

## **MANDATORY PROVIDENT FUND SCHEMES AUTHORITY**

### **III.1 Guidelines on Debt Securities**

#### **INTRODUCTION**

Section 7(1)(d) of Schedule 1 to the Mandatory Provident Fund Schemes (General) Regulation (“the Regulation”) defines “exempt authority” as, inter alia, a government, the central or reserve bank of a country or territory, or a multilateral international agency all with the highest possible credit rating determined by a credit rating agency approved by the Mandatory Provident Fund Schemes Authority (“the Authority”).

2. Section 7(2) of Schedule 1 to the Regulation provides that the funds of a constituent fund of a registered scheme may be invested in, inter alia,

- (a) a debt security issued by an exempt authority; or
- (b) a debt security in respect of which the repayment of the principal and the payment of interest is unconditionally guaranteed by an exempt authority; or
- (c) a debt security that satisfies a minimum credit rating set by the Authority, based on the credit rating of the security as determined by a credit rating agency approved by the Authority for the purposes of the Schedule.

3. Section 7(3) of Schedule 1 to the Regulation provides that the general restrictions on spread of investments under section 2 of the Schedule do not apply to debt securities of a kind referred to in section 7(2)(a) or (b) of the Schedule (i.e. debt securities issued or guaranteed by exempt authorities). The

funds of a constituent fund investing in such debt securities are subject to the following provisions instead:

- (a) not more than 30 per cent of the funds of a constituent fund may be invested in debt securities of the same issue; and
- (b) all of the funds of a constituent fund may be invested in debt securities of the same issuer so long as they comprise at least 6 different issues.

4. Section 37(2) of the Regulation provides that a capital preservation fund may be invested in, inter alia, debt securities with a remaining maturity period of 1 year or less and that satisfy the minimum credit rating set by the Authority, based on the credit rating of the securities as determined by an approved credit rating agency.

5. Section 6H of the Mandatory Provident Fund Schemes Ordinance (“the Ordinance”) provides that the Authority may issue guidelines for the guidance of approved trustees, service providers, participating employers and their employees, self-employed persons, regulated persons and other persons concerned with the Ordinance.

6. The Authority hereby issues guidelines to:

- (a) provide guidance in relation to multilateral international agencies;
- (b) specify the credit rating agencies approved by the Authority and minimum credit rating requirements with respect to debt securities;
- (c) provide guidance on the interpretation of the credit rating requirements; and
- (d) provide guidance on what constitutes “same issue” in respect of debt securities issued or guaranteed by an exempt authority.

## **MULTILATERAL INTERNATIONAL AGENCIES**

7. The following is a list of multilateral international agencies which satisfy the requirements of section 7(1)(d) of Schedule 1 to the Regulation at the time of the publication of these Guidelines:

- (a) African Development Bank;
- (b) Asian Development Bank;
- (c) Caribbean Development Bank;
- (d) Council of Europe Development Bank;
- (e) European Atomic Energy Community (EURATOM);
- (f) European Bank for Reconstruction and Development;
- (g) European Central Bank;
- (h) European Coal & Steel Community;
- (i) European Community;
- (j) European Company for the Financing of Railroad Rolling Stock (EUROFIMA);
- (k) European Investment Bank;
- (l) European Investment Fund;
- (m) Inter-American Development Bank;
- (n) International Bank for Reconstruction and Development (commonly known as the World Bank);
- (o) International Finance Corporation (an affiliate of the World Bank);
- (p) Islamic Development Bank; and
- (q) Nordic Investment Bank.

8. Other multilateral international agencies would also meet the requirements of section 7(1)(d) of Schedule 1 to the Regulation if they have the highest possible credit rating determined by a credit rating agency approved in paragraph 9. Trustees should note that the organizations listed in paragraph 7 will not satisfy the requirements of section 7(1)(d) of Schedule 1 to the Regulation if

at any time they do not hold a credit rating that is the highest possible credit rating determined by a credit rating agency approved in paragraph 9.

### **CREDIT RATING AGENCIES APPROVED BY THE AUTHORITY**

9. The following is the list of credit rating agencies approved by the Authority for the purposes of sections 7(1)(d) and 7(2)(c) of Schedule 1 to the Regulation:

- (a) Fitch Ratings;
- (b) Rating & Investment Information, Inc.;
- (c) Moody’s Investors Service, Inc.; and
- (d) Standard & Poor’s Corporation.

### **MINIMUM CREDIT RATING REQUIREMENTS**

#### **Debt Securities**

10. The following is the minimum credit rating set by the Authority for the purposes of section 7(2)(c) of Schedule 1 to the Regulation:

<u>Credit Rating Agency Approved by the Authority</u>	<u>Minimum Credit Rating</u>	
	<u>Long-term Debt (one year or over)</u>	<u>Short-term Debt (less than one year)</u>
Fitch Ratings	BBB-	F2
Rating & Investment Information, Inc.	BBB-	a-2
Moody’s Investors Service, Inc.	Baa3	Prime-2
Standard & Poor’s Corporation	BBB-	A-2

11. An interim rating of a debt security, assigned by a credit rating agency approved by the Authority, that meets the minimum credit rating set out in paragraph 10, is also the minimum credit rating set by the Authority for the purposes of section 7(2)(c) of Schedule 1 to the Regulation. For the purposes of this paragraph and paragraph 13, the term “interim rating” means a “preliminary

rating” assigned by Standard & Poor’s Corporation or Rating & Investment Information, Inc.; an “expected rating” assigned by Fitch Ratings; or a “provisional rating” assigned by Moody’s Investors Service, Inc.

