Response to Mandatory Provident Fund Schemes Authority's Consultation Paper on Withdrawal of MPF Benefits from the Institute of Financial Planners of Hong Kong (IFPHK)

March 2012

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IFPHK Profile

Background
IFPHK was established in June 2000 as a non-profit organization for the fast–growing financial industry. It aims to be recognized in the region as the premier professional body representing financial planners that uphold the highest standards to benefit the public.

The Institute is the sole licensing body in Hong Kong authorized by Financial Planning Standards Board Limited to grant the much-coveted and internationally-recognized CFP^CM certification and AFP^TM certification[1] to qualified financial planning professionals in Hong Kong and Macau.

It represents more than 10,000 financial planning practitioners in Hong Kong from such diverse professional backgrounds as banking, insurance, independent financial advisory, stockbroking, accounting, and legal services.

Currently there are more than 133,000 CFP certificants in 24 countries/regions; the majority of these professionals are in the U.S., Canada, China, Australia and Japan, with more than 4,200 CFP certificants in Hong Kong.

IFPHK's interest in this consultation
The Mandatory Provident Fund ("MFP") system has been in operation for over 10 years. The Government and the Mandatory Provident Scheme Authority (the "MPFA") have been continuously working with the industry towards improving the system. As a leading professional body serving the financial planning community, the IFPHK is obliged to respond to policy changes that may have an impact on our members and their clients.

Retirement planning is considered an important focus among the financial topics addressed by financial planners. At present, approximately 42% of financial planners with IFPHK are registered as MFP intermediaries. IFPHK submitted its opinion on the supervision of sales and marketing activities of MFP intermediaries in April last year. The proposed changes outlined in this Consultation Paper will increase the number of choices available to MPF scheme members. In addition, it will ultimately open up more opportunities for financial planners to provide quality advisory services to meet the needs of MPF scheme members. Therefore, IFPHK is interested in providing its views and comments on the proposals set out in this Consultation Paper for the consideration of MFPA.

IFPHK's representation
IFPHK was founded by 30 members ('Founding Members') in order to raise the standards of financial planners and highlight the importance of sound financial planning.

IFPHK currently has 69 Corporate Members including banks, independent financial advisors, insurance companies and securities brokerages. With our Corporate Members providing a full spectrum of client services and products, including MPF products, IFPHK is well positioned to understand the needs, concerns and aspirations of the financial planning community.

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Executive Summary

The MPF System was implemented in December 2000 with the objective of helping the workforce save for its retirement needs. In light of the operational experience gained and comments received over the past 10 years, the MPFA has carried out a review of the regulation on withdrawal of MPF benefits, including the mode of payment of MPF benefits on retirement, as well as grounds for early withdrawal of accrued benefits. In December 2011 MPFA published a Consultation Document ("Consultation Paper") inviting public and industry comment on modes of benefit payment and additional grounds for early withdrawal of MPF benefits.

Last year's Policy address highlighted the fact that Hong Kong is facing the acute problem of an ageing population, which will have a negative social, economic and political impact on the community. According to the latest projection of the Census and Statistics Department, the population aged 65 or above will increase from 0.89 million in 2009 to 1.33 million in 2019, to 2.06 million in 2029 and 2.49 million in 2039. Their proportion of the population is projected to rise markedly from 13% in 2009 to 28 % in 2039. The population aged 65 or above will increase at an average annual rate of 3.5% throughout the period from 2010 to 2039, while Hong Kong's total population will increase at an average annual rate of 0.8%[2].

Recognizing the urgency to meet the social challenges arising from an ageing population, it is inevitable that Hong Kong's retirement saving system will require reform. The objective of MPF, which came into force in December 2000, is to assist the employed population of Hong Kong accumulate retirement savings by means of contributions from both employers and employees. Since the inception the MPF system the Government and the MPFA have taken a minimalist approach to the withdrawal of retirement benefits by allowing only lump sum withdrawal for MPF benefit payments. It is true that lump sum withdrawal is the simplest option and accords well with the notion that the retirement benefits are owned by the retirees who should have the freedom to dispose of their accumulated funds as they see fit[3]. However, with the expanding asset size of the MPF system[4] and anticipated increase in the number of retirees more has to be done before the system faces a peak withdrawal in the years between 2035 and 2040. In considering the proposed changes set out in the Consultation Paper, the <u>IFPHK and all the industry representatives it interviewed welcomed the proposals of allowing withdrawal of accrued benefits by installments. Also the addition of "terminal illness" to the reasons for early withdrawals provided the certificate is signed off by at least two locally registered medical practitioners proving that the scheme member's life is expected to end within 12 months from the date of the certificate.</u>

Notwithstanding our support for the proposal, IFPHK is concerned about the execution of the proposed changes. The proposals, combined with other upcoming changes of the MPF system such as the Employee Choices Arrangement, will increase the number of decisions that an individual MPF member will need to make. These decisions include, but not limited to, voluntary contributions, service providers, investment options and the mode of benefits withdrawal. The risks embedded in these decisions are significant and if not executed correctly could have a significant impact on an individual's cash-flow in retirement[5]. Considering the potential impact of the new requirements, IFPHK recommends the following measures to ensure a solid foundation to the proposed changes:

- Enhance transparency to facilitate best decisions
  With an increase in choices for individual scheme members more should be done to improve investor protection on MPF products. One way would be to provide adequate and useful

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[2] The 2011-2012 Policy Address
[3] Alan Siu, Hong Kong's Mandatory Provident Fund, CATO Journal.
[4] Net Asset Value increased from 42,125 million at the end of 2002 to 356,035 million at the end of 2011
[5] Ambrogio I.Rinaldi and Elisabetta Giacomel, Information to members of DC pension plans: conceptual framework and International Trend, September 2008.

information to scheme members to compare products and service providers. A gap in the information issued by service providers and the understanding by scheme members of the major impact of costs and fees of managing MPF contributions, particularly over the long term, will pose a key risk to the MPF system. Greater transparency is therefore essential. Fully informed members can mitigate the risk of making incorrect decisions and help them establish realistic goals for their retirement planning. Consumers have the right to be heard, have access to information and make informed choices. The MPFA might consider working with other regulators to provide a platform for consumers to compare different financial services, products and financial qualifications. Adequate guidance about different financial qualifications can be provided to the consumer in order to allow them to assess the competency of an individual providing financial services and information. Such cross-sectoral comparison is particularly useful when deciding the optimal withdrawal mode and the kind of payout products in which to invest.

- Enhance financial literacy through a comprehensive financial education program
  Enhanced transparency shall be supported by financial education as information to members is only useful to the extent that they are able to understand and use it. When the level of financial literacy is low among scheme members the provision of information is likely to be ineffective. Financial education as stated by the OECD paper does not substitute, but rather complements prudential regulation and consumer protection[6]. Hence, IFPHK would like to reinforce its view that a comprehensive investor education program shall promote the message that there is a level of personal responsibility for the impending demographic and social change that will require individuals to save more for their retirement. Such education programs help maintain transparency and confidence in the MPF system and thereby encourage individuals to take more responsibility towards his or her own retirement. Since behavior change takes time, financial education should begin as early as possible in order to encourage individuals to start savings at a young age. Intermediaries and professional bodies should be encouraged to become involved in the education program to enhance public awareness and to boost the industry's reputation.

- Promoting the concept and practice of good financial planning
  As suggested by the International Organization of Pension Supervisors, providing customized advice to members may be a particularly effective form of delivering the right mix of information and education. Such advice may make it unnecessary to supply detailed information on all possible options available and therefore allow for greater focus on the quality and customerization of information[7]. IFPHK's vision and mission is to promote the importance of financial planning and enhance the professional standard of the industry. Over the past ten years IFPHK has strived to work towards these objectives and has a track record of advocating on the provision of financial education to consumers. Each year IFPHK sends volunteers to participate in "exhibitions" organized by the MPFA in which our volunteers offer neutral one-to-one product and sector financial counseling to consumers. IFPHK regards the changes stipulated in this Consultation Paper as an opportunity to further enhance the awareness of the value of financial planning, which could help to boost the financial planning industry. IFPHK and its members are committed to ensuring that the public understands what financial planning is and is able to provide qualified consultants to deliver such services.

The statements given in IFPHK's response to the Consultation Paper are based on an objective and independent analysis of market and consumer needs. To ensure that IFPHK understands the concerns and practicality of the issue it sought comments from active industry practitioners who deal with this issue on a regular basis.

[6] OECD Council, Recommendation on good practices for financial education relating to private pensions, 28 March 2008
[7] Ambrogio I.Rinaldi and Elisabetta Giacomel, Information to members of DC pension plans: conceptual framework and International Trend, September 2008.

The MPFA Consultation

To prepare for a series of reform of the Mandatory Provident Fund ("MPF"), the Mandatory Provident Fund Authority (the "MPFA") issued the Consultation Paper 'Withdrawal of MPF Benefits' ("Consultation Paper") in December 2011. The paper sought the views of industry and public on the proposal to increase the flexibility governing the withdrawal of MPF benefits.

The Consultation Paper suggests changing the regulation covering the withdrawal of MPF benefits, including the modes of payment of MPF benefits on retirement as well as grounds for early withdrawal of MPF benefits[8].

At present scheme members reaching the age of 65 may withdraw their MPF benefits immediately or at a later date, but the withdrawal must be made in a lump sum. Before reaching retirement age MPF benefits can only be withdrawn under specified condition as stipulated in the Ordinance, such as early retirement, permanent departure from Hong Kong, death, total incapacity or a small balance of account. These reasons are collectively referred to as "grounds for early withdrawal".

To address the increasing demand of more choices and flexibility by scheme members, the MPFA proposes to allow scheme members to choose to withdraw their MPF benefits in a lump sum or over time. No specific payment mode would be mandated. For members who choose a phased withdrawal approach, minimums or maximums would not be prescribed in the MPF legislation in relation to withdrawal frequency or amount.

With respect to grounds for early withdrawal of benefits, MPFA proposes to introduce an additional reason for allowing early withdrawal. It is where a scheme member is certified to have an illness that is likely to significantly reduce their life expectancy (referred to as "terminal illness"). The condition must be certified by recognized medical professional(s).

The Consultation Paper contains 5 chapters with 8 questions relating to the aforementioned proposals.

