This is the last time that I present the MPFA's annual report as its Managing Director. When I wrote the report for last year, I thought it was my last but somehow I managed to continue for one more year.

To start, I am deeply thankful to all those who have contributed to the MPF System and the MPFA during my past three years as its Managing Director. Without the trust and support of the Management Board and its Committees during these crucial years, we would not have made such remarkable progress, both in operating the MPF System and the development of the organization. Our achievements also have been built on the invaluable counsel and assistance provided by the MPF Schemes Advisory Committee and the Industry Schemes Committee. I must express particularly my deep gratitude to the MPFA Chairman, Mr Charles Lee, and the Government, both for their steer, support and understanding during my years as Managing Director.

In this last report, it may be tempting to present a summary of the past and then make a few forward-looking remarks. I have chosen not to do so. First, it would be too lengthy to give a sufficiently ample account of what the MPFA has done. Second, the past is history: reminiscences of a retiring Managing Director are not particularly useful. Instead, I would like to use the space below to make a few observations, none of which is new but nonetheless need reiteration.

- The Chairman, in his Statement, has pointed out the rapidly ageing profile of our population, and the associated worsening dependency ratios. Whilst the gradual but deepening impact of this development may have just dawned on the people of Hong Kong, it is an unavoidable reality that must be faced. By now, I think most people should have come to realize that the capacity and resources of the Government are finite. Having already heavily committed its resources to education, health, welfare, etc, the Government simply cannot be expected to carry the provision of retirement benefits from the public purse. If it were to take up and sustain such an unlimited programme, the only way would be to reduce other services and increase taxes at the same time.

- Mandatory retirement saving systems may take many forms. Some advocate a system with government guarantee and some prefer the system to operate on a "pay-as-you-go" basis. So far, to my knowledge, there has not been a single successful example of such a system continuing on a **sustainable** basis in the whole world. Indeed, the usual outcome (other than collapse of the system) has turned out to be either cutting back of benefits, substantial increase of contributions and taxes and/or deferment of the statutory retirement age. Starting relatively late, Hong Kong has been able to learn from others' mistakes and not fall into the same traps, however enticing some of the models might have appeared at the beginning.

- At times of high asset price inflation, such as in the pre-1997 years, there was a good chance that a reasonable nest egg could be put together by repeated capital gains in, say, "trading up" in properties, and savings for retirement schemes (compulsory or otherwise) conceivably could be argued as unnecessary. But this is no longer a real option, even in the long term. People's inclination to save and abilities to plan vary widely. Very often, individuals are so caught up with their more immediate financial concerns during the most productive period of their lives that they fail to accumulate an adequate sum for their retirement. A certain degree of compulsion therefore is necessary in order to furnish some assurance that an appropriate amount of assets is set aside for the future. Failing this, increasingly heavy reliance on the social safety net and a massive burden on future generations will be unavoidable.

- I would like to once again express my gratitude to the vast majority of employers, employees and self-employed persons for their forbearance and support, without which the MPF System would not have achieved such high compliance rates, despite the harsh economic circumstances. I must also pay tribute specially to the employers who are not only required to make contributions for their employees, but also have to go through the trouble of setting up and maintaining the administrative systems to comply with the MPF requirements.

- Certain employers however have expressed discontent with the mechanism of offsetting MPF benefits with severance payments/long service payments (SP/LSP), which in fact was a major concession very reluctantly made by the labour sector in exchange for the realization of a retirement protection scheme for the workforce. Many labour groups are still very dissatisfied about this offsetting mechanism because of the view that at least the offsetting against severance payment, if not long service payment, is unfair. Some employers complain about employees making high-risk investment choices, resulting, under the current volatile investment environment, in less accrued MPF benefits available for SP/LSP offsetting. These employers should not forget that the converse is also true, i.e. when the investment environment is good, their contributions will generate income to lighten, if not eliminate, their SP/LSP responsibility. Besides, employers are the ones who are vested with the right to choose the MPF trustees and MPF schemes for their employees. The SP/LSP legislation pre-dated the MPF by many years. These employers' discontent leads one to think that, perhaps, some of them have never intended to provide for SP/LSP in any case, even without MPF coming into the picture.

