

MANDATORY PROVIDENT FUND SCHEMES ORDINANCE (CAP 485)

INTERNAL CONTROLS OF REGISTERED SCHEMES

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1. INTRODUCTION

1.1. Background

1.1.1. The introduction of Mandatory Provident Fund (MPF) brought into existence a formal system of retirement protection for Hong Kong's workforce. MPF accrued benefits are an important source in meeting scheme members' basic financial needs after their retirement. It is, therefore, essential that a system of prudential supervision and regulation is in place to protect scheme members' interests.

1.1.2. One of the effective asset security measures commonly adopted by financial regulators is the requirement of maintaining a proper internal control system. In this regard, the Mandatory Provident Fund Schemes (General) Regulation (the Regulation) imposes a statutory requirement on all registered schemes, except for certain employer sponsored schemes, in respect of the maintenance of internal control objectives and the establishment of relevant procedures and measures to achieve these objectives.

1.2. Purpose

1.2.1. These Guidelines are intended to set out:

- (a) the reporting requirements on approved trustees in respect of the internal controls of registered schemes;
- (b) the internal control objectives and suggested internal control measures in respect of registered schemes;
- (c) the reporting requirements on auditors in respect of

- approved trustees' internal control report; and
- (d) the exemption arrangement for certain employer sponsored schemes.

2. REPORTING REQUIREMENTS ON APPROVED TRUSTEES

2.1. General Requirements

2.1.1. Section 39 of the Regulation requires each registered scheme to establish and maintain control objectives and internal control measures for achieving those control objectives at all times while the scheme is registered. Exemption is granted to certain employer sponsored schemes that satisfy prescribed criteria.

2.1.2. While section 39 of the Regulation does not specify who is responsible for maintaining the internal control objectives and measures, section 42 of the Regulation states that the approved trustee of a registered scheme will commit an offence for failure to comply with the requirements set out in section 39. Thus, even though approved trustees must use the electronic MPF system pursuant to section 19M(1) of the Mandatory Provident Fund Schemes Ordinance (the Ordinance) and they could, provided that the Ordinance (including section 19M(1)) and other applicable laws are not contradicted, delegate some of their duties to other service providers as defined in section 2 of the Ordinance (such as scheme administrators, custodians and investment managers), the approved trustees must nonetheless ensure that proper controls are put in place, either by themselves or by the service providers they engaged, for the purpose of complying with section 39 of the Regulation.

2.2. Reporting Requirements

2.2.1. Under section 112 of the Regulation, an approved trustee of a registered scheme is required to submit to the Mandatory Provident Fund Schemes Authority (the Authority) annually a report on the scheme's internal control objectives and major procedures and internal control measures for achieving those objectives. Where an approved trustee administers two or more registered schemes and the control objectives and procedures and internal control measures applicable to those schemes are the same, the approved trustee may lodge a single report in respect of all those schemes. The report must be accompanied by an auditor's report.

2.2.2. Pursuant to section 19M(1) of the Ordinance and subject to section 19M(2) and (3), the approved trustee of a registered scheme must use the electronic MPF system and the scheme administration services provided by the system operator of the system that are made available to the approved trustee to perform their scheme administration functions. To the extent as provided below and subject to the provisions stated below, an approved trustee of a registered scheme can rely on an auditor's assurance report provided by the system operator on the major procedures and internal control measures for achieving the control objectives of the scheme (Operator's Assurance Report):

(a) in respect of the approved trustee's obligations under section 39 of the Regulation to establish and maintain control objectives and internal control procedures, and to the extent that such obligations under section 39 of the

- Regulation which are required under section 19M(1) of the Ordinance to be performed by the approved trustee by using (i) the electronic MPF system and (ii) the scheme administration services provided by the system operator (in performing the approved trustee's scheme administration functions), such obligations shall be regarded as being fulfilled by the approved trustee obtaining the Operator's Assurance Report and ensuring that the report covers the relevant control objectives and internal control measures as required under section 39 of the Regulation; and
- (b) in respect of the approved trustee's obligations under section 112(1) of the Regulation to lodge a report specifying the registered scheme's control objectives and the major procedures and internal control measures for achieving them, and to the extent that the control objectives and the major procedures and internal control measures relate to the obligations under section 39 of the Regulation which are required under section 19M(1) of the Ordinance to be performed by the approved trustee by using (i) the electronic MPF system and (ii) the scheme administration services provided by the system operator (in performing the approved trustee's scheme administration functions), such obligations shall be regarded as being fulfilled by the approved trustee by lodging, together with the Operator's Assurance Report, a report which relies on the relevant parts of the Operator's Assurance Report.

For the avoidance of doubt, the above is not intended to replace any statutory provision and should not be interpreted in such a way that would override any statutory provision.

2.3. Timing of Submission of the Report

2.3.1. Section 112 of the Regulation states that an approved trustee's internal control report, together with its auditor's report, must be submitted to the Authority within six months after the "relevant period". Section 111 of the Regulation provides that:

- (a) if the trustee is the approved trustee of only one registered scheme, the "relevant period" is the financial period of that scheme; or
- (b) if the trustee is the approved trustee of two or more registered schemes and a single internal control report is prepared for those schemes, the trustee shall nominate either the financial period of one of those schemes specified by the trustee or the financial year of the trustee as the "relevant period" and notify in writing the Authority. Subsequent variation of the nomination in respect of a later relevant period is only permitted with the consent of the Authority.

