



強制性公積金計劃管理局
MANDATORY PROVIDENT FUND
SCHEMES AUTHORITY

**Consultation Conclusions on the
Draft Code on Disclosure for MPF
Investment Funds**

June 2004
Hong Kong

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BACKGROUND

1. The Mandatory Provident Fund Schemes Authority (“the Authority”) issued a Consultation Paper on the Draft Code on Disclosure for MPF Investment Funds on 2 February 2004. The Authority invited interested parties to submit written comments on the proposals discussed in the Consultation Paper by no later than Monday, 15 March 2004.

2. The Authority accepted submissions after 15 March 2004 and in total received 39 written submissions from approved MPF trustees, fund management companies, professional bodies, other market participants and individuals. A list of the respondents is set out in Appendix A to this paper.

SUMMARY OF COMMENTS RECEIVED

3. In general, the respondents were supportive of the direction of the draft Code and, in principle, supported the need for improvements to the disclosure of fees and charges for mandatory provident fund investments. None of the submissions opposed the approach in the draft Code in principle.

4. A large number of comments were received, both in relation to the approach of particular parts of the draft Code and the drafting of particular provisions. A summary of the key comments and the Authority’s responses are set out below.

5. As identified below, many of the submissions, not only as between industry and non-industry sources, but also as between industry sources, expressed differing views in relation to a number of issues. The Authority’s responses to those issues, as a result, will not accord with the wishes of all respondents. The approach of the Authority as set out below has been made based on a balance of the following factors:

- the need to provide MPF members with better information that broadly meets the objectives set out in the seven Good Disclosure Principles in the draft Code,
- the need to provide this better information as soon as is reasonably practicable,
- the need to ensure that changes do not create additional costs that are disproportionate to the benefits to be derived and
- where the above factors are reasonably balanced on an issue, the preponderance of views expressed in submissions.

The Authority has considered and analyzed all of the written submissions received.

6. Whilst the Authority considers that it is important that the initiatives set out in

the Consultation Paper should take effect as soon as is reasonably practicable, this does not mean that the process of development and refinement will cease. As some aspects of the Code (such as the use of On-going Cost Illustrations) will not become operational for some time, issues that arise in preparation for their use can be considered and addressed as they arise. The Authority will also ensure that further details are refined as necessary in the light of operational experience and particularly after taking into account the views of scheme members once they have commenced to use the new information and tools.

CONSULTATION RESPONSES TO SPECIFIC ISSUES

7. The Consultation Paper sought comments on 19 questions and on the content of the draft Code. Rather than dealing with the 19 questions (G1 to G12 and T1 to T7) separately, the comments received in relation to those questions are dealt with under the relevant chapters of the Code as set out below. All references to Parts, Chapters and paragraph numbers used below, refer to the Parts, Chapters and paragraph numbers used in the draft Code on Disclosure for MPF Investment Funds that was Attachment 1 to the Consultation Paper.

PART A - GENERAL

8. **Chapter A1 (Interpretation):** Two respondents suggested different improvements to the definition of “NAV” (net asset value).

9. MPFA’s response: The Authority accepts that the definition of NAV in the draft Code can be improved. The draft Code will be amended taking into account the suggestions made.

10. **Chapter A2 (Purpose and Administration):** Several respondents suggested the need for stronger enforcement mechanisms for the disclosure regime to be put in place by the Code. By contrast, one respondent suggested that the Code should be adopted by the industry only on a voluntary basis.

11. MPFA’s response: The Authority considers that, at least initially, the status of the Code as a guideline issued under section 6H of the Mandatory Provident Fund Schemes Ordinance will enable the Authority to adequately regulate and enforce compliance with the Code. Compliance with a guideline issued by the Authority is a standard condition of approval of an approved trustee, registration of a scheme and approval of an APIF. In the medium term, the Authority will give further consideration as to whether the Code, or parts of it, requires more direct statutory backing and enforcement powers.

PART B – DISCLOSURE PRINCIPLES

12. **Chapter B1.6 (Financial Planning):** One respondent suggested that factors other than past performance should be mentioned in relation to the information which is useful for financial planning purposes.

13. MPFA’s response: The Authority agrees that a range of information would be relevant for the purpose discussed in paragraph B1.6. The reference to past performance information in that paragraph was intended merely to illustrate that past performance information might be relevant for this purpose even though it may be less relevant for other purposes, such as making comparative investment decision across funds. The drafting of

paragraph B1.6 will be clarified accordingly.

14. **Chapter B2 (Good Disclosure Principles – Question G1):** In response to Question G1, a number of respondents supported the approach set out in the Good Disclosure Principles and some suggested that other principles such as “fair presentation”, “unambiguous”, “simple”, “straight forward”, “clear and timely”, should also be included. Other respondents, generally from the MPF industry, expressed some unease with the use of principles that were expressed at the outcome level. Some respondents suggested that the principles should be removed from the Code and others suggested that they should be moved to another conceptual framework document. Industry respondents also commented that principles 6 (Disclosure should not encourage a focus on past performance) and 7 (Disclosure should encourage a consideration of fees and charges) over-emphasised fees and charges and a more balanced view as between the disclosure of fees, charges and past performance should be adopted.

