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For discussion

21 November 2011

LEGISLATIVE COUNCIL
PANEL ON FINANCIAL AFFAIRS

REVIEW OF THE MANDATORY PROVIDENT FUND SCHEMES COMPENSATION FUND

PURPOSE

This paper seeks Members' views on the review conducted by the Mandatory Provident Fund Schemes Authority ("MPFA") on the optimal reserve level of the Mandatory Provident Fund Schemes Compensation Fund ("Compensation Fund") and a mechanism for the suspension and the resumption of levy ("the Review").

PROPOSAL

2. The findings of the Review as set out in MPFA's note at the **Annex** suggest a hybrid funding approach for the Compensation Fund, with the reserve level proposed to be set at a range between \$1 billion ("the floor level") and \$1.4 billion ("the maximum level"). MPFA proposes that the levy should be suspended when the reserve exceeds the maximum level and resumed when it falls below the floor level. Specifically, –

(a) if the net asset value of the Compensation Fund as at the end of a financial year (i.e. 31 March of a year) exceeds the maximum level of $1.4 billion, the levy applicable to the financial period of Mandatory Provident Fund (“MPF”) schemes commencing on or after 1 January of the following calendar year will be suspended. If MPFA has reason to believe that there exists or will exist any circumstances which would likely cause the net asset value to fall below $1 billion on or before the end of the following financial year, MPFA may, after consultation with the Financial Secretary, decide not to suspend the levy such that the reserve level can be maintained within the range as much as possible;

(b) if the net asset value of the Compensation Fund at the end of a financial year (i.e. 31 March of a year) falls below the floor level of $1 billion, the levy applicable to the financial period of MPF schemes commencing on or after 1 January of the following calendar year will be imposed. Similarly, if MPFA has reason to believe that there exists or will exist any circumstances which would likely cause the net asset value to exceed $1.4 billion on or before the end of the following financial year, MPFA may, after consultation with the Financial Secretary, decide not to impose the levy to maintain the reserve level within the range as much as possible; and

(c) to announce the suspension or the imposition of levy, MPFA will issue a levy exemption notice or a termination of levy exemption notice respectively by 30 November of the relevant calendar year.

3. If the proposal is adopted, MPFA will conduct a regular review of the mechanism, in particular the optimal reserve level, to ensure its continued effectiveness.

4. The suspension of the levy would have the effect of reducing scheme expenses by the amount of the levy and thus the impact of fees and charges on scheme members by 0.03% per year.

BACKGROUND

5. The Compensation Fund is established under section 17(1) of the Mandatory Provident Fund Schemes Ordinance (Cap. 485) for the purpose of compensating scheme members (and other persons who have beneficial interests in the schemes) for losses of accrued benefits that are attributable to misfeasance or illegal conduct committed by the approved trustees or other persons concerned with the administration of those schemes. It covers relevant losses in accrued benefits arising from both mandatory and voluntary contributions without limit.

6. The Government provided a one-off grant of $600 million as seed money to the Compensation Fund in 1999. Additional contribution at an annual levy rate of 0.03% of the net asset value of scheme assets has been made by trustees since commencement of the MPF system.

7. As of 31 July 2011, the net asset value of the Compensation Fund stood at about $1.5 billion. No claim has been made against the Compensation Fund so far.

ADVICE SOUGHT

8. Members are invited to note and offer views on the Review and the proposed mechanism. Subject to Members' views, the Administration will introduce amendments to the Mandatory Provident Fund Schemes (General) Regulation (Cap. 485A) within this legislative session with a view to enabling MPFA to take necessary steps to suspend the levy from 1 January 2013.

Financial Services and the Treasury Bureau
14 November 2011

Annex

REVIEW OF THE MANDATORY PROVIDENT FUND SCHEMES COMPENSATION FUND

PURPOSE

This paper sets out the findings of the review conducted by the Mandatory Provident Fund Schemes Authority ("MPFA") on the optimal reserve level of the Mandatory Provident Fund Schemes Compensation Fund ("Compensation Fund").

