

Hong Kong Trustees' Association Conference

Luncheon Keynote Speech

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**Reforming the MPF System to Improve Administration
and Trustee Governance**

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Good afternoon Mr Michael Shue (Chairman of the Hong Kong Trustees' Association), ladies and gentlemen

2. I am delighted and honoured to be here today and would like to thank the Hong Kong Trustees' Association (HKTA) for inviting me to this Conference. I am particularly pleased to meet with so many experts and professionals related to the trust industry, who have a deep knowledge of the Mandatory Provident Fund (MPF) System. The HKTA has always been a valuable partner of the MPFA in the development of the System.

3. With the arrival of the 17th anniversary of the MPF System on 1 December, I would like to take this opportunity to share with you how the System had performed during the period, and also talk about our two major initiatives in the pipeline to improve the System.

4. The MPF System has been doing its job in helping the working population prepare for their retirement and accumulate retirement wealth. From the inception of the System to September 2017, it achieved an annualized return of 4.4% (net of fees and charges), exceeding the corresponding inflation rate of 1.8% over the same period.

5. In dollar terms (as at the end of September 2017) MPF assets under management (AUM) have reached a record high of HK\$793 billion, including HK\$564 billion in MPF contributions and HK\$229 billion in investment returns, net of fees and charges. In other words, about 1/3 of our total AUM are investment returns. There is no doubt that the MPF System has added value to scheme members' retirement savings.

6. The above AUM is equivalent to about 32% of Hong Kong's total 2016 GDP. Compared with more mature pension systems around the world, whose asset size averages 50% of GDP, there is clearly considerable room to grow the MPF assets of our scheme members. A significant part of the growth will depend on how effectively MPF trustees deliver better "value for money" for MPF scheme members, and on that, we would count on your professional expertise to deliver good results for our members.

7. On our part at the MPFA, we have been making tireless efforts to make the MPF System better. I could still recall that, at the Global Forum on Private Pensions held in Hong Kong last year, representatives from different overseas jurisdictions pointed out that private pension systems around the world were facing the same challenge of how to reduce fees.

8. Over the past years, to help bring down the level of fees, the MPFA introduced different means and initiatives, including enhancing and standardizing fee disclosure to facilitate comparison and informed decision, implementing the Employee Choice Arrangement (or "semi-portability of MPF") to allow better working of market forces, streamlining and simplifying administrative processes to cut down administrative costs, requesting trustees to offer low fee funds, and working with trustees to merge less efficient schemes and funds.

9. With the concerted efforts of MPF trustees and the MPFA, the average Fund Expense Ratio (FER) has dropped by 26% to a record low of 1.55% over

the past 10 years. However, we understand that the community would like to see deeper and quicker fee reduction, and we also think that there is still room for further reduction.

10. Among our various efforts and initiatives on this front, the Default Investment Strategy (DIS) is considered to be one of the most significant reforms of the MPF System. For the first time, we are introducing a new investment strategy drawing reference to views of international experts and experience of overseas countries for better retirement protection of scheme members.

11. The aim of the DIS is to standardize the default investment arrangement amongst all MPF schemes. It is a long term investment strategy designed primarily for scheme members who are not interested in managing, or do not know how to manage their MPF. Scheme members can choose to adopt the DIS if they consider that it suits their investment needs. The DIS also aims to address public concerns about the difficulty of selecting MPF funds as well as the high MPF fee levels, and will provide scheme members with better retirement protection.

12. We believe the automatic, age-dependent, de-risking approach of the DIS, along with fee caps (of 0.95%) will benefit scheme members. It assists them in managing the long-term risks associated with investing MPF savings for some 40 years, during which those savings may be exposed to multiple investment and market cycles.

13. While investment returns are subject to market fluctuations, fees are known in advance. As far as scheme members' interests are concerned, the lower the fees, and all other things being equal, the higher the net returns. This is what we expect, among others, how the DIS will work for bringing higher returns for scheme members.

14. With the support of the Government and cooperation of MPF trustees, the DIS has been successfully launched in April this year. As at 30 September 2017, about 960,000 (or 10% of the total) MPF accounts were invested according to the DIS or in DIS constituent funds, involving about \$18 billion of assets. To enhance public understanding of the DIS, the MPFA has rolled out a series of publicity programmes, including TV and radio Announcements in the Public Interests and advertisements on platforms like newspapers, social media, websites, bus bodies and in MTR stations. We have also organized hundreds of talks on the DIS and will continue to monitor the uptake of the DIS and the DIS constituent funds. May I take this opportunity to express my gratitude to the input and support of the HKTA in developing the DIS.

