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Legislative Council

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**Bills Committee on Mandatory Provident Fund Schemes
(Amendment) Bill 2014**

Background brief

Purpose

This paper provides background information on the Mandatory Provident Fund Schemes (Amendment) Bill 2014 ("the Bill"), and summarizes the major concerns and views expressed by Members on related issues during relevant discussions at meetings of the Legislative Council ("LegCo") and its committees since 2010.

Withdrawal of the Mandatory Provident Fund benefits

Current withdrawal requirements

2. The regulation of withdrawal of Mandatory Provident Fund ("MPF") benefits is set out in section 15 of the Mandatory Provident Fund Schemes Ordinance ("MPFSO") (Cap. 485) and Part XIII of the Mandatory Provident Fund Schemes General Regulation. Section 15(1) of MPFSO provides that a member of a MPF scheme who has attained the retirement age shall be entitled to be paid by the approved trustee of the scheme his/her entire accrued benefits in a lump sum immediately or on a later date. Retirement age is defined in section 2 of MPFSO to mean, in relation to an employee or self-employed person, 65 years of age.

3. In recognition of special circumstances justifying earlier withdrawal, the law also allows withdrawal of MPF benefits by scheme members in limited circumstances, i.e. early retirement at the age of 60, permanent departure from Hong Kong, death, total incapacity, or small balance account.

4. As regards payment of benefits derived from voluntary contributions, it is governed by the governing rules of the MPF scheme concerned, which generally provide more flexibility in withdrawal, and are not subject to the withdrawal restrictions in the MPF legislation.

Public consultation on proposals to increase the flexibility of withdrawal of MPF benefits

5. In 2011, the Mandatory Provident Fund Schemes Authority ("MPFA") set up a working group to review the regulation of withdrawal of MPF benefits derived from mandatory contributions, including the modes of payment of MPF benefits on retirement as well as the grounds for early withdrawal of MPF benefits. In conducting the review, MPFA has studied the schemes governing withdrawal of benefits in Australia, Chile and Singapore in detail.

6. In December 2011, MPFA launched a three-month public consultation on the proposals to increase the flexibility of withdrawal of MPF benefits. The consultation conclusions were released in September 2012. In light of respondents' support, MPFA put forward recommendations to the Government to provide the additional option of phased-withdrawal of MPF accrued benefits upon retirement and early retirement of scheme members; and to introduce terminal illness as the new additional ground for early withdrawal.

Measures to reduce MPF fees

7. Since implementation of the MPF system in 2000, there have been comments and criticisms from the public about the high level of fees. In 2004, MPFA introduced the fund expense ratio ("FER") to provide a single indicator disclosed for all MPF funds, aggregating fees and other expenses charged to MPF funds and underlying investments. The Employee Choice Arrangement ("ECA") which allows partial portability of MPF accrued benefits was implemented from 1 November 2012. The arrangement has facilitated market competition and created room for MPF fees reduction.

8. In December 2011, MPFA engaged an independent consultancy firm to conduct a detailed study on the costs incurred by trustees in performing different MPF scheme administration functions ("the Cost Study"). The consultancy report released in November 2012 identified a number of factors contributing to the higher administration costs of the MPF system compared with those of selected international pension systems (Australia, Chile, Mexico and the United States), including a higher percentage of manual and paper-based administration processing, process complexity, small scale of

assets under management, as well as insufficient industry cooperation and pricing competition.

9. In response to the recommendations in the Cost Study, MPFA has adopted short to medium term measures to drive down MPF fees, including (a) urging trustees to provide various types of low-fee funds for each scheme and to promote these funds; (b) facilitating trustees in further automating and streamlining their administration processes, merging smaller scale or less efficient schemes/funds; (c) facilitating scheme members in consolidating their personal accounts; and (d) promoting index funds in the constituent fund approval process. MPFA has also recommended the Government to make fundamental changes to improve the MPF system. Options that could be further explored included mandating providing low-fee funds in all MPF schemes, considering the possibility of introducing a not-for-profit operator to operate a simple and low-fee MPF scheme, reviewing the feasibility of imposing a cap on fund fees, and providing a type of basic, low-fee, default fund arrangement.

10. With a view to driving down MPF fees, MPFA has tightened approval of new funds¹ by adopting the approval criterion of "in scheme members' interests", e.g. a new fund with fees lower than those of similar existing MPF funds is in scheme members' interests. However, the criterion of "in scheme members' interests" is not statutory.

