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Newsletter

Banking and Finance

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What's inside?

Prudential Measures for Property Mortgage Loans

Simon Deane and Martha Lu

After making adjustments and refinements to the countercyclical macroprudential measures for property mortgage loans in February 2024 and June 2024 respectively, the Hong Kong Monetary Authority ("**HKMA**") announced further adjustments to these measures on 16 October 2024 and introduced a one-off special scheme for uncompleted residential properties on 4 December 2024.

The further adjustments to property mortgage loans are as follows:

(i) the maximum loan-to-value ("**LTV**") ratio for all residential properties has been set at 70%, regardless of the value of the property and whether it is for self-occupation;

(ii) the maximum LTV ratio for mortgage loans assessed based on the net worth of mortgage applicants has been adjusted from 60% to 70%, which is the same as the maximum LTV ratio for mortgage loans assessed based on the debt servicing ability of mortgage applicants, regardless of whether the property is residential;

(iii) the debt servicing ratio ("**DSR**") limit for non-self-use properties has been adjusted from 40% to 50%, which is the same as the DSR limit for self-use properties, regardless of whether the property is residential; and

(iv) the requirement to lower the applicable maximum LTV ratio and DSR limit by 10 percentage points for mortgage applicants who have borrowed or guaranteed other outstanding mortgage(s) at the time of making a mortgage application has been lifted.

After these adjustments, the maximum LTV ratio has been standardised at 70% and the DSR limit has been standardised at 50% for all residential properties and non-residential properties. In addition, authorized institutions ("**AIs**") may adjust the cap percentage of their net worth-based lending in their mortgage portfolios based on their own risk assessment without seeking prior consent from the HKMA.

Furthermore, due to a change in property valuation, some stage payment buyers of uncompleted residential properties may find the property valuation at the time of their mortgage applications to be lower than the purchase price, and hence face difficulty in securing extra funds for the down payment. To assist such buyers and continue to ensure the proper risk management of banks' property mortgage lending businesses, the HKMA introduced a one-off special scheme offering AIs the flexibility to provide mortgage loans with a maximum LTV ratio of 80% and DSR limit of 60% for stage payment buyers of first-hand residential properties if:

(i) the provisional sale and purchase agreement was signed during the period from 1 January 2021 to 31 December 2023;

(ii) the date of the mortgage application was 4 December 2024 or after;

(iii) the property is for self-occupation; and

(iv) the valuation of the property at the time of the mortgage application was lower than the property purchase price.

The HKMA circular announcing the further adjustments can be found here. The HKMA circular introducing the one-off special scheme can be found here and the relevant press release can be found here.

Sustainable Finance Action Agenda

Simon Deane and Hui Ling Yuen

The Sustainable Finance Action Agenda ("**Action Agenda**") was launched on 21 October 2024 by the HKMA. With aims to solidify Hong Kong's position as the sustainable finance hub in Asia and support sustainable development regionally and globally, the Action Agenda outlines eight goals across four areas, covering aspirations for both the banking sector and the HKMA.

Key goals under the Action Agenda include:

1. **Goal #1 - Net Zero Targets**: Banks should strive to achieve net zero emissions in their operations by 2030 and in their financed emissions by 2050. Tentatively from 2030, banks should also regularly report to the HKMA on their transition plans on achieving net zero emissions on a 'comply or explain' basis.
2. **Goal #2 - Enhanced Transparency**: Banks should enhance their disclosures regarding climate-related risks and opportunities, aligning with international sustainability frameworks including the sustainability disclosure standards of the International Sustainability Standards Board published in June 2023 and the Pillar 3 disclosure framework for climate-related financial risks to be issued by the Basel Committee on Banking Supervision.
3. **Goal #8 - Talent Development**: The HKMA plans to address knowledge gaps in sustainable finance and strengthen the sustainable finance knowledge of practitioners by investigating into further training needs through its upcoming study "Capacity Building for Future Banking 2026-2030" and developing more training programs, including launching new modules under the Enhanced Competency Framework.

