

**立法會**  
*Legislative Council*

LC Paper No. CB(1)667/15-16

Ref : CB1/BC/3/15

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

**Purpose**

This paper reports on the deliberations of the Bills Committee on Mandatory Provident Fund Schemes (Amendment) Bill 2015 ("the Bills Committee").

**Background**

The Mandatory Provident Fund System

2. Launched in December 2000, the Mandatory Provident Fund ("MPF") System is a mandatory, privately-managed and fully-funded pension system established under the Mandatory Provident Fund Schemes Ordinance (Cap. 485) ("MPFSO") to offer basic retirement protection to the working population. Employees and self-employed persons are required to join a registered MPF scheme selected by the employers or self-employed persons (as the case may be) and make choice from a range of constituent funds ("CFs") (also generally known as MPF funds) available from the scheme for investment of contributions. All provident fund schemes intended to be operated as MPF schemes must be registered with the Mandatory Provident Fund Schemes Authority ("MPFA") and registered MPF schemes must be operated by MPF trustees approved by MPFA. Major service providers in the MPF System are approved trustees, custodians, scheme administrators and investment managers. Other than investment management, service providers of registered MPF schemes provide a bundle of services which include collecting and allocating contributions, assisting in recovery of outstanding contributions, providing statutory reporting to regulators, handling transfers between schemes and fund switches within schemes,

and administering withdrawals of accrued benefits.

### Initiatives to tackle the level of the Mandatory Provident Fund fees

3. The high level of MPF fees has been a pressing concern for the majority of the working population since the implementation of the MPF System. In 2004, MPFA introduced the fund expense ratio<sup>1</sup> ("FER") to provide a single comparative indicator for all MPF funds to disclose aggregated fees and other expenses charged to MPF funds and underlying investments.

4. In December 2011, MPFA commissioned an independent consultancy to conduct a study on the costs incurred by approved trustees in performing different MPF scheme administration functions ("the Cost Study"). Released in November 2012, the report identified a number of factors contributing to the higher administrative costs of the MPF System compared to the international pension systems in Australia, Chile, Mexico and the United States. In view of the recommendations of the Cost Study, MPFA adopted measures to further drive down MPF fees<sup>2</sup>. Furthermore, the Mandatory Provident Fund Schemes (Amendment) Ordinance 2015 ("Amendment Ordinance") was enacted by the Legislative Council ("LegCo") on 21 January 2015. The purposes of the Amendment Ordinance, among other things, are to enhance the powers of MPFA in approving CFs and facilitating approved trustees' compliance with statutory obligations to provide greater scope for MPF fee reduction. Currently, 40% of all MPF CFs, or 184 CFs, are low-fee funds, the FER of which does not exceed 1.30% or the management fees of which are not higher than 1.00%. As of 29 January 2016, the weighted average FER of all CFs in the System is 1.60%. Since 2007, the FER has fallen 24% from 2.10% to 1.60%.

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<sup>1</sup> FER is a ratio that measures the expenses of an MPF fund as a percentage of the fund's asset value. FER of an MPF fund should be prepared and calculated by MPF trustees or appointed operators in the following manner: FER (%) = direct expense (%) + underlying fund costs if any (%) +/- any adjustments permitted or required by MPFA in any individual case.

<sup>2</sup> The measures include (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, and merging smaller scale or less efficient schemes/CFs; (c) facilitating scheme members in consolidating their personal accounts; (d) promoting index funds in the CF approval process; (e) implementing Employee Choice Arrangement to facilitate market competition; and (f) enhancing fee disclosure.

Calls for enhancing investment choices for scheme members and the need to develop a Default Investment Strategy

5. Since the implementation of the MPF System, there have been calls for enhancing investment choices for scheme members. Under the existing MPF System, a scheme member can choose to invest his/her accrued benefits in one or more CFs under the MPF scheme. But if the scheme member, for whatever reason, has not made any CF choice, the approved trustee will invest the accrued benefits of the scheme member in one or more of CFs as determined by the approved trustee according to the relevant governing rules ("GRs"). Currently, the default investment arrangements ("DIAs") determined by GRs and provided under the MPF System are not statutorily regulated. According to the Administration, different MPF schemes have different DIAs/default CFs. The investment objectives, risk levels, fee levels and investment returns of existing DIAs vary widely across different schemes. Some existing default CFs may not suit the long term investment objective of retirement savings. With reference to the recommendations of a research study by the Organisation for Economic Co-operation and Development ("OECD") and international practices, MPFA has recommended the Administration to consider the proposals of requiring all MPF schemes to offer a highly-standardized, globally diversified and fee-controlled default investment strategy to replace the existing DIAs, i.e. the "core fund"<sup>3</sup>.

6. In June 2014, the Administration and MPFA jointly launched a three-month consultation on the Default Investment Strategy ("DIS")<sup>4</sup> proposals. According to the Administration, the majority of the respondents (i.e. 81.4% of respondents) agreed with the proposed general direction of the proposals. In view of the feedback to the consultation, the Administration decided to introduce amendments to MPFSO to require each approved trustee to provide in each MPF scheme a highly-standardized, globally diversified and fee-controlled DIS.

