For discussion
on 4 April 2022

Legislative Council Panel on Financial Affairs

Proposed Legislative Amendments to
Facilitate MPF Investment in Debt Securities Issued in the Mainland

PURPOSE

This paper seeks Members' views on the legislative proposal of the Government to facilitate investment by Mandatory Provident Fund ("MPF") funds in debt securities issued or guaranteed by the Central People's Government ("CPG"), People's Bank of China ("PBOC") and the three Mainland policy banks, namely Agricultural Development Bank of China ("ADBC"), China Development Bank ("CDB") and The Export-Import Bank of China ("EIBC").

BACKGROUND

2. The MPF System currently manages some HK$1.15 trillion in assets, providing basic retirement protection for around 4.5 million MPF scheme members under the multi-pillar retirement protection framework in Hong Kong. Enriching the investment options for MPF funds and enhancing the investment return to scheme members are amongst the key initiatives of the Government and the Mandatory Provident Fund Schemes Authority ("MPFA") to improve the adequacy of the MPF System. For example, in November 2020, the MPFA added the Shanghai and Shenzhen stock exchanges to the list of "approved stock exchanges", thereby facilitating investment by MPF funds into shares listed in the Mainland. As of 31 December 2021, the exposure of MPF funds to China A-shares has more than doubled to around HK$33.1 billion (about 2.8% of total MPF assets).

3. In recent years, there is growing demand from both MPF scheme members and the industry for more investment choices that could yield stable return and enable the development of retirement solutions tailored to the investment appetite of scheme members approaching retirement or in the decumulation phase[1] of their MPF benefits. Specifically, there have been calls from the MPF industry for facilitating MPF investment into bonds issued by the CPG, its central bank (i.e. PBOC) and its three policy banks (i.e. ADBC, CDB, EIBC), which present great investment potential and diversification opportunities for MPF scheme members.

4. The Mainland onshore bond market is now the largest bond market in Asia and the second-largest in the world, with a total size of US$19 trillion. A number of international benchmark indexes have recently included Mainland onshore bonds, and the latest average daily turnover of Northbound Trading of Bond Connect has reached RMB 33.8 billion (involving over 3,300 institutional investors) in February 2022, while the amount of foreign holdings of Mainland bonds has exceeded RMB 4 trillion. These have demonstrated the strong market interest in and demand for debt securities issued by Mainland issuers.

CURRENT RESTRICTIONS ON MPF INVESTMENT IN DEBT SECURITIES

5. Under section 7(2) of Schedule 1 to the Mandatory Provident Fund Schemes (General) Regulation (Cap. 485A) ("the Regulation") and Guidelines III.1 "Guidelines on Debt Securities" issued by the MPFA pursuant to section 6H of the Mandatory Provident Fund Schemes Ordinance (Cap. 485) ("the Guidelines"), MPF funds may invest in –

(a) a debt security issued by an exempt authority, or a debt security in respect of which the repayment of the principal and the payment of interest is unconditionally guaranteed by an exempt authority; or

[1] Decumulation phase generally refers to the period when MPF scheme members are entitled to withdraw their MPF benefits upon reaching the retirement age (i.e. 65) or the early retirement age (i.e. 60) and no longer required to make regular MPF contributions.

(b) a debt security that satisfies a minimum credit rating set by the MPFA (i.e. BBB-)[2], based on the credit rating of the security as determined by a credit rating agency approved by the MPFA[3]; or

(c) a debt security listed on an approved stock exchange, being a security issued by, or guaranteed by, a company or corporation whose shares are listed on an approved stock exchange.

6. Section 7(1) of Schedule 1 to the Regulation provides that an exempt authority means:

(a) the Government (i.e. the Government of the Hong Kong Special Administrative Region ("HKSAR")); or

(b) the Exchange Fund established by the Exchange Fund Ordinance (Cap. 66); or

(c) a company all of the shares of which are owned beneficially by the Government; or

(d) a government, the central or reserve bank of a country or territory, or a multilateral international agency all with the highest possible credit rating (i.e. AAA) determined by a credit rating agency approved by the MPFA.

7. At present, there are 16 sovereign states accorded with the status of "exempt authority" by virtue of attaining the required credit rating. The CPG, its central bank (PBOC) and its three policy banks (ADBC, CDB and EIBC) are currently not on the list of "exempt authority".

