HKFi
The Hong Kong Federation of Insurers
香港保險業聯會

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By Email Only (mpfinvest@mpfa.org.hk)

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

Dear Sir/Madam

Consultation on Providing Better Investment Solutions for MPF Members

Please find enclosed our response to the subject Consultation.

Should you require any clarification, please do not hesitate to contact

Yours sincerely

Wim Hekstra
Chairman
Retirement Schemes Working Group
Life Insurance Council

cc:

註冊有限公司 Incorporated with limited liability
香港灣仔駱克道 353 號三湘大廈 29 樓
29/F, Sunshine Plaza, 353 Lockhart Road, Wanchai, Hong Kong
電話 Tel: 25201868 傳真 Fax: 25201967
網址 Website: http://www.hkfi.org.hk 電郵 E-mail: hkfi@hkfi.org.hk

Industry Response to Consultation Paper on "Providing Better Investment Solutions for MPF Members" from the Hong Kong Federation of Insurers

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

Comments:

(I) The industry agrees with the direction to standardize the default fund arrangement and default investment option to the MPF schemes that offers good value to customers and the investment approach to be designed in such a way that is suitable for retirement savings. The industry prefers the use of default fund, as core fund could be giving a wrong impression to the members. The core fund should be made available to all MPF scheme members to choose from by choice or by default.

(II) The industry agrees to manage assets to a clear mix rather than target date approach. The industry also supports a consistent approach of default arrangement across all MPF schemes. However, there are great concerns on the introduction of "core fund" concept which may be misleading if members consider that the core fund is the recommended investment option.

(III) Low fee is not necessary a good fund. High equity exposure in young age could be very risky and controversial for default members. One must take into consideration the fees of underlying investments as well as the costs of running such a product to realistically set such an aggregate fee cap.

(IV) The industry has reservations in presenting the core fund as 'good value', because generally the public view value as represented by cost as well as the expected return profile. While the former can be made certain, the latter would forever be uncertain. As such, presenting the core fund as a product of 'good value' may make members confuse over the second aspect regarding return. Cheap may not always be good and thus should not be promoted like that.

(V) Some flexibility should be allowed in the design of the core fund in each scheme. For example, the industry would welcome standardization in terms of glide path, asset class involved, but other aspects like the specific APIFs/ITCISs used, whether there may be some added features of return enhancement or volatility limitation should be allowed to vary across schemes, in order to leave some room for competition and product innovation.

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

Yes ☑ No ☐

Comments:

(I) The so-called substantially the same should only be referring to the investment mix between equities and fixed income instruments in broad sense but not the investment outcome.

(II) The default fund could be governed by guiding principles specifying the range of equities and fixed income instruments at different age ranges of members or over the investment horizon of the CFs. The default funds among different MPF service providers would then maintain certain degree of consistency based on such guiding principles while enabling differentiation and flexibility for investment managers to act in the best interest of members.

(III) The design of the default investment option should in principle be the same in all MPF scheme (e.g. Lifecycle or Target Date Funds approach). Moreover, there should also be an alignment in the glide path or the number of CFs required if target date funds approach is adopted.

(IV) There should be flexibility in the choice of underlying funds and aspects of enhancing the risk/return profile should be allowed to encourage innovation and competition between schemes.

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

Comments:

(I) The industry has great concerns that the core fund concept would be misleading.

(II) As there is a variety of default funds across different MPF schemes at the moment, the transitional arrangement for the existing clients who are currently investing and have their contributions in these default funds would need to be very careful in order to avoid complaint and potential legal issues.

(III) As responded in Q2, there should have a good degree of standardization with aligned principle for the design of the product, while some flexibility could be allowed.

(IV) Members should continue to be encouraged to look after their MPF account and make "informed" decision. Education continues to be a key need among members and ultimately will be the key to helping members better understand their financial situation and become better prepared for retirement. This may be a long process but it is a phase the industry needs to go through as the pension system matures.

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?

Comments:

(I). The industry supports the general view to reduce risk over time when members approach their retirement ages.

(II) A more sophisticated approach is to build a target volatility glide path into such de-risking model, e.g. the expected volatility at each 'step-down' age is calculated at spot to determine the appropriate equity/bond portion at the time. However, this approach may involve more system building in advance, which could imply more costs, and also lead to less standardization of results.

(III) 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:

Paragraph 48 (a)

- The industry has varying views, but the concern regarding existing funds and potential fund transfers remains an issue and needs to be addressed.

Paragraph 48 (b)

- The industry prefers to manage assets to a clear mix rather than a target date approach. Even if a target date approach is to be adopted, one fund every 5 years would provide a better matching closer to the retirement year of individual members.

Paragraph 48 (c)

- 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.
- The initial building blocks should include global equity, global bond, money market, and possibly some home bias elements such as Hong Kong or Greater China equities.

Paragraph 48 (d)

- As a rule of thumb, more developed markets with good liquidity may be more appropriately managed in a passive manner as inefficiencies and displacement happen relatively less, thus more difficult to extract alpha from such markets.
- Active management is important as it gives the room for some competitive differentiation. The industry suggests leaving the investment strategies of whether adopting an active or passive approach or a combination of both for the default fund to MPF service providers.

Paragraph 48 (e)

- The de-risking could start from around 20 years preceding the maturity of the target date funds. Any guiding principles on the distribution of assets among equities and fixed income instruments should be broad enough to allow investment managers the flexibility to adjust the distribution of assets taking into consideration the market situation at that time.
- Our view is to take a more conservative line on this: let the de-risking start at 45; 20% in equity at age 65 as the industry agree that some equity portion should be retained at a member's retirement.
- As mentioned in our comments to Q1, aspects such as the specific APIFs to be used, or whether there may be some added features of return enhancement or volatility limitation, should be allowed to vary across schemes, in order to leave some room for competition and product innovation.