## **The Bill**

7. The Bill was published in the Gazette on 13 November 2015 and received its First Reading at the LegCo meeting of 25 November 2015. The Bill seeks to amend MPFSO and the Mandatory Provident Fund Schemes (General) Regulation (Cap. 485A) ("MPFS(G)R") to:

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<sup>3</sup> The term "Default Investment Strategy" is used in the Bill to denote the concept of "core fund" which in fact is comprised of more than one CF.

<sup>4</sup> The proposed "DIS" was previously called "core fund" in the relevant consultation paper.

- (a) require approved trustees to provide in GRs of registered schemes a DIS and to invest scheme members' accrued benefits according to the DIS under certain circumstances;
- (b) specify the requirements of the DIS;
- (c) provide for matters concerning the regulation of the DIS; and
- (d) introduce amendments relating to the offence of making a false or misleading statements under MPFSO, and the operation and daily administration of registered schemes provided in MPFS(G)R.

8. As explained in the LegCo Brief and Explanatory Memorandum of the Bill, the objectives of introducing the DIS are to address the problems of high fees and difficulty in making investment choices in the MPF System by regulating the DIAs, so as to ensure that all scheme members have access to a highly-standardized and fee-controlled DIS that is consistent with the overall objective of retirement savings. The major features of the DIS are as follows:

- (a) Provision of specified CFs  
Each approved trustee will statutorily be required to provide, in each scheme, a regulated, highly-standardized DIS containing two CFs, i.e. a higher risk mixed asset fund called the Core Accumulation Fund, and a lower risk mixed asset fund called the Age 65 Plus Fund<sup>5</sup>;
- (b) De-risking mechanism  
This serves to adjust the investment risk exposure of DIS members in accordance with individual members' age. Under the mechanism, the accrued benefits of a DIS member who is aged between 18 to 49 will be invested in the Core Accumulation Fund only. From the age of 50 onwards, a DIS member's accrued benefits in the Core Accumulation Fund will be gradually switched to and completely invested in the Age 65 Plus Fund by the time he/she is 65; and

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<sup>5</sup> The Core Accumulation Fund is a CF which aims to invest predominantly (i.e. 60%, but with +/- 5% variation) in higher risk assets such as global equities, whereas the Age 65 Plus Fund is a CF which aims to invest predominantly (i.e. 80%, but with +/- 5% variation) in lower risk assets such as global bonds.

(c) Fee control mechanism

The total payment of fees<sup>6</sup> (not including out-of-pocket expenses) charged to the Core Accumulation Fund, the Age 65 Plus Fund or a DIS member cannot exceed a prescribed maximum rate to be specified in the law, i.e. a daily rate equivalent to an annualized rate of 0.75% of net asset value ("NAV") of CF. The fee cap will be reviewed regularly with a view to identifying room for possible adjustment of the level downward further.

The main provisions of the Bill are set out in **Appendix I**.

### **The Bills Committee**

9. At the House Committee meeting on 27 November 2015, members agreed to form a Bills Committee to study the Bill. The membership list of the Bills Committee is in **Appendix II**.

10. Under the chairmanship of Hon TAM Yiu-chung, the Bills Committee held four meetings between December 2015 and February 2016 to deliberate on the details of the Bill with the Administration, including one meeting to receive oral representations from 12 deputations. A list of deputations which have submitted views to the Bills Committee is in **Appendix III**.

### **Deliberations of the Bills Committee**

11. The Bills Committee generally supports the policy intent of the Bill to improve the DIAs by mandating statutorily that each approved trustee is to provide, in each scheme, a regulated, highly-standardized and fee-controlled DIS, which is consistent with the overall objective of retirement savings. Hon WONG Yuk-man and Hon LEUNG Kwok-hung, however, express strong objection to the entire privately-managed MPF System and therefore do not support the DIS proposal.

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<sup>6</sup> The total payments include those asset-based fees paid for the services provided by: (a) the trustee; (b) the administrator, investment manager, custodian and their delegates; and (c) the sponsor and promoter of a scheme and the same types of fees chargeable to underlying investment funds.

12. In the course of scrutiny, the Bills Committee has noted and discussed the various issues and concerns raised by deputations concerning the requirements and regulation of DIS. Members have expressed different views on the introduction of the DIS in the following aspects:

- (a) policy objectives and operation of the DIS;
- (b) investment and transitional arrangements for the DIS;
- (c) MPFA's supervision and consequences of non-compliance by approved trustees;
- (d) investment principles of the DIS and the two CFs; and
- (e) fee control mechanism.

### Policy objectives and operation of the DIS

13. As explained by the Administration, the introduction of a fee-controlled DIS to the MPF System is an expedient and direct solution to address the problems of high MPF fees and difficulty in making investment choices of CFs. Most members and deputations in general express support for the introduction of the DIS. Some members, however, raise queries on the operation of the DIS.

14. Some members, including Hon LEE Cheuk-yan and Hon LEUNG Kwok-hung, and some deputations opine that one of the deep-rooted problems with the MPF System is the arrangements of offsetting severance payments and long service payments against MPF accrued benefits, which has been seriously undermining the accumulation of savings for long term retirement protection. They consider that such offsetting arrangements should be abolished to protect the interests of scheme members. While noting the widespread public concern about the offsetting arrangements, the Administration reiterates that the main object of the Bill is to mandate each approved trustee to provide a highly-standardized, fee-controlled DIS in every MPF scheme. Hence, the proposed abolition of the offsetting arrangements is outside the scope of the Bill.

