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Fees and Value for Money in Private Pension Systems Hong Kong's experience

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1. Introduction



Objective and Salient Features of MPF

Objective

- Help the employed population save for retirement

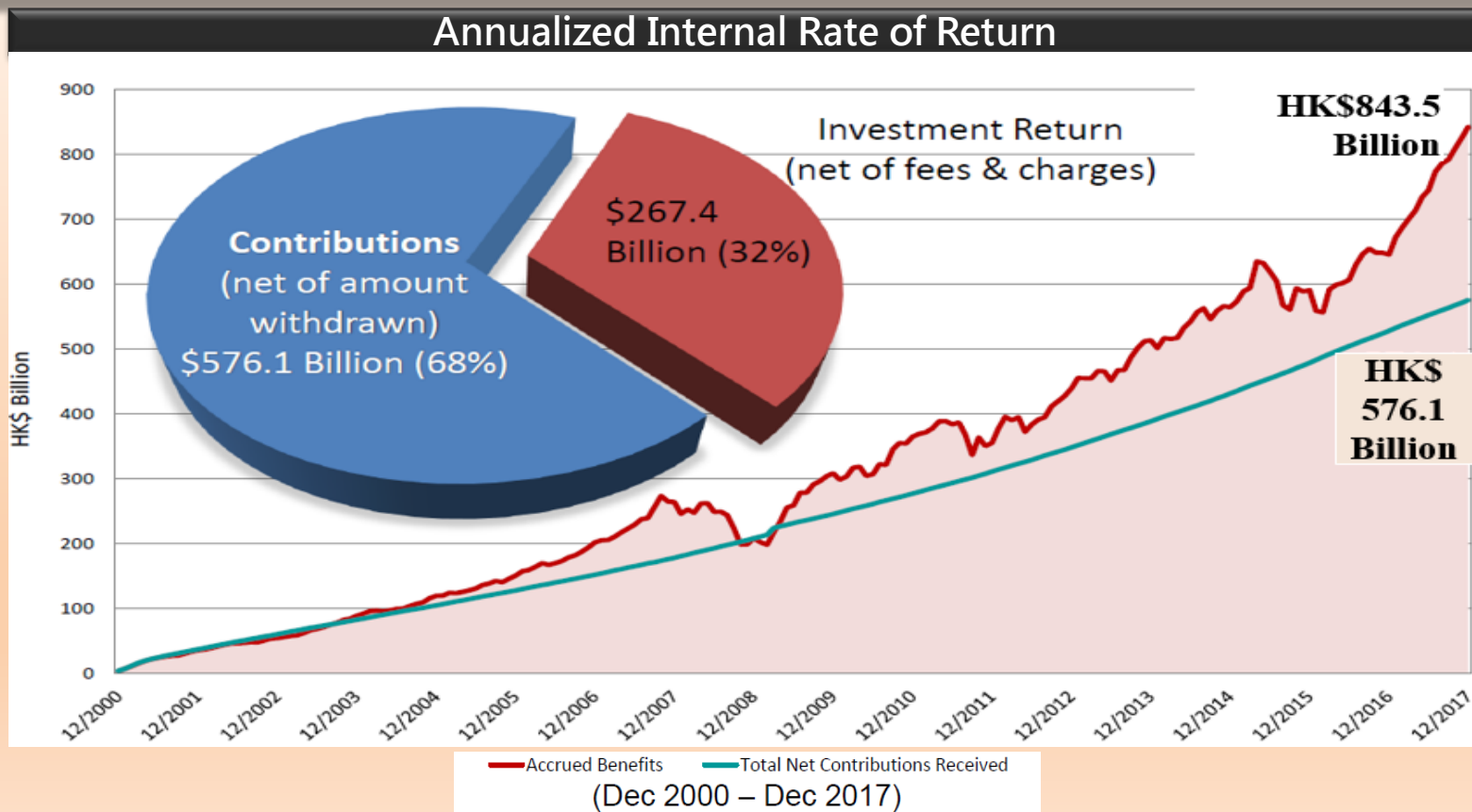
Salient Features

- Mandatory and employment-based system
- Management by private entities
- Defined-contribution, individual account system
- Individual savings as the source of financing
- As a second pillar system, the MPF System is intended to provide **basic retirement protection** for the **employed population** of HK
- Pillars are complementary



