

The Hong Kong Mortgage Corporation Limited
香港按揭證券有限公司

7th Floor Gloucester Tower
11 Pedder Street Central Hong Kong
Facsimile (852) 2536 0090
Telephone (852) 2536 0087

Peter S. T. Pang JP 彭醒棠
Chief Executive Officer 總裁



7 October 2003

BY HAND

Mr. Ip Shing Hing
President
The Law Society of Hong Kong
3rd Floor, Wing On House
71 Des Voeux Road Central
Hong Kong

Dear Mr. Ip,

Project on Standardization of Mortgage Origination Documents – Phase II

As you may recall, in 2001 the Steering Committee of the Project on Standardization of Mortgage Origination Document developed a Model 2-Party Mortgage Deed and Model Guarantee and Indemnity (the “Model Documents”) that represent the best market practice in mortgage origination. The Model Documents were very well received by the banking community, the regulators and the consumer public and since then have been adopted by major financial institutions for use in their residential mortgage lending business.

Encouraged by the success of the Model Documents and in response to the industry’s demands for the development of a model three-party mortgage form, the HKMC reconvened the Steering Committee in March this year, with the purpose of:

- (i) developing and implementing a 3-party mortgage deed (the “3-Party Mortgage Deed”), loan application form, facility letter, instruction letter to solicitors and solicitors’ completion certificate (together the “Additional Model Documents”); and
- (ii) updating and reviewing the Model Documents in light of developments in law and practice since their publications so as to provide a full set of mortgage origination documents for use by the lending institutions.

In developing the Additional Model Documents, the Steering Committee has adhered to the principal objectives of Phase I of the Project which were, namely, to develop a set of model mortgage origination documents that clearly prescribes balanced rights and obligations between the banks and the homebuyers, and which can also be easily understood by the contracting parties through the use of plain English in drafting the documents.

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The re-convened Steering Committee includes the major mortgagee banks, mortgage re-insurers, credit rating agencies, The Law Society of Hong Kong, the Hong Kong Bar Association and the Law Faculty of the University of Hong Kong with other learned contributors from academia. Furthermore, in order to ensure that the provisions in the Additional Model Documents will not present difficulties in interpretation by the judiciary, we will be enlisting the valuable assistance of Mr. Justice Henry Litton, as we had done under Phase I with regard to the Model Documents, to review the draft documents prior to their publication.

The Steering Committee has now completed the drafting of the Additional Model Documents which are available in plain English with a Chinese translation (except for the instruction letter to solicitors and solicitors' completion certificate, which are not meant for use by lay customers). The Chinese translations were prepared by the kind assistance of Mallesons Stephen Jaques and we will be seeking the Law Drafting Division of the Department of Justice to provide comments on the Chinese version, as we had done so for the Model Documents under Phase I.

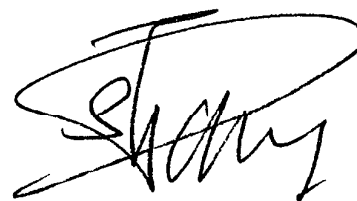
In Phase I of the Project, consultation with the banking industry, professional bodies and relevant regulatory authorities provided us with very valuable comments in improving the Model Documents. Capitalizing on such experience, we are again issuing the draft Additional Model Documents for consultation. For your ease of reference, we have attached the following annexes for your consideration:

- Annex 1 Membership of the Steering Committee
- Annex 2 Draft Additional Model Documents on CD-ROM
- Annex 3 List of Consultative Parties
- Annex 4 Guide to the key features of the draft Additional Model Documents

As we intend to introduce the full set of the model mortgage origination documents on 27 November 2003 at a Forum organized especially for such purpose, to allow time for revisions in light of comments received, I would be most grateful if you would circulate the draft documents to your members and provide your comments on the draft Additional Model Documents by **24 October 2003**.

If you have any queries on the draft Additional Model Documents, please feel free to contact me or Ms. Susie Cheung, General Counsel and Company Secretary, HKMC (telephone number : 2536 0032; e-mail address: susie_cheung@hkmc.com.hk). We also welcome opportunities to meet with representatives of your organisation to discuss issues relating to the draft documents, should you find this useful.

