HONG KONG INVESTMENT FUNDS ASSOCIATION (HKIFA)

Response to Consultation Paper: "Providing Better Investment Solutions for MPF Members"

September 2014

This document is provided to the Mandatory Provident Fund Schemes Authority (MPFA) and the Financial Services and the Treasury Bureau (FSTB) for the purposes of responding to the abovementioned consultation paper issued 24 June 2014. This is a collective response on behalf of the Hong Kong Investment Funds Association (HKIFA) and its members, though as such, may not necessarily reflect the specific views of any single member. Please refer to Appendix 1 for the background on HKIFA and a list of HKIFA members.

Q1. Do you support the direction of introducing a core fund in the manner set out in paragraph 36 (a) to (d) above?

☐ Yes ☑ **No**

Comments:

Whilst the HKIFA members (a broad representation of fund managers) generally agree on the need for improvement to the current guidelines/arrangements for members who fail, or decline, to provide an allocation for their contributions within their respective scheme (the "Defaulters"), we disagree that the solution is the introduction of a core fund as specifically described in 36(a) to (d) of the Consultation Paper.

As set out in our responses to subsequent questions, particularly questions 2, 3 and 9, we contend that:

1. All MPF schemes have existing policies for dealing with the contributions of Defaulters. Indeed, it is the variation of approaches across the schemes that reflects the historical lack of regulatory guidance in this area, plus the complexity of identifying the 'best' approach for Defaulters given their diversity of age, investment experience and financial situation.
2. Launching new Constituent Funds and APIFs to provide for such a 'core fund' would be completely contrary to the stated objectives of the MPFA – more funds will only increase complexity, decrease scale, and increase cost.
3. The term "core fund" is potentially misleading and inaccurate, as handling of Defaulters may not involve a single "fund" nor will such investments necessarily be "core".

Dealing with each of the key elements in Paragraphs 36(a) to (d):

- 36(a): "*the core fund will be based on standardised default funds*".
    - This statement fails to make sense, as it implies that there is a single core fund, which is later contradicted with paragraph 48 which notes the potential life cycle approach that varies the member's holdings of different CFs over time. Hence we agree on the need for more standardisation of default arrangements, but reject the concept of needing a core fund.

- 36(b): "*as a default fund, the investment approach of the core fund should balance long-term risks and returns in a manner appropriate for retirement savings*".
    - Setting aside our abovementioned objection to "core fund" (which will also apply to the remainder of our submission), we fully agree with this point from an investment management standpoint. Individuals are now fortunately living longer, typically meaning a longer retirement, and increasing the importance of retirement savings. Unfortunately, simply delivering positive investment returns may be insufficient to ensure adequate retirement savings given the combined effects of inflation and the current negligible interest rate environment. Hence, investments in non-risk free assets (e.g. stocks) will be required to generate the returns required to achieve most members' retirement savings goals – thus requiring an appropriate balance of risk and return – something foundational to all investment/fund managers.

- 36(c): "*the core fund should be good value*"
    - Agreed, however we emphasise that good value does not equate to low cost/fees (also acknowledged in the Consultation Paper). It is alarming, however, that the Consultation Paper has failed to note that any assessment of 'good value' in an investment context should at least take into account investment risk and investment returns *after fees*, plus other benefits received by members such as service and education. Fees alone are therefore a very poor indicator of value as they are only one piece of the overall picture.

- 36(d): "*the core fund is available to all MPF scheme members to choose*"
    - Agreed.

In summary, whilst we agree to the need to improve current arrangements for Defaulters, we argue that there are more efficient ways of dealing with this issue than the introduction of a proposed core fund as currently outlined in the Consultation Paper.

Q2. Do you agree that the CF that is the default fund should be substantially the same in all MPF schemes?

☐ Yes ☑ **No**

Comments:

A single default Constituent Fund across all schemes is not a suitable approach, given the current structure of MPF schemes, existing investment options (Constituent Funds), and different administrator and/or manager capabilities, etc.

We do agree, however, on the need for a reasonable degree of consistency, but that the Scheme Sponsors and their Administrators are the best to determine how to implement changes to the handling of Defaulters in their respective scheme(s) within any revised default arrangement framework. (As a side note, we would strongly recommend implementing any outcomes of the Consultation Paper via guidelines issued by the MPFA instead of via legislation given the former's speed and flexibility).

For instance, Sponsors / Administrators should have flexibility to implement changes to their default arrangements (if required) by using:

- Single target date CFs
  OR
- A combination of life cycle CFs (e.g. Capital Stable, Stable Growth, Balanced, Growth)
  OR
- Another strategy that achieves the same primary objectives of de-risking towards retirement, and consistency of investment outcomes (e.g. a combination of global equities, global bonds and cash/money market)

We would expect MPFA to provide the framework but for schemes to determine their own default arrangements that comply with the framework.

Q3. Do you agree that it is appropriate that the core fund be based on a standardised default fund?

☐ Yes ☑ **No**

Comments:

We refer to the OECD recommendation and overall objective of the MPFA with regards to default arrangements, i.e. protecting default members from extremely negative outcomes for those approaching retirement, with the default fund preferably being an age-dependent, life cycle/target date fund that reduces equity risk over time.

Given that there are multiple ways of achieving this objective and meeting the default fund criteria, we are unable to agree that a core fund is the appropriate policy response.

Whilst the simplest, and perhaps most intuitive for members, might be for each MPF scheme to offer a series of 5 (or 10) year interval Target Date funds, this option is likely to bring several unintended consequences given that most schemes do not current offer Target Date options, not the least of which will be product proliferation, plus issues with dealing with CF maturation, roll-over and new launches.

A life cycle approach would be able to leverage existing CFs with less need for new fund launches, however is operationally more complex to administer, and is less 'comparable' across schemes (refer to our response to question 5 below for suggestions to deal with this issue).

