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The Hong Kong Mandatory Provident Fund (“MPF”) Experience

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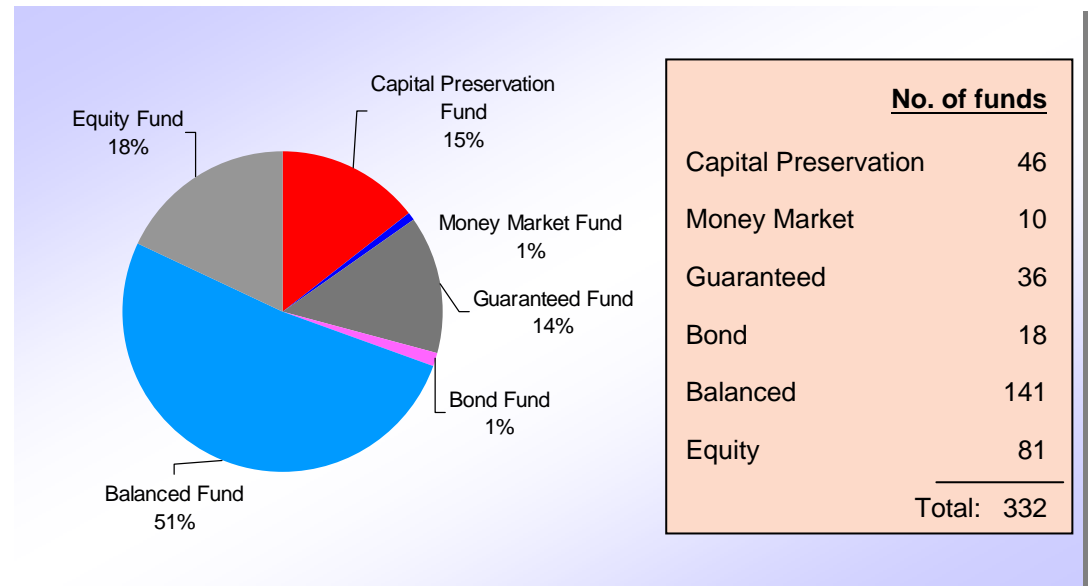
Mandatory Provident Fund

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Mandatory Provident Fund basics

- Commencement: December 2000
- A mandatory, privately managed, fully funded contribution system
- For everyone age 18-64 without existing retirement plan
- Members choice style defined contribution schemes
- Must offer Capital Preservation Fund (for minimum investment return)

Fund choices as at end of December 2005



MPF schemes are governed by a trust and must be registered with the MPF Authority

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Mandatory Provident Fund basics

- Mandatory for employers and employees to contribute 5% of relevant salary each, but up to HKD2,000 each month

- Types of MPF schemes:
 - MasterTrust (for general use)
 - Industry Scheme (for high turnover industries such as catering and construction)
 - Employer Sponsored Scheme (2 only)

- Each member enjoys up to HK\$12,000 tax deduction benefits each year

- Tightly controlled investment guidelines

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Mandatory Provident Fund basics

- Fully vested
- Portability upon termination or retirement – existing or new master trusts
- Preservation - benefits are payable at age 65, but early collection is possible:
 - Early retirement at age 60
 - Permanent departure from Hong Kong SAR
 - Total disability or death
 - Claiming of small account balance

MPF has long-term investment horizon

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Mandatory Provident Fund Schemes Authority (“MPFA”)

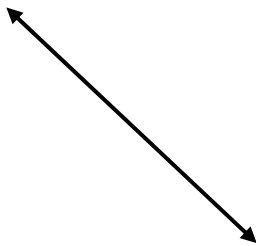
- Ensuring compliance with the MPF Ordinance
- Making rules or guidelines
- Approving trustees, administrators, and fund managers
- Regulating intermediaries
- Registering schemes and funds (working with HKSFC)
- Regulating affairs and activities of approved parties (regular reports and on-site audits)
- Considering and proposing reforms
- Promoting and encouraging development of retirement scheme industry

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Relationship of various parties



