

**Bills Committee on  
Mandatory Provident Fund Schemes (Amendment) Bill 2015**

**Responses to Matters Raised by  
Members at the Meeting on 26 January 2016 and  
in the letter from the Hon SIN Chung-kai dated 25 January 2016**

**Purpose**

This paper sets out the responses from the Government and Mandatory Provident Fund Schemes Authority (“MPFA”) to issues raised at the Bills Committee meeting on 26 January 2016 and in the letter from the Hon SIN Chung-kai dated 25 January 2016.

- (a) further elaboration on whether the proposed opt-out arrangements and subsequent transfer of accrued benefits from the existing Default Investment Arrangements (“DIA”) to the proposed Default Investment Strategy (“DIS”) (especially in the case of negative return after transfer) are constitutionally in order;**

2. The proposed transitional arrangements are in compliance with Articles 6, 25 and 105 of the Basic Law<sup>1</sup>. Specifically, our legal advice has confirmed that the proposed transitional arrangements would not constitute deprivation of default scheme members’ property. Also, the modification of the subsisting rights of default scheme members to invest their accrued benefits as imposed by the DIS serves the legitimate aim of protecting members’ interests, and that the modification imposed by the proposed transitional arrangements would be fair and not disproportionate, taking into account different aspects of the details of the proposed arrangements as discussed below.

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<sup>1</sup> **Article 6:** The Hong Kong Special Administrative Region (“HKSAR”) shall protect the right of private ownership of property in accordance with law.

**Article 25:** All Hong Kong residents shall be equal before the law.

**Article 105:** The HKSAR shall, in accordance with law, protect the right of individuals and legal persons to the acquisition, use, disposal and inheritance of property and their right to compensation for lawful deprivation of their property. Such compensation shall correspond to the real value of the property concerned at the time and shall be freely convertible and paid without undue delay. The ownership of enterprises and the investments from outside the Region shall be protected by law.

3. One of the purposes of the DIS is to protect the interests of existing default scheme members who have not given any specific investment instructions for all of their accrued benefits. At present, DIA are not statutorily regulated. The investment objectives, risk levels, fee levels and investment returns of the existing DIA vary widely across different schemes. Some existing DIA do not serve any long-term retirement protection purpose. On the other hand, the fee-controlled DIS is designed to balance long-term investment risks for a 40-year MPF investment horizon and is developed based on the recommendations of the Organisation for Economic Co-operation and Development. As such, the modification of the subsisting rights of default scheme members to invest their accrued benefits as imposed by the DIS indeed serves a legitimate aim of protecting members' interests.

4. To ensure that default scheme members are aware of the potential risks of DIS transfer, the MPFA will mount large-scale publicity and education programmes a few months prior to the commencement of the Bill. The MPFA will also require approved trustees to provide a standardised DIS information booklet to all scheme members around three months prior to the commencement. This booklet will include key features of the DIS and information about likely risks (including the risks of negative returns). The MPFA is consulting industry bodies in preparing this booklet.

5. In addition, to ensure that default scheme members would have sufficient time to consider the implications for the transfer of the accrued benefits to the DIS, we have proposed a reply period of 42 days in the Bill. Other than the reply period, there are provisions in the Bill that require approved trustees to go through necessary steps to locate scheme members when the members cannot be contacted. So long as approved trustees have gone through the proposed requirements to locate and contact the default scheme members, the modification of the members' subsisting rights on their accrued benefits would be fair and would be able meet the proportionality principle.

- (b) elaboration on the considerations of the proposed 42-day period for scheme members to opt out from the DIS (also the first enquiry in the Hon SIN Chung-kai's letter dated 25 January 2016), and whether the Government would consider extending the proposed period to give more time for default scheme members to make choices for their Mandatory Provident Fund ("MPF") investments;**

6. The 42-day reply period was proposed after extensive discussion between the MPFA and the industry.

7. The MPFA had originally proposed 30 days, drawing reference from some of the notification periods specified in the MPF Schemes Ordinance (Cap. 485) ("MPFSO")<sup>2</sup> and on the working assumption that a one-month period should be adequate for receiving and processing responses. However, approved trustees suggested allowing for a longer time period to add flexibility in processing replies. After taking into account approved trustees' views, the MPFA considered that the length of the reply period should –

- (i) be reasonably sufficient for default scheme members to understand the DIS and its implications and give a reply to the approved trustees should they prefer to invest their accrued benefits in some other manner;
- (ii) be reasonably sufficient for approved trustees to identify the returned mail cases, process those cases for which replies have been received and handle those cases with no reply received in accordance with the law; and
- (iii) not be too long such that default scheme members would tend to set aside the specified notice for the time being, only to have forgotten all about it by the end of the reply period.