15. Hon WONG Yuk-man and Hon LEUNG Kwok-hung strongly object to the entire privately-managed MPF System and criticize the System for high fees and unsatisfactory investment returns of CFs. They oppose to the DIS proposal and consider that the DIS cannot address the most acute problems of the MPF System. They also opine that the Administration has the responsibility to provide retirement protection to Hong Kong people. Both Hon LEUNG Kwok-hung and

Hon LEE Cheuk-yan consider that the Administration should introduce a single DIS, take up the role of a public trustee to operate the DIS, and provide guaranteed returns to truly protect the interests of scheme members. The Chairman and Hon TANG Ka-piu have suggested that guaranteed returns could be provided under the arrangement similar to that offered by iBond issued by the Administration.

16. On the suggestion of introducing a single DIS, some members including Hon IP Kwok-him, Hon Albert CHAN, Hon Kenneth LEUNG and Hon TANG Ka-piu, and a number of deputations take the view that the Administration should also consider introducing a single DIS operated by a public trustee, such as the Hong Kong Monetary Authority, or jointly operated by the existing approved trustees for use by all schemes in the MPF System, so as to achieve greater economies of scale and larger scope of fee reduction.

17. The Administration stresses that operating a DIS through a public trustee will require the establishment of a new operating system and enactment of relevant legislation and thus will involve a long period of preparation and development. In order to allow scheme members to benefit from a fee-controlled DIS as soon as possible, the Administration considers it more appropriate and efficient for the market to develop and operate the DIS that will suit the needs of members of individual schemes based on the highly-standardized investment parameters that are defined in the law. The Administration advises that the MPF System is designed to assist the working population to save for their retirement while public resources will continue to focus on those in need, and as such the Administration has no plan to change the privately-managed model of the MPF System and provide guaranteed returns which require taxpayers to bear the investment risks and take such financial commitments.

18. The Administration further explains that the policy objectives of iBond and that of the DIS are very different. The primary objective of iBond is to promote the development of the local bond market, whereas MPF is a long-term retirement saving system to assist the working population to save for retirement.

19. Members are also concerned about the prospect of the development of the DIS, including its participation rate in a long run. According to MPFA, in many countries, the level of investment into defaults is much higher than in Hong Kong. The Administration explains that it is difficult to estimate the number of accounts and the total amount of benefits that will ultimately be transferred to and invested into

the DIS, but the participation in the proposed DIS should increase over time. MPFA will keep the situation in view and collect from approved trustees DIS-related statistical data for assessment.

### Investment and transitional arrangements for the DIS

#### *Opt-out approach*

20. Members note that the transitional arrangements as specified in the proposed Division 3 of Part 4AA under clause 8 of the Bill apply to all scheme members who satisfy the criteria set out in the proposed section 34DF (i.e. "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 and MPF conservative funds, etc.). Within six months after the commencement of the DIS, an approved trustee has to give a specified notice to a default scheme member. The specified notice will inform the default scheme member that he can choose not to invest in the DIS by specifying his investment instructions. If no reply has been received from the default scheme member, the approved trustee will transfer the accrued benefits to the DIS within 14 days after the expiry of the 42-day reply period.

21. Meanwhile, members note that if the accrued benefits of the default scheme member have been invested in a guaranteed fund according to the DIA, the approved trustee must not invest those benefits according to the DIS if, on the last day 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. As explained by the Administration, this exception is designed to protect scheme members from losing the benefit of a guarantee that has already accrued if they need to sell the fund units invested in a guaranteed fund for transfer to the DIS CFs.

22. According to the Administration and MPFA, 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 the 42-day reply period, unless they choose to give specific investment instructions to their approved trustees within that 42-day period.



23. Members notice that in respect of pre-existing accounts for which the age of the members holding those accounts are known to have reached 60 before the commencement date, the proposed section 34DB(2) applies and those accounts should not be affected by the introduction of the DIS; and in respect of new accounts opened on or after the commencement date, an approved trustee has to invest the accrued benefits of a new scheme member (including those who have reached the age of 60 or whose age is unknown) who has not given any specific investment instructions into the DIS.

24. Members have discussed in detail and some members raised concern about the opt-out approach adopted for the transitional arrangements under the proposed DIS.

25. While most members and deputations consider that the opt-out approach serves the interests of disengaged scheme members, quite a number of members including Hon Alan LEONG, Hon SIN Chung-kai and Hon CHAN Kin-por share a view of the industry that accrued benefits of default scheme members invested in conservative funds or guaranteed funds will be transferred to the higher risk Core Accumulation Fund without their explicit consent, if those members do not respond to the specified notice. Instead, the opt-in approach will avoid possible disputes and legal proceedings arising from the transfer of accrued benefits to the DIS without express investment instructions from scheme members, especially in case of financial loss. The Administration and MPFA are also urged to conduct large-scale promotion and educational activities to raise public awareness of the transitional opt-out arrangements for the DIS, and to continue engaging the industry relating to the technical issues of the implementation of the DIS.

