

MANDATORY PROVIDENT FUND SCHEMES AUTHORITY

III.7 Guidelines on Securities Lending

INTRODUCTION

Section 52 of the Mandatory Provident Fund Schemes (General) Regulation (“the Regulation”) specifies the restrictions on lending of scheme securities.

2. Section 6H of the Mandatory Provident Fund Schemes Ordinance (“the Ordinance”) provides that the Mandatory Provident Fund Schemes Authority (“the Authority”) may issue guidelines for the guidance of approved trustees, service providers and other persons concerned with the Ordinance.

3. The Authority hereby issues guidelines to specify the requirements in respect of security lending.

SECURITY LENDING

Statement of Investment Policies

4. If the constituent fund of a registered scheme will engage in security lending, the statement of investment policies fund must clearly state so.

Written Agreement

5. The custodian cannot enter into security lending unless it enters into a written agreement with the borrowing party which complies with the requirements stipulated in Rule 15 of the Securities (Dealers, Investment Advisers, Partnerships and Representatives) Rules of the Securities Ordinance (Cap. 333).

Requirements of Collateral

6. Collateral for securities lent can be in the form of :

- (a) cash, in the same currency denomination as the securities lent, or in Hong Kong or US dollar if the securities lent are denominated in a foreign currency; or
- (b) debt securities as prescribed under section 7(2)(a) or (b) of Schedule 1 to the Regulation and with remaining maturity of 3 years or less. The remaining maturity period may be more than 3 years if the security lending is conducted on a fully indemnified basis.

7. Cash collateral should be:

- (a) deposited with a bank, as defined in section 2 of the Banking Ordinance (Cap. 155), or an eligible overseas bank; or
- (b) invested in debt securities as prescribed under section 7(2)(a) or (b) of Schedule 1 to the Regulation and with remaining maturity of 1 year or less. The debt securities must be denominated in the same currency as the cash collateral.

8. Collateral must be marked-to-market daily.
9. A minimum margin requirement of 5% over the market value of the securities lent must be maintained for the collateral. The approved trustee and/or the custodian may impose a higher margin requirement taking into account the volatility of the value of the securities lent.
10. The custodian can only transfer the securities lent to the borrower at the time of receiving or after it has received the collateral from the borrower.

Benefit to Scheme Members

11. Security lending can only be conducted if it can bring in additional income (net of fees and expenses) to scheme members and if it does not adversely affect the interest of scheme members.

Identity of Principal Borrower

12. Security lending is not allowed to be conducted on a no-name basis. In other words, the custodian must be fully aware of the identity of the principal borrower.

Qualification of Custodian

13. The custodian, if engaging in security lending, must have proper registration with the Securities and Futures Commission. It has to be either a securities dealer or declared as an exempt dealer under the Securities Ordinance (Cap. 333).

Investment Manager Veto

14. The investment manager has to be given the power to suspend security lending arrangement at any time. Such power should be clearly stated in the investment management contract.

Counterparty risk

15. The custodian is required to closely monitor the risk exposure to counterparties on a daily basis.

Approved Pooled Investment Fund

16. The above requirements also apply to security lending conducted in approved pooled investment funds.

DEFINITION OF TERMS

17. Except where otherwise specified in the guidelines, the terms common to the Ordinance and the subsidiary legislation of the Ordinance carry the same meanings as defined in the Ordinance and the subsidiary legislation. Appropriate references should be made to the Ordinance and the subsidiary legislation, where necessary.