

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 (“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 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 short term 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 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) The African Development Bank;
- (b) The Asian Development Bank;
- (c) The European Investment Bank;
- (d) The Inter-American Development Bank;
- (e) The International Bank for Reconstruction and Development (commonly known as the World Bank);
- (f) The International Finance Corporation (an affiliate of the World Bank);
- (g) The European Bank for Reconstruction and Development;
- (h) Caribbean Development Bank;
- (i) Council of Europe Development Bank;
- (j) European Atomic Energy Community;
- (k) European Central Bank;
- (l) European Coal & Steel Community;
- (m) European Community;
- (n) European Company for the Financing of Railroad Rolling Stock (EUROFIMA); and
- (o) 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 Investor 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>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.	A-	a-1
Moody's Investors Service, Inc.	Baa2	Prime-2
Standard & Poor's Corporation	BBB	A-2

Debt Securities for Capital Preservation Fund

11. 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:

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

CREDIT RATINGS OF DEBT SECURITIES

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

13. 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

14. Credit ratings are issued 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.

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

16. 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(b) of Schedule 1 to the Regulation.

MTN Program Ratings

17. 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

18. 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.

19. For the purposes of section 37(2)(a) of the Regulation and sections 7(2)(c) and 9(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 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 issued in relation to the security.

Short-term Credit Ratings

20. Some of the approved credit rating agencies such as Moody’s Investors Service, Inc., 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

21. The credit ratings given by the various agencies, though generally consistent, are not always the same. If the issue has more than one applicable credit rating, then the credit rating requirement will be met if at least one of the ratings meets the minimum credit rating requirement set out in these Guidelines.

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

22. 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 will be 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.

DEFINITIONS OF TERMS

23. Except where otherwise specified in the Guidelines, the terms common to the Ordinance and the subsidiary legislation of the Ordinance carry the same meanings as defined in the Ordinance and the subsidiary legislation. References should be made to the Ordinance and the subsidiary legislation, where necessary.