Mandatory Provident Fund Schemes Authority
Default Investment Strategy
Press Conference
Key points

12 December 2016

Introduction

1. The Mandatory Provident Fund (MPF) System has been in operation for 16 years. The launch of the Default Investment Strategy (DIS) is another milestone and a major reform of the MPF System. For the first time, we are introducing a new investment strategy that provides scheme members with better retirement protection. With the support of legislators, the legislative process for the DIS has been completed and the DIS will be launched on 1 April 2017.

Reasons for launching the DIS

2. The DIS is being launched to address three major concerns of the public about the MPF System.

3. First, some scheme members find there are too many MPF funds in the market to make a decision, and some do not have time or do not know how to make a suitable choice. The DIS is being launched to take the effort and worry out of selecting MPF funds for these members.

4. Second, at present, the default investment arrangements (DIAs) of MPF schemes have been left to the discretion of trustees. The Mandatory Provident Fund Schemes Authority (MPFA) therefore wants to enhance the regulation of default arrangements by launching the DIS.

5. Third, by launching the DIS, we hope to take this opportunity to address

scheme members’ concerns about the high fee levels of MPF funds.

6. After making reference to the research by the Organisation of Economic Co-operation and Development (OECD), the MPFA decided to launch the DIS, which will provide scheme members with a simple strategy with fee caps that will reduce investment risk automatically as scheme members approach retirement age. The DIS will also help scheme members better manage their retirement savings over a 40-year horizon.

7. The DIS is an investment solution consisting of two mixed assets funds, the Core Accumulation Fund (CAF) and the Age 65 Plus Fund (A65F).

Purposes of the press conference

8. Today, we would like to explain the following:
   - ✓ the features of the DIS;
   - ✓ the impact of the legislative changes on scheme members when the DIS is launched on 1 April 2017; and
   - ✓ the important points scheme members need to note.

9. Today’s press conference will be divided into two parts:
   - ✓ how the MPF System operates and the features of the DIS; and
   - ✓ the impact of the launch of the DIS on scheme members.

Operation of the MPF System and the DIS

10. First, I would like to briefly explain how the MPF system operates.

11. Currently, there are 32 MPF schemes provided by 14 MPF trustees. Under these 32 schemes, there are more than 400 funds.

12. From its inception in December 2000 to September 2016, the MPF System had accumulated total assets of $655 billion. The annualized net rate of return

was 3.3%. On fees, the latest average Fund Expense Ratio (FER) of MPF funds is a record low of 1.56%.

13. Under the law, each scheme will have to offer a DIS starting from 1 April 2017.

14. Like other MPF funds, the DIS funds are managed by the investment managers appointed by trustees (not by the MPFA or the Government).

Features of the DIS

15. As mentioned, the DIS is an investment solution consisting of two funds. The DIS under each scheme has the following three features:

i. Globally diversified investment

16. There are two funds under the DIS: the CAF and A65F. Both are mixed assets funds. They are invested in a globally diversified manner, investing in different markets and in different asset classes, to reduce and diversify investment risk.

ii. Fee caps

17. The MPFA is very concerned about fund fees. In the past few years, we have introduced measures to simplify scheme administration work and have urged trustees to cut fees to improve the net return of MPF funds. The average FER of MPF funds has dropped by 24%, from 2.06% in July 2007 to 1.56% in November 2016.

18. However, the Government and the MPFA still think the fee reductions have not gone deep or fast enough. Therefore, the Government and the MPFA take this opportunity to impose fee caps on DIS funds.

19. Details of the fee caps are:
    - o the management fees must not be over 0.75% of the net asset value of the funds per year; and
    - o the recurrent out-of-pocket expenses must not be over 0.2% of the net asset value of the funds per year.

20. This is the first time for statutory fee caps to be imposed on the management fees of MPF funds in Hong Kong. The management fees level of DIS funds is also the lowest among all mixed assets funds currently available in the MPF market.

21. Scheme members must understand that the returns of the DIS funds are not guaranteed, but the amount of fees and expenses that are charged to a fund can have a significant impact on long-term investment outcome. When fees are lower, all other things being equal, the fund's net return will improve.

22. For example, an employee with a monthly income of $15,000 invests his MPF for 40 years in Fund A with an FER of 1.56% for the whole period. If the annual gross return (before fees and expenses) of his MPF remains at 5% for the whole investment period, and if there is no adjustment to his salary or MPF contributions over 40 years, and the inflation rate is zero, he can accumulate about $1.54 million after 40 years.