15. **MPFA’s response:** The Authority believes that the use of principles within the Code is a valuable component because it helps users of the Code understand the rationale behind the development of the Code and also provides some very general, high level, guidance for the conduct of approved trustees and their delegates. The principles are not intended to be detailed requirements that would, in isolation, be used to assess the adequacy of trustees’ approach or conduct. The Authority is not in favour of providing further details or guidelines on the principles (as suggested by some respondents) because that would unduly add to length and complexity of the Code without materially providing any benefit. If particular aspects of conduct covered in the principles require more detailed consideration, then the Authority will consider including more details in relation to those aspects in other operational parts of the Code in due course.

16. As to the balance between principles 6 and 7, the Authority remains committed to the content sets out in those principles; however it acknowledges that setting those issues out as stand-alone principles may give them undue weight. Accordingly, the content of those two principles will be subsumed within principle 1 (Information should facilitate decision making) as examples of the types of information that do or do not facilitate decision-making in particular circumstances.

17. The draft Code will also be amended to help clarify the intended scope of application of the principles.

PART C – DECISION POINT DISCLOSURE OF FEES AND CHARGES OF A REGISTERED SCHEME

18. **Chapter C1.7-C1.8 (Distribution of offering document and Question G3):** Respondents generally agreed that providing an offering document is a reasonable means of

distributing key information about a registered scheme to its scheme members. A number of respondents from the MPF industry expressed concerns about the cost of distributing offering documents to all members and some respondents expressed concerns about the cost of distributing offering documents to persons who are considering joining a scheme. They were also of the view that, where every effort has been made to distribute offering documents to prospective employee members via their respective employers, approved trustees should not be held responsible if employers fail to forward the documents to their employees.

19. One respondent from the MPF industry questioned the need to provide employee members with offering documents at all, citing the reason that it is the employers rather than the employees who choose a MPF scheme. Another respondent, an industry body, proposed that it would be more cost-effective to provide employee members with extracts of offering documents only.

20. MPFA's response: The Authority considers that in the absence of another regulated document, the SFC approved offering document is the most appropriate method of distributing key information to both prospective and participating scheme members. All of the information that is required to be included in offering documents (as set out in the SFC's Code on MPF Products) is relevant to the decision-making of scheme members both at the time of joining the scheme and thereafter. The use of offering documents as proposed in Chapter C1 of the draft Code can be an effective way of meeting the obligations on trustees as set out in sections 31(2)(c) and 54 of the Mandatory Provident Fund Schemes (General) Regulation ("Regulation") and, on the basis of our reviews, reflects the existing practice of many approved trustees. The draft Code did not suggest that it is necessary to distribute copies of the offering document to all existing members. Respondents' concerns in that respect are unfounded. Given the other concerns raised about the operation of sections 31(2)(c) and 54 of the Regulation however, the Authority will, in due course, undertake a review of those sections to determine whether the statutory obligations need to be clarified or extended.

21. The Authority does not consider it appropriate for approved trustees to distribute only extracts of offering documents to scheme members because this will raise extra regulatory complications about authentication and approval of extracts. This issue can, however, be considered as part of the review identified in the previous paragraph. It may, for instance, be possible to develop another regulated document that is a concise version of the offering document.

22. The Authority accepts that approved trustees are not responsible for the failure of an employer to distribute offering documents to employees, provided that the approved trustee makes copies of the offering document available on request. If, however, an approved trustee becomes aware that an employer is refusing to distribute offering documents to

prospective members (i.e. new employees), then the approved trustee should take other reasonable steps to distribute the document to the new employees. The draft Code will be amended accordingly.

23. The Authority also accepts the suggestions made by some respondents about the need for employers and employees to be educated about the importance of offering documents and the distribution of those documents. Educational initiatives will be introduced accordingly.

24. **Chapter C1.9 (Fee information in documents other than offering documents):** Some respondents were concerned that detailed fee information is required to be disclosed in publications other than offering documents.

25. MPFA's Response: The draft Code did not propose that detailed fee information is to be provided in other documents that merely refer to fees and charges. For most documents, a signpost indicating that detailed fee information is set out in the relevant offering document will be adequate. The exception to this would be publications that contain detailed information about fees and charges of a scheme. To avoid confusion, such documents should set out the information in the same format as in the offering document (i.e. by using the Fee Table, described as the "Standardized Fee Table" in the Consultation Paper¹). The draft Code will be modified to clarify this issue.

26. **Chapter C2 (Fee Table and Question G4):** Respondents generally supported the use of a fee table with standardized format and terminology to show the various fees and charges of a scheme. One respondent also pointed out that while standardization is necessary, providing information that is clear and easy to understand by scheme members is of equal importance. Two respondents suggested that the fund expense ratio ("FER") is a more meaningful figure to members than the individual breakdown of fees in the proposed Fee Table.

27. MPFA's Response: The Authority agrees that any standardization of fee disclosure is only one step towards making fee information clearer and easier to understand for scheme members. The usefulness of the Fee Table needs to be considered in conjunction with other information and tools (such as the On-going Cost Illustrations incorporating the FER) that will be made available to scheme members. The Authority also considers that, whilst the FER might be a useful tool to help members understand the effect and totality of fees and charges, it is no substitute for fully disclosing the various fees and charges of a scheme.