26. The Administration notes the concern from the industry and explains that the proposed DIS is to protect the interests of disengaged scheme members who have not made their own investment decisions relating to all of their accrued benefits. It is roughly estimated by approved trustees that around one million, out a total of 8.8 million accounts, may be subject to the opt-out transitional arrangements. Existing scheme members who have made specific investment instructions (around 90% of existing accounts) will not be affected by the proposed transitional arrangements, unless they specifically choose to invest in the DIS by opting in. The remaining 10% of accounts belonging to disengaged scheme members who have not given investment instructions, are the target group of the DIS.

27. From the operational perspective, the Administration acknowledges that the opt-in approach, with express investment instructions from scheme members, may minimize disputes. However, this will only be a logical approach if the target group is primarily active scheme members who will digest the information about the DIS and make an informed and conscious decision to choose the DIS or otherwise. Yet, in the Administration's view, it is highly unlikely that disengaged scheme members will do so and as a result, adopting the opt-in approach will defeat the objective of helping disengaged scheme members protect their interests. The opt-out approach will best serve the interests of disengaged scheme members by mandating the investment of their accrued benefits in the DIS consistent with the objective of long-term retirement savings.

28. The Administration further explains that to minimize the scope for unintended outcomes, MPFA will mount large-scale publicity campaigns after the enactment of the Bill to enhance public understanding of the DIS including the impact of the transitional arrangements. In order to facilitate disengaged scheme members to understand the implications of DIS transfers, a 42-day opt-out period is proposed in the new section 34DH under clause 8 of the Bill to give sufficient time for default scheme members to consider their MPF investments. In addition to serving the best interests of disengaged scheme members, the opt-out approach will help facilitate early growth of the relevant funds.

#### *Constitutionality of the transitional arrangements*

29. Some members including Hon SIN Chung-kai are concerned about the constitutionality of the proposed transitional arrangements and subsequent transfer of accrued benefits from the existing DIAs to the proposed DIS.

30. The Administration advises the Bills Committee that the proposed transitional arrangements are in compliance with Articles 6, 25 and 105 of the Basic Law. Legal opinion confirms that the proposed transitional arrangements do not constitute deprivation of default scheme members' property. 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 are fair and not disproportionate.

*The proposed reply period*

31. Hon SIN Chung-kai and Hon POON Siu-ping urge the Administration to consider providing a longer period for scheme members to opt out from the DIS to allow more time for default scheme members to make choices for their MPF investments.

32. The Administration and MPFA maintain that the proposed 42-day reply period is appropriate. Having considered the actual operation of the industry, MPFA considers that the proposed length of reply period is sufficient for default scheme members to understand the DIS and respond to the approved trustees should they prefer to invest their accrued benefits in some other manner. The proposed reply period is also sufficient for approved trustees to identify any returned mail cases and handle those cases with no reply received in accordance with the law. MPFA considers that the proposed length of the reply period should 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 about the notice by the end of the reply period.

*Manner of delivery of specified notice*

33. Hon Albert CHAN and Hon SIN Chung-kai have suggested that the notification to existing default scheme members about the DIS transitional arrangements should be sent by registered mail with advice of delivery to avoid possible disputes on the manner of delivery of such notification. The Administration considers in actual operation, the proposed section 34DI can adequately address the members' concern and moreover, it is more appropriate to set out in guidelines the detailed procedures that are to be carried out by approved trustees to locate default scheme members whose contact details (e.g. addresses or telephone numbers) are unknown to the approved trustees. The proposed section 34DI provides that MPFA may issue such guidelines.

*Accounts of bankrupt default scheme members*

34. Some members including Hon Albert CHAN and Hon IP Kwok-him are concerned about the transitional arrangements applicable to default scheme members who are bankrupt. MPFA advises that the accrued benefits derived from mandatory contributions in respect of a member of an MPF scheme are protected and do not become vested in the approved trustee by virtue of MPFSO. The transitional arrangements applicable to bankrupt default scheme members are the

same as to other default scheme members. The approved trustees are required to notify the bankrupt scheme member in writing about the transitional arrangements. The approved trustees are required to inform the Official Receiver's Office and obtain prior consent from the latter in respect of any payment of accrued benefits to a bankrupt scheme member. Afterwards, the trustee-in-bankruptcy will be able to claim the amount as property of the bankrupt scheme member.

### *Standards of conduct of approved trustees*

35. Members have raised concern about how the Administration could prevent the approved trustees from withholding information and not informing their scheme members about the DIS, or directing members away from choosing the DIS. Hon TANG Ka-piu cautions that the approved trustees may have the incentives to encourage existing default scheme members to opt out from the fee-controlled DIS, such as by offering gifts to them.

36. The Administration points out that while MPFA will step up public education and publicity on the introduction of DIS, all approved trustees are statutorily required by the existing relevant provisions in MPFSO to notify all existing scheme members about the introduction of any new CFs because there will be a change to GRs of the scheme. MPFA has also issued guidelines on the standards of conduct expected of MPF intermediaries when conducting sales and marketing activities and giving advice relating to registered schemes.