Investors

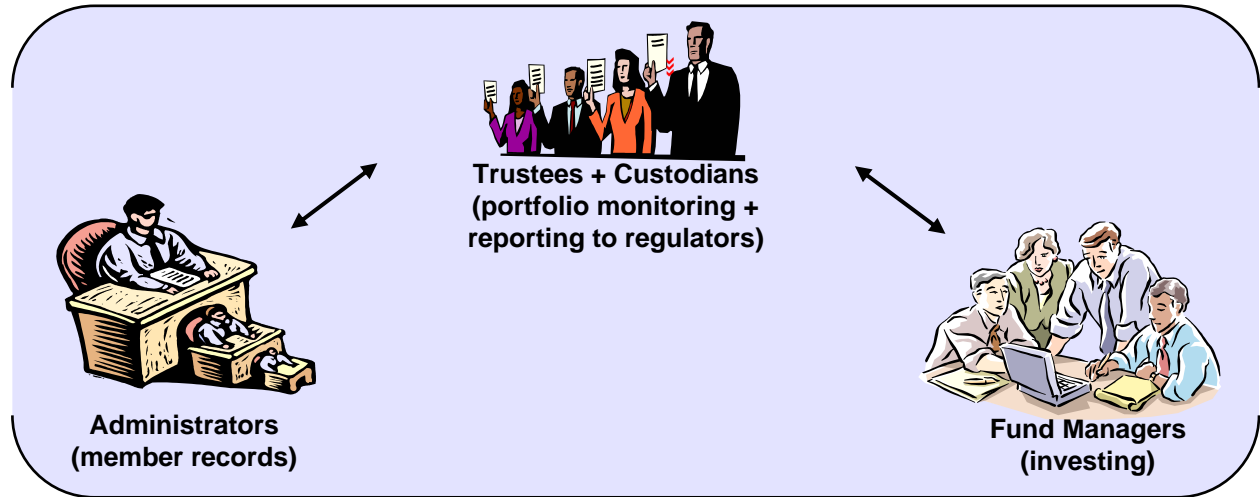


Mandatory Provident Fund Schemes Authority

Regulators



SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會



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Member protection

Four-tier protection

- Stringent approval and registration criteria – all funds by both the MPFA and the Hong Kong Securities and Futures Commission (“HKSF”)
- On-going monitoring – regular filing by funds’ trustees
- Professional indemnity insurance – for all participating service providers
- Compensation fund – 0.03% of NAV levy

Investors are well protected

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Investment restrictions

- Spread and concentration limits
- Maintain at least 30% HKD exposure
- No acquisition that incurs unlimited liability
- No securities borrowing, limited securities lending
- No borrowing of money except to pay benefits or settle transactions

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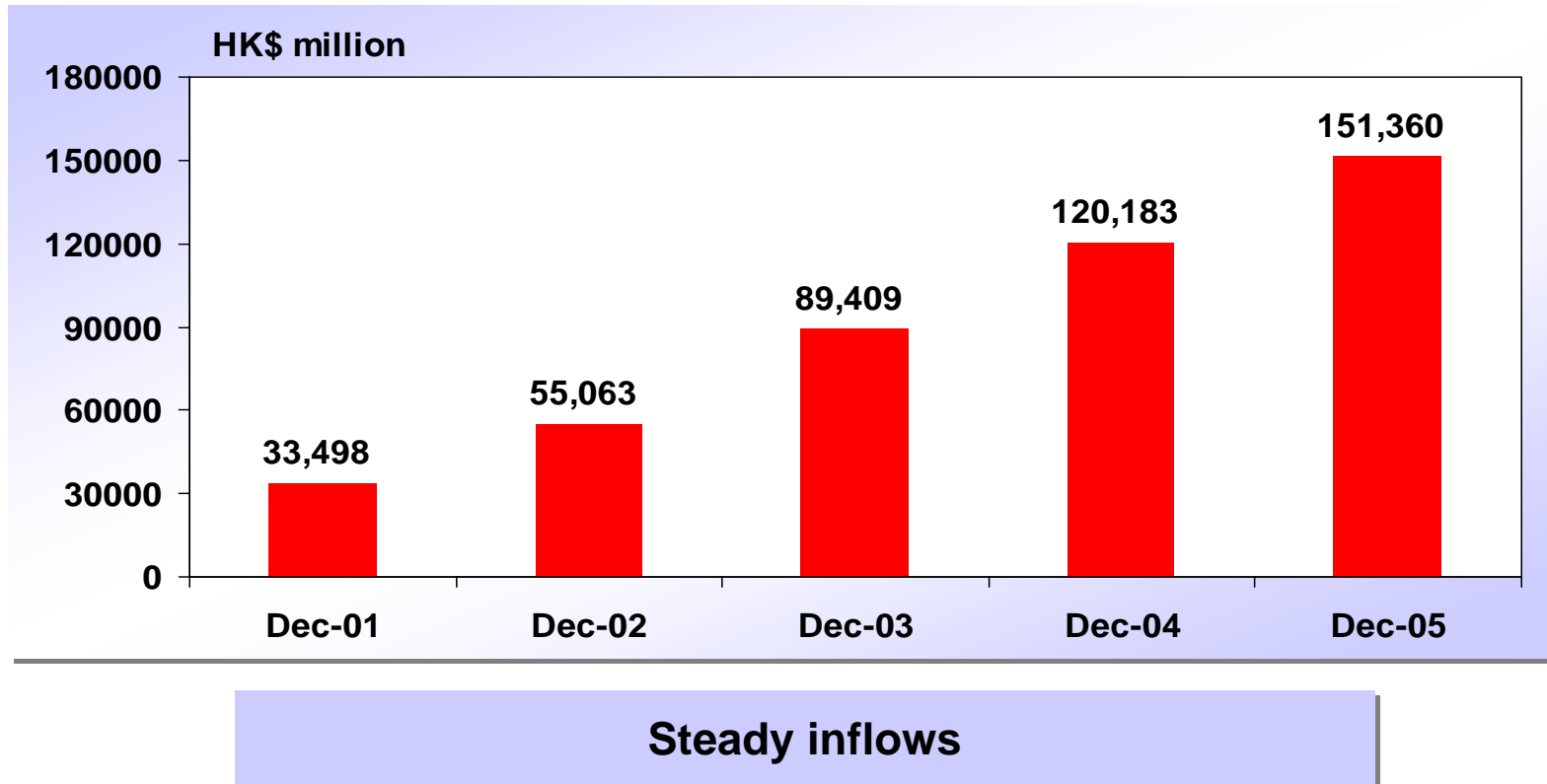
Investment restrictions (cont'd)

