



Mandatory Provident Fund

Hong Kong has a rapidly ageing population. People aged 65 and above currently account for 12.4 per cent of the population. This proportion is estimated to increase to 14.6 per cent by 2015, and to 25.6 per cent by 2033. Before the implementation of the Mandatory Provident Fund (MPF) System in December 2000, only about one-third of the workforce of 3.4 million people had some form of retirement protection. Up to now, 86 per cent of the working population are already under some form of retirement protection.

In August 1995, Hong Kong took a major step in enacting the Mandatory Provident Fund Schemes Ordinance (MPFSO) to provide a formal system of retirement protection. The MPFSO provides the framework for the establishment of a system of privately managed, employment-related MPF schemes to accrue financial benefits for members of the workforce when they retire.

The Mandatory Provident Fund Schemes Authority (MPFA) was established in September 1998 to regulate, supervise and monitor the operation of the MPF System. The MPF System came into operation on December 1, 2000.

Advantages of MPF:

- **Equitable:** MPF is equitable to all scheme members, as the amount of accrued benefits is directly related to the contributions made. This also serves as a positive incentive for scheme members to make additional, voluntary contributions so as to accrue more benefits for their retirement.
- **Cost-effective:** MPF schemes are privately managed under a free competition environment. Competition tends to increase efficiency and reduce costs, which will benefit scheme members ultimately.
- **Suitable for Hong Kong's need:** Hong Kong has a well-established and sound financial services sector. A privately managed retirement system under prudential regulation and supervision is the most effective and secure way to offer retirement protection to the workforce.

At present, Hong Kong is operating a Comprehensive Social Security Assistance (CSSA) Scheme, which offers basic social security to the needy. With the introduction of MPF, complemented by personal savings, insurance and CSSA, Hong Kong has in place all the three pillars for old age protection recommended by the World Bank.

The MPF System: The key features of the System include:

- **Coverage:** All employees and self-employed persons aged 18 to aged below 65 unless specifically exempt under the MPFSO.
- **Mandatory contributions:** The employee is required to contribute five per cent of his/her monthly relevant income and the employer has to match this amount.

An employee earning less than the minimum level of income (\$5,000 per month) is not required to contribute but may elect to do so. However, regardless of the employee's decision, the employer must contribute five per cent of the employee's income. The maximum level of income for contribution purposes is \$20,000 per month. Employees and employers can also make voluntary contributions in excess of the statutory minimum. Self-employed persons also have to contribute five per cent of their relevant income, subject to the minimum and maximum levels of income for contribution purposes.

- **Vesting:** All mandatory contributions to a scheme are fully and immediately vested in the scheme member.
- **Preservation of benefits:** All benefits derived from MPF contributions must be preserved until the scheme member attains the retirement age of 65, or ceases employment and attains the age of 60. However, benefits may be paid earlier in case of death, total incapacity, permanent departure from Hong Kong or small account balance.
- **Portability of benefits:** The accrued benefits of an employee can be transferred to new employer's scheme when the employee changes jobs. However, an employee can opt to leave the accrued benefits in a preserved account in the previous master trust scheme or any other MPF scheme.
- **Voluntary contributions:** Employees (and their employers) may also make voluntary contributions to accrue more benefits for retirement.
- **Tax deduction:** Employees' mandatory contributions are tax deductible, subject to a limit of \$12,000 per annum. Employers' MPF contributions are also tax deductible to the extent that they do not exceed 15 per cent of the employees' yearly emolument.
- **Exemption:** Under the MPFSO, certain persons or classes of persons and their employers are exempt from compliance with MPF requirements, including:
 - ◇ pensionable civil servants, judicial officers, and teachers in subsidised or grant schools who are already covered by statutory pension or provident fund schemes;
 - ◇ employees covered by schemes under the Occupational Retirement Schemes Ordinance where their employers have obtained exemption from complying with MPF requirements;
 - ◇ people from outside Hong Kong who work in Hong Kong for less than 13 months or who are members of retirement schemes of a place outside Hong Kong;
 - ◇ employees of the European Union Office of the European Commission in Hong Kong;
 - ◇ domestic employees; and
 - ◇ self-employed hawkers.

