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Ms Salumi Chan
Clerk to Subcommittee
Legislative Council Secretariat
Legislative Council Building
8 Jackson Road
Central
Hong Kong

19 May, 2000

Dear Salumi,

Mandatory Provident Fund Schemes (General) Regulation

I refer to the letter from Clifford Chance dated 20 April 2000 addressed to you and have the following comments on the points raised therein.

Permitted Encumbrances

As stated in our letter of 20 April 2000, the policy is that the assets of MPF schemes should not be subject to unnecessary risks. Hence borrowing by an MPF scheme should be strictly limited. In this connection, section 65(2)(b) provides a mechanism for a scheme to obtain temporary loans for the settlement of securities in the event of an unexpected failure to receive proceeds from disposal of other securities to settle the trade. The permitted borrowing period of 7 days will give the investment manager

sufficient time to dispose of other securities to pay off the loan. The shorter the permitted period, the lesser the risk exposure.

Trustee's/ Custodian's Indemnity

There is no reference to 'indirect losses' in the primary legislation. By virtue of clause 23(d) of the Amendment Regulation, we propose to give MPFA the discretion to waive/ amend the custodial and sub-custodial agreement subject to certain conditions. The intention is that where the requirement upon the custodian/ sub-custodian to indemnify for indirect losses causes undue hardship, the MPFA may, in exercise of its discretion, waive such a requirement. If the industry can justify why giving the MPFA such a discretionary power cannot address their problem, then we would be prepared to consider the proposal to remove the reference to 'indirect losses' under item 5 of Schedule 3. If such a reference is eventually removed, the MPFA will no longer be given the discretion to waive the provisions in item 5.

Waiver of Schedule 3 Requirements

Section 72 of the General Regulation clearly spells out the policy intent that the agreement between the custodian and its delegate must include the same requirements as those specified in Schedule 3. Such a provision ensures that the provisions in the sub-custodial agreement would be subject to some standard form, and would comply with the principles in respect of safeguarding a scheme's assets as approved by the Legislative Council. We do not subscribe to the view that delegates of custodians should be released from the obligation to comply with the requirements in Schedule 3. Where there are deficiencies in the provisions in Schedule 3, or where the provisions create operational difficulties and undue hardship, we would be prepared to rectify the problematic provisions by way of legislative amendments. The present exercise is an example in point.

Treatment of Scheme Assets as Trust Property

It is of paramount importance for MPF scheme assets to be managed under trust arrangement. This principle is fundamental to the MPF System and should in no way be compromised. According to our legal adviser, the Regulation does not require the assets held in a jurisdiction where there is no trust law to be held on trust. In places where there is no law of trust, the scheme trustee should treat the assets to be held in a quasi-trust and ensure that the assets are properly held and recorded and that there is clear separation of assets. By virtue of clause 23(a) of the Amendment

Regulation, we are proposing to give MPFA the discretion to waive the trust requirement in respect of the agreement between the custodian and the sub-custodian where subject to the proviso, inter alia, that the MPFA is of the opinion that the provision causes undue hardship; or are being incapable of or precluded from being complied with by virtue of a law in a place outside Hong Kong. The onus would of course be upon the custodians and their delegates to prove that there are adequate grounds for waiving the specific requirement. We believe that giving the MPFA such a discretion is wide enough to address the concerns raised by the group of custodians.

Yours sincerely,

(Susie Ho)
for Secretary for Financial Services