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Hong Kong Association of Banks Alternative Means of Payments of Funds Under Payment Arrangements for Property Transactions ('PAPT'): Possible concerns from banks and clients

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Introduction

Hong Kong Association of Banks ('HKAB'), the DTC Association ('DTCA') and the Hong Kong S.A.R. Licensed Money Lenders Association have been working on the provision of an alternative means of payments of funds under Payment Arrangements for Property Transactions ('PAPT'), which aimed to enhance customer protection by allowing homeowners to refinance their mortgages without the assistance of law firms by asking their current banks to directly transfer their approved mortgages loans. Hong Kong Monetary Authority ('HKMA') fully endorses and supports the initiative. It is argued that the newly proposed arrangement deliberately eliminated the role of law firms as an agent in the transfer of residential mortgage payments. The following argues that although the measure streamlines the process, it might be riskier than it is safe to forego solicitors when payment is involved due to the technical and legal reasons that would be explained.

Background

Following the circulars issued by the HKMA on 29 December 2021 and 20 July 2022, HKAB, DTCA, and the Hong Kong S.A.R. Licensed Money Lenders Association have been working on an initiative to explore alternative means of making the substantial payments involved in residential property conveyancing transactions. This is being done in an effort to lessen the impact of the current practice of routing such payments through the client accounts of the law firms handling the transactions on the residential mortgage markets. In consultation with the HKMA, the HKAB, DTCA, and the Hong Kong S.A.R. Licensed Money Lenders Association have formulated the proposed PAPT and have been soliciting feedback from various stakeholders, including the Law Society of Hong Kong ('Law Society'), the Consumer Council, and the Estate Agents Authority. At the completion of the trial term in six months, the HKMA has stated that it may extend the proposed PAPT to encompass other types of property transactions on the secondary market or even first-hand sales.

In the proposed PAPT, the mortgage loan proceeds advanced to the buyer in a residential property transaction will be distributed by the buyer's mortgage institution directly to the seller's mortgage institution through the Clearing House Automated Transfer System ('CHATS'). This will take place in the event that the seller has an outstanding mortgage over the property in question. This will make it possible to settle any outstanding balance on the seller's mortgage loan, and the seller's mortgage institution will then pay any surplus proceeds (above such outstanding balance) to the bank account designated by the seller, again through CHATS. This will allow any outstanding balance on the seller's mortgage loan to be paid off. In situations where the seller does not have any outstanding mortgage over the property, the proceeds of the buyer's mortgage loan will be disbursed directly to the seller's bank for credit to the seller's account by CHATS. This will occur when the seller does not have any outstanding mortgage over the property. The utilisation of such electronic means to make payments directly from bank to bank offers the benefits of safety, certainty, and speed and should avoid, or at the very least mitigate, the risk to the parties concerned that sizeable payments could be held up due to an unexpected disruption to the operations of a conveyancing law firm. If a balance that still needs to be paid by the buyer, payments will be sent in the form of a cashier's order, which the buyer is responsible for arranging.

Possible Concerns from Clients and Banks

The proposed PAPT will be used only by the licensed banks on a residential property transaction in the secondary market and mortgage financing. The coverage includes properly all individual- to-individual property transaction as well as individual who hopes to repay their existing mortgages early through securing another mortgage in the same bank or a different bank. We find that each of these processes could impose possible risk if payment can be made without a solicitor from the clients' perspective. We will discuss it one by one.

The first scenario is when an individual hopes to repay their mortgage early through another mortgage obtain from the original mortgage bank. In this scenario, although there are number of legal actions to discharge the original mortgage and create and register a new mortgage, the clients may not feel the impact as there is no direct transfer of proceeding. And even if there is any surplus or shortfall of loan proceed, clients may not practically feel the involvement of a solicitor when clients simply hope to extend their tenure with a smaller outstanding balance or take advantage of the interest rate changes throughout the long mortgage life. The proposed PAPT would have merit when any shortfall or surplus of loan proceeds generated by the new mortgage can be transferred via the CHAT system without running the risk of going through a law firm because law firms are not involved as agents to receive and pay money.

he second scenario is that the mortgagee engages another refinancing bank which is not the same bank as the original mortgage bank, a solicitor's involvement is more apparent to a layman as there will be a transfer of possession of title deeds and documents and also other relevant titles or rights. Also, a new loan agreement will be signed by the new mortgagee bank. The new mortgagee bank will transfer the part of loan proceeds equivalent to the redemption money to the original mortgagee bank only after all legal clearance is obtained. Theoretically, there is a gap between the security of title deeds by the existing mortgage bank (who will not release the same unless the mortgage is fully redeemed) and the need for perusing title deeds and property titles by the new mortgagee bank (who will not release the mortgage loan proceed without satisfactory confirmation of mortgagor's good title to the property). Existing practice will bridge this gap when the original mortgagee bank sends the documents to the firm upon an undertaking to return the same on demand until the redemption will be made. The new mortgagee bank will only release loan proceeds only upon firm's confirmation or certification of a good title – in this sense, the loan proceeds have been escrowed to the solicitors to secure the interest of both parties. However, the proposed PAPT might have undermined this undertaking role of solicitors as they need additional efforts to ensure the
loan proceeds are released at the right time when solicitors do not escrow the proceed, it is the legal risk the mortgage bank might not be ready to accept when the mortgage bank would still need solicitors to take other legal actions.

