SUPERVISING THE INDUSTRY

OVERVIEW

Our role

- To approve and supervise MPF trustees
- To register and approve MPF schemes and funds
- To register and supervise MPF intermediaries
- To supervise the operation of occupational retirement schemes ("ORSO schemes")

In 2012–13, we

- Supervised trustees' preparation for and implementation of the changes to the MPF System that came into effect in the year, including the Employee Choice Arrangement ("ECA")
- Launched a Trustee Service Comparative Platform
- Completed a Consultancy Study on MPF Trustees' Administration Costs and commenced developing short-term measures with the industry to improve the MPF System
- Commenced the statutory regulatory regime for MPF intermediaries

As at 31 March 2013,

- There were 19 MPF approved trustees, 41 registered MPF schemes, 469 approved constituent funds and 297 approved pooled investment funds
- Aggregate net asset value of all MPF schemes was $455.33 billion
- There were 34 131 registered MPF intermediaries, comprising 388 principal intermediaries and 33 743 subsidiary intermediaries
- There were 5 206 ORSO schemes
- The total asset size of ORSO registered schemes was $261.55 billion

SUPERVISION OF MPF APPROVED TRUSTEES

In 2012–13, the number of MPF trustees remained unchanged from last year at 19. A list of the trustees and their background as at 31 March 2013 is at Appendix 2.

Ongoing Monitoring

We continued to adopt a proactive and risk-based supervisory approach and refine the risk profile of each trustee as a basis for monitoring and supervising trustees via on-site visits, thematic reviews of specific areas of operation and off-site monitoring. Our off-site monitoring effort encompasses investigation of complaints and breaches, review of regular returns, audited financial statements and reports in respect of trustees and the schemes under their trusteeship. We also continued to review fund governance and investment compliance issues relating to MPF funds.

In 2012–13, we received 347 complaints (compared with 269 in the previous financial year) against trustees, most of which were related to customer service, and handling of contributions and transfer requests by scheme administrators. We have been taking actions to follow up and resolve the issues with the trustees concerned. During the year, we assessed 34 and 19 breach incidents relating to non-compliance with scheme administration and investment requirements respectively. Trustees and their service providers were required to take appropriate actions to ensure that all incidents were properly rectified in a timely manner, affected MPF scheme members and MPF funds were appropriately compensated and effective preventive measures were implemented. In addition, 14 financial penalty notices were issued to seven trustees in relation to 14 incidents of non-compliance with the regulatory requirements under the MPF legislation.

We maintained a regular dialogue with trustees on MPF-related issues and worked closely with them to pursue initiatives to enhance the MPF System. There was regular dialogue between senior management of MPFA and the trustees to exchange views on the development of the MPF System, reform initiatives, and ways to enhance the MPF System. Separately, the Trustees Operations Liaison Group, comprising representatives from trustees and MPFA, met three times during the year to discuss the development of information systems, MPF scheme operation issues that are of common interest across the industry, and developments in the MPF System. We also conducted individual meetings with trustees on a regular basis to discuss governance, compliance, operational and trustee-specific issues.

Launch of Trustee Service Comparative Platform

On 28 September 2012, we launched on MPFA's website a Trustee Service Comparative Platform. On the Platform, there is information on the services offered by different MPF schemes of each trustee in respect of fund choice, account administration and customer service. This new tool facilitates comparison of services across trustees by scheme members. Employers and self-employed persons can also refer to the information when selecting trustees and schemes for their employees or themselves. We have prepared a user guide for the Platform and made it available on MPFA's website and offices. A summary of the content of the Trustee Service Comparative Platform is also available in printed form.

Streamlining and Standardization of Scheme Administration

The MPF System involves scheme administration such as the processing of contributions, the reporting of default contributions, and the processing of fund transfer and withdrawal requests. Over the years, we have been looking into ways to simplify and standardize scheme administration with a view to reducing the costs of the MPF System, thus facilitating fee reduction. In this light, we engaged an independent consultant in late 2011 to analyse the scheme administration costs of the MPF System, and make suggestions on how to better achieve simplicity and cost reduction ("Cost Study"). The results of the Cost Study were released in November 2012. The consultant identified several cost drivers and recommended strategic responses to provide the industry with an overall direction in improving efficiency and achieving simplicity, thereby reducing scheme administration costs.

In the light of the Cost Study, we have commenced developing short-term measures to improve the MPF System. The work included requesting trustees to provide low-fee funds, and facilitating further automation and streamlining of administration processes among trustees, mergers of smaller scale or less efficient schemes and funds, and consolidation of scheme members' personal accounts. We have formed a task force with trustees to make plans for standardizing and simplifying administration processes and encouraging wider adoption of electronic solutions.