PROPOSAL

2. It is proposed to adopt a hybrid funding approach for the funding of the Compensation Fund such that a certain level of reserve would be maintained under the Compensation Fund for immediate payment to scheme members should claims arise, while levying would be suspended when the reserve exceeded a maximum level so that scheme members could benefit from the suspension when there had been no claims against the Compensation Fund over a period of time. The parameters of the levying mechanism would be set out in the legislation to allow prompt suspension and re-imposition of the levy without the need to introduce legislative amendments each time.

BACKGROUND

3. The Compensation Fund is established under section 17(1) of the Mandatory Provident Fund Schemes Ordinance (Cap. 485) ("MPFSO") for the purpose of compensating Mandatory Provident Fund ("MPF") scheme members (and other persons who have beneficial interests in MPF schemes) for losses of accrued benefits that are attributable to misfeasance or illegal conduct committed by the approved trustees or other persons concerned with the administration of those schemes. It covers relevant losses in accrued benefits arising from both mandatory and voluntary contributions ("MC" and "VC" respectively) without any limit.

4. From the commencement of the MPF System, the Compensation Fund's annual levy rate has been set at 0.03% of the net asset value of the scheme assets[1]. Besides the annual levy contributed from the scheme assets, the Government also provided a one-off grant of $600 million as seed money to the Compensation Fund in 1999.

5. At that time, the Administration envisaged that MPFA could consider suspending the collection of levy once the level of the accumulated reserve of the Compensation Fund reached $900 million[2]. The Administration also undertook that MPFA would keep the reserve level of the Compensation Fund under constant review in the light of the total amount of accrued benefits and other prevailing factors.

6. On reaching the reserve level of $900 million in 2006, reviews of the Compensation Fund were conducted by MPFA in 2006 and 2009 and the results of the reviews were reported to the Legislative Council Panel on

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[1] Section 188 of the Mandatory Provident Fund Schemes (General) Regulation (Cap. 485A).

[2] Legislative Council Subcommittee on MPF System Information Note: Compensation Fund – Coverage/ Operation/ Administration and Levy (19 March 1997) and Provisional Legislative Council Sub-Committee on Subsidiary Legislation of the MPF System Information Note: Compensation Fund – Coverage/ Operation / Administration and Levy (14 November 1997).

Financial Affairs ("FA Panel") on 3 July 2006 and 6 July 2009 respectively. Having regard to the review of local and overseas compensation funds and the relatively uncertain economic and financial environment amid the global financial crisis, it was agreed at the meeting of the FA Panel on 6 July 2009 that it was prudent to retain the current levy rate of 0.03% of the net asset value of MPF schemes and MPFA would closely monitor market developments and review the Compensation Fund again in 18 to 24 months' time. MPFA therefore conducted another review in late 2010 for reporting the findings to the FA Panel in 2011.

REVIEW METHODOLOGY

7. MPFA reviewed the circumstances of the Compensation Fund and recent developments of the MPF System that might have a direct or an indirect impact on the likelihood of claims against the Compensation Fund and the factors that might have bearing on the size of claims. The experience of other compensation funds, both local and overseas, were also examined. Based on the circumstances of the MPF System and the Compensation Fund, proposals were then drawn up on a funding approach as well as the key features of the funding approach.

Circumstances of the Compensation Fund

8. As of 31 July 2011, the net asset value of the Compensation Fund stood at about $1.5 billion. No claim has been made from the Compensation Fund so far nor are we aware of any potential claims against the fund.

Recent Developments of the MPF System

9. MPFA has reviewed recent developments in the MPF System to identify those that might have an impact on the Compensation Fund. These developments are set out in the ensuing paragraphs.

Scheme Administration and Fund Governance of MPF Schemes

10. MPFA has continually monitored the scheme administration and fund governance of MPF schemes to ensure members' interests are protected. It is considered that trustees have in place control measures that can effectively reduce the risk of loss of accrued benefits that are attributable to misfeasance or illegal conduct committed by their own staff or their appointed service providers, and this in turn, reduces the risk of claims against the Compensation Fund.

