



Response to the consultation paper on “Providing better investment solutions for MPF members”

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Prepared for: The MPFA

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

a) General view

Generally, we agree with the general concepts suggested in paragraph 37 and 38 explaining the rationale to set up the core fund and standardization of the fund. For the detailed discussion about Part III.2 as mentioned in paragraph 38, please refer to the answers at 1(b). However, we would like to raise concerns towards part of the content in paragraph 39 and 40.

Fee and charges

For paragraph 39, we think that the fee of core fund could become a good reference for comparison of fees across and within MPF schemes. However, we doubt if we need to consider the investment performance of core fund as the benchmark of same type of funds. We also disagree with the rationale for this suggestion in paragraph 39 Line 4-7.

The considerations for various settings of core fund suggest that it is not suitable to set benchmark for fund performance. If the core fund is provided on a multi-provider



platform, its investment performance is related to numerous factors including investment strategy, underlying asset class, fund size, fee and charges, the scope of market involved...In particular, the performance of core fund provided by different trustees might be of different fund type. In contrast, if the core fund is provided on a single provider platform, we suggest that a reference level instead of a benchmark to be set for monitoring the investment performance of core fund.

Even if the fund type is restricted to be the lifestyle fund or target-date fund, the fund portfolio could be different among the trustees. Added to the above, we agree with the statement “investment always involves a trade-off between risks and likely returns” as state in paragraph 42 Line 4-5. Therefore, it would be of difficulty to set up the benchmark.

We also have doubt towards the expected outcomes from the standardization of default funds in paragraph 40. To naturally reduce the operational cost of the fund, it is needed to reduce the total expense of the fund or increase the sum of assets under management. However, the lower operational cost mentioned in paragraph 40 is not the expected outcome but the initial setting of the core fund as the artificial control over the total expenditure of the fund. If the core fund does not receive adequate assets under management, the actual operational costs would be high. Moreover, we could not see that the current setting of core fund could provide greater structural efficiencies. Such guaranteed statement could generate unnecessary responsibility to the authority and generate misleading messages to the public.

Suggestion

If a benchmark has to be set up, further discussion is needed to achieve ‘meaningful comparison’ among funds. There are four possible choices of



benchmark: market average, internal rate of return, average fund performance of the same type and mixing a series of well recognized index.

b) General view

We agree with the concepts discussed in paragraph 41-46. However, we have concerns towards the ideas proposed in paragraph 47-49.

General concepts towards investment approach of core fund

To supplement the discussion in paragraph 41-43, four types of employee are associated with core fund:

1. Employee who have no interest in the entire MPF system
2. Employee who are concerned about the benefit of MPF only but no interest in MPF management
3. Employee who actively manages how interest to entire MPF system but have inadequate knowledge towards MPF management
4. Employee who actively manage their MPF, have adequate knowledge towards MPF management and they select the core fund upon their own judgement

We agree that the core fund should serve the employee for type 1-3. Moreover, we agree that we need to consider the difference in the risk level that each employee could bear and pay special attention towards those employee who are close to retirement.

Selection of investment approaches between target-date fund and lifestyle fund



For paragraph 47, we agree with the general concept that the setting of core fund should be target-date fund or lifestyle fund. Between the two investment approaches, we have higher preference on lifestyle fund over target date fund. For target date fund, as employee are at different ages and with varied preference in retirement setting when starting their core fund scheme. It would be difficult to set several funds with limited choice of date. If there is no restriction in the settings of target date fund, the trustees might need to set the target-date fund with as many choices of date as possible. As a result, the unnecessary competition in the variety of target date offered to the clients would be generated among trustees. In contrast, the lifestyle fund is more applicable that suits the complexity of employee profiles.

Technical consideration towards the set-up of core fund

We have queries towards the technical consideration raised in paragraph 48. The discussion towards the two paragraphs would be raised in Q5.

Limitations towards the investment approaches of core fund

In general, we prefer that the standardized guidelines are given to the service providers and allow them to make up the details about core fund. We would like to make comment in particular to each statement in paragraph 49.

