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By E-mail and By Courier

30 September 2014

Investment Regulation Department
Mandatory Provident Fund Schemes Authority (the "Authority")
Units 1501A and 1508, Level 15
International Commerce Centre
1 Austin Road West, Kowloon
Hong Kong
Attn: Consultation on Providing Better Investment Solutions for MPF Members

Dear Sir/Madam,

Response to Consultation Paper on "Providing Better Investment Solutions for MPF Members" (the "Consultation Paper")

We refer to the Consultation Paper issued by the Financial Services and the Treasury Bureau ("FSTB") and the Mandatory Provident Fund Schemes Authority (the "Authority") in June 2014 inviting interested parties to submit written comments on the proposals set out in the Consultation Paper.

We, HSBC Provident Fund Trustee (Hong Kong) Limited and HSBC Institutional Trust Services (Asia) Limited (together referred to as "HSBC Trustee" in this submission), are acting trustees and/or administrators for 11 MPF schemes[1] in Hong Kong in total. We set out below our responses to the questions in the Consultation Paper for your consideration, which we have provided taking into account of our obligations and duties as approved trustees as well as the best interest of our MPF scheme members.

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

HSBC Trustee understands and supports the overall direction of introducing a core fund in the manner as set out in paragraphs 36 (a) to (d) but there are several areas which we hope the Authority could clarify.

Whilst HSBC Trustee understands the rationale set out in paragraph 36 (a) that the core fund is based on standardized default funds to ensure consistency across MPF schemes, we do not have sufficient information regarding the areas to be standardized (e.g. costs, structure, investment

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[1] The 11 MPF schemes are Hang Seng Mandatory Provident Fund - SimpleChoice, Hang Seng Mandatory Provident Fund - SuperTrust, Hang Seng Mandatory Provident Fund - SuperTrust Plus, Hang Seng Mandatory Provident Fund - ValueChoice, HSBC Mandatory Provident Fund - SimpleChoice, HSBC Mandatory Provident Fund - SuperTrust, HSBC Mandatory Provident Fund - SuperTrust Plus, HSBC Mandatory Provident Fund - ValueChoice, Schroder MPF Master Trust, Fidelity Retirement Master Trust and Haitong MPF Retirement Fund.

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arrangement, etc.) and levels of standardization on the default fund (e.g. ranging from one single method to a range of options).

HSBC Trustee supports the key element sets out in paragraph 36 (b) that the core fund should balance long-term risks and returns in a manner that is appropriate for retirement savings, and we suggest that the sponsors and approved trustees of the MPF schemes shall be able to decide whether it is more suitable for their MPF schemes to adopt the Life Cycle Approach or Target Date Funds approach from member's interest perspective as both approaches have their own pros and cons as set out below:-

	Life Cycle Approach	Target Date Funds
Key Pros	- Fewer constituent funds ("CF") would need to be created under the Life Cycle approach when compared with Target Date Funds - Fixed cost can be shared by many members and thus it could be more efficient - Flexible to maintain more combinations of asset mix	- Creating new CFs on a regular basis provides a more concrete picture on the changes of the fund portfolio over the life of MPF scheme members, hence allows easier understanding and communication to members - Do not involve redemption and subscription of funds, hence the adjustment to asset mix would be seamless to members - Avoid forced redemption when the market condition is unfavourable
Key Cons	- Automatic rebalancing to de-risk the portfolio over the life of the member is more difficult to be understood by scheme members - The fund is exposed to additional operational risks and errors due to complicated processes needed for administrators to adopt this approach	- The creation and termination of CFs may result in high operating costs - The interval to be set, i.e. whether it be every five years, should be open to further discussion

On paragraph 36 (c), whilst HSBC Trustee agrees that the core fund should be of good value to MPF scheme members, we would like to emphasize that we should not only look at costs, but should also take into account both risks and returns of the fund when we try to maximize the net return to members.

Lastly, HSBC Trustee is fully supportive of paragraph 36 (d) that the core fund should be available to all MPF scheme members to choose to ensure fairness and openness. However, there should not be any forced redemption of members' investment in the current default funds. For more details, please refer to Q11.

