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"Vision for MPF"

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Good afternoon, Ladies and Gentlemen,

I am pleased and honoured to be here today and I would like to thank the Hong Kong Investment Funds Association ("HKIFA") for inviting me to its 9th Annual Conference. I am particularly pleased to meet with so many experts and professionals, who have a deep knowledge of the investment aspects of the Mandatory Provident Fund ("MPF") System. The HKIFA, which was established in 1986, has not only witnessed the birth of the MPF System, but has also been a valuable partner in many of its subsequent developments.

As you know, the MPF System is mandatory in nature and covers a large proportion of the working population in Hong Kong. We have been refining and improving the MPF System since its establishment. The title of my speech today is "Vision for MPF". In a moment, I will share with you the latest developments of the MPF System and the work ahead.

The MPF System came into operation on 1 December 2000. In about a month's time, we will celebrate its 15th anniversary. As some of you are well aware, I have long been an advocate of the MPF System. The launch of the System is a milestone in the development of Hong Kong's retirement protection policy. In these 15 years, we have witnessed the MPF System from birth to adolescence, yet to mature, but already yielding considerable results. I strongly believe that the MPF System is and shall continue to be a key pillar of Hong Kong's retirement protection framework.

Coverage of the Working Population

Before the launch of MPF, only around 30% of employed persons in Hong Kong had any formal retirement coverage. MPF now covers almost every employee that the System was intended to cover. As a result, about 85% of employed persons now have some form of formal coverage - 73% under MPF schemes and 12% under other retirement schemes, such as the Civil Service Pension Scheme and MPF exempted ORSO schemes. The coverage of Hong Kong employees by an occupational retirement savings framework is amongst the highest in the world. The remaining 15% are mainly those who are not required by law to join any retirement scheme.

Rapid Growth of MPF Assets

Although the MPF is designed to provide basic retirement protection for the employed population only, it is an important component of the overall retirement protection framework. The total value of MPF assets has grown significantly in these 15 years. As at June 2015, MPF assets have reached more than HK$620 billion. This translates into, on average, almost HK$150,000 MPF assets for each scheme member, and this amount will continue to grow as the System matures.

The outcomes enjoyed by scheme members in retirement phase are fueled by many factors, including the efficiency of the accumulation phase of retirement benefits, and the investment fund industry plays an important role here. Of the HK$620 billion MPF assets, more than a quarter, or HK$165 billion, are investment returns. It can be seen that, in part through the efforts of the investment fund industry, the MPF System has added substantially to the retirement savings of the Hong Kong workforce.

I am also pleased to share with you that the value of MPF has been increasingly recognized by employees and employers, as reflected by the continuous increase in voluntary contributions made by them, in addition to the mandatory contributions. The amount of voluntary contributions has jumped from $700 million in the fourth quarter of 2005 to $3.8 billion in the second quarter of 2015, representing a fourfold dramatic increase and now accounting for over 23% of the overall MPF contributions.

An increasing part of these voluntary contributions are contributions not related to employment – namely "special voluntary contributions" or "SVC". I trust you will agree with me that for scheme members to take their own time and effort to open their own SVC accounts and to make contributions voluntarily into those accounts is a clear demonstration of their confidence in the System. It also shows that more and more MPF scheme members have become aware of the need to save for retirement and taken action to build a larger pool of retirement assets. In the process, they have furthermore recognized that the MPF System provides an appropriate vehicle for them to achieve their goal.

Expansion of Fund Choices

One of the features of the MPF System is the choice of investment funds available to scheme members. Many of you in the room may be familiar with the fact that the number of MPF constituent funds rose substantially from 299 in March 2001 to 457 in June 2015. On average, there are now about 12 MPF funds under each MPF scheme, compared with about 5 when the System was first launched.

While many scheme members cherish the freedom of choice, when it comes to actually making a choice, the vast number of funds may just make it more difficult for the average member. Having too many funds may also limit the scale efficiencies that can be achieved by individual funds, making it less easy for fees to come down.

Trends of Fees and Charges

As you are aware, there have always been critics that fees, including investment management fees, charged to MPF funds are too high. Regardless of whether fees are objectively high or not, we have always maintained the position that lower fees are in members' interests, and driving fees to as low a level as possible is therefore a natural target of the MPFA.

In order to bring fees down, over the past decade, the MPFA has made use of different means and introduced a range of initiatives, including enhancing and standardizing fee disclosure to facilitate comparison and informed decisions, implementing the Employee Choice Arrangement to allow better working of market forces, streamlining and simplifying administrative processes to cut down administrative costs, requesting trustees to offer low fee funds, and working with trustees to merge less efficient schemes and funds. All of these have helped reduce the average Fund Expense Ratio ("FER") of MPF funds by almost a quarter from 2.10% in December 2007 to 1.60% in September 2015.

As of today, almost 40% of the MPF constituent funds are low-fee ones, with either management fees at 1% or lower, or an FER not exceeding 1.3%. We would of course like to see more funds in this category as assets continue to grow and for fees to continue to come down as scale is achieved.

