Private and Confidential : Restricted Circulation

MPF Matters
July 2014

Issue #158

MPF MATTERS – FINAL ISSUE

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THE MONTH GONE BY…

…and also into July was notable for some good moves in equities, with Wall Street hitting new highs and other mature markets in Europe making new recovery highs. After quiet spells Hong Kong, China and Japan were among equity markets that made some good gains. Maybe it didn't feel like new all time high time, but some of that would be down to stock selection and after all Hong Kong is a long way short of its all time closing high of 31,958.41 on 30th October 2007.

On the domestic front there were two notable events, firstly the MPFA's consultation on the introduction of a new series of core funds which would be the default funds, so that those members who didn't make a choice would have their funds invested in the new range. Given the support and interest from the Financial Secretary, it seems as it might be a joint submission rather than solely the work of the MPFA.

It is clear that the intent of the legislation is to get headline MPF fees down under the guise of doing something for those who cannot chose their MPF funds.

MPF Matters research into just how much is currently going into default funds indicates that the MPFA's survey number of 24.1% "having never made a fund choice" not only sounds wrong, it is wrong.

As the article below shows, the various default choice funds are currently attracting just 11.1% of total inflows. On the reasonable assumption that some people actually chose those funds, the actual inflows from those in the default fund arrangement will be less.

As for the asset values of the default choice funds they total 14.1% of the MPF system, as at March 2014, still substantially less than the MPFA's 24.1%. These figures should have been available to the MPFA. To use their Survey figures as the basis for a major policy change is unacceptable in MPF Matters' view.

The second event was Professor Nelson Chow's report for the Poverty Commission, which was delivered but with no assurance that it would be published. It was thought it would contain a strong recommendation for a Universal Pension. If so it was something that the Government didn't want to hear.

MPF Matters is a little late this month, hoping to include something substantial from Professor Chow's Report. There is also another contributing factor.

MPF MATTERS – FINAL ISSUE

After considerable thought I have decided that this should be the final issue of MPF Matters.

It has been published continuously since April 2001 and has attempted to track the progress of MPF through the years. Whilst there has been no shortage of material to

write about each and every month, for a number of reasons, mainly personal, it just might be time to cease the struggle to solve the troubles of MPF.

Regular readers will be aware of MPF Matters' views, hopefully stimulating thought and discussion, but always intended to be constructive rather than destructive, showing a better way forward rather than merely being critical. That has been the intention.

This edition is though rather critical of the MPF system's Regulator the Mandatory Provident Fund Schemes Authority. MPF Matters has attempted to be creative in its criticism over the years but I do feel that MPF is being taken down the wrong path on the obsession with fees and on a regulatory heavy hand that is squeezing innovation and imagination out of the system and doing little to add to members' retirement balances.

MPF is on the verge of further changes, whether they are major or minor we shall see. Regretfully the years have seen MPF become increasingly unpopular, as its members have realised that the benefits are inadequate, falling short of providing any sort of decent amount of savings after age 65. The ultimate balances depend on contributions, investment performance and to a lesser extent fees. The Government and the MPFA long ago decided on 5% and 5% contributions by employer and employee with caps and nil employee contributions up to certain levels, these low contributions leading to inadequate balances at retirement. If you don't make decent contributions in the first place then the only way to get to any sort of goal is through a high risk investment policy. Contributions into MPF are low by any standards.

The MPF system still pays more attention to what employers feel like contributing to rather than looking at the interests of members. And this has been going since before MPF started.

Other factors too have not helped, notably the significant contributions going into poorly performing default funds, where the member does not make a choice, particularly the Conservative Funds. It is no fault of the MPFA that early money market yields of 5% were replaced by no yields at all, but it was and still is the responsibility of the MPFA to have reviewed the existing default arrangements at some point in the last thirteen years or so.

One would have expected the MPFA to have continuously monitored the proportion of members in each scheme in default arrangements and encouraged those with a high number to improve their member education programmes. Maybe they did.

Now we have the prospect of a new series of default funds where the emphasis is on fees rather than performance. Contributions and performance are what makes balances meaningful, not fees.

A year ago

A year ago I made a presentation on MPF to the Hong Kong Retirement Funds Association on "Why MPF – or something like it- matters". Regretfully nobody from the MPFA or various Government bodies who had been interested in what MPF Matters had to say attended. The simple message at that time was for an acceptance that MPF in its present

form was proving inadequate, and a fundamental reason was the low level of contributions. The poor standing of MPF in the community was understandable, for a variety of reasons.