Chapter 1 – Introduction

Chapter 2 – Current Requirements

Chapter 3 – Review of current requirements

Chapter 4 – Proposal on modes of benefits payment

Chapter 5 – Proposal on additional ground for early withdrawal of MPF benefits – "TERMINAL ILLNESS"

[8] For the purpose of the Consultation Paper, MPF benefits only refer to those derived from mandatory contributions, as benefits derived from voluntary contributions are not subject to the withdrawal restrictions in the MPF legislation

IFPHK Response Methodology

IFPHK is a professional body that seeks to promote the highest professional standards in the financial planning industry. It is therefore important to respond to consultation and policy papers that significantly impact on the financial planning sector. When formulating its response to such papers it takes a systematic approach to its conclusions. This includes:

1. An independent and objective study of the proposals and their overall impact, both positive and negative on the industry and consumers, based on theoretical and practical analysis.
2. Study of international practices in markets that are either more developed or similar to Hong Kong's in order to understand how similar proposals may have succeeded or failed and the reasons why this happened.
3. Collection of comments and opinions from industry participants including legal and compliance professionals whose business practices may be impacted by the proposals in the Consultation Paper.

After collecting and consolidating industry views, IFPHK analyzed the information together with its own research in markets deemed relevant to the situation in Hong Kong, such as Australia, Chile, the United Kingdom and Singapore. IFPHK formulated its responses to the various questions raised in the Consultation Paper as well as the recommendations on the practical application and effectiveness of the relevant proposals after taking into account the likely impact on the industry.

The views expressed in this submission paper are not necessarily summaries of the views taken from the industry, but may have undergone more independent and critical analysis and consideration by IFPHK as a professional body. As a result, not all the views collected by IFPHK are recorded in this submission paper and neither have all the views expressed in this submission paper been directly endorsed by those industry representatives or members consulted.

IFPHK’s Submission

The submission below is the result of IFPHK seeking views from industry participants in addition to its own independent internal analysis. IFPHK considers the practical implication of the proposed changes on the business of those financial planners who consider advising and providing professional services to investors as its uppermost priority.

Questions raised in the Consultation Paper

Chapter 4 – Proposal on Modes of Benefits Payment

Section 15(1) of the Mandatory Provident Fund Ordinance (hereunder referred to as the “Ordinance”) provides that a member of an MPF scheme who has attained retirement age i.e. 65, shall be entitled to be paid by the approved trustee of the scheme his entire accrued benefits in a lump sum payment. At present lump sum payment is the only permitted mode of MPF benefit payment for MPF mandatory contributions. With longer life expectancy and lower birth rate it is generally believe that scheme members will have to rely on themselves to provide retirement income and as such may not have enough savings left for their remaining years. Responding to the population’s demand for a reform of the MPF system, the MPFA proposes to allow scheme members greater flexibility to choose their payment mode. MPFA proposes to allow scheme members who are entitled to withdraw their MPF benefits on the grounds of retirement or early retirement to choose the mode of withdrawal as a lump sum or gradually in a manner that best suits their individual needs. MPFA considers that by allowing options there would be more incentive for the financial services industry to develop a range of payout products to meet the needs of different individuals and encourage more competition among service providers in keeping the cost of payout products to a reasonable level. Question 1 to 3 below summarizes the views and comments from IFPHK.

Question 1:

Do you agree that scheme members on reaching retirement should be allowed to choose whether to withdraw their MPF benefits in a lump sum, or gradually over their retirement years? If not, please explain your views.

<u>**IFPHK’s Response**</u>
The proposal stipulated in this Consultation Paper is to allow retirees to withdraw their mandatory MPF contributions by installments. Such a decision will be made by the individual on a voluntary basis (hereafter referred to as “voluntary stage withdrawal”). The main modes of retirement payment allowed in most of the countries studied are lump-sum, programmed withdrawals and life annuities. Voluntary stage withdrawal is also a form of programmed withdrawals. Programmed withdrawals consist of a series of fixed or variable payments whereby the retiree draws down a part of the accumulated retirement capital. Programmed withdrawals provide more financial discipline than lump sum payment as payments are prearranged[9]. In some countries, programmed withdrawals are allowed or even encouraged. In Australia, Canada, and the U.S., tax discounts have lured retirees to choose a programmed withdrawal. IFPHK and industry participants it interviewed <u>all support the proposal of voluntary stage withdrawal</u>. Such relaxation aligns with the trend in other countries which have well-established retirement saving systems. Forms of benefit payment at retirement vary considerably across countries. Globally there is considerable debate about enlarging the list of permissible modes of benefit payment with some arguing for a combination of arrangements as each option has its strengths and weaknesses. A combination arrangement would allow the individual to develop an optimal mix of different types. Australia has the widest choice of retirement

[9] Pablo Antolin, Colin Pugh, Fiona Stewart, “Forms of Benefit Payment at Retirement”, OECD Working Papers on Insurance and Private Pensions No.26, 2008.

benefit payout options which include lump sum, life annuities and various forms of programmed withdrawals. It also includes the ability to select a mixture of different forms[10]. Appendix 1 sets out a list of benefit payment options in Hong Kong and overseas. IFPHK's specific comments on each option will be set out in Q1 to Q3.

