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**"MPF as an Integral Part of Hong Kong's Retirement Protection"**

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Good Afternoon, Ladies and Gentlemen,

1. I would like to thank the Hong Kong Retirement Schemes Association and the Association of Superannuation Funds of Australia for inviting me to this forum.
2. As pointed out by the speakers this morning, the Commission on Poverty is now conducting a public consultation on retirement protection. I would like to take this opportunity to share with you my thoughts about the roles of the MPF System in Hong Kong's retirement protection.

World Bank's Multi-pillar Framework

3. The MPF System was designed to be a Pillar 2 system in the multi-pillar model as advocated by the World Bank. The model is based on the premise that a multi-pillar model is best able to provide retirement income protection as any one pillar is unable to address the total retirement needs of the whole population. The current model comprises 5 pillars –

Pillar 0: a non-contributory, publicly financed and managed system that provides a minimal level of protection for retirement;

Pillar 1: a mandatory, contributory and publicly managed system;

Pillar 2: a mandatory, privately managed, fully funded contribution system;

Pillar 3: voluntary savings; and

Pillar 4: informal support, other formal social programmes and other individual assets.

4. If you look at the 5 pillars, Pillar 0 is really a kind of safety net (minimum level of protection), Pillar 3 is very important because you could easily imagine that in most societies (including Hong Kong), the major source of funding for retirement protection would have to come from private savings. Pillar 4 is rather intangible in that it is not cash income. Instead it consists of items like housing, medical, and elderly caregiving services. But if these are adequately provided for, then the elderly retiree is in pretty good shape already.
5. It is clear that the global trend is for increasing reliance on Pillar 2 systems for basic retirement protection. In 1981, Chile introduced the first Pillar 2 system in the world. In 2014, Pillar 2 systems were in operation in 32 jurisdictions. The assets accumulated also grew substantially. In the 24 jurisdictions with data available, the total accumulated assets increased from US\$411 billion in 1999 to US\$2,018 billion in 2012.
6. Hong Kong is one of the pioneers in putting a Pillar 2 system in place in the Asian region through the establishment of the MPF System.

#### Roles of the MPF System in Hong Kong's Retirement Protection

7. In Hong Kong, the MPF System aims to offer basic retirement protection for the employed population. For this purpose, the MPF System was carefully designed to supplement other pillars, with features different from those of other pillars.

8. MPF schemes are managed by private entities. Private management is generally regarded as a more efficient way to manage pension assets than public management.
9. MPF schemes are managed under trust. Scheme assets are kept separately from the assets of employers, trustees and other service providers. As such, the assets will remain well protected even if any of these parties get into financial difficulties.
10. Scheme members' contributions are invested in MPF funds managed by professionals. Pooling small contributions from a large number of individual scheme members allows MPF funds to work with a much more diversified portfolio of assets than an individual could afford to buy on his or her own.
11. The MPF System is a fully-funded system with its assets originating from contributions made by and on behalf of scheme members. It does not rely on contributions from the Government. The MPF System is financially sustainable and is not affected by the financial situation of the Government.
12. The MPF System is a mandatory system. Why is it necessary to mandate our workers to save for retirement? I like to use the seat belt requirement as an analogy. You will put only yourself at risk if you do not buckle up. But we mandate the wearing of seat belts nevertheless. Why? This is to protect those who do not know how to protect themselves. Similarly, MPF ensures that all our workers set aside some savings during their working years for retirement use, including those who otherwise will not be doing so.
13. Ever since its inception, the MPF System has not stopped evolving and improving itself. Just to name a few examples – the range of MPF funds has

expanded, the number of low fee funds has increased, scheme members have more control over the investment of their MPF benefits through the Employee Choice Arrangement, and from this year onwards, they can also choose to withdraw their MPF benefits by instalments on retirement.

14. Consumer protection has also been strengthened, with the putting in place of a statutory registration system for MPF intermediaries and a statutory regime for regulating the sales and marketing activities of these intermediaries.

#### Challenges and Issues of Public Concern

15. We have frequently heard voices from the community commenting on the fees, investment performance and the adequacy of the MPF System.
16. In considering these issues, it must first be recognized that MPF is a large scale social programme covering a big chunk of the population of Hong Kong. There are around 280 000 employers and 4 million employees, self-employed persons and personal account holders participating in the MPF System. Some scheme members have more than one account, and altogether there are 8.9 million member accounts administered by MPF trustees.
17. Employees must participate in the MPF System but they have different levels of financial knowledge and investment experience. Some may be financially astute. But for some others, MPF may be their first and only exposure to the investment market.
18. Similarly, employers come from all industries. Some are large corporations with dedicated staff and systems for handling MPF contributions. Over 90% of total business units in Hong Kong however are small or medium-sized enterprises. Many of these employers send cheques and other supporting

documents by post to trustees to make contributions each month.

