



Mandatory Provident Fund Schemes Authority

**CODE ON
MPF INVESTMENT FUNDS**

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CODE ON MPF INVESTMENT FUNDS

Explanatory Notes:

- (a) Section 21BA(1) of the Mandatory Provident Fund Schemes Ordinance (Cap 485) (the Ordinance) provides that an approved trustee of a registered 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 Mandatory Provident Fund Schemes Authority (the Authority).
- (b) Section 6(1) of the Mandatory Provident Fund Schemes (General) Regulation (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 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 regulation¹ and to such conditions (if any) as the Authority considers appropriate. Subject to section 6(3) of the Regulation, the Authority may vary any such conditions by written notice given to the investment manager, insurer or trustee of the investment fund concerned.
- (d) Section 6H(1) of the Ordinance provides that the Authority may issue guidelines for the guidance of approved trustees, service providers, participating employers and their employees, self-employed persons, regulated persons 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 Authority's guidelines relating to investment funds are made available on the Authority's website at: www.mpfa.org.hk.
- (f) Part B of this Code establishes requirements, in addition to those prescribed in the Ordinance and the Regulation, on a constituent fund in an MPF scheme. Parts C and D of this Code establish requirements on 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/PIF must seek prior approval from the Securities and Futures Commission (the SFC) under section 105 of the Securities and Futures Ordinance (Cap 571) (the SFO). Please refer to the SFC's requirements and guidance in this respect.

¹ Fees regulation means the regulation (if any) made under section 46 of the Ordinance prescribing fees for the purposes of the Regulation.

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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 “Constitutive documents” means the principal documents governing the formation and operation of an MPF scheme or a PIF, including the policy document in the case of a PIF which is an insurance policy and the trust deed in the case of an MPF scheme comprising one or more constituent funds or a PIF which is a unit trust.
- A1.2 “Money market fund” means a constituent fund or a PIF with the sole objective of investing in short-term deposits and debt securities.
- A1.3 “MPF scheme” means an employer sponsored scheme, a master trust scheme or an industry scheme.
- A1.4 [deleted]
- A1.5 “SFC’s Code” means the SFC Code on MPF Products.
- A1.6 “UT Code” means the Code on Unit Trusts and Mutual Funds issued by the SFC.

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 PIFs, and monitor their compliance with the Ordinance, the Regulation and the guidelines issued by the Authority. MPF schemes (other than employer sponsored schemes) and PIFs, being collective investment schemes, are required to be authorized by the SFC pursuant to the SFO. 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 21BB of the Ordinance 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 104(1) of the SFO. In this regard, the SFC is responsible for licensing and regulating 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 105(1) of the SFO.

Pooled Investment Funds

- A2.6 The Authority is responsible for approving PIFs under section 6 of the Regulation and in accordance with this Code.
- A2.7 The SFC is responsible for authorizing PIFs that are unit trusts or insurance policies pursuant to section 104(1) of the SFO.
- A2.8 In authorizing PIFs, 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 [deleted]
- A2.10 The SFC is also empowered to authorize advertisements and other marketing materials of PIFs under section 105(1) of the SFO.

Application Procedures

- A2.11 An applicant has to submit applications seeking registration of schemes/approval of funds from the Authority and the relevant authorization from the SFC respectively. 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 PIF 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 [deleted]

A2.15 [deleted]

A2.16 [deleted]

Chapter A3 : MPF Investments

Regulatory framework

- A3.1 The regulatory framework for MPF permissible investments is set out in the MPF legislation and supplemented by the Authority's guidelines, and they are reflective of a set of principles which seek to strike a balance between flexibility to achieve investment performance and safeguarding against excessive risk taking.
- A3.2 The Authority's evaluation of whether, and to what extent, an asset class should become permissible for MPF purposes is guided by the Principles of MPF Permissible Asset Classes (Principles), the details of which are set out in Appendix C to this Code.
- A3.3 The Principles are kept under review by the Authority on an ongoing basis taking into account relevant market and regulatory developments to ensure they remain relevant, applicable and appropriate, in order to protect scheme members' interests and achieve better outcomes for scheme members.

