Mandatory Provident Fund Schemes Authority
Fund Expense Ratio Press Conference
Key points

23 November 2016

Slide No

1 **Introduction**

1. The MPFA understands that the public are very concerned about MPF fund fees and is committed to taking necessary measures to continue to drive fees down.

2. The objective of today's press conference is to further explain what fund fees are made up of and to announce the publication of a report which analyses the historical trend of the Fund Expense Ratio (FER) and whether there is any relationship between the FER and a fund's performance, size, age and investment style.

2 *Why do MPF service providers have to charge fees?*

3. MPF scheme providers provide services that go far beyond simple investment management. The MPF System is a mandatory retirement savings system, so MPF trustees have to provide a basket of services – collecting and allocating employers' contributions, assisting in chasing employers for outstanding contributions, providing statutory reporting to regulators, administering MPF withdrawals, and so forth. These services involve much more than just buying and selling stocks or the types of services involved in retail funds. Therefore, under the MPF System, scheme members have to pay not just for investment management fees, but also for scheme administration fees.

4. The MPF System is Pillar 2 under the World Bank's multi-pillar retirement protection framework. It is privately managed. Trustees, investment managers and other service providers are private companies. They must charge fees to cover the costs of their operations.

5. As in many other pension markets, the fees of most MPF funds are not deducted from members' accounts. They are based on the daily net asset value of the fund

and are deducted from the fund's assets. The daily unit price of the fund already reflects the fees charged, and the fees are not deducted from nor recorded in individual accounts. In general, trustees deduct fees from a member's account only for services provided specifically for that member (for example, providing an additional benefits statement or processing an additional withdrawal of benefits). All fees and expenses payable by a member or out of a fund are set out fully in the Fee Table of each MPF scheme.

3 6. In 2012, the MPFA appointed an independent consultant to study scheme administration costs. The consultant identified three components of fund fees and expenses: investment management fees, scheme administration, and other fees and charges (such as sponsor charges). According to the report, out of the then 1.74% FER, some 30% (0.59%) was investment management fees, more than 40% (0.75%) was scheme administration costs and the remaining 20% (0.4%) was other fees, charges and expenses.

4 *What is the FER?*

7. In addition to standardizing the presentation of fees and expenses in the scheme Fee Table to further help members compare the total fees, charges and expenses of MPF funds across schemes, the MPFA introduced a single measure, the FER, in 2007. The FER is a comparison tool that shows the total impact of fees, charges and expenses charged to an MPF fund as a percentage of the size of the fund, using the data reported in the fund's latest financial statement.

5 8. However, the FER has its limitations. First, it is only a comparison tool. It is constructed and designed to enhance the comparability of fees and expenses of MPF funds.

9. Second, the FER is a lagging figure. It is based on data from the previous financial year, so it does not reflect the latest changes in the fee level or the current fee level.

10. Third, it is not appropriate to compare the FER to the fees of retail funds or overseas pension systems.

11. As we just mentioned, the operation of MPF funds involves specific scheme administration work that retail funds do not need to do. It is therefore unfair to compare the fee levels of the two types of funds. It should also be noted that on

top of ongoing fees based on assets under management, most retail fund investments also have subscription and redemption fees related to the amount invested, but MPF funds do not.

12. It is also extremely difficult to make a meaningful comparison between the FER and the fee levels of overseas pension schemes. The first challenge is the availability of reliable data. A further difficulty is that many overseas pension systems adopt different charging structures. They are also different in system design, maturity and asset size. In some systems, for example, non-profit organizations may act as scheme administrators; in others, employers may take up or incur some of the administrative expenses. These differences make it nearly impossible to compare the FER with the fees of pension funds in overseas jurisdictions.

6 13. According to the MPFA's *Code on Disclosure for MPF Investment Funds*, the FER of an MPF fund has to be published on its Fund Fact Sheet[1]. Our online Fee
7 Comparative Platform also sets out the FER of various funds, as well as the average FER[2] of different fund types, to help members compare the FER of an individual fund with the average FER of funds of the same type.

14. The offering document of an MPF scheme is the primary source which sets out the fees and charges of the scheme, which have to be presented in a standardized Fee Table for easy comparison. The Fee Tables of schemes are also available on the MPFA's online Fee Comparative Platform. The offering document of each scheme will also be available on the MPFA's website from mid-December 2016.

8 15. In December 2011, a working paper (no.15) published by the International Organisation of Pension Supervisors (IOPS) noted that among different private pension systems in the world, Hong Kong was a pioneer in developing and using a synthetic indicator of fees (i.e. the FER) to help scheme members compare fund fees, and that the FER was regarded as an effective tool.