At present lump sum payment is the only permitted mode of MPF benefit payment in Hong Kong. Lump sum refers to a single payment where the entire value of the accrued retirement benefits is settled in one single payment. The advantage of lump sum payments for policy makers and trustees is that they are easy to administer, do not require complex calculations or record keeping. For scheme members, lump sums allow them the flexibility to utilize the retirement capital for their own purposes. For example, they can choose to invest part of the money, pay down debt or satisfy a bequest. It also gives them the ability to self-annuitize by purchasing annuity products with insurance companies. However, lump sum payments also have their disadvantages. Lump sum payments do not protect the retirees from the longevity risk[11]. Also, few retirees are really prepared to "self-annuitize" as they lack appropriate financial skills and discipline. As highlighted by IFPHK in its previous submission to MPFA, consumers consistently demonstrate low levels of financial literacy and often lack a good understanding and knowledge of pensions and retirement saving plans. Consequently potential problems of moral hazard arise as retirees can squander their assets and fall into the social security safety net[12]. Hence, many countries discourage people from choosing the lump sum method. In Ireland, the Netherlands and Mexico, a lump sum payment is generally restricted by law.

Despite the industry welcoming a relaxation of the modes of benefit payments, IFPHK would like to remind the Government and the MPFA not to underestimate the impact of giving more choices to scheme members. Deciding what to do with MPF benefit is one of the most difficult personal finance dilemmas some people may face and there is no easy answer. The decision involves complicated calculations and not everyone has the time or skills to do them. In the existing MPF system key choices are made not by individual workers, but rather by their employers. Countries with a similar practice to that in Hong Kong are Australia and Switzerland. Please refer to Appendix 2 for reference.

Whilst empowering scheme members by giving them more options is definitely the right thing to do, but where choices are available there is an urgent need to facilitate retirees in making the best decision in relation to their needs. A survey by Towers Watson shows that most employers and employees have no idea regarding the cost of retirement, though most believe that MPF mandatory contributions are not sufficient. Another survey conducted by scholars indicated that around 67% of respondents think the MPF cannot or may not be able to give them a happy retirement. About 71% do not know the estimated accumulative amount of MPF by the time of their retirement, and around 66% do not know how to calculate the yield on MPF[13]. It is expected that MPF and retirement planning will become more prominent within society over the coming years. Therefore the government and MPFA should be prepared for the increase in demand for education and knowledge from the public. IFPHK would also like to highlight the fact that programmed withdrawals do not involve longevity guarantees and thus the complaints about mandatory contributions being too small to offset living expenses later in life are still unresolved. Hence in countries like the UK and Italy, partial withdrawal is allowed in the form of a lump sum and annuitization for the rest of the retirement benefit.

[10] Pablo Antolin, Colin Pugh, Fiona Stewart, "Forms of Benefit Payment at Retirement", OECD Working Papers on Insurance and Private Pensions No.26, 2008.
[11] The risk that retirement capital will be completely exhausted while the retiree is still alive.
[12] Pablo Antolin, Colin Pugh, Fiona Stewart, "Forms of Benefit Payment at Retirement", OECD Working Papers on Insurance and Private Pensions No.26, 2008.
[13] Dr. Wai-kee Yuen, Wan-Ling Chu, "Can a "Force Saving" Policy Enhance the Future Happiness of the Society? A Survey Study of the Mandatory Provident Fund (MFP) policy in Hong Kong, 14 June 2007

Question 2:
If you support the proposal to permit scheme members to withdraw their MPF benefits gradually over their retirement years, do you agree that the withdrawal arrangement (e.g. frequency or amount per withdrawal) should be between the MPF trustee and the scheme member or some requirements (e.g. a minimum amount per withdrawal or a maximum number of withdrawals per year) should be prescribed in the legislation? If not, please explain your views.

IFPHK's Response
Similar to lump sum payments, voluntary stage withdrawal also satisfies the bequest purpose. Any balance remaining at the retiree's death is payable to the individual's estate and distributed accordingly. Another benefit of voluntary stage withdrawal is that capital can continue to be invested in MPF funds to earn investment return, although this advantage can also be obtained through the purchase of a variable life annuity. Countries that allowed programmed withdrawal varied in the administration of their practices from no restriction or imposing minimum payment requirement, to highly prescriptive formulas that leave no discretion to individuals. Under the prescriptive approach the amount to be withdrawn each year is calculated in accordance with a prescribed formula which is based on average life expectancies. In Chile, if the programmed withdrawal option is chosen the annual amount is equal to the balance of the individual's account at the beginning of the year divided by the family group's life expectancy. In Australia the minimum payment for the most common form of programmed withdrawal is determined by dividing the fund by life expectancy; the maximum payment is also determined so that individuals have capital through until their early 80s[14]. The Australian government supplies a table for this purpose. Some countries apply certain minimums on the withdrawal amount. In Singapore a minimum amount has to be taken as annual payments over 20 years while the rest can be taken as a lump sum. The minimum sum scheme in Singapore is to ensure that the saving of the Central Provident Fund members will not be used up during the early years of retirement and they can receive monthly payments from their Minimum Sum after reaching the draw-down age to meet basic needs during retirement[15].