28. **Chapter C2 (Fee Table - Question G4):** In response to question G4 in the

¹ The name "Standardized Fee Table" will be changed to "Fee Table"; see Paragraph 34.

Consultation Paper, most respondents preferred the proposal of having a single fee table to cover all the fees and charges of the various constituent funds of a scheme instead of having one fee table for each constituent fund.

29. MPFA's Response: Comments noted and accepted in line with the proposals in the draft Code.

30. **Chapter C2 (Fee Table – Appendix A):** Respondents from the MPF industry were concerned that certain items in the Fee Table (e.g. “other expenses” under Part (C) and “fees and charges payable out of the underlying funds” under Part (D)) are required to be disclosed in such details that require regular updating of the Fee Table. They would prefer to have the Fee Table separate from the offering document if such details are to be disclosed.

31. A few respondents suggested some alternative names for the various types of fees and charges that appear in the Fee Table. Furthermore, a suggestion was also received that the name “Standardized Fee Table” might be perceived by the public as standardization of the various fees charged by different MPF schemes.

32. MPFA's response: The Authority accepts that certain administrative expenses of a registered scheme are likely to change over time and it is not practicable to disclose the exact amount in advance. The wording of the draft Code was intended to make it clear that a narrative description of “other expenses” under Part (C) of the Fee Table will suffice; however Instruction (g) of Appendix A will be further amended to clarify this point. The Authority does not consider it necessary or appropriate to separate the Fee Table from the offering document.

33. The Authority is of the view that the disclosure of fees and charges payable out of any underlying funds is essential in order for members to understand fully the impact of fees and charges. The differing MPF fund structures make it difficult to set down detailed guidance about how fees of underlying funds should be disclosed. The overriding principle should be that approved trustees should disclose whatever information they can that helps scheme members to understand the fees and charges that apply at the underlying fund level. For example, to the extent that these fees are fixed and known in advance (e.g. for a feeder fund arrangement) then the amount of those fees should be disclosed in the Fee Table. For other fund investments which might change from year to year it might not be possible to provide specific fee information and a more generalized statement about the types of fees and charges that will be incurred in those investments should be included in the Fee Table.

34. In order to avoid any misconception that the fees and charges of different MPF schemes are being standardized, the name “Standardized Fee Table” will be changed simply to “Fee Table”.

35. In addition to the points identified above, the wording of the Fee Table and instructions will be refined in accordance with other suggestions made.

36. **Chapter C2 (Fee Table – guarantee reserves/charges):** Several Respondents raised questions about the treatment of guarantee charges and guarantee reserves in the Fee Table.

37. MPFA’s response: As a matter of principle, those guarantee charges or reserves (however described) that are really in the nature of a fee or charge should be disclosed in the Fee Table so that all “fee” items are contained in one place. A strong indicator as to whether such an item is really in the nature of a fee or charge is whether the amount is deducted out of the assets of a fund (hence reducing the NAV of the fund) for the purpose of providing the guarantee. In those cases the item should be included in the Fee Table. For other cases, disclosure about the amount and nature of the item should be contained elsewhere in disclosure documentation, for instance in the part dealing with the features of the guarantee. Corresponding changes will be made in the “Definitions” section of Appendix A of the draft Code.

38. **Chapter C2 (Fee Table – Rebates):** Several respondents raised questions about how customized rebates should be dealt with in the Fee Table. Some suggested that providers should be permitted to make additional disclosure about customized rebates.

39. MPFA’s response: Where rebates are offered to only some members of a scheme, it would be appropriate to include an additional note in the Fee Table that the table does not incorporate information about those rebates. The draft Code and Appendix A will be amended accordingly.

40. **Chapter C2 and Appendix B (OCI and Question G5):** A number of respondents from the MPF industry raised concerns that the On-going Cost Illustrations (“OCI”) might cause members to place undue focus on the effect of fees and charges to the exclusion of other important factors. One respondent from the MPF industry disagreed with the use of OCI in whatever form on this basis. A number of respondents from the MPF industry proposed an alternative form of the OCI. It was suggested that the alternative OCI would compound the effect, in dollars, of three different levels of notional fund expense ratio (“FER”) on an investment of \$1,000. Since the on-going costs would be based on notional FER figures, annual updates would not be required and actual FERs of constituent funds would not be shown in the alternative OCI.

41. MPFA’s response: The Authority agrees that scheme members should consider a range of factors, not limited to fees and charges, when making investment decisions. This is

already stated in the draft Code and will be reinforced by modifications to the OCI in Appendix B of the draft Code and in consumer education. However, the Authority maintains the view that information about fees and charges is very important in comparative decision making for scheme members and is an area where scheme members need additional help to understand existing information. The proposed OCI was designed for use by scheme members to facilitate such comparative investment decision-making.