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<sup>2</sup> For example, under section 15 of the MPF Schemes (Exemption) Regulation (Cap.485B), an employer is required to provide specified information to its new eligible employee to enable the employee to elect between joining a relevant ORSO registered scheme and an MPF scheme. The new eligible employee shall give notice in writing to his employer not later than 30 days after the employee becomes such an employee advising the employer whether he elects to become a member of the ORSO scheme or the MPF scheme.

8. Based on the aforementioned considerations, a reply period of 42 days is eventually proposed in the Bill. We have taken note of Members' views that a longer reply period would allow default scheme members more time to understand the DIS and make investment choices. However, having balanced all of the abovementioned considerations, we maintain that the proposed 42-day reply period is appropriate.

**(c) the estimated number of scheme members whom the contact details (e.g. addresses or telephone numbers) are unknown to approved trustees and the measures to be adopted by the MPFA to ensure the approved trustees to get hold of these scheme members (also the second enquiry raised in the Hon SIN Chung-kai's letter)**

**(d) a preliminary draft of the guidelines set out in the proposed section 34DI(2) (also the enquiry from the LegCo Assistant Legal Adviser raised at the meeting);**

9. According to the estimates made by approved trustees, there are about 404 000 accounts (representing about 4.6% of the total 8.8 million MPF accounts) belonging to scheme members whom cannot be contacted by approved trustees due to lack of valid contact details (i.e. telephone number and address). These accounts, however, include all MPF accounts and not only those default accounts that may be subject to the proposed transitional arrangements. We expect that the approved trustees should have a clearer picture closer to mid-June 2016.

10. To facilitate the serving of a specified notice on default scheme members whose contact details are unknown to approved trustees, we have included a specific provision in the Bill (i.e. the proposed section 34DI) to require approved trustees to locate scheme members in the manner and within the time limit as specified in the guidelines to be issued by the MPFA. Once approved trustees have been able to locate those members, the approved trustees will need to follow the normal transitional arrangements proposed under the Bill, including the serving of a specified notice on the members. An extract of the draft guidelines is at **Annex**.

- (e) **elaboration on the transitional arrangements in relation to the accrued benefits of a default scheme member currently invested in guaranteed funds (also the third enquiry in the Hon SIN Chung-kai’s letter dated 25 January 2016); and**

11. The transitional arrangements as specified in the proposed Division 3 of Part 4AA of the MPFSO in the Bill are intended to apply to all scheme members who satisfy the criteria set out in the proposed section 34DF (i.e. generally “default scheme members” who have not given any investment instructions and have their accrued benefits fully invested in the DIA of the scheme which can be guaranteed funds, MPF conservative funds, etc.).

12. Within six months after the commencement of the DIS, an approved trustee has to give an opt-out specified notice to a default scheme member. The specified notice will include a form, allowing the default scheme member to choose not to invest in the DIS by specifying his investment instructions.

<b>Possible reply given by a default scheme member during the 42-day reply period</b>	<b>Follow-up by the approved trustee</b>
(a) choose to stay in the existing constituent funds (“CFs”)	▪ continue investing the accrued benefits in the existing CFs
(b) make some other selection of CFs by completing the aforementioned form	▪ invest the accrued benefits according to his selection
(c) take no action	▪ transfer the accrued benefits to the DIS within a 14-day period after the expiry of the 42-day reply period if no reply has been received from the default scheme member, unless the member’s benefits are in default funds which are guaranteed funds as explained below.

13. The procedure for transferring the accrued benefits of any scheme members investing in a guaranteed fund where the proposed section 34DF in Division 3 applies starts with the issuance of the specified notice under the proposed section 34DH in Division 3. The only procedural difference between the treatment of existing accrued benefits invested in guaranteed funds and those in other CFs is that, as set out under the proposed section 34DJ(2) in Division 3, an approved trustee must not invest those benefits in guaranteed funds according to the DIS of the scheme if, at the end of the 42-day reply period, the market value of those benefits is less than the value guaranteed by the fund to be paid to the member on that day. This exception is designed to protect scheme members from losing the benefit of a guarantee that has already accrued but is not unconditional.

14. As set out in paragraph 10 of LC Paper No. CB(1)396/15-16(02), there are four approved trustees using guaranteed funds as the DIA for seven MPF schemes-

<b>Name of Approved Trustee</b>	<b>No. of MPF Schemes</b>	<b>No. of Years of Continuous Investment</b>	<b>Latest Fund Expense Ratio (FER) available</b>	<b>NAV (HK\$ million)</b>
<b>Conditional Guarantees</b>				
FWD	2	5 years	2.21% and 2.31%	\$624.30 (30 June 2015)
Mass Mutual	1 <sup>3</sup>	The guarantee is provided in the event of occurrence of one of the qualifying events including normal or early retirement, death and total incapacity.	3.75%	\$118.79 (30 October 2015)

<sup>3</sup> DIA contributions equally spread among all CFs.