The MPF System has also built in certain special features to cater for the needs of the workforce, such as:

- **'No rejection' requirement:** All approved trustees must not refuse applications for scheme membership made by employers or self-employed persons on behalf of their employees or themselves. This measure prevents the discrimination of employees and self-employed persons, particularly the low-income earners.
- **Capital preservation fund:** All MPF schemes are required to offer a capital preservation fund that invests in bank deposits and high-quality money market instruments. This fund serves as a low-risk investment option to scheme members such as members approaching retirement and those who are unwilling to expose themselves to shorter-term market movements.
- **Industry schemes:** Industry schemes are established for certain high labour mobility industries. The MPFA has set up industry schemes for the construction and catering industries. Under the arrangement, members of the two industries are able to participate in the same industry schemes, thus minimising the administrative and cost burden to employers and employees entailed by the transfer of accrued benefits from one scheme to another.

Supervision of the MPF industry: To ensure that service providers in the MPF industry are complying with legislative requirements and are acting in scheme members' best interest, the MPFA has put in place various measures:

- **Stringent approval and registration criteria:** MPF schemes are under trust arrangement governed by Hong Kong's law. In this regard, only companies and individuals that meet the stringent criteria on capital adequacy, financial soundness, fitness and propriety can become MPF approved trustees. In addition, only schemes that comply with prescribed standards, including those relating to internal controls and investment of scheme assets, can be registered as MPF schemes.
- **On-going monitoring:** The MPFA is empowered to regulate and monitor the operation of the MPF System and MPF trustees' compliance with statutory requirements. Approved trustees are required to submit returns, financial statements and internal control reports on a regular basis. The MPFA also conduct field inspection, and may commission special audit and investigation, and impose sanctions on trustees that breach the relevant requirements.

Security of MPF Scheme Assets: MPF accrued benefits will be an important source to meet scheme members' financial needs after their retirement. To ensure that their interests are adequately protected, there is a 'safety net' mechanism in the System. First, the approval criteria on capital adequacy and financial soundness will ensure, in case trustees fail to administer the schemes properly, they will have reasonable financial means to indemnify losses and improve the administration of schemes. Second, MPF trustees are required to take out adequate insurance to indemnify scheme members against losses incurred as a result of misfeasance or illegal conduct by the trustees and other service providers to whom the trustees have delegated their duties. Finally, where losses due to misfeasance or illegal conduct are not sufficiently indemnified by the above measures, scheme members may seek compensation from the Compensation Fund.

While the Government attaches great importance to the security of MPF scheme assets, the potential cost implications to scheme members as a result of stringent rules has not been overlooked. The MPF asset security measures have been formulated after extensive consultation with the legislature and the retirement schemes industry, having regard to local and international market practices. The MPF regulatory framework represents a reasonable balance between the security of scheme assets and cost-effectiveness in scheme operations. It allows flexibility for service providers to manage the schemes for best returns for scheme members and also safeguards members against undue risks. The system of prudential regulation and supervision serves the best interests of the community.

MPF's Economic Impact: The significant amount of retirement assets generated by the MPF System will add impetus to the further development of the financial markets. MPF is a long-term investment. There will be demand for quality bonds meeting minimum investment grade ratings given by recognized rating agencies. Demands for equities and other investment products will also increase. This will in turn foster the development of the bond market in Hong Kong.

As at end of September 2008, the Net Asset Values of Approved Constituent Funds of MPF Schemes was \$223.77 billion. This figure includes assets that have been transferred from Occupational Retirement Schemes.

MPF creates new challenges and opportunities for the financial services sector. All MPF schemes are under the trusteeship of approved trustees, and scheme assets must be kept separate from those of the sponsoring employers, the trustees and other service providers. The assets are under the safe custody of qualified financial institutions. There have been increased demands for trust and custodial services, investment management and scheme administration. All qualified local and overseas service providers can participate in the MPF business on a level playing field. The MPF System will, in effect, enhance Hong Kong's position as one of the leading financial markets in the world.

The Way Forward: As at end of October 2008, 99.8 per cent of employers, 99.2 per cent of employees and 73.8 per cent of self-employed persons have enrolled in MPF schemes.

Since the commencement of the MPF System in December 2000, the MPF legislation has been under continual review in the light of operational experience in order to enhance the effectiveness and efficiency of the System. Over the years, provisions related to operational and technical issues and investment regulation have been amended. Further amendments to the legislation covering scheme administration and enforcement issues were enacted in 2008. Proposals on increasing employee control over MPF investment are being prepared for submission to the Legislature.

To enhance transparency and to enable scheme members to make informed investment decisions, the MPFA has issued a Code on Disclosure for MPF Investment Funds to improve the disclosure of information on fees and charges and performance of MPF funds, and launched a web-based MPF Fee Comparative Platform to facilitate comparison of fees and charges of MPF funds. A set of Compliance Standards is also in place to assist approved MPF trustees in establishing a rigorous framework for monitoring their compliance with statutory duties and responsibilities.