



Supervision of MPF schemes, trustees and intermediaries AND Enforcement of the MPF regulation

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Outline

1. Functions of MPFA in the regulatory oversight of MPF schemes
2. Risks and Challenges to MPF schemes and trustees from a regulatory perspective
3. Supervision and Enforcement of MPF regulations on schemes and trustees
4. Supervision on compliance with investments restrictions
5. MPF Intermediaries supervision and enforcement policy
6. Concluding remarks



Regulatory functions of MPFA regarding MPF schemes



- Section 6E (1) – The functions of the Authority are as follows:
 - (a) To be responsible for ensuring compliance with this Ordinance;
 - ...
 - (d) To regulate the affairs and activities of approved trustees and to ensure as far as reasonably practicable that those trustees administer the registered schemes for which they are responsible in a prudent manner;
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 - (eb) To promote and encourage the development of the retirement scheme industry in Hong Kong, including the adoption of a high standard of conduct and sound business practices by trustees and other service providers;

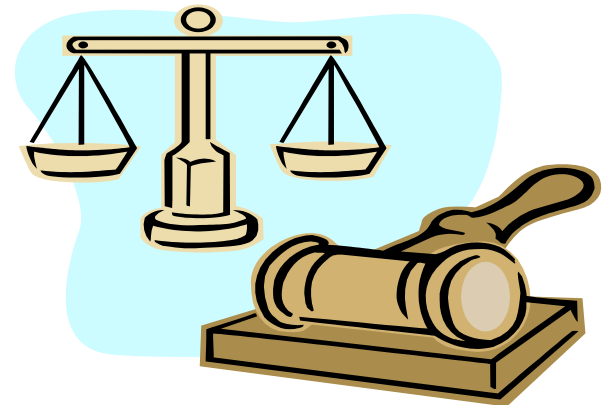


MPFA's structure in support of our regulatory functions

- **Supervision Division** – trustee supervision and intermediaries regulation
- **Enforcement Division** - integrated functions on enforcement against breaches committed by trustees, intermediaries and criminal prosecution
- **Members Protection Division** – process employees' complaints against default contributions and debt recovery

Enforcement Division

- Complaints Handling Team – scheme administration
- Investigation Team
- Disciplinary Team
- Prosecution Team



Roles and obligations of trustees of MPF schemes



- Fundamental principles relating to administration of trusts
- What does “administration of trust” mean?
 - Section 2 – “administer” – manage and maintain
 - Higher duty than just being an administrator
 - In parallel, common law duty as a fiduciary

Statutory duties of Approved Trustees



- Duties that must be performed by trustees are set out in the Regulations of the MPFSO
 - Reg. s43 (a) – duty of care and diligence expected of a prudent person who is acting in a similar capacity and who is familiar with registered schemes
 - (b) duty to make use of knowledge and skills
 - (c) duty to ensure funds are invested ...to minimize the risk of losses of those funds
 - (d) duty to act in the interest of scheme members and not in trustees' own interest
 - (e) duty to act in accordance with governing rules
 - (f) duty to supervise and exercise proper control of all service providers appointed or engaged for the purposes of the scheme