2.3.2. To facilitate the Authority's monitoring of receipt of internal control reports, an approved trustee is expected to submit the nomination made under section 111(1)(b) of the Regulation on or before the earlier of the ending date of:

- (a) the financial period of the registered scheme which will have the earliest financial period end date among all the registered schemes administered by the approved trustee and to be covered by the same internal control report; and
- (b) the financial year of the approved trustee.

3. INTERNAL CONTROL OBJECTIVES AND SUGGESTED CONTROL MEASURES

3.1. Introduction

3.1.1. The Hong Kong Standard on Auditing 315 (Revised 2019) “Identifying and Assessing the Risks of Material Misstatement” issued by the Hong Kong Institute of Certified Public Accountants defines the term “system of internal control” for the purposes of the Hong Kong Standards on Auditing as being: “The system designed, implemented and maintained by those charged with governance, management and other personnel, to provide reasonable assurance about the achievement of an entity’s objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations...”.

3.1.2. These Guidelines are not intended to prescribe specific control systems for all registered schemes. They mainly set out the general objectives and major components of internal controls which are applicable to all registered schemes. It is recognized that a wide variety of internal control systems can be adopted to achieve the relevant internal control objectives and different registered schemes may require different internal control systems. Furthermore, the suggested procedures and measures are not intended to be exhaustive and in many instances alternative control procedures and measures will be equally appropriate and acceptable. Approved trustees and auditors need to exercise their judgment in deciding whether a particular

control procedure or measure is appropriate in a given circumstance.

3.2. Control Objectives

3.2.1. Section 39(2) of the Regulation states that the internal control objectives of a registered scheme must include (but are not limited to) the following:

- (a) ensuring that the scheme assets are safeguarded in the interests of scheme members;
- (b) ensuring that the guidelines made by the Authority under section 28 of the Ordinance with respect to forbidden investments practices are not contravened;
- (c) ensuring that the limitations and prohibitions imposed under the Regulation with respect to the investment of the funds of the registered scheme in restricted investments are complied with;
- (d) ensuring that the following provisions of the Ordinance are complied with:
 - section 27(2A);
 - section 34DB(1)(a), (b), (c) and (d);
 - section 34DC(1)¹;
 - section 34DD(1) and (4);
 - section 34DH(1) or (2);
 - section 34DI(1) and (2);

¹ With the commencement of section 52 of the Mandatory Provident Fund Schemes (Amendment) Ordinance 2021 (Amendment Ordinance), section 39(2)(ca)(iii) of the Regulation is repealed. Pursuant to section 2 of Schedule 5 to the Regulation, despite the commencement of section 52 of the Amendment Ordinance, section 39(2)(ca)(iii) as in force immediately before the commencement of section 52 of the Amendment Ordinance applies to the control objectives of a pre-existing scheme, to the extent that section 34DC(1) of the Ordinance applies to the approved trustee of the registered scheme.

- section 34DJ(2), (3), (4) and (5);
 - section 34DK(2); and
 - section 34DM;
- (e) ensuring that the requirements of sections 37(2), 51 and 52 of and Schedule 1 to the Regulation with respect to permissible investments are complied with in relation to the registered scheme; and
- (f) ensuring that the funds of the registered scheme and the scheme assets are, except as permitted by the Regulation, kept separate from those of the participating employers, the scheme's trustee, service providers and other persons appointed or engaged for the purposes of the scheme.

3.2.2. In connection with compliance with the requirements under section 39(2)(e), an approved trustee is required to maintain books of accounts and other records as are necessary to separately identify the scheme assets so as to ensure the scheme assets are distinct from the approved trustee's personal assets and from any assets held by the approved trustee for the benefit of a participating employer or any other person.

3.2.3. Besides the above objectives, an internal control system of a registered scheme should aim at providing reasonable assurance that:

- (a) operation of the registered scheme is planned and conducted in an orderly, prudent and cost effective manner;
- (b) transactions are entered into in accordance with the governing rules of the registered scheme and with proper authority;

- (c) regulatory requirements as set out in the Ordinance and the Regulation are not contravened;
- (d) the accounting and other records of the registered scheme provide complete, accurate and timely information; and
- (e) customer and personal data security is adequately safeguarded.

3.3. Suggested Control Measures

3.3.1. The following paragraphs set out internal control measures the Authority expects the internal control system of a registered scheme to cover. However, these measures are not intended to be exhaustive and the Authority may revise these guidelines from time to time to take account of new developments and experience of the Authority and users. Other possible effective methods of achieving the control objectives in paragraph 3.2 above are equally acceptable. Approved trustees and auditors should take into account the circumstances of individual schemes when assessing the adequacy of a registered scheme's internal control system.

- (a) Controls relating to the security of scheme assets: There must be adequate controls to ensure the security of scheme assets against loss due to irregularities, fraud or errors. Examples of key control measures are in Appendix A.
- (b) Controls relating to the compilation of returns and information to be submitted to the Authority: There must be adequate controls to ensure the accuracy and reliability of the information contained in statements, returns and reports submitted to the Authority. Examples of key control

measures are in Appendix B.

