Motion on
"Comprehensively reforming the Mandatory Provident Fund Scheme" moved by Hon TAM Yiu-chung at the Legislative Council meeting on 2 November 2011

Progress Report

Introduction

As a retirement protection arrangement, the operation of the MPF System is still at an early stage and requires continuous improvement to meet social development and the needs of scheme members. The Government and the Mandatory Provident Fund Schemes Authority (MPFA) have been reviewing the operation of the MPF System, and introduced improvements as necessary. This note updates Members on our efforts with reference to the Legislative Council ("LegCo") motion carried on 2 November 2011 - "Comprehensively reforming the Mandatory Provident Fund Scheme" as moved by Hon Tam Yiu-chung and further amended by Hon Chan Kin-por, Hon James To and Hon Alan Leung. The wording of the amended motion is at **Annex**.

Lowering MPF Fees and Charges

2. It is high on the agenda of the Government and MPFA to promote reduction of MPF fees and charges. While individual MPF trustees have introduced new MPF schemes with lower fees or reduced the fee level of their existing schemes, and the average fund expense ratio has decreased by more than 14% in the last couple of years, taking into account the growing assets in the MPF System and its operation becoming more mature, the Government and MPFA believe there is room for further reduction of MPF fees and charges. The latest developments are set out in the ensuing paragraphs.

Employee Choice Arrangement ("ECA") and enhancement of MPF intermediaries regulation

3. As a priority item, the Government and MPFA have been pressing ahead with the early implementation of ECA, which will increase scheme members' choice by allowing them to transfer accrued benefits derived from their mandatory contributions during present employment to a scheme of their own choice at least once a year. According to MPFA's estimate, the size of transferable MPF assets will be increased from 39% to around 67% with the implementation of ECA,

thereby intensifying market competition and the pressure on fee reduction.

4. To pave way for the implementation of ECA, the Government introduced the Mandatory Provident Fund Schemes (Amendment) (No.2) Bill 2011 ("the Bill") into the Legislative Council on 14 December 2011 to put in place a statutory regulatory regime for MPF intermediaries. In the coming months, the Government and MPFA will work closely with the relevant Bills Committee with a view to putting in place an effective regulation of MPF intermediaries before implementation of ECA. If the Bill is enacted by July 2012, ECA can be implemented on 1 November 2012. In parallel, MPFA will make sure that the various administrative measures, including the issue of the Code of Conduct and public education, etc., are ready for the commencement of ECA in November 2012.

5. At the same time, MPFA is exploring the feasibility of setting up a central database to keep track of employers' MPF contributions, as one of the supporting measures to facilitate consideration of implementation of full portability in the longer term.

Review of the mechanism of Compensation Fund levy

6. With the support of the LegCo Panel on Financial Affairs at its meeting on 21 November 2011 on the proposal to introduce an automatic levy suspension/resumption mechanism for the Mandatory Provident Fund Schemes Compensation Fund ("Compensation Fund"), we are working on the amendments to the relevant subsidiary legislation and aim to proceed with the legislative procedures in Q2 2012. Subject to LegCo's approval of the legislative amendments within the current legislative session, the current 0.03% levy to the Compensation Fund can be suspended before end 2012 and will be reflected in the form of a lower average fund expense ratio of MPF funds.

Consultancy study on trustees' administrative costs

7. Trustees' administration costs have been named as a major component of fees and charges of MPF Schemes. To identify ways to further simplify administrative processes with the aim of reducing costs and allowing room for further fee reductions, MPFA commissioned a consultancy study in December 2011. The preliminary findings are

expected to be available to MPFA in Q2 2012. The Government will liaise closely with MPFA on the follow-up action.

Fund Choice

8. As at 30 November 2011, there were a total of 439 MPF constituent funds which means more than 10 funds on average in every MPF scheme. Among these, there were 153 equity funds, 36 bond funds, 177 mixed assets funds (including mainly equities and bonds), 28 guaranteed funds, 41 conservative funds and 4 money market funds and others. The underlying investment of equity funds, bond funds and mixed asset funds as well as their return are comparable with those of the Exchange Fund; and those of the conservative fund (with an average fund expense ratio of 0.39% to cover scheme administration) are similar to bank deposits.

9. MPFA will continue to approve new funds that bring material benefits to scheme members, such as those which charge a lower fee; as well as funds which are not simply replicating the risk and investment profile of existing funds or narrowly focused on highly concentrated equity. We believe trustees will respond to market demand on new fund types as appropriate.

Enhanced Disclosure of Information

10. Market transparency also plays a key role in fee reduction. MPFA has been reviewing the disclosure regime and introducing improvements over the years. The on-line fee comparative platform introduced in 2007 was a key initiative in this regards. MPFA is now considering measures that may help scheme members to find other essential information (e.g. investment return) more easily via the fee comparative platform or MPFA's website.

Review of other aspects of the MPF System

Review on withdrawal of accrued benefits

11. In response to suggestions for review of the conditions and mode on withdrawal of accrued benefits, MPFA commenced a public consultation on 16 December 2011 regarding its proposals to allow scheme members to withdraw accrued benefits gradually over their

retirement years in addition to the current arrangement of withdrawal in a lump sum, and to include "terminal illness" as an additional ground for early withdrawal. The consultation period will end on 31 March 2012. In considering the way forward, MPFA and the Government will take into account the need to meet the needs of scheme members and achieve the policy objective of the MPF system to assist the working population in saving for their retirement.