There are also other investment strategies that can achieve this overall objective, including:

- Inflation Protected funds – by protecting against specific market conditions (rising inflation) it provides protection for members' savings at retirement, and will typically have lower equity risk for the entire investment horizon
- Absolute Return funds – aim to produce stable investment returns over relatively short periods of time (e.g. rolling 3 years) often using derivative investments to hedge equity risks.

Further, investment theory continues to evolve with regards to retirement investing, and requiring a core fund to be based on a standardised default fund may stifle such research and innovation (or prevent MPF members from benefiting from defined contribution developments in other markets).

Q4. Do you agree that the appropriate investment approach of the core fund is one that automatically reduces risk over time as the member gets closer to age 65? If not, what other option would you propose?

☑ **Yes** ☐ No

Comments:

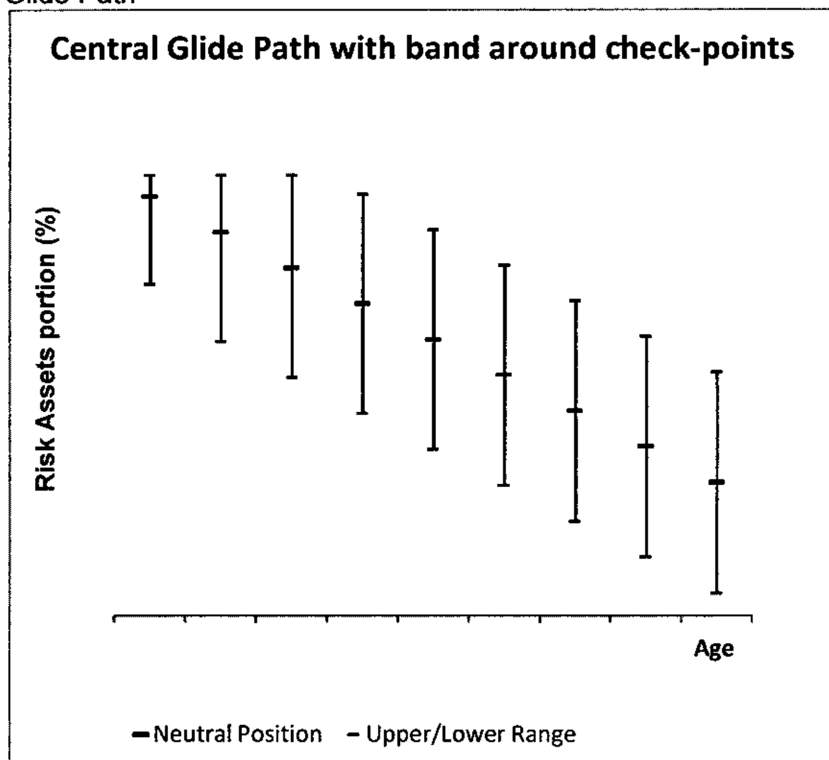
As members approach retirement, they have a reduced ability to tolerate large investment declines given the fewer remaining years to re-grow their savings before they need to draw upon them. Although age 65 is entirely arbitrary 'deadline', we agree with the proposition that a default arrangement should have lower risk nearer to retirement. Indeed, we strongly feel that the MPFA / FSTB needs to consider *post-*retirement investing as an extension of this Consultation Paper as it will impact some of the technical discussions with the industry that are contemplated under Paragraph 48.

However, there are many ways to achieve the same desired result at retirement. The change of asset allocation from having higher equity content to lower equity content over time is described as a glide path.

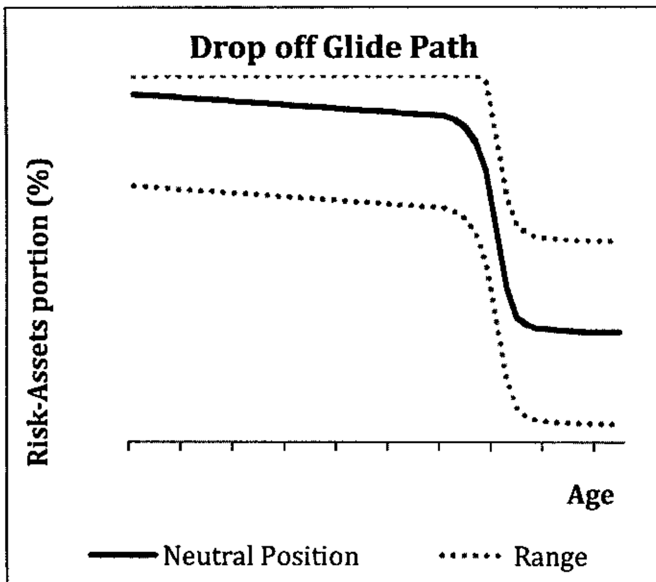
We propose the MPFA consider adopting a single Central Glide Path with target asset allocations at appropriate time intervals ("check-points") corresponding to a members' age. It is imperative that providers be given the flexibility to achieve the desired results, relying on the providers' expertise, structure, and preference. As such, a band around the check-points should be established to allow for providers to exercise their expertise in investments in a highly volatile financial market. It is observed that unforeseen market and geopolitical events may trigger large portfolio drifts that impact the asset allocation. If the band is too narrow, portfolios may be forced into rebalancing at times of distress which may result in suboptimal performance and incur additional trading costs, negatively affecting members.

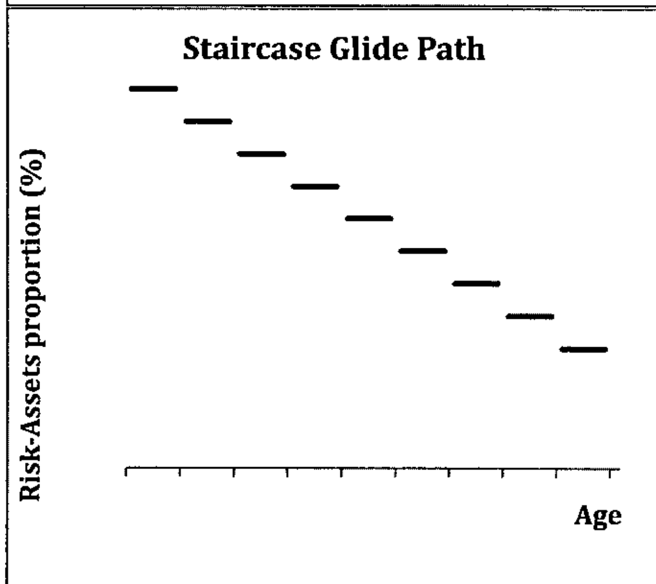
A Central Glide Path is equally applicable to schemes that select a Target Date approach or a Life Cycle approach. This has the benefit of allowing providers to adjust to the different ways of achieving the same desired result. This is also highly effective for investment strategy implementation. The band around the various check-points reduces the need for frequent rebalancing and the associated cost.