MPF Benefits and Net Contributions

(Dec 2000 to Dec 2017)





2. Value for Money



Offering Better Value for Money

- Good governance of MPF trustees is crucial to deliver better value for money to scheme members.
- MPF Trustees should strive for better value for money to scheme members
 - Develop a strong discipline to review regularly the fee level, the services offered, the range of MPF funds and their suitability as part of the retirement solutions to MPF members
 - Develop clear benchmark to measure its value for money proposition for MPF scheme members
 - Challenge the justification for
 - certain fee formulation basis e.g. flat fee vs AUM based
 - use of actively managed vs passively managed funds
 - Review the design of default fund arrangement



Fees

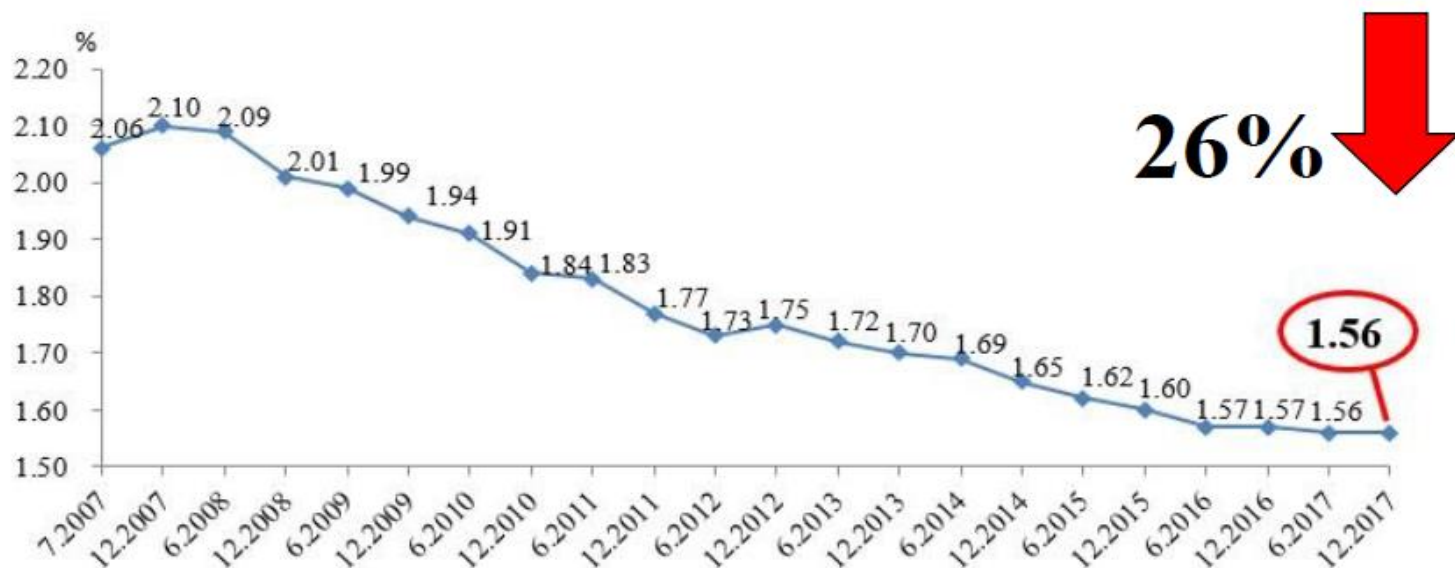
- Fees matter!
- Fees are just one component of net return – but they are known in advance and are controllable
- 1st step was to help members understand what they were paying (disclosure, FER)
- 2nd step was to help market forces work better in setting reasonable price levels
- Other steps - help system be more cost effective and introduce price controls where necessary



Fees - trend

- From Dec 2007 to Dec 2017: Average FER dropped by 26%

Fund Expense Ratio (FER)





3. Default Investment Strategy (DIS)



Development of the DIS - Objectives

Why develop this reform?

