Mandatory Provident Fund

Hong Kong has a rapidly ageing population. People aged 65 and above accounted for 15 per cent of the population in 2014. This proportion is estimated to increase to 28 per cent by 2034, and to 33 per cent by 2064. 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 retirement protection. Up to now, around 85 per cent of the working population is already under retirement protection.

In August 1995, Hong Kong took a major step in enacting the Mandatory Provident Fund Schemes Ordinance (“MPFSO”) (Chapter 485, Laws of Hong Kong) to provide a formal system of retirement protection. The MPFSO provides a framework for establishing a system of privately managed, employment-related MPF schemes for members of the workforce to accrue financial benefits for retirement.

The Mandatory Provident Fund Schemes Authority (“MPFA”) was established on September 17, 1998 to regulate, supervise and monitor the operation of the MPF System. The MPF System has come into operation since December 1, 2000.

About Mandatory Provident Fund

The MPF System: The MPF System is the “second pillar” of the multi-pillar retirement protection framework recommended by the World Bank. The key features of the MPF System include:

• Coverage: All employees and self-employed persons aged 18 to 64, unless exempt under the MPFSO, are covered by the MPF System.

• Exemption: Under the MPFSO, the following are exempt persons who are not required to join an MPF scheme:
  ♥ persons covered by statutory pension or provident fund schemes (e.g. civil servants, judicial officers, and teachers in subsidised or grant schools);
  ♥ members of occupational retirement schemes regulated under the Occupational Retirement Schemes Ordinance (“ORSO”) (Chapter 426, Laws of Hong Kong) that are granted exemption under the MPFSO (i.e. MPF-exempted ORSO schemes);
  ♥ persons from overseas who enter Hong Kong for employment or self-employment -
    • for not more 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.

Employees who are employed for less than 60 days, excluding casual employees as defined under the MPFSO, are also exempt from joining an MPF scheme.

• Mandatory contributions: An employee and his/her employer are both required to contribute five per cent of the employee’s relevant income as mandatory contributions for and in respect of the employee to an MPF scheme, subject to a maximum relevant income level for contribution purposes (currently, $30,000 per month or $1,000 per day). An employee whose income is less than the minimum level of relevant income (currently, $7,100 per month or $280 per day) is not required to contribute. However, his/her employer is still required to make mandatory contributions for him/her. Self-employed persons also have to contribute five per cent of their relevant income as mandatory contributions, subject to the minimum and maximum levels of relevant income for contribution purposes. The MPF legislation provides that MPFA must, not less than once in every period of four years, conduct a review of the minimum and maximum levels of relevant income for MPF contribution purposes to ascertain whether or not there are grounds to amend the levels.

• Vesting: Any mandatory contributions paid to an MPF scheme for and in respect of an employee and any investment return derived from the investment of the mandatory contributions are fully and immediately vested in the employee as accrued benefits (i.e. accumulated contributions and investment returns), except for those derived from the employer’s mandatory contributions which can be used for offsetting severance payments and long service payments. Similarly, contributions made by a self-employed person and the related investment return are fully and immediately vested in the person.

• Preservation of benefits: Accrued benefits derived from mandatory contributions must be preserved until a scheme member reaches the retirement age of 65 or satisfies other circumstances specified in the MPFSO, namely early retirement on attaining the age of 60, permanent departure from Hong Kong, total incapacity, terminal illness, small balance of $5,000 or less in an MPF scheme, and death.

• Portability of benefits: When an employee ceases employment or changes jobs, he/she can transfer the accrued benefits from his/her contribution account to:
  ♥ a contribution account in his/her new employer’s MPF scheme; or
  ♥ an MPF personal account in any MPF schemes (excluding an employer sponsored scheme).

Furthermore, under the Employee Choice Arrangement, an employee can, during employment, elect to transfer his/her accrued benefits derived from the employee’s mandatory contributions made during current employment from the employee’s contribution account to an MPF personal account in any MPF scheme of his/her own choice once every calendar year.

• Voluntary contributions: Contributions paid in excess of the mandatory amount are voluntary in nature. Employees and self-employed persons may make voluntary contributions to accumulate more accrued benefits.
benefits for retirement. Employers may also make voluntary contributions for their employees.

• Tax deduction: Subject to limits, mandatory contributions of employees and self-employed persons, and mandatory contributions made by employers for their employees are tax deductible.

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

• ‘No rejection’ requirement: All MPF trustees must not refuse applications for scheme membership made by employers on behalf of their employees or by self-employed persons.

• MPF Conservative Fund: Each MPF scheme is required to offer a capital preservation fund, namely the MPF Conservative Fund, that mainly invests in bank deposits and high-quality money market instruments. This fund serves as a low-risk investment option to scheme members who are, for example, approaching retirement or unwilling to expose themselves to shorter-term market movements.

