Submitted by email only to: mpfinvest@mpfa.org.hk

30 September 2014

Investment Regulation Department
Mandatory Provident Fund Schemes Authority
Units 1501A and 1508, Level 15
International Commerce Centre
1 Austin Road West, Kowloon
Hong Kong

Re: Consultation on Providing Better Investment Solutions for MPF Members

ICI Global¹ applauds the Mandatory Provident Fund Schemes Authority (“MPFA”) for soliciting stakeholders’ views on its consultation that proposes the introduction of a “core fund” that each MPF scheme will be required to use as a default fund.² We support the part of the proposal that default and core funds should be lifecycle type products, but we caution the MPFA about establishing rules so specific and rigid that they result in an investment option that may not be attractive to MPF investors or could stifle innovation in product update and development.

The MPFA explained that one of the reasons for the core fund proposal is its concern about a significant divergence in the default fund products among the 41 existing MPF schemes. The products range from money market type funds (12 schemes) and guaranteed funds (7 schemes) to mixed-asset

¹ ICI Global, the international arm of the Investment Company Institute, is a global fund trade organization with offices in Hong Kong, London and Washington, D.C. ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US$18.6 trillion. We count among our membership 6 Hong Kong-headquartered fund managers and many more of our members have significant operations in Asia. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision.

funds (14 schemes) and target date/lifecycle funds (4 schemes). We agree that the range of default investments should be narrowed to include investments that are more appropriate for long-term retirement saving such as lifecycle type products. In this regard, ICI research shows that “401(k) plans that set a lifecycle fund as the default investment option tend to have higher forecasted replacement rates than plans that have a money market fund as the default investment option.” This is because, historically, equity securities generate higher returns than fixed-income securities.4

Further, the US experience with lifecycle investments (in the form of target date funds (TDFs)) shows that TDFs also eliminate extreme asset allocations observed in some retirement accounts. For example, some young workers invest very conservatively by allocating all, or almost all, of their accounts to fixed-income investments, while some participants nearing retirement invest very aggressively, allocating all, or almost all, of their accounts to equity investments.5 TDFs are professionally managed to avoid such extremes.

The MPFA also requested views regarding how detailed the technical requirements should be for the core/default fund. We strongly believe the core/default fund rules should only go as far as to endorse a lifecycle approach, and not even prescribe whether the default should be a target date fund or structured as a lifecycle product.6 Either product uses a lifecycle approach and would benefit a long-term

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4 Id.

5 See Holden, VanDerhei, Alonso, and Bass, 401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2012. ICI Research Perspective 19, no. 12, and EBRI Issue Brief, no. 394 (December 2013), available at www.ici.org/pdf/per19-12.pdf. In an ongoing collaborative effort, the Employee Benefit Research Institute and the Investment Company Institute collect annual data on millions of 401(k) plan participants as a means to accurately portray how these participants manage their accounts. The EBRI/ICI database includes data on target date funds offered as mutual funds, collective investment trusts, and other investment vehicles. The EBRI/ICI 401(k) database is the largest, most representative repository of information about individual 401(k) plan participant accounts. The EBRI/ICI 401(k) database includes statistical information on 24.0 million 401(k) participants, in 64,619 employer-sponsored 401(k) plans, holding $1.536 trillion in assets at year-end 2012.

6 The consultation describes target date funds (TDFs) as “a series of [constituent funds] CFs in a scheme, each targeting a different retirement year. Members would be invested into the CF that is closest in date to the year that the member will turn 65.... The asset allocation within each CF would be adjusted over time to reduce risk.” (emphasis in the original). “Life style or life cycle approach” is described as another method “to adjusting the risk exposure of investing members over time.” Under this approach, a trustee would invest the member’s contributions across several CFs and then it would automatically adjust the proportion of that member’s investment in those CFs over time. The trustee would not adjust the asset allocation within each CF, but it would increase the proportion invested in less risky CF over time. The consultation provides an example of how this approach could work: a young member would begin with 75% of contributions invested in a global equity CF and 25% invested in a global bond CF. As the member gets older, the trustee would automatically invest a greater proportion of the member’s contributions and/or accrued benefits into the global bond CF as a way of reducing risk. See page 20 of the consultation.
retirement investor. In our US experience, target date fund providers periodically revise asset allocation paths of their products or employ new strategies for underlying investments. If the regulator prescribes a specific product, that product may be out of date – and unattractive to investors – by the time the prescription becomes law. Considering the MPFA’s goal is to make the default fund attractive to non-default investors, overly prescriptive regulation may not reach this goal.

By way of illustration, US law (the Pension Protection Act of 2006) defined a default investment option in broad terms. It only had to be a product that included a mix of asset classes consistent with capital preservation or long-term capital appreciation, or a blend of both. The regulator (the Department of Labor, or DOL) subsequently interpreted this definition to include three types of products that could be used as long-term default investment options:

1. An investment fund product or model portfolio that applies generally accepted investment theories, is diversified so as to minimize the risk of large losses and that is designed to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures based on the participant’s age, target retirement date (such as normal retirement age under the plan) or life expectancy. Such products and portfolios change their asset allocations and associated risk levels over time with the objective of becoming more conservative (i.e., decreasing risk of losses) with increasing age. 

2. An investment fund product or model portfolio that applies generally accepted investment theories, is diversified so as to minimize the risk of large losses and that is designed to provide long-term appreciation and capital preservation through a mix of equity and fixed income exposures consistent with a target level of risk appropriate for participants of the plan as a whole. 

3. An investment management service with respect to which a fiduciary, ..., applying generally accepted investment theories, allocates assets of a participant’s individual account to achieve varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures, offered through investment alternatives available under the plan, based

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on the participant’s age, target retirement date (such as normal retirement age under the plan) or life expectancy. Such portfolios are diversified so as to minimize the risk of large losses and change their asset allocations and associated risk levels for an individual account over time with the objective of becoming more conservative (i.e., decreasing risk of losses) with increasing age. ... Asset allocation decisions are not required to take into account risk tolerances, investments or other preferences of an individual participant. An example of such a service may be a "managed account."

In this regulation, the DOL’s language describing option one is particularly instructive, as it defines a lifecycle type product, without favoring a particular design for that product and without being overly prescriptive about the product features.9

Because we object to the specificity at this higher level, our objection also applies to anything that might regulate the specific features of the product (such as question 48, including the shape of a glide path or the type of underlying investments; or questions 70–72 whether passive or index strategies should be required). We believe these decisions should be left to investment providers.

The MPFA states that it will continue to consult with stakeholders, including the industry, as it moves forward with its work on the core/default fund proposal. In this regard, we welcome an opportunity to provide further input to the MPFA. If you have any questions, please feel free to contact the undersigned or Anna Driggs, Associate Counsel—Pension Regulation, at +1-202-218-3573, or by email to Anna.Driggs@iciglobal.org.

Sincerely,

/s/

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9 We note that even though three types of default products are allowed and lifecycle approach could be structured in different ways, US plan sponsors overwhelmingly use TDFs as default investment options for automatically enrolled participants. In 2012, more than 73% of 401(k) plans surveyed with automatic enrollment used target date funds as a default investment option for automatic deferrals. See Plan Sponsor Council of America. 2013. 58th Annual Survey of Profit Sharing and 401(k) Plans Reflecting 2012 Plan Experience. Chicago, IL: Plan Sponsor Council of America (formerly Profit Sharing/401k Council of America; www.psca.org).