15. As you are aware, costs of the MPF System do not only arise on the investment front, but also on the administrative side. The System involves numerous scheme administration processes, and each trustee has its own platform for handling these administration matters. I believe that technology can play a key role here. The use of electronic processing and streamlining of processes should further improve the operational efficiency of the MPF System. As such, another important task for us is to explore ways to reduce the complexity of the System, and enable the provision of all major member-related services via electronic means and online channels. This brings me to one of the focuses of my speech today – the “eMPF”.

16. “eMPF” is the tentative name for the electronic infrastructure and processes to standardize, streamline and automate MPF scheme administration in the long run. As I mentioned just now, at present, each MPF trustee operates its own unique administration system that is independent from others. This decentralized system is also paper-intensive which may bring about a lot of operational inefficiencies.

17. The MPF System is a savings scheme involving over 4 million scheme members and 9 million MPF accounts. We are given to know that there are around 30 million MPF administration transactions per year and up to 100 000 transactions a day are paper-based or executed via cheques. As such, there are bound to be a lot of administrative costs involved which make up a significant portion of total fees and expenses.

18. To tackle the issue, the MPFA has earlier developed a conceptual model to standardize, streamline and automate MPF scheme administration. The MPFA has commissioned consultancy studies on the conceptual model and has briefed the trustees on it.

19. Although the eMPF is in its conceptual stage, we are encouraged that the Government has put its support behind it. The 2017 Policy Address set out that the next objective of the MPFA is to put in place an eMPF, a centralized electronic platform to facilitate the standardization, streamlining and automation of MPF scheme administration, thereby reducing costs, paving the way for “full portability” so employees will have full control over the investment strategy, promoting market competition among trustees, and increasing the prospect of further fee reductions. The Government’s vision is “one member, one account”, so that each employee will pool all MPF accrued benefits into a single MPF account for more effective management of his/her retirement savings. In this regard, the Government has set up a Working Group on eMPF in June this year to steer the development of the electronic platform.

20. In the initial stage, the Working Group will focus on building a centralized electronic administration platform to enhance the cost-efficiency of MPF scheme administration. It will later map out the strategy for encouraging employers and employees to manage MPF matters electronically so as to address the problem of the existing high administrative costs due to voluminous paper-based transactions.

21. Members of the Working Group include the Government and MPFA representatives, as well as representatives of the 14 MPF approved trustees who are operating MPF schemes. A User Committee on Digital Take-up and Centralized Electronic Platform has been formed to hear the views of employers, HR practitioners and scheme members from the perspective of users on the electronic services now provided by trustees as well as those to be made available by the eMPF.

22. We would like the eMPF to achieve several purposes. Firstly, it would provide centralized collection of MPF contributions and necessary information from employers through an electronic channel. Secondly, it would automatically calculate the amount of contributions in respect of each employee and submit such information to the trustees concerned. Thirdly, it would provide a one-stop electronic portal for scheme members to access all relevant information about their MPF accounts.

23. Upon implementation of the eMPF, it will bring significant and fundamental changes to the administration of the MPF System, leading to better operational efficiency and lowering administration costs over the longer term. Even more importantly, it will allow scheme members to manage their MPF more conveniently and access the most updated information about their accounts at any time. This will greatly improve the user experience, and encourage members to take better care of their MPF benefits.

24. Of course, we would not underestimate the challenges involved as the success of the eMPF would be highly dependent on the willingness of scheme members and employers to go paperless. Given that a majority of the employers in Hong Kong are MSMEs (micro, small and medium enterprises), this would not be an easy task. We need to work together with the industry to encourage and educate MPF scheme members and employers to use the electronic services, and to facilitate the use of such services. We will also

consider how to encourage more use of electronic facilities even before the launch of the eMPF, as you will understand that behavioural changes take time to materialize. Despite these challenges, I am nevertheless cautiously optimistic that this vision will come to fruition.

25. With that, I would like to go to the other important initiative of the MPFA to strengthen the protection of MPF scheme members. Some of you may probably be aware that, two weeks ago, the MPFA has organized a workshop on “Governance of MPF Trustees” whereby our fellow financial regulators and leading figures working in different disciplines related to MPF shared their knowledge and experience on the topic of “Governance”. Over 100 representatives, including directors of the boards of MPF trustees, other local financial regulators and market experts attended the Workshop. Today, I would like to keep up the momentum by touching on this important topic again.

26. Hong Kong has adopted the multi-pillar retirement protection model recommended by the World Bank, and our MPF System forms the second pillar of the World Bank’s model. Employees are mandated to join the MPF schemes chosen by their employers, and contributions made to the schemes are privately managed.

27. Under the MPF System, MPF trustees assume a fundamental role in protecting scheme members’ interest and delivering “value for money” outcomes for scheme members. They manage the investments and make sure that everything is in good order for scheme members, so that members can have a certain level of retirement protection based on the contributions they accrued over their work life, which may span over 40 years.