Yours sincerely,



**Membership of Steering Committee on
Standardization of Mortgage Origination Documents – Phase II**

Banks

1. Bank of America (Asia) Limited
2. Bank of China (Hong Kong) Limited
3. The Bank of East Asia, Limited
4. Chekiang First Bank Limited
5. DBS Bank (Hong Kong) Limited
6. The Hongkong and Shanghai Banking Corporation Limited
7. Hang Seng Bank Limited
8. Standard Chartered Bank

Credit Rating Agencies

9. Fitch (Hong Kong) Limited
10. Moody's Asia Pacific Limited

Mortgage Reinsurers

11. Hang Seng Insurance Company Limited
12. United Guaranty Mortgage Indemnity Company

Observer

13. Hong Kong Monetary Authority

Expert Adviser

14. Ms. Judith Sihombing

Professional / Academic Bodies

15. Hong Kong Bar Association
16. The Law Society of Hong Kong
17. The Law Faculty of The University of Hong Kong

Annex 2

Draft Additional Model Documents on CD-ROM

- (a) Three-Party Mortgage Deed
 - (i) English version
 - (ii) Chinese version

- (b) Recommended Core Provisions for Loan Application Form
 - (i) English version
 - (ii) Chinese version

- (c) Recommended Core Provisions for Facility Agreement
 - (i) English version
 - (ii) Chinese version

- (d) Instruction Letter to Solicitors

- (e) Solicitors' Completion Certificate

List of Consultative Parties

Industry Associations

The Hong Kong Association of Banks
The Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies
The Hong Kong Capital Markets Association
Code of Banking Practice Committee

Consumer Council

Regulators

Hong Kong Monetary Authority
Housing, Planning and Lands Bureau
The Land Registry

Professional Bodies

The Law Society of Hong Kong
Hong Kong Bar Association

Financial Institutions

ABN AMRO Bank N.V.
AIG Finance (Hong Kong) Limited
American Express Bank Limited
Asia Commercial Bank Limited
Bank of America (Asia) Limited
Bank of China (Hong Kong) Limited
Bank of Communications
The Bank of East Asia, Limited
Canadian Eastern Finance Limited
Chekiang First Bank Limited
Chiyu Banking Corporation Limited
Citibank, N.A.
CITIC Ka Wah Bank Limited
Dah Sing Bank, Limited

DBS Bank (Hong Kong) Limited
Fortis Bank Asia HK
GE Capital (Hong Kong) Limited
Hang Seng Bank Limited
Hang Seng Credit Limited
Hang Seng Finance Limited
The Hongkong and Shanghai Banking Corporation Limited
Inchroy Credit Corporation Limited
Industrial and Commercial Bank of China (Asia) Limited
International Bank of Asia Limited
Liu Chong Hing Bank Limited
Nanyang Commercial Bank, Limited
ORIX Asia Limited
ORIX Finance Services Hong Kong Limited
Pacific Finance (Hong Kong) Limited
Shanghai Commercial Bank Limited
Standard Chartered Bank
Wing Hang Bank, Limited
Wing Lung Bank, Limited

Guide to the key features of the draft Additional Model Documents

1. Model 3-Party Mortgage

Major principles adopted in drafting

1.1 The Model 3-Party Mortgage draws upon the Model Mortgage Deed published in July 2001 and has been drafted on the same premises as the principal objectives established under Phase I of the Project which were, namely, to develop a set of model mortgage origination documents that clearly prescribes balanced rights and obligations between the banks and the homebuyers, and which can also be easily understood by the contracting parties through the use of plain English in drafting the documents. With these principles in mind the Model 3-Party Mortgage contains the following key provisions:

- it secures the liabilities of the borrower only and not those of the mortgagor;
- the mortgagor is given an option to decide whether the liabilities secured should be for the specific amount drawn down under the Facility Agreement only or for an unlimited amount i.e. for all monies. *(Note: This follows the principles of Paragraphs 21.3(A) and 21.3(B) of the Code of Banking Practice (the "Code") which provide that a guarantor (to which the position of a mortgagor is analogous) should be given an option to choose whether the secured indebtedness should be for a specified loan amount or for an unlimited amount);*
- if the mortgagor chooses to limit its liability under the Model 3-Party Mortgage to the specific amount drawn down, any further liabilities in excess of the specified amount will be secured under the mortgage only if such liabilities have been granted to the borrower with the consent of the mortgagor;
- the Model 3-Party Mortgage does not contain an "on demand" repayment clause;
- to comply with Paragraph 20.6 of the Code, the Mortgagor is given an option to choose whether the amount of the insurance taken out on the Property should be based on the loan value or the reinstatement cost of the Property;
- provision has been made in the Model 3-Party Mortgage for the bank and the borrower / mortgagor to agree on the allocation of the cost for the production of certified copies of the transfer documents where the bank has previously transferred the mortgage to an assignee or transferee;
- to ensure that independent legal advice has been given to the mortgagor, a solicitor's statement that he/she has given to the mortgagor, in the absence of the

borrower, legal advice regarding the nature and effect of the deed, has been incorporated into the attestation clause of the Model 3-Party Mortgage.

