



**Mandatory Provident Fund Schemes Authority**

**CODE ON  
MPF INVESTMENT FUNDS**

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**Hong Kong**

## CODE ON MPF INVESTMENT FUNDS

### Explanatory Notes:

- (a) Section 36 of the Mandatory Provident Fund Schemes (General) Regulation (“the Regulation”) provides that a constituent fund must be approved by the Mandatory Provident Fund Schemes Authority (“the Authority”).
- (b) Section 6(1) of the Regulation provides that an investment fund is an approved pooled investment fund (“APIF”) for the purposes of the Regulation if it is an insurance policy, authorized unit trust or authorized mutual fund<sup>1</sup> that complies with the requirements set out in section 17(2) of Schedule 1 to the Regulation and is approved by the Authority.
- (c) Section 6(2) of the Regulation provides that the granting of an approval in respect of a pooled investment fund (“PIF”) is subject to the payment to the Authority of such fee (if any) as may be prescribed in the Fees Regulation and to such conditions (if any) as the Authority considers appropriate. The Authority may vary any such conditions by written notice given to the investment manager of the investment fund concerned.
- (d) Section 6H(1) of the Mandatory Provident Fund Schemes Ordinance (Cap. 485) (“the Ordinance”) provides that the Authority may issue guidelines for the guidance of approved trustees, service providers and other persons concerned with the Ordinance. Section 6H(2)(a) provides that a guideline may consist of a code, standard, rule, specification or provision relating to provident fund schemes or a class of such schemes.
- (e) The list of guidelines on investments that are already issued by the Authority is set out in Appendix A.
- (f) Part B of this Code establishes requirements, in addition to those prescribed in the Ordinance and the Regulation, on the approval of a constituent fund in an MPF scheme. Parts C and D of this Code establish requirements on the approval of a PIF, being an authorized unit trust and insurance policy respectively. This Code carries the same effect as a guideline.
- (g) The issue of an advertisement, document or invitation to the public in Hong Kong to participate/invest in, a master trust scheme/industry scheme/pooled investment fund must seek prior approval from the Securities and Futures Commission (“the SFC”) under section 4 of the Protection of Investors Ordinance (Cap. 335) (“PIO”). Please refer to the SFC Code on MPF Products (“SFC’s Code”) in this respect.

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<sup>1</sup> It is practically impossible to establish and operate a mutual fund corporation under existing Hong Kong law. This Code therefore does not cover requirements on mutual funds.

## TABLE OF CONTENTS

<b>PART A – GENERAL</b>		Page
Chapter A1	Interpretation	1
Chapter A2	The Authority and the SFC	2
<b>PART B – CONSTITUENT FUNDS</b>		
Chapter B1	Operations of Constituent Funds	5
Chapter B2	Investment Requirements	10
<b>PART C – POOLED INVESTMENT FUNDS - UNIT TRUSTS</b>		
Chapter C1	Trustee, Custodian and Investment Manager	15
Chapter C2	Operations of Pooled Investment Funds	17
Chapter C3	Investment Requirements	19
<b>PART D – POOLED INVESTMENT FUNDS - INSURANCE POLICIES</b>		
Chapter D1	Insurer, Custodian and Investment Manager	23
Chapter D2	Operations of Pooled Investment Funds	26
Chapter D3	Investment Requirements	29
<b>APPENDICES</b>		
Appendix A	List of Guidelines on Investments	30
Appendix B	List of Applicable Sections for APIF	31

## **PART A - GENERAL**

### **Chapter A1 : Interpretation**

Unless otherwise defined below, words and expressions used in this Code are as defined in the Ordinance and the Regulation.

- A1.1 “Cash management fund” or “Money market fund” means a constituent fund or a PIF with the sole objective of investing in short-term deposits and debt securities.
- A1.2 “Constitutive documents” means the principal documents governing the formation and operation of an MPF scheme or a pooled investment fund, including the policy document in the case of a pooled investment fund which is an insurance policy and the trust deed in the case of an MPF scheme comprising one or more constituent funds or a pooled investment fund which is a unit trust.
- A1.3 “MPF scheme” means an employer sponsored scheme, a master trust scheme or an industry scheme.
- A1.4 “Offering document” means a document containing information on a master trust scheme, industry scheme or pooled investment fund as stipulated in Chapter 5 of the SFC’s Code.

## Chapter A2 : The Authority and the SFC

### Complementary Regulatory Functions

A2.1 The Authority is the statutory body established under the Ordinance for regulating the mandatory provident fund system in Hong Kong. It registers MPF schemes, approves constituent funds of the schemes, approves pooled investment funds and ensures that they operate properly in accordance with the Ordinance, the Regulation and the guidelines issued by the Authority. MPF schemes (other than employer sponsored schemes) and pooled investment funds, being collective investment products offered to the public, are required to be authorized by the SFC pursuant to the relevant ordinances. There are complementary regulatory functions between the Authority and the SFC.

### Delineation of Work

A2.2 To make clear the roles and functions of the Authority and the SFC concerning MPF matters, the two bodies have agreed on a clear delineation of work which, in broad terms, is set out below.

#### *MPF Schemes and Constituent Funds*

A2.3 The Authority is responsible for registering MPF schemes under sections 21 and 21A of the Ordinance, approving their constituent funds under section 36 of the Regulation and in accordance with this Code.