Risks and challenges to trustees in scheme administration

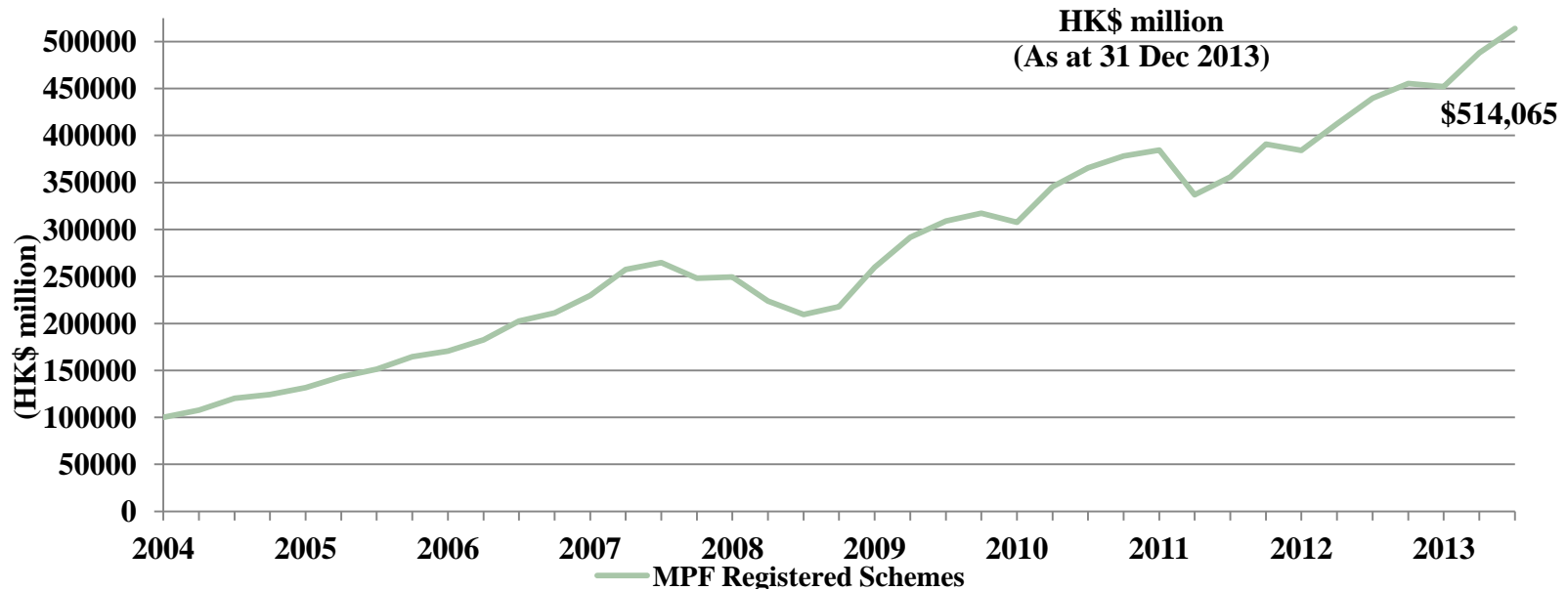


- According to a paper issued by IOPS (International Organisation of Pension Supervisors) in 2010, Defined Contribution schemes are facing challenges not seen before in Defined Benefits Schemes
- DC plans have to tackle risks in a number of areas:
 - Investment Risks (investment outcome, performance, liquidity)
 - Operational risks and Outsourcing
 - Governance risks
 - Market risks



MPF Assets

(as at 31 Dec 2013)



- Average monthly contribution (in the past 12 months) : \$4,470 (HK\$ million)
- Roughly over 30 million transactions in MPF contribution p.a.

Operational risks

- Inaccurate data keeping and improper accounts of accrued benefits and unit balance
- Unable to manage the schemes and supervise the performance and standards of service providers to deliver long term return on their retirement savings
- Inaccurate payment
- Ineffective supervision of service providers
- Inability to detect “red flag” in internal controls and system weakness
- Insufficient provision of resources (e.g. IT, human resources, capital) to support operational needs and risk management



Case Studies – Trio Capital

(1) Australia : Trio Capital Fraud

Key Facts

- Largest superannuation fraud in Australian history
- Approx. A\$176M in Australian's superannuation funds was lost or missing from two fraudulently managed investment schemes.
- Approximately 6,090 Australians invested in Trio
- A number of investment vehicles operated by Trio Capital were merely conduits through which investors' money was stolen.
- The funds of Australian investors were moved overseas
- A key factual question is whether the principal underlying asset of one of the funds ever existed at all, and had value.