- (c) Controls which enable compliance with statutory provisions: There must be effective monitoring and reporting systems to enable compliance with the Ordinance. These systems should be able to give sufficient advance warning to the approved trustee (including its service providers) and the system operator of situations which may lead to breaches so that appropriate remedial action can be taken. Examples of key control measures are in Appendix C.
- (d) Controls relating to the separation of scheme assets: There must be adequate controls to ensure that books of accounts and other records are maintained as are necessary to separately identify the scheme assets so as to ensure that the scheme's assets are distinct from the approved trustee's personal assets and from any other assets of a participating employer or any other person. Examples of key control measures are in Appendix D.
- (e) Controls relating to the security of data: There must be adequate controls to ensure the security of personal data as defined under the Personal Data (Privacy) Ordinance (Cap 486) (PDPO) and customer data. Examples of key control measures are in Appendix E.

The internal control measures for the system operator in the Appendices are applicable to a registered scheme only if the approved trustee of the registered scheme uses the electronic MPF system and the scheme administration services provided by the system operator to perform their scheme administration functions as required under section 19M(1) of the Ordinance.

3.3.2. Even though approved trustees are not required to report on all the internal control measures applicable to their registered schemes, approved trustees are expected to ensure that a proper system of internal controls is in place for all aspects of their schemes' operation. The Authority is empowered under section 116(2) of the Regulation to direct approved trustees to rectify any deficiencies in the internal control measures of registered schemes, whether or not the Authority becomes aware of such deficiencies as a result of an auditor's report under section 113 of the Regulation (see Chapter 4 below).

3.4. Role of Internal Auditors

3.4.1. Internal auditors of approved trustees and service providers engaged by the approved trustees play an important role in monitoring the effectiveness of the internal control system of registered schemes. The internal auditors should review and test the internal controls from time to time to ensure that they are functioning properly, and advise the approved trustees or services providers on improvements and solutions to problems. This is equally important in relation to those internal control measures that are not required to be reported to the Authority and reviewed by the external auditors under sections 112 and 113 of the Regulation.

3.4.2. If a registered scheme has an effective and independent internal audit function, the external auditors of the scheme are encouraged to liaise closely with the internal auditors in the

planning and execution of their reviews under section 113 of the Regulation. Effective cooperation would help to minimize duplication of work depending on the extent the external auditors are satisfied with the scope, effectiveness and independence of the internal auditors' work.

4. REPORTING REQUIREMENTS ON AUDITORS

4.1. Scope of Review

4.1.1. Section 113 of the Regulation sets out the duty of auditors in respect of the report on control objectives and internal control measures which is required to be prepared by the approved trustee under section 112 of the Regulation.

4.1.2. Under section 113(4) of the Regulation, the auditor's report on the review of the trustee's report must state the auditor's opinion as to:

- (a) whether or not appropriate control objectives were established and maintained for the registered scheme during the period to which the trustee's report relates;
- (b) if appropriate control objectives were so established and maintained, whether or not effective internal control measures were established and maintained for the purpose of achieving those objectives; and
- (c) whether or not those internal control measures (if any) were likely to have been sufficiently effective to provide a reasonable assurance that the control objectives established and maintained for the registered scheme would be achieved if those measures were fully and properly implemented.

4.1.3. For the purpose of section 113(4) of the Regulation, auditors shall consider the control objectives and internal control measures specified in the report prepared by the approved

trustee in accordance with section 112 of the Regulation, review the report and report in writing to the approved trustee in accordance with section 113(4) and (5) of the Regulation.

4.1.4. Auditors are not expected to test or ascertain whether the control objectives or internal control measures were actually implemented during the period.

4.1.5. However, section 113(5)(a) requires an auditor to state in the auditor's report, whether or not, during the course of the review of the approved trustee's internal control report, the auditor became aware of any shortcomings in the internal control measures that could materially affect the operation of the registered scheme (including its financial position) or the financial interests of scheme members.

4.1.6. In addition to the reporting requirements with respect to the report on internal control measures, auditors are also required to report to the Authority when they become aware of or identify any matters as stated in section 103 of the Regulation in the course of performing the auditor's duties, and the reporting should be in accordance with the requirements specified in that section.

4.2. Auditing Guideline

4.2.1. The Hong Kong Institute of Certified Public Accountants has issued the Practice Note 860.1 (Revised) "The Audit of Retirement Schemes" to provide more specific guidance to

auditors in the conduct of their work under section 113 of the Regulation.

5. EXEMPTION ARRANGEMENT FOR EMPLOYER SPONSORED SCHEMES

5.1. Exemption Criteria

5.1.1. The Regulation exempts an employer sponsored scheme from complying with section 39 of the Regulation during a financial period of the scheme and section 112 of the Regulation during a relevant period if the scheme has no more than 1 000 scheme members throughout (i) the immediately preceding financial period of the scheme (in the case of section 39(6)(a)) and (ii) the immediately preceding relevant period (in the case of section 112(5)(a)); or if it is exempted by the Authority under paragraph 5.1.2 below.

5.1.2. Alternatively, under sections 39(7) and 112(6) of the Regulation, the Authority may grant an exemption if satisfied that:

- (a) for a substantial portion of (i) the immediately preceding financial period of the scheme (in the case of section 39(7)(a)) or (ii) the immediately preceding relevant period (in the case of section 112(6)(a)), the scheme had no more than 1 000 members; or
- (b) the scheme will not have, or is unlikely to have, more than 1 000 members during (i) the current financial period of the scheme (in the case of section 39(7)(b)) or (ii) the current relevant period of the scheme (in the case of section 112(6)(b)).