    However, if the same employee chooses to invest his MPF in Fund B, which is exactly the same as Fund A except that Fund B's FER is 0.95%, if the assumptions set in the above scenario remain unchanged, the benefits he can get after 40 years would be about $1.8 million.

    In other words, if he chooses to invest in Fund B, which has a lower FER, instead of Fund A, he will have about $260,000 more after 40 years.

23. This example shows how fees can affect a fund's net return. The reason for imposing fee caps on the DIS funds is to help scheme members strive for a

better net return.

24. The current fee cap levels of the DIS funds are only the starting point. Within three years after the launch of the DIS, the Government and the MPFA will review them with the aim of lowering them further.

iii. <u>Automatic reduction in investment risk as scheme members approach retirement age</u>

25. As mentioned, the DIS consists of two funds: the CAF and A65F.

26. The CAF holds about 60% of its assets in higher risk assets, which are mainly global equities, and the remaining 40% in lower risk assets, which are mainly global bonds. The A65F, on the other hand, holds only 20% of its assets in higher risk assets.

27. Once scheme members have their MPF invested according to the DIS, the benefits they accumulate at or before age 49 will be fully invested in the CAF.

28. After scheme members reach the age of 50, trustees will automatically adjust their portfolio every year, reducing their holding in the CAF and increasing their holding in the A65F. When scheme members reach the age of 64, all their MPF benefits will be held in the A65F.

"A Product for All"

29. If scheme members find the DIS or the funds under the DIS suit their needs, they can choose to invest their MPF according to the DIS, or in one or both funds under the DIS. Therefore, the DIS can be called "A Product for All", as it can be chosen by all scheme members.

Impact on scheme members after the DIS is launched on 1 April 2017

30. Currently, the MPF System has 9.1 million MPF accounts, held by 4.1 million scheme members. Among the 9.1 million accounts, about 3.8 million are contribution accounts and 5.3 million are personal accounts. Most of the personal accounts are created automatically when scheme members do not actively manage their contribution accounts after leaving their jobs.

31. The launch of the DIS will affect all the 9.1 million accounts under the MPF System.

32. There are four main points about the impact of the DIS on the 9.1 million accounts that scheme members should take note:

33. First, after the new law takes effect on 1 April 2017, if scheme members do not provide their trustees with investment instructions, all new MPF benefits (whether they are put into accounts set up before or after 1 April 2017) will be invested according to the DIS.

34. Second, if scheme members do not provide trustees with any investment instructions, all benefits accrued before 1 April 2017 which are currently in the default investment arrangement (DIA) of each MPF scheme will, in general, be invested according to the DIS instead of the DIA. The latest information provided by trustees shows that there are about 700,000 such accounts.

35. From April to September 2017, trustees will issue a DIS Re-investment Notice (DRN) to all of these account holders.

    Scheme members can choose to opt out of the DIS before the deadline (generally within 42 days after the date of the issuance of the DRN). We will hold another press conference explaining the details of the transitional arrangement in March 2017.

36. Third, there is a special case that scheme members should take note of. If scheme members do not do anything about their MPF accounts after leaving their jobs, the MPF benefits accumulated in their contribution accounts will, as required by law, be transferred to their personal accounts. The investment arrangement of these accrued MPF benefits will remain unchanged.

37. However, since no investment instructions have been given on how to handle future benefits, if there are new MPF benefits transferred to these personal accounts, they will be invested according to the DIS after 1 April.

38. To ensure that their MPF benefits are invested according to their wishes when the new law becomes effective, scheme members who have changed jobs should contact their trustees to confirm their investment mandates (for both accrued and future benefits) and to fully understand the impact of the launch of the DIS on their accounts.

39. Fourth, scheme members will have more investment choices after the launch of the DIS. They can choose to invest their MPF:
   - ✓ according to the DIS; or
   - ✓ in the CAF; or
   - ✓ in the A65F.

DIS Pre-implementation Notice (DPN)

40. Starting from today (12 December) to the end of January 2017, trustees will send DIS Pre-implementation Notices (DPN) to all 9.1 million account holders in batches. To help scheme members identify DIS-related documents, there will be a DIS icon on the envelopes carrying these DPNs.