Illustrative Central Glide Path --



Within this Central Glide Path, investment/fund managers would have sufficient flexibility to leverage their firm's existing glide path methodology, which typically fall into one of two main glide paths (Drop off and Staircase) – both are illustrated below for reference.





Whilst both have their own individual pros and cons, more importantly both are compatible with the Central Glide Path proposed above.

Q5. Do you have any preliminary views on the technical issues set out in paragraph 48, in particular whether consistency is required on all aspects of default fund design in all schemes or can some elements be left to the decision of individual product providers?
Comments:

Whilst we will attempt to address a number of the technical issues set out in paragraph 48, our overall recommendation is that consistency is <u>not</u> required on all aspects, but that certain elements should be left to the decision of individual product providers within a general framework provided by the MPFA.

- 48(a): "*Whether the preferred approach is a series of target date CFs that adjust risk in each target date CF over time or a life cycle approach that varies the member's holdings of different CFs over time*"
    - o We strongly feel this should be left to each scheme provider to determine. Each provider has different strengths, structure, preference, and existing products and hence is difficult to mandate a single approach without disadvantaging certain scheme providers.
    - o Target Date funds, whilst conceptually simpler, require a certain degree of product proliferation,
    - o A Life Cycle approach generally avoids this product proliferation issue, but has the downside of limited ability to easily compare investment returns across schemes.

    - o To address this comparability issue, we would propose that schemes publish the returns of a 'hypothetical investor' as well as the Central Glide Path (to serve as a market benchmark).
        1. The return profile of the Central Glide Path can be calculated based on the specific weightings of the set of asset classes. Calculate the returns of key milestones along the Central Glide Path (e.g. age 20, 25, 30... up to age 65) using a common cut-off date (e.g. 1 July). This forms the "benchmark return" of various age groups.
        2. Using a 'hypothetical investor' approach, the same member, Joe Smith, remains invested in the default arrangement of the scheme over time. Each scheme calculates the series of returns of its own Joe Smiths (i.e. Joe Smith 20, Joe Smith 25, Joe Smith 30... up to age 65), also with a common cut-off date (e.g. 1 July).
        3. Members can then compare their own return profile against the closest aged Joe Smith of his scheme. In addition, the same member can also compare his scheme's default arrangement performance against the market benchmark (i.e. the Central Glide Path).

- 48(b): "*if a series of target date CFs is the preferred approach, how many funds are needed: is one fund every 5 years adequate or are more or less funds preferred, taking into account the establishment and maintenance costs of new funds*"
    - o A target date fund series with 5 to 10 year intervals tends to be market practice. It will be increasingly expensive to go for intervals less than 5 years. On the other hand, given the decreasing length of market cycles, intervals of 10 years or more may be too long to achieve the objective of protecting default members from extremely negative outcomes for those approaching retirement

- 48(c): "*what types of assets should be the investment building blocks at the underlying fund level: more sophisticated design might require more asset types, however, this will involve greater complexity and costs*"
    - o Similar to 48(a), the asset classes to be used as the building blocks should be left to the respective providers. By prescribing the building blocks, MPFA may force the investment/fund managers providers to invest in asset classes that may not necessary be their strength or cannot operate efficiently. This may result in inferior, riskier, or more costly products.

- 48(d): "*which investment building blocks are more appropriately managed in a passive manner*"
    - o Most asset classes can be passively managed. However, a passively managed portfolio does not necessarily provide you with the best possible return or the desired risk-return profile. Further, the existing range of MPFA approved Index Tracking Collective Investment Schemes (ITCIS) fail to cover a broad range of asset classes due to the inability/unwillingness of most index managers to provide products that meet MPFA's non-standard guidelines.

- 48(e): "*what should be the approach for reducing risk over time (i.e. the glide path): should de-risking start 20 or more years away from retirement or should it only happen in the 10 years immediately preceding age 65*"
  - There is no right or wrong prescribed time to de-risk, especially as market conditions are not constant, hence the MPFA should provide some flexibility in achieving the desired risk-return profile at maturity. This can be done by :
    1) prescribing the desired risk-return profile and allow the industry discretion to achieve the desired risk return profile by the best possible means available to them / their situation.
    2) providing a recommended range of equity/fixed income allocation at age-related check points (refer response to question 4). It will be up to the provider to maximise the return for members via tactical allocation decisions within the equity/fixed income range acceptable to the MPFA.
    3) provide a specific age range where de-risking needs to commence and the manager determine the speed and mode in which the de-risking will take place.

- 48(f): "*what should be the terminal risk profile of the approach at age 65: should risk be reduced as far as possible, or given that members will still need investment exposure post retirement, should some equity exposure be maintained at and beyond age 65*"
  - Retirement planning now goes beyond age 65 and it would be incorrect to have completely de-risked by then as it may make the retiree venerable to inflation risk. Therefore, it is likely necessary to leave a certain equity exposure beyond retirement.

- 48(g): "*whether consistency is required on all of these aspects across all defaults in all schemes or can some elements be left to the decision of individual product providers*"
  - As mentioned above, the MPFA should provide guidance on the desired risk/return profile at retirement but the means to achieve this desired "end-game" should be left to the provider.

Q6. Do you agree that keeping total fee impact for the core fund at or under 0.75% is a reasonable initial approach?