The HKMA will provide further guidance and consult the industry regarding these goals, including the development of a new Supervisory Policy Manual on transition planning.

The full Action Agenda, which sets out the details of each goal, is available here. You can also access HKMA's press release on the launch here.

Guideline on Authorization of Digital Banks

Simon Deane and Phyllis Leung

On 25 October 2024, the HKMA published a revised Guideline on Authorization of Digital Banks ("**Guideline**") (superseding the previous "Guideline on Authorization of Virtual Banks"). The Guideline sets out the principles which the HKMA will take into account in deciding whether to authorize digital banks applying to conduct banking business in Hong Kong.

As set out in the Guideline, in considering whether to approve or refuse an application for authorization, the HKMA needs to be satisfied that the minimum criteria for authorization in the Seventh Schedule to the Banking Ordinance (Cap. 155 of the laws of Hong Kong) ("**BO**") are met.

The Guideline also highlights the following points:

a. **Ownership**: Digital banks are expected to be locally incorporated banks. In addition, it is generally the HKMA's policy that a person who holds more than 50% of the share capital of a bank incorporated in Hong Kong should be a bank or a financial institution in good standing and supervised by a recognised authority in Hong Kong or elsewhere. If a locally-incorporated digital bank applicant is not owned by such a bank or financial institution, the HKMA expects the applicant to be held through an intermediate holding company incorporated in Hong Kong, with supervisory conditions imposed on this intermediate holding company.
b. **Ongoing supervision**: Digital banks will be subject to the same set of supervisory requirements applicable to conventional banks. That said, some of these requirements will be adapted to suit the business models of digital banks under a risk-based and technology-neutral approach.
c. **Physical presence**: Digital banks are required to maintain a physical presence in Hong Kong for interaction with regulators and customers.
d. **Technology risk**: To manage technology-related risks, digital banks are required to have "fit for purpose" security and technology related controls in place. As part of the application process, digital bank applicants are required to engage a qualified and independent expert to perform an independent assessment of the adequacy of their planned IT governance and systems and provide the assessment report to HKMA. Before a digital bank commences operation, it is required to conduct a more detailed independent assessment of the actual design, implementation and effectiveness of its computer hardware, systems, security, procedures and controls.
e. **Risk management**: At a minimum, digital bank applicants must go through the eight basic types of risk identified in the risk-based supervisory framework of the HKMA (i.e. credit, interest rate, market, liquidity, operational, reputation, legal and strategic risk) and establish appropriate controls to manage these risks.
f. **Business plan**: Digital bank applicants must be able to present a credible and viable business plan which strikes an appropriate balance between the desire to build market share and the need to earn a reasonable return on assets and equity.
g. **Exit plan**: Digital bank applicants are required to provide an exit plan in case their business model turns out to be unsuccessful.
h. **Customer protection**: Digital banks are required to adhere to the Treat Customers Fairly Charter and observe the standards contained in the Code of Banking Practice issued by the Hong Kong Association of Banks and the DTC Association. Digital banks also have clearly to outline the rights and obligations of both the bank and customers in their terms and conditions, ensuring fairness and balance.
i. **Outsourcing**: Outsourcing of computer or business operations of a digital bank to a third party service provider is allowed, subject to specific conditions. Digital banks should discuss their plans for material outsourcing with the HKMA in advance. It is important to note that the principles outlined in the SPM module on "Outsourcing" (SA-2), the Personal Data (Privacy) Ordinance and common law customer confidentiality must be adhered to. The HKMA must also be satisfied that his powers and duties under the BO (in particular, section 52 relating to the power of control over an institution) will not be hindered by the outsourcing arrangements.
j. **Capital requirement**: Digital banks must maintain adequate capital commensurate with the nature of their operations and the banking risks they are undertaking.

Please click here to read the Guideline.

