

By email: bc_11_20@legco.gov.hk

Date: 3 August 2021

To: Chairman of the Bills Committee, the Mandatory Provident Fund Schemes (Amendment) Bill 2021
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

From: Hong Kong Trustees' Association on behalf of the 14 MPF Trustees

Subject: Industry Response to Mandatory Provident Fund Schemes (Amendment) Bill 2021
(the "Bill")

Dear Sir,

We are pleased to submit comments on behalf of the MPF Trustees in response to the Bill.

With the Bill having been gazetted and introduced to the Legislative Council, the implementation of the project to establish the eMPF Platform ("Project") has reached an important milestone. While we are delighted to see progress being made, there remain key issues in the Bill which have not been appropriately addressed, despite our efforts (before and during the preparation of the Bill) to bring our concerns to the attention of the Government and the Mandatory Provident Fund Schemes Authority ("MPFA"). We therefore write, at the kind suggestion of the Hon KP Chan, to make submission to the Bills Committee on those issues.

We are all fully in support of the key objectives of the Project to reduce overall costs of the MPF System, centralize and consolidate MPF scheme administration, improve user experience and enable greater transparency and MPF member engagement; and we have, in this regard, communicated to the Government and the MPFA on various occasions that such objectives should be achieved on the basis of certain guiding principles, including:

- (i) transparency and clarity of how the new regime will work as well as the roles and responsibilities of stakeholders thereunder; and
- (ii) fair compensation for trustees and relevant service providers for work performed by and liabilities attributed to them.

Such transparency, clarity and fairness is of fundamental significance for ensuring the proper implementation of the Project on an ongoing basis, particularly in terms of nurturing and sustaining the trust between the stakeholders and their commitment to working together towards successful

project implementation. Along the same vein, the Government, in the paper for the House Committee meeting dated 12 June 2020 (LC Paper No. CB(1)740/19-20), reported to the House Committee of the Legislative Council that “MPFA will also ensure a level playing field for the healthy and sustainable development of the MPF system for the benefit of scheme members and Hong Kong.”

By our submission below, we draw the attention of the Bills Committee to the said key issues which, we maintain, should be addressed in accordance with the said principles.

A. Safe Harbour Provisions

Proportionate basis

We, as we have reiterated to the Government and the MPFA on multiple occasions, are highly concerned about the application of the general principle of “proportionality” informed by the MPFA as to how the regulator would handle non-compliance acts due **partly** to the failure of the system operator after the eMPF implementation, where the **eMPF ecosystem will be fundamentally different from the current MPF operation model** (especially given the different roles and responsibilities of the parties involved which represent a major deviation from the current model).

Pursuant to the Bill, trustees will have neither the monitoring nor supervisory power over the MPF system operator. In the event of a breach of the law partly due to the non-compliance by the system operator, it is not feasible for trustees to collect sufficient evidence to safeguard our interests and/or to establish a defense. Given the eMPF system operator is a wholly-owned subsidiary by the MPFA, there would be **an obvious appearance, and even potentially actual, conflict of interest** if the regulator plays any active roles in determining the “*proportionality*” of the liabilities of any non-compliance acts to be allocated between the system operator and the trustees. In the light of this, we would like to request further clarification and elaboration in the Bill, including but not limited to schedule 4 of the MPFSGR, **on how to apply the principle of “*proportionality*” in future enforcement actions**, particularly to the determination of financial penalty and criminal offence of trustees, and also to the extent the system operator having contributed to the non-compliance.

Appeal mechanism

In respect of the safe harbour provisions, the industry has repeatedly emphasized the importance of an **independent appeal mechanism** for trustees to cater for scenarios where trustees may reasonably appeal against the regulator’s judgement on the extent of liability between user trustee and system operator, in particular when taking the factor of the conflict of interest in respect of the MPFA’s role as explained above.

Likewise, trustees should be allowed to appeal against the MPFA’s decision of the relevant rate of administration fee for constituent fund determined under the new sections 19ZB and 19ZC (for more of our detailed submission on the new section 19ZB, please see section C

below). We would like to draw the Bills Committee's attention to the **IOPS guidelines for supervisory intervention, enforcement and sanctions issued in November 2009**, which have been echoed in the OECD core principles of private pension regulation published in 2016 that **a sound appeal mechanism** should be in place in order to allow supervised entities (i.e. for HK, MPF trustees) to challenge the decisions of the supervisory authority (i.e. the MPFA).

