Sun Life Financial
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<u>BY HAND & EMAIL</u>

September 30, 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

Attention: Consultation on Providing Better Investment Solutions for MPF Members

Dear Sir/Madam,

I refer to the consultation paper on "Providing Better Investment Solutions for MPF Members". Enclosed please find the comments on the proposal from Sun Life Hong Kong Limited for your perusal.

Yours sincerely,

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Head of Business Proposition
Pensions and Group Business

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

Overall speaking, Sun Life Hong Kong ("SLHK") supports the direction of standardizing the default fund arrangement for merit of easy understanding and protecting members' interest in the long run.

Considering the objective of this fund is to provide members a more desirable option in case they do not want to make an active selection, we suggest the name of the option should properly reflect this main purpose. As such we have reservation to the proposed name "Core Fund", as the name implies higher sense of preference than the other funds in the scheme. We recommend to continue using the name "default fund" for this option since such name is widely recognized in the market. Using the same name will also improve the effectiveness of communications to the public and members.

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

SLHK agrees the default fund should be substantially similar, in attributes such as fund name, investment strategy, default conditions etc. for the purpose of easy communication. However, scheme providers should be allowed ample flexibility in the composition of the underlying investments, de-risking or auto-rebalancing mechanism. We support to follow a common set of investment principles or guidelines that is especially designed for default fund but would prefer to leave the actual construction to the providers in order to deliver the best values to their members.

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

This will contingent on the degree of standardization. In reference to our response to Question 2, SLHK agrees that the standardization is agreeable on some aspects such as investment principles and fund name while flexibility should be given to product providers on the design of product features and administrative arrangement, allowing innovation and continuous improvement.

Q4. Do you agree that the appropriate investment approach of the core fund (default option) is one that automatically reduces risk over time as the member gets closer to age 65? If not, what other option would you propose?

SLHK supports the view that investment risk could be reduced over time as members get closer to retirement age. We will further suggest that such "de-risking" mechanism should attempt to cater individual members' risk appetites, which is not solely linked with age. Moreover, in view of the fact that the life expectancy is getting longer which in turn may push the retirement age to beyond age 65, the risk adjustment should continue after 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?

Similar to Question 2 & 3, SLHK supports consistent practice on some aspects such as the investment principles and fund name, as well as default conditions. To achieve optimal implementation result we strongly prefer overarching principles rather than stipulating guidelines, since this will allow flexibility for providers to construct product or service differentiation for members' benefits.

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

SLHK 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, reasons as below:

1. The 2012 Consultancy Report commission by the MPFA on a study of total cost in the MPF system indicated an overall weighted average FER of 1.74% (in which the average administration cost and investment management fee were 0.75% and 0.59% respectively). The expectation of a 65% FER reduction for the default option in a time span shorter than three years, and with no major operation streamlining, is inconceivable.
2. We foresee the execution logic of the default fund option still follows the prevailing member enrolment requirement therefore not bringing any simplification of the enrolment process or reduction of cost. The execution of "de-risking" mechanism requires special investment arrangements which cost is not to be easily offset by the omission of future investment instruction from the relevant group of members.
3. Our view is the introduction of default fund may provide better benefit to members in the long run but lacks compelling reason for cost reduction in the near term. We note funds with a fee level lower than 1% in the market which we opine, are highly subsidized by other higher fee funds in the scheme.
4. In 2013 the MPFA published a "low fee fund" listing which FER is on or lower 1.3%. This has been widely used by the market and the media as the benchmark of low fee fund. The proposed fee of 0.75% for the default option represents a significant downward variance of over 30% under a state of operation "status quo". As such we holds doubt on the reasonability of the proposed fee (0.75% and 1% FER) and are gravely concerned of the Authority's drastic change of opinion.
5. The consultation paper proposed using an index-based, passive investment strategy to achieve "low fee" result. However, at present there are only 5 fixed income ITCIS's which none tracks global government bonds, and with an average FER as high as 0.45%. Also, some of the 126 authorized ITCIS's within the MPF system (single country ITCIS's) commands a fee in the 0.6% - 0.7% range. In this respect, using the existing ITCIS's to construct a passive investment strategy might not necessarily resultant in a default fund of 0.75% fee.

Overall speaking, SLHK 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. As such, we suggest the fee and total expense ratio of the default option to be no lower than that of the MPFA's definition of "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 (default option) at or under 1.0% over the medium term is a reasonable approach?

Same as Question 6, SLHK does NOT believe that keeping the total expense impact for the default option at or under 1% over the medium term is 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 (default option)?

Any investment approaches which can deliver the best value to the members can be considered to put into the MPF default fund, but shouldn't be restricted to passive, index based, investment strategy. In refer to our response in Q2 & 3, SLHK deems that product providers should be given flexibility to structure their own products within the guiding principles set out by MPFA.

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

To protect our members' interest, we think that the following asset classes may not be appropriate for the new default option investment:

- Asset class that is in speculative nature
- Asset class with low liquidity and trading volume

Q10. Do you agree that the name of the core fund (default option) should be standardized across schemes? If so, do you have any preference amongst the possibilities set out in paragraph 77?

- **MPF Core Fund**
- **MPF Basic Investment Fund**
- **MPF Simple Investment Fund**
- **MPF Default Investment Fund**
- **MPF "A" Investment Fund**

SLHK supports to standardize the name of the default option across all schemes for easy communication and we prefer MPF Default Investment Fund to the others to minimize any quality implication.

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

SLHK supports that all existing MPF members should be made aware of the new default option arrangement, but do not agree that those existing members who are currently investing in default fund will need to switch both their accrued benefits and future contributions to the new default option automatically without their active election. We opine the concerned members should be retained in the current default fund investment unless they have elected to switch to the new default option.
We are of the view that the new default option should be applied to new MPF members only.

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?

Same as Question 11, SLHK do not agree to switch the accrued benefits and future contributions of the existing members who are currently investing in the default fund to the new default option without their action election.