A2.4 The SFC is responsible for authorizing master trust schemes and industry schemes (both of which include constituent funds) pursuant to section 4(2)(g) of the PIO. In this regard, the SFC is responsible for approving the investment manager and vetting the disclosure of information in the offering documents in accordance with the SFC's Code.

A2.5 The SFC is also responsible for authorizing advertisements and other marketing materials of master trust schemes and industry schemes pursuant to section 4(2)(g) of the PIO.

### *Pooled Investment Funds*

- A2.6 The Authority is responsible for approving pooled investment funds under section 6 of the Regulation and in accordance with this Code.
- A2.7 The SFC is responsible for authorizing:
- (a) pooled investment funds that are insurance policies pursuant to section 4(2)(g) of the PIO; and
  - (b) pooled investment funds that are unit trusts pursuant to section 15(1) of the Securities Ordinance.
- A2.8 In authorizing pooled investment funds, the SFC is responsible for approving the investment manager and vetting disclosure of information in the offering documents in accordance with the SFC's Code.
- A2.9 For pooled investment funds that are unit trusts available to both MPF schemes and retail investors, in addition to A2.8, the SFC would authorize the funds in accordance with the Code on Unit Trusts and Mutual Funds ("UT Code").
- A2.10 The SFC is also responsible for authorizing advertisements and other marketing materials of pooled investment funds pursuant to section 4(2)(g) of the PIO.

### **Application Procedures**

- A2.11 An applicant seeking registration of schemes/approval of funds from the Authority and the relevant authorization from the SFC is recommended to submit the applications concurrently. The applicant should also lodge with the Authority a prescribed consent for the Authority to use and exchange information with the SFC both in connection with the application and on an on-going basis.
- A2.12 The Authority shall be responsible for preliminary vetting of the application documents.

## **Change of Information**

- A2.13 After a constituent fund or a pooled investment fund has been approved by the Authority, if there is any change to the information previously provided in the application forms, the applicant should notify the Authority by completing the relevant parts of application forms. It should be noted that some changes specified in the Regulation and this Code, e.g. amendments to governing rules, require prior approval from the Authority.
- A2.14 In the case where the applicant needs to notify the SFC of the change of information, the applicant may direct the Authority to release the updated information to the SFC.
- A2.15 Where the change requires authorization from the SFC, e.g. change of investment manager or changes to offering documents, etc., the applicant should first submit the application for the change to the SFC. After the authorization is obtained from the SFC, the applicant should notify the Authority in accordance with A2.13. A document evidencing that the SFC has granted such authorization should also be lodged with the Authority.

## **SFC's Code**

- A2.16 The SFC's Code establishes guidelines which will be applied by the SFC for authorization of MPF products.

## **PART B - CONSTITUENT FUNDS**

### **Chapter B1 : Operations of Constituent Funds**

#### **Constitutive Documents**

- B1.1 Nothing in the constitutive documents may provide that the approved trustee, custodian or investment manager of the constituent fund can be exempted from any liability to scheme members imposed under Hong Kong law or breaches of trust through fraud or negligence, nor may they be indemnified against such liability by scheme members or at scheme members' expense.

#### **Separation of Assets**

- B1.2 The approved trustee should ensure that records are kept such that the assets and the liabilities of a constituent fund can be distinguished from those of the other constituent funds.

#### **Use of Omnibus Accounts**

- B1.3 Where a custodian (or a sub-custodian) is also the holder of assets of one or more other registered schemes or other financial schemes or undertakings, the custodian may mix scheme assets with those other assets. The custodian should keep a separate account of scheme assets and those other assets in such a way as to enable them to be separately identified. Omnibus accounts may be used provided that scheme assets are recorded and controlled in such manner as may be reasonable and prudent in the circumstances considering usual custodial practices.

#### **Financial Period**

- B1.4 The financial period of a constituent fund must coincide with that of the registered scheme.

#### **Choice of Constituent Funds**

- B1.5 All constituent funds of an MPF scheme must be made available to all members of the scheme. The approved trustee and any participating employers of the



scheme are not allowed to restrict the members to only some of the constituent funds.

B1.6 Scheme members must be given the right to place or transfer 100% of their accrued benefits into any one of the constituent funds within the scheme.

B1.7 Where a constituent fund takes the form of a feeder fund or a portfolio management fund<sup>2</sup>, member choice is not available at the APIF level.

### **Switching between Constituent Funds**

B1.8 Sections 34 and 35 of the Regulation prohibit the imposition of a fee, charge or financial penalty (other than a bid/offer spread permitted under section 34) when a member transfers from one scheme to another or from one constituent fund to another within the same scheme. The prohibition applies to both “back end” charges imposed by the transferor trustee as well as to “front end” charges imposed by the transferee trustee. Section 34 does not apply to non-financial penalties or restrictions.

B1.9 The interval between the receipt of a properly documented request for switching between constituent funds and the completion of the switching must not exceed one month.

### **Currency Denomination**

B1.10 Constituent fund must be denominated in Hong Kong dollars.

### **Unitization of Fund**

B1.11 All constituent funds must be unitized except for those which are non-investment linked and providing investment guarantees.

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<sup>2</sup> A constituent fund is a feeder fund if its assets are invested in a single APIF. A constituent fund is a portfolio management fund if its assets are invested in more than one APIF.

### **Initial Offers**

- B1.12 If an initial offer is made in respect of a unitized constituent fund, no investment of subscription money can be made until the conclusion of the first issue of units at the initial price.

