The Hong Kong Mortgage Corporation Limited
香 港 按 揭 證 券 有 限 公 司

| Annual Report 2002 年報 |

Contents

Financial Highlights

	2002 HK$'000	2001 HK$'000	2000 HK$'000
FOR THE YEAR			
Net interest income	**430,956**	324,430	357,711
Profit after taxation	**263,809**	255,526	233,106
Mortgage purchases [1]	**14,393,226**	13,222,492	6,345,111
Mortgage-backed securities issued	**2,000,000**	632,690	–
Debt securities issued	**14,956,450**	15,583,550	6,625,000
Mortgage insurance			
– net premiums underwritten	**53,984**	58,742	29,174
AT YEAR END			
Mortgage portfolio, net	**28,257,727**	19,777,884	11,083,025
Total assets	**32,186,615**	23,219,832	14,844,616
Debt securities	**28,615,000**	20,058,550	11,621,000
Mortgage insurance – risk in force [2]	**779,779**	513,031	172,286
OTHER STATISTICS			
Net interest margin	**1.5%**	1.5%	2.8%
Capital-to-assets ratio [4]	**8.9%**	11.6%	13.5%[3]
Cost-to-income ratio	**23.1%**	28.2%	25.1%
Return on total assets	**0.9%**	1.2%	1.8%
Return on shareholder's equity	**8.9%**	9.4%	9.4%

[1] *The mortgage purchase includes loan purchased from Authorized Institutions for issuing back-to-back MBS from 2001 onwards.*

[2] *The risk-in-force excludes exposure that has been covered by reinsurance arrangement.*

[3] *The ratio is restated according to the revised guidelines approved in 2001, previously reported as 12.3%.*

[4] *Computing in accordance with the provisions in the Banking Ordinance, the capital–to–assets ratios of the Corporation were 29.3%, 22.1% and 16.6% for 2000, 2001 and 2002 respectively.*

Chairman's Statement

The Honourable Antony LEUNG, GBS, JP
Chairman
Financial Secretary

The HKMC recorded a sound performance in 2002, which was particularly satisfactory in the context of largely unfavourable operating conditions. It is now five years since the HKMC was established. During this time, the Corporation has achieved robust growth in its core businesses. Since 1998, the size of the retained mortgage portfolio has grown at an annual compound rate of 25.6% to the current amount of HK$28.3 billion, which is close to 5% of the residential mortgage loan market. Both banks and, increasingly, Government agencies find the ability to offload mortgages to the HKMC an attractive method of freeing up capital and replenishing their funding. This in turn benefits consumers in need of funds for home purchases.

By steadily expanding the eligibility criteria for its mortgage purchases and insurance, as well as serving as a funding vehicle for Government housing agencies, the HKMC has also made a major contribution to bringing home ownership within reach of more people in Hong Kong.

- *Profit-after-tax increased 20.5% to HK$263.8 million after an adjustment for tax write-back booked in 2001*
- *Strong momentum in mortgage purchases*
- *High asset quality maintained*
- *Most active issuer of HK$ debt securities and retail bonds*

Over 12,000 families have now benefited from the HKMC's mortgage insurance, enabling them to own their own homes on more favourable terms than would otherwise have been possible, whether by way of an earlier purchase owing to a lower down payment or a lower interest rate.

In its funding activities, debt issuance by the HKMC has also grown substantially from HK$5.2 billion in 1998 to HK$15 billion last year. In a short span of five years, the Corporation has firmly established itself as the most active issuer in the Hong Kong dollar debt market, providing additional choices of investment products to investors. At the end of December 2002, the Corporation had 73 issues of debt securities outstanding. The outstanding amount of HK$28.6 billion accounts for 7% of the market other than the Exchange Fund Bills and Notes. The Corporation's effort to expand its investor base has also helped to kick-start the retail bond market by providing not only innovative products, but creating an efficient distribution network through an increasing number of placing banks and assisting the regulators to streamline legislation so as to make the issue process more efficient and user friendly.

The year 2002 saw developments in all these areas, but also marked something of a milestone in the HKMC's evolution. The solid foundation established in the previous five years has enabled the HKMC to move on to a new phase of business development that focuses on building a critical mass for its core businesses and enhancing the return on equity. The Corporation did well in 2002 in advancing these objectives and met or exceeded most of its business and financial targets.