<u>MPFA efforts to drive fees down</u>

9 16. While the MPF System generally relies on market forces to adjust fees, the MPFA has undertaken the following measures to drive them down:

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[1] It is not necessary for MPF funds which are less than two years old to show an FER.
[2] The average FER is weighted by the funds' respective net asset value. In other words, when calculating the average FER, the FER of larger funds carries a heavier weighting.

i. Laying down requirements on fee disclosure to increase transparency, such as requiring different fee items (including joining fees and management fees) to be included in the Fee Table;

ii. Launching the Low Fee Fund List[3] to help scheme members identify funds with lower fees;

iii. Introducing the Employee Choice Arrangement to foster market competition;

iv. Closely monitoring fund fee levels and urging trustees to lower the fees if the FER of funds under a trustee is much higher than that of its peers. The MPFA will require the trustee to review the situation and consider formulating plans to reduce fees;

v. Simplifying scheme administrative work, by for example, setting up the electronic Portability Automation Services System (ePASS) and the E-Payment for MPF Transfer System, which facilitate efficient and paperless processing of MPF transfers among MPF trustees. In addition, trustees now only need to send out notices of participation to new scheme members, not membership certificates or notices of acceptance;

vi. Encouraging trustees to merge less efficient schemes and funds. From 2003 to October 2016, 36 schemes were consolidated into 14 schemes, and 168 MPF constituent funds were terminated, mainly because of scheme mergers;

vii. Implementing the Default Investment Strategy (DIS) with fee caps; and

viii. Exploring an initiative, tentatively called eMPF, to streamline MPF scheme administration by making better use of electronic platforms.

17. The MPFA is committed to assisting and encouraging trustees and service providers to lower fees. The average FER of all MPF funds has dropped 24%, from 2.06% in July 2007 (when the FER was first launched) to 1.56% in October 2016.

10 **Major findings of the report**

18. Today we are releasing a report which analyses the historical trend of the FER of MPF funds, and the relationship between the FER and various factors. The major findings are as follows:

[3] Low-fee Funds are funds with an FER≦ 1.3% or current management fees ≦ 1%

11 *The FER reduction trend is persistent and material*

19. Since July 2007, the average FER of all MPF funds has dropped significantly:

	Average FER（%）
July 2007	2.06
June 2016	1.57 （**↓24%**）

As at the end of October 2016, the average FER had dropped further to a record low of 1.56%.

12 20. As the following table shows, there was also a downward trend for the FER of all fund types.

Fund type	Average FER as of July 2007（%）	Average FER as of June 2016（%）	Reduction
Equity Fund	2.07	1.58	↓24%
Mixed Assets Fund	2.11	1.72	↓18%
Bond Fund	2.12	1.38	↓35%
Guaranteed Fund	2.55	2.08	↓18%
MPF Conservative Fund	1.48	0.69	↓53%
Overall	**2.06**	**1.57**	**↓24%**

13 21. The number of funds with an FER of 1.25% or below in the MPF market also increased substantially during this period:

	Number of funds with an FER of 1.25% or below
September 2008[4]	12
June 2016	154 （**↑12 times**）

[4] The FER data of each constituent fund was not available before September 2008.

14 *Passively managed equity funds generally reported a lower FER*

22. The report examined whether there was any relationship between the FER and fund investment style. In June 2016, the average FER of passively managed equity funds (i.e. index-tracking funds) was 0.89%, significantly lower than that of actively managed equity funds (i.e. 1.74%).

23. In terms of fee reductions, from September 2008 to June 2016, passively managed funds recorded a bigger reduction in the average FER than actively managed equity funds did.

	FER of passively managed equity funds（%）	FER of actively managed equity funds（%）
September 2008	2.02	2.34
June 2016	0.89 （**↓56%**）	1.74 （**↓26%**）

15 *No evidence showing higher FER can generate higher returns*

24. Some members may think if a fund delivers a better return, they would not mind paying more, so the report explored whether there was any relationship between the FER and past investment performance of MPF funds.

25. Correlation tests were applied to different types of MPF funds. For equity funds, the test findings showed no association between the FER and the one-, three- and five-year performance.

26. For mixed assets funds, bond funds and MPF conservative funds, the findings suggested that their one-, three- and five-year investment performance was negatively correlated with the FER (i.e. higher fees means lower returns).

27. Therefore, there is no evidence suggesting that a higher FER generates better investment performance. Members should be cautious about suggestions that they should invest in a well-performing fund without regard to fees.