- a) We agree with the primary aims in setting up the core fund, such that the core fund is have preset criteria in terms of fund type and level of services that suit the employee falling in the category 1-3 stated in Q1b. We do not advice that the setting of core fund provides choices tailor-made to employees. Instead, the fund portfolio should be direct and simple to understand. The general guideline in the fund setting would be to provide automatic risk switching based on age of participants.
- b) As stated in Q1(a) paragraph 2, we agree that the risk in investment markets are



difficult to be predicted and managed. Therefore, we agree that the values of fund investment could fluctuate with time and it would be rather impossible to guarantee the investment outcomes. We would like the regulatory bodies to highlight this message to the public and clear the unnecessary expectations or confusions from the public.

- c) We agree that frequent switching of investment method or limited years of accrued benefits could increase the fluctuations in investment benefits. This message should be well distributed to the public so that they hold the sole liabilities if they make such preference in investment.
- d) In line with the response made in (a), we agree that the participants showing concerns towards the investment risk should invest in suitable funds other than the core fund. As in (b) and (c), the regulatory bodies should highlight this issue to the public for stated purposes

We have concerns towards the descriptions in respective paragraphs. Although we agree with the general ideas towards criteria about the 'good value' of MPF stated in paragraph 50, we have doubts towards the details in the four bullet points. Enquires towards low fees would be discussed in Q6 and 7, while the doubts towards the structural efficiencies would be discussed in Q8 and 9. The comments towards the investment design associated with risk management are stated in Q1b paragraph 3.

Suggestions

We suggest that further considerations are required towards the establishment of core fund. As stated in paragraph 44 Line 5-6, the core fund is preferred to be set with automatic adjustment according to the age of employee. We suggest that three criteria have to be considered: age, level of investment risk and whether any preference in the investment plan. For the employee type 4 employee (the

employee who actively manage their MPF, have adequate knowledge towards MPF management and they select the core fund upon their own judgment choosing the core fund), they could be informed that core fund is only one selection towards their set-up of MPF portfolio. They could be asked to choose other types of MPF scheme if they would like to have tailor-made MPF investment portfolio.

- c) We agree with the establishment of policy to distribute the message to the public that core fund could be one of the choices in MPF management. We agree with paragraph 74 based on a standardized default fund and in consideration of different investment approaches. We also agree with the suggested fund types for core fund and paragraph 75 for the guidelines on sales and distribution practices, and the notice on scheme disclosure documents.

However, we have concerns towards paragraph 76 and 77 about the naming of “core fund”. The respective queries would be raised in Q10.

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

Views towards the MPF scheme

We do not prefer to have only one central organized provider for the core fund. This is because this setting will limit the choice of the MPF consumer and any monopoly operation to support compulsory saving will create wastage and will not create an efficient market to drive cost down effectively. We also prefer free market condition to offer good choice and efficient market to the consumer and that is the fundamental concept of the success of HK and we did not want to see the contrary



to happen in the MPF market.

Suggestions

Therefore, we suggest that the MPFA should instead provide standard guidelines to the trustee companies. Greater flexibility should provide to the trustee on decision in the details of the scheme. For example, the trustee companies could decide the portfolio setting of core fund scheme provided that they fulfill the guidelines that they only involve the particular type of fund instructed by MPFA. This policy could provide the fair competition platform for all trustee companies so that the employee involved in the core fund scheme could freely choose the best service provider out of all providers. The competition could ultimately improve effectiveness and efficiency in core fund among the trustee companies.

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

We agree with this suggestion in reply to that the setup of core fund is based on a standardized guideline. The rationale for our response is as stated in Q2.

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?

We agree with the strategy for automatic reduction of risk over time of investment

no matter the investment approach of a core fund is based on target-date approach of lifestyle fund. We think that such approach suits with the employee type 1-3 mentioned in paragraph 2 of the answer under Q1b.

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?

