Chairman’s Speech for
HKRSA ORSO & MPF Seminar
Hong Kong Retirement Schemes Association
26 March 2014

INTRODUCTION

1. I am honoured to be invited by the HKRSA to the ORSO and MPF Seminar. Both the ORSO and MPF Systems are important components of the retirement savings of the Hong Kong working population.

2. As you probably know, before the launch of MPF, only around 30% of employed persons had any formal pension coverage. MPF now covers almost every employee that the System was intended to cover. Now 85% of employed persons have some form of formal coverage, with 72% of them covered under MPF schemes, 9% still under ORSO schemes and 4% under other pension schemes (e.g. Civil Service Pension Scheme). The coverage of Hong Kong employees by an occupational retirement savings framework is amongst the highest in the world.

3. As at 28 February 2014, there are 41 MPF registered schemes and 477 constituent funds under the schemes. As at 31 January 2014, total assets stood at $502 billion. The annualized rate of return of the MPF System from inception to end-January 2014, after netting fees and charges, was 3.9%, exceeding the annualized change of the Composite Consumer Price Index of 1.6% and the average
one-month Hong Kong Dollar deposit rate\(^1\) of 0.8\% per year over the same period. MPF benefits are, on average, earning investment returns well above inflation. Fees have come down. The latest available average Fund Expense Ratio (“FER”) of MPF funds is 1.70\%, representing a drop of 17\% from the ratio of 2.06\% when FER was first published.

4. As for the ORSO System, it is still an important part of the retirement savings landscape. Employers had used retirement schemes as an incentive to attract good employees and to keep employee loyalty long before the enactment of the ORSO and MPF legislation. As early as 1955, tax relief was provided to employers operating occupation retirement schemes. The ORSO legislation was passed in 1993 to provide a formal registration framework. [\text{As at 31 March 2000, before the launch of MPF, there were almost 19,000 ORSO schemes covering over 900,000 employees. With MPF implementation, many employers opted for having just one MPF scheme, rather having both an MPF scheme and an ORSO scheme.}] The number of ORSO schemes has been falling since 1 December 2000. It is interesting to note though that it took over 6 years for the MPF System to overtake the ORSO System in terms of assets under management. As at 28 February 2014, there are 4 208 ORSO registered schemes with total net assets of HK$286 billion and annual contribution of $19 billion. There are still 396,000 employees participating in ORSO schemes.

\textbf{LATEST DEVELOPMENT}

\(^1\) On deposit of less than $100,000.
5. The MPF System is mandatory and affects a large proportion of the working population, we have been refining and improving the MPF System since its establishment. I would therefore like to share with you some of the recent trends and developments of the MPF System, and some areas for reforms.

6. Firstly, we are happy to see that the amount of voluntary contributions into the MPF System continues to grow (from below 10% in the third quarter of 2004 to around 20% of total contributions in the last quarter of 2013). An increasing part of these voluntary contributions are contributions not related to employment – so called “special voluntary contributions” (around 30% of all voluntary contribution in 2013). These may reflect that more and more MPF scheme members are recognizing the benefits of MPF schemes and using them as a substitute for retail investment fund products. We can see why MPF funds may be attractive to some scheme members given that returns are, on the whole, similar, but fees of MPF funds are actually lower than retail funds. There are generally no sales/commission charges. This development is encouraging as it illustrates a growing confidence in the MPF System. Voluntary contribution means that scheme members identify with the system and are more aware of the need to save for retirement.

7. Secondly, there is an increasing trend in equity exposure for MPF assets in the last 10 years: from 47% in Q1 2001 to 67% in Q3 2013.
This does concern us as equity content at 67% is, as far as we can ascertain, the highest equity exposure of any retirement savings system in the world. Some members may not fully understand the choices they are making and the potential consequences.

8. Member decision-making is also affected by another trend – the increasing number of funds. As mentioned above, there are 477 constituent funds under 41 registered MPF schemes (average 12 constituent funds per scheme) as at 28 February 2014. [Compared to 299 constituent funds under 51 schemes (average 6 constituent funds per scheme) as at 31 March 2001.] While having many choices may sound appealing, there may be a limit beyond which choices would actually start to work against scheme members’ best interests. We have heard that the large number of funds has made decision-making difficult for some scheme members. More funds also limit the scale efficiencies that can be gained by each fund, making it harder for fees to come down and scheme administration less efficient.

**Default/Core Investment Strategy**

9. To facilitate employee choice, to achieve greater efficiency and to reduce volatility, the MPFA is considering whether to introduce a relatively standardized, low-cost default investment arrangement for all schemes. Scheme members who do not know how to make a fund choice would have their MPF assets invested in accordance with this default investment arrangement.
10. This default arrangement should help protect the interests of average members. The low fees charged would help members accumulate their retirement benefits faster and the approach to investment would seek to minimize the scope for extremely negative outcomes as members approach retirement age.