All the industry players the IFPHK interviewed considered setting limits on frequency, minimum installment and length of the payment period as reasonable and appropriate, as small installment amounts may be costly and defeat the purpose of retirement planning. Nevertheless, IFPHK thinks that a highly prescriptive approach would not be suitable for Hong Kong because there is inadequate data to reach a reasonable and consistent formula. Since MPF system is a mandatory privately held pension scheme and operational costs vary across different MFP trustees depending on the scale of operation, adopting a highly prescriptive approach would discourage service providers from designing payout products. As such, IFPHK considers any limits on the withdrawal mode should not be prescribed in the legislation. The design of the withdrawal mode shall be determined between the MPF service providers and the scheme members. By offering high degrees of flexibility MPF service providers will have more incentives to design payout products that suit the needs of retirees. To further encourage competition between MPF service providers and to provide more choices to retirees, IFPHK suggests MPFA to follow the practice of other countries by allowing scheme member to change the voluntary stage withdrawal provider when investment performance is unsatisfactory, and scheme members can also have the option to withdraw the remaining balance in a lump sum if they wish to do so.

[14] Pablo Antolin, Colin Pugh, Fiona Stewart, "Forms of Benefit Payment at Retirement", OECD Working Papers on Insurance and Private Pensions No.26, 2008.
[15] Information note IN13/10-11, Legislative Council Secretariat, "The World Bank conceptual framework on the reform of pension system and latest development of social security system for retirement protection in selected places"

Question 3:

Do you have any other views on permitting scheme members to withdraw their MPF benefits either in a lump sum or gradually over their retirement years?

IFPHK's Response

As already stated, voluntary stage withdrawal cannot resolve the issue of longevity risk, and if the objective of the proposal is to address the concern of the public in respect to inadequate retirement capital to ensure stable living at retirement, the proposed changes may not be effective in meeting that objective. In view of the above, IFPHK think that annuities might be a better alternative to protect retirees from longevity risk. The Government and industry should work together to explore the opportunities to expand the annuities market. Annuities are regular payments until the death of individual members or of their survivors[16]. Life annuities have the advantage that payments are made for the entire lifetime of the retiree and therefore retirees are protected from longevity risk. Annuities are very popular in the Western hemisphere. Life annuities are the only permitted form of retirement benefit payout in several countries including Austria, Bolivia, Colombia, Croatia, Hungary, Netherlands, Norway, Poland, Sweden and Uruguay. Latin America countries such as Argentina, Chile, El Salvador and Peru, mandate a life annuity purchase in the event of early retirement. However, annuities have their disadvantages. Retirees need to forego future control over investments and lose the potential to earn investment returns in other investment products. It also runs counter to the bequest motive. Another argument against heavy annuitization is more relevant to countries without universal and comprehensive health systems and where retirees can be exposed to very heavy and unanticipated medical expenses during retirement[17].

The annuity business in Hong Kong has long played a minor part in the domestic insurance industry. For the year 2010 in-force office premiums of annuity and other business dropped by 26.3% to reach $2.1 billion and accounting for 1.2% of the total in respect of long term insurance business[18]. In the past it was believed that the lack of a mandatory pension system was the reason for the underdevelopment of Hong Kong's annuity market. It was hoped that implementation of the MPF would help develop the undersized life annuity market as retirees would invest their lump-sum benefit into annuity products in order to protect themselves from the risk of longevity. However, the annuity market in Hong Kong still remains very small. Please refer to Appendix 3 for the amount of annuities business from 2002 to 2010. There are some good reasons why people might not want to convert their retirement savings into an annuity. The root causes of problems for investors are mostly intrinsic and psychological rather than financial and technical[19]. The first is bequests. Bequests can used to encourage relatives to look after themselves in their old age in exchange for the promise of an inheritance. A second motive is precautionary savings. A sudden medical emergency requires liquidity and flexibility that is impossible if wealth is fully annuitized[20]. Also, people are generally unwilling to give away lifelong savings in one go. The unwillingness can be justified by the myriad of ways in which retirees can invest their savings, especially in Hong Kong where there is no capital gain tax. Insurance companies also face difficulties in designing and pricing annuity products because of the lack of available information to assess longevity risk and annuities products provided by insurance companies tend to be expensive due to adverse selection problems[21].

Comparing the situation with the U.K. and U.S. where the annuity markets are among the most developed in the world, annuitant mortality tables have been available in these countries since 1899. With such data

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[16] OECD, Pensions in Asia/Pacific – Ageing Asia must face its pension problems.
[17] Michael Yue Yat Hui and Wai-sum Chan, A search for the root causes of the underdevelopment of the Hong Kong annuity market, The Geneva Papers on Risk and Insurance vol. 29 no.3 (July 2004) 440-454.
[18] Hong Kong insurance business statistics 2010, Office of Commissioner of Insurance.
[19] Michael Yue Yat Hui and Wai-sum Chan, A search for the root causes of the underdevelopment of the Hong Kong annuity market, The Geneva Papers on Risk and Insurance vol. 29 no.3 (July 2004) 440-454.
[20] Michael Yue Yat Hui and Wai-sum Chan, A search for the root causes of the underdevelopment of the Hong Kong annuity market, The Geneva Papers on Risk and Insurance vol. 29 no.3 (July 2004) 440-454.
[21] Alan Siu, "Hong Kong's Mandatory Provident Fund", CATO Journal

lacking in Hong Kong it is doubtful whether it can provide a sound foundation for the development, marketing and management of annuity products. Although IFPHK thinks it important to develop the annuities market, it considers that it is not the right time to mandate retirees to purchase annuity. IFPHK is concerned that compulsory annuitization at this stage may ultimately become a burden on the insurance industry.