42. The OCI as proposed in the draft Code illustrates the cost, in dollars, associated with each contribution of HK\$1,000, based on a constituent fund's actual fee structure and expenses for the immediate past year and a consistent rate of return. The Authority believes that such an illustration will provide scheme members with expense information in a standardized manner that will facilitate comparison of on-going costs among constituent funds. By contrast, the alternative OCI would not assist scheme members in making comparisons among constituent funds because it would not be based on actual expenses of constituent funds and it does not take into account charges such as contribution charge. The alternative OCI therefore fails to facilitate the comparison of on-going costs among constituent funds. The Authority is not convinced that the alternative OCI should be adopted. However the modifications identified in the previous paragraph will be incorporated into Appendix B of the draft Code.

43. **Chapter C2 and Appendix B (OCI – Question T1):** The majority of respondents who responded to question T1 of the Consultation Paper indicated that the actual FER, instead of an adjusted FER (one that takes out the effect of some non-recurring expenses and is used as the basis for calculating the OCI) should be disclosed in the OCI. Some proposed that an explanatory note could be attached to the illustration indicating amounts of any non-recurring expenses and the adjusted FER. Some industry respondents proposed that FER should not be adjusted in the OCI calculation.

44. MPFA's response: Given the preponderance of views, the Authority accepts that the OCI should disclose the actual FER accompanied by explanatory notes, where necessary, to explain any adjustments made for non-recurring expenses. The draft Code will be amended accordingly.

45. **Chapter C2 and Appendix B (OCI – Showing Returns):** A number of industry respondents suggested adding an extra column in the OCI to indicate the gross return in dollars on each HK\$1,000 contribution over the different periods shown in the OCI.

46. MPFA's response: This was an issue that was discussed with industry bodies prior to the issue of the draft Code. At that time the industry bodies were of the view that a column showing gross returns should not be used. The Authority accepts that adding a column

showing gross return would help put the figures illustrating fees in context. The Authority is concerned however that adding such information will, in all likelihood, cause members to focus on the ‘projected’ returns rather than, as intended, on the fees. In addition, providing such information may cause some members to view the return figures as some kind of projection or undertaking about what they might get back. On balance, the Authority is not in favour of including a column about gross returns in the OCI.

47. **Chapter C2 and Appendix B (OCI – Question G6):** Most respondents who submitted an answer to question G6 of the Consultation Paper believed that the OCI should merely accompany the relevant scheme offering document rather than being part of the offering document although two non-industry respondents suggested that the OCI should form part of the offering document. Finally, a few respondents suggested some refinements to the wording used in the template in Appendix B.

48. MPFA’s Response: The Authority agrees with the sentiment of those few respondents who suggested that the OCI would best be incorporated into the scheme offering documents. Given however that the OCI will require annual updating to reflect changes in FER, the Authority considers that the costs involved in annually updating and republishing offering documents might be disproportionate to the benefits gained. Accordingly, at least in the medium term, the existing proposal that OCI accompany offering documents will be maintained. Additional refinements will be made to the drafting of the template in Appendix B of the draft Code.

49. **Chapter C2 and Appendix B (OCI – Question G7):** Very few suggestions were made for improvements to the warnings about assumed return in the OCI.

50. MPFA’s Response: No major adjustments to be made to the existing drafting except that the warning will be moved closer to the relevant text in Appendix B.

51. **Chapter C2 and Appendix C (Illustrative example for capital preservation funds):** A few respondents submitted suggestions for improving the illustrative example for capital preservation funds, for example, that the example be improved to make it more comparable with the OCI.

52. MPFA’s response: The Authority agrees that scheme members would be better served if the OCI and the illustrative example for capital preservation funds were made more comparable. However, it should be noted that the illustrative example for capital preservation funds, which is currently set out in Guidelines IV.1, was designed for the purpose of section 31(3) of the Regulation. The specific provisions in the Regulation governing the fee deduction for capital preservation funds (which do not apply to other constituent funds) also warrant a

different illustration for this type of fund. The Authority will, in due course, conduct a review to improve the illustrative example for capital preservation funds in a way that meets both the requirement of section 31(3) of the Regulation and the objective of the Code. Pending that review, and in the interest of not requiring too many changes at the one time, the Authority will maintain the current version of the illustration as set out in Guidelines IV.1.

53. **Chapter C2.16 (Verification of the calculation of the illustrations):** Respondents were divided on the issue of which party should perform the verification work for the OCI. Some agreed with the proposal in the draft Code that approved trustees should be the appropriate party while others suggested independent audit.

54. MPFA's response: One of the most important parameters used in the calculation of the on-going costs is the FER of a constituent fund for the immediate past financial year. Once the FER figure is determined, the computation process for the on-going costs should be reasonably straightforward. In the interest of reducing process and costs, and in light of the arrangements that will be put in place for verifying FER (see discussion in paragraphs 85 to 88 below), the Authority does not propose that any process for verifying OCI additional to that set out in the draft Code should be put in place.