We have also put forward to the Government fundamental MPF reform approaches to achieve more substantial fee reductions. Policy directions were subsequently given in the 2013 Policy Address and the 2013–14 Budget on the adoption of a multi-pronged approach to bring down MPF fees. The Government and MPFA are now working together on several long-term reform proposals.[1]

Implementation of Changes to the MPF System

We supervised trustees' preparation for, and implementation of the changes to the MPF System that came into effect in 2012–13. We assessed trustees' readiness for the implementation of ECA[2] and supervised their preparatory work. We also monitored trustees' handling of contributions in the initial period of implementation of the new maximum level of relevant income for MPF contribution purposes that took effect on 1 June 2012, and urged trustees to step up communication with employers.

1 More information can be found in the chapter "Refining the Regulatory Framework".

2 An arrangement to allow employees to elect to transfer the MPF accrued benefits derived from employee mandatory contributions made during current employment and held in a contribution account under an MPF scheme to an MPF scheme of their own choice at least once per calendar year. Details of the implementation of the arrangement are reported in the chapter "Preparing for and Implementing the Employee Choice Arrangement".

SUPERVISION OF MPF INTERMEDIARIES

The number of MPF intermediaries is on the rise. As at 31 March 2013, there were 34 131 registered MPF intermediaries (compared with 30 071 last year), comprising 388 principal intermediaries and 33 743 subsidiary intermediaries.

Table 1. Breakdown of the Number of Registered MPF Intermediaries
(as at 31 March 2013)

	Principal Intermediary	Subsidiary Intermediary	Total
Number of Registered MPF Intermediaries	**388**	**33 743**	**34 131**
By Frontline Regulator			
— the Insurance Authority	329	24 795	25 124
— the Monetary Authority	20	7 321	7 341
— the Securities and Futures Commission	39	1 344	1 383
Total *	**388**	**33 460**	**33 848**

* A subsidiary intermediary, who is registered with MPFA, may be attached to more than one principal intermediary or none (normally, for a period not exceeding 90 days). All subsidiary intermediaries are assigned to their principal intermediary's frontline regulator. Therefore, depending on the specific circumstances, a subsidiary intermediary may be assigned to more than one frontline regulator or may not have any frontline regulator.

Members of the public can check MPF intermediaries' registration status through the public register on MPFA's website or by calling MPFA's hotline.

Statutory Regulatory Regime for MPF Intermediaries

The statutory regulatory regime for MPF intermediaries came into operation on 1 November 2012. All MPF intermediaries are required to register with MPFA before they can carry out sales and marketing activities or give advice in relation to MPF schemes, and are supervised by the regulator of their respective trade (i.e. Hong Kong Monetary Authority, Insurance Authority or Securities and Futures Commission) ("frontline regulators"). In September 2012, we issued a set of MPF Guidelines on Conduct Requirements for Registered Intermediaries to provide the industry with guidance in respect of the minimum standards of conduct expected of MPF intermediaries, and uploaded to MPFA's website a set of Frequently Asked Questions to facilitate understanding of the legislative requirements. Three other sets of MPF Guidelines on Registration, Annual Returns and Continuing Training have also been issued. Operationally, we maintain a close dialogue with the frontline regulators. For instance, for a small number of complaints against MPF intermediaries received so far, we have assessed the cases and passed some of them to the appropriate regulator to consider whether to launch an investigation. Statistics on complaints against intermediaries and enforcement actions relating to intermediaries taken in the period from 1 November 2012 to 31 March 2013 are in Parts D and E of the Statistics section respectively.

MPF intermediaries with valid registration with MPFA immediately before the commencement of the statutory regime are given two years to apply for registration under the statutory regime, if they wish to conduct MPF sales and marketing activities after the transitional period that ends on 31 October 2014. During the transitional period, these intermediaries are subject to the conduct requirements and sanctions in the same way as any other newly registered MPF intermediaries under the statutory regime. New applicants for registration as an MPF intermediary or applicants who had left the industry for three years or more are required to take an MPF intermediary examination. We have updated the relevant study notes and examination questions to take account of ECA and the new regulatory regime.

Under the new regime, MPFA is empowered to impose disciplinary sanctions on registered intermediaries if they fail to comply with performance requirements or are convicted of an offence under the MPF legislation. For those persons carrying out regulated activities without the appropriate registration, offenders are liable, upon conviction, to a maximum fine of $5 million and imprisonment for seven years.

