IFPHK's Response to the Financial Services and the Treasury Bureau and Mandatory Provident Fund Schemes Authority's Consultation Paper on Providing Better Investment Solutions for MPF Members

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Institute of Financial Planners of Hong Kong (IFPHK) Profile

<u>Background</u>

IFPHK was established in June 2000 as a non-profit organization for the fast-growing financial industry. It aims to be recognized in the region as the premier professional body representing those financial planners that uphold the highest standards for the benefit of the public.

The IFPHK is the sole licensing body in Hong Kong authorized by Financial Planning Standards Board Limited to grant the much-coveted and internationally-recognized CFP^{CM} Certification and AFP^{TM} Certification to qualified financial planning professionals in Hong Kong and Macau.

It represents more than 6,800 financial planning practitioners in Hong Kong from such diverse professional backgrounds as banking, insurance, independent financial advisory, stockbroking, accounting, and legal services.

Currently there are more than 147,000 CFP certificants in 25 countries/regions; the majority of these professionals are in the U.S., Canada, China, Australia and Japan, with more than 4,800 CFP certificants in Hong Kong.

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<u>IFPHK's interest in this consultation</u>

The Mandatory Provident Fund ("MFP") system has been in operation for over 10 years. The Government and the Mandatory Provident Fund Schemes Authority (the "MPFA") have been continuously working with the industry towards improving the system. As a leading professional body serving the financial planning community, the IFPHK is obliged to respond to policy changes that may have an impact on our members and their clients.

Retirement planning is considered an important focus among the financial topics addressed by financial planners. At present, approximately 54% of the IFPHK's financial planners are registered as MFP intermediaries. The IFPHK submitted its opinion on the supervision of sales and marketing activities of MFP intermediaries and withdrawal of MPF benefits in 2012. Therefore, the IFPHK is interested in providing its views and comments on the proposals set out in this Consultation Paper for the consideration of the MFPA.

<u>IFPHK's representation</u>

The IFPHK was founded by 30 members (the "Founding Members") in order to raise the standards of financial planners and highlight the importance of sound financial planning advice.

The IFPHK currently has 47 Corporate Members including banks, independent financial advisors, insurance companies, and securities brokerages. With our Corporate Members providing a full spectrum of the client services and products, the IFPHK is well positioned to understand the needs, concerns and aspirations of the financial planning community.

Executive Summary

The MPF System was implemented in December 2000 with the objective of helping the workforce save for its retirement needs. In light of heavy criticism of the MPF system over the past 10 years, the MPFA has proposed a number of changes in the past few years which include Employee Choice Arrangement ("ECA"), amendments to withdrawal of accrued benefits, consolidation of MPF accounts, etc.

Notwithstanding the good intention of setting up a mandatory privately-held pension to fund retirement, the MPF system is being heavily criticized. Various issues such as the level of fees and charges, the complexity of decision-making for members and whether returns generate adequate income for retirement savings are heavily debated within the society. Whilst the IFPHK recognizes there are structural problems of the MPF system, the IFPHK thinks that the system's reputation has been unfairly tarnished by the financial crisis and low-growth environment. The financial turmoil and the ensuing economic crisis have had a major impact on the MPF market. The crisis is also causing a shift in asset allocation patterns, with investors moving into more conservative investments. Such moves risk locking in portfolio losses and could also reduce the potential of funds to generate retirement incomes. The fall in the value of assets accumulated for retirement reduces the amount of money that individuals have accumulated in the MPF to finance their retirement[1]. Increasing longevity, a low-growth environment, low bond yields and rising retirement lifestyles all make the appropriate investment solution for retirees increasingly challenging. In a lower interest rate, lower growth environment, a contribution rate of 10% p.a. is unlikely to be sufficient to provide an acceptable replacement ratio[2].

The IFPHK's submission is based upon several principles which the IFPHK considers essential to improve the MPF system:

- ***Advocating the importance of financial planning on retirement planning***
  It is the IFPHK's mission to increase all external stakeholders' awareness of the importance of financial planning and advice from a financial planning professional. As Hong Kong has one of the world's fastest growing ageing populations, it is expected that MPF and retirement planning will become more prominent within our society. Also, since retirees receiving benefits from a defined contribution scheme like the MPF will confront several risks they have not faced before as individuals, the importance of personalized financial advice for retirees is now greater than ever before.

- ***Enhancing financial literacy and promoting financial education***
  Notwithstanding the priority to tackle Hong Kong's fast ageing population, research shows there is a general lack of understanding regarding MPF and retirement planning. It is the IFPHK's view that improved financial literacy levels will not only allow consumers to make more informed investment decisions, but also result in greater consumer appreciation of planning for a long-term financial future – a concept the IFPHK continuously promulgates. To the IFPHK, financial literacy is important to all scheme members, including those who do not make any fund choices. Financial education helps to maintain transparency and confidence in the MPF system, and thereby encourages individuals to take more responsibility towards their own retirement.

[1] Pablo Antolin and Fiona Stewart, Private Pensions and Policy Responses to the Financial and Economic Crisis, IOPS Working Paper No. 9, April 2009
[2] Schroders Investment Perspectives, Lessons learnt in DC from around the World

- ***Streamlining and simplifying the MPF system***
  Many have criticized the MPF system as being structurally flawed and capable of providing only a subsistence income or less to retirees. At present, there are 477 MPF funds, which is quite substantial for a fairly small place like Hong Kong. Having too many investment choices is problematic to scheme members, and makes decision-making difficult. The large number of funds offered through the MPF system creates a skewed attitude towards risk. Also, the low asset level of each MPF fund as a result of the vast fund choices curtails economies of scale and so is a potential factor that drives up management fees. The administration of the MPF involves many steps and processes. Indeed, research shows that of the average Fund Expense Ratio (FER) of 1.74%, investment management accounts for 0.59%, administration cost 0.75%, and scheme sponsor charge, trustee profit, member rebates and other expenses, as a whole, 0.4%. Detailed components of each cost are not available. In view of the above, any reforms to the MPF system should strive towards simplifying the system instead of adding complications to providers and/or to members.

In principle, the IFPHK agrees with the idea of standardizing the existing default arrangement to provide better benchmark and consistency to those who do not wish to select a fund. Improving and standardizing the retirement outcome for default fund members, especially during times of financial instability, will facilitate a safer investment horizon and greater certainty of MPF funding retirement income needs. This in turn promotes public confidence in the MPF industry.