Paragraph 48 (f)

- In general, there would be about 20 years of retirement living after people reaching the age of 65. Thus, the post retirement investment strategy still needs to balance between risk and return. It is suggested to maintain an exposure of about 20-30% in equities with the remaining in fixed income instruments after maturity.

Paragraph 48 (g)

- Guiding principles given by the MPFA would be sufficient for the purpose of maintaining consistency. Such guiding principles should be kept at a broad level 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?

Comments:

(I) In general, the industry agrees with the direction of a low cost for this fund. However, this is subject to the complexity and design of the proposed core fund as well as the required administrative arrangement.

(II) The suggested level of 0.75% per annum is unrealistic. From the study of administrative costs in the Hong Kong MPF system issued by Ernst & Young in 2012, the weighted average of the administration cost which represents the total expenditure incurred by the trustees in performing MPF administration functions is already 0.75%. Other costs e.g. investment management fees have not been included. Moreover, it has been the market trend in recent years in expanding the administration team and putting more resources in order to cope with the regulatory changes and requests.

(III) Also, taking the passively managed approved ITCIS as example, except for the two Hang Seng Index related ITCIS and some US equity market related ITCIS, the FER of other equity markets related ITCIS ranges from 34 bps to 149 bps. Thus, it is impossible to construct a geographically diversified portfolio using ITCIS as the underlying building blocks to achieve all-in management fees of 0.75% per annum and FER of 1.0%.

(IV) Comparing to the pension systems in other countries, Hong Kong's MPF system is still at the developing stage. As the MPF system becomes more mature over time, the management fees will gradually be adjusted by market force.

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?

(I) The suggested level of 1.0% is unrealistic. This is subject to the complexity and design of the proposed core fund as well as the required administrative arrangement.

(II) Please see comments to Q6 above.

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

Comments:

Both active and passive investment strategies have their pros and cons. In particular, active management is important as it gives the room for some competitive differentiation. As a result, more room should be given on the cap of the management fees and FER and then leave the fees to be driven by market force. The decision should be left to each MPF scheme, in order to encourage innovation and competition between schemes. Certain level of flexibility on the strategies by the service provider should be retained.

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

Comments:

(I) Most of the asset classes could be managed by active or passive strategies. In addition, currently the MPF legislation sets out investment guidelines and restrictions in detail. The default fund, which is CF, would be subject to such investment guidelines and restrictions and thus it is not necessary to further define any particular asset classes which could be or could not be invested in. Active approach to asset management is important as it gives the room for some competitive differentiation. This could enable MPF service providers to utilize their existing underlying APIFs as the building blocks for establishing the default fund. Investment managers should continue to exercise their skills to ensure any investments should be consistent with the investment objectives and at appropriate level of the total assets of the CFs.

(II) If the liquidity or trading volume of some asset classes is very thin, it may mean that there would be a huge bid/ask spread for the ETF concerned and that the FER of operating such ETFs may be high.

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 of the Consultation Paper?

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)

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

Comments:

(I) Agree with paragraph 78 that all members should be offered a choice to reselect and the accrued benefits **and** future contributions of members who have made a clear fund choice in the past should not be affected by the core fund.

(II) Disagree with paragraph 79 for the following reasons:

(a) Many of the scheme providers have shown concerns that they cannot identify the members who were 'truly' defaulted in the default fund.

(b) The industry should fully respect those members who intended to invest into the existing default fund because of its features.

(c) For the 'true' defaulters, they may be satisfied with the current default options and may find them suitable based on their needs.

(d) Existing members who have not previously made a choice of CF would have been brought to attention about their existing default fund arrangement when they enrolled in the MPF scheme and some may have been receiving annual benefit statements for a number of years. These members may be comfortable with the default fund arrangement and thus they did not take any further action.

(e) Applying the new default fund arrangement to the accrued benefits of these existing members would inevitably involve redemption and subscription of CFs. It could result in a realization of gains or losses, depending on the individual situation of their MPF accounts. If the existing default fund is a guaranteed fund or low risk fund (such as MPF Conservative Fund), members may lose the guarantee or their investments may be exposed to higher risk.

(f) Thus moving all members' assets from the existing default fund to the core fund (even at the end of a noticing period) will cause issues. In principle, the industry considers that all members should be notified of the core fund arrangement, but should not be forced into fund switching if no actions are taken within the notice period. Rather, their assets should only be moved into the core fund should they give their consents.

(III) The industry proposes that the transitional arrangement be well covered in the legislation especially when there involved switching of members' accrued benefits from the existing scheme default fund to the new core fund based on members' elections to transfer or make no election.

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?

Comments:

(I) As mentioned in our response to Q11, the industry does not agree with moving existing member's accrued benefits and future contributions, which are in the existing default funds, into the core fund if they do not make an active choice within the notice period. Their assets should only be moved into the core fund should they give their consents.

(II) Apart from the reasons in our response to Q11, which make the issue of such transfer complicated, the root cause is that the nature of the existing default funds differs greatly across each scheme provider, which means the risk profile between the existing default option and the new core fund could differ greatly.

(III) Some of the members may be holding MPF accounts with more than one MPF service provider. Different practices may cause confusion to them and may even lead to complaints. Thus, the arrangement for existing members should be consistent across all MPF schemes, i.e. existing members are being notified about the availability of the new default funds. With the concerns mentioned in the comments under Q11, the choice of taking any action or not on the investment of accrued benefits and future contributions should be left to the existing members.

(IV) The industry proposes to extend the considerations to existing members in the current lifecycle approach / target date funds. There may be complications for the existing default fund and the new core fund to exist in the same scheme as the default option at the same time.

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