### **Valuation & Pricing**

- B1.13 Offer and redemption prices in respect of a unitized constituent fund should be calculated on the basis of its net asset value divided by the number of units outstanding. Such prices may be adjusted by fees and charges, provided that the amount or method of calculating such fees and charges is clearly disclosed in the offering documents.
- B1.14 Pricing of unitized constituent funds must be on a forward basis.
- B1.15 For non-unitized constituent funds, the accounts of scheme members must be credited with the investment return at least once a month.

### **Pricing Errors**

- B1.16 If an error is made in the pricing of units for a unitized constituent fund, the error should be corrected as soon as possible and any necessary action should be taken to avoid further error. If the error results in an incorrect price of 0.5% or more of the fund's net asset value per unit, the approved trustee and the Authority must be informed immediately. In such a case, scheme members should be compensated as follows, unless determined otherwise by the trustee with justification to the Authority:
- (a) where total loss to each individual scheme member (either purchasing or redeeming) is more than HK\$100 or such lesser amount as the trustee may decide, scheme members should be compensated in such manner as the trustee should determine; and

- (b) where the loss is to the trustee or other service providers, no compensation should be paid.

### **Dealing**

B1.17 There must be at least one regular dealing day per month. However, the approved trustee should be aware of the time limit for portability or payment of accrued benefits provided under Parts XII and XIII of the Regulation.

B1.18 Any offer price quoted or published in respect of a unitized constituent fund must be the maximum price payable on purchase and any redemption price must be the net price receivable on redemption.

### **Changes to Dealing**

B1.19 A permanent change in the method of dealing may only be made after giving one month's notice to scheme members.

B1.20 A temporary change may only be made:

- (a) in exceptional circumstances, having regard to the interests of scheme members;
- (b) if the possibility of a change and the circumstances in which it can be made have been fully disclosed in the offering document; and
- (c) with the approval of the approved trustee.

### **Suspension and Deferral of Dealings**

B1.21 Suspension of dealings may be provided for only in exceptional circumstances, having regard to the interests of scheme members.

B1.22 The approved trustee must immediately notify the Authority if dealing ceases or is suspended. The fact that dealing is suspended must be published immediately following such a decision and at least once a month during the period of suspension, in the newspaper(s) in which the constituent fund's prices are

normally published. In respect of constituent funds of an employer sponsored scheme, the approved trustee may choose other means to release such information to scheme members.

- B1.23 Where redemption requests on any one dealing day exceed 10% of the net asset value of the constituent fund, redemption requests in excess of 10% may be deferred to the next dealing day.

#### **Publication of Prices**

- B1.24 The latest available offer and redemption prices or net asset value per unit of unitized constituent funds must be published at least once a month in at least one leading English language and one leading Chinese language daily newspaper in Hong Kong. However, for unitized constituent funds of an employer sponsored scheme, the approved trustee may choose other means to release such information to scheme members.

#### **Associated Agency Transactions**

- B1.25 Section 47(5) of the Regulation restricting the amount of transactions conducted by associated agents shall apply individually to each constituent fund managed by an investment manager.

#### **Merger, Division or Termination of Constituent Fund**

- B1.26 If a constituent fund is to be merged, divided or terminated, prior approval must be obtained from the Authority. The Authority shall ensure that proper arrangements are in place for scheme members concerned before granting the approval.
- B1.27 After the merger, division or termination of the constituent fund has been approved by the Authority, notice must be given to the scheme members concerned. In respect of constituent funds of master trust schemes or industry schemes, prior approval from the SFC should be obtained for the notice.

## Chapter B2 : Investment Requirements

### General Requirement

- B2.1 A constituent fund may maintain an internal portfolio by investing in permissible investments in accordance with sections 2-5 and 7-16 of Schedule 1 to the Regulation, or may invest in one or more APIFs.

#### *Financial Futures and Option Contracts*

- B2.2 In the case of a constituent fund acquiring financial futures and option contracts for purposes other than hedging, the approved trustee and the investment manager must have the relevant experience in administering and managing futures and options funds recognized by the SFC.

#### *Borrowing of Money*

- B2.3 No borrowing of money for a constituent fund is allowed otherwise than in accordance with section 4 of Schedule 1 to the Regulation. Temporary borrowing can be made for the purposes of settling a transaction to acquire securities or other investments only if at the time the decision to enter into the transaction was made, it was unlikely that the borrowing would be necessary. It means that, as a matter of course, borrowing to settle a transaction to acquire securities or other investments, or entering into transactions with the intention of borrowing to cover settlement is not allowed. At the time an acquisition transaction is entered into, the constituent fund should have sufficient cash on hand or, in the reasonable opinion of the investment manager, cash will be available from the disposition of other securities or investments in time to settle the acquisition transaction.

#### *Bank Deposits*

- B2.4 For the purposes of section 11 of Schedule 1 to the Regulation, “deposit” has the same meaning as in section 2 of the Banking Ordinance (Cap. 155) and also includes a certificate of deposit issued by an authorized financial institution. That definition may include deposits that are at negative interest, at no interest or

are repayable in such a way that the amount repaid is less than the amount originally deposited. Negative interest, no interest and diminishing deposits should be entered into by a trustee only in circumstances where it is reasonable to do so. Otherwise, the trustee may breach its duties under the MPF legislation, in particular section 43 of the Regulation, and the relevant trust deed. The Authority intends to investigate the circumstances of such deposits to ensure that no such breach has occurred. In the event of a breach, the Authority will take appropriate action.