Responsibility of approved trustees and investment managers

- A3.4 It should be noted that even if an asset class is considered permissible for MPF purposes, approved trustees remain responsible and accountable for supervising and monitoring investment managers to ensure that they make sound judgments and investment decisions as to which specific investment products to invest in, bearing in mind scheme members' interests and taking into account the risks which are specific to the intended investments.

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 a 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 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 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, and any investment option that is formed by a combination of constituent funds within an MPF scheme (e.g. the Default Investment Strategy) 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 [deleted]

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 an amount representing the necessary transaction costs that are incurred, or reasonably likely to be incurred, by the approved trustee in selling or purchasing investments in order to give effect to the transfer and are payable to a party other than that approved trustee e.g. bid/offer spread) when a member transfers from one scheme to another scheme or from one constituent fund to another constituent fund within the same scheme or from an account to another account 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 All constituent funds 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.

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 and 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 should fairly reflect the value of a fund's assets and 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.

- B1.13A The approved trustee should ensure that appropriate policies and procedures are established for proper valuation of each type of assets held by a scheme. Such policies and procedures should seek to detect, prevent and correct pricing errors and be consistently applied. The approved trustee should review the valuation policies and procedures on a periodic basis to ensure their continued appropriateness and effective implementation. In conducting the valuation of fund assets, the following requirement should be observed:

- (a) Where fair value adjustments are necessary in view that market value of a fund's assets is unavailable, or reasonably considered to be not reliable or reflective of an exit price upon current sale, the approved trustee shall ensure such adjustments are conducted with due skill, care and diligence, and in good faith.
- (b) The approved trustee must ensure compliance with all applicable legal and regulatory requirements in respect of the valuation of a scheme's assets.
- (c) For the purpose of satisfying the requirement on periodic review of valuation policies, procedures and process, the review should include testing the valuation procedures by which fund assets are valued. The approved trustee

shall exercise due skill, care and diligence in the selection of a competent and functionally-independent party to perform such review at least annually.

B1.13B Assets of a constituent fund should be valued on a regular basis and in any event, on the days that the fund's units are offered or redeemed in accordance with the constitutive documents. Valuation frequency and the basis of valuation of a fund's assets should be clearly disclosed in the offering document.

B1.13C Where a third party is engaged in the valuation of a fund, the approved trustee shall exercise reasonable care, skill and diligence in the selection, appointment and ongoing monitoring of such third party in ensuring such entity possesses the appropriate level of knowledge, experience and resources that commensurate with the appropriate valuation policies and procedures for each fund. The valuation activities of such third party should be subject to ongoing supervision and periodic review by the approved trustee.

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. In the event that compensation is made to one or more affected scheme members for the errors not falling under B1.16A, compensation to all other affected scheme members should be made on the same basis.

B1.16A 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 must inform the Authority immediately. Where fund valuation is performed by a third party other than the approved trustee, the approved trustee must ensure it is informed of such an error immediately, and must in turn inform the Authority of the same immediately. For the avoidance of doubt, any error that accounts for less than 0.5% of the fund's net asset value per unit or net asset value individually but amounts to 0.5% of the fund's net asset value per

unit or net asset value or more in aggregate for incidences that occur in a simultaneous or recurring manner, such errors should be reported to the approved trustee and the Authority immediately.

B1.16B For any error in the pricing of units for a unitized constituent fund referred to in B1.16A, affected scheme members and/or the constituent fund should be compensated as follows, unless determined otherwise by the approved trustee with justification to the Authority:

- (a) where total loss to each affected 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;
- (b) where the loss is to the trustee or other service providers, no compensation should be paid; and
- (c) where the loss is to the constituent fund, the constituent fund should be compensated in all circumstances referred to in B1.16A.

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 12 and 13 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.

B1.19 [deleted]

B1.20 [deleted]

Suspension and Deferral of Dealings

B1.21 Suspension of dealings may be provided for by the approved trustee, having regard to the interests of scheme members. The approved trustee must regularly review

any suspension of dealings and take all necessary steps to resume normal operations as soon as practicable.

