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Pension funds warned of governance problems

By Jame DiBiasio | 4 May 2006

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MPF and other Asian pension fund schemes may be vulnerable to a crisis, argues consultant.

Pension fund schemes under Hong Kong's Mandatory Provident Funds regime and pension funds generally in Asia face political risk in the event of a crisis or scandal if they don't improve their governance and transparency, says Jamie Allen, secretary general of the Asian Corporate Governance Association in Hong Kong.

He presented his remarks to a luncheon hosted by the Hong Kong Retirement Schemes Association. The audience was small, which is a pity, as Allen actually had something to say. Perhaps HKRSA members were sceptical following last month's luncheon, featuring a regulator who chose to enlighten the industry by reading slides found on his organisation's website.

Specifically addressing the MPF scheme, Allen argues that while the government and the service providers view it as a sensible package, to most users, it is a black box. The government has rightly installed numerous checks and balances into the MPF system, and spells out the duties of trustees, investment managers and custodians. The Mandatory Provident Fund Schemes Authority has also recently promulgated standards for presenting performance and fees.

Rather, Allen sees a weakness in the opacity concerning trustees. Members have no idea who these people actually are, or what they do, and there is no way to verify that they are acting independently in members' best interest, and compelling fund managers to vote their shares. One-stop shops, where one financial group owns multiple functions of a pension scheme, may be particularly difficult to judge.

While MPF members are hardly agitating to find the answers, Allen suggests that in the event of a crisis, the role of trustees will fall under a microscope. Providers that can demonstrate their trustees are fulfilling their fiduciary responsibility will escape with their reputations intact. It is possible that most MPF master trusts can in fact withstand such scrutiny – but without a regulatory or media-driven enquiry, today members can't ascertain whether they are being properly looked after.

"In governance terms,"Allen says, "this is prima facie an inherently weak structure and lacks credibility. In a crisis, it could lead to problems."

Given crises in pension funds elsewhere, such as corporate scandals a la Robert Maxwell in the UK and Enron, or insolvencies such as US airlines, it is reasonable to assume Asia will one day suffer its own. And with the expansion of defined contribution plans, as governments and companies shift risk to individuals, and as MPF account sizes continue to become a bigger part of members' total assets, any such scandal could hurt a lot of people – and put governments under political pressure to make amends.

However, Allen's argument is not simply finger-wagging. He argues, rather, that investment managers stand to benefit by pursuing corporate-governance agendas regarding the companies in their portfolios. This is especially true of state pension systems, which much invest passively in their home markets and therefore benefit from fighting for better corporate governance.

Indeed, Allen notes that organisations such as the National Council for Social Security Fund in China, the Employees Provident Fund in Malaysia and the Pension Fund Association in Japan tend to be local leaders in governance issues. Japan's PFA is perhaps the most proactive, having developed a proxy voting policy for its own assets, and now votes on over 80% of its shares. It also seeded a good-corporate governance fund in 2004 managed by Nomura Asset Management.

Allen recommends MPF master trusts ensure they have an experienced and independent board of trustees, develop a policy on corporate governance and on share voting, create a dedicated unit for corporate governance and consider setting up corporate-governance funds.

Finally, he argues that MPF providers will benefit if they can change people's perceptions of their MPF scheme's inner workings as a black box. He says the extremely low percentage of voluntary contributions suggests that people don't trust MPF plans.

"Now is a good time, while the MPF is still young, for trustees and investment managers to institute explicit policies and practices on corporate governance," Allen says. "This can only be good for business as the benefits outweigh the costs."