#### *Hong Kong Dollar Currency Investments*

- B2.5 Any investment, including shares, that can be purchased and sold in Hong Kong dollars on the Unified Exchange shall be regarded as a Hong Kong dollar currency investment under section 16(3) of Schedule 1 to the Regulation.

#### *Investment in the Parties to the Constituent Fund*

- B2.6 The funds of a constituent fund must not be invested in the securities of the approved trustee, the custodian, the investment manager or the guarantor, except where any of these parties is a substantial financial institution. For the purposes of this provision, securities do not include units in authorized unit trusts or shares in authorized mutual funds.

#### **General Requirements for Constituent Funds Investing in Approved Pooled Investment Fund(s)**

- B2.7 The constituent fund may hold cash and bank deposits for ancillary purposes, such as for meeting redemption requests or defraying operating expenses, or for reducing market exposure.
- B2.8 The constituent fund may enter into currency forward contracts for hedging purposes.
- B2.9 The constitutive documents must state clearly the maximum fees that may be charged for the constituent fund.

B2.10 Where a constituent fund changes its underlying APIF(s) and the change leads to amendments to the constitutive documents, prior approval must be obtained from the Authority.

#### **Specific Requirements for Feeder Funds**

B2.11 If the underlying APIF of a feeder fund is denominated in a foreign currency, a unified exchange rate should be applied in calculating the bid and offer spread.

B2.12 The statement of investment policy of a feeder fund must state that it will invest entirely in one APIF.

B2.13 A feeder fund itself may not enter into financial futures and option contracts.

#### **Specific Requirements for Portfolio Management Funds**

B2.14 Not more than 90% of the total funds of a portfolio management fund may be invested in any one of its underlying APIFs.

B2.15 The statement of investment policy of a portfolio management fund must state that the fund will invest in a number of APIFs and the criteria for selecting those APIFs.

B2.16 A portfolio management fund may enter into financial futures and option contracts only for hedging purposes.

#### **Capital Preservation Fund**

B2.17 A capital preservation fund must meet the requirements stipulated in section 37 of the Regulation and the Guidelines on Capital Preservation Funds (Guidelines III.6). Given that a capital preservation fund is a money market or cash management fund in nature, it must also observe the relevant disclosure requirement prescribed in the SFC's Code.

### *Pricing and Charges*

- B2.18 Neither initial fees nor redemption charges can be imposed on a capital preservation fund. Bid and offer spread is also not allowed.

### *Form of Capital Preservation Fund*

- B2.19 A capital preservation fund can maintain a portfolio of qualified investments in accordance with section 37(2) of the Regulation or invest in a single APIF, which may be a unit trust or an insurance policy, meeting the requirements specified in C3.10–C3.14.

### *Crediting of Investment Income and Profits to Scheme Members*

- B2.20 For the purposes of section 37(3) of the Regulation, income and profits mean “net income and profits”, i.e. income and profits remaining after deducting all expenses related to the derivation of that income and profits. In other words, investment expenses may be deducted from a capital preservation fund in order to arrive at the net income and profits derived from the investment of the funds comprising a capital preservation fund.

### *Deduction from Scheme Members' Accounts*

- B2.21 Subject to B2.20, amounts which otherwise do not fall under section 37(5)-(7) of the Regulation (which applies to compensation fund levies and scheme administrative expenses) are not allowed to be deducted from the capital preservation fund accounts of scheme members.
- B2.22 If a scheme member has any accrued benefits in a capital preservation fund account of the scheme, section 37(5)-(7) of the Regulation only applies to the deductions from that capital preservation fund account.

### *Scheme Administrative Expenses*

- B2.23 Scheme administrative expenses as specified in section 37(6)-(7) of the Regulation refer only to expenses related to the management of a registered



scheme and its assets. Normally, these would be fees such as trustee's, custodian's, investment management and administrator's fees.

### **Guaranteed Funds**

B2.24 A constituent fund is a guaranteed fund if a guaranteed amount will be paid to scheme members who hold their investments in the constituent fund at a specified date in the future.

B2.25 A guaranteed fund must have a guarantor that is an authorized financial institution unless the fund invests in an APIF which is a guaranteed fund.

## PART C - POOLED INVESTMENT FUNDS - UNIT TRUSTS

### Chapter C1 : Trustee, Custodian and Investment Manager

#### Provisions of the Regulation relevant to APIF

C1.1 A PIF must comply with the requirements stipulated under section 17(2) of Schedule 1 to the Regulation. In particular, section 17(2)(g) requires that the trustee of the fund, and any investment manager or custodian appointed by the trustee in relation to the fund, must comply with such of the requirements of the Regulation as relate to an approved trustee of a registered scheme, and to an investment manager or custodian appointed by such an approved trustee, in so far as those requirements are relevant to the fund.

#### *Trustee*

C1.2 The requirements stipulated in sections 28, 43, 48, 61-62, 70, 109 and 114-116 of the Regulation<sup>3</sup> are relevant to the trustee of APIF.

#### *Custodian*

C1.3 The requirements stipulated in sections 50, 68-69 and 72-73 of the Regulation are relevant to the custodian of APIF.

#### *Investment Manager*

C1.4 The requirements stipulated in sections 44 (excluding subsection (2))-47 of the Regulation are relevant to the investment manager of APIF.

