Circular No. 035/B/2010-DSB/AMCM
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GUIDELINE ON RESIDENTIAL MORTGAGE LOANS

The Monetary Authority of Macao (AMCM), under the powers conferred by Article 9 of the Charter approved by Decree-Law no. 14/96/M of 11th March and by Article 6 of Financial System Act of Macao approved by Decree-Law no. 32/93/M of 5th July, establishes the following:

1. INTRODUCTION

1.1 In light of the upsurge in property prices and the considerable growth in property lending, the AMCM has, through a comprehensive survey, assessed the policies and procedures adopted by authorized credit institutions in their property lending activities. The result of the assessment indicated that institutions generally adopt a cautious and vigilant approach towards their residential mortgage business and have rigorous risk management processes in place to monitor and manage the risks associated with such business.

1.2 Despite of the above findings, the AMCM considers that for the long-term development of the institutions' residential mortgage business, it would be advantageous to stipulate a loan-to-value (LTV) limit as the industry benchmark, as this could level the playing field and help institutions to play safe along with increasing competition. Also, the AMCM would like to alert the industry to the importance of assessing carefully and prudently the financial strength and debt servicing capacity of the borrowers, instead of relying on the value of the collateral.

1.3 Accordingly, this Guideline sets out the basic principles and standards for residential mortgage lending. A supervisory LTV limit for residential mortgage business is also established to reflect the result of the above mentioned survey that institutions were supportive of the intention for the AMCM to devise such limit.

1.4 This Guideline applies to all authorized credit institutions either locally incorporated or being branches of overseas banks in Macau. For the purpose of this Guideline, residential mortgage loans refer to loans extended to individuals for the purchase of residential properties or parking spaces in Macau. This definition of residential mortgage loans however does not preclude institutions from applying the same lending criteria to loans with similar characteristics.

2. POLICIES AND PROCEDURES

2.1 Authorized credit institutions are expected to have established lending policies that set out their general strategies and objectives and define the level of risk that is acceptable to their board of directors (or, in the case of branches of foreign banks, their head offices). Such policies should be based on a careful review of internal and external factors and must be reviewed and approved by the institutions' board of directors at least annually. As far as residential mortgage loans are concerned, they should provide clear and measurable underwriting standards that enable the institutions' lending staff to evaluate the capacity of the borrowers in servicing the loans. The policies should at least address the following standards:

(a) maximum loan amount;

(b) LTV limit;

(c) maximum debt servicing ratio;

(d) maximum loan maturity; and

(e) valuation method.

2.2 Institutions should also establish loan administration procedures for their residential mortgage lending. The procedures should address the followings as well as any other prudent measures that may be adopted by the institutions:

(a) the documents or requirements for verification of information provided by the borrower;

(b) loan closing and disbursement (e.g. preparation of legal documents and disbursing funds in accordance with the loan agreement);

(c) escrow administration (e.g. collecting insurance premiums from borrower and remitting the funds to the insurance company)

(d) payment processing (e.g. collecting and applying loan payments);

(e) collateral administration (e.g. maintaining documents to reflect the status of the institutions' lien on the collateral);

(f) loan review; and

(g) collections and foreclosure.

2.3 The above administration procedures should ensure segregation of duties for disbursement and receipt of funds and document control because of the importance of timely registration of the institution's security interests. Wherever possible, institutions should take out insurance (e.g. fire insurance) for the collateral properties naming themselves as the beneficiary. Irrespective of whether the cost of insurance is to be borne by the borrowers, institutions should take note that most insurance policies would provide an option for the insurance companies to limit their liabilities to the amounts necessary to reinstate or replace the mortgaged properties. In order to justify the costs, institutions should ensure that the insured amounts are not excessive[1].

2.4 To monitor compliance with their lending policies and procedures, institutions are also expected to establish and maintain:

(a) effective compliance functions to ensure compliance with the policies and procedures; and

(b) effective internal audit functions to objectively examine, evaluate and report on the adequacy and effectiveness of the institutions' internal controls on the business.

3. UNDERWRITING STANDARDS

3.1 Prudently underwritten residential mortgage loans should base on clear and measurable underwriting standards. The basic standards that the AMCM expects institutions to have established are set out in paragraphs 3.2 to 3.6 below.

3.2 *Maximum loan amount.* Residential mortgage loans are relatively illiquid assets. Also, the property market is subject to be influenced by factors over which individual institutions have no control. Institutions should therefore establish a cap on their residential mortgage loans to avoid undue concentration and to facilitate the management of the relevant risks. The maximum amount of residential mortgage loans can be an absolute amount or be expressed as a percentage of the loan book having regard to individual institution's size and financial condition, expertise and size of the lending staff, market conditions, etc.

[1] For example, it would be regarded as excessive if the amount to be insured is up to or more than the market value of the property. A usual practice is for institutions to limit the insured amount to the amount of the mortgage loan or building costs.

