



# Recent Trends in Institutional and Pension Fund Investment Management in Asia

## Mandatory Provident Fund and the Development of Capital Markets

**Andrew Sheng**

**Chairman**

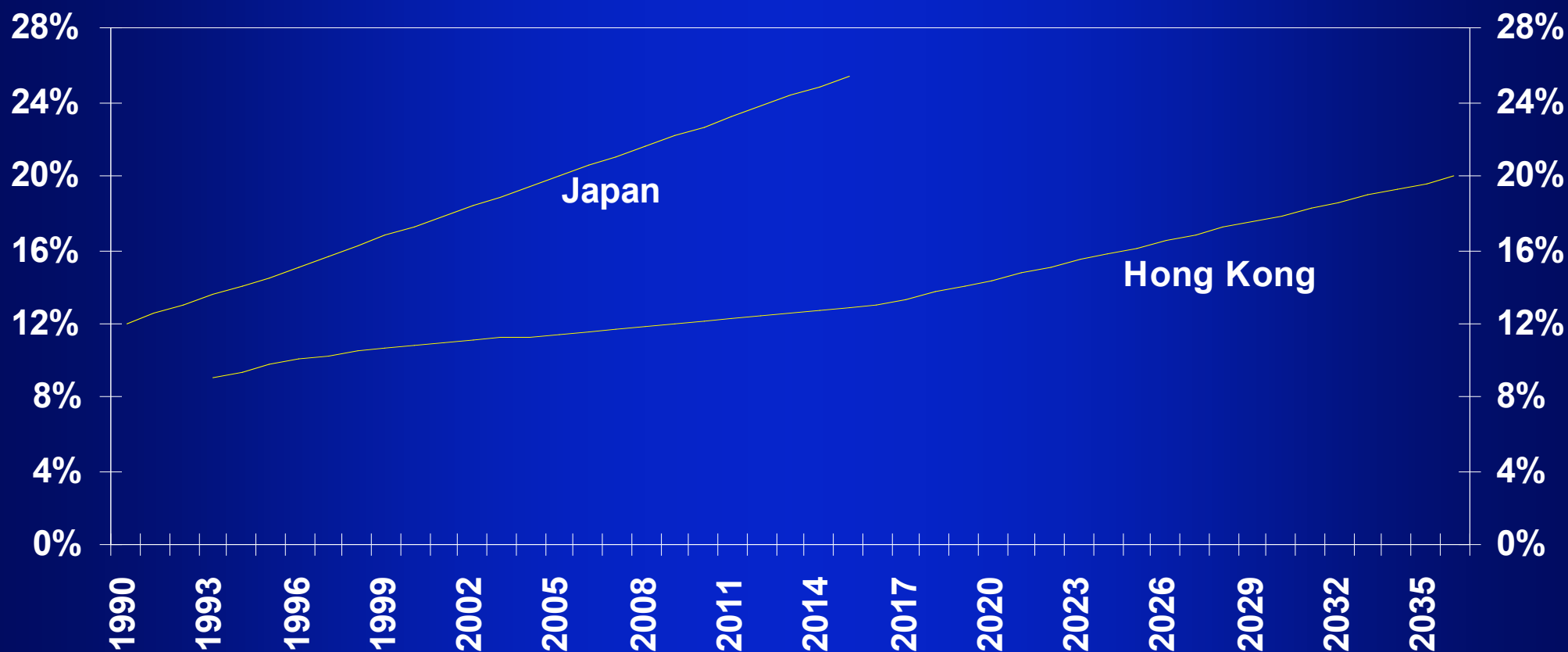
**Securities and Futures Commission**

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# Aging in Hong Kong and Japan

- ◆ In HK, population aged 65+ : 9.8% in 1995, 10.5% in 1998, 13% in 2016 and 20% in 2036
- ◆ In Japan, population aged 65+ : 14.5% in 1995, 16.2% in 1998 and 25.4% in 2015



Sources: MPFA, Statistics Bureau of Japan and World Bank



# Aging leading to unsustainable public pension spending

	Population Aged 65+ (% of total)		Public Pension Spending (% of GDP)	
	1997	2015	1995	2030
Japan	15.5	25.4	5.7	8.9
Germany	15.5	20.5	10.0	18.4
France	15.4	18.0	12.5	19.4
Italy	16.6	21.1	16.0	23.3
US	12.3	14.2	4.4	7.4
Sweden	17.3	21.1	8.5	9.2



# Government-funded retirement schemes

- ◆ **Government schemes** have low credit risks & low intermediation costs, and raise funding for Government at cheap cost
- ◆ **Disadvantages** are centralized investment, which may crowd out private investment choice and private sector access to funding
- ◆ If investment guidelines are not appropriate, investment losses are borne by retirees, or impose burden on fiscal budget to replace losses