- Debt securities / convertible debt securities – listed or meet quality requirement (e.g. credit limit)
- Shares listed on approved stock exchanges
- Warrants (<5% of fund)
- Deposits with banks
- Futures and options contracts – only for hedging or <10% of fund

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Market statistics

- As at the end of 2005, total asset size at HK\$151,360 million (US\$19,522 million)



Source : MPF Schemes Statistical Digest, December 2005

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Market statistics

■ Coverage:

- 2.4 million working population
- 97.4% compliance rate (relevant employees)

■ Service providers:

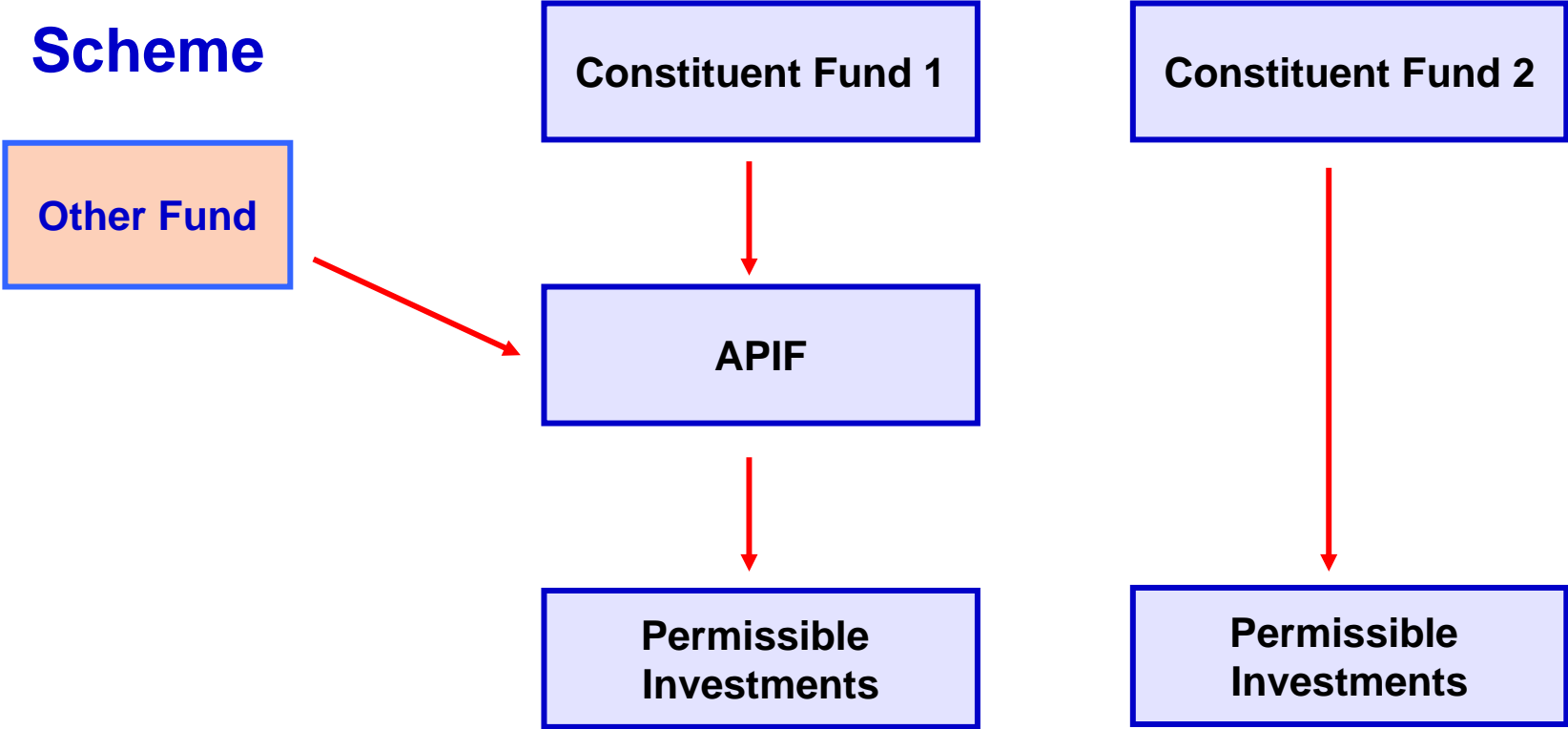
- 19 approved trustees
- 46 MPF schemes: 332 constituent funds
- 24,934 MPF intermediaries

