



HONG KONG MONETARY AUTHORITY
香港金融管理局

Our Ref: B1/C1

14 February 2017

The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Clarification of sections 22.5 and 22.12 of the Code of Banking Practice (CoBP)

I am writing to clarify our supervisory expectation in relation to sections 22.5 and 22.12 of the CoBP as recent enquiries and complaints indicated that some authorized institutions (AIs) may not fully appreciate the policy intention of these provisions. I have written to the Hong Kong Association of Banks and the DTC Association and requested them to arrange for the amendment of the two sections immediately.

For section 22.12 of the CoBP regarding fire insurance for mortgaged properties, it requires AIs to be transparent and flexible in providing options of insured amount for customers to choose under the overarching principle that the amount should be reasonable and of mutual agreement. An insured amount based on reinstatement cost is provided in the section as one of the examples of reasonable insured amounts as it would normally be the most appropriate to protect customers and AIs from the risks of fire or other serious damage to a mortgaged property and to put both parties back to their positions before fire or other serious damage. In practice, however, we note that there are circumstances where customers prefer not to choose this option or other options provided in the section. This may be because in some cases, a high annual valuation fee is charged where reinstatement cost is involved or the current loan value is far below reinstatement cost. Under these circumstances, on a correct interpretation of the section, customers and their AIs can mutually agree on a reasonable amount other than the three examples provided in the section. But from the enquiries and complaints recently lodged with the Hong Kong Monetary Authority (HKMA), we note that some AIs refused to provide other reasonable options to accommodate customers' preferences, claiming that the three options provided in the section represent an exhaustive list of permissible insured amounts under the requirement of the CoBP.

To clarify the policy intention of the section, we consider that the following amendments (marked in tracked changes) are necessary. We expect that AIs should come to mutual agreement with their customers on a reasonable insured amount after taking into account the circumstances of each case and, where relevant, explaining clearly to customers the implications of not basing the insured amount on reinstatement cost.

“The amount and the nature of risks to be insured during the term of the loan should be reasonable and should be a matter of mutual agreement between institutions and their customers. Institutions should provide an option for the customers or prospective customers to choose whether the insured amount should be based on, for example, the original loan value, the current loan value ~~(provided it is not below the cost of reinstating the property)~~ or the cost of reinstating the property, and should inform them if any options involve ~~of any extra costs or fees involved~~ ~~(for example, annual valuation fees)~~ ~~for the latter two options.~~”

For the avoidance of doubt, the different options provided in the section are meant to be examples, while AIs should follow the overarching principle of reasonableness and mutual agreement when dealing with customers. It should also be noted that the above revision to the wording is intended to be a quick clarification while AIs should continue to explore any measures that can further benefit both customers and AIs.

The HKMA also considers a textual amendment to section 22.5 (marked in tracked change below) necessary to clarify the policy intention which is to enhance transparency:

“Institutions should inform customers and prospective customers ~~that~~ if they have to pay for the legal expense of both the solicitors who represent themselves and the solicitors who represent the institutions to prepare mortgages on properties.”

Given the clarification of the policy intention, AIs are expected to amend their relevant customer communication materials according to the revised sections 22.5 and 22.12 with immediate effect and strengthen staff training to ensure correct interpretation and implementation of the two sections. If there are enquiries or complaints attributable to AIs' incorrect interpretation of section 22.12, the AIs concerned should look into the situation and follow up as appropriate.

We will continue to review the CoBP in view of new developments and overseas experiences, monitor AIs' compliance with the CoBP as part of our supervisory work, and follow up with individual AIs on cases of non-compliance or misinterpretation of the CoBP clauses.

Yours sincerely,

Arthur Yuen
Deputy Chief Executive