### MPFA's supervision and consequences of non-compliance by approved trustees

37. Members are concerned about MPFA's power of on-going supervision over the DIS CFs for protection of scheme members' benefits. The Administration assures the Bills Committee that the DIS CFs will have to comply with the additional specific requirements to facilitate MPFA's assessment of the approved trustee's compliance with the DIS requirements (e.g. investment principles and fee cap). MPFA is empowered under the Bill to request an approved trustee to provide an auditor's investigation report on its compliance with the DIS if MPFA reasonably believes that the approved trustee fails to comply with DIS-related requirements.

38. As for the financial penalties for the approved trustees' failure to comply with DIS-related requirements such as failing to transfer default

scheme members' accrued benefits to the DIS CFs for investment according to the DIS, the Bills Committee notes that the approved trustees concerned are to be subject to the amount of financial penalty proposed to be set out in Schedule 4 to MPFS(G)R under clause 26 of the Bill.

*Suggestion of introducing a performance-based mechanism*

39. In view of the general criticism within the society about the poor investment performance and unsatisfactory investment returns of the existing MPF schemes, some members including Hon TANG Ka-piu and Hon CHUNG Kwok-pan are keen to urge the Administration to introduce a performance-based mechanism for controlling the management fees charged by the approved trustees of the DIS CFs, so as to better protect the interests of scheme members.

40. While taking note of the members' concern about the investment performance of existing MPF schemes, the Administration advises that there is currently no plan to include any investment performance-based elements within the fee control mechanism proposed for the DIS. Approved trustee administrative functions, and hence costs, are not in any material way related to investment performance. There is no logical basis to link approved trustee fees to investment performance. Investment performance-based fees are sometimes considered in relation to investment management fees but it is difficult to adopt such a fee model in the DIS context based on two reasons. First of all, a performance-related fee introduces a conditionality which will make the calculation and operation of a daily fee control much more difficult. Secondly, index-based investment may well be a common feature of DIS CFs. Under such an approach, which is encouraged in terms of cost and consistency, investment outcomes are almost exclusively driven by investment markets, rather than the efforts of individual investment managers. In the Administration's view, it appears quite arbitrary to attach the manager's fees to the outcome of a particular index over which the manager has no control. Nevertheless, the approved trustees can include any performance-related component in setting their management fee to be charged to their DIS CFs, subject to the total management fee cap of 0.75%.

41. To help protect the accrued benefits of scheme members and drive approved trustees to maintain reasonable investment returns for the DIS CFs through market competition, Hon TANG Ka-piu has indicated his intention to propose Committee stage amendments ("CSAs") to

clauses 4, 11 and 26 of the Bill to the effect that a performance-based penalty be introduced for the DIS, whereby the annualized investment return rate of the Core Accumulation Fund under the DIS for the past three or five years must not be lower than the annualized Consumer Price Index of the same respective period, failing which the approved trustee concerned will face financial penalties or revocation of its approval by MPFA.

42. Hon TANG Ka-piu has further indicated that in order to facilitate the monitoring by the general public of the investment performance of the DIS CFs managed by approved trustees and to facilitate fund competition, he also intends to propose a CSA to add a new section 34DBA under clause 8 of the Bill to the effect that MPFA be requested to prepare a report including the ranking of investment return rate of Core Accumulation Funds after the end of each financial year and deliver the report to LegCo and scheme members for reference.

#### Investment principles of DIS and the two CFs

##### *De-risking mechanism*

43. Members raise concern about the effectiveness of using the two CFs (i.e. the Core Accumulation Fund and the Age 65 Plus Fund) and applying the globally diversified and de-risking investment principles under the DIS, as set out in Part 2 of the proposed Schedule 10 under clause 11 of the Bill.

44. Members note that the de-risking mechanism refers to the allocation of the benefits of a DIS member from investing in a CF comprising higher risk assets to one comprising more lower risk assets based on the member's age. In considering the optimal number of CFs to be adopted to achieve de-risking, factors such as efficiency of the investment structures and benefits of economies of scale strongly suggest that the fewer CFs used, the more efficient will be the structure. The proposed DIS uses the least possible number of CFs, thus minimizing the cost implication for the industry and scheme members.

45. Members also note that another element of achieving efficiency is through setting up a DIS under each individual scheme. The current proposal of requiring approved trustees to set up DIS CFs under each MPF scheme will allow the quickest implementation, as compared to using a single set of funds across all schemes.

46. As for the proposed allocation of higher risk assets and lower risk assets in the two DIS CFs, the Administration and MPFA have taken into account the recommendations of a research study by OECD, international practices and local expert consensus. The proposed asset allocation is 60% exposure to higher risk assets until age 50, which is reduced gradually to 20% by age 65. The proposed approach represents a good balance of empirical analysis and observed practice. As for the proposed globally diversified investment principle, the Administration and MPFA have taken into account the need to balance the investment risks over a 40-year benefits accumulation period, exposing investments to multiple market investment cycles, as well as the need to prevent concentration of investments in one single market or region. The Administration and MPFA are of the view that focusing on one single market will lead to a greater dispersion of outcomes and increase the probability of extremely negative outcomes which is not in the best interest of scheme members.

47. The Administration further advises the Bills Committee that currently, none of the existing CFs under the DIAs of the approved trustees has met the proposed investment requirements of the DIS, i.e. globally diversified and de-risking investment principles, in the Bill. After the enactment of the Bill, the approved trustees have to submit their proposals of DIS for each scheme to MPFA and the Securities and Futures Commission for approval.

