

**2017 APIC-ABAC/APFF
Regional Pension Funds & Social Security Systems Summit
5 December 2017**

**Special Address
Pension Reform and the Development of the MPF System**

**Dr David Wong Yau-kar
Chairman
Mandatory Provident Fund Schemes Authority**

Good afternoon, ladies and gentlemen

2. I am delighted to be here today and would like to thank the Asia Pacific Investors Cooperation (APIC) for inviting me to this Summit. I am also pleased to meet with so many experts and professionals across the financial regulatory and market space around the region, and learn from them issues impacting the investor community, and in particular, pension funds.

3. The Mandatory Provident Fund (MPF) System came into operation on 1 December 2000 and has just celebrated its 17th anniversary. In a moment, I will share with you how the MPF System had performed during the period, as well as the latest developments and the work ahead.

4. The MPF System is the second pillar system of the World Bank approach to old age protection. Under the System, employees are mandated to join the MPF schemes chosen by their employers, and contributions made to the schemes are privately managed. The trustee of an MPF scheme is the party responsible for all scheme administration and management functions. They provide fund choices managed by investment managers and scheme members choose the funds that suit their investment needs.

5. The System has been doing its job in helping the Hong Kong working

population prepare for their retirement and accumulate retirement wealth. From the inception of the System to October 2017, the MPF System achieved an annualized return of 4.6% (net of fees and charges), exceeding the corresponding inflation rate of 1.8% over the same period.

6. Although MPF is designed to provide basic retirement protection for the employed population only, it is an important component of the overall retirement protection framework. In dollar terms (as at the end of October 2017) MPF assets under management (AUM) have reached a record high of HK\$810 billion, including HK\$568 billion in MPF contributions and HK\$242 billion in investment returns, net of fees and charges. There is no doubt that the MPF System has added value to scheme members' retirement savings.

7. The above AUM is equivalent to about 33% 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.

8. On our part at the Mandatory Provident Fund Schemes Authority (MPFA), we have been making tireless efforts to make MPF better. I could still recall that, at the OECD/IOPS 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 are facing the same challenge of how to reduce fees.

9. As you are aware, the level of fees and charges of MPF funds is a major concern of the public. The MPFA has always maintained the position that lower fees are in member' interests. Over the past years, to help bring down the level of fees, we have introduced a range of initiatives, including enhancing and standardizing fee disclosure to facilitate comparison and informed decision, providing employees with greater control over their MPF investment,

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.

10. One of the measures to facilitate the assessment of the fee level of MPF funds is the requirement for the calculation and publishing of the Fund Expense Ratio (FER) for each MPF fund. The FER is a synthetic indicator of the expense level of an MPF fund based on the previous year's accounts. It provides a measure of the total level of expenses incurred in investing through an MPF fund, including the costs incurred at the underlying funds. The FER was designed to reduce various fee and expense elements into a single figure so that fee impacts could be more easily understood and compared. We have also established a fee comparative platform on the MPFA's website to allow members to easily compare the fees and expenses of all MPF schemes and funds.

11. With our continuous efforts, the average FER has been reduced by 26% to 1.56% over the past 10 years. However, we all know that the community would like to see deeper and quicker fee reduction, and we also think that there is still room for further reduction.

12. Among our various efforts and initiatives on this front, the Default Investment Strategy (DIS) introduced in April this year 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 that provides scheme members with better retirement protection.

13. The aim of the DIS is to standardize the default investment arrangement amongst all MPF schemes by applying an automatic, age-dependent, de-risking approach with fee caps. 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.

14. 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.

15. As you all know, 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.

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 extremely paper-intensive which has brought about a lot of operational inefficiencies.

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

and expenses. To tackle the issue, the MPFA has earlier developed a conceptual model to standardize, streamline and automate MPF scheme administration.

18. 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.

19. Should the eMPF be implemented, 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.

20. 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 SMEs (small and medium enterprises), this may not be an easy task. We would 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 come to fruition. Despite these challenges, I am nevertheless cautiously optimistic that this vision will come to fruition.

21. Another important initiative of the MPFA that I am going to talk about is to strengthen the protection of MPF scheme members through the promotion of high standard of governance amongst MPF trustees. Under the MPF System, MPF trustees assume a fundamental role in protecting scheme members' interest and delivering "value for money" outcomes for scheme members.

22. 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 compulsory. 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.

23. With the MPF assets under management reaching a record high (exceeding HK\$810 billion as of 31 October 2017) covering over 4 million scheme members, MPF trustees, though not being "public trustees", are indisputably, "trustees of the public".

24. 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 the selection, appointment and renewal of board members as some of the key factors contributing to good governance of pension funds.

25. 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 risk management culture. 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 also plans to issue a set of “High Level Principles on Governance of MPF Trustees” in 2018 for industry guidance.

26. As professionals entrusted with the management of MPF savings, trustees have the responsibility to work for their scheme members’ greatest benefit. 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.

27. How to ensure the working population will have a reasonable standard of living after retirement is a major challenge faced by many societies. This is especially true for Hong Kong where life expectancy is among the highest in the world. The MPF System therefore has a very important role to play.

28. It has been 17 years since the implementation of the MPF System. For the MPF System to continue develop into a retirement savings system valued by scheme members, we will need to continually refine and reform it to better protect scheme members’ interests. We look forward to your ideas and cooperation in bringing about future improvements and changes, so that the MPF System can better fulfill its role as the second pillar of retirement protection for the working population of Hong Kong.

29. Once again, I would like to thank the APIC for inviting me to this function today, and I wish you a prosperous year ahead.