Annex 1

Irrevocable Forward Commitment Facility by The Hong Kong Mortgage Corporation Limited to purchase mortgages

Introduction

The Financial Secretary has, by notice in the gazette, amended the Fourth Schedule to the Banking Ordinance (the "Fourth Schedule"), to enable "residential mortgage loans in respect of which there has been issued by The Hong Kong Mortgage Corporation Limited an irrevocable commitment to purchase which is approved by the Monetary Authority" to be included as liquefiable assets. The amendment took effect on 30 April 1999. A copy of the gazette notice is attached (Appendix). This policy paper sets out the manner in which the Monetary Authority will recognise such residential mortgage loans as liquefiable assets under the Fourth Schedule of the Banking Ordinance.

Background

2 In June 1998, The Hong Kong Mortgage Corporation Limited ("HKMC") introduced a forward commitment facility ("Facility") to purchase residential mortgage loans from authorized institutions ("AIs") which are Approved Sellers[*] of HKMC. Under the Facility, HKMC irrevocably commits to purchase an agreed amount of eligible mortgage loans within a specified period of up to 12 months from an AI which has signed the Facility with HKMC. Mortgage loans which conform to HKMC's purchasing requirements as set out in the facility agreement will qualify for sale under the Facility.

3. The Facility will be offered for periods of 3, 6, 9 and 12 months. For facilities with a commitment period of 6 months or less, the commitment amount will apply throughout the entire commitment period. For facilities with a commitment period of more than 6 months, the commitment amount will be split into an Initial Allocated Amount for the Initial Period (the first 6 months) and a Subsequent Allocated Amount for the Subsequent Period (the remaining period). Notwithstanding the split of the commitment amount into the initial and subsequent allocated amounts, an Approved Seller may utilize the whole commitment amount during the Initial Period. If any portion of the Initial Allocated Amount remains unutilized at the end of the first 6 months, an Approved Seller may request HKMC, no later than 21 days before the end of the Initial Period, to roll over the unutilized amount to the Subsequent Period.

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[*] An Approved Seller is an authorized institution (a bank, a restricted licence bank or a deposit-taking company) which has entered into a Master Mortgage Sale and Purchase Agreement with HKMC and which has obtained the approval to sell residential mortgages to HKMC.

Considerations for granting approval

4. AIs which intend to report their residential mortgage loans as liquefiable assets should seek prior approval from the MA. The MA will approve the inclusion of such residential mortgage loans as liquefiable assets for the purpose of calculating the liquidity ratio only if the Facility meets the following requirements:

(a) HKMC's commitment is irrevocable;

(b) the whole process for the mortgage loans to be converted into cash or cash equivalent will normally take no more than one month; and

(c) HKMC has no right to refuse to purchase any mortgage loan covered by the commitment provided that it satisfies HKMC's purchasing requirements.

5. The HKMA will review the Forward Commitment Facility Letter Agreement between HKMC and the AI to confirm that the Facility granted under the agreement satisfies the above conditions.

6. In addition, AIs wishing to claim residential mortgage loans as liquefiable assets under item 7 of the Fourth Schedule will be required to maintain adequate systems and controls to monitor the residential mortgages to ensure that they can determine the amount of mortgages immediately saleable to HKMC. These institutions will be required to confirm to the HKMA that they have such a system in place. Such system will be subject to examination by the HKMA, or alternatively, the HKMA may require an external auditor's report to confirm the same.

The Reporting

7. Residential mortgage loans which are approved by the MA can be reported under Part I1 item 7 "Residential mortgage loans in respect of which there has been issued by The Hong Kong Mortgage Corporation Limited an irrevocable commitment to purchase which is approved by the Monetary Authority" in the Return of Liquidity Position with a liquidity conversion factor of 90%. The 10% haircut takes into account the possibility that HKMC may purchase loans at a discount.

8. Instalment repayments on such mortgage loans should be excluded from item 6 "eligible loan repayments" to ensure that there is no double counting of liquefiable assets. The definition of "eligible loan repayment" in the Fourth Schedule has been amended to this effect.

9. Only mortgage loans which are immediately saleable to HKMC should be reported. This means that reported mortgage loans must conform to HKMC's purchasing requirements and fulfil all other conditions stipulated in the relevant facility agreement.

10. In addition, the total reported amount cannot exceed the amount of commitment agreed under the Facility less any commitment amount utilised. During the Initial Period, the amount of commitment shall be the entire amount under the approved Facility (i.e. both the Initial Allocated Amount and the Subsequent Allocated Amount). During the Subsequent Period, it shall be the Subsequent Allocated Amount adjusted for any unutilized amount rolled over from the Initial period.

11. If the AI is required under the relevant facility agreement to repurchase default mortgages, the obligation to repurchase the mortgage should be included in qualifying liabilities for liquidity calculation purpose if the repurchase is to be made within 1 month.

Hong Kong Monetary Authority
May 1999