Supervisory Policy Manual: Revised module TM-E-1 on "Risk Management of E-banking"

Simon Deane and Crystal Choi

After consultations with two industry associations, on 25 October 2024, the HKMA issued a revised version of the Supervisory Policy Manual ("**SPM**") module TM-E-1 "Risk Management of E-banking" as a statutory guideline under section 7(3) of the BO.

The HKMA's review and update of the module was part of an ongoing commitment to effective supervision of e-banking services and payment card services provided by AIs. The revised version incorporates relevant requirements from various supervisory documents (such as circulars and the Operational and IT Incidents Watch) to give AIs a more comprehensive understanding of supervisory guidance for these services. This revised module came into effect on 25 October 2024.

The main changes are summarised as follows:

(i) The revised SPM module now includes controls for payment card transactions.
(ii) Relevant security measures from various supervisory documents have been consolidated into the updated SPM module.
(iii) More principle-based guidance has been provided to strengthen AIs' risk management controls for e-banking and payment card services.

Please click here for the letter issued by the HKMA.

Policy Statement on Responsible Application of Artificial Intelligence in Financial Market

Simon Deane and Natalie Chan

On 28 October 2024, the Hong Kong Government ("**Government**") issued a policy statement on responsible application of artificial intelligence ("**ArtIn**") in the financial markets, setting out the Government's policy stance and approach towards this field.

Some of the key takeaways of the policy statement include:

- Financial institutions should formulate an ArtIn governance strategy to provide direction on how ArtIn systems should be implemented and used. A risk-based approach should be adopted in the procurement, use and management of ArtIn systems and human oversight will be crucial to mitigating the potential risks.

- As regards financial regulations, the Government took the view that the potential risks posed by ArtIn have been suitably reflected in the relevant regulations and/or guidelines issued by financial regulators. To keep pace with the latest developments of ArtIn and international practice (such as the emergence of explainable ArtIn), financial regulators will continue to review and update the existing regulations and/or guidelines as appropriate.

- The Hong Kong Police has been exchanging intelligence with international organisations, law enforcement agencies of different jurisdictions, and the ArtIn industry in order to address the challenges to cyber policing posed by ArtIn.

The full version of the policy statement can be found here.

Review of the Banking Ordinance

Simon Deane and Ruby Hui

In light of the evolution of the banking sector and the changing domestic and international regulatory and supervisory landscape, the HKMA has recently proposed reforms of the law in relation to banking regulations and supervision in Hong Kong, with a focus on the following two areas:

(i) establishment of a statutory regime for the exercise of direct regulatory and supervisory powers by the HKMA over the designated locally incorporated holding companies of locally incorporated AIs; and

(ii) flexibility for the HKMA to appoint skilled person(s) on a case-by-case basis, with a view to facilitating the performance of its functions under the BO.

<u>Establishment of a statutory regime</u>

A group-wide approach is currently adopted by the HKMA in relation to the supervision of locally incorporated AIs. The HKMA considers the consolidated risks of an AI's banking group (including its downstream operations), and the risks presented by other group companies (including financial or non-financial) when carrying out his supervisory duties. Nonetheless, the HKMA does not have direct regulatory or supervisory powers over holding companies of AIs under the BO. Consequently, the HKMA can currently only rely on powers to require the "fitness and propriety" of a controller of an AI on a continuing basis for supervision and regulatory purposes.

With the establishment of the proposed statutory regime mentioned in (i) above, the HKMA will be able to exercise direct regulatory and supervisory powers over designated locally incorporated holding companies of locally incorporated AIs.

Flexibility to appoint skilled persons

At present, the HKMA is not explicitly entitled to engage anyone (other than his own staff authorised by him) to assist in the performance of his functions under the BO. Owing to the growing complexity and technicality of AIs' operations caused by factors such as digitalisation and adoption of fintech, the HKMA has come to the conclusion that it is necessary to appoint skilled persons with the relevant and appropriate skill sets and resources, in order to assist him in the performance of his functions under the BO.

The HKMA initiated a public consultation on the above proposed enhancements and a number of technical amendments to the BO on 5 December 2024. Please click here for the consultation paper issued by the HKMA.

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