Mandatory Provident Schemes (Amendment) Bill 2014

11. The Bill, which was published in the Gazette on 27 June 2014 and received First Reading in LegCo on 2 July 2014, covers amendments to MPFSO (and relevant subsidiary legislation there under), Occupational Retirement Schemes Ordinance ("ORSO") (Cap. 426) and some other ordinances/regulations. Apart from implementing the proposals in paragraph 6 above, the Administration also takes the opportunity to propose some other enhancement of the withdrawal arrangements, provide MPFA with a clear legal basis to refuse applications for new MPF schemes and funds, provide greater scope for fee reduction by trustees, amend the secrecy provisions of MPFSO and ORSO to allow trustees and administrators to disclose information under specified conditions, and extend the prosecution time far for offences under MPFSO, etc. The main provisions of the Bill are as follows –

¹ Pursuant to MPFSO, new MPF schemes and constituent funds requires approval of MPFA.

Withdrawal of accrued benefits

- (a) *clauses 6(1), 6(2) and 25* – to add a new entitlement to scheme members to withdraw their accrued benefits by phases upon their retirement and early retirement, and provide the requirements on the payment of accrued benefits respectively. Trustees will be required to process free of charge a scheme member's request to make withdrawal no more than 12 times a year, with no restriction on the amount withdrawn in each installment;
- (b) *clauses 6(6), 38 and 40* – to introduce terminal illness as an additional ground of early withdrawal of accrued benefits by scheme members before they reach the age of 65. "Terminal illness" refers to an illness that is likely to reduce the life expectancy of the scheme member to 12 months or less as certified by a registered medical practitioner or a registered Chinese medicine practitioner;
- (c) *clause 6(8)* – to clarify the meaning of permanently ceasing employment or self-employment;
- (d) *clause 25* – to prescribe that trustees must not charge scheme members any fee or impose any penalty for the payment of accrued benefits other than necessary transaction costs;
- (e) *clause 37(4)* – to clarify the meaning of departing from Hong Kong permanently;
- (f) *clause 39* – to remove the requirement for scheme members to obtain confirmation letter from their former employers for certifying the termination of contract of employment and statutory declaration by scheme members for claiming early withdrawal of accrued benefits on the ground of total incapacity;
- (g) *clause 42* – to provide that a committee of estate appointed under the Mental Health Ordinance (Cap. 136) may make claims on behalf of the scheme members;
- (h) *clause 51* – to allow certain ORSO scheme members to enjoy the same arrangements mentioned in paragraphs (b), (c), (e) and (g) above;

- (i) *clauses 56 and 57* – to provide that the accrued benefits withdrawn by installments or on the additional ground of terminal illness will be exempted from the calculation of salaries tax;

Driving down MPF fees

- (j) *clause 7* – to empower MPFA to refuse to approve a constituent fund of registered schemes if it is not satisfied that the fund is in the scheme members' interests;
- (k) *clause 27* – to remove the requirement for trustees to give membership certificates to employees;
- (l) *clause 47* – to facilitate the use of electronic communications;

Other amendments

- (m) *clause 8* – to amend section 23(2), (3) and (4) of MPFSO to amend the Chinese rendition of "Authority" from "監督" to "管理局" to ensure consistency throughout MPFSO; and
- (n) *clauses 9 to 11 and 55* – to allow disclosure of confidential information subject to specified conditions, update the list of parties and organizations to whom the MPFA and frontline regulators in respect of regulation of MPF intermediaries may disclose information, and to include a mechanism to prohibit further disclosure unless the further disclosure is in accordance with the circumstances provided for in MPFSO; and similarly, to allow disclosure of confidential information subject to specified conditions in respect of ORSO;
- (o) *clause 17* – to extend the time limit for instituting proceedings in respect of certain offences under MPF legislation to within three years after the commission of the offence; and
- (p) *clauses 32, 52 and 53* – to clarify the determination of the contribution day and permitted period in MPF schemes in cases where the contribution day or the last day of the permitted period falls on a Saturday or a public holiday, or a gale warning day or black rainstorm warning day.

Discussions by Members on related issues

Meetings of the Panel on Financial Affairs and Finance Committee

12. The Administration/MPFA briefed the Panel on Financial Affairs ("FA Panel") on the results of the Cost Study and MPFA's proposed reform directions to lower MPF fees at the meeting on 7 January 2013. The Administration further briefed the FA Panel on the various proposals in the Bill at the meeting on 5 May 2014. Issues relating to reduction of MPF fees were also discussed at meetings of the FA Panel on 28 January 2013 and 29 January 2014, and at special meetings of the Finance Committee on 8 April 2013 and 31 March 2014 for the examination of the Estimates of Expenditure 2013-2014 and 2014-2015 respectively. The major views and concerns expressed by Members at these meetings are summarized in the ensuing paragraphs.

