

The evolving MPF system: an objective assessment

Study on fees, fund options and
fund performance in the Hong Kong Mandatory Provident Fund sector

Presentation of key study findings

Commissioned by the Joint Industry Group



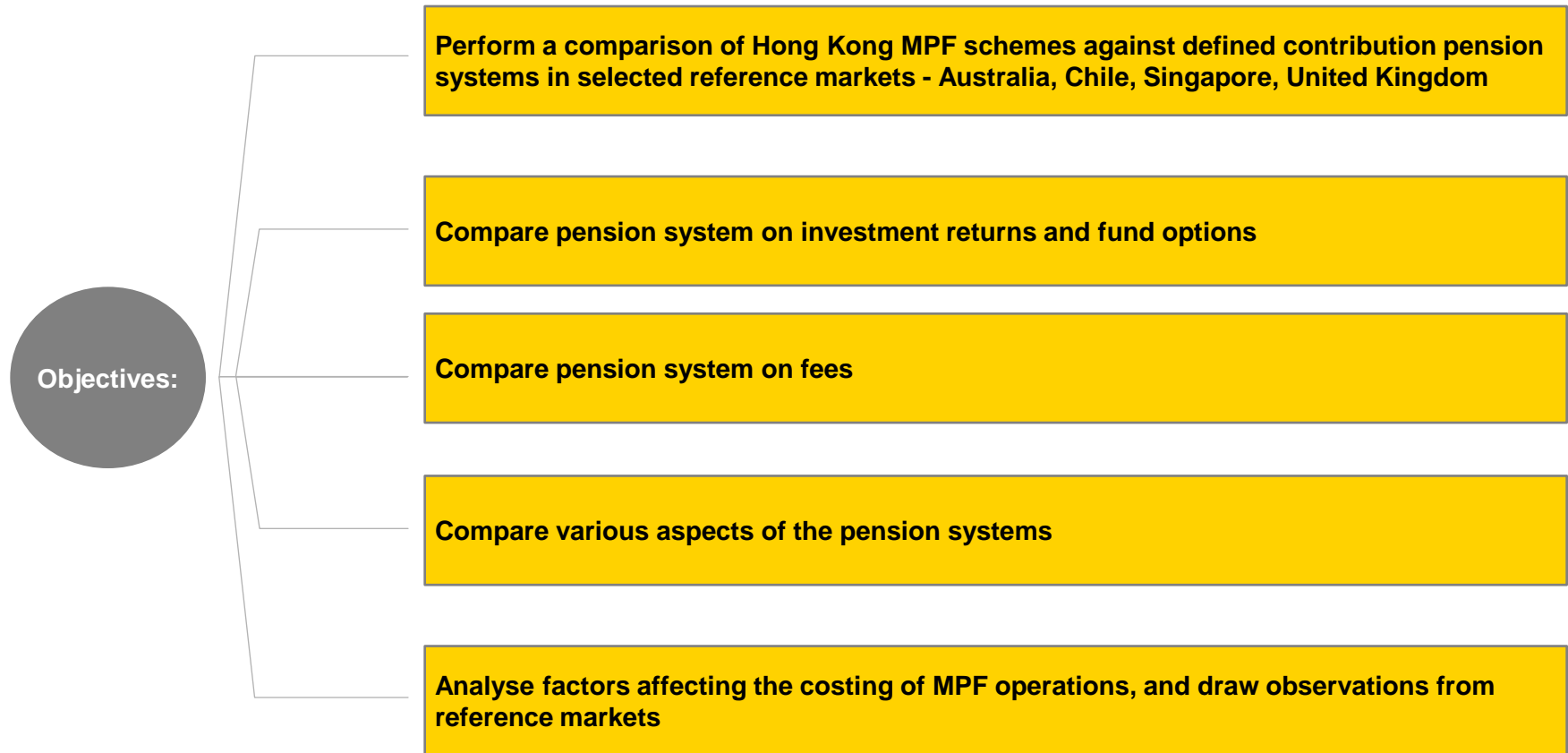
May 2012



Purpose of this report

We use publicly available data

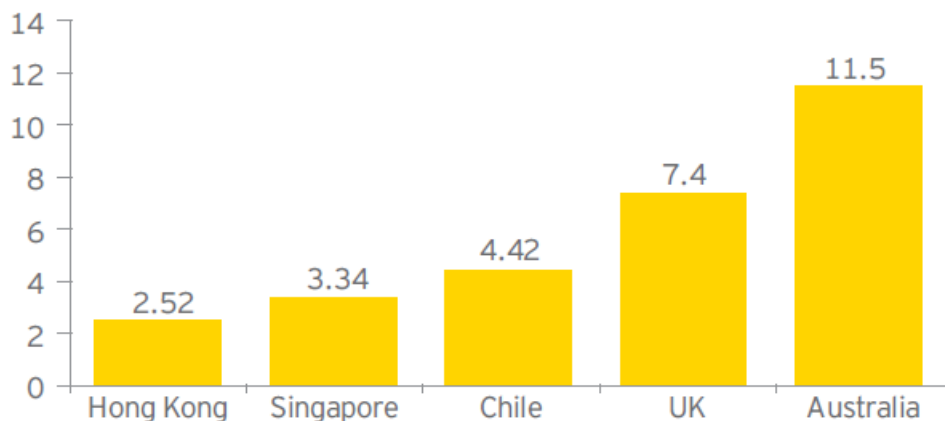
This report aims to provide better understanding of the Hong Kong MPF system's investment performance, management fees charged to members and fund options, via comparison to selected reference market / pension systems.



MPF market context (2010 data)

Limited benefits from economies of scale impact total management fees and operating cost

Number of contributors by Reference System in millions



AUM size of Reference Systems (HKD)



Aspects to consider

- ▶ The MPF system is small compared to the reference systems
