Annex 1

Detailed Guidance relating to Reverse Mortgage Programme

Underwriting Standards

1. Evaluation of borrower's indebtedness and validation of charged property's legal title and effectiveness of repossession arrangements

The existing prudential guidelines on LTV and DSR are not applicable to RMP loans. However, AIs should still exercise due diligence in underwriting RMP loans with a view to ensuring that the associated risks, such as legal risk, operational risk and reputational risk, are adequately managed.

In particular, an AI participating in the RMP should put in place proper control procedures to ensuring the validity of its legal title to the underlying residential property and effective repossession of the property when a maturity event arises (e.g. when the last surviving borrower of an RMP loan has passed away). In this regard, AIs should ascertain whether there is any other charge on the underlying residential property for any loan facility when assessing the application and, if so, the implication for their eventual repossession of the property.

2. Use of monthly payouts under RMP loans as regular income sources for repaying another conventional residential mortgage loan (RML)

The HKMA has no objection for AIs to taking into account the monthly payouts received by a borrower under an RMP loan in assessing the borrower's ability to repay another conventional RML. In this case, however, AIs are expected to adhere to the existing prudential guidelines on LTV, DSR and net worth-based lending and adopt at least the same internal prudent standards (e.g. maximum loan tenor plus borrower's age) in underwriting the conventional RML.

Capital Adequacy

3. Treatment of RMP loans under the Standardized and Basic approaches

For capital adequacy ratio calculation purposes, RMP loans granted by AIs fall within the definition of "residential mortgage loan" under section 2(1) of the BCR. AIs that are using the STC approach or the Basic approach to calculate the credit risk for non-securitization exposures should use their respective

approach to calculate the credit risk for RMP loans.

AIs may regard exposures to RMP loans (both on- and off-balance sheet), as fully covered by the insurance provided by the HKMC under the Master Reverse Mortgage Insurance Policy (the "Policy") of the RMP (HKMC insurance) and treat the insurance protection as recognized guarantee for capital adequacy purposes, provided that the AIs have not breached any of their obligations under the Policy.

4. IRB approach not appropriate for RMP loans

The IRB approach is considered not an appropriate approach for capturing the inherent risks and calculating the credit risk capital charge for RMP loans. This is because the concept of default of obligor, which is central to the IRB approach, is not applicable to these loans. The existence of the HKMC insurance further protects AIs from credit losses in the event that the sales proceeds from the underlying mortgaged residential property are not sufficient to cover the amounts owed to the AIs under the loans. As such, AIs using the IRB approach for credit risk are expected to adopt the STC approach for credit risk in respect of their exposures to RMP loans. These AIs should seek the MA's approval under section 12(1) of the BCR for exempting their RMP loans from using the IRB approach, and for applying the STC approach for credit risk, to calculate the capital requirements.

Loan Classification

5. Assessment of repayment ability and collectability of the principal and interest remain relevant for loan classification purposes

In general, the principle that classification of loans should be largely judgemental based on the assessment of the borrower's capacity to repay and the degree of doubt about the collectability of the principal and interest of a loan remain relevant for RMP loans.

For RMP loans against which the HKMC insurance is in force, the AI relies on the collateral value of the underlying residential property as the primary source of repayment and on the HKMC as the ultimate source of repayment. AIs could assess the collectability of the principal and interest of a fully covered RMP loan by taking into account the financial strength and repayment ability of the HKMC as if it were the borrower of the loan, in addition to assessing the net realisable value of the underlying mortgaged residential property.

Where the HKMC insurance is no longer enforceable (e.g. due to the *Exclusions* provisions of the Policy), in whole or in part, in respect of the amounts owed to the AI, the AI should apply the HKMA's loan classification guidelines in respect of the uncovered portion of the RMP loans as asset-based lending, with particular focus on the collectability of the principal and/or interest of the loan and the estimated net realisable value of the underlying mortgaged residential property.

Accounting and impairment treatment

6. Measure RMP loans at amortised cost less any impairment loss and determine impairment allowance according to applicable accounting standards for financial reporting purposes

Consistent with applicable accounting standards, AIs may measure RMP loans at amortised cost (less impairment loss) and classify them as "Residential Mortgage Loans" or "Other Loans" under "Loans and Receivables" for financial reporting purposes. In addition, any undrawn credit commitment under these loans is expected to be disclosed as contingent liability in accordance with the applicable accounting standards. AIs and their external auditors should take into account the HKMC's credit profile and financial strength for determination of any impairment allowance for RMP loans.