



強制性公積金計劃管理局
MANDATORY PROVIDENT FUND SCHEMES AUTHORITY

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By Email

17 November 2022

Circular Letter: PR/CTR/2022/003

To: All Approved Trustees

Dear Sir/Madam,

Approval criteria for constituent funds within an MPF scheme

This circular letter sets out the approval criteria for constituent funds within an MPF scheme and supersedes the circular letter dated 23 February 2011 on the same subject (the 2011 Circular) with immediate effect.

Background

2. Constituent funds offered in an MPF scheme are subject to the Authority's approval for the protection of scheme members' interests¹. There are currently 27 MPF schemes with 412 constituent funds on the market. As Hong Kong has a rapidly aging population and the financial markets are becoming more volatile, it is imperative that the range of constituent funds in an MPF scheme is sufficiently diverse to address the needs of

¹ Section 21BA of the Mandatory Provident Fund Schemes Ordinance (the Ordinance) provides that an MPF trustee of an MPF scheme must, before making a constituent fund available in the scheme for investment by scheme members, ensure that the fund has been approved by the Authority. Section 21BB(6) of the Ordinance provides that the Authority may refuse to approve a constituent fund if it is not satisfied that the fund is in scheme members' interests.

scheme members with different investment outcome expectations and risk appetites in both the accumulation and post-retirement phases. In this regard, a balance needs to be struck between offering too narrow a choice of different constituent funds, which may impede the ability of scheme members to allocate their MPF investments according to their risk appetite and target investment outcome, and providing too many choices, which could result in choice overload on the part of scheme members. As such, the promotion of diversity of fund choices in an MPF scheme should not lead to a proliferation of funds.

3. Over the years, the Authority has been making efforts to promote the diversity of constituent funds within MPF schemes to cater for scheme members' needs in both the accumulation and post-retirement phases, including the introduction of the default investment strategy in 2017 and the issuance of a set of principles in 2020 that provides a high-level framework to assist the MPF industry in developing suitable retirement solutions. Taking these efforts further, with the benefit of the views of scheme members and the support of the MPF industry associations, the Authority has refined the approval criteria for constituent funds set out in the 2011 Circular and will adopt them with immediate effect. The refined approval criteria are set out in the ensuing paragraphs.

(I) Overarching principle in relation to the range of constituent funds in an MPF scheme

4. The addition of a new constituent fund to the existing range of constituent funds in an MPF scheme should enhance the diversity of the range of constituent funds to meet the needs of scheme members with different outcome expectations and risk appetites in the accumulation and post-retirement phases. Proposals from MPF trustees would be assessed on a case-by-case basis, taking into consideration the current range of constituent funds within the relevant MPF scheme. The Authority would not approve a new constituent fund unless it is satisfied that this overarching principle could be met.

(II) Addition of constituent funds to an MPF scheme

5. The MPF trustee applying for approval of a new constituent fund is required to demonstrate, as part of the relevant application for approval, that (a) the proposed new fund has a different investment policy from those of the existing constituent funds and (b) the proposed addition is in scheme members' interests. The addition of a new constituent fund may be in scheme members' interests if, for example, it adds to the existing range of constituent funds in the MPF scheme by providing access to a fund type, an asset class or a geographical exposure that is not already provided and which meets the criteria in respect of coverage and diversification referred to in (III) below. Another example is where there is an existing actively managed equity constituent fund in an MPF scheme, the introduction

of a passively managed equity constituent fund investing in the same market charging lower fees compared to the actively managed constituent fund.

(III) Criteria for constituent funds with an equity focus

6. The MPF trustee applying for approval of a new constituent fund with an equity focus (except those types of fund which are exempted from these criteria, as set out in paragraph 7 below) should demonstrate that the investment profile of the new fund is at least as diverse as a broadly based regional equity fund (such as an Asia Pacific (ex-Japan) equity fund). Diversity in this sense relates to factors such as the number of securities, geographical regions, sectoral diversity, the equity market size of the relevant markets, and the underlying return volatility of those markets. The following types of funds with an equity focus would be considered as satisfying those criteria: global, European, North American, Asia Pacific and combinations including any of these types. For other fund types, the application must include a comparison of the proposed fund with a typical Asia Pacific (ex-Japan) equity fund or index. Such comparison should be focused on a comparative analysis balancing the factors set out above. We do not consider that emerging market funds or most single country funds would satisfy these criteria.

