中銀國際英國保誠信託有限公司
BOCI-Prudential Trustee Limited

26 September 2014

Investment Regulation Department
Mandatory Provident Fund Schemes Authority
Units 1501A and 1508, Level 15
International Commerce Centre
1 Austin Road West, Kowloon
Hong Kong

By Fax & By Post

Attention: Consultation on Providing Better Investment Solutions for MPF Members

Dear Sirs,

Consultation on "Providing Better Investment Solutions for MPF Members"

We refer to the captioned Consultation Paper issued in June 2014 and would like to submit our comments on the above subject.

Enclosed please find our comments in response to the questions as set out in the consultation paper.

Should you have any queries in relation to the above, please feel free to contact our

Yours faithfully,

Alex Chu
Chief Executive Officer

Encl.

香港銅鑼灣威非路道 18 號萬國寶通中心 12 字樓 電話 Tel : (852) 2290 1000
12/F., Citicorp Centre, 18 Whitfield Road, Causeway Bay, Hong Kong 傳真 Fax : (852) 2151 9888

Response to Consultation Paper

(Providing Better Investment Solutions for MPF Members)

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

We generally support MPFA to improve MPF system to cater the retirement saving of members who do not manage their MPF funds and do not make, or not want to make a choice of a fund as mentioned in the Consultation Paper. However, we have reservation that the proposed manners set out in the paragraphs 36 (a) to (d) of the Consultation Papers can well fit with each other and/or other surrounding circumstances as discussed below and can deliver desirable results.

Q2. Do you agree that the CF that is the default fund should be substantially the same in all MPF schemes?

The CF or core fund that is the default fund in all MPF schemes could be similar, but needs not be substantially the same. As mentioned in Part III.2 of the Consultation Papers, the investment approach of the core fund should balance long-term risks and returns in a manner appropriate for retirement savings of the target group (those who do not, or do not want to make investment decisions). Therefore, we believe that the balance between risk and return could be attributed by a general guidance on investment strategies and fund managers' professional judgement. The existence of certain variety between different default funds may increase the competition and motivation to strive for better performance. Otherwise, standardized investment strategies of a CF may not benefit from the talent and professional service of fund managers. MPF Conservative Fund is an example in the industry.

With reference to Q5, the consultation paper proposes that the investment approach for the MPF default funds should be a series of target date CFs or a combination of life cycle CFs. Currently, since most MPF schemes offer numbers of target date CFs and/or life cycle CFs, the MPFA may consider to issue a general guidance on the default fund arrangement, so that each individual product providers can optimize the existing fund options under their MPF schemes based on the particular features of their MPF schemes. This can also avoid the proliferation of constituent funds and substantial change to each individual MPF scheme.

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

Please refer to our reply to Q2.

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?

We generally agree that the core fund adopts the investment approach of reducing risk over time as the members get closer to age 65. However, some members might not complete the relevant forms on joining a scheme due to the reason mentioned in paragraph 75 of the Consultation Paper or some other reasons. The contributions of this kind of members currently are invested in the respective default fund(s) of the trustees. Trustees do not know certain kind of their personal information, including age, until the members actively contact the Trustees. Under the proposed investment approach of the core fund, trustees need guideline from the MPFA to handle the contributions of this kind of members.

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?

Para.48a. whether the preferred approach is a series of target date CFs 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;

Both approaches involve running more than one fund. As more funds involve, we foresee that more costs would be incurred, in particular, the legal costs such as establishment fees and operating costs such as audit fees (no matter regular annual audit fee or exit audit fee for the matured target date fund) may inevitably incur in on-going manner under "target date funds" approach and under "life cycle funds" approach (if trustees are required to establish several new funds for the purpose of running core fund) while the system enhancement cost may be enlarged under "life cycle funds" approach as the system should be capable to automatically vary members' holding among different CFs over time.

Therefore, also referring to our response to Q2, we are of the view that it should leave to individual product providers to decide whether the default fund(s) should be target date CFs or life cycle CFs.