2. Recommended Core Provisions for Loan Application Form

Recommended Core Provisions

2.1 It is acknowledged that each bank will have its individual preferences regarding the format of application forms and, accordingly, it may not be appropriate to prescribe a standard application form for general adoption by the banking industry. The Steering Committee has therefore developed a set of recommended core provisions covering the following main issues for incorporation by banks into their standard forms:

- authorization given to the bank by the applicant to use and disclose the personal data and financial information of the applicant;
- reliance on such information by the bank;
- assignment of the loan; and
- representation by the applicant on the accuracy and completeness of the information given.

Code of Practice on Consumer Credit Data

2.2 In addition, in view of the revised Code of Practice on Consumer Credit Data, which came into effect on 2 June 2003, the authorizations given by the applicant to the bank on the disclosure of personal and financial information need to be widened to cater for the following purposes:

- credit assessment including credit scoring;
- obtaining references from the applicant's employer, accountant, bank or other similar sources;
- credit reference purposes, including searching the files of a credit reference agency and disclosure to a credit reference agency, in which case it be used by other lenders for credit assessment purposes and may be used for debt tracing;
- disclosure to any proposed guarantor of the loan, to the bank's insurers, auditors, professional advisors, sub-contractors or any person providing services to the bank who have agreed to treat the personal information as confidential; and
- disclosure to any assignees, transferees, or successors in title of the bank.

3. Recommended Core Provisions for Facility Agreement

- 3.1 The facility agreement is an important document and is legally binding between the bank and the borrower. According to the principles set out in the Code, it should aim to strike a reasonable balance between consumer rights and the efficiency of banking operations and promote a fair and cordial relationship between banks and their customers.
- 3.2 For considerations similar to those which arose in the development of the loan application form, it was decided that a set of recommended core provisions for incorporation into banks' facility agreement be developed instead of a model form of facility agreement.

Compliance with the Code

- 3.3 Paragraphs 19.2 and 20 of the Code provide that banks should endeavour to ensure that the prospective borrower understands the principal terms and conditions of any borrowing arrangement and that the certain information should be provided to the borrower upon application for the loan or in the subsequent offer. Accordingly, the recommended core provisions cover the following matters as set out in the Code:
- the rate of interest for the loan and whether it may be varied over the period of the loan;
 - the basis on which interest will be determined and when it will be payable, including the number of days in the year that will be used for calculation;
 - all fees and charges which will be applicable;
 - the specified period for which the loan is to be made available;
 - details of the terms of repayment;
 - any overriding right to demand immediate repayment (*Note: in line with the principles of fairness underlying the model documents, the Steering Committee recommends that there should not be any overriding right to demand immediate repayment and that the exercise of such right will be triggered only upon the happening of an event of default*);
 - other significant features such as security requirements, late payment penalties, and charges or termination fees for early repayment;

- the bank's right, in the event of default of the borrower, to set off any credit balance in other accounts held by the borrower against the amount due to the bank;
- a warning to the customer that the mortgage loan is secured on the property in question and that default may result in the bank taking possession of, and selling, the property;
- customers to be provided with revised particulars of instalments after every adjustment of the interest rate;
- notification to the customer of his right to instruct a solicitor of his choice not on the approved list and of the fees and procedures involved; and
- notification to the customer of his right to engage separate legal representation.

3.4 According to paragraph 21.1 of the Code, banks should obtain the consent of the borrower to provide a surety with a copy or summary of the contract evidencing the obligations to be guaranteed or secured, and if the borrower refuses to permit the supply of such documents, the surety should be informed of such refusal prior to the bank accepting any guarantee or security from the surety. Accordingly, the Steering Committee recommends that provision should be made in the facility agreement for the guarantor to sign on it.

4. Instruction Letter to Solicitors

4.1 The mortgage/legal charge is an important document under which the bank's interest in the property is secured. While the solicitors will prepare the mortgage/legal charge and other security documentation for and on behalf of the bank, it is of the utmost importance to ensure that clear instructions have been given to the solicitors to effect the transaction according to the parties' intention.

4.2 In view of the different forms of instruction letter now adopted by banks, the Steering Committee has developed a model form of instruction letter for the banking industry's adoption.