48. Hon WONG Yuk-man is of the view that the proposed de-risking mechanism is not effective enough to help scheme members achieve greater risk diversification in their MPF investments. In this connection, Hon WONG Yuk-man has indicated that he may propose CSAs to amend the provisions relating to the de-risking mechanism to the effect that the de-risking be commenced when the DIS member reaches the age of 42, which is about the mid-point between 18 and 65 so as to better diversify investment risks.

#### Fee control mechanism

##### *Level of management fee cap of 0.75% and out-of-pocket expenses*

49. The Bills Committee notes that the control of payment for services (i.e. management fees) to the DIS is set out in the proposed new section 34DC under clause 8 of the Bill. Such fees to the approved trustee, a specified service provider, a sponsor or promoter should not in total exceed 0.75% of the NAV of a DIS CF per annum (i.e. a daily rate

equivalent to an annualized rate of 0.75% of the NAV of the CF). Under the proposed section 34DD, the Secretary for Financial Services and the Treasury is empowered to amend the investment requirements in the proposed Schedule 10 and the level of the fee cap in the proposed Schedule 11. Such empowered amendments will be subject to negative vetting by LegCo.

50. The Bills Committee also notes that there are other fees and expenses permitted to be charged to the DIS CFs. These fees and expenses are broadly referred to as out-of-pocket expenses<sup>7</sup> relating to the discharge of approved trustees' duties. According to MPFA's internal analysis conducted with reference to the fee information available in June 2014, the difference between the average FER and average aggregate management fees (simple average) was estimated to be 0.2%. In other words, the components of fees and expenses other than management fees in FER amount to 0.2% of NAV as an average across all CFs.

*Adjustment of the management fee cap level of 0.75% and the request for capping the fee level for out-of-pocket expenses*

51. Members and some deputations raise queries about the proposed level of the management fee cap and what fee items should be included under the cap. While some members including Hon CHUNG Kwok-pan, Hon TANG Ka-piu and Hon LEE Cheuk-yan consider that the proposed management fee cap of 0.75% should not exclude those other fees and charges which are primarily out-of-pocket expenses, some other members including Hon WONG Yuk-man and Hon Kenneth LEUNG are of the view that such management fee cap can be adjusted downward further. Members also have reservation about the difficulty in capping other fees and expenses permitted to be charged to the DIS CFs. They are concerned about whether there is room for lowering the percentage of such fees and charges in future.

52. The Administration and MPFA explain that it will be difficult to cap other fees and expenses that could apply to the DIS CFs since they are primarily out-of-pocket expenses relating to the discharge of approved

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<sup>7</sup> Out-of-pocket expenses relating to the discharge of approved trustees' duties include: auditor's fees; legal and other professional charges; preparation cost and publication expenses; printing and postage; fund price publication expenses; bank charges; dealing costs; transaction cost incurred in buying and selling underlying investment; and governmental fees and charges (including, without limitation, stamp duty, licence fee and other duties), etc.



trustees' duties. Such costs, which are fact specific, are often unpredictable, not known in advance and outside the approved trustees' control. They are also charged at a fixed amount. It is also difficult to include these fees and expenses in the calculation and operation of a daily fee control mechanism based on the NAV of the CFs.

53. Regarding the room for lowering the percentage of such other fees and charges in future, the Administration and MPFA advise that these other fees and expenses vary by fund type (being higher, for example, for equity funds), and that funds with smaller asset sizes on average have higher percentages of other fees and expenses (in terms of a percentage of NAV) than those with bigger asset sizes. Mixed assets funds with an asset size of \$100 million and below are estimated to have an average "other fees and expenses" of 0.32% of NAV, while those with an asset size over \$10 billion have an average "other fees and expenses" of 0.14% of NAV.

54. The Administration and MPFA further explain that there are two types of custodian fees and only the transaction-based fees paid for the services provided custodians that are similar to out-of-pocket expenses are not subject to the management fee cap of 0.75% for the DIS. The asset-based fees paid for the services provided by the custodians that are similar to management fees are subject to the fee cap of 0.75%. Other custodian fees are transaction-based out-of-pocket expenses, which are customarily not calculated as a percentage of the NAV of the CF and are not charged on an ex-ante basis. Those out-of-pocket expenses charged by custodians may vary with asset allocation, or are trading fees resulting from re-balancing, etc. which cannot be included in the fee cap.

55. Noting that some of the custodian fees may not be included in the management fee cap of 0.75%, Hon TANG Ka-piu is worried that the approved trustees or custodians will circumvent the fee control by alternating fee charging practices. To eliminate the possibility of overcharging for transaction-based custodian fees, Hon TANG Ka-piu has indicated his intention to propose a CSA to delete the proposed section 34DC(3)(b) to the effect that all custodian fees be subject to the management fee cap of 0.75%.

56. Hon WONG Yuk-man considers the level of management fee cap of 0.75% for the DIS CFs unacceptable. He notes that the two DIS CFs target to invest a considerable percentage (about 40% to 80%) of the NAV of the CF in lower risk investments, and considers that such investments rarely require active management by the investment managers and that

minimal marketing charges will be required for the DIS. According to the Cost Study commissioned by MPFA in 2012, data collected from approved trustees and administrators indicate that the weighted average investment management fee is 0.59% of the assets under management. Against this background, Hon WONG Yuk-man has indicated his intention to propose a CSA to the effect that the proposed management fee cap be amended as 0.59% for the DIS CFs.

