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HONGKONG'S MANDATORY PROVIDENT FUND SCHEME

Fiduciaries' Honey Pot; Retirees' Future Nightmares

Ever since the Government of the Hongkong Special Administrative Region (HKSAR) of the People's Republic of China (PRC) introduced the **M**andatory **P**rovident **F**und (**MPF**), there has, from time to time, been controversy, surrounding the scheme.

Without going into the many and varied criticisms of the MPF, such as the high administrative fees that are being charged by banks, insurance companies and other providers that act as depositories and managers of MPF funds, and the fact that most junior employees of the territory do not understand a great deal as to how the MPF is supposed to help them in years to come (other than provide some money on retirement), that which has, always, been absent in the arguments with regard to the MPF is the matter of the bona fides of fiduciaries.

For the most part, junior employees of companies know only that the MPF forces them to save five percent of their salaries, and, also, forces employers to match their five percent with another five percent.

(Some employees, however, still maintain that the MPF is a kind of tax on their earnings and have attempted to demand employers to remit it back to them – in cash.)

However, one junior employee of a service company, intent on vehemently defending the MPF Scheme, told **TARGET** ():

> '*It's a good way to help me to save money and my employer has to give me an extra five percent of my monthly salary, too. Not bad, uh!*'

When questioned as to which fund this employee requested her MPF contributions to be invested, the answer was that she had forgotten, '*but it does not matter because they are all very good. Aren't they?*'

In truth, however, not all of the funds are '*good*' for all employees. In fact, as will become evident, further on in this report, some funds are even not appropriate for most employees.

Further, some funds are very bad for the uninitiated in the ways of trying to safeguard savings for the day when it is time to retire.

The concept of the MPF Scheme was introduced on or about September of 1998. It was introduced into law in the Hongkong Special Administrative Region (HKSAR) of the People's Republic of China (PRC) in December 2000.

Its purpose was, and always has been, a compulsory saving scheme to assist in the planning for the retirement of HKSAR residents.

One of the many MPF providers in the HKSAR is Manulife Financial Corporation (), listed on the Main Board of The Stock Exchange of Hongkong Ltd, being Stock Code, Number 945.

Manulife Financial Corporation is the Hongkong division of a subsidiary of Manulife (International) Ltd, the

Bermuda-domiciled company that claims to have been in territory for more than one century and has been managing pension schemes since 1936.

Manulife Financial Corporation makes the claim that it provides the highest quality of provident funds services to both employers and MPF members.

In its introduction to the company's MPF products that it offers to valid participants to the MPF Scheme, it states:

> *'For Manulife Global Select (MPF) Scheme*
>
> *Important to note:*
>
> - *You should consider your own risk tolerance level and financial circumstances before making any investment choices. When, in your selection of funds, you are in doubt as to whether a certain fund is suitable for you (including whether it is consistent with your investment objectives), you should seek financial and/or professional advice and choose the funds most suitable for you taking into account your circumstances.*
> - *The asset allocation of some constituent funds, referred to as "Retirement Funds", will change over time and hence the risk profile and return will also change over time. These constituent funds may not be suitable for all members. You should understand the relevant risks involved before investment and consider factors other than age and review your own investment objectives.*
> - *The Manulife MPF Interest Fund and the Manulife MPF Stable Fund (collectively the "Guaranteed Funds") under this scheme invests solely in approved pooled investment funds in the form of insurance policies provided by Manulife (International) Limited. The guarantee is also given by Manulife (International) Limited. Your investments in the Guaranteed Funds, if any, are therefore subject to the credit risks of Manulife (International) Limited. Please refer to sections 6.2.2 and 6.2.3 of the Offering Document for details of the credit risks, guarantee features and qualifying conditions.*
> - *You should not make your investment decision based on this material alone and should read the Offering Document.'*

In this introduction, on three separate occasions, the matter of '*suitability*' is raised.

Fees charged in respect of MPF funds are, today, about 1.62 percent, according to the MPF Schemes Authority.

As at March 31, 2015, the total net asset value of all MPF Schemes was $HK594.85 billion. A breakdown of this figure is that $HK444.08 billion were net contributions and $HK150.77 billion were investment returns.

The annualised rate of return since the inception of the MPF on December 1, 2000, net of fees and other charges, was 4.30 percent.

The annual inflation rate for the territory, over the past 15 years, has been about 1.80 percent.

The number of employees, contributing to the MPF, is 2,564,000.

The number of approved constituent funds is 458.

The annualised return of approved constituent funds under the MPF Scheme is, since the MPF was founded:

Money Market Fund and Others	0.60 percent
MPF Conservative Fund	0.80 percent

Guaranteed Fund	1.40 percent
Bond Fund	3.10 percent
Mixed Asset Fund	4.40 percent
Equity Fund	5.00 percent

<u>The Difference between ‘*Suitable*’ and ‘*Best*’</u>

A fiduciary is, simply put, a guardian; a trustee.

In the HKSAR, it is doubtful that most people, empowered to give financial advice by virtue of the office that they hold, whether or not they are qualified to wear the mantle of a fiduciary, are cognizant as to the nuances behind the concept of the Latin phrase: ‘*Cestui que trus*t’ – the beneficiary of a trust; for whom the trust was created.

And the concept of cestui que trust is a paramount consideration in respect of the duties of all fiduciaries.

For the most part, HKSAR ‘*fiduciaries*’, including representatives/salesmen/salesladies, employed by most HKSAR banks and insurance companies, those that go knocking on prospective clients’ doors, hoping to sell one or more of their bank’s products, about which they, really, do not understand, whether or not they may realise it, have a terrible conflict of interest between the amount of commission that they may be able to earn from advising a prospective customer and the requirements of the prospective customer.