### **Debt Securities for Capital Preservation Fund**

12. Guidelines I.9 set out the names of approved credit rating agencies. The following is the minimum credit rating set by the Authority for the purposes of section 37(2)(a)(iii) of the Regulation:

<b><u>Approved Credit Rating Agency</u></b>	<b><u>Minimum Credit Rating</u></b>	
	<b><u>Long-term Debt</u></b> <b>(one year or over)</b>	<b><u>Short-term Debt</u></b> <b>(less than one year)</b>
Fitch Ratings	A	F1
Rating & Investment Information, Inc.	A	a-1
Moody’s Investors Service, Inc.	A2	Prime-1
Standard & Poor’s Corporation	A	A-1

13. An interim rating of a debt security, assigned by an approved credit rating agency, that meets the minimum credit rating set out in paragraph 12, is also a minimum credit rating set by the Authority for the purposes of section 37(2)(a)(iii) of the Regulation.

### **CREDIT RATINGS OF DEBT SECURITIES**

14. The following paragraphs provide guidance on the interpretation of “credit rating of the securities” as it applies to section 37(2)(a) of the Regulation and “credit rating of the security” as it applies to sections 7(2)(c) and 9(1)(b) of Schedule 1 to the Regulation.

15. The prescribed minimum credit rating is only one of the criteria to be considered in determining whether a particular debt security is an appropriate investment for a fund. Approved trustees and their delegates are also subject to duties to act with skill, diligence and prudence and in accordance with the investment policies and objectives of the funds concerned.

### **Issuer Ratings**

16. Credit ratings are assigned on specific financial obligation (“issue credit rating”) and on the obligor level (“issuer credit rating”). An “issue credit rating” is a current opinion of the creditworthiness of an obligor with respect to a specific financial obligation, a specific class of financial obligations, or a specific financial program. “Issuer credit rating” is a current opinion of an obligor’s overall financial capacity (its creditworthiness) to pay its financial obligations, focusing on the obligor’s capacity and willingness to meet its financial commitments as they come due.

17. An issuer may in the general course, issue debt securities having a higher or lower credit rating than the issuer by means of securing assets or revenue flows or subordination. As a result, the creditworthiness of these securities may differ from the issuer’s own financial capacity.

18. It is therefore inappropriate to equate the credit rating of the relevant issuer with the credit rating of the security and, as such, issuer credit ratings cannot be used for the purposes of section 37(2)(a) of the Regulation and sections 7(2)(c) and 9(1)(b) of Schedule 1 to the Regulation.

### **MTN Program Ratings**

19. Securities issued under a medium-term note (“MTN”) program may have a final credit rating different from that of the overall program, due primarily to the specific features of a particular issue. Accordingly, program ratings cannot be considered as the “credit rating of the security”.

### **Debt Class Ratings**

20. In addition to providing credit ratings for individual debt issues, the rating agencies also assign debt class ratings for specific classes of debt (for instance, senior unsecured debt). The debt class ratings are said to apply, in general, to all debt securities under the relevant class issued with standard terms, essentially reflecting the cross default clauses which are incorporated in substantially all debt documentation.

21. For the purposes of section 37(2)(a) of the Regulation and sections 7(2)(c) and 9(1)(b) of Schedule 1 to the Regulation, debt class ratings may be used as the “credit rating of the security” for individual issues within a class provided that the approved trustee ensures, to the extent reasonably practicable, that -

- (a) the security concerned is appropriately classified by class;
- (b) the security is issued under standard terms and conditions applicable to that particular class; and
- (c) no issue specific rating has been assigned in relation to the security.

### **Short-term Credit Ratings**

22. Some of the approved credit rating agencies may issue short-term ratings that apply both to the issuer and the short-term obligations of the issuer. As such, these short-term credit ratings apply to an individual issuer’s capacity to repay all short-term obligations rather than to specific short-term borrowing

programs. These short-term credit ratings can therefore be used as the “credit rating of the security” in relation to all of the issuer’s senior unsecured obligations with an original maturity of less than one year, regardless of the currency or market in which the obligations are issued.

### **Rating Differences**

23. The credit ratings given by the various credit rating agencies, though generally consistent, are not always the same. If the issue has more than one applicable credit rating, it is considered that the credit rating requirement has been met if at least one of the ratings meets the minimum credit rating requirement as set out in these Guidelines.

### **Debt Securities Issued or Guaranteed by an Exempt Authority – Same Issue**

24. For the purposes of section 7(3) of Schedule 1 to the Regulation, debt securities referred to in section 7(2)(a) or (b) of the Schedule are regarded as being of a different issue if, even though they are issued by the same issuer, they are issued on different terms whether as to repayment dates, interest rates, the identity of the guarantor, or otherwise.

### **DEFINITION OF TERMS**

25. Where a term used in the Guidelines is defined in the Ordinance or the subsidiary legislation then, except where specified in the Guidelines, that term carries the meaning as defined in the Ordinance or the subsidiary legislation.