PART D – FUND FACT SHEET

55. **Chapter D2.3 (Minimum Content – additions and deletions and Question G8):** Respondents made a range of suggestions for additions to the list of minimum content requirements in paragraph D2.3 of the draft Code. Suggestions were, for example, made to include items such as fund sponsor, portfolio manager, risks measures and indicators over defined time periods, size of underlying APIFs, all holdings over 2%, peer group comparisons, currency hedging, dollar cost average performance figures, portfolio turnover and transaction costs. Respondents also suggested that some of the items proposed in paragraph D2.3 of the draft Code be deleted. These suggested deletions included details about the statement of investment policy and objectives, any information about benchmarks or peer comparisons, reserves, risk indicators and the declaration of compliance.

56. MPFA's response: As identified in the Consultation Paper, the objective of this part of the draft Code was merely to put in place some minimum standards to ensure that all scheme members are provided with at least a basic level of information about schemes and funds on a regular basis. The draft Code focused on pieces of information that were either particularly important for scheme members and/or pieces of information that were identified as currently being disclosed in an inconsistent manner. It was not the objective of the Authority to set out a template for fund information in addition to information that is already required under statutory mechanisms. In accordance with their general duties and the good disclosure

principles, approved trustees will naturally give consideration to providing members with a range of information additional to that contained in the draft Code. Accordingly, whilst the Authority might agree that some of the suggested inclusions are relevant pieces of information, the Authority does not consider it necessary to add all of those items as contents of the draft Code at this stage. Once fund fact sheets complying with the Code have been in use for a reasonable period of time, the Authority will review whether other items, such as those suggested, should be included.

57. In relation to the suggested additions and deletions, the Authority has considered each of them based on a balance of factors such as the value of the information to scheme members, the level of sophistication required to make use of the information and the costs and/or inconvenience of providing the information. Generally, the Authority considers that existing proposals strike a reasonable balance between those factors; however, the draft Code will be amended to delete the following three items:

- reserves (given that the potential for confusion about the meaning of this information might outweigh the benefits of disclosure at this stage),
- full details of the statement of investment policy (only a brief description of the investment objectives and any change in the statement of investment policy will be required), and
- the declaration of compliance.

58. **Chapter D2.3 (Minimum Content – Question T2 Class FER):** Six respondents replied to Question T2 on whether FER should be calculated and disclosed (in both the fund fact sheet and OCI) for each class of a constituent fund. Respondents generally accepted the need to calculate and disclose FER for each class.

59. MPFA's response: Comments noted and accepted in line with the proposal in the draft Code.

60. **Chapter D2.3 (Minimum Content – Performance Information):** Most industry respondents supported the use of annualized return for performance information. One industry body supported the use of cumulative return.

61. MPFA's response: In order to ensure regulatory consistency as between the draft Code and the SFC Code on MPF products, the reference to compound annualized rate of return will be removed from the draft Code. The methodology for calculating performance information can be re-considered in the development of industry performance presentation standards.

62. **Chapter D2.3 (Minimum Content – Benchmark Information):** A number of

respondents raised issues about the use of benchmarks. Some respondents opposed any requirement to disclose performance against benchmarks, one respondent opposed the disclosure of benchmarks at all and one respondent supported a requirement to use and disclose benchmarks.

63. MPFA's response: The intention of the Authority was not to mandate the use of benchmarks for all funds. The intention was merely that those funds that have committed to a benchmark in their offering documents should report performance against that benchmark. The draft Code will be amended accordingly to clarify this.

64. **Chapter D3 (Frequency, Timing and Distribution of Fund Fact Sheets – Question G9)**: The majority of respondents that commented on this question agreed that two fund fact sheets per year was an appropriate number. Several respondents however suggested that quarterly fund fact sheets should be required. A large number of respondents suggested that the reporting date for one fund fact sheet should be as at financial year-end of a constituent fund rather than 31 December each year as proposed in paragraph D3.2 of the draft Code.

65. MPFA's response: The Authority considers that, at least initially, two fund fact sheets per year is an adequate number. Approved trustees would however be encouraged to provide whatever additional information to members they consider appropriate in accordance with their general duties and the good disclosure principles.

66. The Authority accepts that there are reasonable arguments for both a fixed reporting date and a date fixed by reference to scheme financial year-end. Given the preponderance of industry views on the issue, and the associated timing and distribution issue discussed below, the Authority is agreeable to fixing the date of one fund fact sheet by reference to scheme financial year-end (referred to as “year-end fund fact sheet” below) provided that the other fund fact sheet reports as at a date 6 months later. The draft Code will be amended accordingly.

67. **Chapter D3.3 (Timing of Fund Fact Sheet)**: As a part of the suggestion of fixing one fund fact sheet reporting date to scheme financial year-end, a large number of respondents suggested that 3 months (instead of the proposed 2 months) be allowed for distribution of the year-end fund fact sheet so that it could be sent out with annual benefit statements.

68. MPFA's response: The Authority accepts that the benefits of physically providing members with a copy of the year-end fund fact sheet at the same time as the annual benefit statement outweighs the disadvantage of delaying that information by one month. Given that the other fund fact sheet will not be tied to distribution of the annual benefit

statement, the original requirement that it be made available within two months of reporting date should continue to apply. The draft Code will be amended accordingly.

69. **Chapter D3.4 (Distribution of Fund Fact Sheet):** A number of respondents raised questions or suggestions about distribution of fund fact sheet. In particular, some raised questions about the responsibility of trustees when an employer fails to distribute the fund fact sheet. Some raised specific questions about what methods of distribution would be adequate.