5.1.3. For the purposes of sections 39(7)(a) and 112(6)(a) of the Regulation, the Authority will regard an employer sponsored scheme as having no more than 1 000 members for a “substantial portion” of (i) the immediately preceding financial period of the scheme (in the case of section 39(7)(a)) and (ii) the immediately preceding relevant period (in the case of section 112(6)(a)) if the average number of scheme members at the end of each month was not more than 1 000 for at least seven months in the immediately preceding financial period of the scheme and the immediately preceding relevant period.

5.1.4. For the purposes of sections 39(7)(b) and 112(6)(b) of the Regulation, an approved trustee has to submit an exemption application with the following information:

- (a) the number of scheme members as at the end of each month of (i) the immediately preceding financial period of the scheme (in the case of section 39(7)(b)) or (ii) the immediately preceding relevant period (in the case of section 112(6)(b)); and
- (b) the grounds, with supporting evidence such as staff budget showing the expected number of staff for the current period, for believing that the scheme will not have, or is unlikely to have, more than 1 000 members during (i) the current financial period of the scheme (in the case of section 39(7)(b)) or (ii) the current relevant period (in the case of section 112(6)(b)).

The Authority will consider the merit of each application on a case by case basis.

5.1.5. It should be noted that an exemption under sections 39 and 112 of the Regulation only exempts an approved trustee from maintaining a formal internal control system and reporting to the Authority in respect of the internal controls for the relevant employer sponsored scheme. The approved trustee will continue to have the responsibility of taking appropriate measures to ensure security of scheme members' interests and compliance with the MPF legislation.

5.2. Application Arrangement

5.2.1. The exemption criteria for the purposes of sections 39 and 112 of the Regulation are the same. Approved trustees are therefore requested to submit their exemption applications under sections 39 and 112 of the Regulation together.

5.2.2. The Authority recognizes that “immediately preceding financial period” as stipulated in section 39 of the Regulation and “immediately preceding relevant period” as stipulated in section 112 of the Regulation do not exist at the inception of the MPF System. Under such circumstances, the Authority is ready to accept employee statistics provided by the sponsoring employers for the twelve months prior to the commencement of the schemes' first financial period under section 39 and the schemes' first relevant period under section 112 as evidence for an exemption application.

Appendix A

Controls Relating to the Security of Scheme Assets

I. Objective

There must be adequate controls established by the approved trustee and the system operator, where applicable, to ensure the security of scheme members' assets against loss due to irregularities, fraud or errors.

II. Key Control Measures

To achieve the above objective, typical control measures which can be employed are:

- (a) There should be a proper segregation of duties in scheme operation. In particular, the functions of record keeping, authorization and physical custody of scheme assets should be separated.
- (b) A system of authorization for entering transactions should be established. Transactions exceeding the designated authorization limit can only be entered into with the prior approval of a higher level authority.
- (c) Transactions (such as the receipt and payment of contributions and accrued benefits and investments of scheme assets) should be handled and recorded in a timely manner.
- (d) The approved trustee (including its service providers) and the system operator should discourage any money receipt or payment in respect of a registered scheme by cash and petty cash should not be maintained for a registered scheme.
- (e) No monies other than amounts received attributable to scheme contributions, contributions surcharge, investment transactions or

accrued benefits transferred from other registered schemes can be paid into the registered scheme's account.

- (f) For a registered scheme the approved trustee of which has yet to use the electronic MPF system, monies received for the scheme must be paid without delay (within four bank trading days after receipt) into a bank account held on trust for scheme members. When the approved trustee of the registered scheme uses the electronic MPF system and the scheme administration services provided by the system operator of the electronic MPF system that are made available to the approved trustee to perform their scheme administration functions, any physical cheque received by the approved trustee for the registered scheme must be sent to the system operator of the electronic MPF system or returned to the sender within three specified working days after receipt. The approved trustee (including its service providers) and the system operator should require cheques payments to the registered scheme to be crossed and payable only to the approved trustee of the registered scheme.
- (g) Payment of scheme funds should only be made for valid benefit payments, transfer of accrued benefits of a scheme member from the registered scheme to another registered scheme, payments of the scheme's levies and administration charges and payments for investment transactions. There should be adequate procedures to ensure that any instruction for payments is bona fide and in accordance with relevant statutory requirements and payment cheques are crossed "Account Payee Only".
- (h) The approved trustee and the system operator should establish and maintain appropriate and effective procedure in respect of transaction review process to prevent and detect errors, fraud and other improper activities. Preferably, an independent internal audit department should be established within the organization of the approved trustee (including

its service providers) and that of the system operator.

- (i) The approved trustee and the system operator should make regular reconciliations of their internal records with those issued by third parties (e.g. statements from custodians, banks, investment managers and the system operator of the electronic MPF system as applicable) to identify and highlight for action any errors, omissions or misplacement of assets and such reconciliations should be reviewed by appropriate senior staff of the approved trustee and the system operator.
- (j) The approved trustee and the system operator should make regular reconciliations between the total accrued benefits of each scheme member and each employer unit under a registered scheme as recorded in the scheme administration system or the electronic MPF system as applicable and the total assets held for the registered scheme should be made regularly according to the documented procedural manual.
- (k) Scheme assets and other important documents such as cheque book and agreements are securely stored while they are in the approved trustee's or its service providers' premises.
- (l) Effective procedures should be established and audit trails should be properly maintained to acknowledge and account for scheme assets movements.
- (m) Appropriate controls exist with respect to access to computer systems to prevent unauthorized access for inputting, processing and retrieving computer data. Clear policies regarding confidentiality of passwords are developed e.g. passwords are regularly changed and relevant passwords disabled upon a staff member leaving the organization of the approved trustee (including its service providers) or that of the system operator.
- (n) Formal back-up and offsite storage procedures should be arranged for all computer files and key documentation by the approved trustee (including

its service providers) and the system operator.