Reduction of MPF fees

13. Noting that there have been concerns from the community about the high fees and low investment returns of MPF schemes/funds, Members generally supported MPFA's proposed reform directions to improve the MPF system fundamentally and lower MPF fees and agreed on the need to implement measures to facilitate trustees to streamline their administration processes.

14. There was another view that as the Hong Kong MPF system was still at its initial stage of development, the administration fees would gradually come down to lower levels when the assets had accumulated to a certain level along with more experience and streamlined operations. Attempts should first be made to streamline and automate MPF's administration processes in order to reduce costs, thus driving fees down. Only when such attempts were to no avail should other options such as fee control measures be considered.

15. As regards the estimated timeframe for achieving substantial reduction in MPF fees and setting indicators (e.g. FER) to assess the effectiveness of industry's efforts in lowering fees and the need to take forward other measures such as introducing fee caps, the Administration responded that given the complexity of the existing MPF system, it would take time for the measures to streamline MPF's operation to take effect and it would be difficult to predict when MPF fees could be reduced. Nevertheless, the Administration envisaged that full implementation of the recommended measures in the Costs Study would result in further reduction of MPF fees. The Administration and MPFA would continue to observe the changes in the average FER in monitoring the developments.

16. As some of the reform proposals to reduce MPF fees might entail statutory requirements to improve governance and transparency of the MPF system, or to enhance MPFA's powers (e.g. approval for MPF funds), some Members urged that the Administration should ensure that the relevant initiatives would not result in over-regulation of the insurance industry, and conduct thorough consultation with the industry before taking forward the relevant proposals.

Terminal illness as additional ground of early withdrawal of accrued benefits

17. In respect of the proposal allowing early withdrawal of accrued benefits by scheme members on ground of terminal illness, FA Panel members were concerned about adopting "remaining life expectancy of 12 months" in the definition of terminal illness and the difficulties in obtaining the required medical certification. There was a view that the provision of a medical certificate that a person was suffering from a terminal illness or a certain stage of the terminal illness should suffice to justify the early withdrawal. Some members also suggested allowing early withdrawal of accrued benefits on other grounds, such as meeting medical expenses for early diagnosis and healing of terminal illnesses.

18. The Administration explained that to ensure effective and efficient administration, it was necessary to provide an easy-to-understand and objective definition of "terminal illness" so that the claim procedure would be straightforward. The proposed definition of "remaining life expectancy of 12 months" was the outcome of public consultation and discussion with medical professional bodies, and reference was also drawn to the 12-month life expectancy yardstick adopted for similar purposes in the Australian Superannuation System.

19. The Administration further pointed out that the MPF system was a dedicated scheme designed exclusively for retirement benefits for the workforce in Hong Kong. Allowing early withdrawal for medical treatment should be weighed against the consideration that the scheme member, if not terminally ill, still required retirement protection. Allowing such an early withdrawal meant less would be remained for the retirement needs of the scheme member concerned in future. Given that the public healthcare system in Hong Kong provided adequate healthcare services to members of the public, the Administration did not consider that using MPF benefits for medical treatment should be included as an additional ground for early withdrawal at this stage. However, it would continue to keep under review the scope of the grounds for early withdrawal in future review exercises.

Withdrawal of MPF accrued benefits by installments

20. On the proposal to allow phased withdrawal of accrued benefits upon retirement and early retirement, the Administration originally proposed that trustees should be required to accept scheme members' request to withdraw up to four times a year and with at least \$5,000 in each installment free of charge. In response to members' request for increasing the number of free withdrawals per year, and to strike a reasonable balance between improving flexibility in withdrawal to scheme members and maintaining the efficiency and cost-effectiveness of the MPF system, the Administration has amended the proposal to statutorily require trustees to allow scheme members to make free withdrawals no more than 12 times a year, with no restriction on the amount withdrawn in each installment.