41. As the trustees will send each account holder a DPN, scheme members holding three accounts, for example, will receive three DPNs.

42. The DPN is an important document carrying essential information, including:

- ✓ an explanation of the DIS;
- ✓ the features of DIS funds;
- ✓ the possible impact of the new law on MPF accounts; and
- ✓ the amended governing rules.

43. Even though the DPNs look alike, scheme members should read the DPNs of the different MPF schemes they are enrolled in, as the governing rules may differ.

44. If scheme members do not receive DPNs from their trustees by the end of January 2017, they should contact their trustees immediately. And if they have any questions, they should enquire with their trustees.

45. The MPFA has also produced a DIS flyer which will be sent together with the 9.1 million DPNs to help scheme members understand the key legislative changes and features of the DIS.

46. The DPNs and the most up-to-date offering documents have been uploaded on the respective trustees' websites today (12 December). The MPFA website also provides hyperlinks to the related documents.

47. Scheme members, therefore, should take action now:
    - they should first ensure that their trustees have their current correspondence address;
    - after receiving the DPN, they should read it carefully to understand the features of the DIS and its impact on them;
    - if they have any problems concerning their accounts or investment instructions, they should contact their trustees; and
    - if they find the DIS or one or both funds under the DIS suit their needs, they could give their trustees such investment instructions when the DIS is launched next year.

48. The hotline / call centres of the MPFA and all trustees are all ready to handle

public enquiries.

Publicity and education campaign

49. The launch of the DIS is a milestone in the MPF System, which will affect all 9.1 million MPF accounts under the System. To generate awareness of the DIS and make scheme members better understand the impact of the legislative changes to their MPF accounts, the MPFA will kick off a series of publicity and education programmes on the DIS today.

50. We will launch the following in phases:
- ✓ TV Announcement in the Public Interest (API);
- ✓ Radio API;
- ✓ Newspaper advertisements;
- ✓ Website advertisements;
- ✓ Bus-body advertisements; and
- ✓ MTR station advertisements.

51. At the same time, we will produce:
- ✓ leaflets;
- ✓ comic strips; and
- ✓ short videos

to explain to the public the details of the DIS.

52. We will also participate in various district activities and hold briefing sessions for different sectors (including District Councils and labour unions, employers and human resources practitioners) to introduce the DIS and explain its impact on scheme members.

53. The TV and Radio API just mentioned will be rolled out this evening. We are pleased to share the TV API with all of you now.

Conclusion

54. Reforms to the MPF System need the active participation of three parties – the

MPFA, trustees and scheme members.

- ✓ The MPFA will soon implement the DIS;
- ✓ Trustees will as required by law launch their DIS funds and make the necessary arrangements;
- ✓ It is time for scheme members to actively manage their MPF accounts and investments.

55. As the launch of the DIS will affect up to 9.1 million accounts, the DIS can be called “A Product for All”. Its launch is worthy of everyone’s attention.

56. Of the $655 billion assets under the MPF System, the 700,000 accounts in existing default investment arrangements (DIAs) have about $13 billion in assets. These account holders have never provided investment instructions to their trustees.

    However, there are in fact many members who actively manage their retirement investment. The total amount of voluntary contributions increased from $3.254 billion in 2006 to $15.371 billion in 2015, a fivefold increase in 10 years. This is an indicator of the growing confidence of both employees and employers in the MPF System.

57. Scheme members are the “master” of their own MPF accounts, and their MPF is their hard-earned money. All scheme members should take the opportunity presented by the launch of the DIS to check the following:
    - ✓ the number of accounts they are holding;
    - ✓ the trustees and schemes their MPF accounts are with;
    - ✓ the fund choices they have made; and
    - ✓ the fee levels and performance of their chosen funds.

    They should also review their portfolios and make adjustments if necessary.

58. If they have changed their correspondence address, or if they have not received letters from their trustees for a while, they should contact their

trustees immediately and provide them with their up-to-date address so that they will receive all notices sent by their trustees in a timely manner.

59. Scheme members should also spend some time carefully reading all the letters and notices sent by their trustees in order to learn more about the new products. They should also understand the impact of the legislative changes on their MPF accounts. If they receive more than one DPN, that means they have more than one account and should consider consolidating them.

60. I would like to remind scheme members that it’s your MPF; it’s your choice. Take control of your MPF!

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