Case studies - Trio Capital (cont'd)



Key Issues

- Inability of trustees to provide basic valuation information regarding the fund
- Financial advisers were paid high commissions
- Auditors failed to obtain adequate evidence of the value and existence of the investments and effectiveness of compliance program
- No independent checks by custodians before transferring money offshore

Regulatory actions

- Enforceable undertakings from several former Trio directors
- One other former director was sent to jail

Case Studies – Trio Capital (cont'd)



Lessons learnt

- Proactive monitoring by trustees and their service providers: identify patterns of red flags over time concerning governance issues, internal administration issues, significant events/changes in the entity/key personnel, investment strategy, risk disclosure, audit irregularities, etc.
- Enhanced communication and intelligence sharing amongst regulators
- Service providers involved (including auditors, custodians and trustees) should develop a healthy level of “professional scepticism”, in assessing the scheme’s compliance plans, existence and whereabouts of the underlying fund assets and its valuation.
- Better disclosure of portfolio assets



Case Studies (2) – GP Noble

(2) UK : GP Noble Trustees Pension Fraud

Key Facts:

- Pitcher, MD of GP Noble Trustees Limited (GPNT) and company secretary of BDC Trustees Limited, disinvested £52M of 9 Schemes under their trusteeship.
- Without informing other directors of the trustees and the statutory bodies, Pitcher invested the Scheme's assets in offshore investment vehicles and a company financially advised by parties associated with GPNT.

Regulatory Actions

- Appointed an independent trustee to take over the scheme administration and prohibited GPNT and Pitcher from acting as trustees.
- Freezed the accounts and recovered £36 million by civil proceedings. Pitcher was sentenced to 8 years' imprisonment.

Case Studies (2) – GP Noble (cont'd)



Key issues

- Improper investment advice and investment risk level
- Inadequate internal control
- Failure to respond to identified significant concern
- Association between financial adviser and trustee

Lesson learnt

- Trustee should have:
 - investment advice from independent, qualified and registered professionals
 - adequate internal control, quick response to “Red flag”
 - monitoring of the nature of investment of fund
- Regulator should tighten up the control and monitoring on investment made by trustees

Governance issues – Risk Culture



- Weak risk culture and governance structure (e.g. conflicts of interest, inability to tackle system wide governance issues)
 - Global expectation - Financial Stability Board (consultative document Nov 2013):
 - Financial institutions' senior management should take lead in setting sound risk management culture
 - Indicators of accountability – Ownership of risk, escalation process, enforcement
 - Importance of risk management function – given the right stature and recognition in the senior management level
 - Proper feedback mechanism of risks to the senior management team

Governance issues - Risk culture

Case in point – recent UK FCA case

- FCA issued its largest ever retail fine of £30,647,400 to an insurance intermediary, HomeServe, for mis-selling insurance policies, failure to investigate complaints adequately, its Board insufficiently engaged with compliance matters and its senior management being reluctant to address risks to customers during the period January 2005 to October 2011.
- Dangerous if trustees adopt a risk culture or attitude that – “we only do what is minimally prescribed by the law or the regulators” - insufficient buffer for compliance.

Governance issues

– conflicts of interest

- Structural issues – relationship between trustees and other market participants/service providers:
 - Sponsors – to what extent is the trustee sufficiently independent of the influence or direction of sponsors? How to manage conflicts if trustees' discretion may be fettered?

Governance issues – performance

- Investment managers – the extent to which trustees actually drive the performance of investment managers? For poorly performing investment managers, what did trustees do on behalf of members to drive better performance or even terminate the mandate? To what extent the trustees have rigorously challenged the investment managers?



Governance issues – compliance risks



- Inaccurate compliance logic - attributed to a number of factors:
 - lack of understanding of the statutory requirements;
 - inadequate training of frontline and back office staff;
 - ineffective calibration of risk profiles ;
 - lack of support or direction from senior management team



Governance issues – business continuity plan and resolution regime



- G20 resolution regime – public consultation on how to establish a resolution regime framework in Hong Kong (2013)
- Of 15 trustees and custodian banks serving the MPF system, 4 trustees and 5 custodian banks fall within the list of SIFI (systemically important financial institutions)
- Once resolution regime kicks in for the SIFI, a number of possible outcomes but “government bail out” would not be an option