MPF creates jobs for the financial industry

Source : MPF Schemes Statistical Digest, December 2005

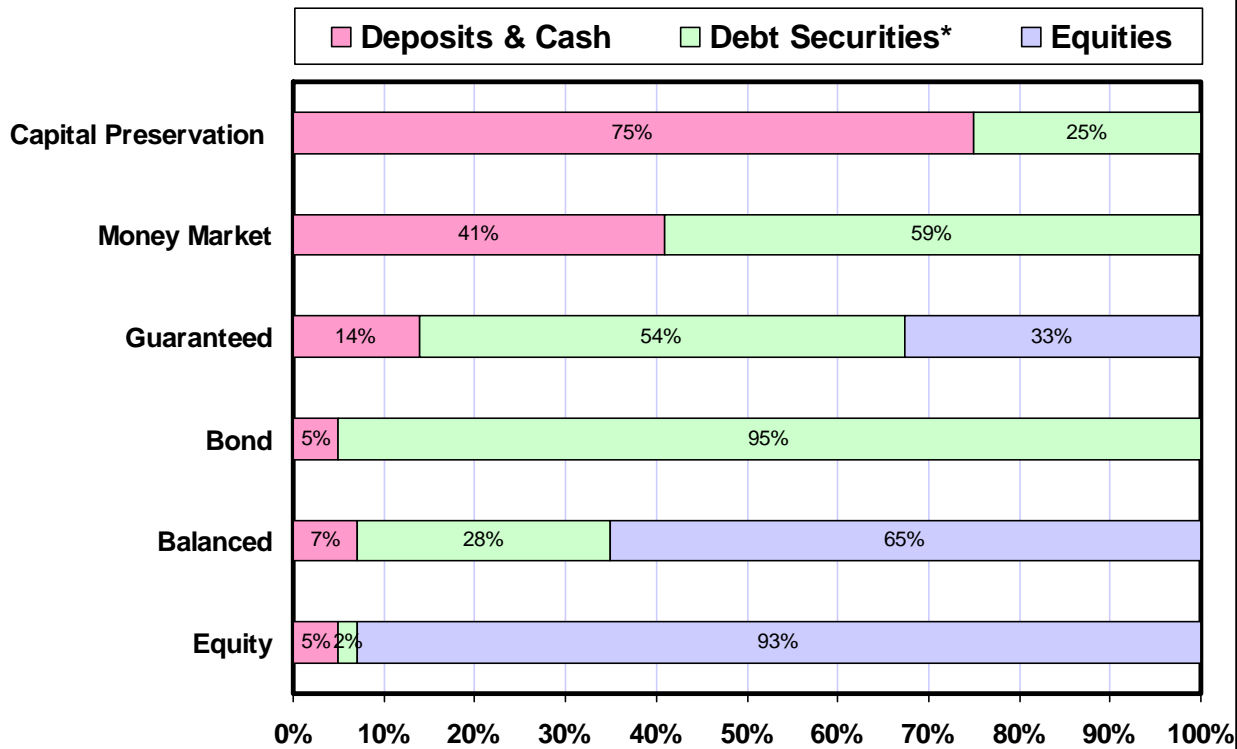
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Scheme structures



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MPF asset allocation (September 2005)



No. of funds	Fund sub-categories
46	Balanced
	▪ >20-40 equity (Stable)
	▪ >40-60 equity (Stable Growth)
	▪ >60-80 equity (Balanced)
	▪ >80-100 equity (Growth)
10	
36	Equity
	▪ Hong Kong
	▪ US
	▪ Japan
	▪ Asia ex Japan
	▪ Pacific Basin ex Japan
	▪ European
	▪ Global
	▪ Other
18	
141	
81	
Total 332	

* Include convertible debt securities
Source: MPF Schemes Statistical Digest

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Balanced Fund – asset allocation change (2001-2005)

	2001	2002	2003	2004	2005
Deposits & Cash	7.0	7.0	5.0	6.0	7.0
Debt securities*	28.0	30.0	24.0	23.0	21.0
Equities	65.0	63.0	71.0	71.0	72.0