Nevertheless, the IFPHK has reservations regarding setting up a core fund by standardizing existing default arrangements. The name “core fund” is misleading; it suggests other funds within the MPF system are non-core and secondary. It also gives the public a misconception that the core fund is the government’s “preferred” fund. Taking into account the lesson of the “Lehman Brothers Mini-Bond”, it is desirable to use a name that is fit for the purpose. The IFPHK thinks that it should only be called a “core fund” if it follows the Chilean example that all contributions are first allocated to a default fund. Subsequently, members who wish to make a fund choice can then re-allocate their contributions to other funds. Such an arrangement may minimize administration costs and encourage those who wish to make fund choices to seek financial planning advice.

The IFPHK is also concerned that the proposals may encourage inertia and increase scheme members’ apathy on their responsibilities towards their own retirement savings. The need for financial education would not diminish with the standardization of default arrangements, so the IFPHK believes that if the MPFA and the industry implemented a proper financial education program throughout the scheme’s working life, it would find a much higher level of member engagement and much less of a need to provide a default fund solution.

The IFPHK also thinks that the proposals do not directly address all the existing core problems of the MPF system, in particular the overly complex and redundant administration processes and lack of structural efficiency due to low asset levels. We understand the MPFA is pushing some measures such as urging providers to provide electronic platforms and will push forward an amendment bill to simplify statutory procedures and requirements. All reforms need to be coherent with a holistic view to address all the core problems. To deal with the structural inefficiencies of the MPF system effectively may require revolutionary changes. By requiring each scheme to provide a default fund, the proposals tend to add requirements and complications to the system rather than simplifying it. While setting up low cost funds are still beneficial to scheme members, to make the reforms more effective, the MPFA and the Government should consider broader and more comprehensive reforms by referring to the experiences of Chile (a competitive bid to select a default fund provider) and Sweden (the central administration of pension funds).

The IFPHK received mixed views on the adoption of life-cycle strategies that automatically reduce risk over time. Some members suggest using a rule-based global equity index fund with a fixed sliding scale that reduces risk every year at a standard rate based on the member's age. While other members suggest that inflation-link investments are better option in terms of returns and volatilities for those who have no time and no knowledge to manage their MPF funds. The IFPHK has no specific comments on the technical issues, and will leave the detailed design of the default fund to investment management experts.

Without detailed information on the cost structure, the IFPHK is not able to provide comments on the reasonableness of the proposed fee caps. Whilst the paternalistic approach is the quickest way to drive the fee of a particular fund down, the IFPHK thinks that being a privately-held pension system, providers shall at least obtain a reasonable margin to maintain service quality and, for future investment on electronic systems, to simplify the administration process. The MPFA shall continue carrying out active dialogue with the providers to understand their cost structures and to obtain their buy-in to the proposals.

As aforementioned, the MPF has its own merits, because it successfully acts as a forced saving measure and after all it is a sustainable system. However, sustainability is not the same as adequacy. Hong Kong's system is sustainable, but it ranks very low internationally with respect to retirement income adequacy[3]. In view of the urgency of the problem of Hong Kong's ageing population to society, it makes sense to carry out additional reforms to attain adequacy. Nevertheless, the reforms must be designed with a holistic view that addresses all the key issues of the MPF system, and ensures that all the future changes of the system are aligned and coherent. Without holistic reform, the impact of the proposed changes will be less profound than expected, just like other previous reforms, such as the Employee Choices Arrangement.

[3] ICI Global, Insights from the 2013 Global Retirement Savings Conference – the role of investment funds, Hong Kong 26-27 June 2013

The FSTB and MPFA's Consultation

To address concerns over "high fees" and "difficulty in making choices", the Financial Services and the Treasury Bureau ("FSTB") and Mandatory Provident Fund Schemes Authority ("MPFA") launched a public consultation in June on the proposal to enhance the regulation of default arrangements in MPF schemes by introducing a "core fund" as the standardized low fee default fund of all MPF schemes (the "Consultation Paper"). The three-month pubic consultation will end on 30 September 2014.

Under the MPF System, scheme members have the right to make their own investment choices by selecting funds. For those who do not select funds, the trustees of the respective schemes will, by default, invest the scheme members' contributions in one or more of the funds as specified in scheme rules. At present, different MPF schemes have different default arrangements. According to a member survey conducted by the MPFA in 2013, some 24.1% of members indicated that they had never made a fund choice.

The Consultation Paper proposes that the "core fund" should automatically reduce investment risk as members approach retirement age, and its fee will be kept at 0.75% of fund assets or under. The proposed "core fund" will adopt a life cycle or target date investment strategy that automatically reduces investment risks as scheme members approach retirement age. It is expected that the "core fund" will provide a benchmark for MPF fees and performance.

The Consultation Paper contains 12 questions in 5 chapters. The chapters of the Consultation Paper are as follows:

I. The Path to a Better Mandatory Provident Fund System

II. Investment Decision-making in MPF – Issues and Concerns

III. Proposals – The MPF Core Fund Based on Standardized Default Funds

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

Q2: Do you agree that the Constituent Fund that is the default fund should be substantially the same in all MPF schemes?

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

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

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?

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

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

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

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

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

IV. Implementation and Transitional Arrangements

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

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?

V. Comments Sought

IFPHK’s Response Methodology

The IFPHK is a professional body that seeks to promote higher professional standards in the financial planning industry. Therefore, the IFPHK considers it important to respond to consultation and policy papers that significantly impact on the financial planning sector. When formulating its response to such papers, it takes a systematic approach that includes:

1. An independent and objective study of the proposals and their overall impact, both positive and negative, on the industry and consumers, based on theoretical and practical analysis.
2. Study of international practices of markets that are either more developed or similar to Hong Kong’s in order to understand how similar proposals may have succeeded or failed and the reasons why that happened. These countries include the United Kingdom, Chile, Australia, the United States, New Zealand and Sweden.
3. Collection of comments and opinions from industry participants whose business practices may be impacted by the proposals in the Consultation Paper.

After collecting and consolidating industry views, the IFPHK analyzed the information obtained in conjunction with its own research from markets deemed relevant to the situation in Hong Kong. The IFPHK formulated its responses to the various questions raised in the Consultation Paper as well as the recommendations on the practical application and effectiveness of the relevant proposals after taking into account the likely impact on the industry.

