Mandatory Provident Fund System and Retirement Protection of Hong Kong, China

Dr David Wong Yau-kar, GBS, JP
Chairman
Mandatory Provident Fund Schemes Authority
25 October 2018
# Public and Private Components of Retirement Protection in Hong Kong, China

<table>
<thead>
<tr>
<th>Pillar</th>
<th>World Bank</th>
<th>Retirement Protection in Hong Kong</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>Non-contributory, publicly financed and managed system</td>
<td>Comprehensive Social Security Assistance (CSSA) Scheme and Social Security Allowance (SSA) Scheme</td>
</tr>
<tr>
<td>1</td>
<td>Mandatory, contributory and publicly managed system</td>
<td>Nil</td>
</tr>
<tr>
<td>2</td>
<td>Mandatory, privately managed, fully funded contribution system</td>
<td><strong>Mandatory Provident Fund (MPF) System</strong> Occupational retirement schemes (including those for civil servants and teachers)</td>
</tr>
<tr>
<td>3</td>
<td>Voluntary savings</td>
<td>Voluntary contributions to MPF; Retirement savings-related insurance</td>
</tr>
<tr>
<td>4</td>
<td>Informal support, other formal social programmes, and other individual assets</td>
<td>Public housing &amp; healthcare; Annuity; Residential and community care services; Public transport fare concession; Community Care Fund’s elderly programmes; Family support and self-owned properties</td>
</tr>
</tbody>
</table>
Public Components: Government’s Subsidized Benefits for the Elderly

- Elderly receiving cash allowance mostly based on needs; most public services available for all elderly

<table>
<thead>
<tr>
<th>Cash assistance (CSSA &amp; SSA e.g. old age allowance, old age living allowance)</th>
<th>$2 transport fare concession</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public housing &amp; residential homes for elderly</td>
<td>Home/ community care services</td>
</tr>
<tr>
<td>Public healthcare; Elderly healthcare voucher</td>
<td>Community Care Fund’s elderly programmes</td>
</tr>
</tbody>
</table>

Reference: Chief Secretary for Administration’s Office (2017), Poverty Alleviation and Retirement Protection: Progress and Vision.
Public Components: Long-term Fiscal Pressures on the Government

- Recurrent social welfare and health expenditure by the Government (assume no service enhancement)

References:
Private Component: MPF System

- Launched in December 2000
- Designed to supplement other pillars
- Availability of MPF:
  - Reduces the risk of over-reliance on the public components of retirement protection; and
  - Reduces the fiscal pressures on those public components
MPF System: Key Features

- Mandatory participation (except for exempt persons)
- Privately managed (investments not government managed)
- Managed under trust
  - savings protected from employer insolvency
- Employment based
- Fully funded
  - financially sustainable (not dependent on government financial situation)
- Defined contribution (DC)
- Trustees/schemes chosen by employers*; funds chosen by employees
- Decentralised administration

* Under the Employee Choice Arrangement, employees have the right to transfer part of their accrued benefits to a scheme of their choice.
Financial Inclusion Brought about by MPF

- Help the workforce develop investment discipline
- Enable individuals with only small sums to invest in quality products
  - different markets and diversified portfolios
  - stringently regulated financial products managed by major financial institutions
- Enhance financial literacy & self-preparation for retirement
  - scheme members acquire basic investment knowledge by managing their MPF accounts
  - may apply their accumulated knowledge in managing and growing their other investments
How Does MPF Contribute to Retirement Protection?