* Include convertible debt securities
Source: MPF Schemes Statistical Digest

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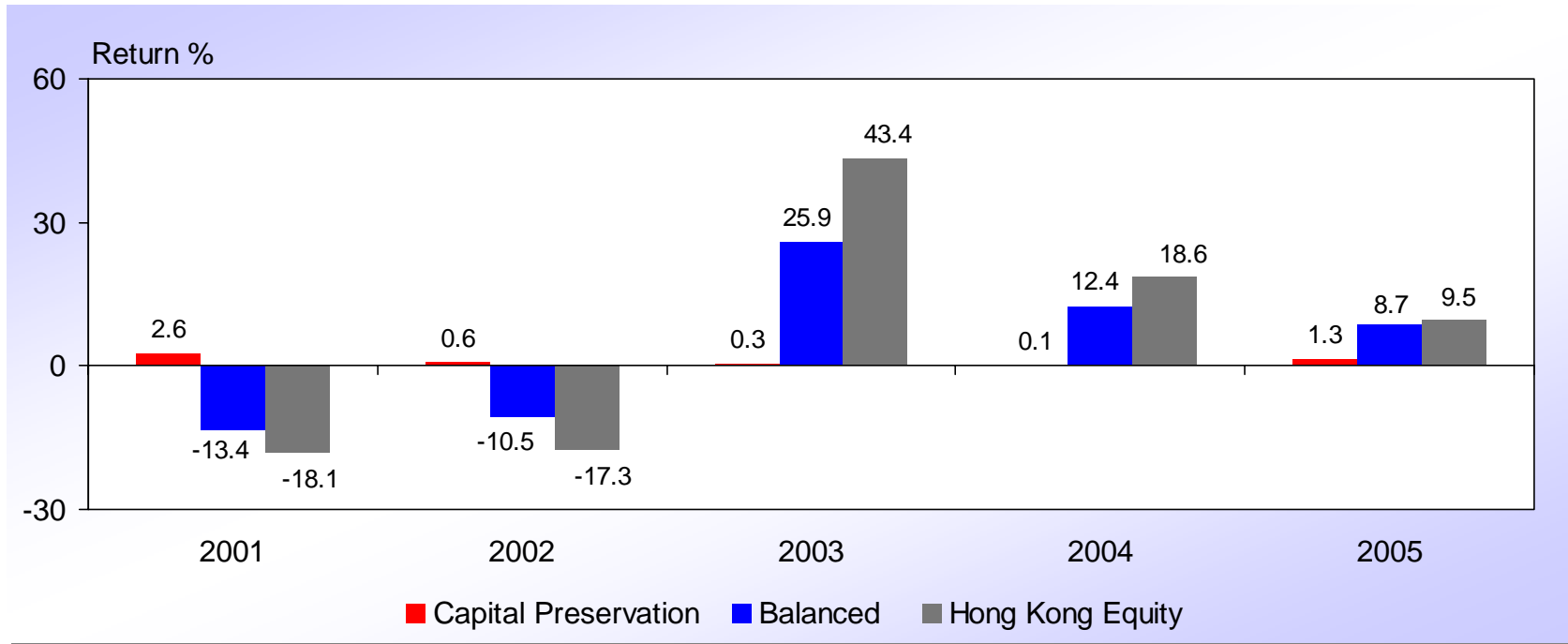
Lifestyle fund benchmark weightings

	Growth	Balanced	Stable Growth	Stable
Equities				
<i>Hong Kong</i>	30.0	24.0	17.0	10.0
<i>Japan</i>	12.0	9.0	6.5	4.0
<i>Other Asia Pacific</i>	12.0	9.0	6.5	4.0
<i>N. America</i>	18.0	14.0	10.0	6.0
<i>Europe inc. UK</i>	18.0	14.0	10.0	6.0
Sub-total	90.0	70.0	50.0	30.0
Bonds	7.0	25.0	45.0	60.0
Cash	3.0	5.0	5.0	10.0

Benchmark : Hong Kong Equity – (90% FTSE HK + 10% HSBC), US Equity - FTSE MPF US, Japan Equity - FTSE MPF Japan, Europe Equity - FTSE MPF Europe, Asia Pacific Equity- FTSE MPF Asia Pacific ex Japan/HK, Bond - Citigroup WGBI (25% Hedged to HKD), Cash - MPFA prescribed savings rate.