The views expressed in this submission paper are not necessarily summaries of the views taken from the industry, but may have undergone more independent and critical analysis and consideration by the IFPHK as a professional body. As a result, not all the views collected by the IFPHK are recorded in this submission paper and neither have all the views expressed in this submission paper been directly endorsed by those industry representatives or members consulted.

IFPHK's Submission

The submission below is the result of the IFPHK seeking views from industry participants in addition to its own independent internal analysis. The IFPHK considers the practical implication of the proposed changes on the business of those financial planners who consider advising and providing professional services to investors as its utmost priority. In considering the various proposals of the Consultation Paper, the IFPHK identified several key principles which the IFPHK considers important to improve the MPF system. Our comments are based upon these principles.

Advocating the importance of financial planning on retirement planning

It is the IFPHK's mission to increase all external stakeholders' awareness of the importance of financial planning and advice from a financial planning professional. Since its inception, the IFPHK has been striving to promote public awareness of the financial planning industry in Hong Kong and uphold the standard of CFP professionals. According to the IFPHK, a financial planner is someone who uses the six-step financial planning process[4] to provide a client with integrated strategies to achieve financial and life goals. A financial planner typically reviews relevant aspects of a client's situation across a large breadth of financial planning activities, which may include financial management, asset management, risk management, tax planning, retirement planning and estate planning.

Hong Kong has one of the world's fastest growing ageing populations. The number of people aged 65 or above in Hong Kong is expected to surge from the current 1.0 million to 2.6 million in 2041. The median age will also climb to 52 by then, versus 43 today. By 2041, around one in three people will be among the elderly, up from the current level of one in seven[5]. It is therefore expected that MPF and retirement planning will become more prominent within our society. Despite this, the demand for the knowledge and services of financial planners, and market for financial planning advice on MPF or retirement is still developing slowly. The report from Ernst & Young commissioned by the Joint Industry Group pointed out that there is an absence of personal financial advice to help MPF members make an informed choice[6]. According to a survey conducted by the Investor Education Centre, Hong Kong people were found to have the least knowledge and capability in relation to financial planning. There are also misconceptions about the nature and benefits of financial planning. About half of the respondents believe that financial planning is only necessary for multi-millionaires. The majority of people believe that financial planning only involves investment and wealth management advice[7].

The shift away from defined benefit funds to defined contribution funds is part of an international trend, and the MPF system is one of the younger systems developed in recent years. It is apparent that most retirees receiving benefits from defined contribution plans confront several risks they have not faced before as individuals, including some that previous generations of retirees did not have to address. The importance of personalized financial advice for retirees from these plans is now greater than ever before.[8] Hence, financial planning services is very important for a healthy pension system, and the IFPHK and its CFP professionals are equipped with the knowledge, skills and experience necessary in assisting the MPFA and MPF scheme members in this respect.

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[4] The 6-steps financial process is a holistic approach to assess a client financial well being. The six-steps include 1. Establishing client-planner relationships 2. Gathering client data and determining goals and expectations 3. Determining the client's financial status by analyzing and evaluating client's information 4. Developing and presenting the financial plan 5. Implementing the financial plan 6. Monitoring the financial plan

[5] Third quarter economics report 2013. HKSAR Government

[6] "The evolving MPF system: an objective assessment", Ernest & Young, HKFI, HKIFA and HKTA, May 2012

[7] Also stated in the survey are that the top motivator to perform financial planning is preparation for retirement. Among those who seek advice from qualified professionals, investors, and more educated and high income individuals talk to financial advisors more often.

[8] Melbourne Mercer Global Pension Index, Australian Centre for Financial Studies, October 2013

Enhancing financial literacy and promoting financial education

As stated by the OECD's recommendations on good practices for financial education relating to private pensions, financial education is particularly important in the private pension field due to the unique nature of these financial products, which are complex, exceptionally long-term contracts with wide social coverage. Despite the importance of pensions, consumers consistently demonstrate low levels of financial literacy, and often lack a good understanding and knowledge of pensions and retirement saving plans. Financial education specifically related to retirement products should help to promote understanding of the changing retirement environment, the need for long-term savings, and of investment products. Well-informed consumers can help to improve the performance of trustee and financial intermediaries.[9] Research shows that people who are more financially literate do a better job saving, investing and managing their payouts in retirement.

Notwithstanding the priority to tackle the fast-ageing population, there is a general lack of understanding on MPF and retirement planning. A survey by Towers Watson shows that 66% of respondents have a good impression on MPF Investment, yet close to 90% (87%) spend little or no time managing their MPF accounts. Over 40% of the employees surveyed consider HK$5 million to be sufficient for their retirement but 90% of them rarely if at all spend time managing their MPF account.[10] There are also misconceptions on MPF investment strategies. Another survey conducted by Fidelity revealed that respondents do not consider their MPF as part of their overall portfolio. However, 32% of the respondents indicated that MPF assets represent more than 10% of their total assets. Only 12% of people spend more than 10% of total asset management time on their MPF investments. Also, respondents would only change their MPF portfolios when the stock market fluctuates, or when they are going to retire[11.]

Financial literacy is important to all scheme members including those who do not make any fund choices. Financial education programs shall promote the growing individual responsibility over demographic and social change that requires individuals to save more for their retirement. Such education programs help to maintain transparency and confidence in the MPF system, and thereby encourage individuals to take more responsibility towards their own retirement. The IFPHK regards that intermediaries in direct contact with clients can help promote consumer protection by assisting them make better-informed decisions about the products they buy. Intermediaries should be encouraged to become involved in the education program to enhance public awareness and to boost the industry's reputation. In Japan, defined contribution plan providers are required by law to provide financial education.

Over the past fourteen years, the IFPHK has worked towards the objective to promote public awareness of the financial planning industry and has a track record of advocating the provision of financial education to consumers. It is the IFPHK's view that improved financial literacy levels will not only allow consumers to make more informed investment decisions, but also result in greater consumer appreciation of planning for a long-term financial future – a concept the IFPHK continuously promulgates and a principle that is important in improving the MPF system. Thus, volunteer CFP professionals actively participate in MPF clinics organized by the MFPA.

