

## **LEGISLATIVE COUNCIL BRIEF**

### **Banking Ordinance (Chapter 155)**

#### **BANKING ORDINANCE (AMENDMENT OF SCHEDULE) NOTICE 1999**

### **INTRODUCTION**

The Financial Secretary is going to make the Banking Ordinance (Amendment of Schedule) Notice 1999 (the Notice).

### **BACKGROUND AND ARGUMENT**

#### **Mortgage Purchase Programme**

2. The Hong Kong Mortgage Corporation (HKMC) started its residential mortgage purchase programme in November 1997. The Programme is one of the initiatives of the HKMC in developing the secondary mortgage market to enhance the liquidity of mortgage assets and to broaden the funding source of mortgage loans. It enhances the banking sector's appetite for mortgage loan by providing a reliable avenue for the banks to offload their mortgages, making their management of the risk in mortgage business more effective.

#### **Forward Commitment Facility**

3. In order to streamline the mortgage purchase programme, the HKMC introduced the Forward Commitment Facility (the Facility) in June 1998. Under the Facility, the HKMC will irrevocably commit to purchase an agreed amount of eligible residential mortgage loans from Approved Sellers<sup>1</sup>

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1 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 the HKMC.

within a specified period of up to 12 months. Only residential mortgage loans that conform to the HKMC's mortgage purchasing criteria will qualify for sale under the Facility. To protect the HKMC's interest, for loans whose current loan-to-value ratio is above 90% at the time of sale, the Approved Seller will be required to provide a warranty for the repurchase of such mortgages which become overdue for more than 90 days in the 18 months subsequent to the sale.

4. The Facility provides Approved Sellers with greater certainty on the amount of residential mortgage loans they can sell to the HKMC within a specified period. As Approved Sellers have to sound out the HKMC the constituents of the mortgage portfolio they wish to sell and the timing of the sale before an agreement is made under the Facility, it also enables the HKMC to more accurately assess the selling interest of the Approved Sellers. As a result, the HKMC's funding activities and mortgage purchase operations can be improved.

### **Liquidity Ratio of Authorised Institutions (AIs) and the Fourth Schedule to the Banking Ordinance**

5. The Fourth Schedule to the Banking Ordinance provides the framework for measuring an AI's liquidity position and its adequacy using a liquidity ratio. Broadly, an AI's liquidity ratio is expressed in terms of its liquefiable assets (which can be realised in cash or cash equivalent within one month) as a percentage of its qualifying liabilities (which will or could mature within one month). The Fourth Schedule provides that qualifying liabilities include customer deposits, net interbank borrowing and other liabilities. Table A of the Schedule lists out the categories of liquefiable assets and their respective liquidity conversion factors<sup>2</sup>. They include cash,

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2 Liquidity conversion factor is a discount ranging from 0% to 20% that are applied to the various types of liquefiable assets to take into account varying liquidity for the purpose of calculating the liquidity ratio.

gold, net interbank placements, marketable debt securities, export bills and eligible loan repayments.

6. As mentioned above, the HKMC will be irrevocably committed to purchasing residential mortgage loans covered by the Facility once it has been confirmed that they conform to the HKMC's mortgage purchasing criteria. The purchase is normally completed within one month. The Hong Kong Monetary Authority (HKMA) therefore considers that such loans have the characteristic of liquefiable assets and should be included in Table A of the Fourth Schedule. The HKMA is also of the view that a liquidity conversion factor of 90% should be applied. The 10% discount takes into account the possibility that the HKMC may purchase the mortgage loans at a discounted price, depending on, among other things, whether and by how much the Gross Mortgage Rate<sup>3</sup> has fallen short of HKMC's Net Required Yield<sup>4</sup>.

7. Monthly instalment repayments from residential mortgage loans is a type of eligible loan repayment, hence, liquefiable assets. To avoid double counting the principal amount of mortgage loans covered by the Facility (to be recognized as liquefiable assets by virtue of the subject Notice) and the monthly instalment repayments from these mortgage loans as liquefiable assets, the latter will be excluded from the definition of "eligible loan repayment".

## **THE NOTICE**

8. Under section 135(3) of the Banking Ordinance, the Financial Secretary may, by notice in the Gazette, amend the Fourth Schedule.

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3 The rate of interest applicable to individual mortgages.

4 The yield required by the HKMC relating to the purchase of a mortgage as adjusted from time to time.

9. This Notice to be made by the Financial Secretary will amend the Fourth Schedule by including in Table A “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, with a liquidity conversion factor of 90%”. The definition of “eligible loan repayment” will be amended to exclude instalment repayment in respect of these residential mortgage loans.

### **PUBLIC CONSULTATION**

10. We have consulted the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, the Hong Kong Association of Banks and the Deposit-taking Companies Association on the recognition of the residential mortgage loans covered by the Facility as liquefiable assets. They support the proposal.

### **BASIC LAW IMPLICATION**

11. The Department of Justice advises that the Notice is consistent with the Basic Law.

### **HUMAN RIGHTS IMPLICATIONS**

12. The Department of Justice advises that the Notice has no human rights implications.

### **BINDING EFFECT OF THE LEGISLATION**

13. The amendment will not affect the current binding effect of the Banking Ordinance.

### **FINANCIAL AND STAFFING IMPLICATIONS**

14. There are no financial or staffing implications for the

Government.

## **LEGISLATIVE TIMETABLE**

15. The Notice, being subsidiary legislation, will come into operation when it is published in the Gazette on 30 April 1999. The Notice will then be tabled at the Legislative Council for negative vetting.

## **PUBLICITY**

16. The HKMA will issue to all AIs a policy paper on the Facility and recognition of the residential mortgage loans covered by it as liquefiable assets upon gazetting of the Notice.

## **ENQUIRIES**

17. Enquiries on this brief may be directed to Mr Edward Mak, Assistant Secretary for Financial Services (telephone number: 2527 3974).

**Financial Services Bureau**  
**April 1999**

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