70. MPFA's response: As discussed under paragraph 68, the draft Code will be amended to provide that the year-end fund fact sheet should be sent with the annual benefit statement. The following discussion therefore principally relates to distribution of the second fund fact sheet distributed each year. The principle about adequacy of distribution is set out in paragraph D3.4 of the draft Code. Fund fact sheets should be distributed in a manner that is reasonably likely to bring them to the attention of scheme members.

71. Clearly, sending the year-end fund fact sheet with the annual benefit statement is adequate distribution. The Authority accepts the suggestion made in several submissions that the information sent out with the annual benefit statement (which will include the year-end fund fact sheet) should signpost when and how the second fund fact sheet will be made available. One possible method of distribution is through employers. The Authority accepts that an approved trustee would not be responsible for the failure of an employer to distribute fund fact sheets to employees. In accordance with the above principle however, if the approved trustee is aware that an employer is refusing to distribute the second fund fact sheet, then it should be made available by other means e.g. by making it available through a call centre upon request in addition to, for example, electronic means of distribution. The draft Code will be amended accordingly.

PART E – FUND EXPENSE RATIO (“FER”)

72. **Chapter E2 and Chapter E3 (Formula for Calculation of FER and Explanation of Defined Terms – Questions G10 and T3):** Paragraph E2.2 of the draft Code sets out the formula for calculating the FER percentage. The formula is that the FER percentage is calculated as the sum of the fund's direct expenses and the costs of underlying fund investments. A fund's direct expenses is defined as the expenses of the fund divided by the average NAV of the fund. The term “expense” is in turn defined in the table in paragraph E2.2 as being the amount of expenses of the fund as set out in the income statement/profit and loss account of the fund for the relevant year plus any adjusted unit expenses. In substance the expense figure is obtained by reference to the relevant financial statements of a fund rather than by any process of addition or subtraction.

73. The Authority deliberately adopted the approach of deriving this figure from the

financial statements of a fund rather than the approach of defining a list of items that are added together in order to ensure that the calculation of FER is as simple and inexpensive as possible. A large number of comments received from respondents indicated a failure to appreciate that that figure was derived directly from the financial statement of the relevant fund. A number of comments were received about “including” items as “expenses” where the item would already be captured as an expense in the financial statements or “excluding” an item from “expenses” where the item would never be captured as expenses in the financial statements in the first place. Question T3 in the Consultation Paper specifically raised the question of whether the approach of defining expenses by reference to the accounts of a fund was consistent enough to be relied upon for the purpose of the formula. Very few respondents responded on this issue and no respondent suggested that that approach should not be adopted.

74. MPFA’s response: Given that no respondents have suggested that it was inappropriate to do so, the Authority will persist with the approach that expenses be primarily defined by reference to the financial statements of a relevant fund. Users of the Code should note that the “Explanations of defined terms” in Chapter E3 does not modify, in any respect, the amount of “expenses” as it appears in the relevant financial statements. The explanations in paragraphs E3.1 to E3.3 are merely included to assist readers to understand what would typically be captured as expenses in the financial statements based on our understanding of the current accounting conventions. The fact that an item appears in the lists in paragraphs E3.2 or E3.3 does not suggest that the “expenses” figure in the accounts needs to be adjusted in any way. Paragraphs E3.1 to E3.3 will be modified to clarify that intention.

75. **Chapter E2 and E3 (Specific Inclusions and Exclusions in Calculation of FER and Questions T4, T5 and T6):** As discussed under the preceding heading, a number of comments were received suggesting inclusions or exclusions to the calculation of FER and specifically in relation to the definition of expenses. In most cases it was difficult to ascertain whether the submission misconceived the effect of paragraphs E3.1 to E3.3 or whether the respondent was suggesting that certain items should actually be “included” or “excluded” from the formula in E2.2. Specific suggestions for inclusions and exclusions included the following:

- a number of submissions suggested that brokerages and commissions should be included in the FER calculation;
- several respondents suggested that member-based fees and charges such as bid/offer spreads should be included in the FER calculation;
- several respondents suggested that guarantee reserves should not be included in FER;
- one respondent suggested that guarantee reserves should be included in FER;
- one submission suggested interest charges should be excluded from expenses;

- a number of varying views were received on whether transaction-based fees such as custodian fees should be “included” or “excluded”, and
- one respondent suggested that “loyalty bonuses” should be deducted from expenses.

76. MPFA’s response: For the reasons discussed under the preceding heading, the Authority is reluctant to specifically add inclusions or exclusions to the definition of expenses unless it is essential from a policy perspective to do so.

77. It appears from the submissions received that there may be some inconsistency in accounting practices in relation to some transaction costs (particularly transaction-based custodian fees). Submissions indicate that some funds would include transaction-based custodian fees as expenses (in which case they would be counted in the FER calculation) and some funds would capitalize these fees (in which case they would never be “included” in the FER calculation). It is less clear from the submissions whether there is any inconsistency of practice in relation to expensing or capitalizing other transaction costs/fees of a fund.