Adjustment of Minimum and Maximum Relevant Income Levels and Increase in VC

11. Section 10A of MPFSO requires MPFA to conduct a review of the minimum and maximum levels of relevant income not less than once every four years. MPFA completed the latest review of the minimum and maximum levels of relevant income and submitted the findings to the Government for consideration in July 2010. The Government introduced two motions into the Legislative Council (“LegCo”) on 14 June 2011 respectively for the amendment of the minimum level of relevant income (from $5,000 to $6,500) and the maximum level of relevant income (from $20,000 to $25,000). The revised minimum level of relevant income of $6,500 with effective date on 1 November 2011 was passed by LegCo on 30 June 2011. In relation to the maximum level of relevant income, a Subcommittee of the LegCo House

Committee has been formed and completed the vetting of the amendment. The Government plans to move a motion to effect the increase of the maximum level of relevant income from $20,000 to $25,000 from 1 June 2012.

12. Based on the data of Q4 2010, the adjustment of the minimum level of relevant income from $5,000 to $6,500 per month would exclude an additional 162,000 employees and 18,900 self-employed persons (“SEPs”) from MPF contributions. The reduction in MPF contribution would amount to about $51 million per month. The proposed adjustment of the maximum level of relevant income from $20,000 to $25,000 per month would increase the monthly contribution of 424,600 employees (and their employers) and 89,900 SEPs. The increase in total MPF contribution would amount to about $217 million per month.

13. The amount of VC made to the MPF System has been growing in the past few years, from $2,088 million in 2002 to $5,810 million in 2010. The amount of VC as a percentage of MC has also been growing, rising from 9.2% in 2002 to around 18.2% in 2010. The continuous growth of VC would contribute to a faster growth rate of total MPF assets. With the implementation of the Employee Choice Arrangement (“ECA”) (please see paragraph 15 below), it is expected that employees will take a more active interest in their MPF investments and may also make additional VC to the MPF System.

14. While the adjustment of the minimum and maximum relevant income levels and the expected increase in VC may accelerate the accumulation of MPF scheme assets, MPFA does not observe any additional risk factors which may have an impact on the Compensation Fund arising from these changes.

Expanding Employee's Control over their MPF Investments

15. The Mandatory Provident Fund Schemes (Amendment) Ordinance 2009 which allows employees to transfer, on a lump sum basis, accrued benefits derived from their own mandatory contribution, from a contribution account under an MPF scheme chosen by their employers to an MPF scheme of their own choice at least once a calendar year was passed by LegCo on 8 July 2009. This arrangement is generally referred to as ECA. ECA aims to allow employees greater freedom to choose the trustees and MPF schemes that best suit their needs and to facilitate market competition, so that fees and charges can be kept at as low a level as possible. As sales and marketing activities of MPF schemes will likely shift from the initial employer-targeted model to reaching out to individual members, with a view to enhancing the protection of scheme members, the Government, MPFA and other regulators of MPF intermediaries are currently working on providing statutory backing to the regulation of MPF intermediaries. Subject to the passage of the relevant legislation to regulate MPF intermediaries in this legislative session, ECA can be implemented by end 2012. MPFA considers that the implementation of ECA should not have any significant impact on possible claims against the Compensation Fund.

Global Financial Crisis

16. The onset of the global financial crisis in September 2008 affected the financial soundness of a number of global financial institutions, including corporations with subsidiaries operating MPF businesses in Hong Kong. Although MPFA was satisfied that the operations of MPF trustees had not been affected to any material extent, some scheme members may have become more

attentive to the financial soundness of their MPF service providers and in turn the protection of their MPF assets. Whilst the economic and market impacts of the global financial crisis have not passed (e.g. the recent European debt crisis and downgrade of the credit rating of the United States etc.), MPFA has seen nothing that suggests any lingering impact on MPF scheme operations that may lead to any greater likelihood of a claim on the Compensation Fund arising out of the aftermath of the global financial crisis.