11. Our research on the “Default/Core Investment Strategy” is reasonably advanced, but key issues like the best or the preferred investment solution have yet to be determined. Questions like whether this should be based on some simple static funds or an approach that adjusts risk over time are areas where input is required from the industry and other stakeholders.

12. If the “Default/Core Investment Strategy” becomes the mainstream long-term retirement investment strategy, and the relevant funds can achieve economy of scale in a relatively short period of time, the overall cost effectiveness of the entire MPF System will be enhanced as a result.

13. To gauge the views of different stakeholders on the “Default/Core Investment Strategy”, the MPFA intends to launch a public consultation in the mid 2014.

Full Portability

14. Apart from the “Default/Core Investment Strategy”, you may have heard that the Government has asked MPFA to deliver a plan by early 2016 for implementation of full portability. This term “full
portability” is of course linked to the term “half portability”, or what we refer to as the “Employee Choice Arrangement” (“ECA”). ECA makes the benefits derived from the employees’ own mandatory contributions from current employment portable. Full portability refers to making both the employer and the employee’s contributions portable.

15. We will be looking into different implementation options and comparisons will take into account various factors, including the likely financial costs and the administrative work required of trustees, employers and employees. We will also be seeking input from stakeholders in the process.

Other Initiatives

16. You may recall that in late 2011 to early 2012, we conducted a public consultation relating to whether grounds for withdrawal of MPF benefits should be relaxed. After gathering the views of the public, the MPFA have been working out the legislative proposals with the Government and the Government plans to introduce the relevant legislative amendments into the Legislative Council later this year. The amendments would allow phased withdrawal of benefits on retirement and early withdrawal on the ground of terminal illness. At this stage, phased withdrawal is being introduced as an alternative to lump sum withdrawal and the choice will remain with the scheme members. This will allow members to
withdraw their MPF benefits gradually over their retirement. In the longer run, we look forward to this initiative stimulating market development of a range of suitable investment products that can provide members with a secure income stream for their retirement years.

17. On the questions of fees, although the MPFA is not empowered to directly regulate fund fees, it has been working hard to deliver better fee outcomes for members. Fee levels are driven by a range of factors, including the size of the System, operational efficiency, and the effectiveness of competition. Fees are expected to lower progressively as total MPF asset value grows. To better understand the cost drivers in MPF schemes, in 2012, MPFA commissioned a consultancy study to identify aspects that could be improved to achieve additional cost savings. Based on the study findings, MPFA identified a number of short-term measures, including ensuring the availability of low cost funds under each MPF scheme, encouraging scheme members to consolidate their personal accounts and working with trustees to rationalize MPF schemes and funds. We have made some headway in these aspects in 2013. The consultancy study also pointed out the manual processing of MPF transactions added significant administration costs to the System. Use of electronic processing and streamlining of processes can further improve the operational efficiency of the MPF System. MPFA’s long-term work plan is to enable the provision of all major member-related services via electronic means and online channels.
In November 2012, MPFA launched the ePASS to complement the implementation of the Employee Choice Arrangement. The ePASS is the first centralised electronic platform adopted by the entire MPF industry to facilitate the transfer of MPF benefits among all MPF trustees, making the transfer of data more reliable and efficient. After ePASS, MPFA will launch an electronic payment and settlement system in the second quarter of 2014, with a view to further shortening the time required for MPF benefit transfers by about one week (i.e. only one-third of the time expected when Employee Choice Arrangement was first launched). By then, transfers will be completed in two to three weeks. MPFA will continue to work with the industry on making wider use of common electronic platforms in the operation of the MPF System.

MPFA will need to encourage both employers (in particular small-and-medium sized enterprises) and employees to increase their usage of electronic platforms.

Concluding Remarks

18. The MPF System has only just passed the first phase of establishment. The MPF System will take some 40 years to mature.

19. In the 13 years since its launch, it has come through the Asian Financial Crisis, the SARS epidemic and the Global Financial Crisis. There are, of course, more challenges ahead.
20. To better protect members’ interests, we are moving from refining operational matters to broader policy proposals, and we will be assuming an increasingly more proactive advocacy role to tackle the greater structural issues. Needs and circumstances have changed since the establishment of the MPF System. We need to focus on issues like the withdrawal phase as the employees age. Electronic infrastructure is one way to set the MPF System on a more efficient footing for the future. The default fund proposal addresses the needs for an easier choice for scheme members as well as to achieve economy of scale.

21. MPFA is an advocate for scheme members’ interests and for improvements to the System. Today’s Seminar is a good opportunity for us to share ideas on how the MPF and ORSO Systems may be improved. In the years ahead, we look forward to working closely with you so that the MPF and ORSO Systems can better fulfill their roles as the second and third pillars of retirement protection for the working population of Hong Kong. Thank you.