- 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 an appropriate manner with reference to the means of dissemination contemplated under B1.24.
- B1.23 Where redemption requests on any one dealing day exceed 10% of the net asset value of a 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 made public free of charge on every dealing day in an appropriate manner. Means of dissemination may include websites, newspapers and telephone hotlines. 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 value of the commission or other agency rewards paid for the 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 approved trustee should ensure and demonstrate to the Authority that proper arrangements are in place for scheme members concerned before the granting of the approval by the Authority.
- B1.27 After the merger, division or termination of a constituent fund has been approved by the Authority, prior notice must be given to the scheme members concerned.

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 and/or index-tracking collective investment schemes approved by the Authority (Approved ITCISs) in accordance with section 6A(b) of Schedule 1 to the Regulation.

B2.2 [deleted]

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, amongst other things, 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 or eligible overseas bank. 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 sections 43 and 66A of the Regulation, and the relevant trust deed.

B2.5 [deleted]

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) and/or Approved ITCISs

B2.7 A 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 A 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 a constituent fund.

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

Specific Requirements for Feeder Funds²

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

² A constituent fund is a feeder fund if its assets are invested in a single APIF or Approved ITCIS.

entirely in one APIF or Approved ITCIS.

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

Specific Requirements for Portfolio Management Funds³

- 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 or Approved ITCISs.
- 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/or Approved ITCISs and the criteria for selecting those APIFs and/or Approved ITCISs.
- B2.16 A portfolio management fund may enter into financial futures and option contracts only for hedging purposes.

Capital Preservation Fund (also known as MPF Conservative 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 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 meeting the requirements specified in C3.10–C3.14.

³ A constituent fund is a portfolio management fund if its assets are invested in two or more APIFs and/or Approved ITCISs.

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 fees payable to trustee, custodian, investment manager and administrator / eMPF Platform Company Limited (as the case may be).

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 43, 48, 61-62, 70, 71(2) and (3), 109 and 114-116 of the Regulation⁴ are relevant to the trustee of APIF.

Custodian

- C1.3 The requirements stipulated in sections 50, 68-69 and 71-73 of the Regulation are relevant to the custodian of an 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 an APIF.

⁴ 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 PIF 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 (Guidelines II.5).

Service Providers Generally

- C1.5 The requirements stipulated in sections 74-76 of the Regulation are relevant to the service providers and/or service suppliers of an 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 63-66A 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 an 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 an 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

- C2.6 In general, the requirements prescribed in 6.10, 6.11, 6.11A, 6.11B, 6.11C, 6.13, 6.14, 10.2, 10.2A, 10.2B, 10.6-10.8 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.

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 fund⁵.

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 an APIF. The guidelines issued by the Authority in connection with those sections (Guidelines on Securities Lending (Guidelines III.7) and Guidelines on Repurchase Agreements (Guidelines III.8)) should be observed.

Financial Futures and Option Contracts

- C3.3 The requirements prescribed under section 53 of the Regulation are relevant to an 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, amongst other things, 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 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.

⁵ An APIF is a feeder fund if its assets are invested in a single APIF or Approved ITCIS. An APIF is a portfolio management fund if its assets are invested in two or more APIFs and/or Approved ITCISs.

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 or an eligible overseas bank. 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 sections 43 and 66A of the Regulation, and the relevant trust deed.

C3.6 [deleted]

Forbidden Investment Practices

C3.7 Guidelines made under section 28 of the Ordinance with respect to forbidden investment practices (if any) also apply to an 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) and/or Approved ITCIS(s), requirements similar to B2.7-2.10 and B2.12-B2.16 should be complied with.

Capital Preservation Fund (also known as MPF Conservative 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 Funds (Guidelines III.6).

Pricing and Charges

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

Fund of Funds Arrangement Not Permitted

- C3.12 An 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 an 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 APIF⁶

- 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, 68-76 and 116 of the Regulation are applicable to APIFs. 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 an 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 an 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.
- D1.4 Sections 48, 109, 114-116 of the Regulation are applicable to custodian which is an approved trustee.

