



HONG KONG MONETARY AUTHORITY
香港金融管理局

Circulars

29 Oct 1999

Refinancing of Residential Mortgage Loans

Our Ref.: B9/25C
B1/15C

29 October 1999

The Chief Executive
All Authorized Institutions

Dear Sir/Madam,

Refinancing of Residential Mortgage Loans

The residential mortgage portfolio of authorized institutions ("Als") has performed extremely well during the difficult conditions of the last two years. It is important that this performance is maintained. I write therefore to remind institutions that prudent lending criteria should not be relaxed and proper standards of conduct should be upheld amid keen competition for residential mortgage business.

Active competition for residential mortgage business has been reflected in the undercutting of mortgage rates and the various types of marketing incentives offered to home mortgagors. More recently, there has been an upsurge in the amount and percentage of new loans for refinancing purposes.

The proportion of refinancing loans, as a percentage of new loans approved, has increased rapidly in the last six months. At end-September 1999, the percentage stood at 35.6% compared with the monthly average of 3.0% for 1998 as a whole¹. By contrast, the growth of the total amount of outstanding loans has recently slowed. Over the last three months, the total amount of outstanding mortgages has grown by only 1.4% at an annualised rate. This indicates that the active marketing efforts of banks are tending to increase the amount of switching of existing mortgages rather than generating new business.

The Hong Kong Monetary Authority ("HKMA") supports free competition and is of the view that the strategy for mortgage business is a commercial decision for Als. However, Als should consider the commercial rationale of their strategy if they are simply exchanging customers at less favourable terms without generating new business for the sector as a whole. The HKMA therefore recommends that Als should review their own commercial case for refinancing loans particularly if it is part of institutions' strategy to actively seek this kind of business. The HKMA understands that the primary objective of attracting customers from competitors is to increase market share. However, according to the statistics we have collected, no single player in the market has gained significant market share in the past six

months. Even if individual institutions have been successful in increasing market share slightly, they should critically examine their costs in achieving this. There is a risk that this is achieved at the expense of lowering the margin for existing customers in order to retain them, thus driving down the return from such customers. When Als formulate their competitive strategy, they should also take into account the corresponding strategy adopted by their competitors and the overall effect on the market. An aggressive refinancing strategy may simply be self-defeating if competitors retaliate. This may lead to a "merry-go-round" effect where existing mortgages circulate around the system with an ever decreasing return.

Besides commercial considerations, the HKMA has previously reminded Als of the importance to adhere to prudent lending criteria in granting mortgage loans. This is important to ensure that the relatively low delinquency ratio on mortgage loans is maintained. In particular, the 70% loan-to-value ratio ("LVR") guideline should be continue to be observed when refinancing loans are granted. It is reiterated that the 70% LVR should be applied against the market value of the property at the time when refinancing loans are approved. It is important that the current market value of the property is professionally and objectively appraised.

The HKMA also understands that one of the competitive measures taken by Als is to offer a cash rebate to property agents for referring business. Where this does not involve a sale and purchase transaction, it is obviously a measure targetted at the refinancing market. As noted above, the commercial case for such a practice should be carefully reviewed. In addition, the HKMA is concerned that when Als market their loans, whether or not through property agents, they should observe proper standards of conduct, particularly those set out in the Code of Banking Practice ("the Code"). In this respect, clause 10 of the Code on bank marketing is of particular relevance. e.g. Als should ensure that both the costs and benefits of a refinancing proposal are fairly and reasonably represented to the customer.

The HKMA will, as part of its ongoing examination of Als, determine that :

- a. the Als have a properly formulated competition strategy, especially regarding refinancing loans; and
- b. the 70% LVR guideline is adhered to, and the valuation of properties is properly conducted.

Yours Faithfully

(D T R Carse)
Deputy Chief Executive

c.c. Chairman, Hong Kong Association of Banks
 Chairman, DTC Association
 Secretary for Financial Services

1. Source: HKMA's monthly survey of residential mortgage loans on 33 authorized institutions.

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