Larger funds and older ones do not necessarily have lower FERs

28. We found that overall, larger funds have a higher FER than smaller funds do.

29. Correlation tests also showed that the FER of older funds generally tended to be higher than that of younger funds.

30. These findings may be explained by the introduction of funds with lower fees (e.g. index-tracking funds) in recent years. As mentioned above, the number of funds with an FER of 1.25% or below has increased twelvefold in the past eight years. As the FER of MPF funds is on a downward trend, trustees have to consider setting a lower fee level for their new products for them to be competitive.

<u>Schemes with larger fee reductions do not mean higher growth of MPF inflows</u>

31. The study also found that schemes with higher growth of contribution and benefit inflows were not necessarily the ones with larger fee reductions. At the same time, larger fee reductions in the funds of a scheme did not necessarily lead to higher growth of contribution and benefit inflows into that scheme.

16 32. This may imply that scheme members do not necessarily consider fund fees to be
the most important factor when choosing funds, schemes or trustees. We would
like to highlight that of the 400-plus MPF funds in the market, around 40% (169)
are Low-fee Funds, many of which are equity funds or mixed assets funds which
17 have relatively higher management costs. Moreover, <u>70% (about $450 billion) of
MPF assets</u> (namely the benefits in personal accounts and those derived from
employee contributions in contribution accounts) in the MPF System are portable.
We would like to remind scheme members that if they are concerned about fee
levels, there are actually plenty of Low-fee Funds for them to consider when
making investment decisions.

Introduction of fee caps and the DIS

18 33. At the Global Forum on Private Pensions, which was held in Hong Kong earlier this month, representatives from many overseas countries (like Mexico and Slovakia) pointed out that there was inertia among scheme members when managing their pensions. Despite remarkable differences in investment performance and fees, scheme members tended to keep the same investment portfolio. This may be the result of them not knowing enough about the market, or having no interest in managing their accounts. As these members do not switch funds or providers, service providers have less incentive to reduce fees.

34. Apart from increasing market transparency, simplifying the calculation of fund fees and improving public education on pension funds, IOPS members suggested that the introduction of fee caps could be a way to drive fees down.

35. The MPF System has been relying mainly on market forces to drive fees down. However, despite the 24% decrease in the average FER, fee reductions have not been fast or sharp enough. Therefore, the Government and the MPFA now propose introducing the DIS, which will have two funds with fee caps. The MPFA hopes this will help address public concern about the high fees of MPF funds.

How can the DIS help drive fees down?

36. The DIS is a ready-made investment solution using two mixed assets constituent funds – the Core Accumulation Fund (CAF) and the Age 65 Plus Fund (A65F).

19 37. Under the law, the management fees and the recurrent out-of-pocket expenses of the DIS funds are capped:
- Management fees, such as fees paid to trustees and investment managers, must not be higher than 0.75% of the fund's net asset value; and
- Recurrent out-of-pocket expenses, such as audit fees, must not be higher than 0.2% of the fund's net asset value.

38. The current average FER of MPF mixed assets funds is 1.72%, with the highest 2.1%. The FER of both the CAF and A65F will be much lower than 1.72%.

20 39. The existing fee cap levels are only the starting point. The Government and the MPFA will review the fee caps within three years after the launch of the DIS with a view to lowering the fee cap levels further.

40. We also hope that the fee caps will have a benchmarking effect, enhancing competition among MPF funds and bringing about further MPF fee reductions. In fact, since the passage of the DIS-related legislation in May this year, 40 funds have lowered their management fees by as much as 55%.

Conclusion

21 41. We would like to draw your attention to the following points:

i. Private pension systems around the world, including Hong Kong's MPF System, are facing the same challenges of how to reduce fees and provide better value to members.

ii. The FER is an important indicator, developed for comparing the total impact of fees and charges on the investment outcomes of MPF funds. However, the fees of MPF funds should not be compared with those of retail funds.

iii. The average FER is decreasing. It has fallen 24% from 2.06% in July 2007 to 1.56% in October 2016, which is a record low.

iv. Our study showed that MPF funds with a higher FER may not have better investment performance.

22 v. Fees are generally known, but a fund's investment performance is not. When two MPF funds have similar investment objectives (e.g. both are tracking the Hang Seng Index), the one that charges lower fees would likely have a better return.

vi. Forty per cent (169) of the MPF funds in the market are Low-fee Funds, and 70% ($450 billion) of MPF assets are portable. Scheme members should proactively manage their MPF accounts and consider fund fees and the FER when making investment decisions.

vii. For scheme members who are not interested in managing their MPF investment or do not wish to do so, the soon-to-be-launched DIS will provide them with a ready-made investment solution, which also has low fees.

23 42. If scheme members actively manage their MPF investment, it would bring market forces to bear on trustees. We urge scheme members to consider fund fees when making investment decisions. With the concerted efforts of scheme members and
24 the MPFA, we believe that fee levels of MPF funds will continue to fall.

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