- Inconsistency of approaches across MPF schemes
- Post GFC – “good defaults” more important
- Relieve members of the “burden” of choice Moving disengaged members to a better long-term strategy
- A vehicle for addressing “high fees”



Development of the DIS - Features

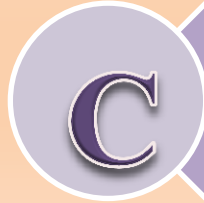
3 key features



Globally diversified
investment



Automatic reduction in
investment risk as members
approach retirement age



Fee caps



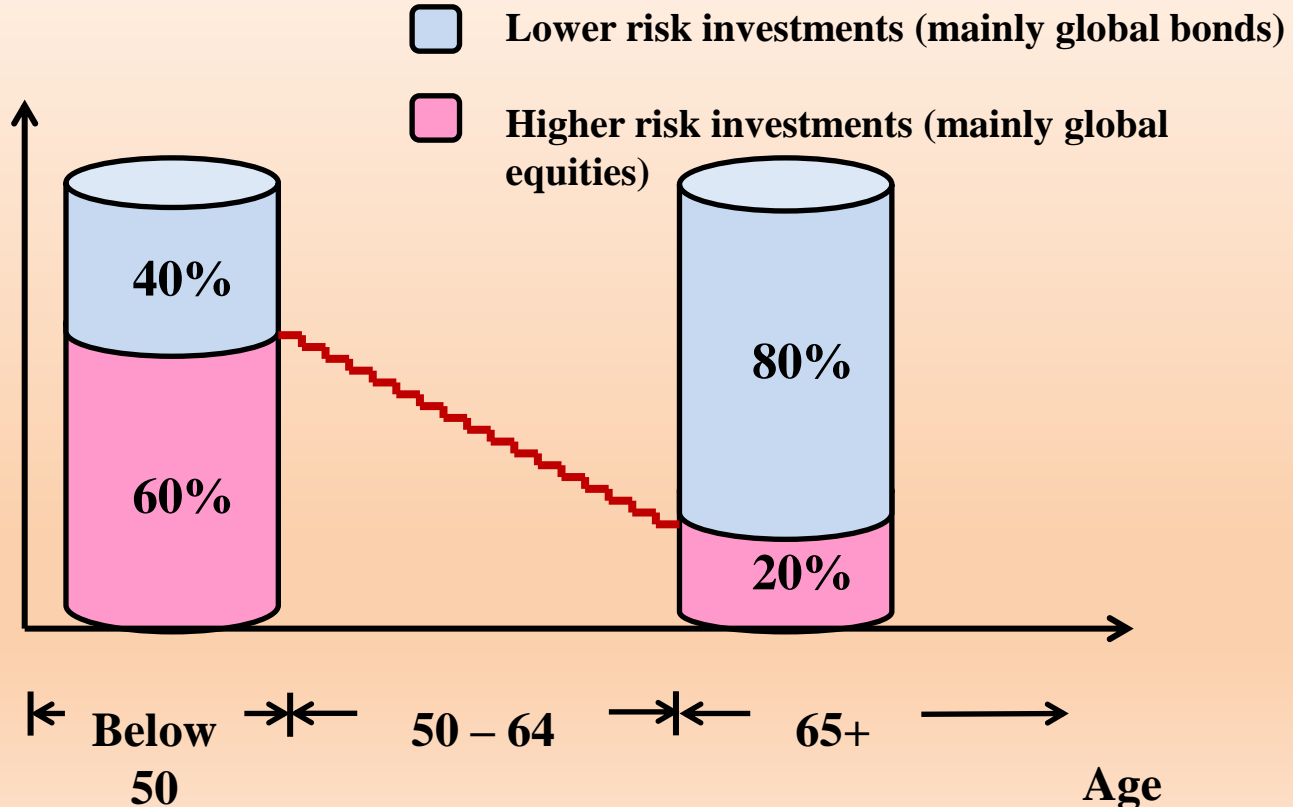
Key Features – Investment approach

Conclusions on design issues

- Based on analysis, OECD modelling and observed practice/consensus
- Diversify across major asset classes
- Take on quite a bit of risk - 50%-60% equity
- Reduce risk near retirement – but not too early (50 y.o.)
- No basis for complex glide paths
- Terminal equity exposure around 20%