Default Investment Strategy with Fee Controls

Looking ahead, I have two important tasks set as the MPFA's priorities for the next two years. First and foremost, I hope to see the Default Investment Strategy ("DIS") launched by the end of 2016.

As mentioned before, not all scheme members prefer many choices of funds and some scheme members express difficulty in choosing MPF funds even if they are provided with standardized disclosure materials on each of the funds. Some may lack the financial knowledge or expertise required to make investment decisions. Some may simply be disinterested in MPF because of the small amount of contributions made each month.

According to a survey conducted by the MPFA in 2013, almost a quarter of the respondents claimed that they had not made any investment choices. For members who made no fund choices, currently their benefits would be invested according to the default arrangement of their schemes. The default arrangement of each scheme is different and some may not be appropriate for long-term retirement savings purpose. There has been much recent discussion in the international arena that an appropriately designed default investment arrangement is particularly important to the success of defined contribution schemes, since the investment risk is borne by scheme members.

Our next major step in reforming the MPF System is therefore to introduce a relatively standardized default investment arrangement, referred to as the

Default Investment Strategy or DIS, for all schemes. Scheme members who do not make a fund choice would have their MPF assets invested according to the DIS. In addition, any scheme member may also actively select to have their benefits invested according to the DIS.

As mentioned before, the MPF System has been subject to severe criticism over its costs for years. In response, the Government has decided that the DIS would have its management fees capped at 0.75%, and the rate may be further adjusted downwards in time. This fee cap, a first time ever under the MPF System, represents a major departure from the past policy of not interfering with private market price setting. It would directly benefit scheme members whose MPF benefits are invested according to the DIS. Indirectly, the impact of the fee cap may be felt across all MPF funds and create an opportunity for some cost-efficient service providers to enter the MPF market.

The DIS would be designed in a way that best manages the long-term risks associated with investing retirement savings. There would be a higher proportion of benefits invested in higher risk assets for a member aged below 50. Between age 50 and the retirement age of 65, there would be de-risking, meaning that the proportion of benefits invested in higher risk assets would be reduced gradually during this period. The DIS would only involve two constituent funds, the minimum number of funds for achieving the de-risking arrangement. The performance of these funds would be benchmarked against an agreed portfolio to increase transparency and consistency across schemes.

We believe that, with the DIS, the MPF System would offer better protection to those scheme members who lack the time or expertise to plan for their own retirement - the low fees charged would translate into more retirement benefits, and the investment approach would minimize the scope for extremely negative outcomes as members approach retirement age. We strongly believe that the DIS would also improve outcomes for all members in general, with the fee levels and performance of the DIS funds exerting competitive pressure on other funds as well.

As you should know, we have been working closely with the industry, including the HKIFA, on the details of the DIS, such as the fund structures, disclosure requirements and fee calculations. May I take this opportunity to express my gratitude to the technical input and support of the HKIFA in developing the DIS. I hope that we can build an even stronger relationship between the investment fund industry and the MPFA through the DIS project.

We are also working very hard with the Government on drafting the bill for introducing the DIS. The Government plans to introduce this bill to the Legislative Council very soon.

<u>Standardization, Streamlining and Automation of Scheme Administration</u>

Costs of the MPF System do not only arise on the investment front, but also on the administrative side. The System involves numerous scheme administration processes, and each trustee has its own platform for handling these administration matters. I believe that technology can play a key role here and the use of electronic processing and streamlining of processes should further improve the operational efficiency of the MPF System.

As such, another important task for us is to explore ways to reduce the complexity of the System and enable the provision of all major member-related services via electronic means and online channels.

We have already appointed a consultancy and it is now conducting a study on the development of what we now tentatively call “eMPF”, an initiative to streamline, standardize and automate scheme administration as far as possible. Different options are being investigated for delivering the outcomes, including their feasibility as well as the costs and benefits involved.

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

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

The study is expected to be completed by the end of this year, and we will work on a blueprint for taking the proposals forward thereafter.

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

Despite these challenges, I am nevertheless cautiously optimistic that this vision will come to fruition.

Conclusion

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

In its short history of 15 years, there had been particularly difficult times for the MPF System - the Asian Financial Crisis, the SARS epidemic and the Global Financial Crisis. The MPF System has sailed through these difficult times safely. In recent months, we are seeing substantial market volatility. There may, of course, be even more challenges ahead. For the MPF System to rise to these challenges and continue to develop into a retirement savings system valued by scheme members, we will need to continually refine and reform it to better protect scheme members' interests.

The HKIFA and the MPFA have long been close partners in promoting the MPF System. In the years ahead, I trust that the HKIFA will continue to work closely with the MPFA so that the MPF System can better fulfill its role as the second pillar of retirement protection for the working population of Hong Kong.

Once again I would like to thank the HKIFA for inviting me to speak to you today.