- (o) The approved trustee (including its service providers) and the system operator should have a formal business contingency plan in case of any disaster which will affect the registered scheme's operation. The business contingency plan should be reviewed, tested and updated regularly to ensure that the contingency situations could be effectively and efficiently dealt with in order to protect the interests of scheme members.

Appendix B

Controls Relating to the Compilation of Returns and Information to be Submitted to the Authority

I. Objective

There must be adequate controls established by the approved trustee and the system operator, where applicable, to ensure the accuracy and reliability of the information contained in statements, returns and reports submitted to the Authority.

II. Key Control Measures

To achieve the above objective, typical control measures which can be employed are:

- (a) There should be a procedural manual setting out the timing and method of compilation, source information used and other information gathering techniques which are necessary to ensure complete, timely and accurate preparation and compilation of statements, returns and reports and that changes in personnel will not affect the quality of the information submitted.
- (b) There should be clear documents/data for compilation of statements/returns/reports to be submitted to the Authority to provide audit trails between the registered scheme's records and the statements/returns/reports lodged with the Authority. Any material discrepancies between the records and the statements/returns/reports submitted should be investigated and explained.
- (c) The approach and procedures used in the compilation of the

statements/returns/reports to be submitted to the Authority should be clearly understood by the officers responsible for the preparation and checking. The guidelines and explanatory notes issued by the Authority for the purposes of preparing the statements/returns/reports should be filed and kept up to date to facilitate future reference and made available to the staff concerned.

- (d) In case of questions or uncertainties in the compilation process, clarification should be sought from the Authority and any results should be documented to facilitate future reference.
- (e) Prior to the submission, the statements, returns and reports should be checked by a designated officer who takes no part in the actual preparation work.

Appendix C

Controls which Enable Compliance with Statutory Provisions

I. Objective

There must be effective monitoring and reporting systems to enable the approved trustee (including its service providers) and the system operator, where applicable, to comply with their statutory duties under the Ordinance. These systems should be able to give sufficient advance warning to the approved trustee (including its service providers) and the system operator, where applicable, of situations which may lead to breaches so that appropriate remedial action can be taken.

While this is a general principle which applies to all provisions under the MPF legislation, approved trustees and auditors will be asked to report specifically on those controls relevant to the compliance with:

- (a) guidelines made by the Authority under section 28 of the Ordinance with respect to forbidden investment practices;
- (b) the following provisions of the Ordinance:
 - section 27(2A);
 - section 34DB(1)(a), (b), (c) and (d);
 - section 34DC(1)²;
 - section 34DD(1) and (4);
 - section 34DH(1) or (2);

² With the commencement of section 52 of the Amendment Ordinance, section 39(2)(ca)(iii) of the Regulation is repealed. Pursuant to section 2 of Schedule 5 to the Regulation, despite the commencement of section 52 of the Amendment Ordinance, section 39(2)(ca)(iii) as in force immediately before the commencement of section 52 of the Amendment Ordinance applies to the control objectives of a pre-existing scheme, to the extent that section 34DC(1) of the Ordinance applies to the approved trustee of the registered scheme.

- section 34DI(1) and (2);
 - section 34DJ(2), (3), (4) and (5);
 - section 34DK(2); and
 - section 34DM; and
- (c) sections 37(2), 51 and 52, Part 10 of and Schedule 1 to the Regulation.

II. General Requirements

As a general principle, the approved trustee (including its service providers) and the system operator should:

- (a) be aware of the relevant statutory provisions in the Ordinance;
- (b) keep up to date with changes in the Ordinance;
- (c) be aware of the guidelines issued by the Authority under sections 6H and 28 of the Ordinance and other communications from the Authority;
- (d) ensure that the information in (a), (b) and (c) above is filed and is communicated to those within the organization of the approved trustee (including its service providers) and that of the system operator who need to be aware of it;
- (e) ensure that the above information is filed along with any specific rulings from the Authority communicated in writing or otherwise;
- (f) ensure that they are fully aware of any transactions which could result in contraventions or potential contraventions of the Ordinance;
- (g) ensure details of the procedures necessary to enable compliance with the various statutory duties should be documented in a procedural manual so that changes in personnel should not affect the ability of the approved trustee (including its service providers) and the system operator to comply with the duties;
- (h) ensure an officer is designated to monitor compliance. In case of doubt about the interpretation of the Ordinance, clarification should be sought

with the lawyers of the approved trustee (including its service providers) and the system operator or with the Authority and the result of such clarification should be documented to facilitate future reference;

- (i) establish an internal reporting and monitoring system to capture the appropriate source data from the accounting and other records in order to comply with any limitations set by the statutory provisions. The reports generated by the system should be reviewed by a designated officer on a timely basis;
- (j) ensure clear, concise and organized working papers for monitoring compliance to provide audit trails for subsequent verification;
- (k) ensure staff performing the compliance function possess the necessary skills, qualifications and experience to enable them to effectively execute their duties; and
- (l) policies and procedures for proper handling of complaints are established and maintained and appropriate remedial action is promptly taken. The complaint procedures should be in writing. Where possible, complaints should be investigated by staff performing the compliance function who are not directly involved in the subject matter of complaint.