• Industry Schemes: Industry Schemes are established for certain high labour mobility industries. The MPFA has registered two Industry Schemes for both the construction and catering industries. Under the arrangement, members of Industry Schemes do not need to move from one employer to another during their employment within these two industries, thus minimising the administrative burden to employers and employees entailed by the transfer of accrued benefits from one scheme to another.

Protection and Safeguard

Security of MPF Scheme Assets: MPF accrued benefits are one of the important sources of income to meet scheme members’ financial needs after their retirement. To ensure scheme members’ interests are adequately protected, all MPF schemes are managed and maintained by MPF trustees, and MPF scheme assets are under the safe custody of qualified custodians (e.g. authorized financial institutions) and are kept separate from those of employers, MPF trustees and other service providers.

To provide additional security and protection to scheme members, there is a ‘safety net’ mechanism in the MPF System:

• Capital adequacy requirement: The approval criteria on capital adequacy and financial soundness of MPF trustees will ensure, in case they fail to administer the schemes properly, that they will have reasonable financial means to indemnify losses and improve the administration of schemes.

• Professional indemnity insurance: 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 or other service providers to whom the trustees have delegated their duties.

• Compensation Fund: Where losses due to misfeasance or illegal conduct of MPF trustees or their service providers are not sufficiently indemnified by the professional indemnity insurance, scheme members may seek compensation from a Compensation Fund set up under the MPFSAO. Investment losses due to market fluctuations however will not be compensated.

While MPFA attaches great importance to the security of MPF scheme assets, the potential cost implications to scheme members as a result of stringent rules are not overlooked. The MPF asset security measures are 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 trustees and service providers to manage the schemes for best returns for scheme members and also safeguards members against undue risks. The system of regulation and supervision serves the best interests of the community.

Investment Regulation: Given that MPF is a mandatory and long-term investment for retirement purposes, investments in MPF schemes are subject to stringent regulation to safeguard scheme members against undue investment risks. MPF investments must be done by investment managers registered with relevant regulatory authorities. MPF trustees and investment managers are bound by detailed duties and powers set out in the law regarding the administration and investment management of MPF funds.

MPF investments must be permissible investments prescribed in the MPF legislation. The list of permissible investments is developed in the light of prevailing best practices in the retirement fund industry in order to reduce risks, such as those relating to liquidity, valuation, counter parties and diversification. MPF investments are also subject to general restrictions, including the spread of the investments, borrowing and lending of securities, currency exposure, etc.

Supervision of the MPF Industry: Various measures are in place to ensure that MPF trustees and service providers in the MPF industry comply with legislative requirements and act in scheme members' best interests:

• Stringent approval and registration criteria: MPF schemes must be governed by the laws of Hong Kong. In this regard, only companies and individuals that meet the stringent criteria, including capital adequacy, financial soundness, fitness and propriety of directors and controllers, can become MPF trustees. In addition, only schemes that comply with the prescribed standards, including those relating to internal controls and investment of scheme assets, can be registered as MPF schemes. For applications for MPFA’s approval to introduce new MPF funds to existing schemes, MPF trustees must justify that the addition of the new funds is in the interest of scheme members. Furthermore, MPF intermediaries are required to register with MPFA before they can carry out sales and marketing activities or give advice in relation to 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. MPF trustees are required to submit returns, financial statements and internal control reports on a regular basis. The MPFA also conducts field inspections and may commission special audits and investigations, and imposes sanctions on MPF trustees that breach relevant requirements. Under an institution-based regulatory regime, MPF intermediaries are supervised by the financial regulator of their respective trade and MPFA may impose disciplinary sanctions on registered intermediaries if they fail to comply with performance requirements or are convicted of an offence under the MPF legislation. MPF intermediaries are required to submit returns to MPFA annually.

To promote good corporate governance, proper risk management and a strong compliance culture among the MPF trustees, MPFA has put in place a set of Compliance Standards to assist MPF trustees in establishing a rigorous framework for monitoring their compliance with statutory duties and responsibilities.

To enhance transparency, 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. Tools such as web-based calculators, the MPF Fee Comparative Platform (hyperlinked to the website of the Hong Kong Investment Funds Association, which provides MPF fund performance data), and the Trustee Service Comparative Platform have been launched to facilitate informed decisions in choosing suitable MPF schemes and making investment choices. Fund performance information is displayed alongside expense ratios of funds on the Fee Comparative Platform. Separately, a list of MPF funds charging low fees is available on MPFA’s website to facilitate comparison by scheme members and the information is updated regularly.