<b>Name of Approved Trustee</b>	<b>No. of MPF Schemes</b>	<b>No. of Years of Continuous Investment</b>	<b>Latest Fund Expense Ratio (FER) available</b>	<b>NAV (HK\$ million)</b>
<b>Unconditional Guarantees</b>				
AIA	3	Not applicable	1.69% and 1.70%	\$7,174.94 (30 September 2015)
Manulife	1	Not applicable	1.79%	\$10,203.70 (30 September 2015)

15. In those cases where the guarantee is unconditional, the market value of the relevant guaranteed fund is the same as its guaranteed value. Accrued benefits of default scheme members in those cases will be transferred to the DIS within the 14-day period following this 42-day period, unless they choose to give specific investment instructions to their approved trustees within that 42-day period.

16. It is therefore only the accrued benefits of those default scheme members investing in the conditional guaranteed funds may not be transferred to the DIS if, on the expiry day of the 42-day reply period, the market value of the fund is less than its guaranteed value. As set out in paragraph 10 of LC Paper No. CB(1)396/15-16(02), the guaranteed funds of FWD and Mass Mutual are subject to long-term conditions. That said, default scheme members can, at any time before or after the transitional process, give specific investment instructions to their approved trustees to invest in the DIS if they do not want to stay in the guaranteed funds. In any event, in terms of net asset value (“NAV”), these conditional guaranteed funds only account for a very small portion (i.e. 4%) of all guaranteed funds under the existing DIA.

17. Regarding the Hon SIN Chung-kai’s enquiry on the potential risks that might arise during the transfer of accrued benefits from a guaranteed fund to the DIS in times of adverse economy, the MPFA will mount large-scale publicity programme to help scheme members understand the potential risks of any DIS transfers.

18. Regarding his enquiry on why there is a difference in the transitional arrangements between conditional and unconditional guaranteed funds, we consider that accrued benefits invested in a guaranteed fund should not be transferred to the DIS if such transfer would cause the loss of a currently accrued guarantee benefit.

**(f) the estimated total amount of accrued benefits of scheme members' pre-existing accounts that might be subject to the opt-out transitional process and subsequently be transferred to and invested in the DIS, and the projection of possible further reduction in the fees charged to other MPF CFs managed by the trustees under the MPF system.**

*Estimated amount of accrued benefits subject to the proposed opt-out transitional arrangements*

19. As set out in paragraphs 1 to 3 of LC Paper No. CB(1)396/15-16(02) and paragraph 4 of LC Paper No. CB(1)480/15-16(02), approved trustees have roughly estimated that around one million accounts, out of a total of about 8.8 million accounts, are investing in existing default funds. Based on information available to the MPFA, as of the end of November 2015, assets in CFs comprising existing DIA is roughly estimated to be 11.8% of NAV of the MPF System, or HK\$69.6 billion.

20. It should however be noted that the HK\$69.6 billion includes accounts in which the scheme members have made a decision to select the CFs comprising the DIA. It is also the case that the number of DIA accounts, scheme members and assets involved will vary over time. New members will be joining the MPF System without giving investment instructions, some existing scheme members having a DIA account will give investment instructions, some accounts will be closed and new accounts will be opened. Numbers relevant today might be substantially different from numbers on commencement date which might also be different from the numbers of accounts that are eventually subject to the transitional process as set out in the Bill.



21. It is also expected that only a proportion of the actual amounts of assets in existing default funds and accounts would be transferred to the DIS, given that a proportion of investment in existing default funds are scheme members' conscious choices (not subject to the transitional process) and some that are subject to the transitional process may opt out from the new DIS during the statutory transitional process. Some may also be excluded from the DIS if they have reached the age of 60 before the commencement of the Bill or have their assets in guaranteed funds. Given these uncertainties, it is difficult to precisely estimate the total amount of accrued benefits that will ultimately be transferred to and invested into the DIS. We expect that approved trustees will have a clearer picture closer to mid-2016. That said, in view of the implementation of the DIS, the MPFA will keep the situation in view and collect from approved trustees DIS-related statistical data for assessment.

