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LEGISLATIVE COUNCIL BRIEF

Mandatory Provident Fund Schemes Ordinance
(Chapter 485)

MANDATORY PROVIDENT FUND SCHEMES (GENERAL) (AMENDMENT) REGULATION 2022

INTRODUCTION

At the meeting of the Executive Council on 10 May 2022, the Council ADVISED and the Chief Executive ORDERED that the Mandatory Provident Fund Schemes (General) (Amendment) Regulation 2022 ("Amendment Regulation") at **Annex** should be made under section 46 of the Mandatory Provident Fund Schemes Ordinance (Cap. 485) ("MPFSO"), subject to the approval of the Legislative Council ("LegCo"), in order to facilitate Mandatory Provident Fund ("MPF') investment in Mainland government debt securities.

JUSTIFICATIONS

Growing demand for Mainland government bonds

2. The MPF System currently manages some HK$1.12 trillion in assets, providing retirement protection for around 4.6 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 Shanghai and Shenzhen stock exchanges became "approved stock exchanges" under the Mandatory Provident Fund Schemes (General) Regulation (Cap. 485 sub. leg. A) ("Regulation"), thereby

facilitating investment by MPF funds into shares listed in the Mainland. As of 31 March 2022, the exposure of MPF funds to China A-shares has increased by some 130% to HK$25.9 billion, representing about 2.3% of total MPF assets.

3. 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 28.2 billion (involving over 3 400 institutional investors) in March 2022, while the amount of foreign holdings of Mainland bonds has reached RMB 3.88 trillion. These have demonstrated the strong market interest in and demand for debt securities issued by Mainland issuers.

4. 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 Central People's Government ("CPG"), its central bank (i.e. People's Bank of China ("PBOC")) and the three policy banks (i.e. Agricultural Development Bank of China ("ADBC"), China Development Bank ("CDB") and The Export-Import Bank of China ("EIBC")), which present great investment potential and diversification opportunities for MPF scheme members.

Current landscape of MPF investment in China bonds

5. As of 31 March 2022, about 19.9% of the total MPF assets (about HK$222.9 billion) 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 2.4% 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 policy banks amounted to only

[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.

about 0.3% of total MPF assets (about HK$3.2 billion). These figures are not commensurate with the growing opportunities and investment interest in the Mainland bond market.

MPF Investment (as of 31 March 2022)	Investment Amount in Debt Securities (in HK$ billion)	Percentage of Investment Amount over Total MPF Assets
Mainland debt securities	**27.0 (12%)**	**2.4%**
MOF-issued	1.5	0.1%
PBOC-issued	-	-
Policy bank-issued	1.7	0.2%
Corporation-issued	23.7	2.1%
Non-Mainland debt securities	195.9 (88%)	17.5%
Total:	**222.9 (100%)**	**19.9%**

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

Current restrictions on MPF investment in debt securities

6. Under section 7(2) of Schedule 1 to the Regulation and Guidelines III.1 "Guidelines on Debt Securities" ("Guidelines") issued by the MPFA pursuant to section 6H of the MPFSO, MPF funds may be invested 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

(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

[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.

(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.

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

(a) the Government; 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.

8. 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 comprising at least 6 different issues issued or unconditionally guaranteed by an exempt authority[5]. As the CPG, its central bank (i.e. PBOC) and the three policy banks (i.e. ADBC, CDB and EIBC) are currently not on the list of exempt authority, the

[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 investment of assets of a unit trust or mutual fund in a single issue of government debt securities, and a requirement of a minimum of six different issues for investment of all assets of the unit trust or mutual fund in government debt securities.

exposure of MPF investment to debt securities issued or unconditionally guaranteed by these Mainland authorities is currently quite limited.