- ▶ This has fundamental implications on fees

Five key messages from our report

The MPF system

- ▶ The MPF system has made considerable progress in its 11 years of existence which is a short timeframe for a pension system that can take up to 40 years to mature

Investment performance

- ▶ Assets performed comparatively well during adverse times based on members' investment choices which are overweight in high risk and low risk categories with a strong home bias

Fees

- ▶ Average management fees show grounds for optimism, particularly when assessed against the small scale in terms of AUM and number of contributing members as well as the comparatively young existence of the system

Efficiency and effectiveness

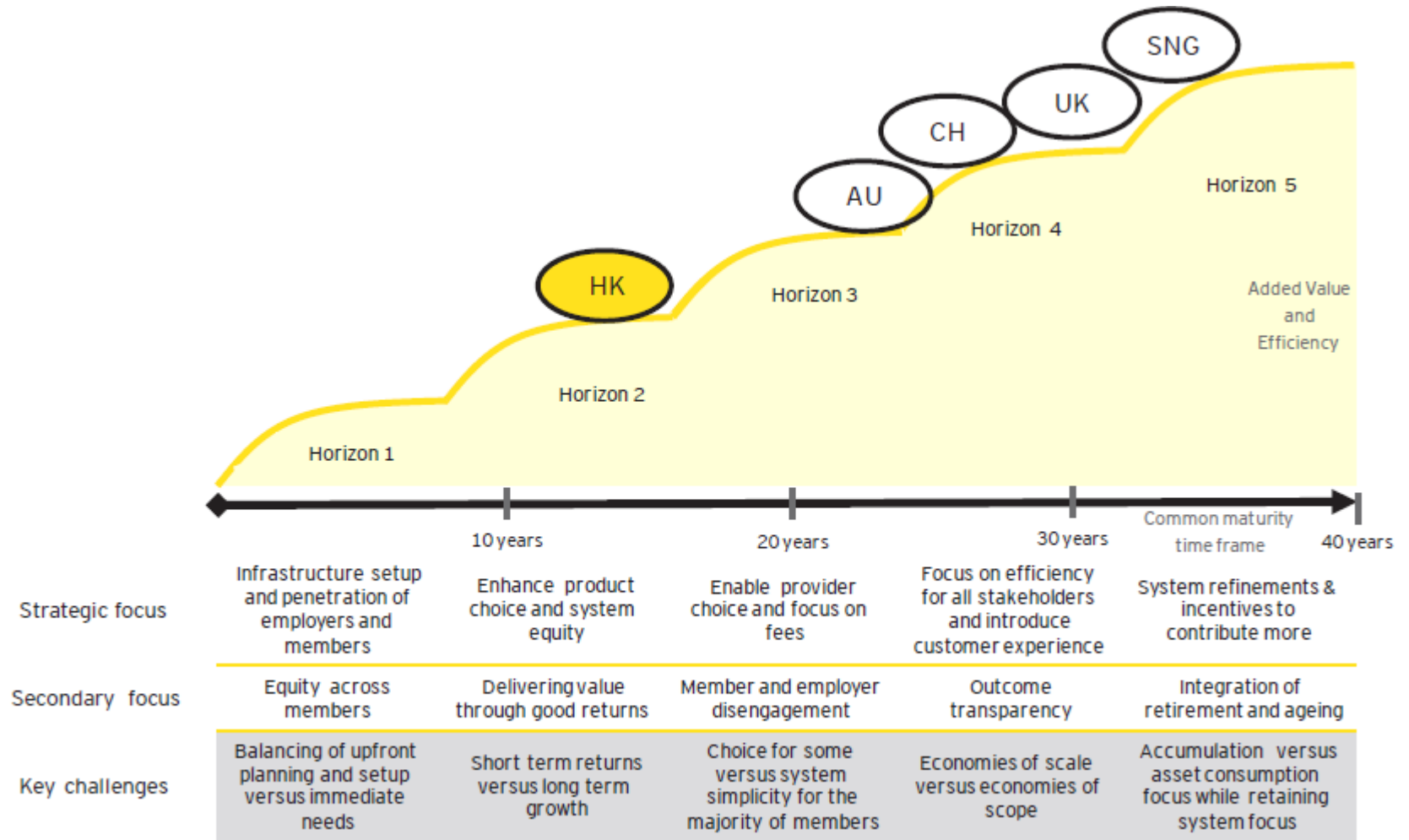
- ▶ Like most evolving pension systems, the MPF system offers opportunities for refinement to adapt to maturity requirements and market changes