4.3 The model form of the instruction letter contains the following key provisions:

- the solicitors are required to produce to the bank a solicitors' completion certificate in a form issued by the Steering Committee;
- the solicitors are requested to advise the third party surety to instruct his own independent solicitors;

- the solicitors are requested to follow the relevant procedures as recommended by The Law Society of Hong Kong (the “Law Society”) to provide relevant information and advise the potentially unduly influenced party on the nature of the document that he is signing and to keep a written record of the steps taken.

5. Solicitors’ Completion Certificate

5.1 In July 2001 the Property Committee of the Law Society issued a form of Solicitors’ Completion Certificate for adoption by the banks in Hong Kong in connection with residential mortgage lending transactions. Despite the issue of the recommended form of the Solicitors’ Completion Certificate by the Law Society, the form has not been widely adopted in Hong Kong, and solicitors continue to provide their banking clients with title reports or certificates which are often quite brief and do not attempt to cover a list of all the important matters which are of relevance to a secured lender. The Steering Committee has revised the form of Solicitors’ Completion Certificate and incorporated comments from the Property Committee of the Law Society to the extent the Steering Committee considered appropriate. The Steering Committee recommends the banking industry to adopt the form of the Solicitors’ Completion Certificate once it is issued in its final form.

5.2 In the standard form of the Solicitors’ Completion Certificate, solicitors are requested to confirm and undertake some of the following matters:

- the bank’s standard form of completion certificate has been adopted;
- a bankruptcy or winding up search (where applicable) has been conducted and is in order;
- the mortgagor has a good and marketable title to the property free from all encumbrances;
- the mortgage and the relevant title deeds will be sent to the bank within a specified time limit;
- the certificate shall be for the benefit of the bank and its successors and assigns.

6. **Separate Legal Representation for the Mortgagor**

Background

- 6.1 Since the mortgagor under the Model 3-Party Mortgage is providing third party security, it is important to ensure that the mortgagor fully understands the implications and the extent of liabilities which it is assuming under the mortgage.
- 6.2 It is also the mortgagee bank's duty to make clear to a mortgagor the nature of the security document to be signed by it. The Steering Committee has therefore considered various viable approaches in order to ensure that the mortgagor is made aware of the nature and the legal implications of the mortgage before signing it.

The Three Approaches Considered

- 6.3 The following three approaches have been considered by the Steering Committee:

(a) Mandatory separate representation for the mortgagor

The bank specifies in its instruction letter to the solicitors firm instructed to act in the mortgage transaction that the firm may only act for either the bank or the mortgagor.

This represents the best practice and is one which is adopted by various advanced jurisdictions with more developed consumer protection rights.

(b) The Chinese wall approach

The bank states in its instruction letter to the solicitors firm that the bank accepts that different solicitors from the same firm may act for the bank and the mortgagor separately, but that the same solicitor must not act for both (i.e., no joint representation).

This is a less rigorous approach than mandatory separate representation, but one that certainly represents a step forward in promoting the provision of independent legal advice to the mortgagor.

(c) Joint representation

This reflects the current conveyancing practice in Hong Kong, i.e. the same solicitor acts for both the bank and the mortgagor in a mortgage transaction unless the solicitor considers that he is unable to act for both due to a conflict of interest which may arise, e.g., if there is a defect on title.

- 6.4 Whether separate legal representation for the mortgagor should be mandatory in Hong Kong has been a long-standing issue. The Consultation Paper on Legal Service (Summary Version) by Attorney General's Chambers Hong Kong in 1995 set out the view of the administration that joint representation in mortgage transactions gave rise to potential conflicts of interest and could not be justified simply on the basis of that it was quicker and cheaper than separate representation and recommended a prohibition of joint representation in respect of all mortgage transactions.
- 6.5 The Steering Committee has sought the views of its bank representatives who have expressed their view that in situations where there are apparent conflicts of interests, e.g. in lending transactions involving third party surety providers, the bank involved should opt for separate legal representation for itself and the mortgagor so as to minimise the risks of its security being impeached. This view is also supported by paragraph 21.2(f) of the Code which recommends that the bank should advise a guarantor or third party surety to seek independent legal advice before entering into a guarantee or providing third party security.
- 6.6 However, while separate legal representation represents the ideal approach, the Steering Committee also understands that mandatory separate representation may attract objections or even complaints from bank customers as additional legal costs and expenses will be involved with the need to instruct a separate solicitor.

Recommendation

- 6.7 In view of the cost considerations and the legal implications, the question whether separate legal representation should be made mandatory has to be balanced against the potential vulnerability to the bank's security as against the cost considerations. The Steering Committee would therefore like to seek the views of the consultative parties and the financial institutions on their preferred approach before recommending any particular course for adoption.