Drawing Experience from Other Compensation Funds

Local Experience

17. There are existing compensation funds covering other losses in the financial markets in Hong Kong, notably the Investor Compensation Fund and the Deposit Protection Scheme Fund. The Government is also looking into the setting up of a Policyholders' Protection Fund for insurance policyholders.

Investor Compensation Fund ("ICF")

18. The ICF was established under the Securities and Futures Ordinance (Cap. 571) in 2003 to pay compensation to those investors who suffer pecuniary losses as a result of default of a licensed intermediary or authorized financial institution in relation to exchange-traded products in Hong Kong, with a compensation limit of $150,000 per investor. The ICF imposes a levy when its net asset value falls below $1 billion, and suspends the levy when the value exceeds $1.4 billion. The levy amount is set based on 0.002% transaction levy on each side of securities transactions, and $0.5 per side of a futures contract. The optimal level of the ICF is derived from

analysing the funding needs based on past claims experience prior to the set up of the ICF. The levy had been suspended since 19 December 2005 in view that the net asset value of the ICF exceeded $1.4 billion.

Deposit Protection Scheme Fund ("DPS Fund")

19. The Deposit Protection Scheme ("DPS"), which aims to protect depositors for deposits held with banks[3] in Hong Kong, was launched in September 2006. Like the ICF, there is a limit on compensation, currently set at $500,000 per depositor[4]. The target size of the DPS Fund is set at 0.25% of the total amount of protected deposits held with all DPS members (translating into a fund size of approximately $3.5 billion). Unlike the ICF where a standard rate of levy is charged, differential contributions are made by different banks to the DPS Fund based on the supervisory rating of the individual DPS members, while the target size of the DPS Fund has been determined with a statistical model based on the amount of relevant deposits and credit ratings of the DPS members.

Policyholders' Protection Fund ("PPF")

20. Apart from the ICF and the DPS Fund, the Office of the Commissioner of Insurance and the Task Force formed by the Hong Kong Federation of Insurers have also been working in close collaboration in developing proposals to establish the PPF in Hong Kong in order to better protect policyholders' interest, maintain market stability in the event of insurer

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[3] All licensed banks, unless otherwise exempted by the Deposit Protection Board, are required to participate in the DPS as a scheme member.

[4] This limit was $100,000 per depositor per bank before 1 January 2011. During the period of 14 October 2008 to 31 December 2010, the Government introduced the Full Deposit Guarantee on top of the then $100,000 limit to boost depositor confidence in the face of the global financial crisis.

insolvency and enhance public confidence in and competitiveness of the insurance industry. It has been proposed that a progressive funding model be adopted, under which an initial target fund will first be built up through a moderate levy rate, with the option to impose a "stepped-up" levy rate as necessary upon insolvency of an insurer. To ensure that the PPF can make timely compensation payment to affected policyholders, the PPF should be allowed to borrow from a third party to bridge any gap. Based on the actuarial consultancy study, the initial target fund size should be $1.2 billion for the Life Scheme and $75 million for the Non-Life Scheme. On this basis, the initial levy rates for both Schemes should be set at 0.07% of the applicable premiums. The Government has just conducted a public consultation on the above proposals.

Overseas Experience

21. There are not many pension systems which have set up compensation funds for frauds around the world. Australia and the United Kingdom are two countries which operate some kind of compensation fund under their pension system. By contrast, systems in the United States, Canada and Singapore do not have compensation funds for frauds involving defined contribution pension schemes.

22. Unlike the compensation funds currently adopted in Hong Kong, both the retirement compensation systems in Australia and United Kingdom adopt an ex-post approach and impose a limit on the compensation to scheme members, which are not the current features of the Compensation Fund.

Application to the Compensation Fund

23. The ICF and the DPS Fund determine the optimum reserve levels and levy rates using statistical models based on claims experience, either local or overseas. The proposed reserve levels of the PPF Schemes are also calculated based on claims experience. In contrast, the MPF System has only a short history and there have been no claims from the Compensation Fund. Due to the unique nature of the MPF System and the Compensation Fund, there also seems to be no claim experience from overseas jurisdictions that can be used for the modeling purpose at present. It will therefore be very difficult to apply the modeling mechanism in setting up the ICF and DPS Fund to the Compensation Fund under the MPF System in the short term.