The best possible outcome was for the Government and all is policymakers to focus on what Hong Kong needed, a savings system that was valuable and appreciated. One way to do this was to suspend contributions to the MPF system at some stage, still keeping it going as a frozen system that might take voluntary contributions, and begin to make new larger contributions to a new system and one structurally designed so fees could be low, such as having a single administrator.

Whether the new system would have the characteristics of MPF with its many providers and multiplicity of the same fund choices was a matter for discussion. But the idea of a central fund, with one administration and recordkeeping system, with a single range of funds would be one way forward. It would be dominated not by banks and insurance companies but by investment management companies and their products.

It may not be the most appropriate approach but I believe it is worthy of inclusion in a broad discussion on what to about Hong Kong's ageing population, where MPF or something like it is part of the solution, not the problem. I believe there is too much focus on MPF rather on the current and future elderly and where the pot pourri of MPF, ORSO, CSSA, OAA, OALA and Government pensions can play a role. But since nobody in Government or the MPFA was there to hear or discuss, it was somewhat disappointing.

A favourable environment

Hong Kong has some special characteristics, notably a high rate of employment. The employment years are where you start a family, buy a property, gradually (hopefully) improve your standard of living. These are the only times when you can save money and Hong Kong has a greater capacity to save than many places.

Hong Kong also has a high degree of financial literacy, one supposes. If there was a better place to launch a member choice savings scheme, it is hard to think of one.

Why, oh why didn't Hong Kong take the opportunity to save more through MPF from the very beginning?

Is it too late to change? The Government are showing increasing concern about an ageing population, even if little is being done about responding to the challenges. Let us hope that they have the courage to think about a much better savings system for the years ahead, one that is appreciated as you contribute and when the benefits, in whatever form they come, are received.

MPF – or something like it – Matters

WITH NO MPF MATTERS

Life without MPF Matters will continue, articles should appear from time to time on the MPF Blog web page, www.thempfblog.com. The research and consulting business of Gadbury Group will continue, it is currently enjoying an increasing number of subscribers to its range of research products.

MPF Matters has enjoyed its independence, envied as I know by a number working in and around MPF. It has opened doors and been a wonderful calling card. It has been enjoyable if a little pressured writing it.

Not everybody agrees with everything in it, and what surely would be point of agreeing? But to have readers say that it makes them think is perhaps the greatest compliment that there could have been.

Thank you to those who have commented over the years.

UNIVERSAL PENSION – NOW IS THE TIME; PROFESSOR NELSON CHOW'S REPORT

Professor Nelson Chow's report for the Poverty Commission was delivered to the Government on 30th June 2014. Although not yet published, and possibly never to be in its original form, it is clear that Professor Chow believes that it is appropriate to consider introducing a Universal Pension for Hong Kong, sweeping aside the Old Age Living Allowance and Old Age Allowance and their means testing.

Maybe the Government had thought that passing over discussion to a respected Consultant and waiting a year for a Report would make the issue of a Universal Pension go away. Various Hong Kong Governments have maintained a policy of not having anything to do with a Universal Pension, saying that there is no consensus on the matter and occasionally citing its excessive cost that would require increased taxes. That the Government want Hong Kong to be a low tax economy is understandable but the pressure outside Government to introduce a Universal Pension has been building, no matter the cost. The Universal Pension idea has not gone away.

While Governments and even the MPFA often refer to the World Banks' multipillar approach of different sources of income and support for the elderly they rarely think that anybody should have all five, from the zero pillar Universal Pension all the way through to varied support in Pillar five. In any sort of reform they tend to pick and choose. Former Soviet economies have attempted to build a Pillar II on top of basic state pensions, although the public reaction in Armenia to a new system saw six months of demonstrations before the new system was declared unconstitutional in April this year. Nobody in Armenia liked the idea of making contributions to a Government sponsored system.

In Hong Kong it is the Government that has to fund a Universal Pension. Nobody including Governments like to pay for anything, no matter how it might be for the best

Successive Hong Kong Governments have railed against introducing a zero pillar to add to the Pillar II MPF. That they already have one in the form of the Old Age Allowance (those 70 and over get a flat rate, but means tested from 65-69) seems to escape their attention. MPF Matters was perhaps not alone in thinking their next move would have been to abolish the Old Age Living Allowance or make it means tested for all ages.