The third scenario, which is similar to the second scenario, naturally comes about, but this time the buyer and seller are two different parties, and so both parties shall be represented separately. In this case, the solicitors' roles are more complicated. The seller's solicitors usually issue split

cheque direction to instruct the buyer's solicitors as to how the balance of purchase price should be split and paid on the completion date, covering the range of payment such as mortgage redemption money to the original mortgagee bank, the seller's solicitors' costs, payments to other relevant parties, and finally, the net balance to the seller.
The three scenarios under the proposed PAPT may give rise to the two issues of complication:

First, it will add an additional layer of communication of split cheque direction from the buyer's solicitors to the new mortgagee bank while "time is of the essence" for the buyer to make such payment. Sellers are also obliged to provide split cheque instructions to the buyer at a reasonable time before the completion is due. It remains uncertain whether the new mortgagee banks may be able to cater timely transfer of mortgage loan proceed in accordance with urgent split cheque instruction, especially in the circumstance where the seller's solicitors issue split cheque direction to the buyer's solicitors shortly before the completion date. For example, both buyer and seller may reach a last- minute settlement to deal with certain outstanding issues affecting title to the property by way of lump sum payment or stakeholding money in favour of the buyer.

Second, payment arrangement is less flexible under the proposed PAPT if the new mortgagee bank may be required to take a role in scrutinizing the identity of payees under split cheque instruction. Typical examples are that the joint-tenant sellers do not hold a joint-names bank account to receive the sale proceed, or the balance be paid to a third party to the transaction. Under the prevailing anti- money laundering regulation, it remains uncertain whether the mortgagee bank should be required to undergo an additional process of due diligence on the identity of that payee, even presumed that the mortgagee bank policy allows the transfer to that third party payee. How much would that flexibility of payment be preserved remains to be seen? It relates to the first issue: in the event that the bank's scrutiny and due diligence works are required, and these take time to proceed, how long will it add to the length of "reasonable time" to allow the transaction to be effected under the proposed PAPT.

Why Do We Need Solicitors to Help Us Pay?

The existing proposed PAPT aims to facilitate the smooth property transaction not disrupted by the operations of a conveyancing law firm but skipping them may not serve the purpose. There are two major issues we observed. First is the conflict of interests arising when the new mortgagee bank instructs buyer's solicitors to peruse and check the title deeds documents. Unlike banks, law firms focus on dealing with the legal aspects of the entire transaction and handling the documents and communications. Unless the bank will check the title themselves, if solicitors lose control of the final payment, the bank would have access to request payment even when the relevant legal check has not been obtained, and clients would also be tempted to release the money as soon as the financing is available, there is a clear need for an individual third party. Second is the communication gap when payment is segregated from all other legal works involved. The fact that the Land Titles Ordinance (Cap. 585) has not yet been in operation since its enactment on 4 July 2004 has indicated conclusive evidence that title provided by the government could not replace the communication between buyers and sellers, and hence the banks involved, and hence it may be premature to exclude solicitors in property transaction, especially the most crucial part in payment.

Although it is conceivable to argue that the presence of law firms is unimportant in refinancing since banks have a more extensive payment system and function as trustees, and money may be frozen if the law firm handling the fund goes bankrupt or its practices are intervened. Law firms remain crucial in the transaction process. To the best of our knowledge, the involvement of solicitors has been pervasive in Hong Kong. It is more driven by the need to manage risk than to need to comply with regulations, the existing requirements on mortgage transactions requiring solicitors to gate- keep the final payment part is vital to ensure that all the documents are in place and registered. Unlike other countries such as the UK, where the titles (instead of documents) are registered under the Land Registration Act 2002, in the Hong Kong situation, the involvement of banks and solicitors would build trust between seller and buyer and allow time and expert judgment required in the transaction, by removing this particular part, it is doubtful that actual practice will alter unless clients or legislation permit a complete withdrawal of legal services.

The original aim of the proposed PAPT is to eliminate the risk on the mortgage loan proceeds being held in the event that law firm's operation is unexpectedly disrupted. However, the proposed PAPT does not deal with other legal services required such as the issue of custody of the title deeds. Law firms still play a critical role in mortgage transactions, particularly in handling mortgage instruments, perusal and custody of title deeds. It is foreseeable that lawyers are still likely to be involved in the pilot transaction. Still, it may be a welcomed move that the involvement of solicitors would now be more driven by clients' need instead of regulatory requirements imposed. We are hopeful that would further build flexibility on property transaction that are similar to what we observe in most of the other foreign jurisdictions.

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