Moreover, in order to ensure that service providers engaged by the approved trustee and the system operator possess the necessary skills, qualifications and experience to enable them to comply with statutory duties under the Ordinance and duties delegated by the approved trustee and the system operator, the approved trustee and the system operator should establish a formal policy setting out the selection criteria of service providers to be engaged by the approved trustee and the system operator.

III. Specific Requirements

In addition to the above common features, specific control measures should

be installed in respect of the following:

- Capital preservation fund (section 37 of the Regulation)
- Repurchase agreements (section 51 of the Regulation)
- Securities lending (section 52 of the Regulation)
- Restricted investments (Part 10 of the Regulation)
- Permissible investments (Schedule 1 to the Regulation)
- Forbidden investment practices (as set out in the guidelines made under section 28 of the Ordinance) (Note: no such guideline has yet been issued)

(a) Capital preservation fund (CP Fund)

Objective

There must be adequate controls to ensure that the assets of the CP Fund are invested in secured instruments prescribed in section 37 of the Regulation, and administrative expenses are properly deducted in accordance with that section.

Key Control Measures

To achieve the above objective, typical control measures which can be employed are:

- (a) The approved trustee should require the investment manager to provide periodic reports (e.g. monthly or quarterly report) relating to the investment portfolio of the CP Fund and check to ensure that it consists of investment types that are permitted by the Regulation and guidelines. In particular, the approved trustee should assign an officer to keep in view changes of credit rating of the debt securities which the CP Fund invests in to ensure that they meet the minimum credit rating requirement.

- (b) The approved trustee should maintain clear working papers for calculation of income and profit for investment and determination of the administrative expenses deductible from the CP Fund each month. These calculations should be independently checked and approved by senior personnel.
- (c) Officers of the approved trustee responsible for monitoring the CP Fund's operation should keep in view changes in the guidelines and other information issued by the Authority in relation to CP Funds (e.g. class of authorized financial institutions and prescribed savings rate) to facilitate their monitoring of the CP Fund.

(b) Repurchase agreements

Objective

There must be adequate controls to ensure that the risk of loss of scheme assets resulting from repurchase agreement is minimized.

Key Control Measures

To achieve the above objective, typical control measures which can be employed are:

- (a) A system of authorization for entering into repurchase transactions should be established and details of all the proposed transactions should be reviewed by an officer of the approved trustee to ensure the transactions comply with the requirements before the transactions are entered into. If the approved trustee has delegated the authority to enter into repurchase agreements to the custodian, then the approved trustee should ensure that the custodian also has such an authorization system.

- (b) If the approved trustee has appointed a custodian for a registered scheme and has, in the custodial agreement, delegated the authority to enter into repurchase agreement to the custodian, then the approved trustee should require the custodian to report from time to time on all the repurchase transactions entered into by the custodian and should review the transactions to ensure they fulfill the requirements set by the Regulation and guidelines issued by the Authority.
- (c) An authorized list of eligible counterparties for entering into repurchase agreements must be in place and reviewed regularly by the approved trustee for credit risk. If the authority to enter into repurchase agreements has been delegated to the custodian, then the approved trustee must ensure that the custodian is kept informed of the updated list.
- (d) The basis to determine the margin requirement for different categories of debt securities based on their price volatility and other relevant factors should be clearly formulated, set out and updated in a manual by the approved trustee so that the officers involved are fully informed of, and can make appropriate reference to the manual. If the authority to enter into repurchase agreements has been delegated to the custodian, then the approved trustee must ensure that the custodian has a copy of the updated manual.
- (e) The approved trustee should have procedures to ensure adequate internal control measures in respect of repurchase agreements are in place. For example:
- different personnel are designated to check and mark-to-market daily the collateral in a repurchase agreement;
 - an independent personnel is responsible to conduct regular reconciliation of reports issued by counterparties, to identify and report omissions, errors or misplacement of assets and the reconciliation is checked and approved by senior staff.

If the authority to enter into repurchase agreements has been delegated to the custodian, then the approved trustee should require the custodian to report to the approved trustee on the procedures on internal control measures. The approved trustee may, if it considers necessary, require the custodian to make appropriate improvements to these procedures.

- (f) The agreement between the custodian and the counterparties of the repurchase transaction should be documented and, where appropriate, reviewed by the approved trustee.

(c) *Securities lending*

Objective

There must be adequate controls to ensure that the risk of loss of scheme assets resulting from security lending transaction is minimized.

Key Control Measures

To achieve the above objective, typical control measures which can be employed are:

- (a) A system of authorization for entering into securities lending transactions should be established and details of all the proposed transactions should be reviewed by an officer of the approved trustee to ensure the transactions comply with the requirements before the transactions are entered into. If the approved trustee has delegated the authority to enter into securities lending transactions to the custodian, then the approved trustee should ensure that the custodian also has such an authorization system.
- (b) The approved trustees should require the officers responsible for

monitoring the securities lending transactions to have a clear understanding on the policies set in respect of securities lending transactions and requirements under the Ordinance, Regulation as well as guidelines issued by the Authority. If there is any uncertainty in the compilation process, clarification should be sought and documented.