The way forward

- ▶ The MPF industry can build on the strengths and advantages to achieve the next level of pension system maturity

Maturity of different reference pension systems

Five development horizons of pension fund maturity



The MPF industry is adding value

A sample of services delivered every day to run the MPF system (2010 data)

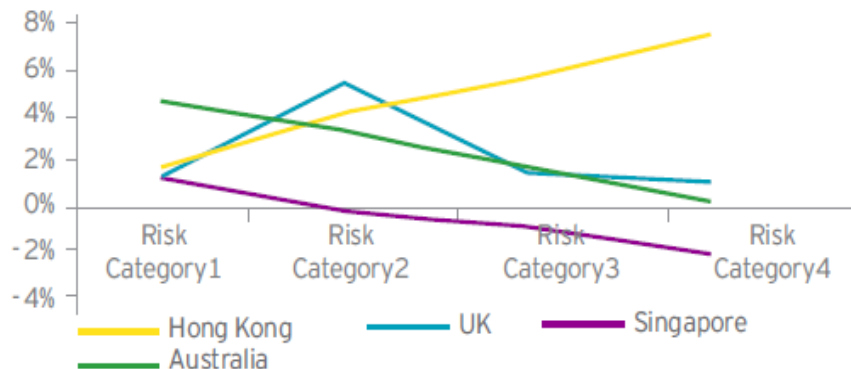
Members may not always see these necessary aspects

- ▶ Engaging with 2.5 million Hong Kong citizens to make contribution
- ▶ Engaging and enrolling 244,000 employers – 98% with less than 50 employees - plus 260,000 self-employed, and servicing them on a monthly basis
- ▶ Handling about 30 million contribution transactions per annum
- ▶ Manually handling a large volume of transactions in paper and cheques, which are prone to errors
- ▶ Managing millions of employer and member queries to educate and answer questions including regarding employer contribution errors, investment switching and account transfers
- ▶ Reviewing and processing complex employer LSP/SP off-setting cases
- ▶ Maintaining about 7 million MPF accounts with up to six sub-accounts
- ▶ Working with a large proportion of employers per month who fail to comply with paying member contributions on time or who request detailed management reports to support their records
- ▶ Establishing and operating 19 trustees, 41 schemes and more than 400 investment funds as legal entities with necessary operating infrastructure
- ▶ Providing free software solutions to assist employers fulfil their MPF obligations
- ▶ Responding to member demand and enhance services including providing free online solutions for members to view their account balances and make investment switches

Most members chose their asset allocation (2010 data)

MPF members are overweight in high risk and low risk investments which impact volatility and returns