One matter that really needs attention is the means testing of CSSA as it affects those with MPF balances at retirement. Having an MPF balance of any reasonable size would disqualify anybody from CSSA, meaning that you have to run down your MPF savings before applying for CSSA.

Professor Chow's Report has set the cat among the pigeons and it will be interesting to see what happens next. Before they even saw his Report the reaction from the Government was negative. Just sometimes though if you appoint an expert to come up with a view that expert will disagree with what you wanted to hear. If Professor Chow is never asked again to work for the Government that will not faze him. Maybe the Government thought that Professor Chow would do the "right thing" and say no to a Universal Pension, but if so they misjudged the man.

PROVIDING BETTER INVESTMENT SOLUTIONS FOR MPF MEMBERS – THE MPFA'S CONSULTATION PAPER

This was the title of the MPFA Consultation Paper that proposed a new core fund that would be the default choice, so that members who couldn't or wouldn't choose for whatever reason could have a low cost appropriate fund for their savings.

The title is of course grossly misleading. There are already a whole range of good investment solutions in the MPF system, and every MPF scheme now has a range that includes funds that should grow nicely over the long term. That the MPFA can get better solutions is debatable, as if they know what returns markets and asset mixes will provide.

The one class of investment that we know produces miserable returns is the Conservative Fund, once known as a Capital Preservation Fund. This the MPFA in its formative stages put into the MPF legislation as being the one fund that every MPF scheme had to have, giving it a cachet that encouraged many MPF members to think that they should invest in them. The millions, nay billions lost by MPF members because of this crude and clumsy piece of legislation has had greater implications than any few basis points of fees.

The Consultation idea is that each scheme should have a new fund, with low fees of course, that will be the new default fund for those who do not decide. This will look something like a Target Date fund or a mixed assets fund without too many equities. Whatever fund it is this low fee fund will be available to all Scheme members. It will become the fund of choice for many MPF members, in much the same way the Capital Preservation Fund became the fund of choice in 2000 and into 2001.

How many MPF members do not choose?

A good question. (It is hard to call them defaulters, maybe defaultees, in the sense that have had default thrust upon them?) In truth the MPF do not know. They did a survey…

> According to a member survey conducted by the MPFA in 2013 (Survey on Members' MPF Investment Knowledge 2013), some 24.1% of members indicated that they had never made a fund choice. These survey results are somewhat higher than an earlier industry survey (The evolving MPF system: an objective assessment", Ernst & Young, commissioned by the Joint Industry Group, comprising Hong Kong Federation of Insurers, Hong Kong Investment Funds Association and Hong Kong Trustees' Association, May 2012) which suggested that less than 20% of members (involving less than 10% of total assets) were in default funds.

The MPFA paper is based then on a Survey. They are proposing to change the MPF system on a Survey.

You think they would have checked with the MPF Providers for a more authoritative number. The MPFA should have of course known just how many defaultees there have been since the MPF system started and how many then subsequently make a deliberate choice. That would have produced some solid grounding for their paper, especially if the number was increasing or whether nobody ever went on to making up their own minds.

It is no surprise then that the figure of 24.1% is misleading and not only that, it is far from the truth. Although the MPFA choose their tenses carefully and the number might have applied to the MPF system over many years, it cannot be the case at the moment.

Gadbury Group's research into MPF Market Shares includes estimates of inflows into each MPF fund. Looking at the quarterly inflows to end of March 2014 into just the default funds, including making suitable allowance for the mixture of funds at Schroders and Fidelity, those default funds accounted for 11.1% of total inflows. This is the maximum amount that current members could be making as defaultees. It is likely to be a few percentage points less, but even at 11.1% it is less than half the MPFA's 24.1%.

A similar calculation on MPF assets shows that these default choice funds account for 14.1% of total MPF assets, again way short of 24.1%. If the MPFA's numbers are the fundamental argument for legislative change, do the proposals have any merit?

A major change in a HK$500 billion system based on a Survey, which has given the wrong answers. The Regulator has no actual data to quote. Tut tut.

What the MPFA have not put in their paper

What the MPFA have not put in their paper are some of the consequences. One is the matter of establishing a new fund for each MPF scheme or if Target Date funds are established then at least four funds per scheme. These funds will cost substantial amounts to establish. If the fairly normal approach in the MPF is followed where these costs are borne by MPF members, then this will add anything up 2½% to the Fund Expense Ratios. That won't look too good for these low cost funds when these FERs are eventually published, so expect a hoo-ha when those numbers get published many years hence.