☐ Yes ☑ **No**

Comments:

Our view is that the introduction of a cap on fees or expenses is not in the long-term interest of members of MPF schemes.

We fully agree that the MPF default option should be designed in a manner that represents good value for money, however, we believe capping total fee and FER is not the most reasonable or effective means to provide members "good value".

The MPF is a legislated mandatory pension system operated by the private sector. As such, there is a need to ensure members' interests are well protected while providing adequate incentives for providers to continually invest in infrastructure and member service innovation. The introduction of such caps could have unintended detrimental impacts such as:

- Impacting the commercial viability of operating an MPF business, and lead to reduced competition in the MPF market.
- Provide a disincentive for product providers to invest in technology to reduce operational risk and improve the service experience for members.
- Stifle product, service and operational innovation which we believe will reduce cost and lead to better outcomes for members.

The structure of MPF is complicated and involves multiple parties, each affected by different cost drivers - including administration complexity, reporting requirement, level of client servicing, etc. The Consultation Paper fails to address any of these cost drivers.

With reference to Ernst & Young's two studies on the MPF system published in May[1] and November 2012[2], (collectively the "E&Y Papers"), we note that:

1. the investment management fees of MPF funds were lower than expected when compared with other countries like Australia, despite the relatively small size of the MPF system;
2. the six (6) cost drivers identified mostly result from scalability and operating inefficiencies:
   i. A higher percentage of manual and paper-based administration processing - each additional transaction adds costs
   ii. A larger percentage of small employers and self-employed persons - increasing the volume of the employer transactions for administrators
   iii. A flexible and full service system offering wider member services - increasing process complexity and workload for administrators
   iv. Smaller scale of assets under management - limits the benefits of economies of scale
   v. Limited industry wide process or infrastructure - limits the ability to spread infrastructure costs across the system
   vi. Insufficient pricing competition - reducing the pressure for providers to minimise costs

Fees have been gradually reducing over time, and the FER measure does not take into account bonus shares or other discounts that reduce the net fees to members. Further the industry / MPF stakeholders have been working with the MPFA to implement some of the cost saving measures as suggested in the E&Y Papers (e.g. Employee Choice Arrangement, online and electronic payments, etc). However, there are still quite a number of measures that have to be implemented before the total potential savings mentioned in the E&Y Papers can be realised.

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[1] *The evolving MPF system: an objective assessment*
http://www.hkifa.org.hk/upload/Documents/2012News/The_evolving_MPF_system_-summary.pdf

[2] *Managing the changing landscape of retirement savings: Report on a study of administrative costs in the Hong Kong Mandatory Provident Fund system*
http://www.mpfa.org.hk/eng/information_centre/publications/research_reports/files/MPF%20Consultancy%20Study%20Report%28Eng%29.pdf

We believe that in order to achieve such low fees contemplated in the Consultation Paper, the MPFA would need to implement or push for a broad package of reforms including: (i) unifying the MPF investment guidelines with the SFC Code on Unit Trusts, (ii) simplifying CF / APIF / ITCIS product approvals, (iii) raising contributions and eliminating contribution caps, (iv) providing greater tax incentives to voluntarily build scale faster, (v) reducing compliance burden, (vi) eliminating all remaining manual processes, (vii) reducing reporting requirements, (viii) remove requirements/restrictions on Conservative Funds, plus other recommendations as outlined by Ernst & Young in their suggested 5 strategic responses (which they estimate would reduce costs by 0.35% of AUM).

The total fee and FER are highly correlated to the investment design as well as the relevant administrative arrangement. While we do not support the introduction of mandated fee or expense caps, if these caps are adopted we believe it is premature to conclude what a reasonable fee level should be given the present uncertainty surrounding the structure of the default option. The Consultation Paper seems to imply that encouraging "passive" building blocks will enable the FER to be reduced from the current 1.69% average (paragraph 54) to below 1.00% (refer question 7) – a drop of at least 69bps. As per Ernst & Young, the investment/fund management component makes up around 1/3rd of the FER, or around 50bps, hence it would be beneficial for the MPFA to share further insights on how the proposed total fee of 0.75% be derived.

Q7. Do you agree that keeping total expense impact (i.e. FER) for the core fund at or under 1.0% over the medium term is a reasonable approach?

☐ Yes ☑ **No**

Comments:

As per the response to question 6, our view is that the introduction of a cap on the FER is <u>not</u> in the long-term interest of members of MPF schemes.

For the same reasons in relation to cost drivers as noted above, it would be beneficial for the MPFA to share further insights on how the proposed FER under 1.00% is derived.

Q8. Do you agree that passive, index based, investment strategies should be the predominant investment approach in the MPF core fund?

☐ Yes ☑ **No**

Comments:

We would object to any requirement that passive, index based, investment strategies be the predominant investment approach for several reasons:

1) There are few, if any, ITCIS available on several key asset classes due to the MPFA's current restrictive stance on stock lending, BBB- rated debt securities, derivatives, permitted stock exchanges, and permitted instruments. Unless these issues are all promptly resolved, most global index managers, who rely on scale to provide cost efficiencies, may be unwilling (or unable) to provide passive building blocks for use in default arrangements.

2) Most existing MPF investment managers are 'active' managers, meaning that a forced switch to 'passive' will involve corporate actions (and related shareholder notices) or the launching of new predominantly passive Constituent Funds. Some managers do not have passive / index fund management capabilities, and need to seek outside expertise which will increase complexity in the MPF scheme.

3) The requirement would generally seem irrelevant as there is no reason to reduce flexibility and require passive investment strategies if active strategies can achieve the same outcome. Passive does not necessarily outperform active strategies, likewise passive is not necessarily cheaper than active, hence the rationale of this proposal is questionable.

Q9. Are there particular asset classes which you think would not appropriately be invested on a passive, index based approach?

Comments:

As noted in our response to question 5, almost all asset classes can be managed on an index-based approach, however some are more complicated, and hence more expensive, than others.

Index managers of traditional asset classes require scale, and repeatability – i.e. consistency of investment guidelines between the various funds managed against the same index.