78. In any event, any resulting inconsistency in outcome is a consequence of differing accounting practices rather than any differing application of the formula for the calculation of FER. The Authority will discuss with the relevant accounting authorities how any inconsistency in accounting practices can be minimized; however this does not appear to be a basis, at this stage, for adjusting the formula for the calculation of FER in paragraph E2.2.

79. The Authority will monitor the calculation of FER once it is operational and may, for example, consider adjusting the definition of “expenses” for transaction costs if there is long term, material differences in outcomes because of differing accounting practices. The Authority is sympathetic to those submissions that suggest that transaction costs should be counted in the formula, principally because excessive turnover in a fund can significantly increase costs. Accordingly, if it becomes necessary to adjust the formula, then the natural position would be to specifically include transaction costs in the definition of “expenses”. As suggested above however, the Authority is not minded to include those items as a specific inclusion to the formula at this stage.

80. For reasons similar to those set out in the preceding paragraphs, the Authority does not believe that it is necessary to adjust the formula for the other items raised, for example in relation to guarantee reserves and charges. Whether an item is covered by the FER calculation should be judged merely by reference to whether it properly forms part of the expenses of the fund as set out in the financial statement of the relevant fund (except for any adjustment arising out of the deduction of expenses by way of units).

81. **Chapter E2 (Definition of Pricing Points):** Several respondents raised

questions about pricing points as defined in paragraph E2.2 and specifically whether pricing points needed to be on the last day of the month and whether pricing points needed to be daily.

82. MPFA's response: The draft Code suggested that, for the purposes of the FER calculation, a fund should use a minimum of twelve pricing points per year. It is not necessary that these pricing points should be at the end of each calendar month and the draft Code will be amended to clarify that point. The existing drafting makes it clear that it is not necessary to use daily pricing points for the purpose of the calculation. Trustees are, however, encouraged to use more frequent pricing points than the twelve points minimum.

83. **Chapter E2 (The Denominator for the Formula – Question T7)**: The Consultation Paper raised the question of whether the denominator in the formula for calculating expense percentages needed to be adjusted where fees are deducted by way of deduction of units. One submission was received suggesting that adjustment to the denominator would be required and five submissions were received suggesting that adjustment to the denominator would not be necessary.

84. MPFA's response: As suggested in the original draft the Authority considers that the denominator (average NAV of the fund) does not need to be adjusted because the units redeemed for expenses are taken out as cash and the NAV of the fund is accordingly reduced. The majority of the submissions concurred with this view which will be maintained.

85. **Chapter E4 (Verification of FER Calculations)**: Chapter E4 of the draft Code proposed that verification of the calculation of the FER should be undertaken by the approved trustees and operators of relevant AIFs who should also document verification procedures. Contrary to the outcome of earlier discussions between the Authority and industry bodies, a number of industry respondents suggested that the FER should be audited to ensure consistency and accuracy.

86. MPFA's response: Auditing, or some other form of third party verification of FER calculations would provide some compliance advantages but needs to be considered against any consequential time delay and costs incurred. Having considered the submissions received, the Authority accepts, on balance, that a verification requirement is justified as it should not cause avoidable delays and should not result in any costs disproportionate to the benefits derived. The draft Code will be amended to include guidance about third party verification. In the interests of minimizing costs, the guidance will refer to a check of the FER calculation rather than a full audit requirement as such.

87. **Chapter E4 (Timing for Calculation of FER)**: The draft Code did not suggest any timing for the calculation of FER as the calculation of FER is not a separate

deliverable. It is merely one of the steps in preparing key documents such as the OCI and the fund fact sheet and necessarily affects how long it takes to prepare those documents. Generally, industry respondents suggested that they needed six months after financial year-end to determine the FER of a fund principally because of the time involved in obtaining relevant information from underlying APIFs. Comments were made that “APIF providers submit funds’ FER to the constituent fund trustees within four months after the financial year-end in accordance with SFC guidelines”.

88. MPFA’s response: The Authority has some difficulty in accepting the reasons proposed, as there are no SFC guidelines requiring production of FER. Nevertheless we understand the thrust of the comments to be that trustees of constituent funds need to rely upon the financial statements of APIFs which are lodged with the SFC no later than four months after financial year-end. The Authority remains of the view that FER for constituent funds could be calculated in a much shorter time frame without relying upon finalized financial statements for underlying funds. However given the clear preference of the industry for doing so, and the incidental timing consequence of accepting the need for third party verification, allowing up to six months for the production of OCI is a reasonable outcome. Appropriate amendments will be made to the draft Code.

PART F – ONGOING DISCLOSURE AT MEMBER LEVEL

89. **Part F (Further Issues to be Included in Code)**: A number of respondents raised suggestions for issues that should be covered in Part F in addition to the items currently proposed. This included, for instance, standardizing the format of benefit statements, improving the frequency of annual benefit statements and providing more details about member transactions in annual benefit statements. Comments were also made that current benefit statements did not enable scheme members to evaluate investment costs and fund performance.