Following the guidelines set out by the renowned international bodies, we respectfully urge that the Bill be revised to devise and implement a working and sound appeal mechanism for the MPF trustees to appeal to **an independent party or a relevant tribunal** against any decisions taken by the MPFA that affect the trustees and which the trustees consider unreasonable or inconsistent with what they have been informed by the regulator during the consultation period before the publication of the Bill.

Section 43 of the MPFSGR

Trustees recognize and are fully aware of the importance of their fundamental duties under the existing legislation as set out in section 43 of the MPFSGR. However, with the new function of the MPFA (but not the trustees) of overseeing operation of the eMPF Platform, there will be fundamental changes to the existing operating model for scheme administration functions (which are currently handled by trustees or their delegates with the requisite direct control and oversight). **The fundamental changes will remove such direct control and oversight from trustees** and, therefore, significantly impact many aspects of the operations of the trustees, including how the section 43 duties will be discharged.

Accordingly, trustees would, as they have reiterated to the MPFA and the Government on multiple occasions, submit that **the safe harbour provisions be extended to section 43 of the MPFSGR, at least covering section 43(a)**, instead of just simply suggesting trustees to rely on the "reasonable excuse" defence under section 67 in the event of non-compliance.

Section 43(a) was introduced for the existing regime where trustees are responsible to carry out the scheme administration work. Without the above-mentioned direct control and oversight over the operation of the MPF platform in the new ecosystem, the trustees will no longer have the said direct control and oversight, and **the mere availability of a "reasonable excuse" defence in the law is inadequate to cater for the fundamental changes** introduced by the new ecosystem, and as such, would lead to uncertainty and confusion as to how the new laws will be implemented by the MPFA, which would be tainted by a conflict of interest as explained above.

B. "Administration" as used in the Bill

"Administration" for the purposes of eMPF **is not defined in the Bill**. As the services to be provided by the eMPF Platform are all scheme administration in nature (as opposed to fund administration), for the purposes of the legislative amendments, "administration" for eMPF purposes should not cover "fund administration" (or other relevant components currently included in the administration fees, but not included in the scheme administration services as

to be provided by the eMPF Platform), and “administration fee” as such should not cover “fund administration fee”. In the absence of proper definitions of “administration” and “administration fee” (as well as “administration services” and “administration functions” that are also used in the Bill), the roles and responsibilities of the eMPF Platform (and also, by necessary implication, those of the trustees) will not be as clearly and properly defined as they should be, and the implementation of the proposed fee arrangement for the eMPF project would be confusing, inefficient and **lacking in the necessary transparency**.

Appendix A sets out a list of typical fund administration functions carried out by trustees (which has been provided to the Government before). The carrying out of such functions requires significant resources and incurs significant costs/expenses on the part of the trustees, but as they should fall outside the ambit of the scheme administration functions to be carried out by the eMPF Platform, those costs/expenses should not be regarded as constituting “administration fee” for the purpose of demarcation between those costs/expenses which should be so regarded and those which should not be so regarded would be uncertain and vague, thereby giving rise to the said confusion, inefficiency and lack of transparency.

C. **Power of Authority to determine rate of administration fee**

The proposed section 19ZB to be introduced by the Bill on the “Power of Authority to determine relevant rate for constituent fund” provides that the MPFA may determine, in the way they considers appropriate, the relevant rate of administration fee for a constitutional fund of a registered scheme. More particularly, sub-section (2) of the new section provides to the effect that the MPFA may do so if it is satisfied that –

- (a) the annual rate of administration fee (or equivalent) of the constituent fund of a registered scheme is not readily ascertainable by reference to the offering document of the registered scheme; and
- (b) the exercise of the power is justified.