The most difficult to manage on a passive, index based approach are small, sub-scale global fixed income funds with customised investment restrictions. The indices are typically very broad (comprise many constituents), and the larger minimum investment sizes of bonds compared to stocks make it difficult to more precisely replicate the weightings. Use of derivatives for investment purposes, for example, can alleviate such issues to a large extent, however are not currently compliant with existing SFC/MPFA investment product restrictions.

Scale in this situation refers to both (i) the AUM size of the MPF fund, and equally to (ii) different investment restrictions being applied to the MPF fund from other index funds managed by the same manager.

Alternatives (including illiquid investments, short selling, leverage/borrowing, and derivatives-based products) are non-traditional asset classes that would most likely not be appropriately invested on a passive, index based approach.

Q10. Do you agree that the name of the core fund should be standardised across schemes? If so, do you have any preference amongst the possibilities set out in paragraph 77 above?

☐ Yes ☑ **No**

Your preference:

☐ "MPF Core Fund" (having regard to its use as a core investment approach for retirement savings)

☐ "MPF Basic Investment Fund" (emphasising its design as a basic investment approach for retirement savings)

☐ "MPF Simple Investment Fund" (emphasising its design as a simple investment process for retirement savings)

☐ "MPF Default Investment Fund" (reinforcing that its primary design is built around the default investment strategy for those who do not, or do not want to make an investment choice in saving for retirement)

☐ "MPF "A" Investment Fund" (or some other term which removes any implications about the nature of the strategy)

Comments:

Our preferred option would be "default arrangement" (or "default option", for the two primary reasons outlined below:

- Based on our other responses, we have supported the approach of implementation via a combination of life cycle CFs and hence not a single "fund".
- "Core" implies recommended or preferred, which would not appear to be MPFA's intention given that the members targeted by the Consultation Papers are those who are unable, or do not wish, to make investment allocations.

We believe that the current terminology, "core fund", is both confusing and potentially misleading, and we seek to clarify this point at the outset of our response.

The term 'core fund' refers to both a 'core' investment choice, and a single 'fund'. As the MPFA would no doubt agree, within the Consultation Paper, reference is made to the possibility of creating multiple investment choices (e.g. target date fund(s), or a life cycle approach, etc.), which would involve the use of several 'funds' beyond just one. We therefore prefer to use the word 'arrangement' (or some similar term) instead of 'fund', to accommodate and clarify that the final result may involve one, or more investment funds.

Furthermore, we believe that the term "default" (i.e. 'default arrangement') would be more appropriate than 'core'. The term 'core'", may give the impression that this is a superior investment proposition that is endorsed by the Authority; and that it is a "must have" (i.e. 'core') holding and therefore be fit for all members. Introduction of the 'core' concept would be misleading if members interpret it to be that the 'core fund' is the "recommended" fund option.

Furthermore, we believe that MPFA needs to be cautious in managing the expectations of members when positioning the default arrangement concept. Over emphasis of the 'default arrangement' as a suitable or fundamental investment choice(s) for members may be misleading, as the default arrangement might only take into consideration the age of members in its design without other factors such as individual risk appetite, or financial or personal circumstances having been taken into account. It should be repeatedly made clear that the objective for the default arrangement is provide a suitable default investment strategy for certain members, and will not necessarily deliver the best investment returns in any given period, or for any given savings-for-retirement life cycle.

As an industry we continue to believe in investor education, and even the MPFA would agree, that ideally all members would take the initiative to review their own retirement planning needs, and then make suitable investment choices for their individual circumstances. The result of such investor engagement might also include a partial, or whole, investment in the new default arrangement.

Q11. Do you agree with the general principle for dealing with implementation and transitional issues as set out in paragraphs 78 and 79?

☐ Yes ☑ **No**

Comments:

Given that we represent investment/fund managers, it may be more appropriate for other MPF functionaries to comment on the transitional issues in detail.

From an investment management viewpoint, and as MPF members ourselves, we would agree with the principles set out in paragraph 78.

The proposals outlines in paragraph 79, however, provide a potential investment management challenge, as a mass re-election or accrued benefits shift will require managers to liquidate potentially large investments from one fund, and reinvest in another, both of which would incur costs for the respective funds. Continuing investors may lose the benefits of scale, resulting in a higher FER, and certain funds may no longer be viable to operate – this may be particularly acute for the Guaranteed or Conservative Funds (potentially requiring MPFA intervention). We would question the benefit for such an arrangement, and hence request the MPFA to consider whether current accrued benefits should not be left in their current Constituent Funds and the new default arrangements applied only to future contributions (except where members specifically elect for their accrued benefits to be transitioned to the new default).

Q12. Do you agree with the proposal in paragraph 81 as to how to deal with the transition for existing MPF members of default funds?

☐ Yes ☑ **No**

Comments:

As per question 11, we would express caution in determining the approach for dealing with current accrued benefits given the potential fund management impact (e.g. breaking of guaranteed return conditions in the Guaranteed Funds, forcing Conservative Funds to break term deposits, and members being 'out-of-the-market' during the transition). There is also the potential for non-Defaulters to be inadvertently caught by a re-election and moved to the new default arrangement even though they had previously made an election to be in that schemes particular default fund.

Information of Respondent
(Please refer to the Personal Information Collection Statement on pages 47 and 48 of the Consultation Paper)

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Mandatory Provident Fund Schemes Authority ("MPFA") Consultation on Providing Better Investment Solutions for MPF Members
HKIFA Response
Executive Summary

The HKIFA strongly supports the Mandatory Provident Fund ("MPF") system as a mandatory, privately-managed, second pillar scheme as a complement to both government social security programs, and individual savings arrangements'. The current MPF framework – with the government being responsible for providing a robust regulatory framework; and the private sector, via competition, designing products and services that best cater for the retirement needs of scheme members – has been developed after careful deliberation and consultation, including detailed studies of various overseas second pillar retirement models.