⁶ 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 PIF 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 (Guidelines II.5).

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 40 of the Regulation.

Investment Manager

Appointment of Investment Manager

D1.6 The insurer may either appoint an investment manager for an 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) and (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) and (c) and 44(4)(b)-(d) of the Regulation are applicable to the insurer of an 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 requirements under C2.1 apply.

D2.2 The requirements under C2.2 apply.

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 under C2.4 apply.

Use of Omnibus Accounts

D2.5 The requirements under C2.5 apply.

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 21B, 22, 22A, 22B and 23 of the Insurance Ordinance (Cap 41) (IO), an insurer is required to maintain a statutory fund under separate account in respect of its Class G insurance business. Section 23 of the IO further places certain restrictions on the application of assets representing such statutory fund.

D2.9 Where there is more than one series of Class G 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 21B, 22, 22A, 22B and 23 of the IO.

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 section 3C of the IO. 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 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 or an eligible overseas bank. 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 approved 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 approved trustee concerned may breach its duties under the MPF legislation, in particular sections 43 and 66A of the Regulation, and the relevant trust deed.

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 [deleted]

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
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PART 4 - REQUIREMENTS AND STANDARDS FOR REGISTERED SCHEMES

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 5 - 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 functions
46	Independence of investment manager
47	Investment management contract
48	Approved trustee to ensure compliance with prescribed capital 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
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

Section No. Description

without Authority's approval

63A Amendments to offering documents require 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

66A Interest to be received where a scheme's assets are placed on deposit

PART 6 - FUNCTIONS OF SERVICE PROVIDERS

68 Eligibility for appointment as custodian

69 Custodial agreement

70 Temporary custodian

71 Eligibility of delegate of custodian

72 Subcustodial agreement

73 Use of central securities depository

74 Approved trustee to review service providers' reports

75 Service suppliers to report certain matters to Authority

76 Power of Authority on becoming aware of matters reported under section 75

PART 7 - 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

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

Section No. Description**PART 8 - 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 to 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 9 - 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
115	Duty of auditor in respect of trustee's report under section 114

Section No.	Description
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116	Power of Authority to direct approved trustee to rectify matters
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117	Approved trustee to lodge monthly return with Authority
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Appendix C : Principles of MPF Permissible Asset Classes

1. The Principles of MPF Permissible Asset Classes (Principles) consist of an overarching General Principle (GP) and four specific principles, namely, risk level, risk control, diversification and liquidity, which are elaborated below.

General Principle

2. The GP refers to the longstanding principle of protecting and furthering scheme members' interests which (i) is the cornerstone of the MPF legislation and (ii) has been informing and guiding the Authority's regulatory work.
3. Scheme members' interests are considered in the context of the MPF System's overall investment goals and public interest considerations. In this regard, the MPF System's overall investment goals include, but are not limited to:
 - (a) promoting prudent investment to enhance member protection;
 - (b) striving to improve risk-adjusted return potential; and
 - (c) lowering costs for members,whereas public interest considerations include but are not limited to legality, government policy direction and national security.

Principle 1: Risk Level

4. At the asset level, asset classes should not be highly risky for MPF purposes. Different asset classes exhibit different risks providing different returns in different market conditions. Non-exhaustive examples of key risks of asset classes include but are not limited to volatility, concentration risk, interest rate risk, credit risk, liquidity risk, complexity/transparency risk, valuation risk, custody risk, platform risk, security risk, counterparty risk and exchange rate risk.
5. In holistically assessing whether an asset class is highly risky, all relevant quantitative factors and/or qualitative factors (as further elaborated in paragraph 6 below) should be taken into consideration.

6. Since risk is relative rather than absolute, quantitative and qualitative factors to be taken into consideration in assessing the risk level of an asset class include but are not limited to:
- (a) quantitative factors: a comparison of risk and return measures (including but not limited to volatility (standard deviation) and risk-adjusted return (e.g. Sharpe ratio or similar measures)) of new asset class with those of Hong Kong listed shares⁷; and
 - (b) qualitative factors: (a) What is the purpose of investing in such an asset class? (b) What are the types and nature of risks? (c) What is the public perception of the new asset class?