# Private-funded retirement schemes

- ◆ **Private schemes** offer investor better choice, but yields may be higher, but with greater volatility;
- ◆ Private funds would be less susceptible to “policy-based funding directives” and on the whole are likely to be more efficient in asset allocation;
- ◆ Likely to be helpful to develop market through innovation and investor choice;
- ◆ **Disadvantages** are transactions costs will be higher due to marketing costs and need for careful supervision to avoid cheating and mismanagement by intermediaries



## MPF : Self-financing and privately-run schemes

- ◆ **Self-financing** : contributions by employers and employees only → ∴ reduce the burden of the government = reduce the burden of taxpayers (corporations and individuals) = enhancing competitiveness and restoring wealth
- ◆ **Privately-run** : funds administered by trustees in the private sector → force of competition to drive down costs
- ◆ Government only acts as as a regulator



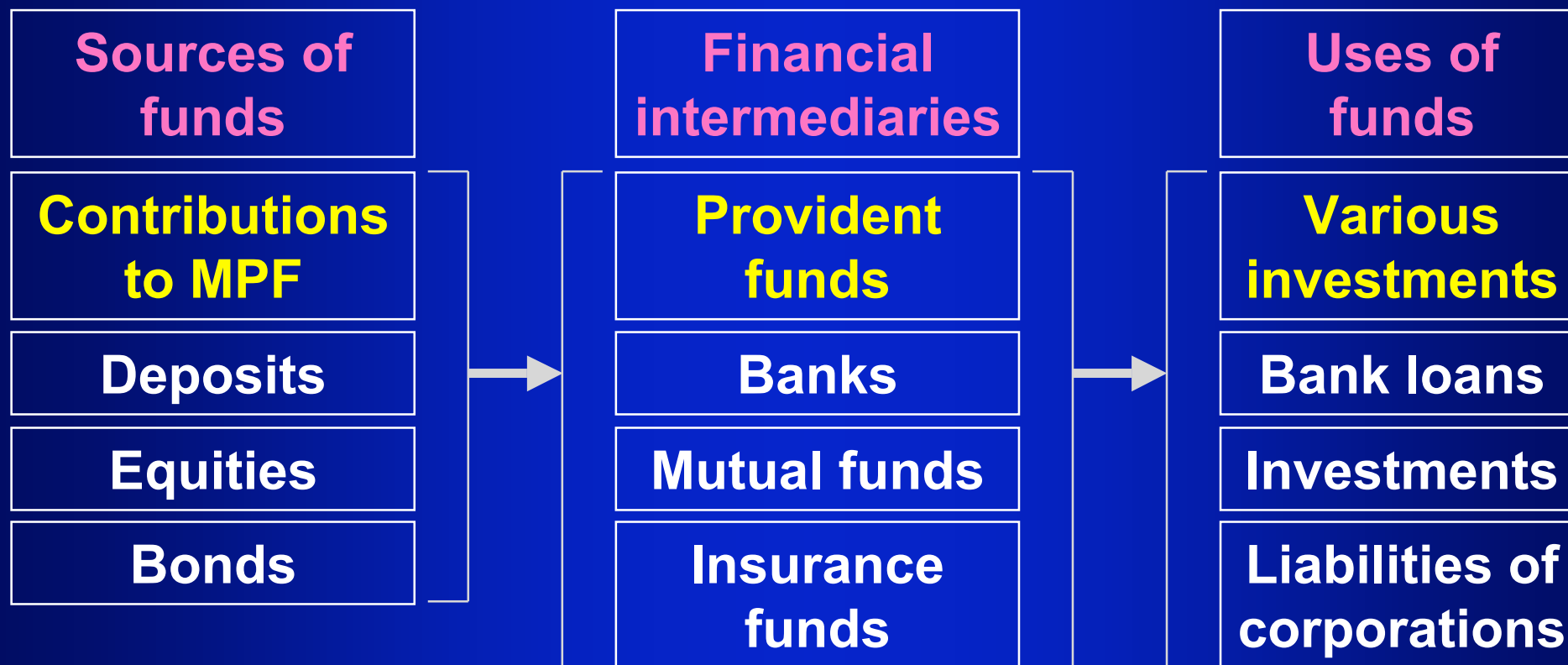
# Impact of the MPF Scheme on Capital Markets

- ◆ Initial MPF contributions > US\$1 bn annually, growing to US\$4 bn as the system matures (60-70% of GDP)
- ◆ Impact on capital markets :
  - ✦ demand for HK\$ debt instruments
  - ✦ development of bond and stock markets by providing a stable source of long term savings
  - ✦ greater stability in the stock market
  - ✦ corporate governance and innovation
  - ✦ development of hedging instruments
  - ✦ institutionalisation of savings
  - ✦ listings of overseas multinationals