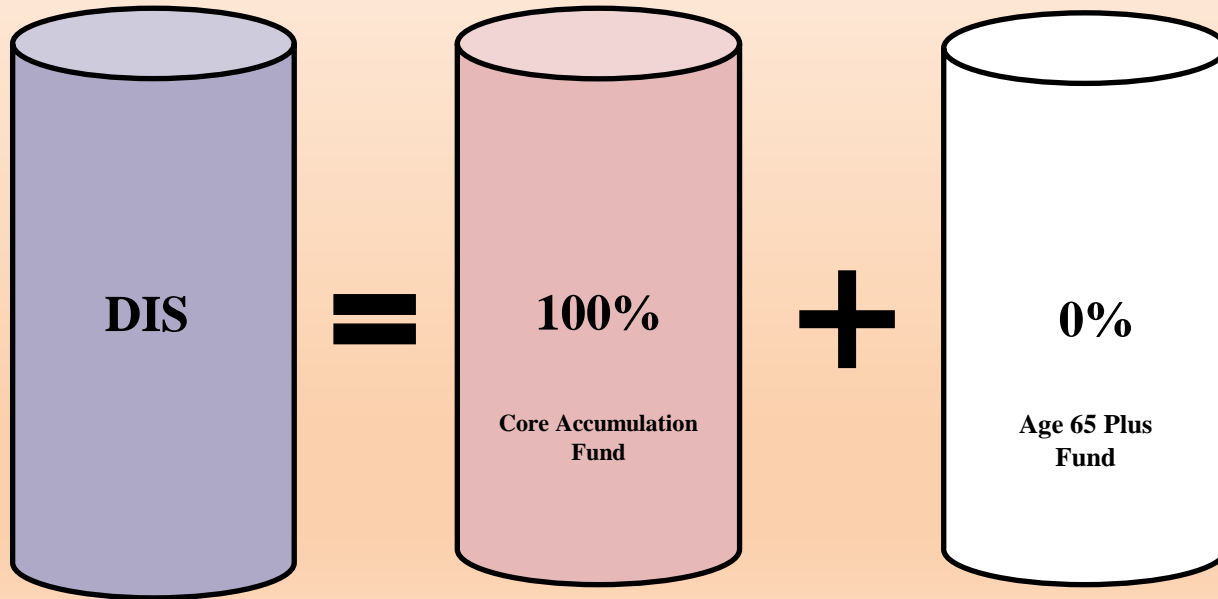
Key Features – Risk Reduction





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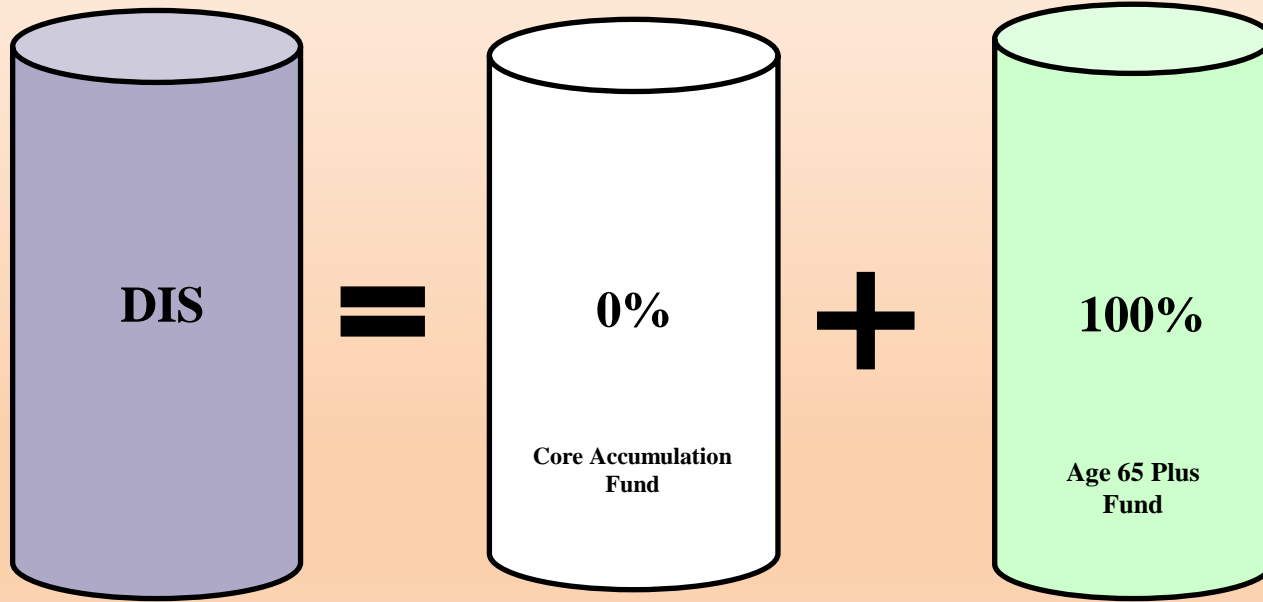
Below 50