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<sup>3</sup> Where requirements stipulated in this Part refer to the Regulation, the following references shall apply:

- (a) References to registered scheme in the Regulation would be construed as references to pooled investment fund in this Part;
- (b) References to scheme member in the Regulation would be construed as references to fund holder in this Part;
- (c) References to governing rules in the Regulation would be construed as references to constitutive documents in this Part; and
- (d) References to financial statements of registered scheme in the Regulation would be construed as references to financial statements of APIF as specified in the Guidelines on Annual Statements of Approved Pooled Investment Funds.

*Service Providers Generally*

- C1.5 The requirements stipulated in sections 74-76 of the Regulation are relevant to the service providers of APIF.

**Retirement of Trustee**

- C1.6 The approved trustee of an APIF may not retire except upon the appointment of a new approved trustee and subject to the prior approval of the Authority.

## **Chapter C2 : Operations of Pooled Investment Funds**

### **Provisions of the Regulation Relevant to APIF**

- C2.1 The operational requirements as stipulated in sections 38, 39, 49 and 63-66 of the Regulation are relevant to APIF.
- C2.2 Accounting, auditing and reporting requirements as stipulated in sections 77, 80-82, 84-85, 92-93, 95-108, 110-113 and 117 of the Regulation are relevant to APIF. The auditing requirements shall be performed by the auditor appointed by the approved trustee for the APIF.

### **Constitutive Documents**

- C2.3 Nothing in the constitutive documents may provide that the approved trustee, custodian or investment manager can be exempted from any liability to fund holders imposed under Hong Kong law or breaches of trust through fraud or negligence, nor may they be indemnified against such liability by fund holders or at fund holders' expense.

### **Maintenance of Adequate Insurance**

- C2.4 The requirements of maintaining adequate insurance for registered scheme under section 29 of the Regulation shall also apply to APIF. The approved trustee of the scheme should ensure that there is no gap in insurance coverage at both the scheme level and the APIF level.

### **Use of Omnibus Accounts**

- C2.5 Where a custodian (or a sub-custodian) is also the holder of assets of one or more other APIFs or other investment funds or financial undertakings, the custodian may mix the assets of the APIFs with those other assets. The custodian should keep a separate account of the assets of the APIFs and those other assets in such a way as to enable them to be separately identified. Omnibus accounts may be used provided that the assets of the APIFs are recorded and controlled in such manner as may be reasonable and prudent in the circumstances considering usual

custodial practices.

### **Requirements adapted from the UT Code<sup>4</sup>**

C2.6 In general, the requirements prescribed in 6.10, 6.11, 6.13, 6.14, 10.2, 10.4-10.8 and 11.7 should be observed. Where “the Commission” appears in those provisions, it should be interpreted as “the Authority”. Where “management company” appears in those provisions, it should be interpreted as “investment manager”.

### **Pricing of Units**

C2.7 Pricing of units must be on a forward basis.

### **Merger, Division or Termination of APIF**

C2.8 Requirements in line with B1.26 and B1.27 should be observed.

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<sup>4</sup> Where references to the UT Code is made in this Code, it refers to the Third Edition of the UT Code with subsequent updates up to December 1999.

## Chapter C3 : Investment Requirements

### General Requirements

- C3.1 An APIF may maintain an internal portfolio by investing in permissible investments in accordance with sections 2-5 and 7-15 of Schedule 1 to the Regulation or may take the form of a feeder fund or a portfolio management fund<sup>5</sup>.

### *Repurchase Agreements and Security Lending*

- C3.2 The requirements stipulated in sections 51 and 52 of the Regulation in respect of repurchase agreements and security lending respectively are relevant to APIF. The guidelines issued in connection with those sections (Guidelines III.7 and III.8) should be observed.

### *Financial Futures and Option Contracts*

- C3.3 In the case of an APIF acquiring financial futures and option contracts for purposes other than hedging, the approved trustee and the investment manager must have the relevant experience in administering and managing futures and options funds recognized by the SFC. In addition, the requirements prescribed under section 53 of the Regulation are relevant to the APIF.

### *Borrowing of Money*

- C3.4 No borrowing of money for an APIF is allowed otherwise than in accordance with section 4 of Schedule 1 to the Regulation. Temporary borrowing can be made for the purposes of settling a transaction to acquire securities or other investments only if at the time the decision to enter into the transaction was made, it was unlikely that the borrowing would be necessary. It means that, as a matter of course, borrowing to settle a transaction to acquire securities or other investments, or entering into transactions with the intention of borrowing to cover settlement is not allowed. At the time an acquisition transaction is entered into, the APIF

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<sup>5</sup> An APIF is a feeder fund if its assets are invested in a single APIF. An APIF is a portfolio management fund if its assets are invested in more than one APIF.

should have sufficient cash on hand or, in the reasonable opinion of the investment manager, cash will be available from the disposition of other securities or investments in time to settle the acquisition transaction.

#### *Bank Deposits*

- C3.5 For the purposes of section 11 of Schedule 1 to the Regulation, “deposit” has the same meaning as in section 2 of the Banking Ordinance (Cap. 155) and also includes a certificate of deposit issued by an authorized financial institution. That definition may include deposits that are at negative interest, at no interest or are repayable in such a way that the amount repaid is less than the amount originally deposited. Negative interest, no interest and diminishing deposits should be entered into by a trustee only in circumstances where it is reasonable to do so. Otherwise, the trustee may breach its duties under the MPF legislation, in particular section 43 of the Regulation, and the relevant trust deed. The Authority intends to investigate the circumstances of such deposits to ensure that no such breach has occurred. In the event of a breach, the Authority will take appropriate action.

