Supervisory Policy Manual

MP-2 Provisioning Requirements for Investment Guarantees under Mandatory Provident Fund Schemes

This module should be read in conjunction with the Contents and with the Glossary, which contains an explanation of abbreviations and other terms used in this Manual. If reading on-line, click on the blue underlined headings to activate hyperlinks to the relevant module.

Purpose
To describe the HKMA’s provisioning requirements for investment guarantees under Mandatory Provident Fund ("MPF") Schemes

Classification
A statutory guideline issued by the MA under the Banking Ordinance, §16(10)

Previous guidelines superseded
This is a new guideline.

Application
To all AIs

Structure
1. Introduction
   1.1 Background
   1.2 Requirement to provide for risks
2. Provisioning requirements
   2.1 Locally incorporated AIs
   2.2 Overseas incorporated AIs
   2.3 Basis of calculation
   2.4 Periodic review of provision
3. Reporting framework
   3.1 Return of Mandatory Provident Fund Related Activities
1. Introduction

1.1 Background

1.1.1 CA-S-4 "Capital Adequacy Requirements for Investment Guarantees under MPF Schemes" identifies the risks from guarantees by Als of the return on MPF funds. Terminology defined in that module also applies to this.

1.1.2 The capital adequacy framework for Als' potential liability under these guarantees is that of the HKMA in the case of locally incorporated Als and of the home supervisor for overseas incorporated Als.

1.2 Requirement to provide for risks

1.2.1 Als should set aside adequate provisions to cover their expected and potential liabilities arising from investment guarantees under MPF schemes.

1.2.2 This is in line with the minimum authorization criterion, as set out in para. 9 of the Seventh Schedule to the Banking Ordinance. The criterion states that an AI should maintain adequate provision for liabilities which will be, or may fall to be, discharged by it and for losses which will or may occur.

2. Provisioning requirements

2.1 Locally incorporated Als

2.1.1 Locally incorporated Als that have already catered for the potential risks of such investment guarantees under the HKMA's capital adequacy framework are only required to maintain adequate provision to cover any expected loss under the guarantees. This represents any shortfall in the actual investment return earned by the relevant fund compared with the guaranteed return. The provision should be made as and when the liability is identified.

2.2 Overseas incorporated Als

2.2.1 Overseas incorporated Als following the capital adequacy requirements of their home supervisor for these investment guarantees are only required to
maintain adequate provision in Hong Kong to cover any expected loss under the guarantees as mentioned above. The HKMA may, where it deems necessary, request confirmation from the AI's head office or its home supervisor of the level of capital maintained for these purposes.

2.2.2 If the home supervisor has not prescribed any capital adequacy requirement for such investment guarantees, overseas incorporated AIs are required to maintain a provision adequate to cover the expected loss as well as any potential liability arising from the guarantees.

2.3 Basis of calculation
2.3.1 The potential liability should be calculated on the basis of the internal models approach set out in CA-S-5 "Use of Internal Models to Measure Market Risks for Investment Guarantees under MPF Schemes".

2.3.2 Under this approach, the provision for potential liability under the investment guarantee is equivalent to the capital charge derived from the internal model for the guarantee.

2.3.3 The internal model used requires the prior approval of the HKMA. AIs which wish to use other methods not based on the approach set out in CA-S-5 for determining the provisioning requirements should seek the prior approval of the HKMA.

2.3.4 The method adopted by AIs should be used consistently. The prior approval of the HKMA is required for any change of method.

2.4 Periodic review of provision
2.4.1 The provision to be set aside for investment guarantees should be reviewed and adjusted if appropriate at least on a quarterly basis.
3. Reporting framework

3.1 Return of Mandatory Provident Fund Related Activities

3.1.1 Als are required to report information relating to investment guarantees as set out in the above return (MA(BS)13).

3.1.2 From time to time the HKMA may require Als to report such other information relating to investment guarantees as it deems necessary.