Governance issues

- business continuity

- In view of approach of a resolution regime in the coming years, trustees are urged to:
 - Review BCP – in particular when its parent companies go into resolution or financial support or other links to resources are severed due to resolution
 - Dialogue with sponsors and parent groups' senior management to develop BCP upon commencement of resolution
 - Ensure continuity of services from service providers – would resolution regime of parent companies impact on mutual support of services or provision of services by third party providers
 - Back up plans – as a mandatory scheme, trustees are processing contributions and funds investments continuously

FSB's suggestions on how to strengthen governance and compliance



- Senior management to set direction for good risk detection and management structure
- Custom build an internal risk management system that fits trustees' own business and operational model
- Periodic and ad hoc operational review conducted by independent risk audit teams
- Feedback mechanism – through analyses of complaints, exceptional reporting and regulatory actions (e.g. enforcement or supervision letter)
- Sufficient training of staff at all levels on risk culture and ability to detect operational shortcoming
- Proper governance in place – senior board members have the mandate and expertise to direct resources to manage and minimize risks from emergence

Supervisory Approach

- Supervision -
 - evidence based
 - risk based
 - Proactive and forward looking
 - Focus on regulatory outcome
- Supervision IS NOT equivalent to Enforcement
 - Helps in identifying potential system wide risks
 - Provides regulatory feedback to the compliance level of trustees and service providers
 - Helps raise higher risk awareness of the Board of Trustees
 - Aims at better protection to members' interest

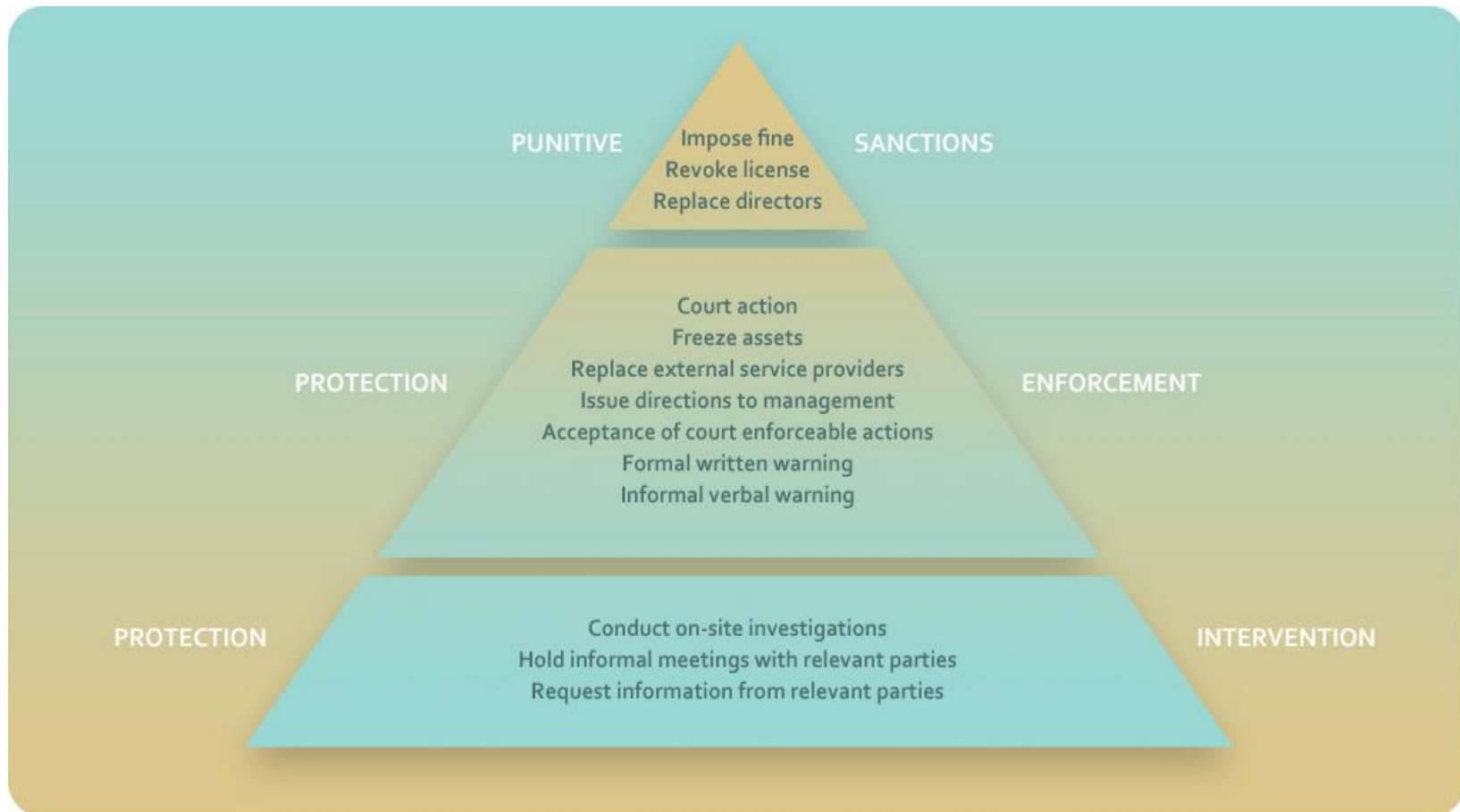
Supervisory Approach (cont'd)