#### *Hong Kong Dollar Currency Investments*

- C3.6 Any investment, including shares, that can be purchased and sold in Hong Kong dollars on the Unified Exchange shall be regarded as a Hong Kong dollar currency investment under section 16(3) of Schedule 1 to the Regulation.

#### *Forbidden Investment Practices*

- C3.7 Guidelines made under section 28 of the Ordinance with respect to forbidden investment practices also apply to APIF.

#### *Investment in Parties to the APIF*

- C3.8 The funds of an APIF must not be invested in the securities of the approved trustee, the custodians, the investment managers or the guarantor, except where any of these parties is a substantial financial institution. For the purposes of this provision, securities do not include units in authorized unit trusts or shares in

authorized mutual funds.

### **Fund of Funds Arrangement**

- C3.9 Where an APIF invests in other APIF(s), requirements similar to B2.7-2.10 and B2.12-B2.16 should be complied with.

### **Capital Preservation Fund**

- C3.10 Where an APIF is formed for investment by a constituent fund to meet the requirements stipulated in section 37 of the Regulation, the requirements on investment and expense deduction (other than compensation fund levy) are relevant to the APIF. The APIF should also observe the requirements in the Guidelines on Capital Preservation Fund (Guidelines III.6).

### *Pricing and Charges*

- C3.11 Neither initial fees nor redemption charges can be imposed on the APIF. Bid and offer spread is also not allowed.

### *Fund of Funds Arrangement Not Permitted*

- C3.12 The APIF must maintain an internal portfolio by investing directly in instruments permitted under section 37(2)(a) of the Regulation. A feeder fund or a portfolio management fund arrangement is not allowed.

### *Crediting of Investment Income and Profits to Fund Holders*

- C3.13 For the purposes of section 37(3) of the Regulation, income and profits mean “net income and profits”, i.e. income and profits remaining after deducting all expenses related to the derivation of that income and profits. In other words, investment expenses may be deducted from a capital preservation fund in order to arrive at the net income and profits derived from the investment of the funds comprising a capital preservation fund.



### *Deduction from Fund Holders' Accounts*

- C3.14 Subject to C3.13, amounts other than administrative expenses are not allowed to be deducted from the accounts of fund holders.

### *Administrative Expenses*

- C3.15 B2.23 applies in determining administrative expenses for the APIF.

### **Guaranteed Funds**

- C3.16 A PIF is a guaranteed fund if a guaranteed amount will be paid to fund holders who hold their investments in the PIF at a specified date in the future. Section 18 of Schedule 1 to the Regulation specifies the requirements for guaranteed funds.

### **Umbrella Fund**

- C3.17 Where an APIF is an umbrella fund, the requirements of this chapter shall apply to each of its sub-funds as if each sub-fund were a single APIF.
- C3.18 The requirements of section 2(2) of Schedule 1 to the Regulation shall apply to the total collective investment by the sub-funds of the umbrella fund.
- C3.19 Records must be kept such that the assets and liabilities of a sub-fund can be distinguished from those of the other sub-funds.

## **PART D - POOLED INVESTMENT FUNDS - INSURANCE POLICIES**

### **Chapter D1 : Insurer, Custodian and Investment Manager**

#### **Provisions of the Regulation relevant to APIF<sup>6</sup>**

- D1.1 A PIF must comply with the requirements stipulated under section 17(2) of Schedule 1 to the Regulation. An approach similar to that described in Part C is adopted to require the parties administering and managing the APIF, which is an insurance policy, to comply with similar requirements as those for a registered scheme.
- D1.2 Sections 43, 49, 61-62, 68-70, 72-76 and 116 of the Regulation are applicable to APIF. The approved trustee of the registered scheme concerned should ensure that the requirements prescribed in those sections are observed. The applicant should specify clearly the parties responsible for the duties prescribed in those sections when making the application for approval of a PIF.

#### **Custodian**

- D1.3 The approved trustee of the scheme concerned should ensure that a custodian is appointed for the assets of the APIF. The custodian may either be an approved trustee or an authorized financial institution meeting the eligibility requirements as stipulated in section 68 of the Regulation. A custodial agreement in line with Schedule 3 to the Regulation should be entered into when appointing the custodian.

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<sup>6</sup> Where requirements stipulated in this Part refer to the Regulation, the following references shall apply:

- (a) References to registered scheme in the Regulation would be construed as references to pooled investment fund in this Part;
- (b) References to scheme member in the Regulation would be construed as references to fund holder in this Part;
- (c) References to governing rules in the Regulation would be construed as references to constitutive documents in this Part; and
- (d) References to financial statements of registered scheme in the Regulation would be construed as references to financial statements of APIF as specified in the Guidelines on Annual Statements of Approved Pooled Investment Funds.

D1.4 Sections 28, 48, 109, 114-116 are applicable to custodian which is an approved trustee.

D1.5 The custodian is expected to:

- (a) ensure separation of assets as stipulated in section 64 of the Regulation;
- (b) ensure assets are not improperly encumbered as set out in section 65 of the Regulation; and
- (c) ensure assets are invested in line with requirements as set out in section 49 of the Regulation.

### **Investment Manager**

#### *Appointment of Investment Manager*

D1.6 The insurer may either appoint an investment manager for the APIF or, if it is so qualified, take up such role itself.