Some MPF Providers absorb these costs themselves, so they will be footing the bill for funds that they certainly didn't ask for and will possibly lose money on.

A misleading Paper

It is not only the title that is misleading, it is the whole purpose of the Paper. The Paper is not about default choices, it's about getting fees down. Despite the fact that even the contents page strains not mention fees – it refers to value – fees are the focus. If the MPFA were really truly concerned about those defaultees, why did they take 13 years to do something about it?

Citing default funds is merely an excuse to show that the Government and the MPFA have found what they think is a clever way to do something about fees by focussing on a different issue and coming up with a fees headline.

For a few years now the Government and the MPFA have stirred up the debate on fees and costs in the MPF system and have hounded MPF Providers to get fees down, even not allowing new funds unless they are a low fee levels. Legislators and the media have responded by pestering the Government and the MPFA, demanding lower fees by some means or other. The MPFA though have found it difficult getting MPF providers to cut prices.

MPF Matters may not be alone in thinking the Consultation was a way for the Government and the MPFA to get legislators and the media off their backs. "Look" they will cry "We have given you a really low fee good fund in MPF!"

Well not quite, hardly had the ink dried on the Consultation Paper than legislators asked "What about the existing funds, when are you going to get those fees down?"

And are those other fees ever going to come down?

In the absence of legislation, the answer is "No". MPF providers will be taking on a new type of fund that is to all intents and purposes uneconomic. More than that it may draw an unknown percentage of their existing customer's balances away from higher fee funds. How many we do not know, maybe the MPFA can do a survey?

How can any business be forced to offer a possibly loss making product that takes business away from their existing product line, and then be pestered to bring down what they charge for those existing products?

For better or worse the MPF legislation created a business of MPF contributions and their management. Businesses have to profitable if they want to continue. If the Government want to take it into public ownership, then say so. But they cannot expect MPF as a business to continue if prices are forever being driven down. There will be a point where the MPF Providers will begin to want to walk away.

MPF discussion should be about building retirement balances. Unfortunately it is not.

MANDATORY PROVIDENT FUND SCHEMES (AMENDMENT) BILL 2014

Another MPF Amendment Bill, this one tightens the MPFA's grip on the MPF system and pretty well allows them to dictate just what new funds are going to be allowed. And no surprise it focuses on cost reductions that will enable fees to fall.

The MPF system has seen a big increase in the number of funds available to members, reflecting the rather poor range that the MPF allowed in the first place, including one scheme with three fund choices two of which were money market funds. The fund expansion also reflected innovation in funds available but sadly that has come to an end. The MPFA will now be able to reject a fund application that "would not be in the interests of members", in other words have rock bottom fees. Although the MPFA have been doing this for a couple of years or more they will now have the legal power to do so. This means Exchange Traded Funds, although just how you are going to have any balanced or mixed asset approach where there aren't Exchange Traded funds to invest in is hard to say. But that will be the outcome, no new actively managed mixed asset funds.

Who is the judge of what is "in the interest of scheme members"? Why, it is the MPFA of course. Never mind that MPF providers have the day to day contact with over 2½ million of them and have done for over thirteen years. The MPFA think they know best and soon will have persuaded the Legislative Council that this is so.

If some active investment managers weren't so involved in MPF I am sure they would give up. There is certainly no room for any new active manager in the system – indeed when was the last one to arrive, excluding those of course who get mandates from existing managers but who nobody gets to hear about. Aside from name changes, have there been any since MPF started?

Other legislative features revolve around secrecy – members will have less protection on their data – and extending the time allowed for prosecutions.

It is no exaggeration to say that the MPF system is being squeezed of any imagination or innovation, and that is not in the interest of members. Once more there is nothing in the legislation that will improve members' balances at retirement. Just where is the benefit in this new legislation, just what is the point?

NO NEW MPF FUNDS

There haven't been new Constituent Funds since the flurry of activity that saw new funds from FWD, Standard Chartered and Schroders at the turn of the year plus the one new fund from the reorganisation at Principal.

Sometimes it is useful to look at the MPFA web pages for Approved Pooled Investment Funds where there is a link to those approved in the last twelve months. It looks to have been a fairly quiet time for the APIF approvals department as there are just two yet to yield a new Conservative Fund, the BEA Union Investment Asia Pacific Investment Grade Bond Fund and the Fidelity Global Investment Fund - RMB Bond Fund. The BEA APIF was

approved last September. It certainly does seem to take a long time for these to feed into new Constituent Funds.

