIA accounts, of the member; and

- (b) in the specified notice, inform the member of the requirements under subsection (2).
- (2) Subject to section 34DJ, if, by the expiry day of the reply period for the specified notice, the trustee has not received specific investment instructions from the member for the accrued benefits in a DIA account of the member, the trustee must, within 14 days after the expiry day, invest those benefits in the account according to the default investment strategy of the scheme.
- (3) Despite section 27(2A), the trustee must comply with subsection (2) regardless of any specific investment instructions received by the trustee from the member for those benefits within the 14 days referred to in that subsection.

34DI. Locating scheme members whose addresses are unknown etc.

- (1) This section applies if—
 - (a) it comes to the knowledge of an approved trustee of a registered scheme that a specified notice given to an existing member under section 34DH(1) is not taken to have been given under section 206(1A) or (2) of the Mandatory Provident Fund Schemes (General) Regulation (Cap. 485 sub. leg. A); or
 - (b) the trustee does not know any contact details of an existing member that enable the trustee to give the specified notice to the member under section 34DH(1).
 - (2) The trustee must proceed to locate the member in the manner, and within the time limit (*time limit*), specified in the guidelines for the purposes of this section.
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- (3) Subject to section 34DJ, if, after subsection (2) has been complied with, the member cannot be located before the expiry of the time limit, the trustee must, within 14 days after the expiry of the time limit, invest the accrued benefits in the DIA account, or all of the DIA accounts, of the member, according to the default investment strategy.
 - (4) If, after subsection (2) has been complied with, the member is located before the expiry of the time limit, the trustee must, within 14 days after the day on which the member is located—
 - (a) in a case that falls within subsection (1)(a), give another specified notice to the member informing the member of the requirements under subsection (5); or
 - (b) in a case that falls within subsection (1)(b), give a specified notice to the member informing the member of the requirements under subsection (5).
 - (5) For the purposes of subsection (4) and subject to section 34DJ, if, by the expiry day of the reply period for the notice given under that subsection, the trustee has not received specific investment instructions from the member for the accrued benefits in a DIA account of the member, the trustee must, within 14 days after the expiry day, invest those benefits in the account according to the default investment strategy of the scheme.
 - (6) Despite section 27(2A), the trustee must comply with subsection (3) or (5) regardless of any specific investment instructions received by the trustee from the member for those benefits within the 14 days referred to in that subsection.
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34DJ. Guaranteed funds

- (1) This section applies to the accrued benefits of an existing member that have been invested in a guaranteed fund according to a default investment arrangement of the scheme.
- (2) For the purposes of section 34DH(2) or 34DI(3) or (5), the approved trustee of the scheme must not invest those benefits according to the default investment strategy of the scheme if, on the expiry day, the market value of those benefits is less than the value guaranteed by the fund to be paid to the member on that day.

- (3) In this section—

expiry day (屆滿日)—

- (a) in relation to section 34DH(2), means the expiry day referred to in that section;
- (b) in relation to section 34DI(3), means the day on which the time limit referred to in that section expires; or
- (c) in relation to section 34DI(5), means the expiry day referred to in that section;

guaranteed fund (保證基金) means a constituent fund that provides a guaranteed return of capital, income on capital or both the capital and the income.

**Division 4—Transitional and Savings Provisions for
Pre-existing Accounts Partially Invested according to
Default Investment Arrangement**

34DK. Interpretation

In this Division—

default investment arrangement (預設投資安排) has the meaning given by section 34DE.

34DL. Accrued benefits continue to be invested according to default investment arrangement

If—

- (a) a scheme member of a registered scheme is below 60 years of age, or becomes 60 years of age, on the commencement date; and
- (b) immediately before the commencement date, part of the accrued benefits in a pre-existing account of the member have been invested according to a default investment arrangement of the scheme,

then, the approved trustee must continue to invest part of the accrued benefits in the account according to the arrangement unless the trustee has received specific investment instructions from the member for those benefits.”.