57. Hon CHUNG Kwok-pan is not content with the Administration's and MPFA's explanation of the difficulty in capping the out-of-pocket expenses permitted to be charged to the DIS CFs. He considers it necessary to have a cap on these expenses. As such, Hon CHUNG Kwok-pan has proposed to move three alternative sets of CSAs to the following effects respectively:

- (a) all out-of-pocket expenses be included in calculating the management fee which is subject to the proposed fee cap of 0.75%;
- (b) a fee cap level of 0.2% be imposed on out-of-pocket expenses; and
- (c) a sunset clause be added to cause the expiry of the proposed section 34DC (i.e. fee control mechanism) on 31 December 2021, and at the appropriate time before it expires, to conduct a review and public consultation on the implementation of the DIS, in particular its effect on the payment for services charged to the DIS CFs. MPFA must prepare a report on the outcome of the review and public consultation and the report must be laid on the table of LegCo before a specified date.

As regards the order of priority among the three sets of CSAs, Hon CHUNG Kwok-pan has also proposed that subject to all the three sets of CSAs being ruled admissible by the President, the first set of CSAs in (a) above should be moved and voted on first; if they are negatived, the second set of CSAs in (b) above should then be moved and voted on; and if the first and the second sets of CSAs are both negatived, the third set of CSAs in (c) above should then be moved and voted on. Hon CHUNG Kwok-pan has invited the Bills Committee to consider whether the Chairman will move his proposed CSAs on behalf of the

Bills Committee<sup>8</sup>.

*Annual review on fee control mechanism*

58. Some members including Hon POON Siu-ping and Hon TANG Ka-piu are of the view that the Administration should consider conducting an annual review on the level of fee cap of 0.75% for the DIS to keep a close watch on the overall implementation of the DIS for further enhancement, and most importantly, to assess whether further downward adjustment of the fee cap level is possible. Other members including Hon CHUNG Kwok-pan suggested a review to be conducted five years after the implementation of the DIS.

59. The Administration and MPFA advise that it is too early to determine the appropriate timing and frequency of such a review without knowing the eventual participation rate of the DIS and in the absence of experience on the operation of the DIS. The proposed section 34DD under clause 8 of the Bill has already provided a review mechanism with flexibility.

60. Noting the Administration's reply, Hon TANG Ka-piu maintains his intention to propose a CSA to add a new subsection (4A) to the proposed section 34DC under clause 8 of the Bill to the effect that the percentage of the fee cap specified in Schedule 11 is to be reviewed after the end of each financial year, and if downward adjustment of the percentage is warranted after review, the Administration must act correspondingly to make relevant adjustment.

*Central database for MPF schemes*

61. Some members including Hon CHUNG Kwok-pan suggest that the Administration should consider setting up a central database for standardizing and streamlining the administration of different MPF schemes, thereby reducing the relevant administrative costs. The Administration advises that MPFA has commissioned a consultancy study on the feasibility of the standardization, streamlining and automation of MPF scheme administration, and the Administration and MPFA will, based on the study results, consider the requirements for setting up a centralized electronic platform, i.e. eMPF. It is expected that this platform will further streamline operational processes handled by approved trustees and employers, providing a greater scope for fee

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<sup>8</sup> Please also see paragraph 63 of this Report.

reduction.

## **Committee stage amendments**

### CSAs proposed by the Administration

62. Members note that the Administration has proposed to move CSAs which are technical or consequential in nature to improve the clarity of the provisions of the Bill, including the amendments to provide certainty to the timing of the implementation of the DIS, i.e. on 31 December 2016; to clarify the scope of application of the proposed transitional arrangements; and to specify clearly the provisions relating to the investment arrangements as well as the implementation of the de-risking mechanism. The Bills Committee raises no objection to these CSAs.

### CSAs proposed by the Bills Committee

63. At the meeting on 15 February 2016, the Bills Committee considered the request by Hon CHUNG Kwok-pan and agreed to move the CSAs in accordance with his suggestion. Details of Hon CHUNG Kwok-pan's proposed CSAs are set out in paragraph 57.

### CSAs proposed by individual Members

64. The Bills Committee takes note that Hon TANG Ka-piu has indicated his intention to move CSAs to the Bill. Details of Hon TANG Ka-piu's proposed CSAs are set out in paragraphs 41, 42, 55 and 60. The Bills Committee also notes that Hon WONG Yuk-man has indicated his intention to move CSAs to the Bill as detailed in paragraphs 48 and 56.

## **Resumption of the Second Reading debate**

65. The Bills Committee raises no objection to the resumption of the Second Reading debate on the Bill at the Council meeting of 16 March 2016.