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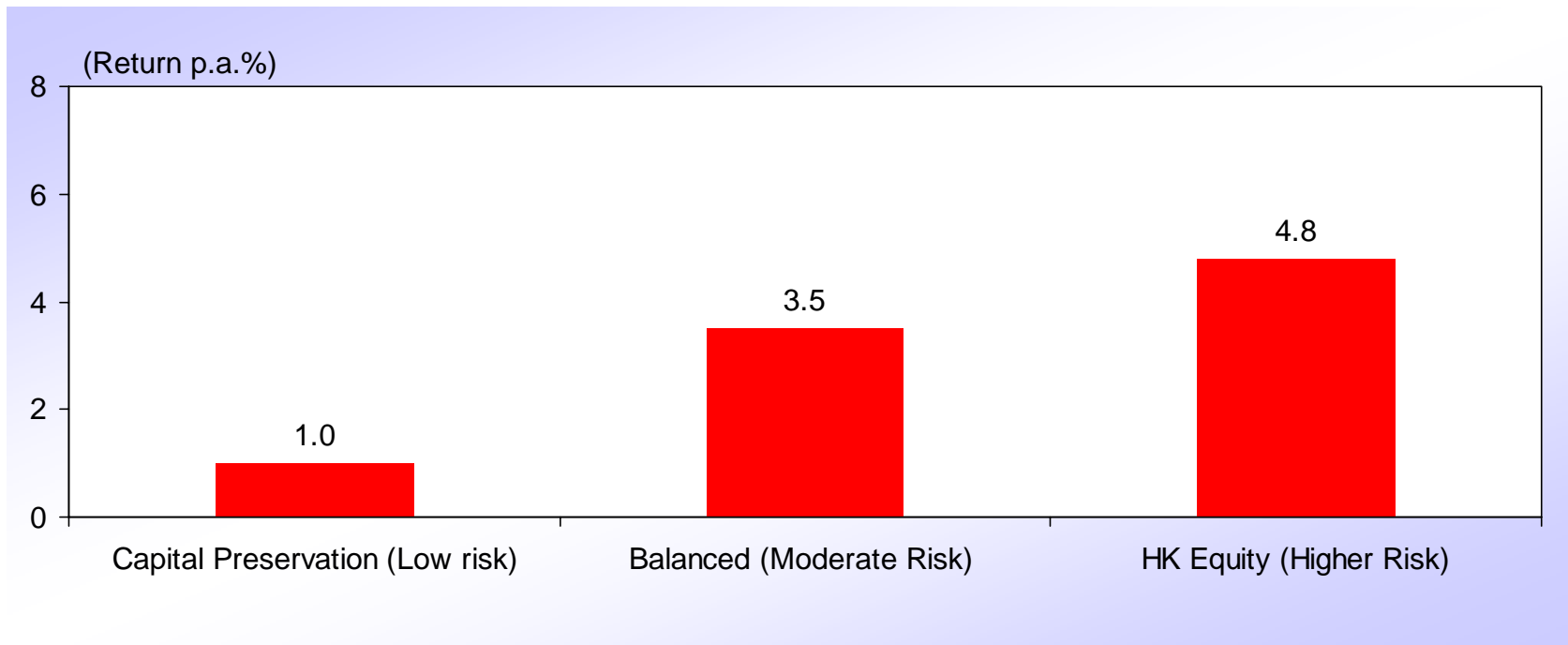
MPF performance – yearly (market average)



Cumulative performance is calculated based on net asset value (NAV)-to-NAV in Hong Kong dollars.
Source : Lippers Peers Comparison Report (MPF), HSBC Investments
Past performance is not necessarily a guide to future performance

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MPF performance – 5-year annualised (market average)



Performance period: 5-year annualised return (2001-2005)

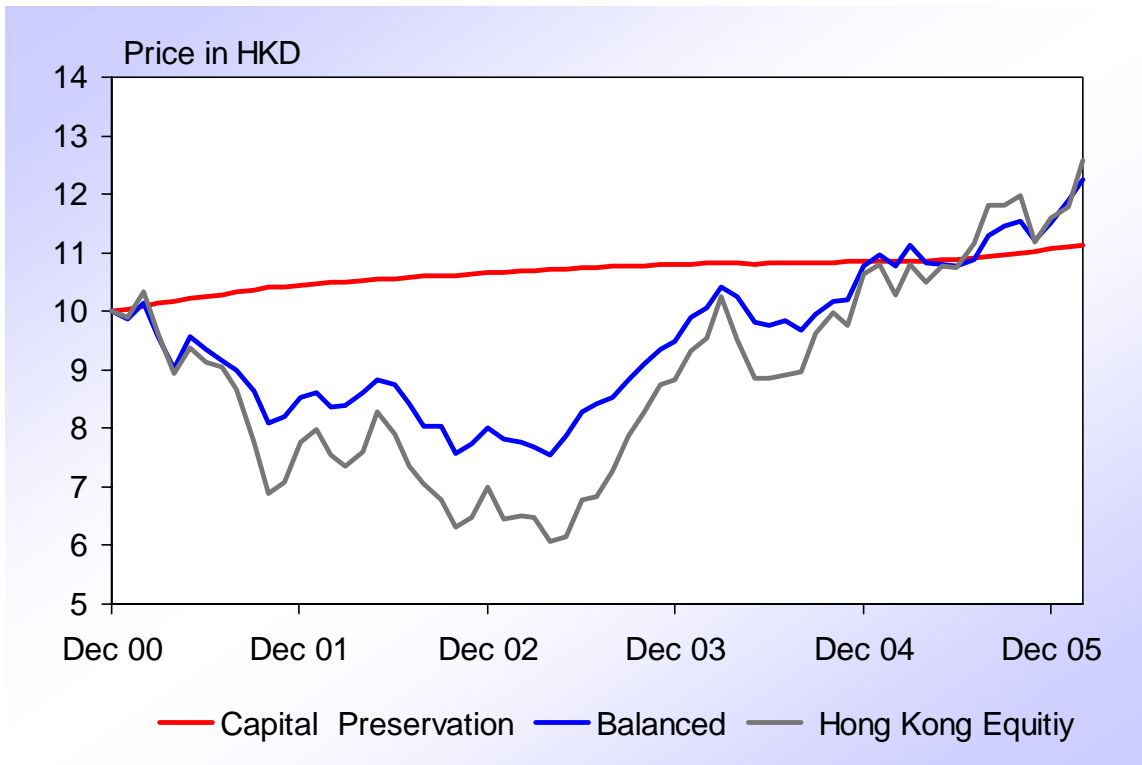
Cumulative performance is calculated based on net asset value (NAV)-to-NAV in Hong Kong dollars.