Training of MPF Intermediaries

In preparation for the implementation of the new regulatory regime for MPF intermediaries, we had enhanced the training of intermediaries to improve the quality of MPF services provided to scheme members. The training was conducted in three phases. Phase 1, covering "MPF Investment Education Campaign — Making Investment Decisions for Your MPF Life", was conducted from 2009 to 2010. Phase 2, covering the legislation on, and operational details of ECA and general guidelines for MPF intermediaries, was conducted in 2011. Phase 3, covering the new regulatory regime and conduct requirements for MPF intermediaries, was conducted in 2012 to familiarize intermediaries with the new regime.

Principal intermediaries have the responsibility to arrange for their subsidiary intermediaries to undertake the training and ensure that subsidiary intermediaries are equipped with the relevant up-to-date knowledge about ECA and the new regime before they engage in any MPF sales and marketing activities. In 2012, we held 16 "train-the-trainer" workshops for trainers who were representatives of trustees, promoters and core Continuing Professional Development ("CPD") activity providers. We closely monitored attendance at training courses, and to ensure consistency and quality, we prepared and distributed a set of standard teaching materials for use in the training and conducted class visits to some training sessions for quality assurance.

To maintain their professional competencies in MPF business, all subsidiary intermediaries must comply with the CPD requirement by undertaking a minimum of 10 hours of CPD activities in each calendar year, with at least two hours devoted to core subject areas. Non-compliance with the CPD requirement may result in suspension or revocation of the registration of the subsidiary intermediaries concerned. As at 31 March 2013, there were 56 activities recognized by MPFA as MPF core CPD activities. We carried out quality assurance checks on these activities, which included vetting the materials used, visiting classes to ensure quality delivery of the activities and reviewing participants' evaluation of the CPD activities. During the year, we conducted 35 such class visits. In March 2013, we conducted three sessions with course providers to share with them best practices and our assessment of the core CPD activities conducted in 2012.

REGISTRATION AND APPROVAL OF MPF SCHEMES AND FUNDS

As at 31 March 2013, there were 41 registered MPF schemes, 469 approved constituent funds and 297 approved pooled investment funds ("APIFs"). The number of constituent funds available under each registered scheme ranged from 3 to 26 (see Figure 1) and the aggregate net asset value of all MPF schemes was $455.33 billion.

Figure 1. Number of Constituent Funds per MPF Scheme
(as at 31 March 2013)

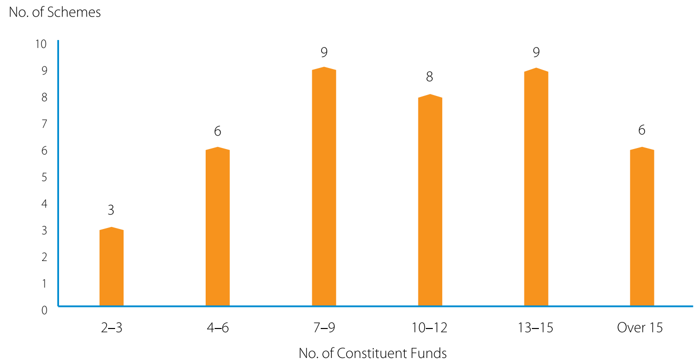

Table 2. Processing Statistics on Registration and Approval of MPF Schemes and Funds

	Number as at 31 March 2012	Terminated/ Withdrawn during the year	Registration/ Approval during the year	Number as at 31 March 2013
Registered Schemes	**40**	**0**	**1**	**41**
Master Trust Schemes	37	0	1	38
Industry Schemes	2	0	0	2
Employer Sponsored Scheme	1	0	0	1
Approved Constituent Funds	**445**	**1**	**25**	**469**
APIFs	**297**	**13**	**13**	**297**
Approved Index-Tracking Collective Investment Schemes	**109**	**0**	**11**	**120**

Table 3. Analysis of APIFs by Fund Structures

	Unit Trust		Insurance Policy		Total	
	as at 31 March 2012	as at 31 March 2013	as at 31 March 2012*	as at 31 March 2013*	as at 31 March 2012	as at 31 March 2013
Umbrella Funds	25	25	1	1	**26**	**26**
Internal Portfolios	178	178	1	1	**179**	**179**
Feeder Funds	22	23	8	8	**30**	**31**
Portfolio Management Funds	59	58	3	3	**62**	**61**
Total	**284**	**284**	**13**	**13**	**297**	**297**

* These refer to Class G insurance policy APIFs.

A list of the registered schemes and their respective underlying constituent funds is at Appendix 3, and more statistics on MPF schemes and funds are included in Part B of the Statistics section.

Fees and Charges of MPF Funds

Over the years, we noted a steady reduction in the average Fund Expense Ratio[3] ("FER"). The average FER of individual constituent funds with financial year-end dates falling within the period from 1 July 2011 to 30 June 2012 was 1.72%. This represents a fall of 17% from the average FER of 2.06% of individual constituent funds with financial year-end dates falling within the period from 1 October 2005 to 30 September 2006 (for which period the ratio was first reported).