3.3 *Maximum LTV limit*. LTV ratio is the percentage or ratio that is derived at the time of loan origination by dividing the amount of each loan by the value of the mortgaged property. The results of certain studies suggest that the lower LTV ratio, the lower the risk of default. Taking into consideration the conditions of the local property market, the AMCM considers it prudent for institutions to follow a maximum 70% limit on LTV ratio. However, for those properties with a value less than or equal to MOP 3.3 million purchased by Macao residents[2], a higher LTV ratio up to 90% can be applied, but the loan amount should not exceed 70% of MOP 3.3 million[3]. Institutions should observe these supervisory limits in establishing their own internal limits and should adopt the lesser of the actual acquisition cost to the borrower or the estimate of value as presented in an appraisal or evaluation in calculating the LTV ratio.

3.4 *Maximum debt-servicing ratio*. A prudent debt-servicing ratio is important to ensure that the borrower will be able to service his loan. The market norm of a prudent debt-servicing ratio is 50% and the AMCM expects institutions to adopt such ratio as their maximum debt-servicing ratio in their lending policies. The nominator of the ratio should include the monthly installment amount of the mortgage loan plus other known liabilities repayable by the borrower on monthly basis, e.g. payment arising from personal loans borrowed from the mortgagee bank or other banks, and payment arising from other mortgage loans. The denominator should include the monthly income of the borrower[4].

3.5 *Maximum loan maturity*. Institutions should establish the maximum maturity for their residential mortgage loans. In response to tough competition and rapid rise in price, some institutions may be prepared to lengthen the maturity of their residential mortgage loans to say, 20 or 30 years. Lengthening the loan maturity will help improve the debt-servicing ratio of borrowers, especially the "fringe" customers whose income is not high. However, this will at the same time increase the risk of the institutions. Hence, as a general rule, the AMCM does not wish to

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[2] For the purpose of this Guideline, "Macao residents" are individuals holding Bilhete de Identidade de Residente Permanente (永久性居民身份證) and Bilhete de Identidade de Residente Não Permanente (非永久性居民身份證).

[3] The purpose of this cap is to avoid the anomaly that the maximum amount a purchaser of a property with a value of slightly lower than MOP 3.3 million could borrow would be greater than that for a property valued at MOP 3.3 million.

[4] This should include any co-borrower. If the borrower and his/her spouse are subject to the joint-asset system, the monthly liabilities and income of the borrower's spouse should be included in the computation of the debt-servicing ratio.

see any institution making loans beyond the retirement age of the borrower. This shall apply even in the case in which a young guarantor guarantees the loan.

3.6 *Property evaluation method*. Institutions are expected to have established clear procedures for appraising the value of properties to be mortgaged. Although institutions specializing in residential mortgage lending may have their own valuation departments, the AMCM expects institutions to use the service of independent professional surveyors for properties of high value. The institutions' policies should therefore set out clearly when an independent professional surveyor would be used. A commonly used approach would be for independent professional surveyors to be used for loans exceeding a certain amount. In cases where internal valuation is used, procedures should be in place to ensure that appraisals are performed by qualified and adequately trained staff that are not involved in the loan approval process. To ensure that such valuation is not out of line with actual market value or over-valued, institutions should cross check internal valuation with professional valuation on a sampling basis from time to time. In respect of both internal and external appraisals, they should contain sufficient information and analysis to support institutions' decision to engage in the transactions. For example, information and analysis on the age, location, conditions, construction, layout and equipment and other factors that are crucial in determining the market value of the subject properties.

3.7 Some institutions may, in addition to residential mortgage loans, make available personal loans to the mortgage borrowers. The AMCM does not wish to see that the personal loans are in fact quasi-mortgage loans granted to circumvent the supervisory LTV limits (see paragraph 3.3 above). Institutions should <u>not</u> therefore design special personal loan terms for their mortgage borrowers. For example: the amount of the personal loan should not be expressed as a percentage of the value of the property to be mortgaged; it should not be packaged in such a way that it is made available only to buyers of a particular property project; the maturity of the personal loan should not be longer than the market norm for such business; and, in the case of a loan for decoration purpose, the actual drawdown should not be made before the completion date for purchasing the property in question.

4. EXCEPTIONS

4.1 It is recognized that on a loan-to-loan basis, institutions may have sound justifications (e.g. the borrower is creditworthy and has additional credit support) that outweigh the need to apply strictly all the underwriting standards. It may therefore be appropriate in individual cases for the institutions to grant residential mortgage loans on exception basis.

4.2 The board of directors should be responsible for establishing standards for the approval and review of exception loans. To prevent a weakening of the underwriting standards and to ensure that the volume of exception loans is not excessive, the board of individual institutions should also consider establishing a limit on the aggregate amount of their exception loans.

4.3 The approval of exception loans should be supported by written justifications that clearly set out all the relevant credit factors that support the approval decision. These justifications and approval documents should be maintained as a part of the permanent loan file. The aggregate amount of exception loans should be reported at least quarterly to the institutions' board of directors.

5. SUPERVISORY REVIEW

5.1 The AMCM will from to time evaluate the adequacy of institutions' residential mortgage lending policies and practices to determine if they are consistent with this Guideline and safe and sound lending practices.

5.2 During the course of examinations, the AMCM will also review exception reports to determine whether the institutions' exceptions are adequately documented and appropriate in light of all of the relevant credit considerations.