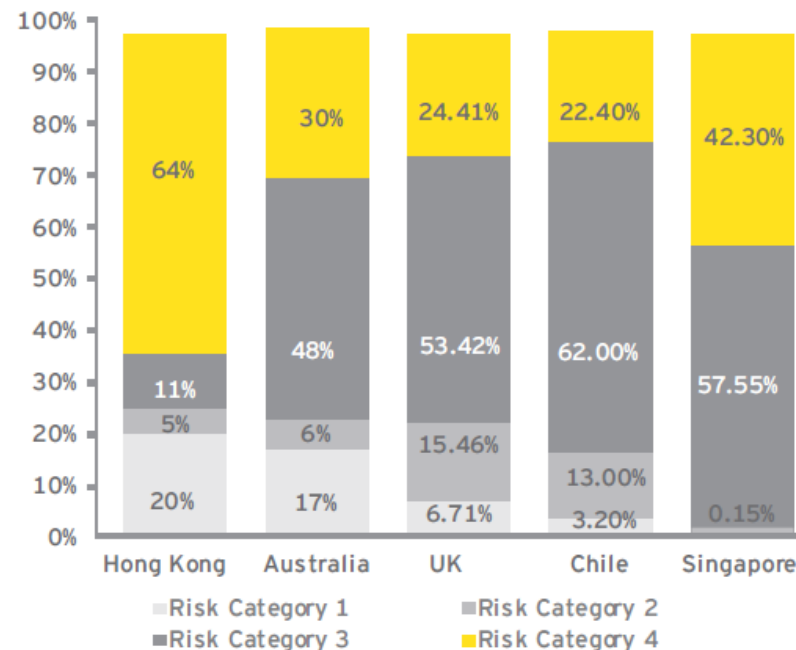
Relationship between risk category and investment returns (%) over five years



Risk category 1: low risk

Risk category 4: high risk

% of assets in each risk category by Reference System



Aspects to consider

- ▶ MPF is a long term retirement savings system
- ▶ A long term performance horizon is vital

Management fees have three key components (2010 data)

Each component has different cost and efficiency drivers that need consideration

Aspects to consider

- ▶ The MPF system is the smallest of its peers and has limited access to benefits from economies of scale in administration
- ▶ If we convert the administration cost as percentage of AUM in HKD terms, MPF members pay as much for operating the system as larger peers
- ▶ MPF members pay little for distribution “effort” which can accumulate to up to 1% of AUM p.a. in other reference systems

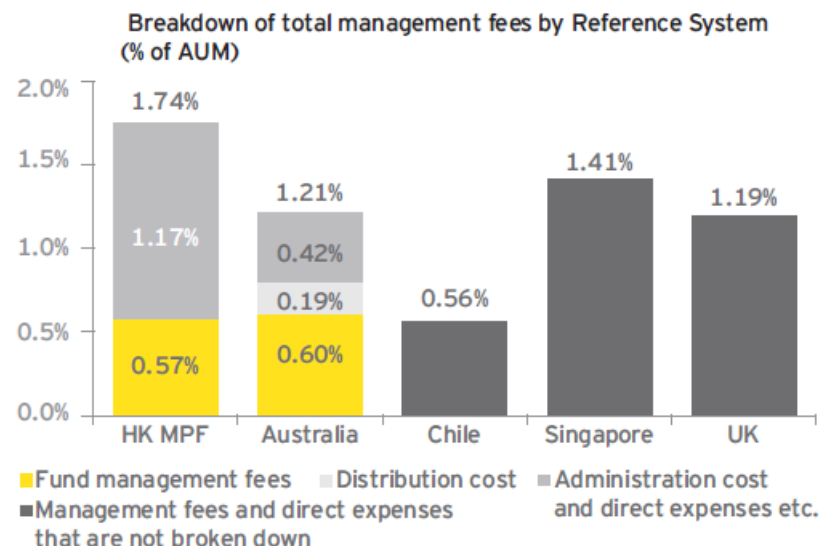


Figure 32: Indicative fees for trustee and administration p.a.

	as % of AUM	In HKD per relevant member
MPF system	1.08%	1,577
Australia	0.42%	1,760

