Form for Responding to Consultation Questions

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

☐ **Yes** ☐ No

Comments:

Generally, BoCom Trustee supports the direction of adopting a more uniform approach to setting the default fund. Current MPF companies use different default funds for their schemes. There might be a need to align the default funds. However, we believe the FSTB and the MPFA must try to determine what type of a default option is the most appropriate for a retirement plan, and also determine what the intention of such default option is and communicate this intention clearly to the general public. Some possible intentions could include the following:-

1. Improve and maintain the MPF system as one of the pillars for retirement?
2. Beat inflation?
3. Become retirees' key retirement nest egg (i.e., allow for phase withdrawal)?
4. Clear message to the members to avoid confusion (the purpose for doing this, the benefits, etc…)?

Rather than calling the new retirement investment strategy a "core fund", BoCom Trustee believes this retirement strategies could be called "default investment fund" or "default option" to avoid any value judgment being imposed onto this product and potentially mislead members.

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

☐ Yes ☐ No

Comments:

The default options in different MPF schemes can be similar in terms of investment strategy/approach, but there must be room for individual schemes to come-up with an appropriate option. However, there is no need for all default options in different MPF schemes to be exactly the same. General guidelines on a de-risking investment strategy (or glide-path approach) should be adequate for design of a default fund.

Q3. Do you agree that it is appropriate that the core fund be based on a standardized default fund? ☐ Yes ☐ No Comments: That will depend on the degree of "standardization" to be proposed. If the default option is going to be under a decentralized approach, only the name and the headline fees could be standardized. Other factors such as administration process, investment outcomes, etc… would be impossible to "standardize". Similar to Q2, an in-principle general approach plus guidelines for the default option would suffice. ☐
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? ☐ **Yes** ☐ No Comments: ☐ BoCom Trustee agrees in principle for the use of default fund to reduce risk over time as members get closer to their retirement age. Given the limitation that the most relevant personal data in the records of MPF service providers is the age of members, the default fund which automatically reduces risk over time as members get closer to age 65 would be a practicable investment approach. However, it is not the most suitable investment approach for members as it has not taken into account factors other than age (such as individual financial or personal circumstances and risk appetite). It has also assumed that members aim to retire at age 65.

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?

Comments:

a. The industry prefers to have more flexibility on either approach. Life cycle approach could avoid new series of CFs to be set up and be flexible to maintain more combinations of asset mix. On the other hand, series of target date CFs do not involve redemption and subscription of funds. The adjustment to the target mix of equities and fixed income instruments would be seamless to members. It can also avoid forced redemption when the market condition is unfavorable. Furthermore, most of the Trustees have provided similar products and built up the infrastructure to either approach currently. Additional cost will be involved to develop the new system and/or new funds if there is no flexibility on the approach. Notwithstanding of the above, if only either target date fund or life cycle fund is standardized across the industry, life cycle fund will be preferable in view of the market situation in HK.

b. The industry supports to have 5-10 years glide path with some flexibilities on ranges of asset allocation in each of the target date CF.

c. In general, we agree that the investment strategy should be globally diversified and focused principally on traditional equities, bonds and money market instruments. The investment building blocks at the underlying fund level could follow the current legislative restrictions and it is not necessary to specify further guidelines or restrictions for the default fund. This would allow MPF service providers to make use of their existing underlying APIFs to achieve better economies of scale.

d. We suggest to leave the investment strategies of whether adopting an active or passive approach or a combination of both for the default fund to MPF service providers.

e. This involves more advanced analyses and the industry would leave this to the technical workgroup.

f. The industry supports to have a terminal fund/risk profile for members beyond age 65. In general, there would be about 15-20 years of retirement living after age 65. Thus the post retirement investment strategy still needs to balance between risk and return and should maintain some equity exposure. Same as point “e” above, the industry would leave the technical workgroup to advise the range of asset allocation.

g. Guiding principles given by the MPFA would be sufficient for the purpose of maintaining consistency. Such guiding principles should be kept as board as possible in order to allow sufficient flexibility for MPF service providers to structure their funds including the objectives, investment strategies, underlying investments, etc.

