In July 2002 the Hong Kong Mortgage Corporation (HKMC) announced the formal launch of the Home Owner Mortgage Enhancement (HOME) Programme. The aims of the HOME Programme are to alleviate the financial burden of negative equity homeowners by facilitating the refinancing of mortgage loans of up to 140% of the current market value of the property at more favourable mortgage rates and to provide an effective tool for authorized institutions (AIs) to reduce the credit risk of such loans by insuring the exposure above 90% of current value.

The HKMA wrote to all participating AIs in July outlining the reporting treatment of loans covered by the Programme in the various HKMA report forms. As a general rule, these loans should continue to be reported as residential mortgage loans in the banking returns and the monthly survey of Residential Mortgage Lending. Set out below are the salient points of the letter, together with some illustrative examples.

Return of Capital Adequacy *(for locally incorporated AIs only)*

The risk weight of the uninsured portion of loans under the HOME Programme will depend on whether: (i) the loan is already on the reporting institution's books at a 50% risk weight or (ii) it is a new loan. Loans falling within the first category will continue to attract a 50% risk weight as their loan-to-value ratio did not exceed 90% at the time they were made (see definition of "residential mortgage"[1] under the Third Schedule to the Banking Ordinance), notwithstanding that their loan-to-value ratio may exceed 90% at the time the loans become covered under the Programme.

Loans falling within the second category refer to loans refinanced by the reporting institution from another institution or loans already on the reporting institution's books which are redeemed and replaced by new loans under the HOME Programme. The uninsured portion of these loans will attract a 100% risk weight because their principal sum will obviously exceed 90% of the market value of the property at the time they are approved by the reporting institution.

As the HKMC is a public sector entity (PSE), reporting institutions may apply a 20% risk weight to the insured portion of the loans in accordance with the provisions of the Third Schedule. The insured portion may include capitalisation of upfront insurance premium on the loans. Institutions should be aware, however, that this weighting could possibly change depending on the treatment determined for PSEs under the New Capital Accord (and it could also change if the status of the HKMC as a PSE were to change). It is therefore necessary for them to take account of this possibility in their forward planning of capital adequacy.

1 Under the Third Schedule, "residential mortgage" means a mortgage under which:
a) the borrower is an individual person;
b) the principal sum does not exceed 90% of the purchase price or the market value of the property at the time the mortgage was approved by the AI concerned, whichever amount is the lower;
c) the debt is secured by a first legal charge on the property; and
d) the property secured by the charge is used as the borrower's residence or as a residence by a tenant of the borrower.

Below is an example showing how a loan covered under the HOME Programme should be risk-weighted in the Return of Capital Adequacy. Two scenarios are illustrated: (i) the loan is already on the books of the reporting institution at a 50% risk weight; and (ii) the loan is refinanced by the reporting institution from another institution.

Background information:

April 1998:	
Principal sum of the initial loan:	$4,200,000
Market value of the property:	$6,000,000
Loan-to-value ratio:	70%

July 2002:	
Outstanding balance of the loan:	$3,600,000
Market value of the property:	$3,000,000
Loan-to-value ratio:	120%
Capitalisation of upfront premium:	2.10% or $75,600

Scenario 1: The loan is already on the books of the reporting institution at a 50% risk weight

Item	Nature of Item	Principal Amount HK$'000	x	Risk Weight %	=	Weighted Amount HK$'000
15.	**Category III: Claims on Public Sector Entities (P.S.E.s)** Claims on, or claims guaranteed by, or claims collateralised by securities issued by, P.S.E.s in Hong Kong	976[2]		20		195
22.	**Category V: Residential Mortgages** Loans fully secured by a residential mortgage	2,700		50		1,350
24.	**Category VI: Other Assets** Claims on non-bank private sector	–		100		–
	SUBTOTAL	**3,676**				**1,545**

Scenario 2: The loan is refinanced by the reporting institution from another institution

Item	Nature of Item	Principal Amount HK$'000	x	Risk Weight %	=	Weighted Amount HK$'000
15.	**Category III: Claims on Public Sector Entities (P.S.E.s)** Claims on, or claims guaranteed by, or claims collateralised by securities issued by, P.S.E.s in Hong Kong	976[2]		20		195
22.	**Category V: Residential Mortgages** Loans fully secured by a residential mortgage	–		50		–
24.	**Category VI: Other Assets** Claims on non-bank private sector	2,700		100		2,700
	SUBTOTAL	**3,676**				**2,895**

2 Includes capitalisation of the upfront premium.

Certificate of Compliance *(for locally incorporated AIs only)*

In accordance with Section 81 of the Banking Ordinance, the financial exposure to the borrower will be the full outstanding balance of the loan (i.e. the exposure will not be reduced by the amount insured by the HKMC).

Additionally, the amount insured under the HOME Programme (which represents indirect exposure to the HKMC) should be aggregated with other non-exempt exposures to the HKMC in determining compliance with the 25% statutory limit under Section 81 of the Ordinance.

At present only exposures under the Mortgage Insurance Programme (MIP) are exempt under Section 81(6)(kc) of the Banking Ordinance, and all other exposures to the HKMC are non-exempt. However, it is the intention in due course to propose an amendment to the Ordinance designating exposures under the HOME Programme and also the Guaranteed Mortgage-Backed Pass-Through Securitisation Programme as exempt. In the meantime, such exposures are not exempt from the 25% statutory limit.

Return of Large Exposures *(for all AIs)*

Reporting institutions should report the gross aggregate exposure to the HKMC (i.e. the aggregate of both exempt and non-exempt exposures), provided that the exposure exceeds 10% of the institution's capital base (this is not applicable to overseas incorporated AIs) or is one of its ten largest non-bank exposures.

If Bank A is used as an example, the total amount to be reported in the Return of Large Exposures for the exposure to the HKMC will be $33.3 million, i.e. the exposure relating to the Mortgage Insurance Programme ($0.8 million) is included, notwithstanding that it is an exempt exposure under Section 81(6)(kc) of the Banking Ordinance.

Return of Liquidity Position *(for all AIs)*

In accordance with the Fourth Schedule to the Banking Ordinance, the monthly repayment instalments of loans covered by the HOME Programme may be treated as eligible loan repayments in calculating the liquidity ratio, provided that all the relevant conditions set out in the Schedule are met.

Below is an example showing how a bank's financial exposure to the HKMC is calculated for the purpose of Section 81 of the Banking Ordinance.

Bank A's position as at 31 July 2002:

Borrower	Outstanding balance	Amount insured under HOME Programme	Amount insured under MIP
	$'million	$'million	$'million
X	4.0	–	0.8
Y	3.5	1.0	–
Z	6.5	1.5	–

(Capital base as at end-June 2002: $200 million)

In addition, Bank A holds $20 million fixed-rate notes and $10 million mortgage-backed securities issued by the HKMC.

Bank A's total financial exposure to the HKMC amounts to $32.5 million (i.e. $1 million + $1.5 million + $20 million + $10 million), representing 16.25% of its capital base.

Monthly Survey on Residential Mortgage Lending *(for AIs participating in the monthly survey)*

For statistical purposes, loans covered by the HOME Programme should continue to be reported as residential mortgage loans and should be included as loans in negative equity, notwithstanding that the negative equity portion of these loans has been insured by the HKMC under the Programme.

Other Issues *(for all AIs)*

Institutions participating in the HOME Programme are requested to advise the HKMA of their proposed level of participation in the Programme. In addition, those planning to participate in any other schemes to refinance loans in negative equity are also requested to consult the HKMA.

- Prepared by the Banking Policy Department