The obsession with fees is one factor as to why fund applications and approvals have been few in number, with the MPFA asking questions about whether it would be a better idea to have a low cost fund instead.

This obsession – it cannot be called anything less – with fees is very near sighted. Fees are not the problem in MPF.

TARGET DATE FUNDS

With more Target Funds a possibility in MPF, it may be appropriate to look at Target Date Funds. Target Date Funds are a popular way of deciding how to invest 401(k) funds in the United States, having a 41% market share[1] and Fidelity had 30% of the total Target Date funds used in 401(k) plans.[2]

A rather different picture emerges in Hong Kong, where only three out the top six providers include them in their range, Manulife, Bank Consortium (managed by Fidelity) and Fidelity itself; the other MPF provider that has them is of AMTD, where they are managed by Invesco. Collectively they have only 0.6% of MPF assets and 2.0% of net inflows. For Fidelity and Bank Consortium the share of inflows though is way above their importance in assets. For Fidelity of course a number of their members who cannot decide are defaulted into the Target Date funds.

HK$ million	Assets	% of Scheme	Quarterly Inflows	Inflows % of MPF Scheme
AMTD	42	10.0%	0	9.1%
Bank Consortium	941	2.7%	20	10.7%
Fidelity	967	4.1%	25	18.0%
Manulife	966	1.0%	77	0.3%
Total	2,729	0.6%*	122	2.0%*

* % of MPF System : Source Gadbury Group Market Share Reports and database

Labelling

One of the debates surrounding Target Date Funds is whether they should be "Through" funds or "To" funds, in other words should the investment policy reflect an ongoing commitment to equities ("Through") or should they be managed as if they were going to be liquidated at the target date ("To")?

Much depends on what you want to do with the money. Clearly if you wanted to continue to invest and expected to replace it with some sort of balanced or even equity portfolio,

[1] Investment Company Institute press release 23rd December 2013 quoted "At year-end 2012, 41 percent of 401(k) participants held target date funds, according to a report released today by the Investment Company Institute (ICI) and the Employee Benefit Research Institute (EBRI)

[2] Morningstar report dated September 2013

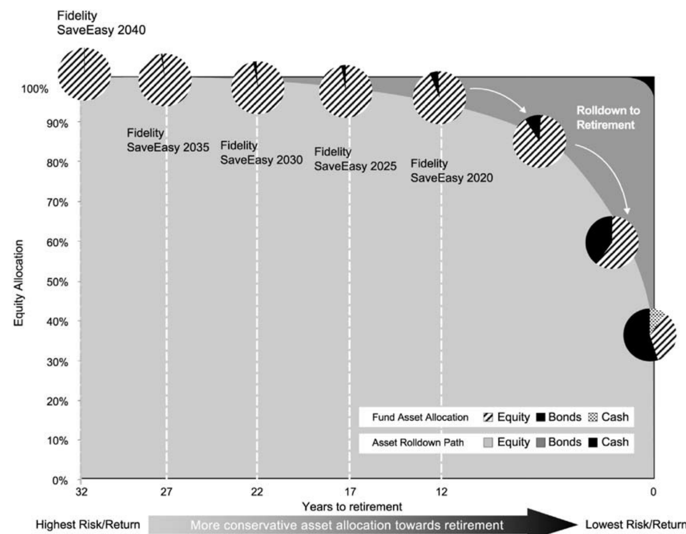
then you would want a Through fund approach. If you had plans to spend the money on the Target Date such as buying an annuity, paying off a mortgage, or just spending it then you would want a To fund.

Of course the reality is that you are most likely to want to spend some and continue to invest the rest, in which case a Target Date fund of either ilk probably wouldn't suit.

The debate in the United States, I am reliably informed, accepts that there are two very valid approaches, but they should be labelled clearly. MPF Matters has long written about the poor and misleading fund names that abound in MPF, that the MPFA continue to accept as entirely normal as if they expected everybody to read and understand the Offering Documents rather than be guided by a label. Labelling a Target Fund and even deciding whether they are more To than Through or vice versa is not easy.