World Bank’s Outcome-Based Assessment Framework

<table>
<thead>
<tr>
<th>Outcomes</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coverage</td>
<td>Maximizing the participation of the working-age population in private pension schemes</td>
</tr>
<tr>
<td>Sustainability</td>
<td>Ensuring that the promised retirement income will be delivered</td>
</tr>
<tr>
<td>Security</td>
<td>Minimizing the risk of loss or misappropriation of pension assets before they are withdrawn by members</td>
</tr>
<tr>
<td>Adequacy</td>
<td>Ensuring people accumulate retirement benefits that could protect them from poverty; allow them to share in increased prosperity; and protect them from a severe drop in living standards at retirement</td>
</tr>
</tbody>
</table>
### Performance of the MPF System

<table>
<thead>
<tr>
<th>Outcomes</th>
<th>Performance of the MPF System</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Coverage</strong></td>
<td>• Very high enrolment rate (100% for both employers and employees)</td>
</tr>
<tr>
<td><strong>Sustainability</strong></td>
<td>• Sustainable by design (mandatory, privately managed, fully funded and DC schemes)</td>
</tr>
<tr>
<td><strong>Security</strong></td>
<td>• Safeguarded by the sound legal and financial systems as well as regulatory and supervisory regime of MPF</td>
</tr>
<tr>
<td><strong>Adequacy</strong></td>
<td>• Only serves as one of HK’s retirement protection pillars</td>
</tr>
<tr>
<td></td>
<td>• Public concerns about being insufficient for retirement</td>
</tr>
<tr>
<td><strong>Efficiency</strong></td>
<td>• Strive for greater efficiency and lower costs of the MPF System</td>
</tr>
<tr>
<td></td>
<td>• Public concerns about fees and returns</td>
</tr>
</tbody>
</table>
Adequacy – Strengths of MPF

- Mandatory participation by workforce (i.e. high coverage)

- Provision of basic retirement protection
  - mandatory contribution: 5% from employer and 5% from employee
  - moderate contribution rate: allow scheme members flexibility to save through other vehicles

- Mandatory contributions keeping up with income changes
  - periodic review of minimum and maximum levels of relevant income
Adequacy – Challenges

- Raising the mandatory contribution rate and maximum level of relevant income
  - Public concern about depriving the right of scheme members to make other personal saving/investment
  - Need to build up social consensus and distill greater confidence in MPF

- Market volatility posing challenges to MPF as a long term investment
  - High equity exposure due to scheme members’ preferences
Adequacy – Initiatives/Reforms

- Encourage voluntary contributions
  - Tax concession for employees to make voluntary contributions
  - Education on retirement planning

- Build up stronger public trust in MPF
  - Engagement with different stakeholders regarding the statutory review of the adjustment of maximum relevant income level
  - Improving the cost efficiency of MPF

- Introduce Default Investment Strategy
  - A retirement solution balancing the long term trade-offs between risk and return
Efficiency – Strengths of MPF

- Investment markets in Hong Kong
  - Very robust financial system
  - Ease of access to overseas markets

- Hong Kong as an international financial centre
  - Home to major banking, insurance and asset management institutions

- MPF as a privately managed system
  - Allow service providers to compete for better services and prices
Efficiency – Challenges

- Scheme administration
  - Small, irregular amounts of monthly contributions per contribution account
  - Millions of transactions yearly, many involve some degree of paper-based or manual processing

- Sub-optimal outcomes, especially high fees, due to certain market inefficiencies
  - Supply side – unable to thoroughly capitalize on the benefits of economies of scale
  - Demand side – absence of strong competitive pressure on prices
Efficiency – Initiatives/Reforms

- Default Investment Strategy (with fee cap)
- Low fee fund initiative
- Consolidation of schemes
- Disclosure and transparency
- Member education
- eMPF (a centralized electronic infrastructure)
- Governance of trustees
Concluding Remarks

- Continuous refinements needed to live up to public expectations
- Around 85% of working population now covered by retirement schemes (before MPF: only 1/3)
- Accumulated HK$856 billion since inception as at Aug 2018 (compared to Hong Kong’s fiscal reserves of HK$1,060.5 billion)
- Out of HK$856 billion, 29% was investment gains
- Voluntary contributions accounting for 15% of total contributions received in 2017
- MPF in the right direction!
Thank You