## **Consultation with the House Committee**

66. The Bills Committee reported its deliberations to the House Committee on 26 February 2016.

Council Business Division 1  
Legislative Council Secretariat  
10 March 2016

**Main provisions of  
the Mandatory Provident Fund Schemes (Amendment) Bill 2015**

The Mandatory Provident Fund Schemes (Amendment) Bill 2015 contains 26 clauses. The main provisions are as follows –

- (a) **Clause 5** – to add a new section 27(2A) to MPFSO to make it a duty for the approved trustee of a registered scheme to invest a scheme member's accrued benefits according to the member's selections;
- (b) **Clause 8** – to add a new Part 4AA to MPFSO to provide matters concerning the DIS, including adding –
  - (i) a new section 34DB to require each approved trustee to provide in GRs of each scheme a DIS that complies with the statutory requirements set out in the Bill, to invest the accrued benefits of a default scheme member according to the DIS and to ensure that the strategy is available for selection by scheme members;
  - (ii) a new section 34DC to require the approved trustee to comply with the fee control mechanism in relation to the DIS;
  - (iii) a new section 34DD to empower the Secretary for Financial Services and the Treasury to amend by notice published in the Gazette Schedule 10 (in respect of investment principles) and Schedule 11 (the percentage for calculation of the cap on the payment for services related to the DIS); and
  - (iv) new sections 34DE to 34DL to provide for the transitional and savings arrangements for accrued benefits held in pre-existing accounts of scheme members;
- (c) **Clause 11** – to add new Schedules 10 and 11 to MPFSO to specify respectively the DIS investment principles and the percentage for calculation of the cap on the payment for services related to the DIS;

- (d) **Clause 20** – to amend section 66 of MPFS(G)R to make the permission given to an approved trustee to deduct expenses from scheme members' account subject to the requirements under the new section 34DC;
- (e) **Clauses 6, 15, 21, 23 and 24** – to amend section 30 of MPFSO and sections 39, 75, 102 and 103 of MPFS(G)R to specify the DIS compliance regime;
- (f) **Clauses 4 and 7** – to amend sections 20B and 33 of MPFSO to empower MPFA to revoke the approval of a trustee as an approved trustee, suspend or terminate an approved trustee's administration of a registered scheme if an approved trustee fails to comply with the trustee's statutory obligations relating to the DIS requirements, and clause 26 to amend Schedule 4 to MPFS(G)R to prescribe the financial penalties in relation to non-compliance of DIS-related requirements and the duty for an approved trustee to invest a scheme member's accrued benefits according to the member's instructions;
- (g) **Clause 9** – to amend section 43E of MPFSO to provide that making a false or misleading statement to a trustee of an MPF exempted occupational retirement registered scheme is a summary offence under MPFSO;
- (h) **Clause 14** – to amend the definition of prescribed savings rate ("PSR") in section 37 of MPFS(G)R to remove the requirement for MPFA to publish the rate in a Chinese language newspaper and an English language newspaper in Hong Kong and to empower MPFA to prescribe the rate by notice published in a manner that it considers appropriate; and
- (i) **Clauses 16, 17, 18, 19, 22 and 25** – to amend sections 42C, 42D, 42E, 62, 99 and 117 of MPFS(G)R to exclude Saturday for the purposes of calculating the time limit of certain reporting obligations of approved trustees and other specified parties.

Source: Legislative Council Brief (File Ref: MPF/2/1/39C(2015)Pt.2) issued by the Financial Services and the Treasury Bureau on 10 November 2015.

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

**Membership List**

**Chairman**

Hon TAM Yiu-chung, GBS, JP

**Members**

Hon LEE Cheuk-yan

Hon Abraham SHEK Lai-him, GBS, JP

Hon Andrew LEUNG Kwan-yuen, GBS, JP

Hon WONG Ting-kwong, SBS, JP

Hon Cyd HO Sau-lan, JP

Hon CHAN Kin-por, BBS, JP

Hon IP Kwok-him, GBS, JP

Hon Alan LEONG Kah-kit, SC

Hon LEUNG Kwok-hung

Hon Albert CHAN Wai-yip

Hon WONG Yuk-man

Hon NG Leung-sing, SBS, JP

Hon CHAN Han-pan, JP

Hon Kenneth LEUNG

Hon KWOK Wai-keung

Hon Christopher CHEUNG Wah-fung, SBS, JP

Hon SIN Chung-kai, SBS, JP

Hon POON Siu-ping, BBS, MH

Hon TANG Ka-piu, JP

Hon CHUNG Kwok-pan

(Total : 21 members)

**Clerk**

Mr Desmond LAM

**Legal Adviser**

Miss Joyce CHAN



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

**List of organizations/individuals which/who have  
submitted views to the Bills Committee**

1. Hong Kong Professionals and Senior Executives Association
2. The Hong Kong Federation of Insurers
3. The Hong Kong Federation of Trade Unions Rights and Benefits Committee
4. Liberal Party
5. Hong Kong Investment Funds Association
6. The Hong Kong Society of Financial Analysts
7. The Actuarial Society of Hong Kong
8. Hong Kong Trustees' Association
9. Employers' Federation of Hong Kong
10. Civic Party
11. The Hong Kong Retirement Schemes Association
12. The Federation of Hong Kong & Kowloon Labour Unions
- \* 13. The Chinese General Chamber of Commerce
- \* 14. The Chinese Manufacturers' Association of Hong Kong
- \* 15. Morningstar Investment Management Asia Limited
- \* 16. A member of the public
- \* 17. The Hong Kong Association of Banks
- \* 18. A member bank of The Hong Kong Association of Banks
- \* 19. MSCI Hong Kong Limited

\* submitted written views only