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

Yes, the design of the default investment option should, in principle, be the same in all MPF schemes, regardless of whether Life Cycle Approach or Target Date Funds is to be adopted.

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Expanding on our reply on standardization to Q1 above, there should also be an alignment in the glide path in the Life Cycle Approach or the number of CFs required in the case for Target Date Funds. Having said that, we do think that the geographical and asset type of securities to be invested by the core fund should be standardized, but the specific securities to be invested in within such categories should be the decisions of the respective investment managers for each scheme.

HSBC Trustee does not have any preference on whether Life Cycle Approach or Target Date Funds shall be adopted, as each of them has their own pros and cons as detailed in our answers to Q1 above. Ultimately, HSBC Trustee highly recommends that whatever approach adopted should take into account all risks and be adaptable to all MPF scheme members at different stages of their life.

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

Whilst HSBC Trustee agrees with the direction that the core fund should be based on standardized default funds to ensure consistency across MPF schemes, we do not have sufficient information regarding the areas to be standardized and levels of standardization on the default fund as detailed in our reply to Q1 above.

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, HSBC Trustee agrees that the investment approach of the core fund should automatically reduce risk over the life of the member, so that their change of risk aversion through time could be aligned with their investments in the MPF scheme.

In light of the introduction of partial withdrawal in the future, we are concerned on the options provided to the MPF scheme members after reaching age 65, in order to ensure that their retirement benefits are being looked after upon retirement.

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 providers?

HSBC Trustee has no comment on the preliminary views on the technical issues set out in paragraph 48, as we are not in a position to comment as administrator and trustee of MPF schemes.

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

HSBC Trustee agrees that the management fee for the core fund could be kept low, subject to the complexity for the design of the proposed core fund and the relevant administrative arrangement.

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However, we would like to have more information behind the setting of 0.75% as proposed for the core fund.

Currently, funds with a management fee level at 1% or under are listed on the "Low Fee Fund List". We believe that this existing level for low fee funds is reasonable and appropriate to allow service providers to provide good value services to members, taking into account the increasing market size and number of participants of the MPF market. Compromising service quality for lower fees may not be beneficial to members.

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. As responded in Q6, HSBC Trustee agrees in principle that the management fee level could be kept low, subject to the complexity of the design and the administrative arrangement.

Further, tabulated below are the average fund expense ratios (FER) of different fund types over the past 4 years collected from the annual reports of the Authority.

Fund Type	Yearly Average Fund Expense Ratio (FER)			
	2009-10[2]	2010-11[3]	2011-12[4]	2012-13[5]
Mixed Assets Fund	2.00%	1.94%	1.90%	1.84%
Bond Fund	1.73%	1.61%	1.60%	1.50%
Equity Fund	1.90%	1.83%	1.74%	1.71%
Guaranteed Fund	2.34%	2.25%	2.16%	2.18%
Money Market Fund - MPF Conservative Fund	0.47%	0.43%	0.67%	0.71%
Money Market Fund - non-MPF Conservative Fund	1.10%	1.09%	1.13%	1.13%
Others	1.56%	1.54%	1.39%	1.45%

A fund with a FER of below 1.00% would most probably have an investment profile that is similar to Money Market Fund – MPF Conservative Fund, which is composed of 82% in deposits and cash, and 18% in debt securities. Such investment portfolio could not achieve the targeted investment approach of the core fund as stated in the consultation paper, which is to balance long-term risks and returns in a manner appropriate for retirement savings. On the other hand, if the core fund is to achieve the risks and returns balance by adjusting the composition into a Mixed Asset Fund, it is unlikely to have FER of under 1% in the near future, as it took the Mixed Asset Fund 4 years to reduce its FER by 0.16%, reaching 1.84% in 2013.

Based on the trend of fee reduction in the past few years, it is very unlikely that the core fund could have an investment profile suitable for retirement saving and, at the same time, keep the FER at below 1%.

