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Paper for the House Committee on 25 November 2016

Report of the Subcommittee on Mandatory Provident Fund Schemes (Amendment) Ordinance 2016 (Commencement) Notice

Purpose

This paper reports on the deliberations of the Subcommittee on Mandatory Provident Fund Schemes (Amendment) Ordinance 2016 (Commencement) Notice ("the Subcommittee").

Background

2. The Mandatory Provident Fund Schemes (Amendment) Bill 2015 ("the Bill") was introduced into the Legislative Council ("LegCo") on 25 November 2015. A Bills Committee was formed at the House Committee ("HC") on 27 November 2015 to study the Bill. The Bill was passed with amendments by LegCo on 26 May 2016, and the enacted Ordinance was published in the Gazette as the Mandatory Provident Fund Schemes (Amendment) Ordinance 2016 (Ord. No. 9 of 2016) ("MPFS(A)O") on 3 June 2016.

3. In gist, MPFS(A)O amends the Mandatory Provident Fund Schemes Ordinance (Cap. 485) and the Mandatory Provident Fund Schemes (General) Regulation (Cap. 485A) to require approved trustees to provide a Default Investment Strategy ("DIS") in each of their Mandatory Provident Fund ("MPF") schemes, so as to regulate the default investment arrangement ("DIA") for all MPF schemes. The main provisions of MPFS(A)O are as follows –

(a) *Fee control mechanism*

The caps on the management fees and recurrent out-of-pocket expenses charged to the two constituent funds ("CFs") of DIS (i.e. the Core Accumulation Fund and the Age 65 Plus Fund) or imposed on a scheme member investing in the CFs are set at a daily rate equivalent to an annualized rate of 0.75% of the CF's net asset value ("NAV") and an annual rate of 0.2% of the CF's NAV respectively.

(b) *De-risking mechanism*

The investment risk exposure of DIS members shall be adjusted in accordance with individual members' age. For the Core Accumulation Fund, 60% of its NAV will be invested in higher risk investments and 40% in lower risk investments; for the Age 65 Plus Fund, 20% of its NAV will be invested in higher risk investments and 80% in lower risk investments. De-risking will commence when a DIS member reaches the age of 50, under which his exposure to investment risk will be reduced automatically as he ages. 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 is 65.

(c) *Investment and transitional arrangements*

After the commencement of DIS, subject to exceptions, an approved trustee is required to invest the accrued benefits of a new scheme member who has not given any investment instruction for his MPF account according to DIS. The transitional arrangements for DIS apply to existing scheme members who satisfy the prescribed criteria. In general, for an existing scheme member who has not given investment instructions for his account, of which the accrued benefits are invested under a pre-existing DIA of the scheme, the approved trustee is required to issue a specified notice within 6 months after the commencement of DIS informing such member, among other things, that he may choose to opt out from DIS. lf no reply is received from the member by the trustee within 42 days after the date of the issue of the notice, such benefit will be transferred to and invested in DIS within 14 days after the expiry of the 42-day opt-out period. Other existing scheme members may select to invest in DIS or other investment options any time after the commencement of DIS.

(d) *Consequences of non-compliance*

Sanctions against approved trustee's failure to comply with DIS-related requirements include revocation of its approval as an approved trustee, suspension or termination of its administration of the scheme by the Mandatory Provident Fund Schemes Authority ("MPFA") and financial penalties.

4. In accordance with section 1(2) of MPFS(A)O, MPFS(A)O will come into operation on a day to be appointed by the Secretary for Financial Services and the Treasury ("SFST") by notice published in the Gazette.

Mandatory Provident Fund Schemes (Amendment) Ordinance 2016 (Commencement) Notice

5. By the Mandatory Provident Fund Schemes (Amendment) Ordinance 2016 (Commencement) Notice (L.N. 156 of 2016) ("Commencement Notice") made pursuant to section 1(2) of MPFS(A)O, SFST has appointed 1 April 2017 as the day on which MPFS(A)O comes into operation.

The Subcommittee

6. At the HC meeting held on 28 October 2016, Members agreed to form a subcommittee to study the Commencement Notice. The membership list of the Subcommittee is in **Appendix**.

7. Under the chairmanship of Hon Jeffery LAM Kin-fung, the Subcommittee held one meeting on 11 November 2016 with the Administration to examine the Commencement Notice.