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

☐ Yes ☐ **No**

☐ Comments:

BoCom Trustee is of the view that keeping the total fee impact for the default option at or under 0.75% is NOT a reasonable initial approach. Our conviction rests on the following facts:

a. In reference to the 2012 Consultancy Report commission by the MPFA on a study of the administrative cost in the MPF system, it clearly indicated that, at the time of that Report, the overall weighted average FER was 1.74% in which the average administration cost and investment management fee accounted for 0.75% and 0.59% respectively. In the last several years, fees of some funds and those of new funds have generally declined. It would take a little more time for these effects to be reflected in the FER. Unfortunately, FER could not reflect the bonus units being rebated to members. Moreover, providers have spent resources in introducing many e-channels for members as well as engaging in many initiatives and workgroups with the MPFA on streamlining administrative processes (such as the introduction of ePass and TRIS), and tightened compliance requirements. As such the industry does not experience a significant cost savings in the past few years. Therefore, we are not convinced for any assumptions on administration cost savings, which in turn is the key driver of a lower FER. Furthermore, as the need for more process simplification is not prevalent, we do not see how the current stage of regulatory requirement on MPF operation could accelerate any reduction in administration cost to a drastically lower level.

b. The publication of a list of funds with fee and total expenses ("FER") at or under 1.0% or 1.3% level by the MPFA in 2013 has invariably set an unofficial benchmark of "low fee fund" for MPF. The listing is widely accepted by the market as a synonym for "low fee fund". Such fee level when compared with the proposed fee and total expense ratio of the default option shows significant negative variance of over 30%. The industry is gravely concerned of the drastic reduction (on fee and total expense) made within a short period of time, without justifiable ground.

c. To develop a low fee "default option", the consultation paper proposed to use the index-based, passive strategy investment approach to achieve the product design efficiency. However, in reality, there are insufficient choices of ITCIS (out of the total 126 authorized ITCIS, only 5 are bond ITCIS) while the average FER of these 5 ITCIS is 0.45% with the FER of a single country ITCIS being as high as 0.5% - 0.7%. In this respect, using passively managed funds might not necessary mean very low fee funds.

d. Apparently, the proposed fee level of default option cannot deliver any meaningful margin to the providers. If the providers are to meet the proposed fee and total expense requirement they will have to find other means to finance the provision of the default option, which could include cross subsidization from other business lines. This kind of trend would not lead to healthy development of the MPF market.

Overall speaking, the industry is of the view that the proposed fee and total expense level for default option could be achieved when fund size accumulates in the longer term. At present, the current asset size of the Hong Kong MPF market is still not large enough to achieve sufficient economies of scale to significantly drive cost down within a short period of time. Considering all factors we suggest to set the fee and total expense ratio of default option should be no lower than that of the MPFA's "low fee fund" i.e., management fee of 1%, and FER of no more than 1.3%.

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? ☐ Yes ☐ **No** ☐ Comments: BoCom Trustee is of the view that keeping the total expense impact for the default option at or under 1% over the medium term is NOT a reasonable approach. Please refer to Q6 for the justifications of our conviction.
Q8. Do you agree that passive, index based, investment strategies should be the predominant investment approach in the MPF core fund? ☐ Yes ☐ No ☐ Comments: ☐ We have reservations over the usage of the word 'predominant'. While we do not disagree that passive, index based, investment strategies should come into the picture when the investment approach in the default option is considered, we believe the decision on the predominant investment approach should be left to each individual MPF scheme provider. If a MPF scheme provider can provide the default option as per the eventual fee cap requirement, the decision on which investment approach would provide the best value to members should be left to scheme

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

Comments:

Our general view is that if the liquidity or trading volume of some asset classes is very thin, it may mean that there would be liquidity for the ETFs concerned and that the FER of operating such ETFs may be high

Another point we would like to mention is that for many (if not all) bond ETFs, the existing indices that they are tracking could have elements that do not meet the MPFA's investment requirements (e.g. on the credit rating of the bonds or type of bonds). Hence, separate ETFs may need to be created. With new ETFs, liquidity and size may be a concern at least at the start-up stage, which again would have ramifications on the liquidity and the FER.
However, we believe that it will be more effective and for ease of complying with the requirement, any non-permissable investment asset should be included in the type of investment restriction.

