CB(1)662/07-08(04)

22 January 2008

Miss Polly Yeung
Clerk to Panel on Financial Affairs
Legislative Council
Legislative Council Building
8 Jackson Road, Central
Hong Kong

Dear Miss Yeung,

Issues and questions to be addressed in connection with the 70% mortgage cap on residential property

I refer to your letter dated 4 December 2007. The HKMA's responses to the four questions raised in the letter are as follows.

Q1. A brief account of the historical background leading to the introduction of the 70% mortgage cap on residential property; the intended policy objectives of the cap and its effect on the residential property market.

A1. The 70% loan-to-value ("LTV") ratio for residential mortgage lending was first initiated by certain leading banks in Hong Kong in November 1991. The practice was then adopted by other banks as a voluntary risk-management measure and evolved into an industry standard. The Hong Kong Monetary Authority ("HKMA") supported the practice and continues to do so. Although the 70% LTV ratio is not a statutory guideline, the HKMA has been monitoring the implementation of this measure through onsite examinations and offsite reviews.

The 70% LTV ratio has helped to maintain the stability of the banking system in Hong Kong even when there were stresses arising from economic downturn and large fluctuations in property prices. Since the measure is directed at ensuring adequate risk management by authorized institutions ("AIs"), rather than regulating the property market, the HKMA has not conducted any assessment of the impact of the measure on the property market.

Q2. The implementation and application of the mortgage cap 70% on residential property market and the circumstances, if any, under which the cap may be relaxed; the number of cases, if any, in which mortgage loans exceeding 70% of the value of property were approved.

A2. Based on the results of on-site examinations and off-site reviews, the HKMA is satisfied that AIs have in general adopted appropriate risk-management measures to implement the 70% LTV ratio.

The 70% LTV ratio generally applies to all residential mortgage loan applications, regardless of the occupation or background of the borrowers. There may be circumstances where AIs can exceed the 70% LTV ratio if they have reasonable justifications from a risk-management perspective. Such circumstances include –

- The AI has conducted proper risk assessment for the concerned loan and the risk of the excess portion of the mortgage loan is properly managed, such as when it is covered by additional collateral or mortgage insurance;

- AIs grant residential mortgages to their staff with a LTV ratio higher than 70% as a staff housing benefit; and

- To facilitate borrowers in negative equity to refinance their residential mortgages with a lower mortgage rate so as to reduce their mortgage repayments, the HKMA has allowed AIs to refinance such residential mortgages by granting up to 100% of the market value of the mortgaged property since October 2001.

The HKMA does not consider it necessary from the supervisory perspective to collect statistics on AIs' residential mortgages exceeding the 70% LTV ratio

55th Floor, Two International Finance Centre,
8 Finance Street, Central, Hong Kong
Website: www.hkma.gov.hk

香港中環金融街8號國際金融中心2期55樓
網址：www.hkma.gov.hk

because the 70% LTV ratio is not a statutory guideline, and the HKMA is satisfied that AIs have in general adopted appropriate risk-management measures to implement the 70% LTV ratio. The effort and resources required to collect the relevant statistics would be very significant for AIs.

Q3: Details of the regulatory oversight by HKMA/the Government on the application of the 70% mortgage cap by the banking sector on their clients and the consequence and sanctions, if any, for not adhering to the cap.

A3: The HKMA monitors whether AIs have adequate risk-management systems to ensure the effective implementation of the HKMA's supervisory requirements and industry standards through on-site examinations and off-site reviews. In addition, the HKMA conducts on-site examinations on AIs' residential mortgage lending business to assess their implementation of the 70% LTV ratio. These on-site examinations mainly cover AIs that are more active in the mortgage market or those in respect of which the HKMA has supervisory concerns. Following the implementation of the 70% LTV ratio in 1991, the HKMA has stepped up its supervisory efforts in response to the developments in the mortgage market and products.

In case of any deviation from the 70% LTV ratio, the HKMA will seek to understand from the AI concerned more details about the deviation. If the AI fails to properly justify the deviation, the HKMA will assess the implications for the effectiveness of the AI's risk-management system. To the extent that the risk-management standard of the AI is called into question, the HKMA would consider the need for appropriate supervisory measures to help ensure that the AI rectifies the weaknesses identified. These measures include:

- requiring the AI to investigate the weaknesses of its risk-management system, rectify them within a prescribed time, and verify the effectiveness of its risk-management system thereafter;
- requiring the AI to appoint an external auditor to review matters of

55th Floor, Two International Finance Centre,
8 Finance Street, Central, Hong Kong
Website: www.hkma.gov.hk
香港中環金融街8號國際金融中心2期55樓
網址：www.hkma.gov.hk

supervisory concern; or

- escalating the matter to the AI's senior management or Board of Directors.

Q4: Are mortgage loan applications by civil servants subject to the 70% mortgage cap in the same way as other applicants? If there is any relaxation of the 70% guideline, what factors are being taken into consideration?

A4: The 70% LTV ratio generally applies to all residential mortgage loan applications, regardless of the occupation or background of the borrowers. Therefore, the HKMA considers that AIs should also adhere to the 70% LTV ratio cap when granting residential mortgage loans to borrowers who are civil servants. As indicated in our response to Question 2, there may be circumstances where AIs can exceed the 70% LTV ratio if they have reasonable justifications from a risk-management perspective.

A. Ching.
(Andy Ching)
for Chief Executive
Hong Kong Monetary Authority

55th Floor, Two International Finance Centre,
8 Finance Street, Central, Hong Kong
Website: www.hkma.gov.hk

香港中環金融街8號國際金融中心2期55樓
網址：www.hkma.gov.hk