[9] OECD Council, Recommendation on good practices for financial education relating to private pensions, 28 March 2008
[10] MPF Performance satisfies 66% of older employees in Hong Kong, Towers Watson, 23 July 2013
[11] Fidelity 2010 Survey of Member's Behavior towards MPF

Streamlining and simplifying the MPF system

Many view the MPF system as structurally flawed and capable of providing only a subsistence income or less to retirees. As stated in the Consultation Paper, various issues are the subject of ongoing debate include the level of fees and charges, the complexity of decision-making for members and whether returns generated by funds within the system meet expectations of what should be delivered by a well-designed retirement savings product. At present, there are 477 MPF funds which is quite substantial for a fairly small place like Hong Kong, and having too many investment choices is certainly problematic to scheme members. Though members in defined contribution systems generally bear most of the investment risk for their investment choices, too much choice can actually confuse members. The large number of funds offered through the MPF system creates a skewed attitude towards risk, because most of the new funds added to the system are higher-risk, mixed-asset or equity funds. Consequently members have an average asset allocation of more than 60% in equities[12]. Besides, the low asset level of the MPF is held up as the primary structural factor responsible for high management fees. The low asset level curtails economies of scale that otherwise would be available to service providers.[13] Some critics said that the exorbitant management fees charged by overzealous MPF service providers rendered investment returns all but worthless. The administration infrastructure of the MPF is manual, complicated and redundant. The total management fee level of 1.74% is higher than four other pension systems in Australia, Chile, Singapore and the UK.

The administration of the MPF involves many steps and processes that are detailed in a statue. Simplifying and streamlining the entire system would benefit members and providers, and help reduce costs. The “Study of Administrative Costs in the Hong Kong Mandatory Provident Fund System” (Cost Study) published in 2012 shows the result of the independent consultant’s analysis of the average Fund Expense Ratio (FER) of 1.74%. Namely, of this 1.74%, investment management accounts for 0.59%, administration cost 0.75%, and scheme sponsor charge, trustee profit, member rebates and other expenses, as a whole, 0.4%.[14] Hence, administration and other costs represent the majority of the fund costs. However, details of cost components e.g. sales and marketing expenditure, and commissions to intermediaries, are not available for public view.

When a similar situation happened in Australia, public apathy allowed leading fund managers to differentiate themselves by offering an ever widening range of products and services, while boosting marketing efforts to expand their market share, thereby driving up costs and fees. Competition on these features, rather than on fees, does not remove other inefficiencies, such as excess pay, manual processes or overly active management of funds that reduce net returns. In the Australian superannuation system, enormous amounts are being spent on administrative infrastructure, developing self-serve capabilities, and in building brand presence in the market. The MySuper reform is the Australian government’s attempt to solve the above issues, which we will discuss further in Question 1.

In view of the above, any reforms to the MPF system should strive towards simplifying the system instead of adding complications to providers and/or to members.

Questions raised in the Consultation Paper

III. Proposals – The MPF Core Fund Based on Standardized Default Funds

[12] ICI Global, Insights from the 2013 Global Retirement Savings Conference – the role of investment funds, Hong Kong 26-27 June 2013
[13] Oswald Chan, Pig of a pension plan, China Daily Asia, 19 July 2013.
[14] LCQ13: Fees and charges of the Mandatory Provident Fund Schemes, Press Release of Hong Kong government

Paragraph 36 of the Consultation Paper proposes key elements of the core fund that

a) The core fund will be based on standardized default funds so that they are substantially the same. These default funds will be used as the investment destination for those members who have not made a fund selection choice.

b) As a default fund, the investment approach of the core fund should balance long-term risks and returns in a manner appropriate for retirement savings. The preferred investment design may be the adoption of a "life cycle" or "target date" approach.

c) The core fund should be good value to scheme members

d) The core fund is available to all MPF scheme members to choose. The core fund will also be available as an investment choice to members who do want to make an investment choice.

Question 1:

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

<u>IFPHK Response</u>
The IFPHK generally agrees to standardize existing default fund arrangements with the broad principles set out in paragraph 36(a) to (d). However, we have reservations on the setup of the core fund which we will further discuss below.

Default funds do bring a number of benefits, especially if they are well chosen with the needs of the members in mind. Where members have relatively little financial knowledge, default funds simplify the retirement funds saving process. The default fund provides an 'obvious' choice for the uninformed member, and helps them deal with an otherwise complex decision[15]. Whilst the IFPHK agrees with the MPFA's intention of standardizing the existing default fund arrangement for benchmarking purposes, the IFPHK and its members interviewed have some concerns or disagreements over the proposals:

The name "Core Fund" is misleading
Some IFPHK members interviewed consider the name "core fund" to be misleading and confusing. The name suggests the other 477 funds within the MPF system are "non-core" and secondary. It also provides a misconception that the core fund is the Government's "preferred" fund. After all, only one quarter of scheme members indicated that they do not make a fund choice and so are non-representative of the majority of scheme members. Taking into account the lesson of the "Lehman Brothers mini-bond", actually a derivative not a bond, the IFPHK suggests using a name that exactly describes the function and nature of the product, namely, an arrangement for those who do not make a fund choice.

The IFPHK thinks it should only be called a "core fund" if the MPF follows the Chilean example that all contributions are first allocated to a default fund, and then those members who wish to make fund choices can then re-allocate their funds. In 2010, the Chilean government made a reform on their pension system. The requirement for employees to make a choice of Authorized Pension Fund ("APF") was removed. Instead,

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[15] Alistair Byrne, David Blake, Andrew Cairns and Kevin Dowd, Default funds in UK defined contribution pension plans, Financial Analysts Journal, July/August 2007

all employees commencing work with an employer are automatically allocated to a single default APF. Employees may still make alternative choices[16]. The IFPHK believes that such arrangements simplify some administration work and thus reduce administration costs, and they also encourage those who wish to make choices to seek financial planning advice.

Low cost is not the only factor

Costs and fees are important for defined contribution plans, as they reduce returns and the size of the accumulated balance, and therefore the amount of retirement income which can be generated. While it is indisputable that lower fees are beneficial to scheme members, good value does not necessarily mean the "cheapest". To the IFPHK, the real rate of return is equally critical to the adequacy of the MPF system to fund retirement saving. If an employee makes annual contributions of only 5% of salary over 40 years, the required real rate of return to hit 2/3 replacement ratio would be nearly 8% p.a.[17]

Guarantees are provided in some defined contribution plans in the growth phase to try to overcome the issues of adequacy. The guarantees are generally a floor to the rate of return on pension contributions or a minimum return that must be obtained beyond which an additional return is provided. In Chile, returns must fall within a percentage peer group average. In Denmark, a minimum return is guaranteed regarding members' contributions[18]. However, such a guarantee is not suggested in Hong Kong at this moment. Thorough research and widespread consultations are required prior to the proposal of any guarantee.