Such power proposed to be given to the MPFA to determine the relevant rate for the constituent fund under the new section is wide, particularly in the absence of the definitions referred to under B above. To help ensure that the relevant rate of administration fee would be determined in a transparent, consistent and impartial manner, the section should, rather than just relying on the guidelines to be issued administratively, also stipulate:

- what grounds the Authority should take into account in determining whether it is justified for the Authority to determine the reference rate for the constituent fund;
- the factors to be considered by the Authority in determining the reference rate of administration fee for the constituent fund and the mechanism for making such determination; and
- an independent appeal mechanism available for trustees to initiate review of the relevant rate determined by the Authority.

D. Use of FER for “Corresponding Topline Reduction”

The use of FER as “A” in the formula (as stated in Schedule 15 of the Bill”): “A-(B-C)” for the implementation of “Corresponding Topline Reduction” came as a total surprise to the industry as the industry had always understood that “A” in that formula would be “**total management fee**” (rather than FER). This was not made known to the industry until 31 May 2021. In fact, the use of total management fee (not FER) in the formula was mentioned in the **LegCo FA paper dated 4 Jan 2021**.

If the reason for the use of FER in the said formula is that there is a need for the topline to be all inclusive (i.e. inclusive of out-of-pocket expenses) to guard against the trustees unreasonably inflating out-of-pocket expenses, such a reason is misconceived because there are well established means (including external audit and disclosure requirements) to ensure that out-of-pocket expenses charged to the scheme are properly incurred. Such a proposed approach to use FER for top-line reduction is logically **inconsistent and inherently unfair**, because:

- **out-of-pocket expenses** are charged on an as-incurred basis and, as such its magnitude is not within the control of trustees
- as out-of-pocket expenses will vary from time to time (e.g. more expenses may be incurred in a year where there are changes to scheme documents driven by regulatory changes) and in a manner not within the control of trustees, the FER cap being referenced to the value on a specific date would unfairly give rise to situations of the cap being exceeded in circumstances that is beyond the control of trustees
- drops in NAV due to market fluctuations and movements amongst different schemes/constituent funds are again beyond the control of the trustees but would also give rise to an increase in FERs.

Specifically, in the situation of market fluctuation or fund movements, the resulting drop in NAV of a constituent fund could be significant and a substantial portion of the out-of-pocket expenses incurred would then require reimbursement by the trustee. It is unreasonable and unjustifiable that the trustee of a scheme has to be penalized in a situation which is totally not under its control.

E. Operating Rules

Pursuant to new section 19K(2)(a) of the MPFSO proposed to be introduced by the Bill, there will be operating rules in place, which are rules made by the system operator and approved by the Authority, governing the administration and operation of the electronic MPF system and a suspension of the system under the proposed new section 19L(1)(a) or (b). That said, there is a **lack of clarity and limited information** on the operating rules thus far, except for the fact that the operating rules will not be subsidiary legislation as stipulated under the proposed section 19K(5) of the MPFSO. Without sufficient information regarding the operating rules, approved trustees would not be able to have a full picture and solid concept of the exact roles and responsibilities of the system operator, or how the administration and operation of the

eMPF Platform is going to be regulated; and, therefore, their ability to properly review and provide comments on the Bill would correspondingly be limited. Also, as raised on various occasions to the MPFA since mid-2020, trustees are expected to be engaged in the formulation and finalization of the operating rules and any development of plans, systems, controls and procedures in respect of such mega-scale project would require a considerable period of time and necessary deployment of financial and manpower resources. Accordingly, approved trustees urge the MPFA to share with the industry the contents of the operating rules as soon as practicable, preferably during the early stage of the legislative process.

F. Subscription Agreement

The industry understands from the previous communications from the MPFA that there will be a subscription agreement. Whilst the subscription agreement would be a crucial document expected to clearly setting out and defining the contractual relationship established between the relevant approved trustee and the system operator, no further details nor information has yet been shared with approved trustees so far (and, there is also no reference to such an agreement in the Bill), including such as the signatories and major contents covered in the subscription agreement. Nevertheless, such subscription agreement could be the **sole official instrument providing legal basis on which approved trustee may seek reasonable remedies from the system operator** in respect of any liability that is attributable to the system operator as specified under the proposed new section 19ZH of the MPFSO to be introduced by the Bill. Given the contract negotiation process would take time, the industry would, therefore, appreciate if the Authority could share with approved trustees more details on the arrangement of subscription agreement in advance, including such as the signatories of the agreement, key content coverage and negotiability of terms and conditions to suit different models which may vary from trustee to trustee with a view that it may include services subscribed by individual trustee.