Key Features – Risk Reduction

Age 65+

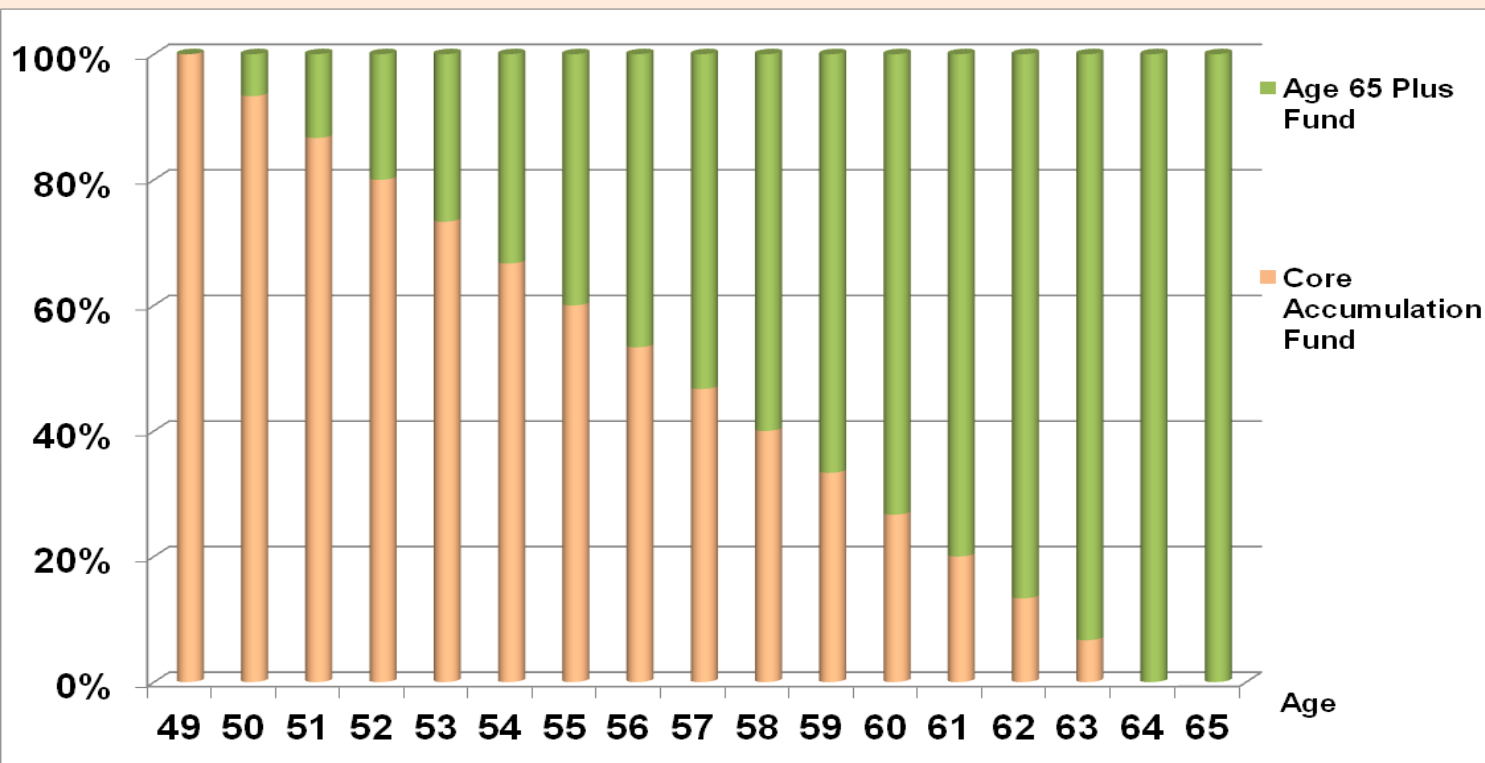


Age 50 – 65 move progressively from CAF to A65F



Key Features – Risk Reduction

Investment Ratio





Key Features – Fee Caps

Management fees
≤0.75% of the fund's
net asset value per year



Recurrent out-of-pocket expenses
≤0.2% of the fund's
net asset value per year



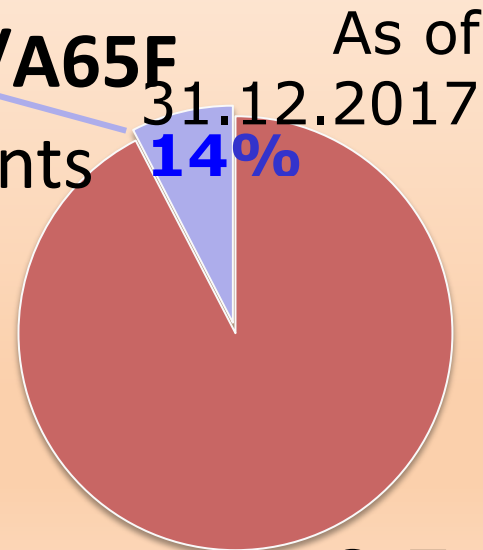


Some Observations since Launch of DIS

- DIS launched on 1 April 2017

Investment in DIS or CAF/A65F

- about 1,376,000 accounts
- ~HK\$22.3 billion



Total no. of accounts: **9.5**



Some Observations since Launch of DIS

- Fee reduction of MPF funds
 - Over 1/4 of all MPF funds have reduced /proposed to reduce fees since launch of DIS in April 2017
- MPF scheme/fund consolidation/restructuring
 - Consolidation of smaller sized funds expected to increase cost efficiency
 - More use of passively managed funds



4. Way Forward



Way Forward

- Review the level of fee caps of DIS
- Enhance transparency of fees and performance
- Further market consolidation/restructuring
- Increase cost efficiency through electronic means - eMPF