Principle 2: Risk Control

7. Investments should be subject to risk control measures so as to protect scheme members from unavoidable risks, including but are not limited to (a) any quantitative limits (investment cap) and/or qualitative restrictions (minimum credit ratings to ensure credit risk is within an acceptable level, listing on approved stock exchanges to ensure transparency in disclosure of information and sufficient liquidity for trading of an asset class, approved types / markets and specified purpose of use to prevent against excessive risk taking) imposed by regulatory requirements; and (b) risk management controls put in place by trustees⁸ and investment managers⁹.
8. The following are examples of tools generally used by the Authority to mitigate different types of risks.

⁷ Hong Kong listed shares serves as a benchmark as it is an existing permissible asset class commonly invested by scheme members in general.

⁸ The Governance Principles for MPF Trustees provide that an MPF trustee should, among others, establish and maintain an effective risk management framework for its MPF business and operation.

⁹ Investment managers, being licencees of the SFC, are subject to SFC's conduct requirements. Among other things, the SFC Fund Manager Code of Conduct provides that an investment manager should, among others, implement adequate risk management procedures (including risk measurements and reporting methodologies) in order to identify, measure, manage and monitor appropriately all risks.

Risk	Tool
Volatility and other types of risks in general	1. Approving certain types of securities ¹⁰ 2. Imposing cap on investment (10% aggregate investment cap ¹¹ , 10% issuer cap ¹²)
Concentration risk, interest rate risk ¹³	Imposing cap on investment
Credit risk, liquidity risk	Specifying minimum credit rating ¹⁴
Risks relating to transparency, valuation, liquidity, custody	Restricting investments in assets which are listed on approved stock exchanges ¹⁵
Risks of misusing investment	Limiting the purpose of use e.g. permitting certain derivatives for risk management purposes only and not for speculative purposes ¹⁶

Principle 3: Diversification

9. At the portfolio level, the asset class should provide diversification benefits for achieving better risk-adjusted returns. Accordingly, for a new asset class to become permissible for MPF investment purposes, it should be of a type different from other existing permissible asset classes such that it can provide such benefits.
10. The performance of the new asset class and those of other existing permissible asset classes should not be highly correlated. This would mitigate the overall volatility of the

¹⁰ Section 8(2)(b) of Schedule 1 to the Regulation.

¹¹ The 10% aggregate limit means that the total amount invested in certain types of approved securities cannot exceed 10% of the net asset value of an MPF fund. These security types include, for example, gold ETFs and other authorized funds (i.e. equity funds, bond funds, mixed assets funds, money market funds and index funds authorized by the SFC). The aggregate limit is shared across these security types. (Section 8(2) of Schedule 1 to the Regulation).

¹² Section 2(1) of Schedule 1 to the Regulation.

¹³ Concentration risk can be mitigated by imposing (i) 10% aggregate investment cap on a particular asset class and (ii) 10% issuer cap on a security in a portfolio of assets. This may indirectly mitigate interest rate risk by limiting exposure to a particular asset class or issuer which may be more susceptible to interest rate risk than other investments in general.

¹⁴ Section 7(2)(c) of Schedule 1 to the Regulation.

¹⁵ Section 8 of Schedule 1 to the Regulation.

¹⁶ Section 14 of Schedule 1 to the Regulation.

investment portfolio as a whole and have the potential to increase the risk-adjusted return of the investment portfolio.

Principle 4: Liquidity

11. In respect of investments, the short-term liquidity needs of an MPF fund should be considered. Liquidity is both relevant and important in considering the permissibility of an asset class for MPF purposes, because there would be a liquidity need in the MPF System which allows scheme members to switch between different funds or to redeem their holdings in the funds when appropriate. MPF funds would therefore need to have sufficient liquidity in their investments to meet those switching or redemption instructions.