D1.7 Where a separate investment manager is appointed, the insurer must ensure that

- (a) the appointment of the investment manager is in accordance with section 44(3)&(4) of the Regulation; and
- (b) an investment management contract in line with Schedule 2 to the Regulation and observing the requirements stipulated in section 47(4) and (5) of the Regulation is entered into between the insurer and the investment manager.

D1.8 In the case where the insurer takes up the investment management function, the qualifications as stipulated in sections 44(3)(b)&(c) and 44(4)(b)-(d) of the Regulation are applicable to the insurer of the APIF.

D1.9 Delegation of investment management function can only be made in line with section 45 of the Regulation.

*Independence between the Custodian and the Investment Manager*

- D1.10 The insurer, if acting as the investment manager, and its delegates of investment management function must be independent of the custodian. In determining their independence, reference should be made to section 46 of the Regulation.
- D1.11 Notwithstanding of D1.10, the insurer, if acting as the investment manager, is independent of the custodian if:
- (a) the insurer is a substantial financial institution;
  - (b) no person is a director of both of them; and
  - (c) both of them give a written undertaking to the Authority to act independently of each other in their dealings with the APIF.
- D1.12 In the case where a separate investment manager is appointed, the insurer must ensure that the investment manager is independent of the custodian. Section 46 of the Regulation is relevant in determining their independence.

## **Chapter D2 : Operations of Pooled Investment Funds**

### **Provisions of the Regulation relevant to APIF**

- D2.1 The operational requirements as stipulated in sections 38, 39, 49 and 63-66 of the Regulation are relevant to APIF.
- D2.2 Accounting, auditing and reporting requirements as stipulated in sections 77, 80-82, 84-85, 92-93, 95-108, 110-113 and 117 of the Regulation are relevant to APIF. The auditing requirements shall be performed by the auditor appointed for the APIF.

### **Constitutive Documents**

- D2.3 Nothing in the constitutive documents may provide that the insurer, custodian or investment manager can be exempted from any liability to fund holders imposed under Hong Kong law or for any losses due to fraud or negligence, nor may they be indemnified against such liability by fund holders or at fund holders' expense.

### **Maintenance of Adequate Insurance**

- D2.4 The requirements of maintaining adequate insurance for registered scheme under section 29 of the Regulation shall also apply to APIF. The approved trustee of the scheme should ensure that there is no gap in insurance coverage at both the scheme level and the APIF level.

### **Use of Omnibus Accounts**

- D2.5 Where a custodian (or a sub-custodian) is also the holder of assets of one or more other APIFs or other investment funds or financial undertakings, the custodian may mix the assets of the APIFs with those other assets. The custodian should keep a separate account of the assets of the APIFs and those other assets in such a way as to enable them to be separately identified. Omnibus accounts may be used provided that the assets of the APIFs are recorded and controlled in such manner as may be reasonable and prudent in the circumstances considering usual custodial practices.

## **Operational Requirements**

- D2.6 In general, the requirements prescribed under B1.12-B1.24 should be observed.
- D2.7 The maximum interval between the receipt of a properly documented request for redemption and the payment of the redemption money to the fund holder may not exceed one calendar month.

## **Statutory Fund Under Separate Account**

- D2.8 Under sections 22/22A of the Insurance Companies Ordinance (Cap. 41) (“ICO”), an insurer is required to maintain an statutory fund under separate account in respect of its Class G and H insurance businesses respectively. Section 23 of the ICO further places certain restrictions on the application of assets representing such statutory funds.
- D2.9 Where there is more than one series of Class G or H insurance policies, the intention of section 19(4) of Schedule 1 to the Regulation is to require a statutory fund under separate account to be kept in respect of each series of insurance policies with identical contract terms.
- D2.10 The statutory funds are subject to the requirements of sections 22/22A and 23 of the ICO. Furthermore, in respect of a series of Class H insurance policies, the assets of the statutory fund shall be applied only for the purposes of such policies.

## **Unitization of Fund**

- D2.11 All insurance policies must be fully unitized except for non-investment linked class G policies.

## **Investment Guarantee (Class G)**

- D2.12 The requirements for reserving for liabilities and provisions for Class G insurance policies with investment guarantees will be determined in accordance with the Insurance Companies (Determination of Long Term Liabilities) Regulation. The statutory fund maintained for each series of Class G policies must have sufficient

assets to meet the required reserves for liabilities and provisions for such policies.

- D2.13 An insurer may not reinsure any part of the liabilities arising out of insurance policies to another insurer or other entity. However, an authorized financial institution may act as the guarantor for the investment guarantee given and this can be taken into account in the determination of reserving liabilities and provisions requirements.

**No Combination of Insurance Business**

- D2.14 There shall not be combined in the one contract Class G or H business and any other insurance business, i.e. such policies should be used solely for investment purposes.

**Merger, Division or Termination of APIF**

- D2.15 Requirements in line with B1.26 and B1.27 should be observed.

## **Chapter D3 : Investment Requirements**

D3.1 The approved trustee of the registered scheme concerned must ensure that the requirements prescribed in Chapter C3 are complied with except for C3.5, C3.8 and C3.16.

### **Bank Deposits**

D3.2 For the purposes of section 11 of Schedule 1 to the Regulation, “deposit” has the same meaning as in section 2 of the Banking Ordinance (Cap. 155) and also includes a certificate of deposit issued by an authorized financial institution. That definition may include deposits that are at negative interest, at no interest or are repayable in such a way that the amount repaid is less than the amount originally deposited. The trustee of the scheme concerned should note that negative interest, no interest and diminishing deposits should be entered into only in circumstances where it is reasonable to do so. Otherwise, the trustee concerned may breach its duties under the MPF legislation, in particular section 43 of the Regulation, and the relevant trust deed. The Authority intends to investigate the circumstances of such deposits to ensure that no such breach has occurred. In the event of a breach, the Authority will take appropriate action.