19. MPF is a “one size fits all” programme. It must be able to cater to the needs of employees, whether financially literate or not, and employers, whether large or small. The System should be kept simple and flexible at the same time it must have sufficient safeguards in place to protect the investments of the scheme members. That is not a simple balancing act by any means.

### Fees

20. In administering an MPF scheme, a trustee has the statutory duty to perform a wide variety of administrative functions. Trustees have to process contributions from around 280 000 employers and then invest the contributions according to the fund choice of about 2.5 million employees each month. For employers who failed to make contributions, trustees have to report to the MPFA and follow up on those cases. Trustees also have to process applications from scheme members for transfer or withdrawal of benefits.
21. These sometimes cumbersome administrative functions naturally incur costs. Indeed, the overall administrative and investment costs for managing an MPF scheme would inevitably be higher than those for managing a retail investment fund which are primarily just investment costs.
22. Nevertheless, the MPFA has always maintained the position that fees should be kept as low as possible for members’ interests.
23. Bearing this in mind, we have introduced a range of initiatives to bring fees down, primarily through enhancing disclosure, promoting competition of the MPF industry and streamlining and simplifying MPF administrative processes

to cut down administrative costs. Leading MPF providers have also responded to the call for better efficiency through consolidating less cost efficient schemes and funds, thereby streamlining their administrative processes. These initiatives have yielded some results. From December 2007 to March 2016, the average Fund Expense Ratio of MPF funds dropped by 25% from 2.10% to 1.58%.

### Investment Performance

24. Regarding investment performance, the MPF System has added value to scheme members' retirement savings in the 15 years since its inception. As at the end of November 2015, the System had HK\$590 billion in assets, of which, one-fifth, or HK\$114 billion, was investment returns. The 15-year annualized rate of return at 3.1% also exceeds the average inflation rate of 1.8% over the same period.
  
25. There are sometimes queries from scheme members as to why they must invest through MPF funds and cannot invest directly in stock markets, commodities or even property markets which may generate higher returns at certain points in time. In this regard, we must not lose sight of MPF's nature as a long-term retirement savings scheme for the entire employed population, a large proportion of which may not have much expertise in pension investment. It is therefore necessary to put in safeguards in the MPF legislation regarding how MPF funds may be invested for the protection of members' interest and have the funds invested by investment managers. In addition, the pooled investment structure of MPF funds is more efficient for amassing small contributions for investment.
  
26. On the issue of investment choice, under the MPF System, the basic arrangement is that scheme members can choose among the MPF funds in the

scheme in which they are enrolled. On average, there are now about 12 funds offered under each scheme, and these funds must have different investment objectives, ranging from conservative or money market funds to equity funds. From 2012, the Employee Choice Arrangement has further strengthened employees' control of their own MPF benefits by allowing them to choose among all MPF schemes.

### Adequacy

27. As a Pillar 2 system, the MPF System has been designed to provide only basic retirement protection, and only for the employed population of Hong Kong. Therefore, it has some unavoidable scope limitations - it applies only to the employed population and it is not intended to be the sole source of retirement savings even for that group.
28. MPF contributions are kept at a relatively low level, being 5% for a self-employed person or an employee, another 5% from the employer in the case of the employee. Below a minimum income level, a self-employed person or an employee needs not contribute. In addition, total monthly contribution is capped at HK\$3,000 per month.
29. Even at such relatively low contribution rate, the MPF can still provide basic retirement protection. According to the example given in the consultation document "Retirement Protection Forging Ahead" of the Commission on Poverty, if an employee with monthly salary of HK\$15,000 contributes from the age of 25 to 65 during which there is no pay adjustments in real terms, benefits of around HK\$1 million can be accumulated by age 65 assuming an annualized internal rate of return of 1.6% after discounting inflation. Dividing the amount into monthly payments based on the average life expectancy of persons aged 65, the member can receive a monthly income of

about HK\$4,200 (male) or HK\$3,500 (female) upon retirement at age 65.

30. I agree that there is some room for increasing MPF contributions in the future. The extent of the increase would of course need to be consistent with the objective of MPF being to provide basic retirement protection and the intention that individuals may choose to use other investment vehicles to accumulate savings to meet additional retirement needs.