*Projection of possible fee reduction*

22. The DIS proposal is intended to not only provide scheme members with a simplified investment option that is consistent with the overall objective of retirement savings, but also addresses the problem of high fees in the MPF System directly. As explained in paragraphs 39 and 50 of the Consultation Paper of Providing Better Investment Solutions for MPF Members, designating a standardised default investment approach and adopting it as the default investment arrangement will facilitate better benchmarking and comparison of investment performance and fees across and within MPF schemes. A standardised DIS will enable scheme members to focus on a single point of primary comparison. Any material differences which are a result of higher fee adversely affecting performance will be readily apparent and should provide greater market discipline for the industry to ensure that their fees and investment structures are optimized to deliver better outcomes for scheme members. Consequently, we expect that the fee cap will have a benchmarking effect, driving fee reduction or consolidation of other MPF CFs in order to make them more attractive as a choice for scheme members.

23. However, any possible further reduction in the fees of other CFs is subject to a range of factors, including the investment behaviour of scheme members (e.g. scheme members' sensitivity to fees when choosing CFs), scheme members' adoption of the DIS, and the business strategy of the industry in response to any shift of investment from other CFs to DIS CFs. Some other general factors may also have a bearing on the future fee levels of CFs, such as changes in their asset sizes and operation costs. Since the information for making a quantitative assessment of these factors is not available, the MPFA is unable to provide any projection on the future level of fee reductions of CFs.

**Financial Services and the Treasury Bureau**  
**Mandatory Provident Fund Schemes Authority**  
**February 2016**

**DEFAULT INVESTMENT STRATEGY  
DRAFT GUIDELINES ON LOCATING SCHEME MEMBERS**

1. Section 34DI(1) of the Mandatory Provident Fund Schemes Ordinance (“Ordinance”) sets out that that 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) of the Ordinance is not taken to have been given under section 206(1A) or (2) of the Mandatory Provident Fund Schemes (General) Regulation (“Regulation”); or
- (b) the trustee does not know any contact details of an existing member that enable(s) the trustee to give the specified notice to the member under section 34DH(1).

2. Section 34DI(2) provides that the trustee must proceed to locate the member in the manner, and within the time limit, specified in the guidelines for the purposes of that section.

**Steps to be taken to locate scheme members [As proposed]**

3. For the purposes of section 34DI(2) of the Ordinance, the specified manner and the time limits for approved trustees to locate scheme members are set out below.

4. Where an approved trustee has complied with section 34DH(1) and, on or before the expiry day of the reply period, has knowledge that the specified notice was “not taken to have been given under section 206(1A) or (2) of the Regulation”, such that section 34DI(1)(a) of the Ordinance applies, the trustee must proceed to locate the member in the manner set out in paragraph [6] below within the time limit of [30] days after the trustee has knowledge that the specified notice was not taken to have been given under section 206(1A) or (2) of the Regulation.

5. Where an approved trustee is unable to comply with section 34DH(1) because it does not know any contact details of an existing member such that section 34DI(1)(b) applies, the trustee must proceed to locate the member in the manner set out in paragraph [6] below within the time limit of [6] months after the commencement date of the [Mandatory Provident Fund Schemes (Amendment) Ordinance 2015].

6. Within the time limits specified in paragraphs [4] and [5] above, the trustee must attempt to locate a scheme member in the following manner:

- (a) contact the employer concerned, if any, to obtain any contact information of the scheme member unless the member has been located before the trustee contacts the employer;
- (b) if the member is not located after the trustee has complied with paragraph (a) above, the trustee must make a first attempt to contact the member based on the contact information provided by the employer in paragraph (a) above or, if none, any other contact information known to the trustee. Where the trustee has already sent a specified notice under section 34DH(1), the trustee should use contact information which is different from the contact information used by the trustee for sending that notice if such information available;
- (c) if the member cannot be located after the first attempt, the trustee must make a second attempt to contact the member, at a time and date different from those of the first attempt. The trustee should use contact information which is different from the contact information used by the trustee for sending the specified notice under section 34DH(1) (if applicable) and in the first attempt, if such information is available and the trustee is satisfied that the contact information used in the first attempt cannot locate the member;

- (d) if the member cannot be located after the second attempt, the trustee must make a third and final attempt to locate the member, at a time and date different from those of the first and second attempts. The trustee should use contact information which is different from the contact information used by the trustee for sending the specified notice under section 34DH(1) (if applicable) and in the first and second attempts, if such information is available and the trustee is satisfied that the contact information used in the first and second attempts cannot locate the member.

7. If, after section 34DI(2) has been complied with, a member cannot be located before the expiry of the time limit, the trustee must comply with section 34DI(3).

8. If, after 34DI(2) has been complied with, a member is located before the expiry of the time limit, the trustee must comply with section 34DI(4), regardless of whether the member is located as a result of the trustee's attempts to locate the member as set out above.

**Mandatory Provident Fund Schemes Authority**  
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