Encourage inertia

We are concerned that the proposals of the core fund may encourage inertia and increase scheme members' apathy on their responsibilities towards retirement saving. As aforementioned, the IFPHK advocates the importance of financial planning services, financial literacy and personal responsibilities towards retirement savings. We also believe that intermediaries can play an important role in delivering financial education. If the industry implemented a proper financial education program throughout a scheme member's working life, it would find a much higher level of member engagement and much less of a need to provide a default fund solution. Given that the total benefit is funded through both contributions and investment earnings, judicious advice will be beneficial in assisting individual members to calibrate these two levers according to their circumstance and market opportunity throughout their accumulation phase.[19]

The need for financial education would not diminish with the standardization of default arrangements. Education programs should promote the concept of life-cycle-based investment as opposed to commonly known risk-based investment. Though the MPF should be considered as part of one's overall investment portfolio, the investment decision should be significantly different from other investment products. As repeatedly stated, the MPF is a defined contribution scheme where members bear the investment risk. It is the individual's responsibility to understand his or her own objective, investment risk, and product offers. Improving financial education may help in promoting income security at retirement. Adequate financial knowledge and awareness would permit people to recognize the long-term nature of saving for retirement, and the importance of keeping up contributions to pension plans in order to guarantee an adequate level of retirement income. It would make sense for the MPFA to work together with the 30,000 individual intermediaries to champion this for the medium to long-term benefit of the market and consumers.

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[16] Default Superannuation Funds in Modern Awards, Appendix B International experience – default funds in pension systems, Australia Productivity Commission

[17] Schroders Investment Perspectives, Lessons learnt in DC from around the world,

[18] Schroders Investment Perspectives, Lessons learnt in DC from around the world,

[19] Deloitte Actuaries & Consultants, Dynamics of the Australian Superannuation System: The next 20 years: 2013-2033, September 2013

Failure to address all core problems
As aforementioned, problems of the MPF that are debated heavily within society are level of fees, too many fund choices, complicated and redundant administration processes, and lack of economies of scale. The proposals of the Consultation Paper make reference to the MySuper reform of Australia, which also encountered similar issues. The shape of default superannuation funds in Australia recently changed with the introduction of MySuper. After 1 January 2014, all new default fund contributions must be invested in a MySuper product. By 1 July 2017, all remaining default fund balances must be transferred into a MySuper product. Each registered superannuation entity can offer one MySuper product.

The reforms highlighted issues that the Australian pension plan system was encountering namely: superannuation fees were too high, inefficiencies with processing payments, competition was not delivering better results and documentation was sometimes difficult to understand[20]. MySuper emerged out of the Super System Review of 2010, and the Superannuation Legislation Amendment (Stronger Super) Act (2012) that subsequently followed. Under the Stronger Super reform, it is also suggested to improve processing of transactions to be easier, cheaper and faster – SuperStream. The MySuper concept is aimed at lowering overall costs while maintaining a competitive market-based, private sector infrastructure for superannuation funds. The concept draws on and enhances an existing default investment option. The main changes expected as a result of the introduction of MySuper include: (a) the emergence of lifecycle products; (b) retail providers to reduce fees by about 14 bps per annum in their actively managed products through a combination of increased use of passive management, decreased use of alternative assets and a lower margin; (c) retail providers to introduce passively-managed products with much lower fees; and (d) underlying costs in the industry to rise at the margin, reflected for instance in a 4 bp increase in the average industry fund fee. Whether MySuper leaves members better off is an open issue. The net impact of these changes largely depends on whether retail default fund members will benefit from the mix of fee reductions and product design changes[21]. One motivation behind MySuper was to foster a range of simple, low-cost, easy-to-compare default products. This goal has not been realized. If anything, the introduction of lifecycle products coupled with other differences in product design give rise to a more diverse range of offerings. Further, the industry still falls short on fee comparability[22]. The development of MySuper has been occurring in conjunction with a raft of other regulatory changes impacting the superannuation industry.

Since the MPF and superannuation funds in Australia have encountered similar problems, it is reasonable to make reference to Australia's experience. However, the Hong Kong system is not comparable to that of Australia. Hong Kong's scale is much smaller and financial planning advice is less popular locally. MySuper is intended to be the default option for around 80% of workers who currently choose to have no direct control over their investment choice.[23] However, only one-quarter of Hong Kong's scheme members have not made a fund choice.

Unlike MySuper reform, the proposals in the Consultation Paper are less comprehensive. The IFPHK thinks that the proposals do not directly address all the core problems of the MPF system, in particular, the overly complex administration processes and lack of structural efficiency due to low asset levels. While the MPFA will push forward the Amendment Bill to simplify certain statutory procedures and requirements with which MPF trustees have to comply, with a view to further reducing their operational and compliance costs, all

[20] Schroders Investment Perspective, Lessons learnt in DC from around the world
[21] Warren Chant, Mano Mohankumar & Dr Geoff Warren, Centre for International Financial and Regulation, MySuper: A New Landscape for Default Superannuation Fund, April 2014
[22] Warren Chant, Mano Mohankumar & Dr Geoff Warren, Centre for International Financial and Regulation, MySuper: A New Landscape for Default Superannuation Fund, April 2014
[23] Schroders Investment Perspective, Lessons learnt in DC from around the world

these measures should be done under a big reform and in a coherent manner. Without a holistic view, the proposal will be like other reforms of the MPFA, with the result being less profound than expected. The MPFA has launched a campaign of account consolidation, sending letters in batches to scheme members with four or more personal accounts (around 180 000 members in total) to encourage account consolidation. About 18,000 (10%) returned the form. Moreover, from the launch of the MPF Employee Choice Arrangement (ECA), which came into effect on 1 November 2012, to 28 February 2014, about 120 000 ECA transfer requests have been received by MPF trustees (less than 5% of the total number of scheme members). When asked why they do not exercise their ECA rights, 32% of the respondents said it is too troublesome.

The MPFA states in the Consultation Paper that the standardization of default funds can provide the opportunity for greater structural efficiencies that can ultimately deliver lower operational cost that can flow through as a lower fee impact on members. Without holistic reform, the IFPHK doubts the effectiveness of this standardization in improving structural efficiencies. Unless there are reductions in administration processes and significant increases in fund sizes, the result will not significantly improve the system.