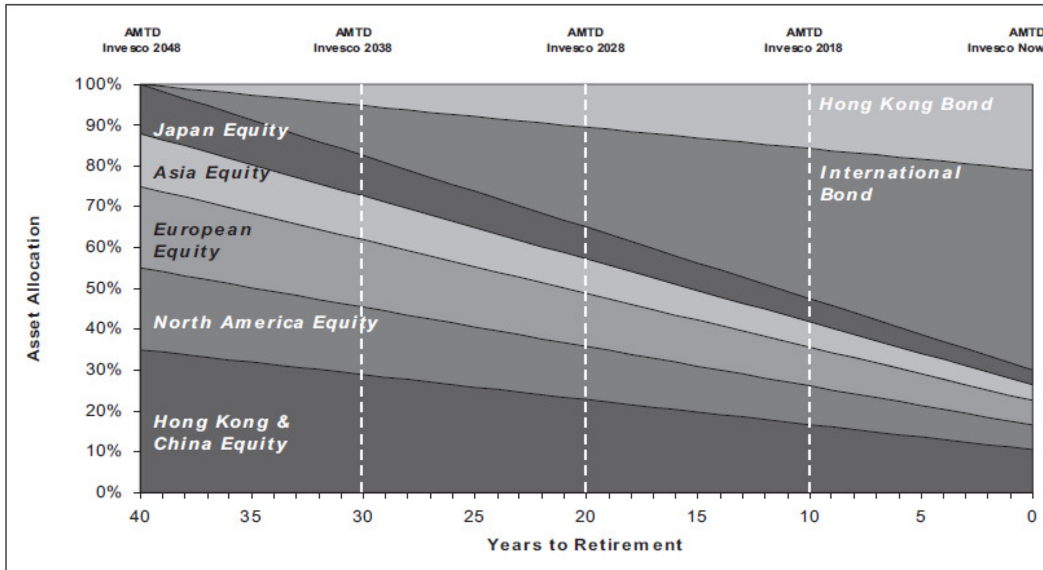
But even if you wanted a To fund you would be upset if quite a few years ahead of the Target date the investment manager decided that that he should sell all and go to cash. So what happens in Hong Kong with the investment policy of Target Date funds? Well, it's a mixture of To and Through, or maybe something in the middle.

Fidelity's investment policy has that idea of a declining equity content for Fidelity and BCT to around 40% at the Target Date…

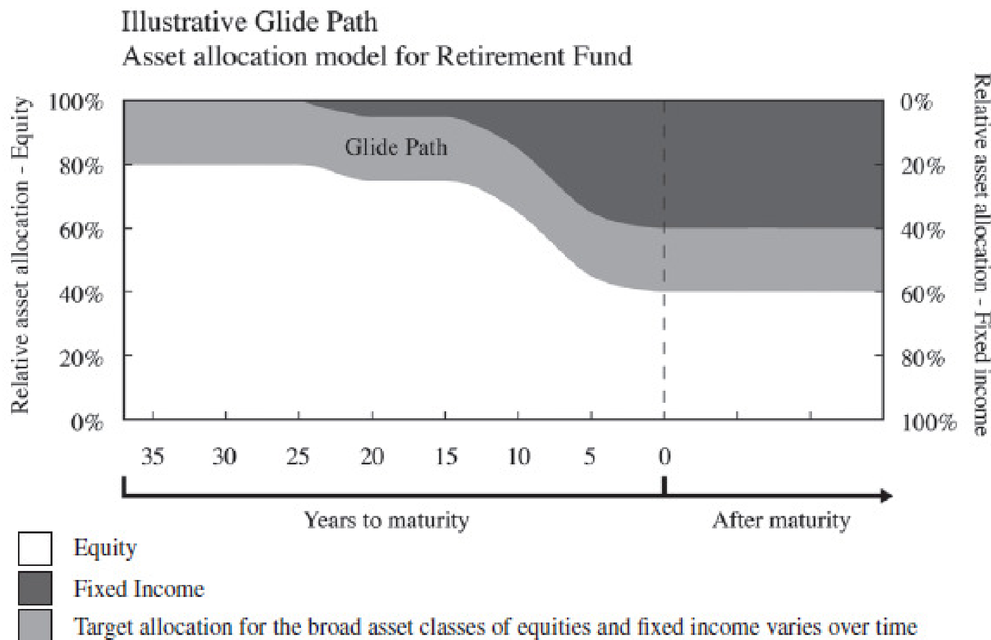


…which BCT call it an Assets Rolldown Chart.