- Under the MPF System, the trustee of a MPF scheme is the central party having an overall responsibility for the administration and management of the scheme. Trusteeship is not a new concept and Hong Kong's trust law has a long history. It was with the widely understood and accepted role of trustees in mind that MPF schemes were entrusted to them when the System was designed. Under the MPF legislation, a trustee has an explicit fiduciary duty to serve the best interests of fund members and are subject to legal liability. Part of the trustee's functions may be delegated to other service providers but a trustee has the duty to supervise and exercise proper control over these service providers. A trustee's responsibilities as provided under the Trustee Ordinance are not less stringent when applied to the MPF System.

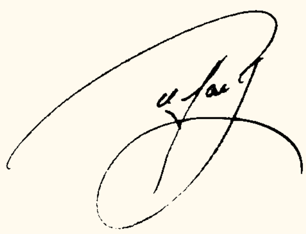
- The MPF System is a social programme, first and foremost. The business opportunities for the financial services sector are only secondary. Means and ends should not be confused. It is not MPF's aim to boost the markets - local, overseas, financial, property, or whatever. The financial infrastructure is only an instrument to facilitate the social programme. It is therefore imperative for the MPFA to focus on protection of employees' rights and benefits and apply prudential regulation/supervision to MPF-related financial services. Investment vehicles for MPF should be evaluated in terms of return and security from the point of view of scheme members. In any case, even though the legally required proportion of Hong Kong dollar denominated assets of a MPF constituent fund is 30%, the actual proportion is around 60%. Matching of assets and liabilities and diversification are basic risk management principles crucial to regulators and service providers alike. It is not necessary for politicians to exercise themselves over such matters.

- With MPF being mandatory in nature, the basic approach of the regulation of MPF-related investment products, almost by definition and certainly of necessity, should be more stringent and detail-specific than those not intended for MPF where 'caveat emptor' should have a larger role in the overall scheme of things. It would be up to the service providers to decide whether they wish to enter into MPF business and abide by the MPF rules, in addition to coming under the ambit of other regulators with regard to their non-MPF businesses.

- Hong Kong always has maintained a free market philosophy. Price control will only be considered under special situations. Hence, there is no policy to control the fees and charges under the MPF System. Only the administrative charges of capital preservation funds are kept under some regulation. Instead, competition and transparency are two important elements to ensure a cost-effective and efficient market. In the coming few years, MPFA will focus its resources and attention on improving transparency and disclosure of MPF products. I hope that, with extensive consultation, measures to tighten regulation with regard to the disclosure of fees and charges and investment performance will be implemented in stages with the MPF industry's support and cooperation. However, even with less than full consensus of the industry, it is still imperative that the System be improved and strengthened in these aspects. The argument that an average scheme member would not be able to understand or cannot be bothered with the information disclosed is unacceptable as scheme members should not be deprived of the opportunity to enhance their investment knowledge and their right to be properly informed. It is the responsibility of the authorities and the service providers to ensure that information concerning scheme members' rights and benefits is set out in a language that they can comprehend. In any case, we must never under-estimate the good sense and discerning power of the average scheme member. After all, it is his or her money.

Before I close, I wish to say that I have been very fortunate to have the staunch support of very capable, professional, dedicated and enthusiastic colleagues, whose commitment and hard work have been indispensible in enabling the MPFA to achieve its mission and to deliver the level and quality of performance clearly demonstrated since the inception of the MPF. The MPFA, as an organization, has always been under stringent public scrutiny. Its establishment (including staff's pay levels) was mapped out in the aftermath of the Asian financial turmoil and in a setting of deflation and high unemployment. In congruence with current philosophies on human resources management, a high proportion of performance-based variable pay has been a principal feature of the remuneration system right at the outset. Being a young organization, the MPFA does not have difficulty in maintaining a lean and relatively flat structure and flexibility in its remuneration system. It is therefore able to implement the remuneration recommendations of the Hay study[1] with ease, both at the directorate and other levels. Since its formation, the organization has been reviewed and downsized almost continually. Not only that salaries have never been increased since the organization was set up, it is also able to attain a staff cost to total expenditure ratio of 65.5%, which is nothing to feel ashamed about for any labour intensive public organization.

Among Hong Kong's public policies in the past decade, MPF is one of the biggest new initiatives. Now that we have laid down a foundation and have had a good start, I sincerely wish that MPF and the MPFA will continue to grow and prosper well into the future.



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1 The study commissioned by the Government on the remuneration of senior executives of ten selected statutory and other bodies in 2002.