

Should the Hong Kong Government Compete with the Private Sector?

Pan Asian Mortgage is a Hong Kong private company established in 2000 as a mortgage securitization conduit (finance company). In May 2002, Pan Asian launched its pioneering program to assist negative equity homeowners in Hong Kong by alleviating their monthly debt burden. Much to the market's surprise, the Hong Kong Mortgage Corporation ("HKMC") – 100% Hong Kong SAR Government owned – "replicated" Pan Asian's Program and launched its own scheme in July 2002, but terminated it in April 2003 due to lack of demand.

Since 2001, Pan Asian has invested over HK\$20 million and nearly 18 months of research and financial engineering. The results speak for themselves – Pan Asian has directly assisted well over 1,000 families and, indirectly, thousands of other families in reducing their monthly mortgage debt burden. Last month, Pan Asian launched its second innovative product: the 95% LTV One-Stop Mortgage Program ("95% Program"). As with our 140% LTV negative equity program, the 95% Program was vetted with the Hong Kong Monetary Authority ("HKMA") by Pan Asian and through our partner bank several weeks in advance of the launch. Once again, the HKMC has launched a directly competitive scheme soon after Pan Asian's 95% Program. In addition, shortly after our launch of the 95% Program, the press reported in mid-July that the HKMC launched a temporary second mortgage purchase scheme for a one-month period with similar pricing terms and a target market segment identical to Pan Asian's 95% Program.

From a private sector's perspective, this sends an alarming message to the market that the HKMC is either consciously or accidentally acting directly to suppress private sector initiatives. Pan Asian is perplexed by the HKMC initiative and leads us to ask the following questions:

1. Is there really a need for HKMC to enter this market segment when the private sector has shown clear willingness and capacity to meet this market need (i.e. property developers have been offering second mortgages for many years and Pan Asian's new 95% Program)?
2. Is it a coincidence that the HKMC launched a temporary second mortgage purchase scheme to compete directly with Pan Asian immediately after Pan Asian launched its 95% Program?
3. Is it appropriate for a public sector entity to use taxpayers' money to underwrite second mortgages which are being offered by the property developers to promote the sale of their properties? Would this create a moral hazard issue by selectively benefiting a particular business sector?
4. What policies does HKMC have to ensure that it does not adopt anti-competitive practices directly or indirectly?
5. Does the public sector wish to set a precedent of suppressing private sector business initiatives? Does it wish to disincentivize private capital investments which relieve the burden and dependencies on public sector finances? Does the public sector wish to disincentivize market innovation which both expands the size and enhances the quality of risk in the Hong Kong capital markets?

The Hong Kong Government has clearly stated its policy of "business leads, government facilitates" on numerous occasions. We believe that Government initiatives can be effective catalysts when private sector companies would not on their own move into a business area. However, in this case, it seems that a Government entity again has moved into a business area where private companies can efficiently operate. Worst of all, it inflicts damage on the fundamental enterprise in our economy if it use privileges associated with being a Government entity to gain unfair competitive advantages.

Pan Asian welcomes and supports free market competition. We thrive on competition where there is a level playing field, and provided that public sector entities ("PSE") do not use their "special influence" to alter market dynamics. The HKMC is 100% owned by the Exchange Fund and has been granted special privileges that no other private company enjoys (i.e. PSE status, preferential capital risk weighting for its debt and mortgage-backed securities, implicit government support, etc.). On the one hand, the HKMC is afforded special status that gives it preferential market access and influence with financial institutions. On the other hand, it has stifled market competition through its considerable sway in the banking industry.¹ The simple truth is that a private sector initiative that is both competing and regulated by related PSEs (in this case, the HKMC and HKMA) has a significant, if not insurmountable, competitive and comparative disadvantage. These actions could tarnish Hong Kong's image as the "freest" economy in the world and have lasting negative implications for the future of its economy.

The private sector is vital to the healthy development of any local capital market and beneficial to the general public. Pan Asian's principal finance approach and innovative product achievements to date is a prime example of how a private sector initiative can benefit the local market. By pioneering the 140% negative equity product, Pan Asian provided both a means, as well as, provoked all banks to accommodate requests to either refinance or renegotiate better terms for negative equity mortgage holders.

Prior to the establishment of the HKMC, officials suggested that it should "play an important complementary role in intermediating between long-term funding sources and long-term borrowers for home finance." In addition, it was envisioned that the HKMC would provide an "avenue by which banks can unload illiquid assets at times of need and to redress the structural maturity mismatch that is so common to banks in Hong Kong. The Mortgage Corporation proposal will provide such an avenue and would also enable the concentration risk to be reduced or contained."² Based on recent activities, it would seem that the HKMC has strayed from its original intended mandate to assist banks and provide banking and monetary stability. Since the HKMC was established as a quasi-government entity entrusted with the use of public funds, is it appropriate for the HKMC to continue pursuing high risk (as related to high LTV) lending/purchasing/insuring activities in the primary and secondary residential mortgage market?

A comparison to the U.S. mortgage corporation, Fannie Mae ("FNMA"), may be helpful to lend further support to our concerns. FNMA is a well-established private company with a long history in mortgage finance and is widely viewed to have the implicit support from the U.S. Government. However, FNMA does not engage in high LTV residential mortgage lending or high LTV mortgage insurance activities as its core business. Instead, FNMA's core business is to purchase or guarantee low risk residential mortgages from mortgage originators based on a well-established set of "conforming" standards (i.e. LTV <= 80%). In the U.S., high LTV lending and the mortgage insurance business are left to the private sector to provide.

Pan Asian believes that the HKMC should not compete directly with the private sector (banks, Pan Asian, etc.) where these have shown a clear willingness to compete on a market basis, nor to use public funds to purchase high risk assets while assisting property developers in selling their flats. Pan Asian strongly believes that if the private sector has provided a commercially viable solution to meet a particular market need, then the HKMC should stand aside and allow the private sector to develop the market.

Pan Asian would appreciate the HKGCC's Financial Services Committee consideration of the above issues at its next meeting on August 20, 2004.

¹ HKMC letter to banks to "discourage" their participation in Pan Asian's 140% Negative Equity Program, June 2002; HKMC MIP Incentive Scheme - discourages banks from working directly with other mortgage insurers, October 2002.

² Establishment of a Mortgage Corporation in Hong Kong. Speech by Joseph Yam to the Hong Kong Economic Association, November 12, 1996.