[2] Source: MPFA Annual Report 2010-11
[3] Source: MPFA Annual Report 2011-12
[4] Source: MPFA Annual Report 2012-13
[5] Source: MPFA Annual Report 2013-14

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

HSBC Trustee has no comment on the predominant investment strategies to be adopted as we are not in a position to comment as administrator and trustee of MPF schemes.

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

HSBC Trustee has no comment on the asset classes to be invested or not be invested in as we are not in a position to comment as administrator and trustee of 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?

Yes, the name of the core fund should be standardized across schemes to allow easy understanding and consistency.

HSBC Trustee prefers the core fund to be named "MPF Default Investment Fund" as it can better describe the essence of the core fund, while the other names reflect only part of the objectives behind.

For instance, "MPF Core Fund" may place an unnecessary focus on the level of importance of the core fund relative to other CFs in the scheme, creating a wrong perception to those who are not sufficiently clear about the objectives of the core fund. On the other hand, the use of "simple" and "basic" in "MPF Simple Investment Fund" and "MPF Basic Investment Fund" may not reflect the default investment option aspect of the core fund.

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

HSBC Trustee understands the rationale behind the general principle for dealing with the implementation and transitional issues proposed by the Authority in the Consultation Paper, but we do not agree with the entirety of the implementation and transitional arrangement.

Whilst HSBC Trustee agrees that all existing MPF scheme members should be made aware of the new core fund 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 core funds nor the future contribution should be invested into the new core fund.

In particular, we have the following concerns:-

1. Given the size of the MPF market, which amounted to $516 billion as of March 2014, and 24% of members indicated that they had never made a fund choice, we are 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.

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2. If the current default fund is a guaranteed fund, there is also the concern that MPF scheme members who are being forced to switch to the new core funds may not be able to benefit from the guarantee, which may only be realized upon satisfying certain conditions in future.
3. There is also the risk of MPF scheme members complaining about the change in their investment portfolio without their consent. We suggest the Authority to seek legal advice prior to making decision in forced redemption of members' investment in original default funds to the new ones.
4. Existing member who have multiple accounts within a MPF scheme may have different investment choice, the proposal create complications in the communication with scheme members.
5. If all contributions currently invested in the existing default fund would need to switched to the new core funds, there is a chance that the members who decide to remain in the existing core funds would need to bear additional costs as there would be less members to share the fixed costs. Further, if the existing default fund is a capital preservation fund, trustees cannot even wind up such funds given that it is a statutory requirement under section 37(1) of the Mandatory Provident Fund Schemes Ordinance that all MPF schemes must have such funds, so there could be members who may not be able to enjoy the full benefits / advantages offered by such funds

Due to our concerns above, we highly recommend that the new core fund arrangement should be applied to new MPF scheme members only. We do, however, agree that existing MPF scheme members would be allowed to switch into the new core fund by making a specific investment choice. Even if the Authority does not agree with our concerns above, we would recommend the Authority to ensure that the transition would not occur on a single day, but it should be spread over a reasonable period of time (say, over 1 to 3 years) to allow MPF scheme members the opportunity to gradually switch to the new core fund.

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

- The transitional arrangement shall be set out specifically in the amendment legislation and regulations, especially when there involved switching of members' accrued benefits from existing default fund to the new core fund. The amendment legislation or regulations should cover but not limited to an aligned switching dealing date to the core fund, handling of members who cannot be contacted and how the members are classified as investing in existing default fund, etc.
- Due to the potential effect of the arrangement, we recommend that the government or the Authority should carry out promotional and educational program and to have extensive coverage to the public on the transitional arrangement prior to the launch of the core funds.
- The Authority must also provide trustees with specific guidance in relation to the submission of applications for the addition of core funds (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?

In relation to existing MPF scheme members in which the trustee or administrator of the MPF scheme cannot readily identified as those who have made an investment choice, we respectfully disagree with the Authority that their invested contributions should be switched from their existing

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default fund to the new core fund 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 be efficiently communicated with all MPF scheme members.

If you have any questions, please feel free to contact me at

Yours sincerely,

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