SOUND FINANCIAL RESULTS

For the year 2002, net interest income rose 32.8% to HK$431 million, largely as a result of expanded mortgage purchase activities. Profit-after-tax increased 20.5% to HK$263.8 million after an adjustment for tax write-back booked in 2001. Return on equity was maintained at approximately the 2001 level of 8.9%. Despite the rapid increase in the Corporation's assets, the balance sheet remained sound, with the capital-to-assets ratio at 8.9%.

In consequence, the HKMC's high credit ratings were reaffirmed by both Standard & Poor's and Moody's in November and remained at the level of the HKSAR Government. We note with encouragement Standard & Poor's assessment that the Corporation has a "strong asset base, good asset quality, adequate profitability, and adequate financial flexibility" and "is expected to continue to benefit from its market position as the major purchaser of residential mortgages in Hong Kong, its strong financial profile, and its implied support from the government of the HKSAR." Equally reassuring, Moody's rating "reflects the HKMC's unique franchise in Hong Kong, its flexible business model, strong management and continued government support."

STRONG MOMENTUM IN MORTGAGE PURCHASES

The expanded network of Approved Sellers under the Mortgage Purchase Programme secured a steady and substantial source of mortgage purchase from both the private and public sectors during the year. Following the doubling of the mortgage purchase amount in 2001, the HKMC in 2002 achieved another record amount of HK$14.4 billion.

We are particularly encouraged by the strong rebound in the purchase amount from the commercial banks. Prompted by a heightened awareness among the banks of the need to manage credit risk and the profit incentive from

Chairman's Statement

the yield enhancement offered by asset reallocation from mortgages to debt securities, total mortgage purchase from banks increased more than five-fold to HK$5.3 billion.

Public sector entities also continued to provide a steady and substantial source of mortgage purchase. The HKMC's mortgage purchase programme is a very efficient way for the agencies to replenish their funding, and will assist them in their efforts to increase home ownership among lower income groups. These mutually beneficial relationships will deepen further following the Government's announcement during the year to suspend the sale of subsidized housing units, with the result that the Housing Authority will rely more on providing subsidized mortgages to assist lower income families to buy residential properties.

An especially encouraging feature of the year's performance was the HKMC's ability to maintain asset quality despite the expansion of its retained mortgage portfolio, at a time of a generally deteriorating credit picture. The 90-day delinquency ratio for the portfolio was 0.31% at year-end, which is substantially lower than that of the banking industry as a whole. This testifies to the Corporation's sound credit risk management, which is solidly based on careful selection of approved sellers, prudent purchasing criteria, effective due diligence and protection against higher risk mortgages.

INNOVATIVE FUNDING ACTIVITIES

On the back of the robust Mortgage Purchase Programme, the HKMC consolidated its status as the most active issuer of Hong Kong dollar debt securities, with a total issuance amount of HK$15 billion in 2002. The Debt Issuance Programme remains the primary funding vehicle for the Corporation and with this nearing its ceiling, the programme size was doubled to HK$40 billion.

Of increasing importance is the retail bond market, where the Corporation again played a useful pioneering role. With HK$5.5 billion raised through three highly successful issues, the Corporation was the most active retail bond issuer, accounting for about one quarter of all retail bonds and certificates of deposit issued during the year.

Our participation in the retail bond market was once again marked by innovation in both the offering mechanism and the investment products. As a result, the HKMC is not only helping to create critical mass in the market, but is providing the variety of products that appeal to an ever wider range of individuals at a time of very low nominal rates of interest, by virtue of their sound credit fundamentals, ease of purchase and low fees.

The HKMC's funding and risk management were aided by the successful launch of its inaugural issue under the Bauhinia MBS Programme in March, which marked a new milestone in the development of the MBS market in Hong Kong. The new bond-style programme and the well-established back-to-back programme together provide a convenient platform for the HKMC and the banks to convert their illiquid mortgage portfolios into tradeable securities in order to achieve their funding and balance sheet management objectives.

IMPROVEMENTS IN MORTGAGE INSURANCE

Continuous product innovation and effective marketing during the year enabled the HKMC to maintain the market penetration ratio at around 9% for mortgages insured under the Mortgage Insurance Programme, despite a moderate reduction in residential property transactions.

During 2002, the Corporation again made strenuous efforts and was successful in expanding the scope of the programme by loan type and borrower category, in response to innovation in the mortgage market and the demands of homeowners. In particular, the HKMC introduced the "one-stop 90% mortgage service". By building the up-front insurance premium into the repayments, this service makes fully transparent cost comparisons among insured mortgages of different loan-to-value ratios and with competing products such as top-up loans offered by developers. This is an important development for Hong Kong home owners, who can now make a fully informed choice concerning the terms of their mortgage borrowing.

