



HONG KONG MONETARY AUTHORITY
香港金融管理局

Circulars

19 Oct 2004

Residential mortgage lending ("RML")

Our Ref: B1/15C

19 October 2004

The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Residential mortgage lending ("RML")

The Hong Kong Monetary Authority ("the HKMA") has completed recently a round of on-site examinations on authorized institutions ("AIs") which are active in RML business. The objective is to review their compliance with the applicable guidelines issued by the HKMA on residential mortgage loans, the risk management practices in relation to equitable mortgage operations, and the extent to which consumer credit data are used in the assessment of RML applications.

Overall, the results of these examinations indicated that effective risk management systems have been put in place by the AIs generally for their RML business. However, we believe that it would be useful to share with you our observations as follows:

1. 70% loan-to-value ratio guideline ("the 70% guideline")

Individual institutions were found to have breached the HKMA's 70% guideline in the following circumstances:

- Unsecured personal loan facilities were granted to certain residential mortgage borrowers, such that the sum of the unsecured personal loan facility and the RML granted to the borrower in each case exceeded 70% of the value of the mortgaged property. The unsecured personal loan facilities were drawn down on or shortly before the day of final payment for the property and the loan proceeds were credited directly to the bank account of mortgagor's solicitor to facilitate the final payment. These arrangements suggested strongly that these loans were used to finance the acquisition of the underlying mortgaged properties.
- A "top-up" loan secured by an existing mortgaged property was granted but the sum of this top-up loan and the RML in question exceeded 70% of the value of

the mortgaged property when the top-up loan was approved.

Als are reminded that the HKMA takes a serious view of non-compliance with the 70% guideline. Als should ensure strict compliance with the 70% guideline, whether it is a new RML (with or without an additional unsecured personal loan) or a "top-up" loan secured by a mortgaged property. In so far as unsecured personal loan is concerned, it would be appropriate to refer to the guidance given in the circular letter dated 12 September 1996. It is also important that the market value of the property is professionally and objectively appraised, after deducting the cash rebate or other discount, if any, offered by the property developer. The granting of any unsecured personal loan facility to a borrower who has taken out a RML should be subject to a separate credit decision based on the institution's normal criteria for unsecured loans. The drawdown of the personal loan facility should be permitted only after the completion of the purchase of the property so that the facility is not used to finance the downpayment.

2. Debt servicing ratio ("DSR") test and use of consumer data

The following exceptions were noted when individual Als assessed the repayment ability of the residential mortgage borrowers:

- the maximum DSR adopted was higher than 60%;
- credit card and revolving loan repayments were not included as debt elements in the calculation of the DSR test;
- reasonable income proofs were not obtained from borrowers; or
- consumer credit data from a Credit Reference Agency ("CRA"), or a satisfactory alternative arrangement, was not used in assessing the borrowers' other financial obligations.

Als should have a clearly defined and documented policy to assess the repayment capability of residential mortgage borrowers and ensure that the policy is observed in practice. In particular, all monthly repayments relating to the mortgage loan application under review and all other debt repayments known to the institution should be taken into account for the purpose of DSR test. To this end, Als are expected to make use of the consumer credit data from a CRA in assessing the borrowers' monthly repayment obligations, unless there are satisfactory alternative arrangements. Satisfactory evidence for the verification of the income level of the borrowers should be obtained. The DSR should not be higher than 50-60% generally, and the upper end of this range should be confined to higher income earners.

3. Equitable mortgages

In addition to the risks associated with legal mortgages, equitable mortgages are exposed to the default risk of the developer (where the project cannot be

completed) or the risk of misappropriation of loan proceeds kept in the stakeholder accounts.

Als are expected to evaluate fully the developer's ability to complete the development project before participating as an equitable mortgage lender, and set appropriate caps to limit the total exposure against a single project, a single developer as well as the total amount of equitable mortgages. Moreover, Als should implement proper measures to ensure that equitable mortgage loan proceeds are paid to a stakeholder approved by the lending banks providing the building mortgage loan¹.

Should you have any questions on the above, please do not hesitate to approach your usual contact in the Banking Supervision Department.

Yours faithfully,

Y K Choi
Executive Director
(Banking Supervision)

¹ The Lands Department has recently introduced additional measures to impose, among others, stricter rules on the appointment of stakeholders and the administration of stakeholder account for projects subject to the Government's Consent Scheme. Further details could be found in the Lands Department's Circular Memorandum No. 54 issued on 8 July 2004 (www.info.gov.hk/landsd/).

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