PROPOSED FUNDING APPROACH

24. Based on the above local and overseas experiences, it appears that the following policy principles drive the design of compensation funds –

(a) funds must be available when needed. This can either be through a standing reserve fund or through borrowings or government grants/ loans;

(b) where used, reserve funds should be kept to a reasonable size so that contributions and earnings are not unnecessarily diverted away from members' accounts; and

(c) there needs to be some flexibility in levy arrangements to cater for changing circumstances.

Practically, there are two major approaches for funding potential compensation payments, and they are the ex-ante funding approach and the ex-post funding approach. The ex-ante funding approach aims to have a reserve for claims payment built up before claims arise, and the levy rate will therefore has to be determined by risk modeling techniques based on past claims experience. Under the ex-post funding approach, levies will only be collected after claims arise. No reserve will be built up beforehand and the levy rate will be determined by the size of actual claims.

Ex-ante Funding Approach

25. Under the ex-ante funding approach, risk modeling techniques would be used to determine an optimum levy rate for the Compensation Fund. The ex-ante approach ensures that a reserve is built in good times to meet possible future requirements. A specified rate of levy would be required from MPF trustees regularly to build up the reserve.

Ex-post Funding Approach

26. Under the ex-post funding approach, the Compensation Fund levy would only be imposed to recoup payments already made or are to be made by the Compensation Fund to scheme members who suffered losses as a result of misfeasance or illegal conduct by MPF service providers. Under the ex-post approach, no advance decisions need to be made about the rate of levy to be charged to scheme members or a fund reserve level beyond which collection of the Compensation Fund levy should be suspended. The approach does not require sophisticated simulation modeling to estimate the levy rate and the reserve level. Funds will not be divested from members' accounts before claims arise.

Which Approach is Suitable for the MPF System?

27. Given that all MPF trustees must satisfy the stringent criteria on capital adequacy, financial soundness, experience and qualifications, and all MPF schemes must comply with all statutory standards and have indemnity insurance as a safety net for compensation for losses of scheme assets due to misfeasance or illegal conduct of trustees, service providers or other persons, the chance that MPFA will have to apply to court for compensation to scheme members from the Compensation Fund as a last resort should be remote. There has been no claim in the past 10 years and a reserve has already been built up. During the FA Panel meeting on 6 July 2009, LegCo members generally supported combining the two funding approaches and adopting a hybrid funding approach.

28. Under the proposed hybrid funding approach, a reasonable reserve of the Compensation Fund is to be built so that there is a ready sum under the Compensation Fund for immediate payment to scheme members. A maximum level will be set above which levying will cease automatically. In the event of payment(s) from the Compensation Fund causing the Compensation Fund to fall below a certain floor level, levies at the current rate of 0.03% will automatically resume.

Proposed Hybrid Approach under the MPF System – Key Features

<u>Reserve level below which the Compensation Fund levy would be imposed</u>

29. As mentioned in paragraph 28, under the hybrid funding approach, a reasonable reserve of the Compensation Fund should be built so that there is a ready sum under the Compensation Fund for immediate payment to scheme members. It is therefore necessary to set a floor level below which the Compensation Fund levy will be imposed at the existing rate of 0.03% of net

asset value of the MPF scheme assets.

30. In the absence of relevant data from local or overseas past claims experience for conducting modeling similar to that of the ICF and the DPS Fund, MPFA has examined the feasibility of determining the maximum level of the Compensation Fund upon which collection of levy may cease, and the floor level upon which collection of levy should be re-activated to restore the fund balance where payments have been made, by making reference to some relevant parameters. Possible parameters indicating the extent of coverage of the Compensation Fund when a relevant event occurs include –

(a) percentage of total scheme assets;
(b) percentage of assets held by MPF trustees;
(c) percentage of assets held by MPF schemes; and
(d) percentage of assets held by MPF constituent funds.