8. As of 31 December 2021, about 19.5% of the total MPF assets were invested in debt securities. As shown by the table below, MPF investment in debt securities issued by Mainland issuers which satisfies the relevant credit rating (BBB- or above) or are listed on an approved stock exchange accounted for only about 2.52% of the total MPF assets. Of these, MPF investment in debt securities issued by the CPG (through the Ministry of Finance ("MOF")) and its three Mainland policy banks

[2] The minimum credit rating of debt security set by the MPFA for the purpose of section 7(2)(c) of Schedule 1 to the Regulation is provided in the Guidelines.

[3] The credit rating agencies approved by the MPFA are: Fitch Ratings, Moody's Investors Service, Inc., Rating & Investment Information, Inc. and Standard & Poor's Corporation. The list is set out in the Guidelines.

amounted to only about 0.28% of total MPF assets, suggesting that there is much room for MPF investment in these securities.

MPF Investment (as of 31 December 2021)	**Investment Amount in Debt Securities (HK$ billion)**	**Percentage of Investment Amount over Total MPF Assets**
Mainland debt securities	**29.7 (13%)**	**2.52%**
MOF-issued	1.4	0.12%
PBOC-issued	-	-
Policy bank-issued	1.8	0.16%
Corporation-issued	26.5	2.24%
Non-Mainland debt securities	200.7 (87%)	17.0%
Total:	**230.5 (100%)**	**19.5%**

Note: figures may not add up to the total due to rounding.

LEGISLATIVE PROPOSAL

9. The prevailing investment rules as set out in the Regulation and the Guidelines are found to be contributing to a dearth of suitable Mainland government bonds for MPF investment. To facilitate MPF investment in Mainland government bonds, we **propose** to amend section 7(1) of Schedule 1 to the Regulation by adding the CPG, PBOC, ADBC, CDB and EIBC to the list of "exempt authority" for the following reasons –

(a) The HKSAR is part of the People's Republic of China ("PRC"). Since the Government is an exempt authority under the Regulation, it is only appropriate to accord the same "exempt authority" status to the CPG. By doing so, bonds issued or guaranteed by CPG through MOF will no longer be subject to the requirement on issue-specific credit rating.

(b) PBOC is the PRC's central bank. As PBOC issues debt securities in its own name and those bonds are the obligations of PBOC itself, there is a need to make PBOC a separate "exempt authority" to ensure that the proposed facilitation measure will cover the full range of CPG bonds.

(c) The three Mainland policy banks (i.e. ADBC, CDB and EIBC) are state-owned and established by the CPG to support the implementation of various policies for the social and economic development of the PRC. Given their crucial role in implementing the national policies of the CPG, they should also be granted "exempt authority" status.

10. Under the current investment rules as set out in the Regulation, MPF investment in securities and other permissible investments issued by a single non-exempt authority is subject to the limit of 10% of the total funds of an MPF constituent fund[4]. On the other hand, an MPF constituent fund could invest up to 30% of its total funds in debt securities of the same issue issued or unconditionally guaranteed by an exempt authority, and may invest all of the funds of the MPF constituent fund in debt securities of the same issuer comprising at least 6 different issues issued or unconditionally guaranteed by an exempt authority[5]. These higher investment thresholds will be applicable to MPF investment in debt securities issued or unconditionally guaranteed by the CPG, PBOC and the three Mainland policy banks after they are classified as exempt authority.

11. To keep up with the development of the Mainland bond market and depending on the market feedback to the proposed facilitation measure, we may consider inclusion of other Mainland government bodies (e.g. provincial government) in the scope of exempt authority by way of amending the Regulation in future.

---

[4] According to section 2(1) of Schedule 1 to the Regulation, an MPF constituent fund can invest at most 10% of its total funds in securities and other permissible investments issued by a single issuer. By section 7(3) of Schedule 1 to the Regulation, this general restriction on spread of investments does not apply to debt securities issued or unconditionally guaranteed by an exempt authority.

[5] These higher investment thresholds are provided for in section 7(3) of Schedule 1 to the Regulation. The Securities and Futures Commission's Code on Unit Trusts and Mutual Funds has also put in place a similar 30% cap for a single issue and a requirement of a minimum of six different issues for investment of all assets for government debt securities.

LEGISLATIVE TIMETABLE

12. We plan to introduce the proposed amendments to the Regulation at the Legislative Council ("LegCo") through a positive vetting procedure in early June 2022. Subject to LegCo's approval, the amended Regulation will take effect upon gazettal in mid-June 2022 the earliest.

ADVICE SOUGHT

13. Members are invited to offer views on the proposed facilitation measure and legislative proposal.

Financial Services Branch
Financial Services and the Treasury Bureau
March 2022