8. To allow sufficient time for the Subcommittee to compile a report for consideration by HC, the Subcommittee agreed to move a proposed resolution at the Council meeting of 16 November 2016 to extend the scrutiny period of the Commencement Notice to 7 December 2016. The proposed resolution was passed at the Council meeting.

Deliberations of the Subcommittee

9. The Subcommittee supports the commencement of MPFS(A)O on 1 April 2017. During its deliberations, the Subcommittee has sought clarification from the Administration and MPFA on the operation of DIS and its investment and transitional arrangements. Members have also made a number of suggestions on the publicity and education campaigns on DIS, and have commented on the fee control mechanism for DIS and other related issues. The deliberations of the Subcommittee are set out in the ensuing paragraphs.

Publicity and education campaigns

10. Members are keen to ensure that the Administration and MPFA will conduct extensive and large-scale publicity and education campaigns to facilitate all scheme members and the other parties concerned to be fully aware of the introduction of DIS and its investment and transitional arrangements. Hon CHAN Kin-por has reiterated the concerns of the insurance industry that as the accrued benefits of default scheme members will be transferred to the higher risk Core Accumulation Fund without their explicit consent under DIS, if those members do not respond to the specified notice, possible disputes and legal proceedings may arise, especially in the case of financial loss. Mr CHAN has called on the Administration to step up publicity to raise public awareness of the transitional opt-out arrangements for DIS. The Chairman has suggested that the Administration should explore mounting publicity campaigns through various media.

11. Given that existing scheme members may choose to invest in DIS after its implementation as the management fees and recurrent out-of-pocket expenses charged to DIS are capped at levels lower than the average of all MPF funds, some members, including Hon LUK Chung-hung and Dr Hon Fernando CHEUNG Chiu-hung, have urged the Administration to disseminate information of DIS to all scheme members, instead of default scheme members only, in the publicity and education campaigns.

12. The Administration has assured members that approved trustees are required by law to notify all scheme members about the two new CFs under DIS added to each MPF scheme, and then subsequently to also issue another notice called DIS Re-investment Notice to default scheme members. As far as the publicity and education campaigns are concerned, the Administration has advised that MPFA has rolled out a three-stage campaign starting from June 2016. The first stage from June to November 2016 comprises a thematic campaign on management of MPF accounts, encouraging all scheme members to update their correspondence addresses with their approved trustees to ensure timely receipt of important information on DIS and other related issues. The second stage from December 2016 to March 2017 includes a large-scale publicity campaign to introduce DIS, its features and commencement date. In the third stage from April to September 2017, MPFA will launch a large-scale publicity campaign and district-based activities to make scheme members aware of the implementation of DIS, and to continue to highlight its features and impact on scheme members. Besides, MPFA will disseminate the relevant information to scheme members through advertisements on different platforms such as print media, websites and social media, press releases and newspaper and magazine articles. MPFA will make use of mass media to raise public awareness of DIS and remind scheme members to peruse information sent by approved trustees.

Operation of Default Investment Strategy

13. Noting the commencement date of MPFS(A)O and the various expiry dates of the transitional arrangements, Hon CHUNG Kwok-pan has enquired when the transfer of accrued benefits of default scheme members under DIS will be fully completed.

14. MPFA has advised that taking into account the time required for approved trustees to issue the DIS Re-investment Notice to existing default scheme members (i.e. during the six-month period after the commencement of DIS), existing default scheme members to respond to the notice (i.e. a 42-day period) and trustees to process subsequent investment instructions (i.e. a 14-day period), it is estimated that the transition will be fully completed by early December 2017.

15. In response to members' concern about the progress of the preparatory work, in particular the technical and manpower support, for the implementation of DIS on 1 April 2017, the Administration has advised that MPFA and approved trustees are actively preparing for the DIS implementation. MPFA is in the progress of considering approved trustees' applications for approval of the DIS CFs and amendments to scheme documents, and promulgating guidelines relating to the DIS implementation. Approved trustees are enhancing MPF administration and computer systems, amending relevant MPF scheme documents and operation procedures, and revising internal control measures.