- Examples of Supervisory powers:
 - Direct audit
 - S.30 of the MPFSO
 - Direct rectification
 - S.76 and 75 of the MPFSO
 - S.104 and 116 General Regulation



Enforcement Pyramid - IOPS



Enforcement Approach

- Why enforcement is important:
 - Effective enforcement actions promote good behaviour amongst market players
 - Penalise the wrongdoers
 - Send unequivocal and strong deterrent message
 - Provides useful feedback on acceptable or unacceptable behaviour to the market
- Enforcement action has to be evidence based and follow due process
- Enforcement actions per se are not ends themselves

Commencement of investigation

- Formal investigation may be commenced if MPFA is satisfied (under section 32) that:
 - (a) a person has contravened the MPFSO with respect to the scheme
 - (b) circumstances may exist that could prejudice the interests of scheme members
 - (c) the trustee is failing or has failed to fulfil the trustees' duties with respect to the scheme

Enforcement actions – Penalties and other consequences

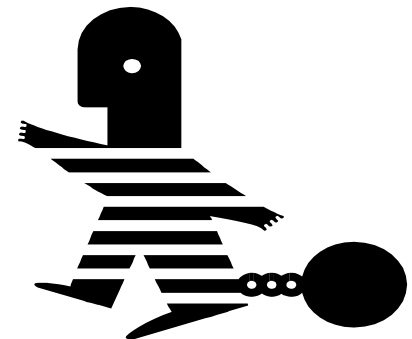


- Enforcement actions towards trustees and their board of directors:
 - Financial penalties – failure to comply with each of the 96 sections under the MPFSO and the General Regulation attracts FP
 - Suspension or Revocation of the status of “approved trustees” – no longer suitable to remain as “approved trustees” of MPF schemes

