

II. REPORT

The date of First Reading of the Bill is 25 November 2015. Members may refer to the Legislative Council (LegCo) Brief (File Ref : MPF/2/1/39C(2015) Pt.2) issued by the Financial Services and the Treasury Bureau on 10 November 2015 for further details.

Object of the Bill

2. The Bill seeks to amend the Mandatory Provident Fund Schemes Ordinance (Cap. 485) and the Mandatory Provident Fund Schemes (General) Regulation (Cap. 485A) to:-

- (a) require approved trustees to provide in the governing rules of registered schemes a default investment strategy (DIS) and to invest scheme members' accrued benefits according to DIS in certain circumstances;
- (b) specify the requirements of DIS;
- (c) provide for matters concerning the regulation of DIS; and
- (d) introduce amendments relating to the operation and daily administration of registered schemes provided in Cap. 485A.

Background

3. Under the existing Mandatory Provident Fund (MPF) system, if a member of a provident fund scheme registered under Cap. 485 (scheme member) does not select funds for investment, the approved trustee of a registered scheme will invest the scheme member's contributions in a default constituent fund (CF) or funds as determined by the trustee. There is at present a wide-range of default CFs being applied as default arrangements in different schemes. According to the Administration, these default arrangements vary greatly in terms of the risk levels, fees, and investment returns and there is no regulatory regime in place to promote uniformity of the default CFs. The Administration therefore proposes to amend Cap. 485 to make it a statutory requirement that an approved trustee must provide a standardized default investment strategy under each MPF scheme.

Key provisions of the Bill

Default Investment Strategy

4. By way of the new Part 4AA to Cap. 485, the Bill seeks to introduce DIS to the MPF system. Under the Bill, DIS is a standardized default investment arrangement that adopts and utilizes two default CFs for investments, namely the Age 65 Plus Fund and the Core Accumulation Fund. The Age 65 Plus Fund is to be a CF which aims to invest its net asset value (NAV) predominantly (about 75%-85%) in lower risk assets such as global bonds, whereas the Core Accumulation Fund aims to invest its NAV predominantly (about 55% to 65%) in higher risk assets such as global equities.

5. Under the new Part 4AA, it is mandatory for an approved trustee to provide DIS in each scheme and to invest the accrued benefits of a new scheme member according to it, unless the member has given specific instructions for those benefits to be invested according to the member's selection.

6. In respect of scheme members who are below 60 years of age, or becomes 60 years of age, on the commencement date of the new Part 4AA (existing members) with accrued benefits held in pre-existing accounts either wholly or partially invested according to existing default arrangements (DIA Accounts), including accrued benefits paid into or transferred to DIA Accounts on or after the commencement date, Divisions 3 and 4 of the new Part 4AA provide for the transitional and savings arrangements. One of these arrangements is that approved trustees are required, within six months after the commencement date of the new Part 4AA of Cap. 485, to notify existing members with DIA Accounts that they may opt-out from DIS.

7. The Bill also provides that accrued benefits of existing members currently invested in guaranteed funds cannot be invested into DIS if this will result in a loss in the promised return for the member.

8. The new Part 2 of Schedule 10 to Cap. 485 is introduced to reduce the exposure of a scheme member who has selected DIS or who has not given any specific investment instructions (DIS member) to relatively higher risk assets as the member approaches the age of retirement. Under the proposed DIS, the accrued benefits of a DIS member who is between the age of 18 to 49 will be invested in the Core Accumulation Fund (i.e. the higher risk fund) only. When the DIS member reaches the age of 50, the member's accrued benefits in the Core Accumulation Fund will be gradually switched to the Age 65 Plus Fund (i.e. the lower risk fund) by annual adjustment of asset allocation according to the table of percentages in the new Schedule 10 to Cap. 485. The DIS member's accrued benefits will be completely invested in the Age 65 Plus Fund by the time he reaches the age of 65.

Fee control mechanism

9. The new section 34DC seeks to impose a cap on the service fees provided in relation to the CFs under DIS. The maximum amount of fees is to be calculated in accordance with the formula set out in the new Schedule 11 to Cap. 485, i.e. a daily rate equivalent to an annualized rate of 0.75% of the NAV of the CF. This prescribed maximum rate would not apply to certain payments for services as stated in the new section 34DC(3), e.g. payments for services relating to the establishment or winding up of a CF under DIS.

Power to amend Schedules 10 and 11

10. The new section 34DD provides that the new Schedules 10 and 11 may be amended by the Secretary for Financial Services and the Treasury by notice published in the Gazette. Such notice would be subsidiary legislation subject to amendment by LegCo under section 34 of the Interpretation and General Clauses Ordinance (Cap. 1), i.e. the negative vetting procedure.

Sanctions for non-compliance with provisions relating to DIS

11. The Bill proposes various sanctions for non-compliance with the provisions relating to DIS. These include revocation of the approval of approved trustees and suspension or termination of the approved trustees' administration of the registered schemes. Clause 26 of the Bill amends Schedule 4 to Cap. 485A to impose financial penalties for contravention of provisions contained in the new Part 4AA.

Duty to invest according to member's selections

12. At present, an approved trustee's failure to invest a scheme member's accrued benefits according to the member's instruction is not subject to express statutory sanctions. The Bill seeks to amend section 27 of Cap. 485 by adding a new subsection (2A) to impose a duty on approved trustees to invest a scheme member's accrued benefits according to the member's selection as permitted under the governing rules of the scheme. Non-compliance with the new section would render an approved trustee liable to the same sanctions as those applicable to non-compliance with the provisions relating to DIS. The Bill also seeks to amend Schedule 4 to Cap. 485A to impose financial penalties for contravention of the new section 27(2A).

Miscellaneous amendments

13. The Bill proposes to make various amendments to Cap. 485A relating to the operation and daily administration of registered schemes. These amendments include excluding Saturday for the purposes of calculating the time

limit of certain reporting obligations of approved trustees and amending the publication requirement for the prescribed savings rate.

Commencement

14. The Bill, if passed, would come into operation on the expiry of six months beginning on the day on which the enacted Ordinance is published in the Gazette.

Public Consultation

15. According to paragraph 16 of the LegCo Brief, the Administration and Mandatory Provident Fund Schemes Authority launched a joint public consultation from June to September 2014. The majority of the respondents agreed with the general direction of the proposals, including the introduction of a fee control mechanism and the adoption of a standardized investment strategy.

Consultation with LegCo Panel

16. The Clerk to the Panel on Financial Affairs has advised that the Panel was briefed on the legislative proposals in the Bill on 6 July 2015. While members supported the legislative proposals in general, some raised questions on a number of issues, including the timeframe and mechanism for lowering the proposed level of fee cap for DIS, measures to prevent trustees from circumventing the proposed fee control mechanism, operational details of DIS, and the need for setting up a public trustee to operate DIS and provide guaranteed returns for investments under DIS.

Conclusion

17. The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. As the Bill introduces a new statutory arrangement to the MPF system, members may wish to form a Bills Committee to study the Bill in detail.

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