Source : Lippers Peers Comparison Report (MPF), HSBC Investments

Past performance is not necessarily a guide to future performance

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Dollar cost averaging



	Lump Sum	Monthly Instalment
Capital Preservation	11.4%	4.5%
Balanced	22.5%	31.4%
Hong Kong Equity	25.8%	47.0%

Data as at 1 February 2006

Source: HSBC Provident Fund Trustee (Hong Kong) Limited

Past performance is not necessarily a guide to future performance.

Risk management for pension providers

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Major risk categories

- Market risk – uncertainty in future asset and liability values as determined by market forces
- Operational risk
- Political risk

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Major risk categories (cont'd)

Market risk

- Main risk amongst the three
- Chief concern – asset allocation drives performance
- Market risks include: currency, concentration, credit quality, counterparts, liquidity and beta risks
- Risk of underperformance: benchmark, fund liabilities and return targets
- Formal analysis: attribution analysis, portfolio optimisation, asset liability analysis
- Non-traditional asset classes gaining importance: diversification, enhanced risk adjusted returns

Operational risk

- Internal and external processes, people and systems
- Range from large-scale corporate accounting fraud to everyday occurrences, e.g. employee errors
- Proper internal controls and systems
- High frequency/low impact: proper records to identify mistakes
- Low frequency/high impact: effective senior leadership, culture of integrity
- Custodians to provide timely and transparent reporting

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Major risk categories (cont'd)

Political risk

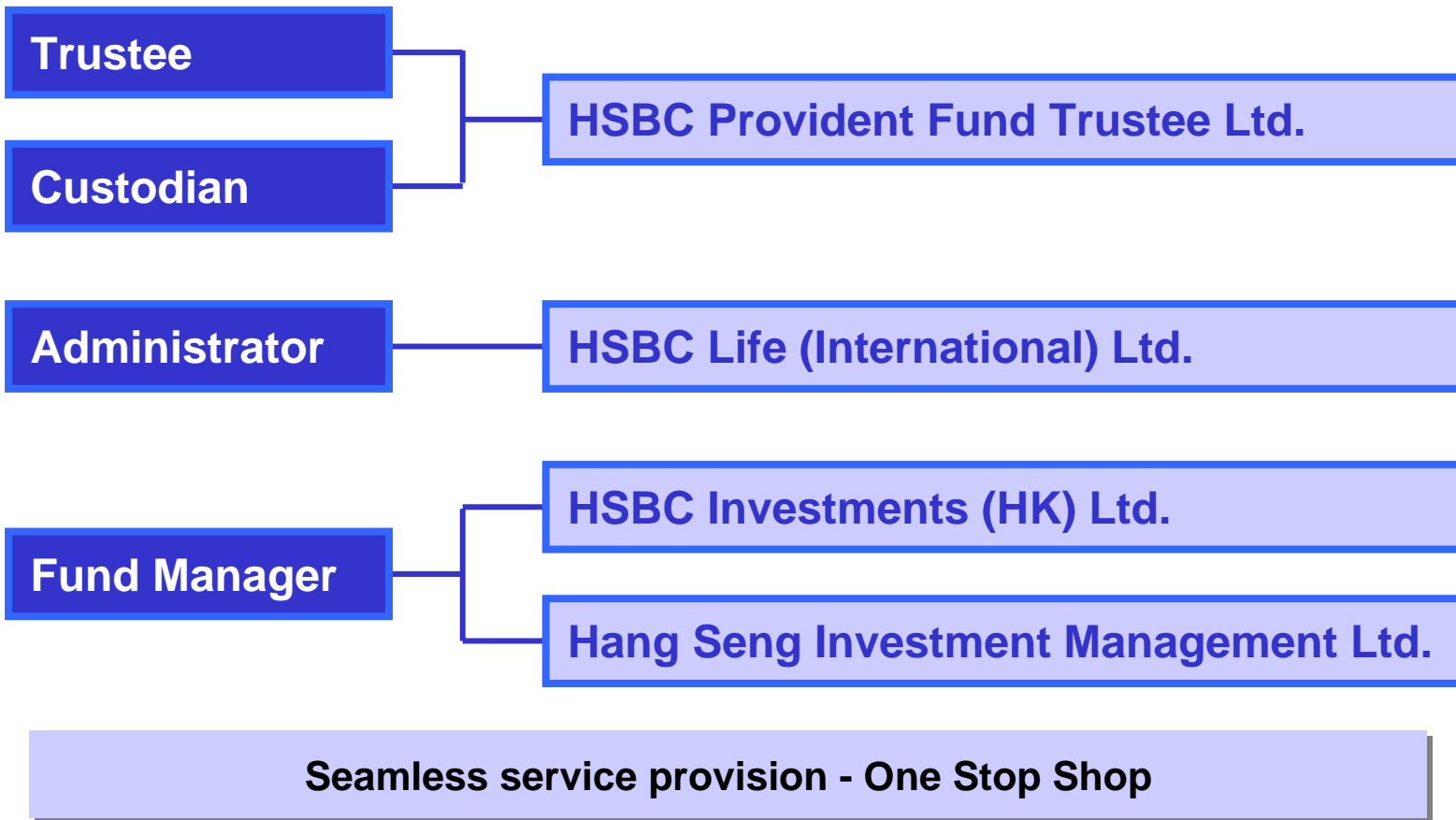
- Related to political processes or events: legislative change to political turmoil
- Study macro-economic trends
- Prepare to comply with new legislative changes
- Determine if socially responsible investing is an issue
- Develop an approved countries list

