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12 May 2000

Miss Salumi Chan  
Clerk to Subcommittee  
Legislative Council  
Legislative Council Building  
8 Jackson Road, Central  
Hong Kong

Dear Salumi,

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

I refer to Mr D.L. Goelzer's letter of 21 April 2000 to you.

We appreciate the concerns of Mr Goelzer and his clients. The Mandatory Provident Fund Schemes Ordinance and the Regulation passed by the Legislative Council in 1995 and 1998 were prepared in consultation with all relevant parties. Since its establishment in 1999, the Mandatory Provident Funds Schemes Authority (MPFA) has been in close dialogue with the relevant parties in the MPF System, including those from the custodian industry, to exchange views on matters of concern. In the process, both the MPFA and the Administration attach great importance to striking a balance between providing a system which would facilitate the work of the custodians including their delegates and the security of scheme assets.

One of the purposes of amending the Mandatory Provident Fund Schemes (General) Regulation is to improve the provisions which cause operational difficulties to service providers. We have proposed to broaden the circumstances under which encumbrances of scheme assets could be created and to extend the period which custodians are required to submit their annual report to the trustees. We also address the concern that some of the provisions in Schedule 3 to the Regulation would create difficulties for custodians and their delegates, by seeking to empower the MPFA to relax some of the provisions on a case-by-case basis, having regard to factors including hardship, operation of laws in a place outside Hong Kong and interests of relevant scheme members.

In respect of the four specific issues raised in Mr Goelzer's letter, we have the following comments :

#### A. Limitations on Custodian Eligibility

The MPF System is a privately-managed retirement protection system. We would like to see as wide participation in the System by different service providers as possible. To be eligible to be a custodian of scheme assets, a person must comply with the provisions of section 68 of the Regulation. Amongst other requirements, section 68(6) stipulates that a person is not eligible to be a custodian of scheme assets unless the person has sufficient presence and control in Hong Kong. Section 68(8) further elaborates the meaning of 'sufficient presence and control' which includes, inter alia, that the chief executive officer of the person ordinarily resides in Hong Kong [s68(8) (c)]. We recognize that such a provision is not clear and may create difficulties, hence an amendment has been proposed in the 'Statute Law (Miscellaneous Provisions) Bill 1999 to add 'Hong Kong' before 'chief executive officer' in s68(8)(c). The Bill has been introduced into the Legislative Council and resumption of the second reading debate will likely take place in June.

#### B. Limitations on Sub-custodian Eligibility

Under the MPF Schemes Ordinance, custodians and their delegates are charged with the important responsibility of holding scheme assets derived, to a large extent, from mandatory contributions. It is therefore crucial for the MPFA to ensure that the scheme assets are secure

and in safe custody. Custodians are required by law to have a nexus with Hong Kong. For persons who wish to act as delegates of custodians, since the law does not require them to have a local nexus, it is reasonable for the MPFA to be in a position to ascertain their suitability and financial soundness by requiring them to undergo a formal approval process. We do not see how such a process would impose undue burden on the institutions. Once approval has been granted to an overseas bank or an overseas trust company, that relevant institution and all of its wholly-owned banking or trust subsidiaries would be considered as qualified to act as delegates of custodians.

### C. Routine Security Interests

Mr Goelzer is of the view that section 65(2)(c) should be further revised to permit liens for safe custody and administration charges imposed by custodians. The purpose of the proposed amendment to the Regulation to permit encumbrances created in favour of delegates of custodians is to facilitate custodians to deploy their existing network of sub-custodians without having to re-negotiate new terms in the sub-custodian agreement which might be difficult, time consuming and costly. However, in relation to the agreement between the trustee and custodian, we envisage that every such agreement in relation to the MPF schemes will necessarily be a new contract incorporating the conditions prescribed in Schedule 3 to the Regulation. Moreover, the parties to the custodial agreement, i.e., the trustee and the custodian, are required to have a presence in Hong Kong. In the unlikely event of non-payment of custodian fees or charges, the custodian can readily resolve such disputes with the trustee face to face. It is therefore considered that no amendment in this regard is necessary.

### D. Schedule 3 and the Proposed Waiver Process

Mr Goelzer proposed that the MPFA should be given further discretion to grant 'block' waivers and that the scope of such waivers should be broad enough to cover prevailing market practices.

Since custodians and their delegates will be the main parties holding the assets of MPF schemes, it is reasonable to stipulate in the Regulation the basic contents of the agreement between the trustees and custodians, and the custodians and their delegates. Whilst we recognize that the MPFA should be given the discretion to waive the provisions in the agreement where such provisions prove to create difficulties, any such discretion should be confined to the specific areas where difficulties are identified.

Yours sincerely,

( Susie Ho )  
for Secretary for Financial Services