There are still good reasons to believe that a comprehensive retirement saving scheme is important to the development of the annuity market. Psychological factors and short-sightedness of an individual can be corrected through investor education and parental guidance. Boosting the annuities market also encourages insurance companies to develop more complex life annuity products in order to address some of the concerns about conventional single life annuities, and provide more choices to retirees. Despite its reputation as the leading financial centre of the region and a major player on world markets, the annuities market in Hong Kong is very small. IFPHK urges the Government to work with MPFA and the Insurance industry to find ways to stimulate the market. Measures could include investor education programs to enhance understanding on the annuities products, and provision of annuitant mortality tables to help alleviate the adverse selection problem faced by insurers.

Chapter 5 – Proposal on additional grounds for early withdrawal of MPF benefits – "TERMINAL ILLNESS"

There is a growing demand for a relaxation to the rules governing early withdrawal of MPF benefits. Among a range of suggestions the MPFA proposes to introduce the reason of "terminal illness". Although the law currently allows early withdrawal on the grounds of total incapacity, some scheme members with "terminal illness" may still be able to continue their employment and hence would not satisfy the requirements for early withdrawal on the ground of total incapacity. "Terminal illness" has been defined in the Consultation Paper as a situation where a scheme member has a critical illness that substantially reduces life expectancy. IFPHK's view and comments in respect of the proposals are set out in Questions 4 to 8 below.

Question 4:

Do you agree that a scheme member who suffers from an illness that is likely to reduce the life expectancy of the scheme member (hereunder referred to as "terminal illness") should be allowed to withdraw MPF benefits early? If not, please explain your views.

IFPHK's Response

The IFPHK and industry representatives it interviewed all agreed to the addition of "terminal illness" to the conditions for early withdrawal. It is reasonable and justifiable to believe that scheme members who suffer from terminal illness do not require the money for retirement purposes. Despite the industry support on the proposals, IFPHK would like to remind that early withdrawal would undermine the retirement saving purpose of MPF and thus early withdrawal shall only be limited to persons who can fulfill the statutory conditions. IFPHK also urges MPFA to strictly enforce rules so as to prevent systematic abuse of the early withdrawal conditions. It is noted that cases of abuse of the scheme have soared with the number of members convicted for making false statements to withdraw accrued benefits rising from only one in 2006-2007 to 79 in 2010-2011[22]. The Government and MPFA should communicate clearly with the medical practitioners that it is a serious offence to facilitate a person in making false statements on "terminal illness" in order to meet the early withdrawal criterion.

[22] From the consultation document

Question 5:

If you support the proposal of allowing early withdrawal on the proposed ground, do you think that the remaining life expectancy of 6 months, 12 months or some other time period should be used as the criterion for allowing early withdrawal? Please explain your views.

IFPHK's Response

IFPHK and all the industry players it interviewed considered that 12 months is an appropriate time period used as the criteria for allowing early withdrawal. In Australia, the certificate issued by a medical practitioner is valid for 12 months from the date of certification and this is referred to as the certification period. If a scheme member fails to apply for a withdrawal within the certification period, he or she needs to be certified by medical practitioners again to ensure that his or her "terminal illness" conditions are still valid.

Question 6:

If you support the proposal of allowing early withdrawal on the proposed ground, do you think that certification that the scheme member is suffering from a "terminal illness" should be provided

- ***By one or alternatively two medical practitioners, and***
- ***Whether they may be either a registered medical practitioner or registered Chinese medicine practitioner, and***
- ***Whether further requirements on the qualifications of the practitioners (such as some relevant medical specialty) should apply?***

Please explain your views

IFPHK's Response

IFPHK recommends the MPFA take reference from the Australian practice in that terminal illness conditions exist only when at least two registered medical practitioners have certified that the scheme member is suffering from an illness, or has incurred an injury that is likely to result in the member's death within 12 months of the date of certification. While there is consensus in the industry of requiring at least two locally registered medical practitioners to certify that a scheme member is with terminal illness, opinion is divided on whether registered Chinese medicine practitioners can be qualified certifiers or whether registered medical practitioners need to be relevant medical specialists. These divided opinions reflect the differences in policy terms and conditions of insurers in Hong Kong. IFPHK has no particular comments on whether the practitioners need to be specialists, but IFPHK generally thinks it is fair to allow registered Chinese medicine practitioners to be qualified certifiers. However, better communication should be delivered to the medical industry on the consequences of facilitating a person making a false statement in order to avoid abuse,

Question 7:

If you support the proposal of allowing early withdrawal on the proposed ground, do you think that a cap on the withdrawal amount should be prescribed? If so, what would you suggest as an appropriate cap for the purpose?

