

MANDATORY PROVIDENT FUND SCHEMES AUTHORITY

I.8 Guidelines on Custodial / Subcustodial Agreement

INTRODUCTION

Schedule 3 to the Mandatory Provident Fund Schemes (General) Regulation (“Regulation”) sets out matters that must be incorporated into agreements for the appointment of custodians of the assets of registered schemes and their delegates (i.e. sub-custodians). Section 11 of the Schedule provides that the Mandatory Provident Fund Schemes Authority (“Authority”) may waive or modify those requirements in certain circumstances.

2. Pursuant to C1.3 and D1.3 of the Code on MPF Investment Funds, Schedule 3 applies in constructing custodial/subcustodial agreements in respect of approved pooled investment funds (“APIFs”).

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

4. The Authority hereby issues guidelines to prescribe :

- (a) the application procedures for seeking waivers or modifications to custodial or subcustodial agreements; and
- (b) the criteria which the Authority will consider in granting the waivers / modifications.

CUSTODIAL AGREEMENTS

5. Section 69 of the Regulation requires that, where the approved trustee of a registered scheme appoints a custodian to administer the scheme assets, the contract of appointment must incorporate a custodial agreement that complies with Schedule 3 to the Regulation.

6. Section 11 of Schedule 3 empowers the Authority to waive or modify the provisions of section 2 of the Schedule (which requires the custodian to record the assets of the scheme separately from the assets of the custodian and the trustee).

SUBCUSTODIAL AGREEMENTS

7. Section 72 of the Regulation requires the subcustodial agreement entered into between a custodian of scheme assets and its delegate (i.e. sub-custodian) to include the same requirements as those specified in Schedule 3 to the Regulation.

8. Section 11 of Schedule 3 empowers the Authority to waive or modify the provisions of the following sections of the Schedule:

- (a) section 2 (which requires the sub-custodian to record the assets of the scheme separately from the assets of the sub-custodian and the trustee);
- (b) section 5 (which requires the sub-custodian to indemnify the scheme against certain losses);
- (c) section 6(1)(a) (which requires the sub-custodian to report to the custodian changes material to the sub-custodian's eligibility to be a sub-custodian);
- (d) section 6(2) (which requires the sub-custodian to provide periodic

reports to the custodian); and

- (e) section 7(a) (which requires the sub-custodian to report within 4 months after the end of each financial year of the sub-custodian whether the sub-custodian satisfies the same eligibility requirements applicable to the custodian).

APPLICATION PROCEDURES

9. Approved trustees, custodians or insurers (in the case of APIFs which are insurance policies) may apply to the Authority in writing for the waiver or modification of the requirements of Schedule 3. Such applications should be addressed to the Executive Director (Services Supervision) of the Authority.

10. In accordance with section 11, the Authority can only exercise its discretion to waive or modify the requirements of the Schedule where the Authority is of the opinion that the requirements of Schedule 3 –

- (a) cause undue hardship;
- (b) are incapable of or precluded from being complied with by virtue of a law in a place outside Hong Kong; or
- (c) are not in the interests of relevant scheme members.

11. Each criterion is discussed below.

12. Applications must address the criteria and specify which of the sections of Schedule 3 are the subject of the application and, in respect of each section, specify whether the applicant seeks a waiver or a modification. If a modification is sought, the applicant should propose a draft of the relevant sections as modified.

13. Applications must state whether waiver or modification is sought for specified jurisdictions or worldwide.

WHO SHOULD APPLY?

14. Applications may be made by:
- (a) An approved trustee on behalf of the custodian(s) and sub-custodians of its registered schemes and APIFs;
 - (b) A custodian for itself and/or its sub-custodians;
 - (c) Individual sub-custodians;
 - (d) A group or association of approved trustees in respect of named custodians or sub-custodians; or
 - (e) An insurer on behalf of the custodian(s) and sub-custodians of its APIFs.

CRITERIA

Causes Undue Hardship

15. This is a very general provision that may apply where hardship is caused to the trustee, custodian, sub-custodian, participating employers or members of a registered scheme. In the context of section 11, hardship is “undue” when it is excessive or disproportionate to the regulatory benefits or safeguards sought to be achieved by compliance with the relevant section of Schedule 3. For instance, where strict compliance with a section of Schedule 3 would cause excessive expense or disruption, achieves little additional protection for scheme members or where such protection can be achieved by more convenient means, that would be regarded as “undue hardship”.

Are Incapable of or Precluded from Being Complied with by Virtue of a Law in a Place outside Hong Kong

16. Whether this criterion is satisfied should be a matter of fact.

Are Not in the Interests of Relevant Scheme Members

17. If compliance with the relevant sections of Schedule 3 will harm the interests of scheme members, this criterion will be regarded as satisfied. Usually such harm might arise from excessive cost, restrictive investment practices, difficulty in finding a willing custodian or sub-custodian or similar grounds causing expense or loss of amenity to scheme members.

DEFINITION OF TERMS

18. Except as otherwise specified in these Guidelines, the terms common to the Ordinance and the subsidiary legislation of the Ordinance carry the same meanings as those defined in the Ordinance and the subsidiary legislation. Reference should be made to the Ordinance and the subsidiary legislation, where necessary.

19. References to “scheme members” and “scheme assets” in these guidelines shall, in respect of APIFs, be construed as references to “fund holders” and “fund assets” respectively.