31. There are altogether 17 MPF trustees[5] operating 41 MPF schemes and 428 constituent funds under the MPF System as at 31 July 2011. Based on the above parameters, the existing level of the Compensation Fund of about $1.5 billion may provide coverage as shown below –

(a) 0.4% of total MPF scheme assets;
(b) 1% - 9% of the assets held by each of the six largest MPF trustees, or all of the assets held by the smallest MPF trustee;
(c) 3% - 9% of the assets held by each of the nine largest MPF schemes, or all of the assets held by each of the 12 smallest MPF schemes; or

[5] There are altogether 19 MPF trustees but only 17 of them operate MPF schemes. The remaining two trustees operate approved pooled investment funds only.

(d) 9% - 25% of the assets held by each of the 12 largest MPF constituent funds, or 100% of the assets held by each of the smallest 342 MPF constituent funds.

32. As noted above, the MPF System is a tightly regulated system, with stringent approval criteria for MPF service providers, statutorily prescribed investment restrictions, requirements on separation of the investment manager role from that of the trustee, and requirements on annual returns and audited accounts. The chance of loss due to misfeasance or illegal conduct committed by MPF service providers should be small. Moreover, there are compulsory insurance coverage[6] and minimum capital adequacy requirement[7] imposed on trustees that can be used to pay out any liabilities incurred for improper acts of MPF service providers within the MPF System. As such, claims of a scale which are affordable to MPF service providers will likely be settled outside the Compensation Fund. In this sense, the Compensation Fund will only be used at a last resort.

33. Based on our supervisory experience in the past, we consider that the risk of losses to scheme members, and the amount of any resultant loss, due to scheme administrative processes (e.g. contribution, transfer and payment processes) should be small and thus MPF service providers should be able to compensate the scheme members using their own funds or insurance should there be losses to scheme members. The more likely risk which may occur in the MPF System which may result in claims on the Compensation Fund is a

[6] The insurance cover depends on the MPF assets managed by the trustee and is calculated based on the scale stipulated in section 8(4) of the Mandatory Provident Fund Schemes (General) Regulation (Cap. 485A).

[7] The requirement of trustee's own capital and net assets depends on the type of trustee. If a company conducts trustee business only and meets the minimum capital and net asset requirement all by itself, the available capital and net asset for compensation is assumed to be $150 million. If the company conducts trustee business but with continuous financial support from an associated company, the available capital and net asset for compensation is assumed to be $30 million. If the company acts as both trustee and custodian and receives continuous financial support from an associated company, the available capital and net asset for compensation is assumed to be $50 million.

breach of an investment restriction by an MPF service provider which may impact on a whole constituent fund or scheme, rather than any particular individual members. Currently, MPF investment restrictions are mainly set out in Schedule 1 (Investment of Scheme Funds) to the Mandatory Provident Fund Schemes (General) Regulation (Cap. 485A). The Code on MPF Investment Funds and a set of Guidelines on Investment issued by MPFA provide further guidance to MPF service providers on investment regulation.

34. As there are no claims data for risk modeling, noting that the hybrid approach allows more flexibility in setting the maximum and floor levels and the existence of borrowing provisions in case of shortfalls, it is proposed to set the floor level based on the assumption that the losses that need to be compensated in one incident would be limited to about 10% of the size of the assets of an average MPF scheme. This assumes that the maximum loss to an MPF scheme would be due to a single investment, which would generally be limited to 10% of the assets of the scheme, given the 10% MPF diversification requirement (i.e. the maximum exposure of an MPF fund to a single investment issuer is 10% in general[8]). Based on the total MPF scheme assets as at 31 July 2011 of $388 billion, 10% of the average amount of assets in an MPF scheme (i.e. about 0.3% of total MPF assets) would be about $995 million[9]. As such, it may be considered reasonable to adopt a figure around this level as the lower threshold amount. *Accordingly, it is proposed to adopt $1 billion as the level below which the Compensation Fund levy would be collected.*

<u>Reserve level above which the Compensation Fund levy would be suspended</u>

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[8] In practice, exposure of an MPF fund to a single investment issuer is far less than 10% in most cases.