III.1 The core fund will be based on standardized default funds

It is proposed that each MPF scheme will be required to offer substantially the same type of Constituent Funds as the default fund for the schemes. The MPFA expects that designating a standardized approach to defaults and adopting it as the core fund will facilitate better benchmarking and comparison of investment performance and fees across and within MPF schemes. A standardized default fund, adopted as the core fund, will enable scheme members and commentators to focus on a single point of primary comparison. Standardization of the default funds can also provide the opportunity for greater structural efficiencies that can ultimately deliver lower operational costs that can flow through as a lower fee impact on members. Without any reform on administration processes, the impact of any reforms will be curtailed, as seen with the account consolidation and ECA reforms.

Question 2:

Do you agree that the Constituent Fund that is the default fund should be substantially the same in all MPF schemes?

<u>IFPHK Response</u>
It is an international trend to revamp the design of the default fund. In general, the IFPHK agrees to standardize the existing default arrangements. Please refer to the responses to Q1.

Question 3:

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

<u>IFPHK Response</u>
As aforementioned, setting up a core fund and standardizing default funds are viewed by the IFPHK as two different arrangements. Whilst the IFPHK agrees to the idea of standardizing default funds, we have reservations on equating the standardized default funds to a core fund. Please refer to the responses to Q1.

III.2 The core fund will be based on standardized default funds

As aforementioned, it is suggested in the Consultation Paper that substantially the same types of Constituent Funds are to be used as the MPF default fund and adopted as the core fund. The investment approach as stated in the Consultation Paper will need to be designed having regard to the purpose of providing a long-term savings solution designed for MPF members who do not make an investment choice. The Consultation Paper states that a particular characteristic of the MPF system is that members are particularly at risk from investment shocks in the years immediately preceding retirement.

It is proposed that the investment approach for the MPF default funds should be a series of target date Constituent Funds or a combination of life cycle Constituent Funds in a way that automatically reduces risk as a member approaches 65 years of age.

As stipulated in paragraph 48 of the Consultation Paper, the MPFA highlighted that there are several technical details that the MPFA would like to consult with the industry. These issues include:

a) Whether the preferred approach is a series of target date Constituent Funds that adjust risk in each target date CF over time or a life cycle approach that varies the member’s holdings of different CFs over time;
b) If a series of target date CFs is the preferred approach, how many funds are needed: is one fund every 5 years adequate or are more or less funds preferred, taking into account the establishment and maintenance costs of new funds;
c) What types of assets should be the investment building blocks at the underlying fund level; more sophisticated design might require more asset types, however, this will involve greater complexity and costs;
d) Which investment building blocks are more appropriately managed in a passive manner;
e) What should be the approach for reducing risk over time (i.e. the glide path): should de-risking start 20 or more years away from retirement or should it only happen in the 10 years immediately preceding the age of 65
f) What should be the terminal risk profile of the approach at age 65: should risk be reduced as far as possible, or given that members will still need investment exposure post retirement, should some equity exposure be maintained at and beyond age 65;
g) Whether consistency is required on all of these aspects across all defaults in all schemes or can some elements be left to the decision of individual product providers.

Question 4:

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

<u>IFPHK Response</u>

The IFPHK considers that a key objective of the MPF fund is to protect members against risk of a poor outcome whilst retaining the prospect of good long-term investment returns. Long-term returns clearly influence the pension outcome. The default fund has a greater role to protect than outperform[24]. Responding to the question, members of IFPHK interviewed has mixed views on adopting life-cycle strategies. The

[24] Mark Jackson, Benefiting by default, LCP Insight Clarity Advice

IFPHK will only provide general comments on the investment approach but will leave the technical and mechanical details to investment experts.

Target date funds and lifecycle funds are now used heavily in the US, Canada and the UK. These funds aim to apply a broadly appropriate risk profile for individuals based on their remaining period to retirement. They automatically decrease investment risk levels over time.[25] The main disadvantage of Target Dated Funds is clear and not hidden: not all investors are typical, and many may prefer a bespoke portfolio customized to their specific needs and attitude to risk as regularly reviewed by their investment adviser.[26] Although scheme members are not homogeneous and target date funds and lifestyle funds may not be the optimum choice that fits every member, the IFPHK thinks that they can be fair choices for those who do not make fund selection as it presumably has lower average risk than equity funds but with better average return than conservative funds. Some Members that the IFPHK interviewed suggest using a rule-based global equity index fund with a fixed sliding scale that reduces risk every year at a default rate based on the member's age. If such an investment program is feasible, it will reduce investment manager involvement and thus reduce costs. If contributions are invested according to the benchmark, only a single fund is required for every provider and hence avoids the administration and legal costs of setting up funds with different target dates.

While other members that the IFPHK interviewed do not regard life-cycle strategies as the cheapest and the best option for default investment. They consider that life-cycle strategies are out-dated method and as aforementioned such strategy is not able to cater risks of individual scheme members. As such, they suggest inflation-linked investments similar to those offered by i-bonds are better options in terms of returns and volatilities for scheme members who have no time and knowledge to manage their MFP funds and should be adopted as the investment strategies of the default funds.

Question 5:

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?

IFPHK Response

The IFPHK has no specific view on the technical issues of the default fund design but the IFPHK agrees to the idea of requiring consistency on all aspects of default fund design for benchmarking purposes.

Default investment strategies are not unique. In the UK, the use of 'default' investment strategies are guided by legislation that requires automatic re-weighting of the default investment asset allocation to accommodate a cash-based pension at retirement (a life-cycle approach). Meanwhile, in the US, also guided by legislation, investors have a choice of default funds: one with a stated investment asset allocation and the other targeted to planned retirement that includes automatic life cycle re-balancing. The US policy relating to the funding of retirement income is based on the target retirement age investment[27]. In Australia, MySuper products must be either a single well-diversified investment strategy or a life-cycle strategy. No restrictions are placed on the number of age divisions or cohorts permitted under a life-cycle strategy.

[25] Schroders Investment Perspectives, Lesson learnt in DC from around the world

[26] International Organisation of Pension Supervisors, IOPS Working Papers on Effective Pensions Supervision, No.18, Supervising Default Investment Funds, December 2012.