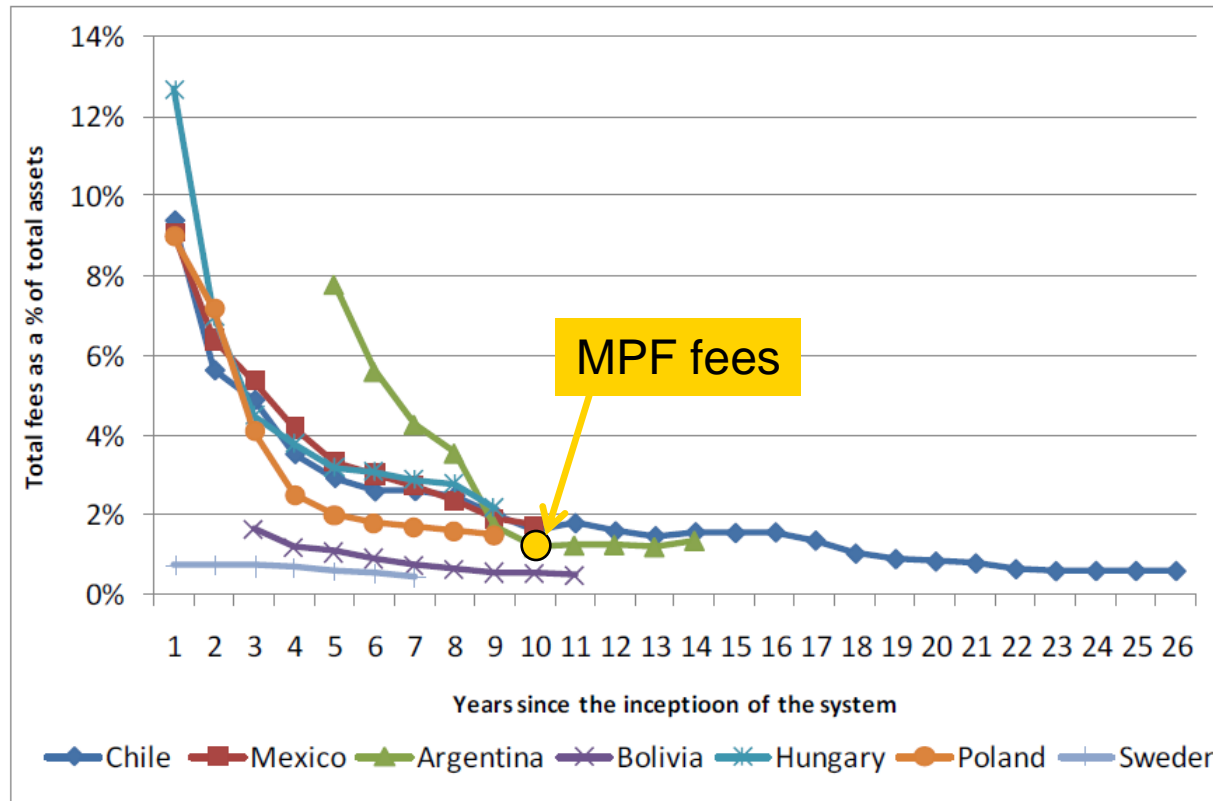
Indication only; 1.08% is the operating fee of 1.17% less direct expenses of 0.09%

Exchange rate used: 6.65

International evolution of management fees

MPF fees evolve as expected compared to peers

Figure 3: Evolution of total fees as a share of total assets since the inception of each system (%)



Source: - Latin American countries: AIOS, 2007, Poland: Insurance and Pensions Supervisory Authority, 2007, Hungary: Impavido and Rocha, 2006, Sweden: Premium Pension Authority, 2007.

Source: OECD 2008 (extract)– We included MPF as Hong Kong is not mentioned in literature

Five key recommendations

Evolving to the next level of MPF system maturity

Communication

- ▶ Communicate the MPF journey and benefits to members to enhance understanding of MPF as a long term retirement savings system

Scale and efficiency

- ▶ Pursue scale and efficiency to reduce cost and fees as a percentage of AUM

Clarity and vision

- ▶ Improve MPF system clarity and vision including guidance around investment beliefs to better align different interpretations