THE PROPOSAL

9. We propose to add the CPG, PBOC, ADBC, CDB and EIBC to the list of exempt authority under the Regulation, thereby facilitating MPF investment into bonds of these entities. Specifically –

(a) Hong Kong 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; and

(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. The higher investment thresholds as mentioned in paragraph 8 above would 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. The proposed facilitation measure will help consolidate Hong Kong's status as a platform to issue RMB bonds and a global offshore RMB business hub, leveraging the opportunities brought by the development of the Mainland bond market.

THE AMENDMENT REGULATION

12. The Amendment Regulation at **Annex** provides for the amendments to section 7(1) of Schedule 1 to the Regulation by adding CPG, PBOC, ADBC, CDB and EIBC to the existing list of exempt authority.

LEGISLATIVE TIMETABLE

13. The legislative timetable will be –

To move a motion in LegCo	1 June 2022
Commencement	The date on which the Amendment Regulation is published in the Gazette following LegCo's approval

IMPLICATIONS OF THE PROPOSAL

14. The Amendment Regulation is in conformity with the Basic Law, including the provisions concerning human rights. It will not affect the current binding effect of the existing provisions of the MPFSO. The Amendment Regulation itself has no civil service, economic, environmental, family, financial, gender, productivity and sustainability implications.

PUBLIC CONSULTATION

15. The LegCo Panel on Financial Affairs was consulted on the proposed amendments to the Regulation at the meetings of 7 February and 4 April 2022 respectively. Panel Members were supportive of the legislative proposal.

PUBLICITY

16. We will issue a press release upon the approval of the Amendment Regulation and arrange a spokesperson to answer media and public enquiries.

ENQUIRIES

17. Enquiries relating to this brief can be directed to Miss Cheryl CHOW, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) Mandatory Provident Fund Reform, at 2810 2061.

Financial Services Branch
Financial Services and the Treasury Bureau
11 May 2022

Annex

Mandatory Provident Fund Schemes (General) (Amendment) Regulation 2022

(Made by the Chief Executive in Council under section 46 of the Mandatory Provident Fund Schemes Ordinance (Cap. 485) subject to the approval of the Legislative Council)

1. Mandatory Provident Fund Schemes (General) Regulation amended

The Mandatory Provident Fund Schemes (General) Regulation (Cap. 485 sub. leg. A) is amended as set out in section 2.

2. Schedule 1 amended (investment of scheme funds)

(1) Schedule 1, section 7(1), definition of ***exempt authority***, before paragraph (a)—

Add

"(aa) the Central People's Government;

(aab) the People's Bank of China;

(aac) the Agricultural Development Bank of China;

(aad) the China Development Bank;

(aae) The Export-Import Bank of China;".

(2) Schedule 1, section 7(1), definition of ***exempt authority***, paragraph (a)—

Repeal

"or".

(3) Schedule 1, section 7(1), definition of ***exempt authority***, paragraph (b)—

Repeal

"or".

Clerk to the Executive Council

COUNCIL CHAMBER

10 May 2022

Explanatory Note

This Regulation amends the definition of ***exempt authority*** in section 7(1) of Schedule 1 to the Mandatory Provident Fund Schemes (General) Regulation (Cap. 485 sub. leg. A) (***Schedule 1***). Once the amendments take effect, each of the following entities is an exempt authority under that Schedule—

(a) the Central People's Government;

(b) the People's Bank of China;

(c) the Agricultural Development Bank of China;

(d) the China Development Bank;

(e) The Export-Import Bank of China.

2. Under section 7(3) of Schedule 1, section 2 of Schedule 1 does not apply in relation to a debt security of a kind referred to in section 7(2)(a) or (b) of Schedule 1 (that is to say, 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) (***specified debt security***) and the following provisions apply instead—

(a) not more than 30% of the funds of a constituent fund (as defined by section 1(1) of Schedule 1) may be invested in debt securities of the same issue if they are specified debt securities;

(b) all of the funds of a constituent fund (as defined by that section 1(1)) may be invested in debt securities of the same issuer so long as they comprise at least 6 different issues and are specified debt securities.

3. The amendments come into operation on the date of gazettal of the Regulation.