[27] Loretta Iskra, A technical Note on Australian Default Superannuation Investment Strategies, Australasian Accounting, Business and Finance Journal, Article 8

III.3 The core fund should be good value

The MPF core fund will be designed and delivered in a manner that represents good value for money. For the MPFA, the concept of “good value” not only should be about the price but also needs to be balanced against what the member gets in terms of associated services and investment outcomes, which includes at a minimum the following:

- Fees are kept low so that the maximum amount of investment returns are delivered through to members
- The range of services associated with the strategy must be reasonable, having regard to how much is paid for those services by way of fees and charges
- The investment product is structured in a way that is efficient thus facilitating lower cost outcomes that can allow for lower fee outcomes; and
- The investment design appropriately manages the risks faced by members who do not, or do not want to make investment decisions.

The fee of the core fund as compared to other MPF funds will be influenced by the structure and nature of the investment strategy. The Government and the MPFA expect the total fee impact of the core fund to be materially lower than the thresholds for the Low Fee Fund List i.e. fees at or under 1.0% or total expenses of at or under 1.3%. The MPFA proposes to require fees for Constituent Funds comprising the core fund to be at or under 0.75% of AUM. The 0.75% would relate to all ongoing fees both at the CF level and at any underlying APIF or index fund level. Legislative means will be pursued to reflect the consultation outcome as necessary.

Question 6:

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

Question 7:

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

<u>IFPHK Response</u>

The IFPHK concurs with the thinking that a lower fee is beneficial to scheme members. Costs and fees are particularly important for defined contribution plans, as they reduce returns, the size of the accumulated balance and therefore the amount of retirement income which can be generated. Given that an annual management charge of 1% of funds under management can reduce accumulated assets by as much as 20% (over a 40 year period) the impact can be substantial. However, without detailed information about the cost structure and cost component of the providers, the IFPHK is not able to provide comments on the reasonableness of the proposed fee cap on total fee (0.75%) and FER (1%). The IFPHK will only provide general comments on fees and share our research on international experiences for the consideration of the MPFA.

Certain countries adopt a paternalistic approach to reduce fees. In the UK, under the auto-enrollment scheme, which began in October 2012[28], a charge cap of 0.75% will be introduced from April 2015 for the default funds of defined contribution qualifying auto-enrollment schemes. There will also be a requirement of disclosure of all pension costs and mandatory charges by the trustees and Independent Governance Committees[29]. As aforementioned, MySuper products in Australia are being engineered in a way that will blunt the ability to compete solely on low fees[30]. Instead of placing a fee cap, fees are generally restricted to administration fees; investment fees; and certain transaction fees on a cost recovery basis such as buy and sell spreads, exit fees and switching fees. Regardless of the Australian government's efforts to drive fees down, the Economist of the Grattan Institute said "MySuper" would do little to reduce upward pressure on fees as it did nothing to address marketing, sales or asset management costs. The Grattan Institute in their report "The $10 Billion Super Sting" urged the Australian Government to copy countries such as Chile, which has regular competition among funds to become the state-approved cut-priced default fund.

Like the Economist of the Grattan Institute, some critics in Hong Kong also suggested mirroring New Zealand and Chile by selecting a default fund provider by using a competitive bid process. KiwiSaver was set up in 2007. It is an automatic-enrollment, voluntary savings system administered by the country's Inland Revenue Department. Employees are automatically enrolled in the system. The Ministry of Economic Development in New Zealand conducted an 'open, competitive tender process' in 2006 to appoint default providers. It was decided in 2014 that the default funds will keep their current fee settings, which are typically about 0.5% of a member's account balance plus a fixed administration fee, and according to the government, the default fund has played an important role in setting the benchmark in the market for fees for the rest of the industry to follow.

Chile is the most prominent example of how high administration and marketing costs can be reduced through a competitive bid process to find a default fund provider. Chile was one of the first countries to implement a three-pillar pension system under the World Bank's recommendation. Pension reform in 1981 introduced mandatory individual accounts. Chilean workers contributed 10% of their earnings plus a fee for administration. Administrative fees for members were high in the 1980s and 1990s as a result of large marketing expenditures by authorized pension funds (APFs). It was common practice for AFPs to recruit large sales forces that were paid commissions for attracting new members to the funds. The marketing costs in the Chilean system have subsided over time as a result of three factors:

1. The Government imposed restrictions on the frequency with which individuals could switch between funds, and regulated the use of sales agents.
2. Consolidation within industry has reduced the competitive forces that drove marketing expenditure.
3. The introduction of an auction process focusing on fees to determine the default provider has helped to create price-based competition.

In 2010, the requirement for employees to make a choice of AFP was removed. Instead, all employees commencing work with an employer are automatically allocated to a single default AFP. Employees may still make alternative choices. The default AFP is determined every two years by an auction process where the AFP that offers the lowest administrative fee is authorized as the default fund for the next two years.[31] The reform worked well at lowering fees. The Chilean system charge average fees of around 0.5% of assets.[32]

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[28] 80-90 per cent of pension scheme members are expected to use the default funds offered under the plan selected by employers
[29] Defined contribution pension reform – DWP confirms charge – capping measures and quality standards, Walker Morris LLP.
[30] Deloitte Actuaries & Consultants, Dynamics of the Australian Superannuation System: The next 20 years: 2013-2033, September 2013.
[31] Default Superannuation Funds in Modern Awards, Appendix B International experience – default funds in pension systems, Australia Productivity Commission
[32] Mark Cobley, "Chile looks to UK for pensions lessons", Financial News, 18 July 2014.

Alternatively, the government of Sweden has kept costs low by centralizing the administration of pension funds. The Swedish system demonstrates the benefits that can be achieved by a single national default fund with small marketing and investment expenditures. The premium pension system is centrally administered by the Swedish Pensions Agency ("SPA"). The SPA acts as a clearing house, forwarding contributions to the pension funds chosen by each individual. The SPA also keeps account records for members of all funds, functioning as a single access point for all individuals seeking information about their accounts.[33] To facilitate the choice of pension funds for individuals, the SPA maintains a catalogue of premium pension funds. The SPA recognized that many workers might not make an active pension fund choice, and thus introduced a default fund. It has achieved this through comparatively small marketing and investment expenditures as the majority of the fund's assets are invested passively. In 2010, the fund shifted to a lifecycle investment strategy. Costs are also kept down through automation, bulk trading of fund switches, and once-a-year transfer of funds into account. The default fund clearly has placed a high priority on keeping fund management charges low. The Swedish model of centralized administration minimizes the additional paperwork burden for employers, facilitates a broad fund choice, and allows the government to negotiate reduced management fees by fund providers[34]. Total fees charged to members are considerably lower than fees in most other pension systems around the world. Also, the use of a passive investment strategy has not diminished returns for members.

