The Mandatory Provident Fund

CHARLTONS
易周律師行
Solicitors

Hong Kong Shanghai Beijing Yangon

www.charltonslaw.com

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Hong Kong has a rapidly ageing population: people aged 65 and above currently account for about 10% of the population, and this figure will increase to 13% by 2016 and 20% by 2036. However, less than 30% of the workforce of 3 million people have any form of retirement protection in place. In August 1995 the Government took a major step forward in enacting the Mandatory Provident Fund Schemes Ordinance (the "Ordinance"), providing a formal system of retirement protection through a system of privately managed, employment-related Mandatory Provident Fund ("MPF") schemes to accrue financial benefits for members of the workforce when they retire. The Ordinance has since been amended and supplemented by way of regulations setting out the standards and detailed requirements governing the operation of the MPF scheme, and detailing the exemptions regarding people covered by schemes under the existing Occupational Retirement Schemes Ordinance ("ORSO"). There are currently around 18,000 insurance-based ORSO schemes that are eligible for exemption under the MPF system, affecting some 800,000 workers. Applications for exemption had to be lodged by 3rd May 2000.

The governing authority of the MPF, the MPFA, was established in September 1998. The key features of the MPF system include:

- **coverage**: all employees and self-employed persons between the ages of 18 and 65 fall under the ambit of the scheme (unless specifically exempted by the Ordinance or employed for a period of less than 60 days)

- **mandatory contributions**: the employee is required to contribute 5% of their monthly income and the employer has to match this amount. If a person earns less than HK$4,000 per month, they are not required to contribute, but may elect to do so. Regardless of the employee's decision, the employer must contribute 5% of the employee's income. The maximum contribution is capped at 5% of HK$20,000 per month, although employees can make voluntary contributions in excess of the statutory amounts. The employer is responsible for calculating and deducting contributions and making payments to the MPF trustee within seven days after the pay period. Similar rules are applicable to self-employed persons

- **vesting**: all contributions to a scheme must be fully and immediately vested in the scheme member

- **preservation of benefits**: all benefits derived from MPF contributions must be preserved until the scheme member reaches the retirement age of 65 or ceases employment and attains the age of 60. Benefits will only be paid before a member reaches 65 by reason of death, total incapacity, or permanent departure from Hong Kong

- **portability of benefits**: the accrued benefits of an employee can be transferred to another scheme upon a change of employment, or the employee can opt to leave the accrued benefits in the previous master trust scheme

- **voluntary contributions**: accrued benefits deriving from voluntary contributions over and above the minimum requirements are not subject to the vesting, preservation and portability rules

- **tax deduction**: employees' mandatory contributions are tax deductible, subject to a limit of HK$12,000 per year. Employers' contributions are also tax deductible to the extent that they do not exceed 15% of the employees' yearly emolument

- **exemptions**: the following classes of people are exempt from the provisions of the ordinance

  - 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 ORSO schemes where their employers have obtained exemption from the MPF scheme

  - persons who, at the commencement of the exemption provisions, have attained the age of 64

  - people from outside Hong Kong who work in Hong Kong for less than 12 months or who are member of retirement schemes in a place outside Hong Kong

  - employees of the European Union Office of the European Commission of Hong Kong

- domestic employees

- self-employed hawkers

MPF benefits will be an important source of income for people upon reaching retirement. To ensure that the scheme is administered correctly, the following safeguards have been put in place:

- **approval and registration**: MPF schemes fall under trusts arrangements governed by Hong Kong law. 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 schemes assets, can be registered as MPF schemes

- **ongoing monitoring**: the MPFA is empowered to 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 may also conduct field inspections, commission special audit and investigations, and impose sanctions on trustees that breach the relevant requirements

- **safety net**: in the case of trustees failing to administer the schemes properly, the criteria requirements will ensure that they have the financial means to indemnify losses and improve the administration of schemes; they are also 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; and where such losses are not sufficiently indemnified, scheme members may seek compensation from the statutory-formed Compensation Fund

It is hoped that the regulatory framework strikes a good balance between securing scheme assets and allowing schemes to be run cost-effectivenely. It allows flexibility for service providers to manage the schemes for the best returns for scheme members, whilst at the same time safeguarding the members against undue risks.

While the main beneficiaries of the MPF system will be the participating members of the workforce, the introduction of the system will have a positive impact on the economy. IT is estimated that the annual MPF contributions will amount to more than HK$10 billion in the initial years of operation. The amount of annual contributions will increase to about HK$60 billion when the system matures after 30 years. The significant amount of retirement assets generated by the system will add impetus to the further development of the financial markets – the MPF scheme must be viewed as a long-term investment. It should generate demand for quality bonds meeting minimum investment grade ratings given by recognised rating agencies and demand for equities and other investment products should also increase. There will also be increased demand for trust and custodial services, investment management and scheme administration. The aim is to allow all local and overseas service providers to participate in the new MPF business on a level playing field, ensuring competition and thus giving choice to the end-consumer.

According to current estimates, contributions to the MPF scheme are scheduled to begin in December 2000.

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The purpose of this note is to summarise the principal features of the SFC's Guidelines on Analyst Conflicts of Interest. Specific legal advice should be sought in relation to any particular situation.