- (c) An authorized list of eligible counterparties for entering into security lending agreements must be in place and reviewed regularly by the approved trustee for credit risk. If the authority to enter into security lending agreements has been delegated to the custodian, then the approved trustee should ensure the custodian is kept informed of the updated list.
- (d) The basis to determine the margin requirement for different categories of debt securities based on their price volatility and other relevant factors should be clearly formulated, set out and updated in a manual by the approved trustee so that the officers involved are fully informed of, and can make appropriate reference to the manual. If the authority to enter into securities lending transactions has been delegated to the custodian, then the approved trustee must ensure that the custodian has a copy of the updated manual.
- (e) The approved trustee should have procedures to ensure adequate internal control measures in respect of securities lending transactions are in place. For example:
 - different personnel are designated to check and mark-to-market daily the collateral in a security lending transaction;
 - an independent personnel is responsible to conduct regular reconciliation of reports issued by counterparties, to identify and report omissions, errors or misplacement of assets and the reconciliation is checked and approved by senior staff.

If the authority to enter into security lending agreements has been

delegated to the custodian, then the approved trustee should require the custodian to report to the approved trustee on the procedures on internal control measures. The approved trustee may, if it considers necessary, require the custodian to make appropriate improvements on these procedures.

- (f) The approved trustee should establish a system on regular reports in respect of securities lending transactions. If the authority to enter into security lending agreements has been delegated to the custodian, then the approved trustee should require the custodian to provide periodic reports on securities lending transactions to review and check the calculations to ensure the transactions comply with the limitations set out in the Regulation.
- (g) The agreement between the custodian and the borrower of the securities should be documented and, where appropriate, reviewed by the approved trustee.

(d) Restricted investments

Objective

There must be adequate controls to ensure that the limitations and prohibitions on restricted investments in Part 10 of the Regulation are not violated.

Key Control Measures

To achieve the above objective, typical control measures which can be employed are:

- (a) In respect of an employer sponsored scheme, the approved trustee should

always maintain an updated list showing all the participating employers and the associates of the participating employers of the scheme. A copy of that updated list should be sent to the investment manager. Whenever there is any change to the information on the list, the approved trustee should inform the investment manager of such change. This list should be confirmed with the participating employers at least twice a year.

- (b) The approved trustee should periodically review the reports prepared by the investment manager to ensure that valuation of scheme assets is conducted on a regular basis to ensure that the stipulated limitations and prohibitions on restricted investments are not contravened.
- (c) The approved trustee should periodically review the details of scheme investments to ensure that the limits of investments in restricted investments are complied with.
- (d) The officer of the approved trustee who is responsible for monitoring investments in restricted investments should keep up-to-date copies of all the guidelines and correspondence issued by the Authority on restricted investments.

(e) Permissible Investments

Objective

There must be adequate controls to ensure that investment of scheme assets meets the permissible investment requirements stipulated in Schedule 1 to the Regulation.

Key Control Measures

To achieve the above objective, typical control measures which can be employed are:

- (a) The approved trustee should require the investment manager to establish a procedural manual for carrying out an investment transaction to ensure the requirements under the Ordinance, Regulation and guidelines issued by the Authority are not contravened. Examples in the procedural manual are:
- valuation of the scheme assets is conducted on a timely basis to ensure compliance with the stipulated requirements;
 - a staff officer is assigned to keep in view changes of credit rating of the debt securities which the funds of the registered scheme invest in so as to ensure that the minimum credit rating requirement is met; and
 - an independent personnel is responsible to conduct regular reconciliation of various reports, to identify and report omissions, errors or misplacement of assets and the reconciliation is checked and approved by senior staff.
- (b) A designated officer of the approved trustee should be assigned to periodically review the investment report prepared by the investment manager in respect of the investment portfolio of each constituent fund of the registered scheme. Random checking may be performed to ensure that the investments are in compliance with the requirements of permissible investments.
- (c) The approved trustee may require the investment manager to provide periodic reports on their internal control system and measures in respect of investment of the funds under the registered scheme to highlight if any actions are required or if any recommendations for improvements have

been made.

- (d) The approved trustee should ensure that guidance in relation to investment of the funds of the registered schemes issued by the Authority is filed properly (e.g. minimum credit rating requirement) for easy reference. It should also require the investment manager to establish and maintain a system for the proper filing of all the relevant investment requirements under the Ordinance, Regulation and guidelines issued by the Authority.

Appendix D

Controls Relating to the Separation of Scheme Assets

I. Objective

There must be sufficient controls established by an approved trustee and the system operator, where applicable, to ensure compliance with the requirements in the MPF legislation relating to separation of scheme assets. In particular, books of accounts and other records are maintained as are necessary to separately identify the funds of a registered scheme to ensure that the scheme's assets are distinct from the assets of the participating employers, scheme's trustee (including its service providers or other persons engaged to provide services for the scheme) and the system operator, where applicable.

II. Key Control Measures

To achieve the above objective, typical control measures which can be employed are:

- (a) Assets of the registered scheme for investment purposes are properly registered in the name of the scheme and documents of such investment assets are physically safe and secured, e.g. held by a custodian bank and that investment assets of the registered scheme are recorded separately from the assets of the participating employers, scheme's trustee, service providers or other persons.
- (b) Specific policies and effective procedures are established, maintained and followed to ensure sufficient independence of the investment manager and the custodian who holds the investment assets of the

registered scheme.

