



Supervisory Policy Manual

CA-S-4

Capital Adequacy Requirements for Investment Guarantees under Mandatory Provident Fund Schemes

V. 1 - 16.02.01

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 explain the HKMA's approach to determining capital adequacy 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Previous guidelines superseded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 locally incorporated AIs

Overseas incorporated AIs operating through branches in Hong Kong are not subject to the HKMA's capital adequacy regime because the primary responsibility for supervising the capital adequacy of these AIs rests with their home supervisor.

Structure

1. Introduction
 - 1.1 Terminology
 - 1.2 Background
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3.1 Return of Market Risk Exposures

1. Introduction

1.1 Terminology

1.1.1 In this module the following terms have the meanings described:

- MPF means Mandatory Provident Fund; and
- MPF guaranteed funds means constituent funds or approved pooled investment funds which provide for an investment guarantee.

1.2 Background

1.2.1 Under the MPF Schemes (General) Regulation, AIs may act as guarantors in respect of MPF guaranteed funds. Such guarantees expose them to potential risks from fluctuations in the value of the relevant fund. Should the rate of investment return earned by the fund fall short of the guaranteed rate of return over a specified period of time, the AI will be obliged to compensate the fund for the shortfall.

1.2.2 In line with the capital adequacy framework of the HKMA, all locally incorporated AIs should maintain adequate capital to cover such potential risks. This module sets out how the quantum of such charges is to be determined.

1.2.3 See [MP-2](#) "Provisioning Requirements for Investment Guarantees under MPF Schemes" for guidance on the relative provisioning requirements.

2. Calculation of capital charges

2.1 Use of internal models

2.1.1 Locally incorporated AIs that provide investment guarantees for MPF guaranteed funds should use



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internal models to measure the potential risks arising from such guarantees and to determine the appropriate capital charges.

- 2.1.2 The internal models require the prior approval of the HKMA. Such internal models should be based on value-at-risk methodology for the measurement of market risk. They will be subject to various qualitative and quantitative criteria relating to the models themselves. Detailed requirements regarding their use are set out in [CA-S-5](#) "Use of Internal Models to Measure Market Risks for Investment Guarantees under MPF Schemes".
- 2.1.3 Als which wish to use methods not based on the value-at-risk approach for determining capital charges should seek the prior approval of the HKMA.

2.2 Potential risks from investment guarantees

- 2.2.1 The potential risks from an investment guarantee comprise general market risk and specific risk.
- 2.2.2 General market risk covers the risks associated with interest rates, foreign exchange rates and prices in equity and commodity markets. It should be measured by the use of internal models as stated above.
- 2.2.3 Specific risk takes into account the risk of default and other elements of an individual stock or interest rate related instrument. Als will be permitted to base their specific risk charge on modelled estimates if they meet all of the quantitative requirements in section 3 of [CA-S-5](#) "Use of Internal Models to Measure Market Risks for Investment Guarantees under MPF Schemes". Als which are unable to meet these criteria will be required to base their specific risk charge on the full amount of the charge required under the standardised approach.
- 2.2.4 The method of measuring the specific risk is set out in the completion instructions for the "Return on Market Risk Exposures - MA(BS)3A".

2.3 Calculation

- 2.3.1 The capital charges for general market risk and specific risk of investment guarantees for MPF guaranteed funds



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should be aggregated with the capital charges for all other market risk categories and multiplied by 12.5¹ to arrive at the total market risk-weighted exposures of an AI. The latter should then be used to calculate the market-risk adjusted capital adequacy ratio, which is expressed as the percentage the AI's capital base bears to its total risk-weighted exposures (including both credit risk and market risk).

2.3.2 See the HKMA's Guideline dated 14.11.97 on "Maintenance of Adequate Capital against Market Risk" and Part VII of the "Return on Market Risk Exposures - MA(BS)3A" for details of the market-risk adjusted capital adequacy ratio and its calculation method.

2.3.3 For the purpose of determining capital charges, the qualifying periods² for a guarantee to be effective are ignored.

3. Reporting framework

3.1 Return of Market Risk Exposures

3.1.1 This return (Form MA(BS)3A) and the corresponding completion instructions will be revised to cater for the reporting of market risk exposures arising from investment guarantees for MPF guaranteed funds.

3.1.2 Locally incorporated AIs will be informed of the revised reporting instructions in due course.

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¹ This is the reciprocal of the Basel minimum ratio of 8%. The effect is to convert the sum of the capital charges into a risk-weighted exposure equivalent, which can then be added to other credit risk-weighted exposures to arrive at a total.

² These refer to the conditions regarding the period of making regular contributions by a member into the guaranteed fund with reference to some specified date(s), e.g. five years of continuous regular contributions before the date of claim for payment of benefit.