21. As regards some members' suggestion to provide incentives (e.g. a higher percentage of guaranteed return from the MPF investment concerned) to encourage scheme members to opt for phased-withdrawal instead of one-off withdrawal in a lump sum, so that scheme members would better plan the use of the retirement funds, the Administration considered that such incentives were not justified since phased-withdrawal was not necessarily the best option for a scheme member, having regard to individual's personal preferences, levels of risk tolerance and other sources of wealth. Nevertheless, MPFA would enhance its education and publicity efforts to remind scheme members that if they were not in urgent need of the MPF benefits upon retirement, they might consider keeping the benefits in their personal accounts for continuous investment until they had the need to withdraw them.

Council meetings

22. At the Council meeting of 1 December 2010, Members passed a motion on "Comprehensively reviewing the Mandatory Provident Fund Scheme" which urged the Government to review the MPF Scheme covering aspects including to lower MPF management and administration fees, allow full portability of MPF benefits, and implement universal retirement protection, etc. Another motion on "Comprehensively reforming the Mandatory Provident Fund Scheme" was passed at the Council meeting of 2 November 2011 urging the Government to conduct a comprehensive review of the MPF Scheme and examine the feasibility and impact of measures, including to allow MPF Scheme contributors with exceptional reasons to suspend contributions or withdraw part of their MPF benefits, allow retirees to withdraw their MPF accrued benefits by instalments after the age of 65, implement a full portability arrangement for the MPF Scheme, streamline the management and administrative procedures to reduce the operating costs of

MPF, press MPF Scheme trustees to lower their fees, and introduce fund products operated by the Government at low management fees, etc.

23. During the debates of the above two motions, some Members suggested that the MPF system should allow withdrawal of contributions by scheme members at suitable time to suit their urgent needs as long as it was subject to proper regulation. They considered that such arrangements, which were already in place in other jurisdictions with provident fund or retirement fund systems, would be humane and allowed more choices for MPF scheme members. Some other members were of the view that the suggestion could not solve the major problems associated with the MPF system, including the low MPF investment return for retirement protection and the arrangement for offsetting severance payment/long service payment against MPF accrued benefits.

Latest Development

24. At the House Committee meeting on 4 July 2014, Members agreed to form a Bills Committee to study the Bill.

Relevant papers

25. A list of relevant papers is in the **Appendix**.

Council Business Division 1
Legislative Council Secretariat
21 July 2014

List of relevant papers

Date	Event	Paper/Minutes of meeting
1 December 2010	Council meeting	<p>Motion on "Comprehensively reviewing the Mandatory Provident Fund Scheme" moved by Hon WONG Kwok-kin</p> <p>Hansard (pages 136 – 234)</p>
2 November 2011	Council meeting	<p>Motion on "Comprehensively reforming the Mandatory Provident Fund Scheme" moved by Hon TAM Yiu-chung</p> <p>Hansard (pages 251 – 319)</p>
December 2011	Mandatory Provident Fund Schemes Authority ("MPFA") launched public consultation on withdrawal of MPF benefits	<p>Consultation paper</p>
September 2012	MPFA published consultation conclusions on withdrawal of MPF benefits	<p>Consultation conclusions</p>
6 June 2012	Council meeting	<p>Written question raised by Hon Paul TSE on "Charging rates of Mandatory Provident Fund Schemes"</p> <p>Hansard (pages 140 – 143)</p>
7 January 2013	Meeting of the Panel on Financial Affairs ("FA Panel")	<p>Administration's paper (LC Paper No. CB(1)358/12-13(03))</p> <p>MPFA's paper (LC Paper No. CB(1)358/12-13(09))</p>

Date	Event	Paper/Minutes of meeting
		Minutes (LC Paper No. CB(1)782/12-13) (paragraphs 16 to 45)
28 January 2013	Meeting of the FA Panel	Minutes (LC Paper No. CB(1)1403/12-13) (paragraphs 21 to 22)
8 April 2013	Special meeting of Finance Committee ("FC") for examination of Estimates of Expenditure 2013-2014	Written questions raised by Members and Administration's replies for the session on "Financial Services" (Reply serial numbers: FSTB(FS)019, 046, 072, 088, 113 and 149) Minutes (paragraphs 3.4-3.5)
6 November 2013	Council meeting	Written question raised by Hon CHAN Kin-por on "Measures to improve MPF Scheme" Hansard (pages 100 – 104)
31 March 2014	Special meeting of FC to examine the Estimates of Expenditure 2014-2015	Written questions raised by Members and Administration's replies for the session on "Financial Services" (Reply serial numbers: FSTB(FS)008, 009 and 045)
5 May 2014	Meeting of the FA Panel	Administration's paper (LC Paper No. CB(1)1309/13-14(04)) Background brief (LC Paper No. CB(1)1309/13-14(05))