In the nearly 14 years since its launch, the MPF system has been tested during a period of significant market volatility, as seen in the bursting of the tech bubble, SARS, and the Global Financial Crisis. Despite such market turbulence, the MPF system has delivered respectable performance to members: registering an annualised 4.3% return, against an inflation rate of 1.6%.[1]

In response to the 'Providing Better Investment Solutions for MPF Members' consultation paper ("Consultation Paper"), the HKIFA broadly supports what we believe are the core objectives of the MPFA, namely: providing consistency and simplicity of investment options to MPF members who choose not to make an investment selection, and addressing some of the concerns regarding costs to members. Since launch, the HKIFA and the industry has worked closely with the MPFA and other stakeholder groups to continuously enhance the system, and we value the opportunity to respond to the Consultation Paper. Before responding specifically to the 12 questions, we wish to share a few of our thoughts and concerns, as well as to clarify a few key discussion items surrounding the core objectives of the Consultation Paper exercise.

On Terminology

We believe that the current terminology, "core fund", is both confusing and potentially misleading, and we seek to clarify this point at the outset of our response.

The term 'core fund' refers to both a 'core' investment choice, and a single 'fund'. As the MPFA would no doubt agree, within the Consultation Paper, reference is made to the possibility of creating multiple investment choices (e.g. target date fund(s), or a life cycle approach, etc.), which would involve the use of several 'funds' beyond just one. We therefore prefer to use the word 'arrangement' (or some similar term) instead of 'fund', to accommodate and clarify that the final result may involve one, or more, investment funds.

Furthermore, we believe that the term "default" (i.e. 'default arrangement') would be more appropriate than 'core'. The term 'core' may give the impression that this is a superior

[1] MPF system annualized internal rate of return and Hong Kong annualized composite CPI % change according to MPFA Schemes Statistical Digest, June 2014.

investment proposition that is endorsed by the Authority; and that it is a "must have" (i.e. 'core') holding and therefore be fit for all members. Any introduction of the 'core' concept would be misleading if members interpret it to be that the 'core fund' is the "recommended" fund option.

Furthermore, we believe that MPFA needs to be cautious in managing the expectations of members when positioning the default arrangement concept. Over emphasis of the 'default arrangement' as a suitable or fundamental investment choice(s) for members may be misleading, as the default arrangement might only take into consideration the age of members in its design without other factors such as individual risk appetite, or financial or personal circumstances having been taken into account. It should be repeatedly made clear that the objective for the default arrangement is provide a suitable default investment strategy for certain members, and will not necessarily deliver the best investment returns in any given period, or for any given savings-for-retirement life cycle.

As an industry we continue to believe in investor education and, even the MPFA would agree, that ideally all members would take the initiative to review their own retirement planning needs, and then make suitable investment choices for their individual circumstances. The result of such investor engagement might also include a partial, or whole, investment in the new default arrangement.

On Investment Strategies

We understand that a key objective of the exercise is to reduce the wide variability of investment outcomes of default arrangements, and we as an industry broadly support this goal. The MPFA has also indicated that other desirable outcomes include: an investment option that de-risks towards retirement, an arrangement that offers broad comparability among providers and transparency for members, and a solution that does not include an excessive proliferation of additional constituent funds.

Meeting all of these objectives in a single solution requires out-of-the-box thinking and an innovative approach. Simply put, any de-risking investment strategy will either require age-specific investment options (i.e. multiple target date funds), or the use of multiple funds in a lifecycle approach. Target date funds may lead to gross proliferation of constituent funds, while the lifecycle approach presents challenges in comparability, as each member will be rebalanced into multiple funds over their working lifespan, with no single fund providing a continuous performance track record.

Our belief is that the best way to achieve these multiple goals is through broad general guidelines that outline de-risking objectives, within certain limited constraints, while leaving flexibility for investment managers and providers to craft creative and innovative solutions, be they target date, lifecycle or something else entirely. Broad comparability between schemes/providers can be achieved so long as the guidelines are not too prescriptive, and further details on how we propose this are laid out in response to Question 5. However, we also seek to remind the MPFA that when considering the 'comparability' of default arrangements among providers, there should not be an exclusive focus on comparing performance. Both the Authority and the industry should remind members not to compare MPF service providers or MPF schemes solely based on performance and investment returns. Members should also take

other factors into consideration, including product features and services provided by the MPF schemes.

Allowing competition through creativity and innovation is a critical component to any privatized system like the MPF. If the regulatory guidelines on investment strategy or product design are too prescriptive, the default arrangement may deliver unforeseen and unintended outcomes. We therefore propose that the parameters be enshrined in guidelines rather than through the ordinance or legislation.

On Fees

In relation to fees, we understand there is an expectation from the MPFA, the government and the general public that the default arrangement should be a lower fee fund option. As an industry group we support the objective of bringing the costs of the MPF system down, and believe that the best way to do so is through addressing the fundamental drivers of those costs. However, a fee cap of any type is counterproductive and will not address the root causes of these cost drivers. Furthermore, legislatively driven fee caps have the potential to lead to unintended consequences, including lower service quality, reduced technological and operational innovation and the sharing of costs with consumers through indirect channels.

In order to begin addressing the cost drivers that underlie the MPF system, we propose beginning with the Ernst & Young ("E&Y") commissioned papers published in May and November 2012. These studies addressed 6 distinct drivers of cost that can be broadly categorized as administrative efficiencies, growing scale, greater pricing transparency and member flexibility. As the Consultation Paper point outs in paragraphs 50 – 56, the MPFA has already taken steps to begin addressing underlying costs and we believe that there is more that can be done to improve the efficiencies in the system. As noted in the studies and the Consultation Paper, the MPF system is relatively young and small when compared to international peers, and has already taken significant steps to providing greater value for members. As the system grows and matures, costs will be driven lower through increased efficiencies, technological developments and competition.

In Conclusion

As both a supporter and stakeholder, the HKIFA has an interest in seeing the successful development of the MPF system, so that we can provide MPF members with suitable and meaningful outcomes for their MPF retirement savings plans.