According to the Cost Study mentioned earlier, it is anticipated that if all the initiatives recommended by the consultant are implemented and potential benefits are fully realized, coupled with the natural growth of MPF assets, the average FER of individual constituent funds could be reduced by 60 basis points. We consider that the pace and extent of fee reduction will not be fast or large enough if we simply rely on the proposed measures to lower administration costs. We have therefore proposed to the Government some fundamental changes to the MPF System[4]. Meanwhile, we are taking some short-term measures to improve the MPF System with a view to reducing the costs of the System, as mentioned on page 42.

REGULATION OF OCCUPATIONAL RETIREMENT SCHEMES ("ORSO SCHEMES")

The MPFA is the Registrar of Occupational Retirement Schemes. As at 31 March 2013, there were 5 206 ORSO schemes. The total asset size of ORSO registered schemes was $261.55 billion.

MPF Exempted ORSO Schemes

Prior to the launch of the MPF System, employers operating ORSO schemes had an option to apply for exemption from MPF requirements. Existing members of MPF exempted ORSO schemes had a one-off option to choose between their existing ORSO scheme and an MPF scheme. For those ORSO schemes which did not obtain MPF exemption status, employers may choose to retain them as top-up schemes, or to freeze or terminate them.

During the year, 119 MPF exempted ORSO schemes, covering about 700 members, relinquished their exemption status. The number of MPF exempted ORSO schemes as at 31 March 2013 was 3 948, covering about 6 000 employers and 361 000 scheme members. Among these MPF exempted ORSO schemes, 270 were ORSO exempted schemes and 3 678 were ORSO registered schemes.

Termination of ORSO Schemes

During the year, 139 ORSO registered schemes and 38 ORSO exempted schemes (comprising 120 MPF exempted schemes and 57 non-MPF exempted schemes) were terminated. As at 31 March 2013, 80 ORSO schemes (including 49 MPF exempted schemes and 31 non-MPF exempted schemes) were in the process of being terminated, pending the transfer of scheme assets and/or provision of the necessary information to MPFA. After the termination of these schemes, the number of remaining ORSO schemes would be 5 126, including 3 899 MPF exempted schemes (covering about 360 000 scheme members) and 1 227 non-MPF exempted schemes (covering about 44 000 scheme members).

Based on the information obtained from the termination notices submitted and the latest annual returns of ORSO registered schemes, the asset arrangements on the termination of these ORSO registered schemes are set out in Table 4.

3 Fund Expense Ratio is a ratio that measures the expenses of an MPF fund as a percentage of fund size. The higher the ratio, the higher the percentage of operating expenses to fund size. The ratio is calculated based on data from the most recently ended financial period. It does not reflect the latest expenses or adjustments to fees and charges.

4 Details are described in the chapter "Refining the Regulatory Framework".

Table 4. Asset Arrangements on Termination of the ORSO Registered Schemes Effected in the Period from 1 April 2012 to 31 March 2013

ORSO Asset Arrangements	Number of Schemes	%	Asset Size (HK$ million)	%
Transferred to MPF scheme	24	17	158	28
Transferred to another ORSO scheme	3	2	77	14
Paid out to scheme members	112	81	327	58
Total	**139**	**100**	**562**	**100**

Funding of ORSO Schemes

We monitor the funding status of ORSO schemes by examining their annual returns and audited financial statements. In the case of defined benefit schemes, actuarial certificates must be supplied to MPFA at least once every three years. According to the reports received up to 31 March 2013, four out of the 250 defined benefit schemes were under-funded, covering around 400 scheme members. The asset size of these schemes was $0.3 billion and the total shortfall was $0.03 billion, representing about 9% of the total assets of these under-funded schemes. For comparison, a year ago, six out of the 254 defined benefit schemes were under-funded with a total shortfall of $0.3 billion, representing about 25% of the total assets of $1.1 billion of these under-funded schemes. Shortfalls in the four under-funded schemes were all caused by investment loss. The relevant employers were required to make up the shortfall in funding by making either a lump sum contribution or regular monthly contributions within three years and to submit actuarial certificates annually until the schemes were fully funded. We continue to monitor the situation closely to ensure that contributions are made in accordance with the terms and rules of the schemes and, if applicable, the actuarial recommendations.

Statistics and other Operation Information

A list of the corporate administrators who administer pooling agreements for ORSO schemes is at Appendix 4. More statistics on ORSO schemes are set out in Part C of the Statistics section. Information on other operations of MPFA as the Registrar of Occupational Retirement Schemes is presented in Appendix 5.