IFPHK's Response

Despite general support for the proposed changes, views are again mixed on whether there should be a cap on the withdrawal amount. Those concerned that scheme members would lose all their retirement savings if they were to recover from a terminal illness think a cap or withdrawal options are appropriate. Others think that scheme members who successfully declare themselves as having a "terminal illness" should withdraw the remaining balance in a lump sum as they will no longer need the funds for retirement purposes. Such withdrawal mode is consistent with the existing practice for other grounds for early withdrawal. IFPHK agrees that a consistent approach should be applied in order to avoid additional administration costs to trustee and scheme members and therefore there is no existing need to prescribe a cap on the withdrawal amount. However, IFPHK urges the Government and the MPFA to review the system periodically. If the situation changes the Government and the MPFA should consider whether a cap on the withdrawal mode is suitable.

Question 8:

Do you have any other views on permitting scheme members to withdraw their MPF benefits on the proposed ground?

IFPHK's Response

Currently there is a general consensus in the industry that "terminal illness" is the only reasonable and appropriate relaxation to the grounds for early withdrawal. Other suggestions such as early withdrawal for personal finance purposes are considered by IFPHK and industry players as contrary to the objective of MPF system.

Conclusion

With the low birth rate and people living longer, 28 percent of the city's population will be over 65 by the year 2039. To meet an expected peak in accrued benefit withdrawal the attention has been shifted from the accumulation phase to the decumulation phase of the MPF system. The decumulation phase is just as important as the accumulation phase if the system is to achieve its goal of providing efficient and effective retirement incomes. If an optimal accumulation phase is followed by a suboptimal payout phase, the end result could be disastrous. The success of the overall system is measured by whether it provides regular and adequate income to retirees and their dependents. Although there is considerable debate on the effective of the MPF system in providing adequate funds for retirement living, the system also has its merits. Since the implementation of the MPF system almost 85% of Hong Kong's workforce is covered by some form of retirement protection.

MPF is a defined contribution scheme where risks are borne by members and risk sharing mechanisms are not automatically available. Therefore, it is a good practice that members are offered different options in order to allow them to match their needs and preferences with the different combinations of risk and reward that are offered by their pension plans[23]. Thus it is right to offer more choices to scheme members on their payout options and on early withdrawal. Whilst IFPHK understands and recognizes that scheme members will be able to exercise greater control over their MPF accounts, the decision on MPF has never been simple. MPFA must carefully address the transition to the payout phase and attempt to avoid scheme members making poor choices that could adversely affect the rest of their retirement. IFPHK would like to highlight that one of the four reasons why pension systems are unlikely to deliver secure income in old age is because of withdrawal of savings before retirement. This is very common and pension savings are often taken as lump sums with the risk that people outlive their resources.[24]

With a growing complexity of choices to be made regarding their MPF funds, scheme members must be equipped with the necessary financial literacy and planning attitude to deal with this complexity. However, financial literacy in Hong Kong, especially in the area of financial planning, is poor when compared to other Asia countries. A recent survey conducted by MasterCard regarding financial literacy levels in Asia Pacific showed that women in Hong Kong ranked in the top five for Investment and Basic Money Management skills across Asia Pacific. However, they were particularly weak in terms of financial planning skills. Hong Kong women scored 67.8 in financial planning skills, significantly below the Asia Pacific average score of 74.6.[25] The result reflects the fact Hong Kong is an international financial centre where people have access to a variety of financial products, but the attitude and awareness of the public towards proper planning for retirement and emergencies is not fully developed.

It is IFPHK's view that improved financial literacy levels will not only allow consumers to make more informed investment decisions, but also result in a greater consumer appreciation of planning for a secure financial future – a concept IFPHK continuously promulgates. Over the past ten years IFPHK has striven to work towards these objectives and has a track record of advocating on the provision of financial education to consumers. IFPHK considers that financial literacy is about more than just knowledge, it encompasses attitudes, behaviors and skills.

IFPHK also supports educating consumers on proper financial planning skills and concept. Financial planning in our view is the process of meeting an individual's life goals through the proper management of

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[23] Ambrogio I. Rinaldi and Elsabetta Giacome, Information to members of DC pension plans: conceptual framework and international trends, September 2008

[24] From OECD "Pensions in Asia/Pacific – Ageing Asia must face its pension problems" Four reasons are

- Coverage of formal pension system is relatively low.
- Withdrawal of savings before retirement is very common
- Pension savings are often taken as lump sums with the risk that people outlive their resources
- Pensions in payment are not automatically adjusted to reflect changes in the cost of living.

[25] MasterCard Intelligence, Hong Kong woman rank high in investment and basic money management, 7 March 2011.

his or her finances. We focus on the 6-steps of the financial planning process, which is product and sector neutral. In consideration of the above, more education programs in the form of financial counseling and coaching is desirable**.** Objective advice is in the OECD's definition of the provision of counsel to consumers regarding generic financial issues and products, so that consumers can make the best use of the financial information and instruction they have received. Financial counseling and coaching can help consumers to become familiar with financial planning concepts and utilizing a financial advisor. IFPHK hopes that these most recent proposals are ways in promoting the financial planning industry and opening up more opportunities for financial planners.