90. MPFA’s response: As identified in the Consultation Paper, Part F of the draft Code is at this stage only intended to provide general guidance on the disclosure of information to members at the member account level. The content of annual benefit statements is set out in the law. The Authority proposes to review the content requirement set out in section 56 of the Regulation reasonably soon. The suggestions for additional content can be considered as part of that process. In the interim, the improvements contained in other parts of the draft Code will, in any event, assist scheme members in understanding investment costs and fund performance.

91. **Part F (Reconciling Information about Accrued Benefits and Contributions)**: Several respondents raised questions about what kind of explanations and supporting material could be provided to help reconcile accrued benefits and contributions

under paragraph F1.5, and the circumstances in which that material should be provided.

92. MPFA's response: Pending the review of the statutory content requirements under section 56 of the Regulation, the content of paragraph F1.5 will be deleted.

PART G – IMPLEMENTATION AND TRANSITIONAL TIMING

93. **Chapter G2 (Transitional Provisions)**: Generally, respondents commented that the transition arrangements in the draft Code strike a reasonable balance between members' needs and the practicality of providing the information.

94. MPFA's response: The Authority takes note of the comments provided.

95. **Chapter G2 (Timing for Fee Table)**: Paragraph G2.2 of the draft Code allows a period of up to eighteen months after publication of the Code for the Fee Table to be incorporated into the offering document of a scheme. Two non-industry respondents suggested that this period should be shortened to either twelve or six to nine months.

96. MPFA's response: The Authority agrees with the sentiment that if it is practical and cost effective to do so, the Fee Table should be incorporated into offering document as soon as possible. Practically however, in some cases it will be necessary to make amendments to constitutive documents and unnecessary additional costs may be incurred if those changes are required within a short period of time. In any event members will get the Fee Table as an attachment to offering document as an interim measure. On balance, the Authority does not see a need to set any period shorter than the proposed eighteen months.

97. **Chapter G2 (Fee Table Distribution)**: Paragraph G2.2 of the draft Code also proposed that pending inclusion of the Fee Table in the offering document, the Fee Table should be provided as a supplement to any offering document or scheme documentation that is distributed to participating employers and members at anytime more than one month after the Authority has given approval in principle to the document. One respondent suggested that the one month period should be extended to three months and a number of respondents suggested that the one month should be extended to two months.

98. MPFA's response: The Authority does not see any compelling reason to extend the time period as proposed in the submissions in this respect. If the circumstances of an individual trustee warrant an extension of that time, for example because of atypical complexities in distribution, then that trustee can approach the Authority for an extension of the relevant time period.

99. **Chapter G2 (OCI)**: Few, if any comments, were received in relation to the time period for preparation of OCI. A large number of comments were received from industry

respondents in relation to the timing for the production of FER (see paragraph 87) which necessarily affects the timing of the OCI.

100. MPFA's response: Given the conclusions to the discussion in paragraphs 87 and 88, it is appropriate to extend the period for updating the OCI to 6 months.

OTHER ISSUES RAISED IN SUBMISSIONS.

101. The submissions contained a number of suggestions or comments relating to issues not specifically covered by the Consultation Paper. These submissions/comments related to a broad range of issues ranging from general disclosure documentation, responsibilities of trustees, tracking of preserved accounts, comparison platforms, general investment education for scheme members, the level of fees and charges, choice of service provider and the role and remuneration of intermediaries.

102. MPFA's response: The Authority appreciates the efforts of respondents in raising these issues for our consideration. Whilst the issues raised cannot be considered as part of the current process, all comments received on these issues will be further considered by the Authority.

LIST OF RESPONDENTS (In Alphabetical Order)

Category A – Respondents who have no objection to publication of names

1. The Actuarial Society of Hong Kong
2. American International Assurance Company (Trustee) Limited
3. AXA China Region Trustees Limited
4. Bank Consortium Trust Company Limited
5. Bank of East Asia (Trustees) Limited
6. Barclays Global Investors North Asia Limited
7. Bermuda Trust (Far East) Limited
8. BOCI-Prudential Trustee Limited
9. Consumer Council
10. Dexia Trust Services Hong Kong Limited
11. Esker Wu (Staff representative of a company)
12. FTSE
13. Gadbury Group Limited
14. Hong Kong Association of Banks
15. Hong Kong Cleaning Association Ltd.
16. The Hong Kong Federation of Insurers
17. The Hong Kong Federation of Trade Unions
18. Hong Kong Institute of Human Resource Management
19. Hong Kong Investment Funds Association
20. The Hong Kong Retirement Schemes Association
21. Hong Kong Social Security Society
22. Hong Kong Society of Accountants
23. Hong Kong Trustees Association
24. HSBC Provident Fund Trustee (Hong Kong) Limited
25. ING Pension Trust Limited
26. Jan Arkesteijn
27. Law Society of Hong Kong
28. Manulife Asset Management (Hong Kong) Limited
29. Manulife Provident Funds Trust Company Limited
30. Morningstar Asia Limited
31. Philip Gunning
32. Principal Trust Company (Asia) Limited
33. Vanguard Investments Singapore Pte Ltd

34. Wah Hing Office Supplies Group Ltd.

35. 鄭成鈞

Category B – Respondents who have requested submissions be on a “no name” basis

4 submissions