7. The following types of constituent funds are exempted from the criteria:
- (a) Funds covering the Mainland of China and/or Hong Kong investing in a diversified manner (e.g. in different sectors), in view of the natural propensity of scheme members to invest locally;
 - (b) Single country funds which invest in equities listed on one or more approved stock exchanges² of a country with a significant market capitalisation in a diversified manner e.g. United States or Japan equity funds; and
 - (c) Specialty funds (e.g. ESG-themed funds³, sector funds) with an expected outcome suitable for addressing scheme members' retirement needs. Such fund should not have a risk level higher than that of an Asia Pacific (ex-Japan) equity fund or index. The MPF trustee should demonstrate how the expected outcome of the constituent fund can be achieved. The Authority would consider other factors such as the risk/return profile of the relevant sector index, concentration of investment in terms of, for example, geographical regions.

² As defined under section 2 of the Mandatory Provident Fund Schemes (General) Regulation.

³ These are funds which incorporate environmental, social and governance (ESG) factors as their key investment focus and reflect such in the investment objective and/or strategy.

(IV) Consideration of index fund option

8. Where the application for approval is for a new constituent fund that is not an index-tracking collective investment scheme, the MPF trustee should provide reasons as to why the index fund option is not used for obtaining the proposed investment exposure.

Application to approved pooled investment funds

9. The criteria set out above do **not** apply to the approved pooled investment funds (APIFs). For a feeder fund arrangement, the criteria above would apply at the constituent fund level but would have necessary implication for the APIF that the constituent fund feeds into.

Responsibilities of MPF trustees under the approval criteria for constituent funds

10. Under section 43 of the Mandatory Provident Fund Schemes (General) Regulation, MPF trustees must perform certain duties with respect to their administration of MPF schemes. These include, without limitation, the duty to ensure that the funds of the MPF scheme are invested in different investments so as to minimize the risk of losses of those funds, the duty to act in the interest of the scheme members and not in the trustee's own interest, and the duty to supervise and exercise proper control over all service providers appointed or engaged for the purposes of the MPF scheme.


11. Against this background, MPF trustees should note the following with respect to the range of constituent funds in the MPF schemes offered by them:

- Before submitting new constituent fund applications, MPF trustees should review, with sponsors and/or investment managers where necessary, whether the proposed new constituent funds could enhance the diversity of the existing range of constituent funds to meet the needs of scheme members with different outcome expectations and risk appetites as mentioned in paragraph 4 above. The duty to take such diversity into account should not be viewed by MPF trustees as well as sponsors and/or investment managers as a means to expand the offering of constituent funds if the funds will invest in a concentrated manner;
- MPF trustees should make sure investment managers have appropriate risk management and control systems commensurate with the risk profiles of different constituent funds, e.g. they should regularly review the liquidity risks and liaise with investment managers to ensure that the constituent funds have sufficient liquidity to meet redemption requests at all times; and

- MPF trustees should on an ongoing basis assess the range of MPF funds and suitability of MPF products in the context of the retirement solutions offered to scheme members and report their assessment results, including any actions taken, in the annual governance report disclosed to scheme members and submitted to the Authority. If an MPF trustee identified that an MPF scheme lacks diversity in fund choice or that an MPF constituent fund is no longer suitable for scheme members (e.g. due to persistently poor performance), the trustee is required to come up with an action plan to address the issue and to include that in the annual governance report.

12. If you have any questions on the above, please contact Mr Henry Leung on 2292 1380.

Yours faithfully,

A handwritten signature in black ink, appearing to be 'Joseph Lee', written in a cursive style.

Joseph Lee
Director
Product Regulation Division