Such activities by these representatives/salesmen/salesladies, in this medium’s opinion, are predatory and should be proscribed by law.

Even when customers go to the offices of banks in which they have dealings in order to deposit/withdraw/transfer funds or even to purchase the currency of another country, it is an almost guarantee that the young ladies, sitting opposite the customers, will, if the spirit moves them, try to sell a bank product to the customers, a product about which the likelihood is high that she has only scant knowledge.

(If this is not a predatory act, then one might like to ask as to what nomenclature an unsolicited attempt by a bank employee, one aimed at inducing a bank customer to buy a bank product, should be ascribed.)

Such bank employees have, foremost in their minds, the commission that they may be able to earn by persuading bank customers to buy a certain bank product – regardless as to whether it is ‘*best*’ for the customer.

In many cases, it is known that many junior bank employees have to meet a certain monthly quota with regard to the sales of bank products, failing which they are given their walking papers.

Banks, as with any for-profit organisation, have to make the best use of their employees, or, in the vernacular of Americans, employees are paid ‘*to drum up business*.’

There is a basic principle, engraved in stone, in respect of fiduciaries: They should, always, act in the ‘*best*’ (not the ‘*suitable*’) interests of their clients, forsaking their own interests.

<u>The All-Important Matter of Security</u>

With regard to matter of retirement, security of savings is fundamental.

Employees, who save responsibly for the day when they are no longer able to find employment, must be ensured by fiduciaries – who have the mandate to assist in determining the best financial product(s) for their clients – that they obtain a fair share of the returns on their savings.

Too many fiduciaries, not just in the HKSAR, but in most parts of the world, they charge unnecessarily high fees for selling financial products with relatively low returns.

This may well be in the interests of fiduciaries, but only too often it is to the detriment of the party to whom they have a duty of fidelity.

One notes that the retirement concept of too many people, around the world, has been shattered when it becomes evident that their savings are far too little to afford them that which they dreamed at the time when they were fully employed.

It is a well-known fact – sadly – that far too many people, even those who save diligently and responsibly, do not have sufficient knowledge, information and/or tools at their disposal to make the '*best*' decisions as to how to plan for their retirement.

Fiduciaries, putting their interests ahead of their clients, know fully well that they can take advantage of their clients' innocence and ignorance and, thus, have the ability to persuade clients, mostly in the interests of expedience, to place funds in financial products that are known not to be in the '*best*' for their clients, but have the outward appearance of being '*suitable*' to meet their clients' needs.

It is not until sometime in the future, when the fiduciaries are long gone, that the client comes to the realisation of the mistakes, made in the past.

There is no requirement, at law, that states that a fiduciary must put clients' interest ahead of his/her own.

As a direct result of the fact that fiduciaries are not, legally, required to put their clients' interests ahead of their own, for many retirees, the reality only hits them with the force of a powerful earthquake when it is far too late – and their retirement dream has become a retirement nightmare.

Thus, formerly flourishing communities can quickly become slums because retirees do not have the wherewithal to maintain their properties as in days of yore.

As an example of the aforementioned, in Detroit, Michigan, once a thriving city, but having had to file for bankruptcy, following the near collapse of the US motor-vehicle industry, is, in hindsight, a situation that could (and should) have been avoided.

Some of the root causes of the Detroit debacle included predatory lending practices by banks and other lending institutions, as well as acts of endemic irresponsibility by employees of lending organisations, employees who were transfixed on meeting quotas and/or obtaining commissions in order to hold onto their positions.

The Detroit situation should be a reminder to societies, round the world, as to how ignorant are most people in respect of making the '*best*' financial decisions; and, how too many of them relied on what they thought were financial professionals in whom trust could be reposed.

They learned, only too late, of their mistakes.

Too many of them lost nearly everything: Their homes; their life savings; and, eventually, their jobs.

To a large extent, the above scenario was due to the innocence and ignorance of blue-collar workers as they, blindly, were led to the financial slaughterhouse.

As one looks back on this situation, it is clear that inadequate regulation led to the Detroit crisis.

Repercussions from it were felt far and wide.

People, who seek advice from doctors when they are unwell, rely on members of the medical profession to prescribe medicines or regimens that are '*best*' for them or, in certain circumstances, to recommend hospitalisation where specialised treatments may be administered.

Patients believe, and rightly so too, that members of the medical profession are under a strict obligation to do that which is '*best*' for them.

Patients may not know of the existence of Oath of Hippocrates, of which all members of the medical profession are well aware, but they have grown accustomed to trusting members of the medical profession, sometimes, with their lives.

The same is true, to some extent, of the legal profession since trust is reposed in solicitors and barristers on the correct assumption that members of the legal profession have a mandatory obligation to do that which is '*best*' for their clients.

In both of the above examples – with regard to members of the medical and the legal professions – people expect to be told that which is '*best*' for them, not that which is '*suitable*' for them.

When people seek financial advice from qualified professionals in this industry, would it not follow that such advisers should be under similar obligations as the qualified professionals in the legal and medical professions and that such advisers should consider, only, that which is '*best*' for their clients, not that which is '*suitable*'?

Sadly, as has become very evident over the years, financial-services professionals, more often than not, consider their pockets before thinking as to what is '*best*' for the people, seeking their advice in respect of retirement.

One is reminded of a man of the cloth who, on asking one of his flock to donate $US200,000 to an organisation of a country that had, recently, been hit by a devastating tsunami, on being asked how much of the $US200,000 would end up in the hands of the organisation of the country, badly in need of the money, was told that only five percent of the money would be deducted by the man of the cloth – to cover his expenses.

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