[9] In view that there are two inactive MPF schemes which are in the process of termination under the MPF System, we have used 39 (instead of 41) MPF schemes to arrive at our calculation of the reasonable reserve level.

35. For the ICF, the floor and maximum levels of its reserve are $1 billion and $1.4 billion respectively. The maximum level is equal to 140% of the floor level. If we adopt a similar relationship between the floor and maximum levels for the Compensation Fund, the proposed maximum level for the Compensation Fund will be $1.4 billion. As such, *it is proposed to adopt $1.4 billion as the level above which the Compensation Fund levy would be suspended*.

Impact of the Proposed Mechanism

36. If there is agreement on the figures and mechanism outlined above, amendments to the legislation would be proposed accordingly. The impact, based on current figures, would be immediate suspension of levy after the proposed amendments are enacted by LegCo, given that the Compensation Fund has now exceeded $1.4 billion already. The suspension of levy would have the effect of reducing scheme expenses by the amount of the levy and as a consequence this would reduce the impact of fees and charges on members by 0.03% per year. That amount would then go towards members' retirement protection. Section 17 of MPFSO provides that for the purpose of the Compensation Fund, MPFA may impose levies to be payable by the trustee of the registered scheme out of contributions in relation to the registered scheme. If the levy is suspended, there would no longer be any payment from scheme assets in this regard[10].

Details on How the Proposed Mechanism would Make Adjustments

[10] MPFA would check against the financial statements of MPF schemes to ensure that any cost reduction due to the levy suspension would benefit scheme members in that more of their contributions would go towards their retirement protection.

37. To facilitate the determination of whether the Compensation Fund levy is required from MPF schemes for a particular year, it is proposed to use the net asset value of the Compensation Fund as at 31 March each year as reference, since 31 March is the financial year end date of the Compensation Fund and the net asset value of the Compensation Fund as at 31 March is certified through an audit by the auditors of the Compensation Fund.

38. In case the net asset value of the Compensation Fund as at 31 March of a year fell below the proposed floor level of $1 billion and the levy was being suspended, MPFA would issue a notice by 30 November of the calendar year to impose the levy[11]. Similarly, in case the net asset value of the Compensation Fund as at 31 March of a year exceeded the proposed maximum level of $1.4 billion and the levy was being imposed, MPFA would issue a notice by 30 November of the calendar year to suspend the levy[12]. For a particular MPF scheme, the levy would be imposed or suspended for its financial period(s) commencing on or after 1 January after the calendar year in which the notice was issued.

SUMMARY

39. In summary, it is proposed to adopt a hybrid funding approach for the Compensation Fund and introduce a levy triggering mechanism in MPFSO with the following key features –

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[11] MPFA may, after consultation with the Financial Secretary, decide not to impose the levy if MPFA has reason to believe there exists or will exist circumstances which would likely cause the net asset value of the Compensation Fund to exceed $1.4 billion on or before the end of the following financial year of the Compensation Fund.

[12] MPFA may, after consultation with the Financial Secretary, decide not to suspend the levy if MFPA has reason to believe there exists or will exist circumstances which would likely cause the net asset value of the Compensation Fund to fall below $1 billion on or before the end of the following financial year of the Compensation Fund.

(a) if the net asset value of the Compensation Fund as at 31 March of a year exceeded the proposed maximum level of $1.4 billion and the levy was being imposed, MPFA would declare the suspension of levy by means of a notice by 30 November of the year. The suspension of levy would be applicable to the financial period(s) of MPF schemes commencing on or after 1 January of the following year; and

(b) if the net asset value of the Compensation Fund as at 31 March of a year fell below the proposed floor level of $1 billion and the levy was being suspended, MPFA would declare the re-imposition of levy by means of a notice by 30 November of the year. The imposition of levy would be applicable to the financial period(s) of MPF schemes commencing on or after 1 January of the following year.

Mandatory Provident Fund Schemes Authority
14 November 2011