**Enforcement Against Non-compliant Employers:** To protect employees’ rights and benefits under the MPF System, MPFA adopts various practicable means to enforce the law against non-compliant employers. In accordance with the MPF legislation, a surcharge calculated at five per cent of the default contribution amount is imposed on employers who fail to make mandatory contributions for their employees on time. The surcharges received are credited into the relevant employees’ MPF accounts. After completing investigations into employers regarding contributions and surcharges in arrears, MPFA may pursue civil claims against the employers in substantiated cases. The MPFA is empowered to impose a financial penalty of $5,000 or 10 per cent of the amount of default contribution, whichever is greater, on a defaulting employer. Where sufficient evidence is available, prosecution may be initiated against employers who do not enrol their employees in MPF schemes, fail to make contributions for employees or do not comply with a court order to settle outstanding contributions. Upon conviction, defaulting employers are subject to a fine and imprisonment.

**Education and Information**

MPF Education: While safeguards have been built into the MPF System through legislative and regulatory requirements, scheme members are encouraged to plan early for their retirement and to actively look after their MPF investments. The MPFA rolls out MPF education programmes to educate scheme members on practical issues including how to manage their MPF investments, the features and relative risk levels of major types of MPF funds, the issues to note when making decisions at different stages of their lifelong investment process, etc. A variety of education programmes are designed for different youth groups to educate them on the importance of saving for the future and about the MPF System.

**Statistics:** As at end of October 2015, close to 100 per cent of employers, close to 100 per cent of employees and 68 per cent of self-employed persons have enrolled in MPF schemes. There were 19 MPF trustees, 38 MPF schemes and 95 MPF funds (among which 180 were fee funds with fee of 1 per cent or below or Fund Expense Ratio^ of 1.3 per cent or below). The Net Asset Value of all MPF schemes amounted to $594.21 billion. The latest average Fund Expense Ratio of all MPF funds was 1.60 per cent, representing a drop of 24 per cent from the Ratio of 2.10 per cent in 2007. From December 1, 2000 to October 31, 2015, the MPF System as a whole achieved average Fund Expense Ratio of all MPF funds was 1.60 per cent per year. The one-month HK Dollar deposit rate (0.7 per cent per year) over the same period.

Despite volatilities in the global economy and financial markets, leading to fluctuations in the return of different types of MPF funds, the MPF System has been adding positive value to scheme members’ contributions. Most importantly, the MPF System has established Hong Kong employers’ responsibility for their employees’ retirement protection and at the same time has raised employees’ and self-employed persons’ awareness of their own retirement protection.

**The Way Forward**

Since the commencement of the MPF System in December 2000, the MPF legislation and operational issues have been under continual review in the light of experience in order to enhance effectiveness and efficiency. In this connection, over 10 legislative programmes had been duly completed to amend and improve the MPF legislation. Following the enactment of the MPF Schemes (Amendment) Ordinance 2015 in early 2015, provisions which allow early withdrawal of MPF accrued benefits on the ground of terminal illness, facilitate streamlining of the administration of MPF schemes, enable more effective enforcement actions to protect scheme members’ interests and certain technical/miscellaneous amendments have come into operation. Provisions which allow withdrawal of MPF accrued benefits by instalments on the ground of attaining the retirement age of 65 or early retirement will take effect from 1 February 2016.

Meanwhile, a proposal is being taken forward to enhance the regulation of default investment arrangements in MPF schemes by introducing an MPF Default Investment Strategy (“DIS”) as a highly standardized, fee-controlled investment approach across all MPF schemes for scheme members who do not make or have not made a fund choice or who specifically choose to invest according to DIS. The DIS adopts a globally diversified investment principle and a de-risking investment strategy according to a scheme member’s age. Subject to the completion of the legislative process and preparatory work, the aim of the Government is to launch DIS by end of 2016.

The MPFA is exploring the development of “eMPF” which seeks to introduce a centralized electronic platform to streamline and automate the administrative procedures of all MPF schemes, enhance the public’s understanding of the MPF System, MPF investment and retirement planning through on-going publicity and education campaigns.

* The pillars are Pillar Zero: non-contributory social pension and assistance (universal or means-tested) for poverty alleviation; Pillar One: a publicly managed, tax-financed social safety net; Pillar Two: a mandatory, privately managed, fully funded contribution scheme; Pillar Three: voluntary personal savings and insurance; and Pillar Four: informal support (e.g. family support), other formal social programmes (e.g. health care and/or housing), and other individual financial and non-financial assets (e.g. home ownership and reverse mortgage where available).

A casual employee under the MPFSO refers to a person employed in the aforesaid industries, which are industries with high intra-industry labour mobility.

* A ratio that measures the expenses of an MPF fund as a percentage of fund size based on data from the most recently ended financial period. The higher the ratio, the higher the percentage of operating expenses to fund size.