For information

Legislative Council Panel on Financial Affairs

Impact of the Financial Turmoil on the Mandatory Provident Fund System

Introduction

The Administration and the Mandatory Provident Fund Schemes Authority ("MPFA") were requested to provide a paper for the LegCo Panel on Financial Affairs on an assessment of the impact of the recent financial tsunami on the Mandatory Provident Fund ("MPF") schemes, information on the investment return of MPF schemes since the implementation of the MPF system in 2000 and the performance of MPF schemes in the past year or so, and measures, if any, to safeguard retirement protection for scheme members. This paper provides the relevant information for Members' reference.

Financial Performance of MPF schemes

2. The value of a member's MPF investments generally rises or falls in line with the investments that the constituent fund of his choice makes. For example, during the past two years when there was considerable fluctuation in the performance of the financial market, the financial performance of MPF schemes varied widely. During the periods between October 2006 and September 2007 and between October 2007 and September 2008, the annualized rate of return of the MPF system (net of expenses) was 25.2% and -22.9% respectively.

3. It should be noted that the MPF System seeks to achieve capital appreciation over a long investment horizon. To date, the MPF system is able to generate a positive aggregate return for its members. The annualized rate of return net of expenses since inception of the MPF System is 2.6% per annum. The actual rate of return in respect of an individual's investments in an MPF scheme will depend on individual circumstances such as the type of constituent fund chosen and the

investment horizon.

Measures to Safeguard Retirement Protection of Scheme Members

4. The MPF legislation has prescribed stringent requirements on the permissibility of investments into which the MPF constituent funds may invest in order to reduce risk as far as possible for the protection of MPF scheme members' interests.

5. The conditions that need to be fulfilled by permissible investments are clearly set out in Schedule 1 to the Mandatory Provident Fund Schemes (General) Regulation ("General Regulation"). For example, debt securities are permissible only if they meet certain criteria, such as when they are issued or guaranteed by a government with the highest credit rating. For corporate debt securities, they must satisfy a minimum credit rating or be listed on a stock exchange approved by the MPFA.

6. In addition, the General Regulation also imposes an investment spread requirement to reduce risk. One of the requirements is that an MPF fund can invest no more than 10% of its total funds in the securities and other permissible investments issued by the same institution. The relevant legislation also restricts MPF funds from carrying out relatively high-risk activities such as those relating to borrowing and leveraging.

7. The MPFA ensures compliance with the investment regulations by the approved trustees of MPF schemes through different means, including examining statutory returns and reports, conducting on-site inspections and investigating into complaints received, etc. The investment of all the constituent funds is managed by authorized investment managers.

8. In respect of disclosure of information, there are already codes which prescribe that trustees must disclose the investment objective, the portfolio allocation and the risk level of the relevant constituent funds in the offering documents and the fund fact sheets distributed to scheme members. This serves to ensure that scheme members have sufficient

information to choose the constituent funds that are suitable for them in accordance with their individual investment preference and risk tolerance level.

9. The MPFA has been making continuous efforts in carrying out MPF investment education to enhance public understanding of the nature and characteristics of different fund types. This would help scheme members to better manage their MPF accounts and make appropriate fund choices.

10. In the light of the current market situation, the MPFA has further stepped up its market surveillance work. For example, it has imposed additional requirements on trustees to submit information on investment holdings of the constituent funds and other relevant information. This will help ensure that the operation of MPF schemes is in compliance with all the relevant requirements.

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