ACTUARIAL SOCIETY
of
HONG KONG
香港精算學會

Attention: Consultation on Providing Better Investment Solutions for MPF Members

Investment Regulation Department
Mandatory Provident Fund Schemes Authority
Unit 1501A and 1508, Level 15
International Commerce Centre
1 Austin Road West, Kowloon
Hong Kong

30 September 2014

Dear Sir/Madam,

Responses to the MPFA Consultation Paper "Providing Better Investment Solutions for MPF Members" (June 2014)

On behalf of the Actuarial Society of Hong Kong ("ASHK"), I like to submit our comments in the following pages on the Consultation Paper on "Providing Better Investment Solutions for MPF Members", published jointly by the FSTB and MPFA in June 2014.

The ASHK is the sole professional body representing the actuaries practicing in Hong Kong. We have around 1,000 members, of which over 600 are fellows. A significant number of our members are involved in the retirement scheme industry, covering both ORSO schemes and MPF schemes.

We believe, as actuaries, we have a social responsibility to help the general public to understand and to appreciate the risks and financial uncertainties surrounding their retirements. Whilst one of the most important components in building up a secured source of retirement income is through investments, we welcome the initiative of FSTB and MPFA to attempt to provide better investment solutions to MPF members in Hong Kong.

Our key comments regarding the consultation are:

- With the implementation of the "core fund", we are not sure if this will further encourage MPF members not to take active interests in their MPF investments. We strongly believe that ultimately, individuals are responsible of their own retirement planning and the MPFA has been doing a lot of good work in the past years educating the public on retirement planning and investments. We fear that the establishment of a standardized core fund will somewhat diminish the effect of the educational work that the MPFA and the MPF industry has been doing.

- There may be a danger that the MPF core fund will be perceived as "anointed" by the MPFA and leads to MPF members taking that investment choice without considering their own individual circumstances and risk appetite.

- MPF system is a Pillar 2 system according to the World Bank model. We feel that the degree of standardization as suggested in the consultation document may turn the MPF system towards a Pillar 1 system. We feel that there is a need for a clearer distinguishment between the two. This is especially the case if there will potentially be some sort of universal pension scheme to be implemented in the future.

Detailed responses to each of the 12 questions can be found in the following pages of this letter. Please note that we feel that we are not qualified to comment on the administration arrangement or the fee level of the investment solution, and have decided that these questions can be better debated among the relevant MPF providers.

We would be happy to discuss any of the comments made in this letter. Please feel free to contact us.

Yours faithfully

ASHK

Detailed Responses to the MPFA Consultation Paper "Providing Better Investment Solutions for MPF Members (June 2014)"

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

In respect of paragraph 36(a), in general, we do not believe there can be one universal investment strategy is suitable to the entire MPF population. Principally, MPF is a pillar 2 system and for the purpose of better financial security of the total retirement saving systems in Hong Kong, we believe pillar 2 should allow more diversity of investment strategy.

Also, if the core fund is overly standardised, it may bring further systematic risks into the system. This may not be desirable if in the future Hong Kong will bring in a Pillar 0 or Pillar 1 system in the form of an universal pension, which will in itself bring in significant systematic risks.

In respect of paragraph 36(b), whilst we agree that there shall be a balance between long-term risks and returns in a manner appropriate for retirement savings, we believe that more attention will need to be paid towards the execution of such strategy particularly with a default target date fund as suggested. This is because the de-risking of the fund may not take place at an appropriate timing, e.g. when the de-risking automatically happens after a crash in higher-risk assets – in which case the member will have materialised the losses which could reasonably be expected to be recovered in a longer term.

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

See answer to Q3 below.

Q3. Do you agree that it is appropriate that the core fund (default option) be based on a standardized default fund?

We have reservation to agree that there exists one universal investment strategy that will provide better investment solutions for the entire MPF population.

Even if some sort of target fund mechanism is built into the default fund (e.g. de-risking by member's age), the risk level of the default fund may still not be appropriate for the individuals concerned, as people with different marital status, income level, etc. will have different needs. On the other hand, it is probably not desirable to make the default mechanism too complicated as this will be difficult to communicate.

If majority of MPF members follow a single investment strategy, it may create a significant systematic risk to the overall financial security of the MPF system. In the scenario that such investment does not work out as expected, the impact will be system wide and this becomes very hard to tackle. The advantage to allow diversity of default funds is to reduce this systematic risk.

Core fund is not a superfund that solves all problems, but it does give us a good opportunity to drive competitions.

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

We agree with the general principle of de-risking as you age, but more analysis is required to justify what is the appropriate asset mix at different ages. Also, some mechanism shall be put in place in the scenarios of market abnormalities (such as market crash) when automatic de-risking may not then be appropriate.

With Hong Kong's life expectancy being around 85, and the lack of life annuity market in Hong Kong. Most people's MPF funds shall continue to be invested following age 65 and the expected investment horizon is around 20 years (or more). Such a long investment horizon shall support a portfolio with reasonable exposure to risky assets. As such, a target age of 65 may not be appropriate, or at least that the target portfolio at age 65 shall not be over conservative.

We should also consider the holistic picture including other pillars as well as other factors like individual's risk appetite before we finalize the decision on how to de-risk MPF. Potentially, even if the member has been defaulted to the default fund, the automatic de-risking may only be executed after giving the member a few months of advance notice, which will give the members a chance to "opt-out" of the de-risking.

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?

As mentioned above, we believe a pillar 2 system like MPF should be given more freedom to diversify. The aim is to provide an opportunity for individuals with different investment objectives to find their own optimal investment solution. Overall, we do not believe consistency across all aspects of default fund is an optimal strategy for MPF members.

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

We believe ASHK is not in a position to comment on the fee level as this is a commercial decision that should be left to the individual MPF providers.

The Actuarial Society of Hong Kong
2202 Tower Two, Lippo Centre, 89 Queensway, Hong Kong
Tel: (852) 2147-9419 Fax: (852) 2147-2497 Web: www.actuaries.org.hk

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

Similar to Q6, we believe ASHK is not in a position to comment on the FER.

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

We believe ASHK is not in a position to comment. However, we do observe that any potential fee cap imposed may put a restriction on the extent of active management that may be included in the investment strategy of the MPF core fund.

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

In general, we believe any asset class for which a well-constructed, marketable, and investible market index has been established, is appropriate for passive, index-based investment.

However, when determining the asset classes (and their corresponding allocations) that shall be included in the MPF core fund, the overall systematic risk of the portfolio will need to be considered in conjunction with the risk-level deemed appropriate for the MPF members who are likely to end up in the default fund.

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

We believe ASHK is not in a position to comment since this is more an operational issue that should be left to the MPF providers.

Moreover, much of this will depend on the decision regarding a standardised investment strategy across all providers for the MPF core fund.

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

We believe ASHK is not in a position to comment. The feasibility of the suggested approach will depend largely on the administration capabilities of the individual MPF providers.

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?

We believe ASHK is not in a position to comment. The feasibility of the suggested approach will depend largely on the administration capabilities of the individual MPF providers.