# Efficient intermediaries needed

- ◆ Delayed consumption = savings = investment
- ◆ ∴ efficient intermediaries needed
- ◆ otherwise, fall in the vicious circle : bad loans → lost savings → lost consumption → suppressed economic growth → bad loans





# Functions of Capital Markets

- ◆ **Price discovery** - pricing of risks and valuation of property rights
- ◆ **Resource allocation** - exchange of property rights
- ◆ **Investor choice** - timing of consumption vs savings
- ◆ **Risk Management** - enable diversification of risks
- ◆ **Role in corporate governance**



# Great development potential for bond market (% of GDP 1998)

	Bank Assets	Equity Market	Bond Market
<b>Hong Kong</b>	<b>214</b>	<b>206</b>	<b>47</b>
China	139	25	12
Singapore	220	112	20*
US	65	158	141
Japan	145	64	101
Germany	273	51	97
S. Korea	233	35	53
Thailand	176	30	21#

Remark: \* figure for Singapore includes government bonds only; # 1997 figure  
Sources: FIBV, IFC, World Bank and various central banks



# Objectives of Financial Reforms

- ◆ Improve resource allocation
- ◆ Improve price discovery
- ◆ Improve risk management
- ◆ Improve corporate governance
- ◆ ∴ need to develop balanced bank, bond, equity and derivative markets



# Information & Markets

- ◆ Markets need real time, reliable information to make correct decisions, especially for risk management in highly volatile environment
- ◆ High quality information needs :
  - ✦ Good accounting standards,
  - ✦ Reliable, timely statistical & reporting processes
  - ✦ Capacity to process, analyze and decide on information critical to competitive success
- ◆ Bad accounting = bad information = poor decision making = bad risk management → financial crisis



# Financial Markets as Networks

- ◆ Networks have positive and negative externalities
- ◆ Power surges can cause weak hubs to trip fuse
- ◆ Stability and resilience of global network only as good as domestic networks
- ◆ Hence, charity begins at home
  - ✦ Need to build strong fundamentals
  - ✦ Fair, efficient and transparent markets, with sound regulation to international standards
  - ✦ Global competition - no one is immune



# Compendium of Sound Practices

- ◆ **APEC Collaborative Initiative on Development of Domestic Bond Markets' guidelines to develop domestic bond markets involve :**
  - ✦ **government policies**
  - ✦ **regulatory framework**
  - ✦ **market infrastructure**
  - ✦ **liquidity**
  - ✦ **risk management**



# Government policies

- ◆ **The government should :**
  - ✱ **strike a balance between its sovereign debt management policy and a strategy for domestic bond market development**
  - ✱ **play a catalytic role in the development of a nascent domestic bond market**
  - ✱ **develop a sound legal framework for its bond programme**
  - ✱ **promote a level playing field**
  - ✱ **ensure that the strategy for bond market development be consistent with fiscal and monetary policies**



# Regulatory framework

## ◆ There should be :

- ✱ **full, timely and accurate disclosure of information to investment decisions**
- ✱ **good governance principles**
- ✱ **clarity in the roles, responsibilities, and objectives of the regulatory authorities**
- ✱ **transparency in trading and price reporting to deter manipulation and unfair trading practices**
- ✱ **uniform regulatory, compliance and enforcement standards for intermediaries**
- ✱ **sound criteria for external credit assessments**



# Market infrastructure

◆ There should be :

- ✱ clear rules and procedures that govern the operations of a market infrastructure system
- ✱ an effective regulatory regime to ensure efficient operations of the systems
- ✱ clear risk management procedures to address the various categories of risks
- ✱ settlement lags of no more than T+3 days
- ✱ provision of relevant information to participants on a timely basis
- ✱ contingency arrangements to handle system problems



# Liquidity

◆ There should be :

- ✦ accurate and reliable benchmark yield curves
- ✦ regular issuance of bonds in large volume and long maturity
- ✦ transparency in the primary and secondary markets to promote market participation
- ✦ low transaction costs achieved through maintaining a competitive dealer structure and standardising trading conventions and settlement processes,
- ✦ wide and open market access available to diverse participants



# Risk Management

◆ There should be :

- ◆ a risk audit to identify the exposure of its bond programme to various risk categories
- ◆ a debt profile that provides protection against temporary market disruption
- ◆ risk-sharing through financial contracting to hedge against the potential costs arising from adverse market conditions
- ◆ sound investment and risk management policies
- ◆ credibility and reputation on the part of credit rating agencies to avoid conflict of interests



**Thank You**