Cost transparency

Despite improving transparency regarding MPF fees, the cost components are not crystal clear to scheme members. The "Study of Administrative Costs in the Hong Kong Mandatory Provident Fund System" (Cost Study) published in 2012 shows that investment management accounts for 0.59%, administration cost 0.75%, and scheme sponsor charge, trustee profit, member rebates and other expenses, as a whole, 0.4%.[35] In general, commission to intermediaries are not charged to MPF funds, but are generally payable by scheme sponsors or promoters. The MPFA does not have the relevant figures[36]. The transparency of costs is also an important issue as there is a big difference between an asset management charge and a total expense ratio. Fuelling lower fees would make it easier for account holders to compare their fees to those of the tender winner. It would also be beneficial to scheme members if they could have a single online platform to review all their MPF accounts and information of all providers so that they could easily access and compare their MPF position. With the detailed disclosure of all fee components, competition would be based on prices rather than other features such as marketing.

Whilst a paternalistic approach is the most effective way to drive down fees, the IFPHK thinks that being a privately held pension system, providers should at least obtain reasonable amounts of profit margins to keep talents and provide services to members. In addition, providers have to invest in building electronic systems to simplify the process. As such, the IFPHK recommends the MPFA to continue to conduct active dialogue with the providers to gain their acceptance. The relationship between cost and performance also needs to be carefully considered as the lowest cost funds are not necessarily the ones offering the best returns and should not therefore automatically be considered as the appropriate default[37].

[33] Default Superannuation Funds in Modern Awards, Appendix B International experience – default funds in pension systems, Australia Productivity Commission

[34] R.Kent Weaver, Social Security Smorgasbord? Lessons from Sweden's Individual Pension Accounts, Brookings Policy Brief Series, June 2005/

[35] LCQ13: Fees and charges of the Mandatory Provident Fund Schemes, Press Release of Hong Kong government

[36] LCQ 13: Fees and charges of the Mandatory Provident Fund schemes, Press Release of Hong Kong Government.

[37] International Organization of Pension Supervisors, IOPS Working Papers on Effective Pensions Supervision, No.18, Supervising Default Investment Funds, December 2012.

In short, the IFPHK considers that while improving the structural efficiency of the MPF system requires revolutionary changes, the proposals in the Consultation Paper tend to add requirements instead of simplifying the whole system. While setting up a low cost fund is still beneficial to scheme members, the MPFA and the Government may wish to refer to the experience of Chile and so also select providers by competitive bid, or Sweden and so also centralize all administration.

INVESTMENT STRATEGY OF CORE FUND

It is suggested in the Consultation Paper that one way of keeping costs and fees as low as possible is ensuring that investment structures are designed efficiently. The general investment structure for MPF schemes is that members invest into CFs which, in turn invest into APIFs or other funds collectively referred to as “underlying funds”. Decisions about which individual securities to purchase are usually made by the investment of the underlying fund, not at CF level.

If different MPF schemes were to invest into the same underlying APIFs, the APIFs will be larger and consequently will have greater opportunity to benefit from scale efficiencies that will in turn flow back to benefit members of the CF. It is suggested that in implementing the new core fund, providers will need to ensure that in making decisions about which underlying funds to use as the investment building blocks, they give proper consideration to the range of APIFs and other funds that are available.

Another element of design efficiency, as pointed out in the Consultation Paper, is whether passive, index based, investment strategies should be the predominant investment approach in the core fund, either at the CF or underlying fund level. The MPFA provided rationale to the theory in accordance to the findings of a study by the Polytechnic University of Hong Kong. The MPFA proposes that the core fund should predominantly use passive investment strategies where it is possible to do so. The MPFA believes that the interests of members who do not, or do not want to make investment choices, will be better protected if the core fund uses passive investment strategies where it is possible to do so.

As the core fund will be investing for retirement purposes entailing a long-term investment horizon, a broad diversification of investments between assets and geography is important as a risk management tool. Diversification will ensure that investments are not overly concentrated in any one asset or geographic region, and limit portfolio risk and exposure to volatility in any specific market.

Question 8:

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

IFPHK Response
Please refer to response of Question 4.

Question 9:

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

IFPHK Response
The IFPHK has no specific comments on this question.

III.4 The core fund is available to all MPF scheme members to choose

It is suggested that standardized names should be used for the core fund in every scheme so that there is no confusion from scheme to scheme. The names suggested in Paragraph 77 of the Consultation Paper include the following:

- MPF Core Fund
- MPF Basic Investment Fund
- MPF Simple Investment Fund
- MPF Default Investment Fund
- MPF “A” Investment Fund

Question 10:

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

<u>IFPHK Response</u>
As discussed in Question 1, some members are wary about calling the default arrangement the ”core fund”. The IFPHK believes the name should be fit for the purpose. Among all the choices suggested in the Consultation Paper, the “MPF Default Investment Fund” is the name closest to the meaning.

IV. Implementation and Transitional Arrangements

In implementing any new core fund, a key transitional issue will be determining the extent to which (a) current accrued benefits and (b) future contributions should be invested into the new core fund. For MPF scheme members who have made a clear choice previously as to how their MPF benefits should be invested, the new core fund will not affect how their accrued benefits or contributions are invested. All existing MPF members should however be made aware of the new core fund arrangements. It is suggested in the Consultation Paper that for those existing MPF scheme members who have not previously made a choice of CF, their accrued benefits and future contributions should be invested into the new core fund unless the member makes an election to invest into some other CF or CFs of their choice. They will be notified of the new arrangements in advance and given a fresh opportunity to make a choice of fund if they wish to.

Recognizing the technical difficulties on the part of the trustee or administrator in not being able to readily identify those members who have never made an investment choice, all members who wholly invest contributions into existing default CF or CFs will be given a fresh opportunity to make a choice of fund, failing which, their accrued benefits and future contributions will be invested into the new core fund.

Question 11:

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

Question 12:

Do you agree with the proposal in paragraph 81 as to how to deal with the transition for existing MPF members of default funds?
<u>IFPHK Response</u>

The IFPHK has no specific views on the proposed transitional arrangements. It is the priority of the MPFA to lobby with all relevant stakeholders to obtain their buy-in of the proposals.