Para.48b. 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;

If a series of target date approach is used, we prefer 10 years (or above) glide path, this can avoid setting up too many constituent funds under each MPF scheme.

Para.48c. 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;

We have no particular views on this issue. However, we maintain our view that a general guidance would be sufficient in such aspect and individual product providers can design their own product based on the particular features of their MPF schemes.

Para.48d. Which investment building blocks are more appropriately managed in a passive manner;

Please refer to our reply to Q5 (Para 48c).

Para.48e. 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 age 65;

Please refer to our reply to Q5 (Para 48c).

Para.48f. 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;

Please refer to our reply to Q5 (Para 48c).

Para.48g. 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.

We are of the view that some elements should 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?

We don't think that keeping total fee impact for the core fund at or under 0.75% as an initial approach is realistic given the current size of our MPF funds under management. In particular, if the proposed fees and fund expense ratio mentioned in Q7 are compulsorily implemented, individual service provider may need to subsidize the cost from its earning from MPF business and even from other business lines. If the service providers could not find the core fund profitable, it is no doubt that the service provider could not reduce any fees applicable to other constituent fund. This undoubtedly goes against the MPFA's expectation that the core fund would be a driving force for fee reduction in other funds in the system.

We would request the MPFA to consider using the current threshold of low fee fund adopted in Low Fee Fund List (i.e. 1% of management fee and 1.3% of fund expense ratio) in the MPFA's website as a starting point and then liaising with stakeholders in the industry to seek for further reduction to 0.75% when the asset under management of MPF funds reaches certain critical size as agreed by major stakeholders. This could be reviewed regularly.

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?

Based on our discussion in Q6, we are of the view that keeping total expense impact for the core fund at or under 1% over the medium term is not quite realistic.

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

We believe that the predominant investment approach in the MPF core fund should be left to the individual service provider.

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

We have no particular views on this issue. However, we maintain our view that a general guidance would be sufficient in such aspect and individual product providers can design their own product based on the particular features of their MPF schemes.

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? Your preference:

- ✧ **"MPF Core Fund"** (having regard to its use as a core investment approach for retirement savings)
- ✧ **"MPF Basic Investment Fund"** (emphasizing its design as a basic investment approach for retirement savings)
- ✧ **"MPF Simple Investment Fund"** (emphasizing its design as a simple investment process for retirement savings)
- ✧ **"MPF Default Investment Fund"** (reinforcing that its primary design is built around the default investment strategy for those who do not, or do not want to make an investment choice in saving for retirement)
- ✧ **"MPF "A" Investment Fund"** (or some other term which removes any implications about the nature of the strategy)

We suggest that the naming of the core fund should be clear to the public that the fund is for the members who do not, or do not want to make investment decisions. As a series of funds may involve, regardless under target date funds approach or life cycle funds approach, it is not easy for the public to understand if using any wording in the name to indicate or imply that core fund is a single fund. Therefore, we prefer to use the term "Default" to reflect the fact that the series of funds are the fund choices applicable for the members without giving any investment choice for any reason, e.g. Default Fund Series and Default Fund Class etc. However, we maintain our view that a general guidance would be sufficient in such aspect and individual product providers can decide their own product name based on the particular features and arrangement of their MPF schemes.

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

We wish that the MPFA could re-consider the proposed transitional arrangement due to the following reasons:

1. The proposed transitional arrangement involves high administration cost, e.g. posting notification to the members without making fund choices or wholly investing into the current default funds, such cost would possibly be shared amongst all members of the MPF scheme and may not be fair to those members who are not investing in the default fund.
2. The proposed transitional arrangement involves changing members' investment choice without their written consent or instruction and members may complain about it.
3. Even though members have not made fund choice, it would be possible that such members are well-aware of the existing default fund arrangement under the particular MPF scheme and therefore, intentionally enrolled without making fund choice because they understand that their monies will be invested into the default fund even they do not take any action. In other words, the default fund is their preferred fund choice.

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?

Please refer to our reply to Q11.