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?

□ Yes □ No

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)

Comments:

Echoing reply from Q1, BoCom Trustee believes rather than calling the new retirement investment strategy a "core fund", this retirement strategies could be called "default investment fund" or "default option" to avoid any value judgment being imposed onto this product and potentially mislead members.

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

☐ Yes ☐ No

Comments:

The BoCom Trustee understands the rationale behind the general principle for dealing with the implementation and transitional issues proposed by MPFA in the Consultation Paper, but we do not agree with the entirety of the implementation and transitional arrangement. Whilst the BoCom Trustee agrees that all existing MPF scheme members should be made aware of the new default option arrangements, we do not agree with the transitional arrangement whereby members who are currently investing into the existing default fund would need to switch their investments to the new default options nor the future contribution should be invested into the new default option. In particular, we have the following concerns:-

a. Given the size of the MPF market as well as the amount which are invested in the existing default funds, we have concerned that there would be significant transactions (in respect of both subscription and redemption) for particular securities in a single day, and such arrangement may lead to unexpected fluctuation which may not be in the best interest of the MPF scheme members.

b. If the current default fund is a guaranteed fund, there is also the concern that these members who are being forced to switch to the new default options may not be able to benefit from the guarantee, which may only be realized upon satisfying certain conditions in the future.

c. There is also the risk of members complaining about the change in their investment portfolio without their consent.

d. Existing member who have multiple accounts within a MPF scheme may have different investment choice. The proposal creates complications in the communication with scheme members.

Due to our concerns above, we highly recommend that the new default option arrangement should be applied to new MPF scheme members only. We do, however, agree that existing MPF scheme members would only switch into the new default option by making a specific investment choice.

In addition, we recommend that the MPFA could further improve the arrangement by taking into account of the following:-

1. The transitional arrangement shall be set out specifically in the amendment legislation and regulations, especially when it involves switching of members' accrued benefits from the existing default fund to the new default option. The amendment legislation or regulations should cover but not limited to an aligned switching dealing date to the default option, handling of members who cannot be contacted, and how the members are classified as investing in existing default fund, etc…

2. Due to the potential effect of the arrangement, we recommend that the government or

the MPFA must carry out promotional and educational programs and to have extensive coverage to the public on the transitional arrangement prior to the launch of the default options.

3. MPFA must also provide all trustees with specific guidance in relation to the submission of applications for the addition of default options (e.g. including guidance on standard wordings for the objectives, restrictions, risk disclosures, timetable, etc.)

☐

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?

☐ Yes ☐ No

Comments:

In relation to the existing members in which the trustee or administrator of the MPF scheme cannot be readily identified as those who have made an investment choice, we are of the view that their invested contributions should not be switched from their existing default fund to the new default option even if they have failed to make another investment choice. In addition to the concerns mentioned in Q11, the transitional arrangement should be standardized and one standard rule to be applied to all MPF schemes in order to ensure efficient and effective communication with all members.

We hope the FSTB and the MPFA would take the above into consideration in revising the proposal for the default fund arrangement. Please contact us if there are further comments or questions.

Information of Respondent

(Please refer to the Personal Information Collection Statement on pages 47 and 48 of this Consultation Paper)

Name (optional):

Bank of Communications Trustee Ltd.

Organization (where applicable, optional):

Bank of Communications Trustee Ltd.

Address (optional):