G. Level Playing Field

The trustees are, as they have indicated to the Government and the MPFA on multiple occasions, very concerned to note the effects the proposed trustee-fee cap will have on trustees with bundled fee arrangements (i.e. arrangements whereby the “trustee and custodian fees” are disclosed in the offering documents in such a manner that they are “bundled” with the “scheme administration fee”). The effect of the proposed cap is that trustees with bundled fee arrangements disclosed in offering documents (which arrangements/disclosures are permitted under existing regulations) will be put in a worse off position than those who do not disclose fees in such a bundled manner. Such an adverse effect on the said former group of trustees will **damage the level playing field for the MPF industry (as referred to the above mentioned LC Paper No.CB(1)740/19-20)**, which will eventually harm the interests of MPF scheme members and the status of Hong Kong as an international financial centre. We respectfully submit that **the proposed trustee fee cap be reconsidered with a view to ensuring that the playing field is level.**

H. Section 206 (e-notification)

In annex B of the Bill, one of the purposes for introducing the eMPF Platform is to reduce paper-based transactions and help boost the development of Hong Kong as a smart and sustainable city. However, in the last couple of years, the MPFA's repeated rejections of the industry's persistent request for amending section 206 of the MPFSGR go contrary to the direction of the Bill.

For meeting the purpose of reducing the paper-based communications and help boost the development of Hong Kong as a smart and sustainable city, trustees respectfully submit, as they have urged the Government and the MPFA on multiple occasions, that section 206 be amended to the effect that each of the **members and employers** who join the MPF schemes is provided with documents by electronic means unless they have opted-out of communications by electronic means (in which case paper-based communications would be provided to them instead).

We look forward to amendments to the Bill to address the above concerns. If you would like to discuss any of the above concerns, please do not hesitate to contact Ms. Ka Shi Lau, Vice Chairman, Hong Kong Trustees' Association (for and behalf of the MPF trustees) at 2298-9298.

Yours faithfully,
Hong Kong Trustees' Association
For and on behalf of 14 MPF Trustees

AIA Company (Trustee) Limited
Bank Consortium Trust Company Limited
Bank of Communications Trustee Limited
Bank of East Asia (Trustees) Limited
BOCI-Prudential Trustee Limited
China Life Trustees Limited
HSBC Institutional Trust Services (Asia) Limited
HSBC Provident Funds Trust Company Limited
Manulife Provident Funds Trust Company Limited
Principal Trust Company (Asia) Limited
RBC Investor Services Trust Hong Kong Limited
Sun Life Pension Trust Limited
Sun Life Trustee Company Limited
YF Life Trustees Limited

Appendix A

List of Typical Fund Administration Functions

- **Fund valuation review and control:** Fund valuation review; reconciliations against valuation agent's books and records; review of fee and charges and FER calculation, price verification of underlying securities and funds
- **Net Asset Value per unit calculation:** NAV per unit price for members to subscribe and redeem units of funds for contribution, fund switching and withdrawal
- **Fund and scheme accounting:** Keeping proper accounting records for investment funds and scheme is important and necessary.
- **Reconciliation:** Reconciliation of total fund units held (aggregated members balance) to that of the registrar of the unit trust funds they invest in
- **Investment operations:** Trade placement and FX forward contract management with investment managers; custody record's reconciliation and settlement management with custodians
- **Financial reporting and regulatory filing:** Preparation and review of regular financial reports such as fund fact sheets, audited financial statements for the MPF funds and scheme; prepare and review relevant regulatory filings
- **Investments related monitoring:** Pre-settlement and post-trade compliance monitoring; fee and expenses monitoring; price and benchmark monitoring; and other oversight activities on investment managers, custodians and fund administrators
- **Fund related project management:** Implementation of the fund related projects such as launch of new funds, scheme and fund restructurings and closure of funds