C1528-00326.JAW2.MGXS 20 April 2000

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BY HAND & BY FAX (No. 2869 6794)
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Dear Sirs

Mandatory Provident Fund Schemes (General) Regulation (the "General Regulation")

Further to our letter dated 11 April 2000 sent on behalf of the group of custodian/trustees (the "**Group**") named at the end of that letter, and in advance of the meeting of the Subcommittee to be held on Wednesday, 26 April 2000, we would like to take the opportunity to summarise (in the same order) the Group's four main points. In our view, these address provisions in the General Regulation which are either practically impossible to comply with or impose severe burdens on custodians without materially increasing the safety of scheme assets (and therefore the protection of scheme members). Rest assured the Group recognises the need to protect the interests of scheme members.

1. ***Permitted encumbrances***

The Group's concern is that custodians will on occasion lend to a scheme to facilitate settlement of customer transactions on a timely basis. Custodian overdrafts may typically be required in circumstances where a sale transaction has failed and anticipated proceeds are not available to settle the purchase order or a failure of a counterparty to deliver funds as instructed. If the custodian is not permitted security (usually a lien) for such borrowings it is feasible that the custodian will not provide these facilities, resulting in market inefficiencies and higher operating costs which may adversely affect the performance of the scheme. Any such encumbrance (once validly granted) should remain valid while the loan remains outstanding.

However, practically speaking such loans are short term not usually exceeding 30 days. After discussion with the Authority and FSB on this point, the Group would as a last resort accept the amendment of "7" days to "30" days in Section 65(2)(b)(iii) of the General Regulation (and paragraph 3(b)(iv) of Schedule 3). Of course, as necessary, custodians may seek to enforce their security towards the end of the 30 day period.

2. ***The trustee's/custodian's indemnity***

The requirements of paragraph 5 pose a serious problematic risk issue for custodians. It also appears inconsistent with market practice (both in Hong Kong and elsewhere). For example, the SFC Code on Unit Trusts and Mutual Funds does not require custodians to give an "indemnity" at all. Deletion of the word "*indirectly*" appearing in parenthesis in the first line of paragraph 5(a) and the addition of "*provided that the agreement need not require the custodian to indemnify the scheme for any indirect, consequential or special losses*" will address the Group's concern in this respect.

3. ***Waiver of Schedule 3 requirements***

On further reflection, if the changes sought by the Group under paragraphs 1, 2 and 4 of this letter are made, then the Group does not feel that it will be necessary to grant the Authority any discretion to waive all or any part of Schedule 3 as it pertains to custody agreements (or trustee deeds of undertaking) for the purposes of Section 69 of the General Regulation.

However, the application of Schedule 3 to sub-custodian agreements does remain a real concern. In the opinion of the Group and after further consideration, the preferred route would in fact be to repeal Section 72 of the General Regulation (so that Schedule 3 has no application to sub-custodian agreements at all). Ultimately, in the event of default by a custodian or sub-custodian (the risk of which the FSB have acknowledged is remote), the trustee would seek recourse from the custodian. Provided that the custodian is liable for the fraudulent, dishonest and negligent acts of its "delegates" (which it would be by virtue of paragraph 5(b) of Schedule 3), there seems to be no material benefit to scheme members to require sub-custodian agreements also to be Schedule 3 compliant. The custodian will remain "on the hook". Without this change custodians will then have to renegotiate the terms of their sub-custodian agreements with their entire sub-custodian network, which in many cases may be impossible (certainly where sub-custodians believe that the requirements of Schedule 3 are not in accordance with market practice in the relevant place) or which, if achievable, is likely to be costly (a cost which may ultimately be borne by scheme members).

There would then be no need to give the Authority any discretion at all to waive any part of Schedule 3.

4. ***Treatment of scheme assets as trust property***

In our view the requirement to treat all scheme assets as trust property is impossible. It fails to make any distinction for scheme assets which are cash. Also custodians simply cannot agree to administer and deal with scheme assets as trust property if these assets are held in a place which has no trust law. In addition, trust law (where it exists) will differ from place to place.

Finally, we would like to take the opportunity of thanking you for inviting us to attend the meeting of the Subcommittee on Wednesday.

Yours faithfully

Clifford Chance

cc Ms Susie Ho

Financial Services Bureau

Mr Greg Willis/Mr Raymond Tam
Mandatory Provident Fund Schemes Authority