The HKIFA would like to thank the MPFA for the opportunity to submit our views and we welcome further discussion with the Authority on how we can work together to achieve meaningful and constructive developments in the MPF system.
(End)

Hong Kong Investment Funds Association

Appendix 1

Hong Kong Investment Funds Association - Introduction

The Hong Kong Investment Funds Association ("HKIFA") is a professional body that represents the asset management industry in Hong Kong. It was incorporated in 1986 as a company limited by guarantee.

The HKIFA has two major roles, namely consultation and education. On consultation, it acts as the representative and consulting body for its members and the fund management industry generally in all dealings concerning the regulation of unit trusts, mutual funds, retirement funds and other funds of a similar nature. Towards this end, it reviews, promotes, supports or opposes legislative and other measures affecting the fund management industry in Hong Kong. Another very important task is to educate the public about the role of investment funds in retirement planning and other aspects of personal financial planning.

The HKIFA has four categories of members, namely full member, overseas member, affiliate member and associate member. A fund company can qualify as a full member or an overseas member if it is either the manager or the investment adviser of at least one Investment Fund.

An "Investment Fund" means

- an authorized unit trust/mutual fund; or
- a pooled retirement fund authorized under the Code on Investment-Linked Assurance Schemes or the Code on Pooled Retirement Funds; or
- a retirement scheme registered under the Occupational Retirement Schemes Ordinance; or
- a provident fund scheme registered under the Mandatory Provident Fund Schemes Ordinance; or
- a closed-end investment company listed on a recognized exchange.

A full member must be a company incorporated in Hong Kong or if it is incorporated outside Hong Kong, has established a place of business in Hong Kong whereas an overseas member must be a company incorporated outside Hong Kong.

An affiliate member is a company that has obtained a licence from the Hong Kong Securities and Futures Commission for type 9 regulated activities or it is a fund company incorporated in the People's Republic of China; and its primary business is fund management including the management of discretionary accounts, segregated portfolios or providing investment management services for non-collective investment schemes or the manager or investment adviser of any fund investment company or arrangement not included as an Investment Fund.

An associate member is a company conducting or providing any service of accounting, legal, trustee, custodian, administration, banking, distribution, and technological support to the fund management industry or any related professional services.

At present, HKIFA has 63 fund management companies as full/overseas members, managing about 1,200 SFC-authorized funds. Assets under management amounted to about US$1,100 billion as at the end of June 2014. In addition, we have 63 affiliate and associate members.

http://www.hkifa.org.hk

(Updated: August 2014)

Hong Kong Investment Funds Association

LIST OF HKIFA MEMBERS

Full/Overseas Members 基金公司會員及海外會員

1. Aberdeen International Fund Managers Limited 安本國際基金管理有限公司
2. Access Investment Management (H.K.) Limited 安信投資管理 (香港) 有限公司
3. AllianceBernstein Hong Kong Limited 聯博香港有限公司
4. Allianz Global Investors Hong Kong Limited 德盛安聯資產管理香港有限公司
5. Amundi Hong Kong Limited 東方匯理資產管理香港有限公司
6. AXA Rosenberg Investment Management Asia Pacific Limited 安盛羅森堡投資管理亞太有限公司
7. Baring Asset Management (Asia) Limited 霸菱資產管理 (亞洲) 有限公司
8. BEA Union Investment Management Limited 東亞聯豐投資管理有限公司
9. BlackRock Asset Management North Asia Limited 貝萊德資產管理北亞有限公司
10. BMO Global Asset Management (Asia) Limited
11. BNP Paribas Investment Partners Asia Limited 法國巴黎投資管理亞洲有限公司
12. BOCHK Asset Management Limited 中銀香港資產管理有限公司
13. BOCI-Prudential Asset Management Limited 中銀國際英國保誠資產管理有限公司
14. China Asset Management (Hong Kong) Limited 華夏基金 (香港) 有限公司
15. CIFM Asset Management (Hong Kong) Limited 上投摩根資產管理 (香港) 有限公司
16. Citic Securities International Investment Management (HK) Limited 中信證券國際投資管理 (香港) 有限公司
17. Citigroup First Investment Management Limited
18. CSOP Asset Management Limited 南方東英資產管理有限公司
19. DB Platinum Advisors
20. Deutsche Asset Management (Hong Kong) Limited 德意志資產管理 (香港) 有限公司
21. E Fund Management (Hong Kong) Co., Ltd. 易方達資產管理 (香港) 有限公司
22. Eastspring Investments (Hong Kong) Limited 瀚亞投資 (香港) 有限公司
23. FIL Investment Management (Hong Kong) Limited 富達基金 (香港) 有限公司
24. First State Investments (Hong Kong) Limited 首域投資 (香港) 有限公司
25. Franklin Templeton Investments (Asia) Limited 富蘭克林鄧普頓投資 (亞洲) 有限公司
26. GAM Hong Kong Limited 環球投資 (香港) 有限公司
27. GF Asset Management (Hong Kong) Limited 廣發資產管理 (香港) 有限公司
28. Goldman Sachs (Asia) L.L.C. 高盛(亞洲)有限責任公司
29. Guotai Junan Assets (Asia) Limited 國泰君安資產管理 (亞洲) 有限公司
30. Hai Tong Asset Management (HK) Limited 海通資產管理(香港)有限公司
31. Hang Seng Investment Management Limited 恒生投資管理有限公司
32. Henderson Global Investors (Hong Kong) Limited 亨德森全球投資(香港)有限公司
33. HSBC Global Asset Management (Hong Kong) Limited 滙豐環球投資管理 (香港) 有限公司
34. Invesco Hong Kong Limited 景順投資管理有限公司
35. Investec Asset Management Hong Kong Limited 天達資產管理香港有限公司
36. J.P. Morgan Asset Management 摩根資產管理
37. Janus Capital Asia Limited 駿利資產管理亞洲有限公司
38. Jupiter Asset Management (Hong Kong) Limited 木星資產管理 (香港) 有限公司
39. Legg Mason Asset Management Hong Kong Limited 美盛資產管理香港有限公司
40. Lyxor Asset Management
41. Man Investments (Hong Kong) Limited 英仕曼投資 (香港) 有限公司
42. Manulife Asset Management (Hong Kong) Limited 宏利資產管理 (香港) 有限公司
43. Matthews Global Investors (Hong Kong) Limited 銘基環球投資(香港)有限公司
44. MFS International (Hong Kong) Limited 麻省金融服務國際 (香港) 有限公司
45. Morgan Stanley Asia Limited 摩根士丹利亞洲有限公司
46. Neuberger Berman Asia Limited 紐伯格伯曼亞洲有限公司
47. NGAM Hong Kong Limited
48. Nikko Asset Management Hong Kong Limited 日興資產管理香港有限公司
49. Old Mutual Global Investors (Asia Pacific) Limited 先機環球投資 (亞太) 有限公司
50. Pictet Asset Management (Hong Kong) Limited 百達資產管理 (香港) 有限公司