Investment and transitional arrangements for the Default Investment Strategy

16. Under the de-risking mechanism for DIS, the investment risk exposure of DIS members shall be adjusted in accordance with individual members' age. Dr Hon Fernando CHEUNG Chiu-hung has enquired whether any analysis of investment strategies of different risk levels has been conducted before introducing DIS. MPFA has explained that for the proposed allocation of higher risk assets and lower risk assets in the two DIS CFs, the Administration and MPFA have taken into consideration the recommendations of a research study by the Organization for Economic Co-operation and Development, international practices and local expert consensus. The de-risking investment principle under DIS represents a good balance of empirical analysis and observed practice.

17. Noting that 60% of the Core Accumulation Fund is composed of higher risk investments, Hon Holden CHOW Ho-ding has enquired as to the risk level of the Core Accumulation Fund compared with other existing funds which may carry lower risk levels. MPFA has advised that while on average, the Core Accumulation Fund takes on more risks compared to certain existing CFs in DIAs (e.g. guaranteed funds and MPF conservative funds), the globally diversified and de-risking investment principles of DIS have taken into account the need to balance the investment risks

over a 40-year benefits accumulation period and to reduce the prospect of getting extremely negative returns for a member as he approaches retirement age.

18. Referring to the two types of accrued benefits exempted from DIS, Hon Holden CHOW Ho-ding has enquired as to the reasons for not transferring the accrued benefits of a default scheme member who is aged 60 and above before the commencement of DIS, and how it is decided whether the transfer of scheme members' accrued benefits invested in guaranteed funds to DIS will lead to the loss of the promised return for scheme members.

19. MPFA has advised that the accrued benefits of a default scheme member aged 60 and above before the commencement of DIS will not be re-invested into DIS because the de-risking strategy based on age is unlikely to bring significant benefits to a member who is about to retire. MPFA has further advised that approved trustees will not transfer the accrued benefits of an existing default scheme member (whose accrued benefits have been invested in a guaranteed fund according to the DIA of the scheme) to DIS if it will cost the default scheme member the promised return in guaranteed fund in the circumstances where the guaranteed value of the benefits invested in the guaranteed fund is higher than the actual market value of those benefits. Yet, these two types of scheme members can still choose to invest in DIS after the commencement date if they so wish.

Fee control mechanism

20. Hon LUK Chung-hung has reiterated the views of the Hong Kong Federation of Trade Unions expressed in the Bills Committee that the Administration should consider introducing a performance-based mechanism for controlling the management fees charged by the approved trustees of DIS in future. The intention, as explained by Mr LUK, is 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. The Administration has advised that there is no logical basis to link the fees chargeable by the approved trustees to investment performance. Moreover, it appears quite arbitrary to peg the management fees to the outcome of a particular index over which the approved trustees have no control.

21. Some members, including Hon LUK Chung-hung and Dr Hon Fernando CHEUNG Chiu-hung, are of the view that the management fee cap can be adjusted downward further, and that an annual review of the fee cap level should be conducted to identify room for lowering the level of fees and charges. The Administration will review the fee cap level within three years after the launch of DIS with a view to lowering the level further.

Recommendation

22. The Subcommittee has no objection to the Commencement Notice. The Subcommittee will not propose any amendment to the Commencement Notice.

Advice sought

23. Members are invited to note the deliberations of the Subcommittee.

Council Business Division 1
Legislative Council Secretariat
24 November 2016

Appendix

Subcommittee on Mandatory Provident Fund Schemes (Amendment) Ordinance 2016 (Commencement) Notice

Membership List

Chairman	Hon Jeffrey LAM Kin-fung, GBS, JP
Members	Hon WONG Ting-kwong, SBS, JP Hon CHAN Kin-por, BBS, JP Hon LEUNG Kwok-hung Hon WU Chi-wai, MH Dr Hon Fernando CHEUNG Chiu-hung Hon IP Kin-yuen Hon POON Siu-ping, BBS, MH Dr Hon CHIANG Lai-wan, JP Hon CHUNG Kwok-pan Hon Alvin YEUNG Dr Hon Junius HO Kwan-yiu, JP Hon Holden CHOW Ho-ding Hon LUK Chung-hung Dr Hon LAU Siu-lai (Total : 15 members)
Clerk	Mr Desmond LAM
Legal Adviser	Miss Joyce CHAN