AMTD have a slightly more informative way of doing things, as suggested by their illustrative and rather mechanical approach which indicates a 30% equity content than Fidelity's and BCT's at the Target Date.



With a glide path that seems ideal for a novice skateboarder, Manulife's approach suggests a 40% equity content at the Target Date.



And what happens at the Target Date and thereafter?

The Manulife funds look like they keep going based on the Glide Path but the Offering Document says otherwise, and apart from their 2015 fund they are redeemed on the Target Date and reinvested in the yet to be established Smart Retirement Fund; there is no explanation of how the Smart Retirement Fund might invest, but presumably it will look like their Glide Path after the redemption date.

And although the Fidelity chart doesn't seem as it has a life after the Target date, it actually could go on for five years, with similar wording in the BCT Offering Document,

> The SaveEasy Funds may remain in existence for a period of up to five (5) years after the designated target year. A particular SaveEasy Fund is expected to terminate with effect from 31 December in the year that is up to five (5) years after its target year (the fund's "Maturity Date").

The AMTD Invesco funds go into AMTD Invesco Now, as their chart suggests, again with no idea offered as yet on what its investment policy might be.

One might have hoped for some consistency in approach. If there are to be more Target Date funds in MPF, hopefully the MPFA will think hard about how they are presented and what happens at the Target Date for those who still own it. It isn't just the dates that make the difference.

MPFA POINT OUT AN ERROR IN MPF MATTERS, THAT FATCA LETTER

MPF Matters made an error last month when it wondered how Hendena Yu could still be sending out MPFA letters two years after she retired, failing to notice that Henrietta Ma was not Hendena Yu.

Betty Chan of the MPFA was kind enough to point this out. My apologies to those concerned.

In the same email she said that all MPF Trustees had indeed received a letter about FATCA and the Hong Kong Intergovernmental Agreement between Hong Kong and the United States, rather than the MPFA just sending one only to ORSO schemes. The MPF FATCA letter has never appeared on the MPFA website though and officially or otherwise none of the 2½ million members know anything about it. My request for a copy of this letter, for interest you understand, has been ignored. Mrs. Chan is clearly very busy.

AND FATCA

FATCA duly kicked off on 1st July 2014 although the impact will not be clear for some time. The current impression continues to be one of delays, with a large number of countries, the list including Hong Kong and China, who are expected to sign InterGovernmental Agreements. There are some 54 waiting to sign Model 1 and a further eight with Model 2. China is in the Model 1 list which looks at Sovereign Tax Collectors sharing information between them. 34 countries have already signed Model 1 agreements and five with Model 2. One wonders if Hong Kong were a bit hasty going to Model 2 where Foreign Financial Institutions pass on information to the IRS directly.

It will be no surprise if many in the list stretch things out with further promises.

The upcoming MPF legislation will allow MPF and ORSO plans to provide FATCA related data, which seems a bit odd as MPF is supposed to be exempted from having to provide

any. One wonders what the various regulators have been doing behind the scenes. Whilst the financial industry is fully aware, Hong Kong's Government and Regulators have a lot of catching up to do if the FATCA related activity in other countries, the Republic of Ireland being a good example, is anything to go by.

And of course FATCA is just the trial run for the OECD's Common Reporting Standards. Tax related information will soon be shared through a wide network of countries.

There are an increasing number of cautionary comments on this data exchange. Used for the purpose of combatting tax evasion, it is fairly acceptable. The concern though is that Governments will use this information as a means of applying greater control over its citizenry, not for the common good but for their and their supporters own policy ends.

MPF FUND PERFORMANCE AND THE REGULAR SAVER'S RETURNS – SIX MONTHS OF 2014

With the demise of MPF Matters, readers are encouraged to look at www.thempfblog.com which has an interesting selection of MPF Performance numbers, but not as much as the monthly Gadbury Group MPF Performance Reports, sent out to subscribers within five days of the end of each month.

Balanced funds were higher in June with the median fund up 1.2%. An investor is now up 6.1% since MPF started in June 2000, based on the median regular saver's annualised return, the cumulative result of investing a fixed sum each month.

The median global bond fund rose 0.4% in June. The median Hong Kong bond fund fell 0.1% in the month.

The median actively managed Hong Kong equity fund rose 1.5% in June; the median regular saver's annualised return is now showing an 8.6% return since MPF began. The median Asia ex Japan fund rose 2.0% whilst the median Asia ex Japan ex Hong Kong fund rose 0.2%.