### MPF Achievements

31. In the past 15 years, the MPF System has been performing its function of helping the employed population to save for retirement. Before the MPF System was implemented, it is estimated that only about one-third of Hong Kong's employed population (about 1.1 million) were covered by any sort of occupational retirement protection schemes.
32. As at 31 December 2015, 85% of Hong Kong's employed population (about 3.2 million) were covered by the MPF System or some other forms of retirement schemes. Most of the remaining employed population was not legally required to join any local retirement scheme.
33. As I have mentioned earlier, as of November 2015, the total asset size of the MPF System reached HK\$590 billion. There are many ways to look at this figure. An important but yet often overlooked aspect is that the retirement savings generated by MPF is almost equivalent to 70% of the Government's estimated fiscal reserve of HK\$860 billion already.
34. Furthermore, the MPF is intended to be a vehicle for an individual to accumulate retirement savings over a full working life, and the individual then spreads the accumulated sum over his or her retirement years for meeting basic



needs. The average working life is around 40 years and so for MPF which was introduced in 2000, it will take until around 2040 for the System to mature, in the sense that only then will there be members who have contributed to MPF for the full working life of 40 years. Only then can scheme members see the full magnitude of benefits that the System can produce.

#### Importance of Members Looking After their MPF Benefits

35. MPF funds are invested in financial instruments in the market. The investment performance of the MPF funds is inevitably affected by the cycles of the financial market and the market can be very volatile at times.
36. Scheme members should not be overly concerned about short-term volatility as making regular contributions over a long period can even out short-term fluctuations in market prices by averaging out the cost of the fund units. Members can also seek to reduce risk by means of a diversified portfolio across regions and asset classes. Younger scheme members may invest a higher percentage of benefits in equity funds and gradually shift the portfolio to bond funds close to retirement age. On reaching retirement age, if the market is in a downturn, a scheme member can choose to retain his or her benefits in the MPF System or to withdraw the benefits by instalments.
37. Fund choices made by scheme members also have an important impact on their saving outcomes. For example, the annualized return for equity funds in the MPF System for the 15-year period of 1 December 2000 to 30 November 2015 amounted to 4.1%, for bond funds 2.8%, and below 1% for MPF conservative funds and money market funds.
38. We believe that it is important for scheme members to have proper understanding of the investment risks in relation to MPF. Against this

background, financial education and proper disclosure of information are the key tools used by the MPFA to help members make informed investment choices and manage their retirement investment effectively. For example, scheme members may obtain information about the fees and investment performance of all MPF funds from the Fee Comparative Platform on MPFA's website. Members may also compare the service of trustees in respect of different MPF schemes using the Trustee Service Comparative Platform on MPFA's website.

### Two Major Initiatives in the Pipeline

39. The MPFA has been continuously working towards refining the MPF System and enhancing its value to scheme members. We have two key tasks set as priorities at present.
40. First and foremost, I hope to see the Default Investment Strategy ("DIS") launched by the end of 2016.
41. While some scheme members want more investment choices, there are also scheme members who comment that they do not know how to choose MPF funds or how to manage their MPF investments. To help the latter group, an amendment bill has been introduced into the Legislative Council last year to mandate a standardized DIS across all MPF schemes. The bill is still being considered by the Council at the moment.
42. The DIS is designed to provide all scheme members with a simplified investment option that is consistent with the overall objectives of retirement savings. The DIS is a globally diversified investment strategy that will de-risk as the age of a scheme member increases. In addition, the funds used for the DIS will be subject to a fee control of 0.75%. We believe the DIS will

be appropriate for scheme members who find it difficult to make investment choices or simply do not have the time or do not want to do so.

43. Second, in parallel with the DIS, we have also embarked on another major initiative which explores possible measures to streamline and standardize the administration of MPF schemes as far as possible (tentatively called “eMPF”). In this regard, the MPFA has developed a preliminary conceptual model of the eMPF infrastructure and processes to standardize, streamline and automate MPF scheme administration in the long run.
44. We would like eMPF to provide a one-stop electronic portal for scheme members to access all relevant information about their MPF accounts. In addition, eMPF would provide centralized collection of MPF contributions and necessary information from employers through electronic channels. The objectives of eMPF are to lower the operating costs of MPF providers, allow employers and scheme members to deal with various MPF matters more conveniently and efficiently, and provide scheme members with more flexibility and better-quality services and tools.

### Concluding Remarks

45. As pointed out at the beginning of my speech, retirement protection involves a balance between public and individual responsibility. Publicly-funded pillars and privately-funded pillars are complementary to each other. In this regard, a well functioning Pillar 2 system is a necessary part of retirement protection.
46. The MPF System is an integral part of Hong Kong’s retirement protection and should not be seen as something that can or should be replaced by other pillars. On the contrary, the stronger the MPF System becomes, the less reliant our working population will be on the publicly-funded pillar after their retirement.

Different pillars need to work together to provide for total retirement adequacy for the population. No single pillar can be an effective solution on its own.

47. To enhance the retirement protection of Hong Kong, what we need to do is to optimize all available pillars, including MPF. I look forward to the sharing of views and ideas on how the MPF System can be refined and improved in this Forum these two days.

48. Thank you.