We agree that we need to consider general aspects suggested by paragraph 48. We would like to provide comments according to each statement in the paragraph.

- a) For statement (a), we agree adopt life style fund with automatic reduction of risk approaches as the preferred approach in the establishment of core fund.
- b) For statement (b), we do not agree to use target-date fund as the investment approach of core fund due to the technical difficulties beyond this approach. Please refer to the answer to Q1b for the detailed discussion on this statement.
- c) For statement (c) to (f), we think that these are the detail settings of core fund. The regulatory bodies are responsible to set the guidelines according to these statements and the decisions should be made by the trustee of MPF scheme.
- d) For statement (g), we think that the guideline should be standardized by the regulatory bodies so that consistency could be provided to the framework of default fund in all schemes. The fine elements of the schemes could be left for the trustees to decide.



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

General view

We have hesitations towards the setup of this approach. We suggest that the implementation of MPF fee expenditure at 0.75% to be reference fee limit instead of capped fee.

Fee of core fund

With reference to Ernest and Young report in 2012 investigating MPF expenditure, we find that the administration charges is already at 0.75%. If the core fund is required to set the total fee level at 0.75% and assets under management is not high enough, we suspect that the fee would be subsidized by increasing fee for other MPF funds provided by the trustee in order to meet the legislation requirements. This would be unfair for the employee who invest on MPF scheme other than the core fund.

Suggestions

To meet the goal of MPF fee at 0.75%, MPFA should take the responsibility to simplify the administration procedures so that the respective fee could be lowered. For instance, MPFA could simplify the process on validation of personal accounts by using certified true copies of ID card instead of relying on signature, which would likely be different especially for employee with long-holding accounts. In our view, the simplification of policies by MPFA is the prerequisite for substantial improvement in order to reduce administration fee in order to drive the lowering of total fee.



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

As stated in Q6, we do not agree with this approach. Please refer to the answer at Q7 for detailed explanation.

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

We do not agree that the passive, index based, investment strategies to be the predominant investment approach. Nevertheless, we suggest that this approach could be one of the proper methods to drive down the fee of MPF fund. The active investment approach could also be considered. The ultimate decision on the MPF investment should be made by the fund manager. Please refer to Q2 for the rationale of this suggestion.

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

The ultimate decision on the MPF investment should be made by the fund manager. As stated for the answer in 5(c), a) we think that these are the detail settings of core fund. The regulatory bodies are responsible to set the guidelines according to these statements and the decisions should be made by the trustee of MPF scheme.

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?

We could not make any suggestion about the name of the core fund at this stage. This is because the infrastructure on core fund is still unclear at this stage. We think that the MPFA should provide guidelines on the name of fund to the trustee. The principles of the guidelines should aim in reflecting the investment nature of the core fund. The name of fund should not generate any confusions and misleading messages to the public especially in the regions of fund investment and investment performance such that the investment benefits of the public could be protected.

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

General view

We do not agree with the general principle as stated in paragraph 78 and 79. We agree that the preliminary direction in the transitional arrangements should be on current accrued benefits and future contributions as stated in paragraph 78. However, we do not agree with the proposed policy as stated in paragraph 79.

Implementation and transitional issues of core fund

As stated in paragraph 79,

“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.”

There are two main reasons for the disagreement. First, we think that there are



discrepancies of bearable investment risk level among the participants. Moreover, there are different investment fund classes and risks in the current situation. If it is decided that the accrued benefit and future contributions of employee are invested into the new core fund, this may arouse potential investment risks or further extended to political risks against MPFA and government.

Suggestions

We suggest to take prudent approach towards the substantial change of MPF policy so that the potential systematic and operational risks are avoided. First, we suggest that the accrued benefit of involved employee should remain unchanged unless black-and-white approval is accepted from them towards the change of accrued benefits. In addition, we suggest that changes also need to be considered according to the existing master deed's terms and conditions stated in the offering documents.

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?

We do not agree with such policy. Please refer to Q11 for the rationale behind our stance.