Financial advice and decision support

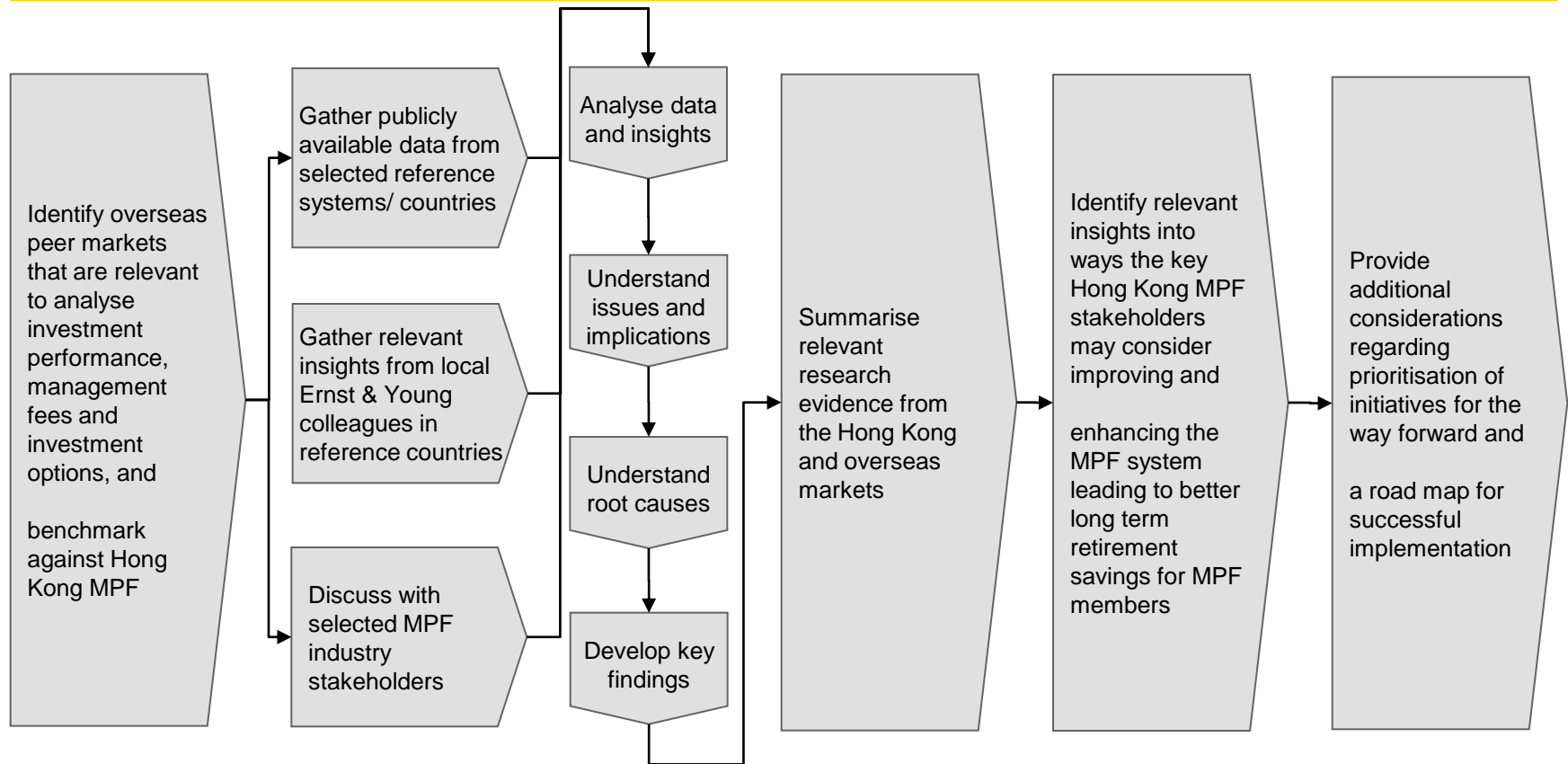
- ▶ Improve personal financial advice and decision support to improve MPF members' decision making that will lead to maximising long term retirement savings

Regulatory refinements

- ▶ Implement operational refinements of some regulatory aspects that have emerged over the past 11 years in order to streamline industry operation

Our approach

This flow chart outlines the approach and key steps we undertook to prepare this report



Key consideration

Data availability and data comparability challenges limit the accuracy and completeness of publicly available evidence in several areas of our research. We therefore complemented the research in some areas with limited additional research we conducted, discussions with industry executives and our professional judgement to support our themes. We indicate the different levels of “strength” of corroborating evidence supporting our research conclusions.

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The observations and comments have been derived from high-level information and samples taken from each individual country. The observations and conclusions drawn by this review on fees and performance will not be a wholly accurate reflection of the pension system in each individual country.

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Data such as total assets under management, portfolio composition, investment returns, and commissions and fees charged were collected from regulators and pension service providers.

Data on investment returns are only available on an annual basis and the available data on commissions and fees is limited. Except for Australia, supervisory entities do not provide breakdown of fees at a granular level.

Data on investment returns was based on aggregate performance of a group of pension funds at the end of a period using data from funds existing as at the period end. Funds that did not survive over the period analysed were not included

The approach to reporting investment returns varies across countries. Chile has detailed regulations defining the methodology for calculating returns. Definitions of and criteria for calculating and reporting total return in Australia, Hong Kong, Singapore and the United Kingdom are stated in the investment policy established by the asset managers

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