Effective risk management to bring better investment performance and lower risk profile

HSBC and MPF

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All four service providers under one roof



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Market share

	Service provider	Estimated overall market share
<div style="border: 1px solid black; padding: 5px; display: inline-block;"> HSBC Group </div>	1) HSBC	24.8%
	2) Manulife	15.4%
	3) AIA-JF	9.7%
	4) Bank of China - Prudential	8.3%
	5) Hang Seng Bank	8.0%
	6) Bank Consortium	7.1%
	7) Fidelity	4.3%
	8) Bank of East Asia	3.9%
	9) INVESCO	2.2%
	10) Dresdner	0.7%
	11) Standard Chartered	n/a*
	12) AXA	n/a*

10 MPF providers accounted for 84% of overall market

* FUM of these MPF service providers are not included in the WW MPF Report.
 The FUM universe in the WW MPF Report consisted of only 84% of the total MPF universe
 Source : Watson Wyatt MPF Report, September 2005

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HSBC Master Trusts

Investment choices

Risk profile	HSBC	Hang Seng	HSBC	Hang Seng
	SuperTrust		SuperTrust Plus	
Low	<ul style="list-style-type: none"> ▪ Capital Preservation Fund ▪ Guaranteed Fund 		<ul style="list-style-type: none"> ▪ Capital Preservation Fund ▪ Guaranteed Fund 	
Medium	<ul style="list-style-type: none"> ▪ Balanced Fund 		<ul style="list-style-type: none"> ▪ Stable Growth Fund ▪ Balanced Fund 	
High	<ul style="list-style-type: none"> ▪ Growth Fund ▪ Hang Seng Index Tracking Fund 		<ul style="list-style-type: none"> ▪ Growth Fund ▪ Hang Seng Index Tracking Fund ▪ North American Equity Fund ▪ European Equity fund ▪ Asian Equity fund ▪ Hong Kong Equity Fund 	

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Service by HSBC

- Enrolment confirmation notice with an MPF membership certificate
- Annual benefits statement
- Account and fund information access:
 - HSBC MPF website
 - 24-hour interactive voice response hotline
 - HSBC and Hang Seng Bank automatic teller machine (ATM)
- HSBC MPF Member's Guide
- Voluntary contributions for additional investment at lower than retail fund costs

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Fees and charges

	Capital Preservation Fund*	Guaranteed Fund	Other Funds
Trustee/Custodian/Administration fee	1.70% p.a.	1.20% p.a.	1.20% p.a.
Investment management fee	0.25% p.a.	0.75% p.a.	0.75% p.a.
Total fees	1.95% p.a.	1.95% p.a.	1.95% p.a.
Guarantee charge	N/A	0.75% p.a.	N/A

* Fees for the Capital Preservation Fund are deducted in the form of fund units from a member's account after the investment return and prescribed savings rate for each month have been ascertained.

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**Key success factors &
future development**

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The importance of members education

- Commencement in December 2000
- Tech-bubble bursted in March 2000 that lead to 2 years of down markets that recovered in 2003
- Much negative feelings on MPF during the first 3 years (falling fund prices)
- Dollar-Cost-Averaging: members have been buying funds in small amount for the past 5 years, and dollar-cost-averaging (DCA) helped to smooth-out volatility and purchase costs.

Members education is very important

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Lessons learnt

- Members education is vital
- Lifestyle fund approach (especially for fund beginners)
- Information disclosure
- Development of voluntary top-up
- Expected MPF provider consolidation did not materialise
 - Larger than expected steady inflow of contributions (including 9% total as top-up)
 - Investment market recovery
- Most providers utilise electronic means to accept and disseminate information
 - Monthly contributions
 - Information made available via internet and auto-phone systems (Interactive Voice Response System – IVRS)

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Lessons learnt

- Restrictive investment guidelines
- High administrative costs
- Capital Preservation Fund
 - Portfolio of short-term fixed-income securities
 - Maximum duration of 365 days, and maximum average portfolio duration of 90 days only
 - If return below prescribed savings rate as disclosed monthly by the MPF Authority, no fees can be collected by **ANY** of the service providers
 - Period of close to zero interest return (4Q03 – 2Q04)

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Suggestions put forward by the industry

- Raise mandatory contribution
- Encourage voluntary contribution – promote private retirement savings / insurance schemes
- Move from lump sum settlement towards providing retirement income – annuities
- Longer-term objectives: enhance employee choice of scheme
- Members financial education – learn more about investment, make better choice

Everyone working together to make MPF better

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