### **Investment in Parties to the APIF**

D3.3 The funds of an APIF must not be invested in the securities of the insurer, the custodian, the investment manager or the guarantor, except where any of these parties is a substantial financial institution. For the purposes of this provision, securities do not include units in authorized unit trusts or shares in authorized mutual funds.

### **Guaranteed Funds**

D3.4 A PIF is a guaranteed fund if a guaranteed amount will be paid to fund holders who hold their investments in the PIF at a specified date in the future. Section 19 of Schedule 1 to the Regulation specifies the requirements for guaranteed funds.



## **Appendix A : List of Guidelines On Investments**

<b>No.</b>	<b>Title</b>
III.1	Guidelines on Debt Securities
III.2	Guidelines on Other Securities
III.3	Guidelines on Eligible Overseas Banks
III.4	Guidelines on Recognized Exchanges
III.5	Guidelines on Investment Managers
III.6	Guidelines on Capital Preservation Funds
III.7	Guidelines on Securities Lending
III.8	Guidelines on Repurchase Agreements

## **Appendix B : List of Applicable Sections for APIF**

The following table lists out the relevant sections in the Regulation which are relevant to APIFs.

### **Section No. Description**

#### **PART IV - REQUIREMENTS AND STANDARDS FOR REGISTERED SCHEMES**

- |    |  |
|----|--|
| 28 | Appointment of officer of approved trustee that is a company                                   |
| 29 | Maintenance of adequate insurance  |
| 37 | Provisions relating to capital preservation fund   |
| 38 | Statement of investment policy to be maintained in respect of each registered scheme           |
| 39 | Control objectives and internal control procedures to be maintained for each registered scheme |
| 40 | Investment standards to be complied with   |

#### **PART V - FUNCTIONS OF APPROVED TRUSTEES**

- |    |  |
|----|--|
| 43 | Approved trustee's general duties with respect to administration of scheme                                       |
| 44 | Approved trustee to appoint investment manager   |
| 45 | Delegation of investment management function   |
| 46 | Independence of investment manager   |
| 47 | Investment management contract   |
| 48 | Approved trustee to ensure compliance with prescribed adequacy requirements                                      |
| 49 | Duties of approved trustee with respect to investment of scheme funds  |
| 50 | Approved trustee to appoint custodian of scheme assets   |
| 51 | Restrictions on entering into repurchase agreements  |
| 52 | Restrictions on lending of scheme securities   |
| 53 | Duty of approved trustee with respect to investing in financial futures contracts and financial option contracts |

**Section No. Description**

- 61 Disclosure of conflicts of interests
- 62 Approved trustee to notify Authority of events of significant nature
- 63 Amendments to governing rules of registered scheme not to take effect without Authority's approval
- 64 Approved trustee to ensure separation of scheme assets
- 65 Approved trustee to ensure that scheme assets are not improperly encumbered
- 66 Approved trustee permitted to deduct from scheme members' accounts amount in respect of administrative expenses

**PART VI - FUNCTIONS OF SERVICE PROVIDERS**

- 68 Eligibility for appointment as custodian
- 69 Custodial agreement
- 70 Temporary custodian
- 72 Subcustodial agreement
- 73 Use of central securities depository
- 74 Approved trustee to review service providers' reports
- 75 Service providers to report certain matters to Authority
- 76 Power of Authority on becoming aware of matters reported under section 75

**PART VII - ACCOUNTING AND OTHER RECORDS**

- 77 Proper accounting records to be kept
- 80 Approved trustee to prepare statement of accounting policies
- 81 Approved trustee to prepare financial statements
- 82 Auditor's report to be attached to financial statements
- 84 Comparative amounts to be included in financial statements
- 85 Signing of financial statements
- 92 Other Records to be kept

**Section No. Description**

93 Period for which accounting and other records are to be kept

**PART VIII - FUNCTIONS OF AUDITORS**

95 Approved trustee to ensure financial statements are audited

96 Approved trustee to appoint auditor to audit scheme accounts

97 Functions of Authority where approved trustee fails to appoint auditor under section 96

98 Qualifications for auditor

99 Removal and resignation of auditor

100 Effect of winding up on office of auditor

101 Fees and expenses of auditor

102 Auditor to report on financial statements etc.

103 Auditor to report certain matters to Authority

104 Power of Authority on becoming aware of matters reported under section 103

105 Access of auditor of scheme records

106 Auditor's opinion with respect to information and explanations

107 Obstruction of auditor

108 Certain statements of auditor not admissible evidence

**PART IX - LODGEMENT OF DOCUMENTS WITH AUTHORITY**

109 Approved trustee to lodge trustee's return with Authority

110 Requirements in section 22A of the Ordinance

111 Meaning of relevant period for the purposes of sections 112, 113 and 116

112 Approved trustee to report on control objectives and internal control measures

113 Duty of auditor in respect of approved trustee's report under section 112

114 Approved trustee to report on compliance with capital adequacy requirements

**Section No. Description**

115	Duty of auditor in respect of trustee's report under section 114
116	Power of Authority to direct approved trustee to rectify matters
117	Approved trustee to lodge monthly return with Authority