Tax allowance for MPF contributions

12. LegCo approved on 23 November 2011 the proposal to increase the Maximum Level of Relevant Income ("Max RI") from $20,000 to $25,000 with effect from 1 June 2012. Subject to the availability of a legislative slot, the Government will introduce amendments to the Inland Revenue Ordinance to correspondingly increase the maximum tax deduction available for mandatory contributions from $12,000 per annum to $15,000 per annum for eligible employees in the coming months.

13. As for voluntary MPF contributions (VC), it is important to note that its nature is similar to other investment or savings for retirement protection. It may not be appropriate to offer tax deduction only for VC as it may be unfair to citizens saving through other means or service providers of other financial products. The financial implication to the public coffer should also be taken into account.

Enforcement against Default Contributions

14. Both the Government and MPFA attach great importance to combat default contributions ("DC"). The manpower of MPFA's enforcement team increased from 160 in 2006-07 to around 220 at present[1], representing some 40% increase. The number of employers who was convicted of DC-related offence increased from 55 in 2006-07 to 203[1] to 2010-11. In 2010-11, MPFA conducted 2,420 inspections to business establishments. MPFA planned to conduct some 3,000 inspections in 2011-12 targeted at industries with more DC and repeated offenders.

15. The bill mentioned in para. 4 above which was introduced into LegCo on 14 December 2011 includes legislative proposals for enhanced deterrent against DC, viz the introduction of a daily penalty against

[1] Figures as at end November 2011.

employers for continuous failure to make MPF mandatory contributions and the creation of a new offence against employers' failure to comply with a court order made in civil proceedings for the payment of arrears of MPF mandatory contributions and contribution surcharges. The proposed daily penalty seeks to ensure that the employer concerned will rectify the situation and make good the default as soon as possible without delay. The new criminal offence, which is modelled on a recent amendment to the Employment Ordinance, would also help in the recovery of DC.

16. MPFA would continue to keep the enforcement strategy under review so as to tackle DC effectively.

Way Forward

17. The above-mentioned initiatives demonstrate the continuous endeavours of the Government and MPFA to improve the MPF System. We will continue to monitor and review the operation of the MPF System in light of the motion passed, and explore initiatives to further enhance the efficiency and effectiveness of the MPF System as well as its enforcement. The enhancement to the MPF System, together with the efforts of the Government in the improvement to the first pillar of our retirement protection, i.e. the non-contributory social security system, would help enhance the retirement protection to the elderly.

Financial Services and the Treasury Bureau
30 December 2011

Annex

(Translation)

Motion on
"Comprehensively reforming the Mandatory Provident Fund Scheme"
moved by Hon TAM Yiu-chung
at the Council meeting of 2 November 2011

Motion as amended by Hon CHAN Kin-por, Hon James TO and Hon Alan LEONG

That, the Mandatory Provident Fund ('MPF') Scheme has already covered almost 85% of the labour force since its implementation, but as the MPF System is still at its initial stage and in need of continuous improvement, and the various social sectors have put forward many proposals for improving the Scheme, this Council considers that the authorities must conduct a comprehensive review of the MPF Scheme and examine the feasibility of the following measures and their impact in various respects:

(a) to prompt the Mandatory Provident Fund Schemes Authority to enhance employees' right to choose through the means of promoting market competition, for example, expeditiously implementing a full portability arrangement for the MPF Scheme;

(b) to streamline the management and administrative procedures of MPF schemes and reduce the operating costs of MPF;

(c) to adopt effective measures to press MPF Scheme trustees to lower their fees, such as enacting legislation to specify fee ceilings for different types of investment funds and fee types, and to require MPF Scheme trustees to collect fixed administration fees to replace the practice of collecting such fees at fixed percentages of the total asset values of MPF accounts;

(d) to require MPF Scheme trustees to provide contributors with products resembling bank deposits that charge no management fees;

(e) to introduce two additional fund products operated by the Government at low management fees, and linked respectively to Exchange Fund returns and inflation rates;

(f) to enact legislation to require MPF Scheme trustees to set out the actual amounts of fees in the annual reports of the years concerned;

(g) to obtain the operating costs data of MPF Scheme trustees and formulate measures to regulate trustees by making reference to the form of regulation of employees' compensation insurance;

(h) to allow MPF Scheme contributors with exceptional reasons (such as critical illness) to apply for suspension of contributions or partial withdrawal of their MPF accrued benefits, so as to meet urgent needs;

(i) to allow retirees to withdraw their MPF accrued benefits by instalments after the age of 65;

(j) to introduce a maximum tax deduction of $12,000 for voluntary MPF contributions;

(k) to prompt the Labour Advisory Board to conduct discussions on the mechanism whereby employers' contributions under the MPF Scheme are used to offset severance payments and long service payments;

(l) to enhance the regulation of MPF Scheme intermediaries; and

(m) to step up law enforcement and increase penalties to combat the situation of default in contributions; and

(n) to ensure that the MPF service market has sufficient competition and the automatic adjustment mechanism of the market can achieve its function, so that market competition can press MPF Scheme trustees to enhance their services; and

(o) to comprehensively consult the community to ascertain the inadequacies of the MPF Scheme and how retirement protection can be effectively offered to all elderly persons, so as to prepare for the population ageing of Hong Kong,

with a view to achieving the aims of lowering fees, increasing employees' choices for investment and perfecting the regulatory mechanism.