Appendix 1

Country	Mode of Benefit Payment			
	Lump sum	Programmed withdrawals	Life annuities	Partial lump sum but otherwise life annuity
Hong Kong	√	X	X	X
China PRC	√	√	X	X
Malaysia	√	√	X	X
Australia	√	√	√	X
Denmark	√	√	√	X
Japan	√	√	√	X
Singapore (Note 1)	√	√	√	X
USA (Note 2)	√	X	√	X
UK (Note 3)	X	X	X	√
Canada	X	√	√	X
Chile (Note 4)	X	√	√	X
Austria	X	X	√	X
Germany	X	X	√	X
Netherlands	X	X	√	X
Switzerland	X	X	√	X
Sweden	X	X	√	X

Note
1. Minimum sum must be taken in installments or used to purchase a life annuity
2. Mostly lump sum payments
3. Programmed withdrawals allowed until age 75, mandatory annuitization
4. With minimum guarantee

Source: Ambrogio I. Rinaldi and Elsabetta Giacome, Information to members of DC pension plans: conceptual framework and international trends, September 2008

Appendix 2

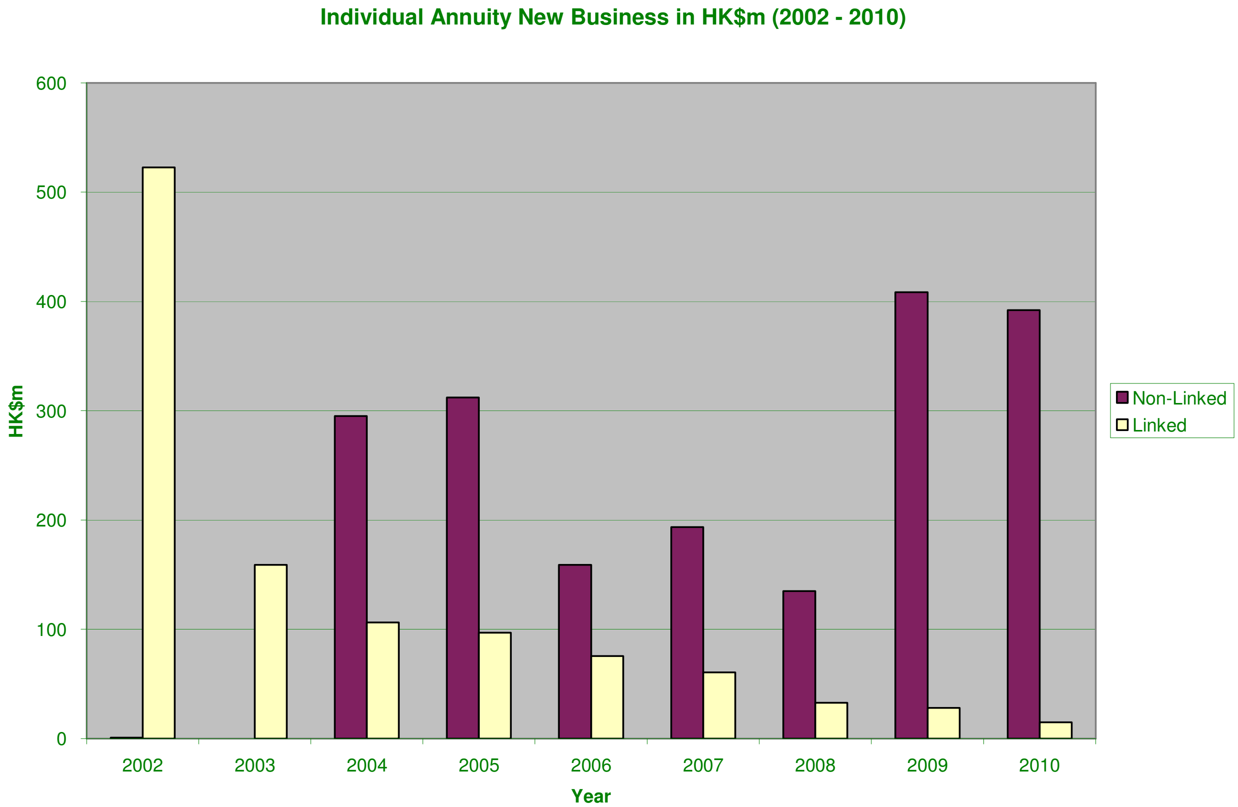
Examples of decision markers in a pension system

	Asset Manager	Investment Portfolio	Payout Provider
Hong Kong	Employer	Employee	Employee
Australia	Employer, Industry or social partner	Employer, Industry or social partner	N/A
Switzerland	Employer	Employer	Employer
Sweden	Employee	Employee	Government regulator
Singapore	N/A	Employee	Employee
U.K.	Employee	Employee	Employee
Chile	Employee	Government regulator	Employee
Denmark	Industry or social partner	Industry or social partner	Industry or social partner

Source: World Bank Pension Reform Primer, Second pillars: provider and product selection for funded individual accounts

Appendix 3

Annuities business remains small in Hong Kong. From 2002 to 2010, amounts of annuities business never exceed 600 million Hong Kong dollars.



Source: Office of Insurance Commissioner website