- (c) Segregated bank accounts may be maintained for transactions of the registered scheme's funds and the name of the bank accounts should make it clear that the relevant registered scheme has ownership of the money held in the bank accounts. Opening of bank accounts should only be possible with the written authorization of the approved trustee, or where there is a corporate trustee with the approval of the board of directors of the approved trustee. A majority of approved trustees or the board of directors in the case of a corporate trustee should approve in writing the signatories for each bank account.
- (d) Appropriate and effective procedures are established, maintained and followed to ensure contributions paid to the approved trustee in respect of the registered scheme are clearly identifiable as relating to the scheme. This may be achieved by means of specifying the payee as the approved trustee of the relevant registered scheme where payment is made by cheque or by electronic means. The approved trustee and the system operator should endeavour to discourage payments of contributions by cash.
- (e) The approved trustee (including its service providers) and the system operator should establish, maintain and follow appropriate and effective procedures to deal with unidentified remittances (e.g. payment without particulars of the person making the remittance). Unidentified remittances should be lodged in a suspense account which should enable the remittances to be separately recorded and readily identified.
- (f) The approved trustee should obtain reports (e.g. monthly statement) provided by its service providers and data from the electronic MPF system, as applicable, to clearly identify the assets of each registered scheme rather than a lump sum figures for all registered schemes operated by the approved trustee.

- (g) Reconciliations of assets held by different parties (e.g. custodians, investment managers and banks) and total assets of each registered scheme should be made regularly by the approved trustee and the system operator as applicable.

Appendix E

Controls Relating to Security of Data

I. Objective

There must be adequate controls established by an approved trustee and the system operator, where applicable, to ensure the security of personal data as defined under PDPO and customer data (generally referred to as “data”).

II. Key Control Measures

To achieve the above objective, typical control measures which can be employed are:

- (a) The approved trustee and the system operator should develop policies and procedures to safeguard data security, particularly in relation to:
 - the granting of data access rights not to exceed the operational needs of different levels of staff;
 - the security of data stored in relatively less controlled peripheral equipment/devices such as portable storage devices and in paper form;
 - the handling of any cases of loss or leakage of data and the requirement to notify the Authority and affected customers of the incident and the remedial actions to be taken as soon as possible. If a large number of customers are affected, making a public announcement should be considered as this is an effective way to notify affected customers quickly and to regain their confidence by advising them of the remedial actions; and
 - the compliance with PDPO and any relevant codes of practice and

guidelines issued by the Office of the Privacy Commissioner for Personal Data.

- (b) The approved trustee and the system operator should set out their data security policies and procedures in a written document and notify all new staff to follow the policies and procedures and how to access them. The approved trustee and the system operator should notify all staff as and when there is any change to the data security policies and procedures, and ensure that the staff have access to the updated policies and procedures. The approved trustee and the system operator should also regularly remind all staff to follow the data security policies and procedures.
- (c) The approved trustee and the system operator should periodically (at least annually) review compliance with data security policies and procedures, assess their effectiveness and, as and when necessary, enhance them.
- (d) Transfer of data from a centralized data facility to end-users' computer workstations for processing may increase the risk of leakage of data through users' internet email or portable storage devices connected to the workstations. The approved trustee and the system operator should put in place adequate controls to limit the transfer of data in this manner. The approved trustee and the system operator may consider controls such as removing the "downloading" facility in all computer workstations, or disabling USB ports and Internet access of, computation workstations that have access to data. Control measures relating to data retrieval and downloading should be developed for regular review to identify irregularities. In addition, a regular review of user access rights and identity should be conducted. Both reviews should be conducted at a frequency of at least every six months.
- (e) The approved trustee and the system operator should prohibit staff from

downloading data from their computer workstations to portable storage devices (e.g. USB memory keys) unless there is a genuine operational need and with prior approval from senior management. The data stored in such devices must be protected by data encryption and password, and the approved trustee and the system operator should take reasonable steps to delete the data from the devices as soon as possible after use. Any loss of the devices should be immediately reported and investigated based on the policies and procedures established under (a).

- (f) There should be adequate controls to protect documents and other peripheral physical devices (e.g. tapes, USB memory keys) containing data and to ensure their security during transportation and in storage. These documents should be properly disposed of when they are no longer required by the approved trustee and the system operator (e.g. shredding, erasure before disposal). Data stored in the peripheral physical devices should be encrypted. The approved trustee and the system operator should consider installing, subject to surveillance laws and/or data privacy guidelines, appropriate surveillance systems in highly sensitive areas (e.g. document scanning areas, computer tape rooms, mailing rooms) to monitor unauthorized activities and to capture evidence for possible future investigation. The controls and procedures should also cover the documents and devices kept offsite.
- (g) If data is kept by outsourced service providers or in offices located outside Hong Kong, the approved trustee and the system operator should be satisfied as to the adequacy of data security measures put in place by these entities taking into account the standards laid down in this Appendix. Regular reviews as to whether the measures are being effectively implemented should be conducted. Data protection obligations and liabilities should be set out in the agreement between the parties including the agreements entered into with the service providers

to ensure that such data security measures are in place during the term of engagement or appointment.