Criminal prosecution of breaches by trustees



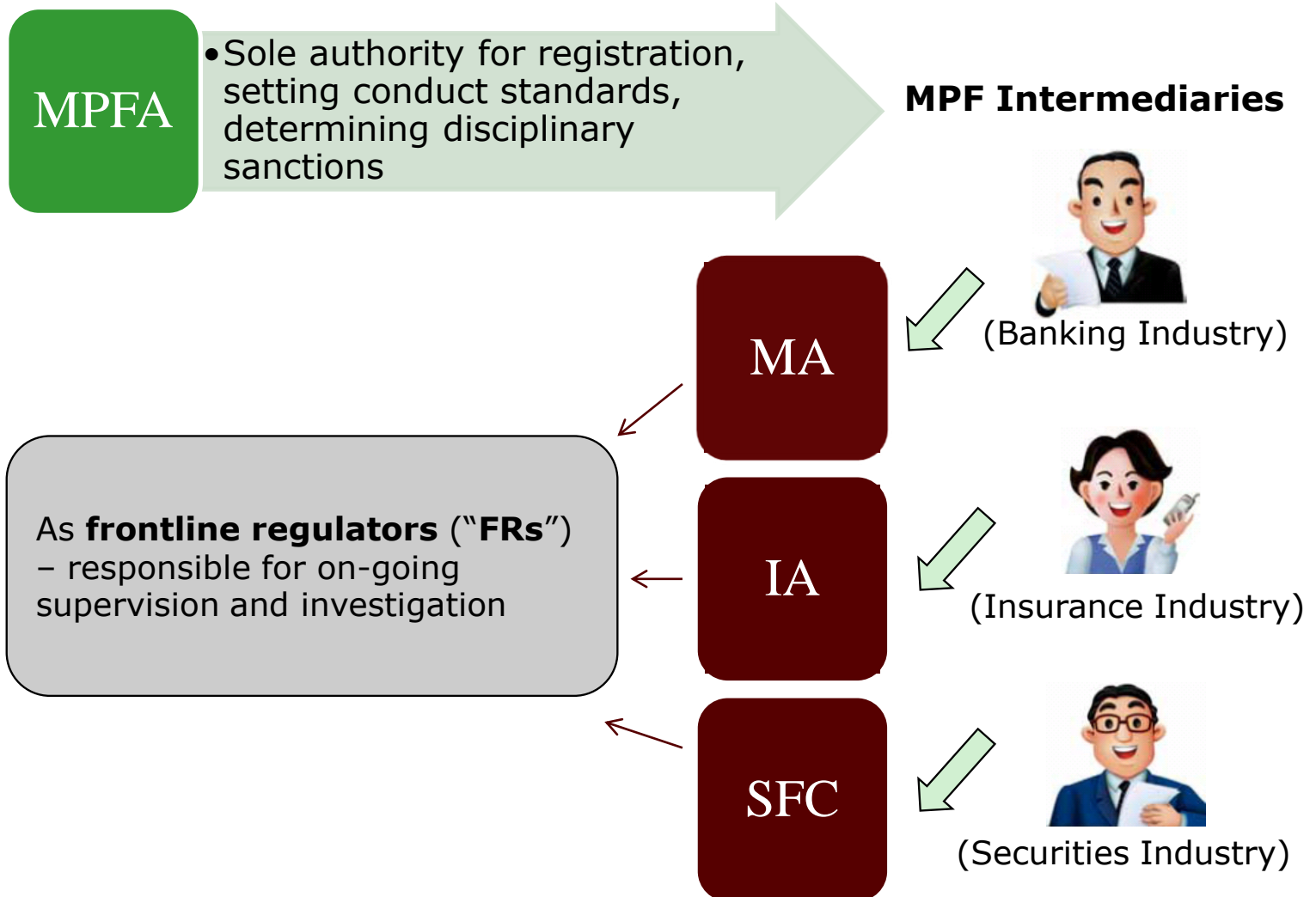
- Criminal offences – 52 provisions in the MPFSO and regulation the breach of which results in criminal liability
- Prosecution lies with the Director of Public Prosecution – provides checks and balance between investigator and prosecutor



