

LEGISLATIVE COUNCIL BRIEF

Banking Ordinance (Chapter 155)

BANKING ORDINANCE (AMENDMENT OF SECTION 81(6)) NOTICE

INTRODUCTION

The Financial Secretary has issued the Banking Ordinance (Amendment of Section 81(6) Notice (“the Notice”) to exempt the exposure of a locally incorporated authorized institution (“AI”) to The Hong Kong Mortgage Corporation Limited (“HKMC”) under the Guaranteed Mortgage-Backed Pass-Through Securitisation Programme (“MBS Programme”) or any company that issues mortgaged-backed securities (“MBS”) in connection with the MBS Programme for the purpose of calculating the financial exposure of the AI under section 81(1) of the Banking Ordinance (“BO”).

BACKGROUND

2. The MBS Programme was launched by the HKMC under which the HKMC, in return for a guarantee fee, guaranteed the timely payment of principal and interest in respect of MBS issued by HKMC Funding Corporation (1) Limited, a Special Purpose Vehicle (“SPV”) formed for the purpose of purchasing mortgages from the HKMC and issuing MBS under the MBS Programme. Both the HKMC and the SPV are companies incorporated in Hong Kong under the Companies Ordinance.

3. The MBS issued under the MBS Programme so far have been on a back-to-back basis and adopt a pass-through structure -

- (a) Back-to-back Structure - after acquiring a pool of mortgages from a bank, the HKMC sells the pool of mortgages to the SPV which then issues MBS back to the bank i.e. the bank becomes an investor in the securities issued by the SPV. The HKMC guarantees the timely payment of all principal and interest in respect of the MBS issued under the MBS Programme. This back-to-back structure is simple and can be implemented relatively quickly and cheaply.
- (b) Pass-through of mortgage receipts - under the MBS Programme, all cash (including interest and both scheduled and unscheduled principal payments) received by the HKMC on the underlying mortgage loans, will be passed through to the investor after deducting from the receipt the servicing fee and guarantee fee.

Pursuant to the HKMC guarantee, the noteholders will receive on each payment date in respect of the notes the aggregate of (i) the scheduled interest payments and (ii) the scheduled principal payments, in respect of the underlying pool of mortgages.

4. As the HKMC guarantees the timely payment of all scheduled principal and interest in respect of the underlying pool of mortgages, the noteholders, in the event if there is any default of payment, have two recourses: first, to the HKMC under the HKMC guarantee and, secondly (in the very unlikely case that the HKMC default), to the assets of the SPV but only up to the extent of the value of the dedicated underlying pool of mortgages. Thus an AI would have financial exposure to the HKMC and any company issuing MBS under the MBS Programme if it has purchased such MBS.

JUSTIFICATION

5. The framework for the limitation on an AI's financial exposure is embodied in section 81 of the BO. Section 81(6A) specifies that the Financial Secretary may, by notice in the Gazette, amend subsection (6), which sets out the types of financial exposure that are exempt from section 81(1). The financial exposure of AIs arising from the obligations placed upon the HKMC under the Mortgage Insurance Programme of the HKMC is already exempted under Section 81(6)(kc) of the BO.

6. At the request of the HKMC, the Hong Kong Monetary Authority ("HKMA") has reviewed whether an AI's exposure to the HKMC or any company under the MBS Programme should be exempted for the purpose of calculating the financial exposure under section 81(1) of the BO. It is considered that the risk of loss to AIs having exposure under the MBS Programme is generally low because -

- (a) the HKMC, which provides the guarantee under the MBS Programme, is a public sector entity in Hong Kong (within the meaning of the BO) wholly owned by the Financial Secretary in his official capacity as the Controller of the Exchange Fund; and
- (b) the MBS issued under the MBS Programme are secured by the underlying mortgages, the quality of which is reasonably assured as they are subject to the HKMC's prudent selection criteria, such as the 50% debt-to-income ratio and the owner occupancy requirement.

It is therefore intended that a specific exemption under section 81(6) of the BO should be granted for an AI's exposure to the HKMC or any company that issues MBS under the MBS Programme.

THE NOTICE

7. This Notice amends section 81(6) of the BO to provide that any financial exposure to the HKMC or any company that issues MBS in connection with the HKMC's MBS Programme will not form part of the financial exposure under section 81(1) of the Ordinance, if the financial exposure to the HKMC or the company arises from the obligations placed upon it for the purposes of the MBS Programme.

LEGISLATIVE TIMETABLE

8. The Notice was published in the Gazette on 30 January 2004 and will be tabled at the Legislative Council on 4 February 2004 for negative vetting. The Notice would take effect on 1 April 2004.

IMPLICATIONS OF THE PROPOSAL

9. The proposal is in conformity with the Basic Law, including the provisions concerning human rights. It has no financial or civil service, productivity, environmental or sustainability implications.

BINDING EFFECT OF THE LEGISLATION

10. The amendments will not affect the current binding effect of the existing provisions of the Banking Ordinance.

PUBLIC CONSULTATION

11. The HKMA has consulted the Hong Kong Association of Banks and the Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies on the proposed exemption and has received no objection.

PUBLICITY

12. After the expiry of the negative vetting period of the Legislative Council on this Notice, the HKMA will inform all locally incorporated AIs and the industry associations on the amendments.

ENQUIRIES

13. Inquiries on this brief may be directed to Ms. Rita Yeung, Head (Banking Policy) of HKMA (telephone number: 2878 1388) or Mrs. Millie Ng, Assistant Secretary for Financial Services and the Treasury (Financial Services) (telephone number: 2528 9076).

Financial Services Branch
Financial Services and the Treasury Bureau
30 January 2004