28. Unlike in the retail investment world where investors can choose their service providers freely and decide whether or not to invest, participation in the MPF System is mandatory. MPF scheme members rely on the integrity and professional judgment of MPF trustees to manage the schemes and safeguard

their retirement savings. Because of that, MPF trustees are expected to have a higher duty of care and take all possible measures to ensure that high quality, value-for-money benefits and services are provided, despite possible conflicts that may arise from their own profit objectives.

29. With the MPF assets under management reaching a record high of almost \$800 billion and covering over 4 million scheme members, **MPF trustees, though not “public trustees”, are indisputably “trustees of the public”.**

30. Good governance is a substantial element of an efficient pension system which could enhance investment performance and provide increased protection of members’ benefits. International best practices indicate that appropriate governance structures, well-defined accountability, policies and procedures, and suitable processes for selecting and operating governing bodies as some of the key factors contributing to good governance of pension funds.

31. Governance structures establish the architecture for decision-making processes within pension funds, and the accountability of pension funds’ governing bodies strongly influences the incentives for sound, judicious decision making.

32. Good governance also calls for clear identification and separation of the operational and oversight responsibilities of a pension fund. Generally, the governing body of a pension fund focuses on strategic decisions and oversight functions, while operational tasks will be delegated to executive staff or external service providers. While the governing body should retain ultimate responsibility for the fund, the governance framework should facilitate two-way communication between the board level and the operational level.

33. Talking about accountability, the governing body of a pension fund should be accountable to members and beneficiaries. In this regard, independent directors or members can be appointed to the board to enhance

accountability of the governing body. Independent directors can bring a wider range of skills and experience to the board and thus enhance decision-making. Having independent directors, however, is not enough. The board should identify directors who will bring the right level of expertise and capability to the board, understand their fiduciary responsibility, be prepared to challenge the decisions of the management team, and act in a manner that is not influenced by any conflict of interest. The board should also make sure that sound appointment and renewal policies are instituted.

34. Currently, MPF trustees do not have legal obligation to include scheme member representatives on their boards, nevertheless, the board should try to gauge the views of these ultimate beneficiaries to support its decisions.

35. Last but not least, policies and procedures are indispensable for the proper functioning of a pensions fund's governing body. They are the mechanisms by which incentives for prudent behaviour are operationalized, and are conducive to sound judgment and decision making. In my experience, key policies and procedures include those that support good governance structures, accountability, transparency, independent oversight, a clear investment policy, risk identification, control and monitoring.

36. Promoting a high standard of governance amongst all MPF trustees has always been a key regulatory objective of the MPFA. Over the past three years, we have embarked on a campaign of regulatory visit to the board of directors of MPF trustees (Governance Visit) with the objective to promote stronger governance and a healthy risk culture. Areas of focus of the Governance Visit included:

- Delivering value for money for MPF scheme members – covering fund performance monitoring / management of MPF fund lifecycle, cost saving initiatives and administrative efficiencies;
- Governance structure and policies;
- Risk management, internal controls and data quality assurance; and

- Enhancing service quality and user experience.

37. During the Governance Visit, some good practices were observed while certain areas for improvement were also identified. MPF trustees have taken measures to enhance the areas identified for improvement from the Governance Visit, including reviewing and revamping the board composition, governance structures and risk management frameworks, as well as streamlining/simplifying the scheme and investment structures. Positive actions have also been taken by trustees to enhance operational efficiency and cost effectiveness of the System.

38. Going forward, the MPFA will maintain a supervisory dialogue with individual trustees on governance based on their business and governance plans. To help board members of MPF trustees uphold good governance practices, the MPFA plans to issue a set of “High Level Principles on Governance of MPF Trustees” in 2018 for industry guidance.

39. While acknowledging that MPF trustees are commercial entities, they also have social responsibilities, as the MPF System is mandatory in nature designed to help the working population save for old age and contribute to their retirement protection. As professionals entrusted with the management of MPF savings, trustees have the responsibility to work for their scheme members’ greatest benefit. To achieve this, MPF trustees should have the right people on the governing board and the right risk culture. They should be member-centric, put in place a good communication system, both internally and with their scheme members, and promote transparency of information. They must understand the needs of scheme members and offer scheme members the products and services that represent good value for money.

40. The governing board should always **“put members’ interests first”** when making both investment and operational decisions for the scheme,

including the service providers they appoint, and the fees and charges for their services. At the end of the day, the trustees and their governing boards are answerable to scheme members for the outcomes of their schemes.

41. It has been 17 years since the implementation of the MPF System. The HKTA and the MPFA have long been close partners in developing and refining the System. We look forward to your ideas and cooperation in bringing about future improvements and changes, in particular bringing the implementation of the eMPF to fruition, which will be in the interest of all scheme members, as well as all key stakeholders of the MPF System.

42. Once again, I would like to thank the HKTA for inviting me to the event today.