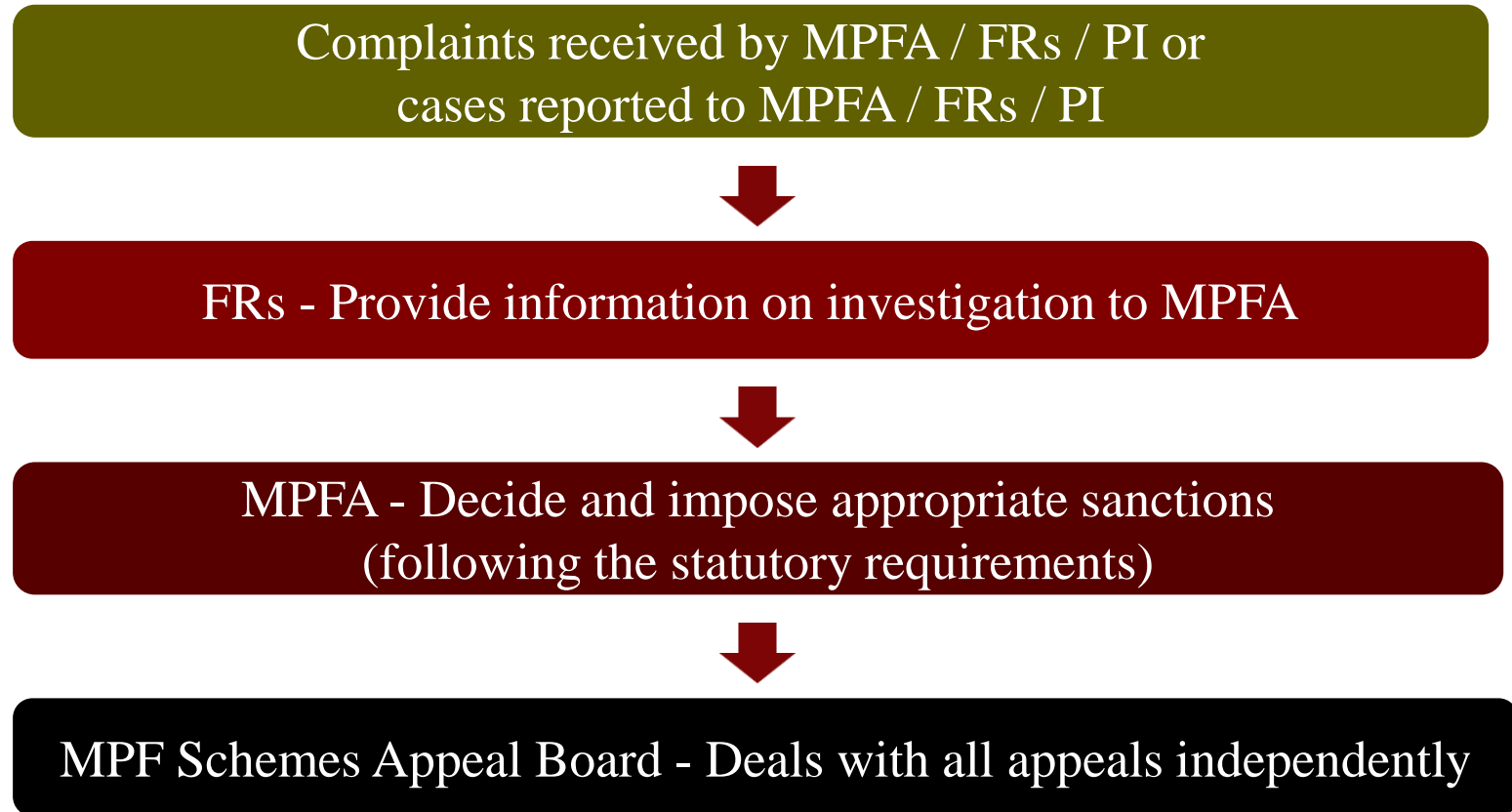
Investment restrictions

- Statutory limits and restrictions imposed under Schedule 1 to the MPFSO and various guidelines issued in connection with permissible investments and limits
- Duty of trustees under section 40(1) (a) and (b) - to ensure compliance with those restrictions
- Duty of investment managers:
 - Ensure compliance with investment restrictions under section 40(2)
 - Report direct to the MPFA on non-compliance (see section 75(1)(e))
- Enquiry by MPFA into the causes leading to the failure to comply and where appropriate referrals may be made to the SFC to further enquire as to whether the fund managers are fit and proper

Multi-regulator Model



Disciplinary Sanctions



Division 8 – Disciplinary Order for Failure to Comply with Performance Requirements

Types of Disciplinary Orders

- **Disciplinary orders include:**

- (i) Public / private reprimand
- (ii) Suspension of registration
- (iii) Revocation of registration
- (iv) Disqualified from re-registration for specific period
- (v) Fines



Concluding Remarks