Hong Kong Investment Funds Association

Full/Overseas Members 基金公司會員及海外會員 (cont'd)

51. PineBridge Investments Asia Limited 柏瑞投資亞洲有限公司
52. Ping An of China Asset Management (Hong Kong) Co., Ltd. 中國平安資產管理(香港)有限公司
53. Principal Global Investors (Asia) Limited 信安環球投資 (亞洲) 有限公司
54. Schroder Investment Management (Hong Kong) Limited 施羅德投資管理 (香港) 有限公司
55. SEI Investments (Asia) Limited 美國信怡泰投資有限公司
56. Standard Life Investments (Asia) Limited 標準人壽投資 (亞洲) 有限公司
57. State Street Global Advisors Asia Limited 道富環球投資管理亞洲有限公司
58. Taikang Asset Management (Hong Kong) Limited 泰康資產管理 (香港) 有限公司
59. Threadneedle Portfolio Services Hong Kong Limited 天利投資管理香港有限公司
60. UBS AG - Global Asset Management 瑞士銀行 – 環球資產管理
61. Value Partners Limited 惠理基金管理公司
62. Vanguard Investments Hong Kong Limited 領航投資香港有限公司
63. Zeal Asset Management Limited 行健資產管理有限公司

Affiliate Members 附屬會員

1. AMP Capital Asia Limited 安保投資管理亞洲有限公司
2. BNY Mellon Asset Management Hong Kong Limited 紐銀梅隆資產管理香港有限公司
3. BRIC Neutron Asset Management Limited 尚金資產管理有限公司
4. Cathay Conning Asset Management Limited 國泰康利資產管理有限公司
5. China Life Franklin Asset Management Co., Ltd 中國人壽富蘭克林資產管理有限公司
6. China Universal Asset Management (Hong Kong) Company Limited 匯添富資產管理 (香港) 有限公司
7. Daiwa SB Investments (HK) Limited 大和住銀投信投資顧問 (香港) 有限公司
8. Fidelity Management & Research (Hong Kong) Limited
9. Generali Investments Asia Limited 忠利投資亞洲有限公司
10. Harvest Global Investments Limited 嘉實國際資產管理有限公司
11. HuaAn Asset Management (Hong Kong) Limited 華安資產管理 (香港) 有限公司
12. Income Partners Asset Management (Asia) Limited 豐收投資管理 (亞洲) 有限公司
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14. Nomura Asset Management Hong Kong Limited 野村投資管理香港有限公司
15. Pangu Capital Limited 盤古資本有限公司
16. Samsung Asset Management (Hong Kong) Limited 三星資產運用 (香港) 有限公司
17. SinoPac Asset Management (Asia) Ltd. 永豐金資產管理 (亞洲) 有限公司
18. Sun Life Asset Management (HK) Limited 永明資產管理(香港)有限公司
19. T. Rowe Price Hong Kong Limited 普信香港有限公司

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3. American International Assurance Company (Bermuda) Limited 美國友邦保險 (百慕達) 有限公司
4. Arendt & Medernach, Hong Kong
5. Baker & McKenzie 麥堅時律師行
6. Bank Consortium Trust Company Limited 銀聯信託有限公司
7. Bank of East Asia (Trustees) Limited 東亞銀行 (信託) 有限公司
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9. Bingham McCutchen LLP 斌瀚律師事務所
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12. CACEIS Hong Kong Trust Company Limited
13. Citibank N.A. 花旗銀行香港分行
14. Clifford Chance LLP 高偉紳律師行
15. Credit Suisse (Hong Kong) Limited 瑞士信貸 (香港) 有限公司
16. Deacons 的近律師行
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Hong Kong Investment Funds Association

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20. Ernst & Young 安永會計師事務所
21. Euroclear Bank Hong Kong Branch
22. Excel Technology International (Hong Kong) Limited 志鴻科技國際(香港)有限公司
23. FTSE Group 富時集團
24. Hang Seng Indexes Company Limited 恒生指數有限公司
25. HLB Hodgson Impey Cheng 國衛會計師事務所
26. The Hong Kong Trust Company Limited
27. HSBC Institutional Trust Services (Asia) Limited 滙豐機構信託服務 (亞洲) 有限公司
28. Hwang & Co in association with Dechert LLP 黃漢龍律師事務所
29. iFAST Financial (HK) Limited 奕豐金融 (香港) 有限公司
30. J.P. Morgan Chase Bank, N.A. Hong Kong Branch 摩根大通
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32. KPMG 畢馬威會計師事務所
33. Loyens & Loeff
34. Morningstar Asia Limited 晨星 (亞洲) 有限公司
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36. ONC Lawyers 柯伍陳律師事務所
37. PricewaterhouseCoopers 羅兵咸永道會計師事務所
38. RBC Investor Services Trust Hong Kong Limited 加皇信託香港有限公司
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40. SGSS Hong Kong Trust Co. Ltd. 法興香港信託有限公司
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43. Tanner De Witt
44. Thomson Reuters Hong Kong Limited 湯森路透香港有限公司