The Corporation was also successful in developing a workable product to address the problem of households in negative equity, which during the year rose to 77,935, representing some 24% of all Hong Kong mortgages. In July, the HKMC launched the Home Owner Mortgage Enhancement Programme (HOME) that aims to reduce the financial burden of homeowners and provide an effective tool for the banks to reduce the credit risk of mortgage loans in negative equity, by insuring losses in excess of 90% and up to 140% of the value of a property at the time of refinancing.

HOME has already given an impetus for banks to accept borrowers' requests for a reduction in mortgage rate and the Incentive Scheme introduced since the launch, which rewards participants for the volume and prudence of their lending, will provide added momentum to acceptance of the programme itself.

ENHANCED SERVICE DELIVERY

Service delivery to individual homeowners as well as the participating banks and insurers took another step forward during 2002 with the phased introduction of the Integrated Information Delivery System. This has streamlined processes, permitted online processing of routine operations and led to improvements in data quality, both at the HKMC itself and for those who sell or service its products.

More banks adopted the model mortgage documentation introduced in the previous year thereby speeding up their mortgage origination procedures. Additional standardized documentation is under development, covering the entire spectrum of the mortgage origination process.

COMMITMENT OF DIRECTORS AND EMPLOYEES

Throughout the year, my fellow Directors on the Board have provided invaluable counsel that has helped the HKMC steer its successful course and I wish to extend them my thanks. I am sincerely grateful also for the hard work, creativity and professionalism of the Management and all HKMC staff, which have enabled the Corporation to fulfil its mission thus far. The HKMC will continue to work in close co-operation with the banks, capital markets participants, insurers and regulators to bring further liquidity, stability and choice to the Hong Kong mortgage and financial markets.

Antony Leung
Chairman

The Honourable Antony LEUNG, GBS, JP
Chairman
Financial Secretary

Mr. Joseph YAM Chi-kwong, GBS, JP
Deputy Chairman
Chief Executive,
Hong Kong Monetary Authority

Board of Directors

The Honourable Michael SUEN Ming-yeung, GBS, JP
Director
Secretary for Housing,
Planning and Lands

The Honourable Frederick MA Si-hang, JP
Director
Secretary for Financial Services
and the Treasury

Mr. Tony LATTER, JP
Executive Director
Deputy Chief Executive,
Hong Kong Monetary Authority

Mr. Norman CHAN Tak-lam, SBS, JP
Executive Director
Deputy Chief Executive,
Hong Kong Monetary Authority

Dr. The Honourable David LI Kwok-po, GBS, LLD (Cantab), JP
Director
Legislative Councillor, Chairman and Chief Executive of The Bank of East Asia, Limited

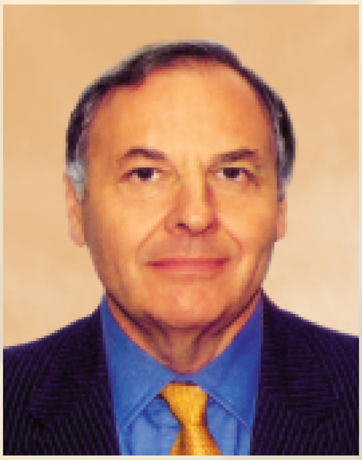
Mr. Ronald Joseph ARCULLI, GBS, JP
Director
Managing Partner of Arculli and Associates

The Honourable Bernard Charnwut CHAN
Director
Legislative Councillor
President, Asia Insurance Co. Ltd.

The Honourable SIN Chung-kai
Director
Legislative Councillor

The Honourable CHAN Kwok-keung
Director
Legislative Councillor

Professor Andrew CHAN Chi-fai, Ph.D.
Director
Chairman of Consumer Council
Professor, Department of Marketing and Director, Executive MBA Programme, The Chinese University of Hong Kong

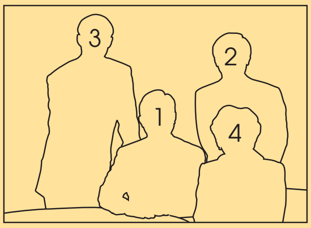


Mr. Clifford Rowland FORSTER
Director
Deputy Chief Executive & Regional Director, Lloyds TSB Bank plc.

Mr. David LAM Yim-nam
Director
Deputy Chief Executive,
Bank of China (Hong Kong) Limited

Mr. David SUN Tak-kei
Director
Chairman, Assurance & Advisory Business Services, Ernst & Young

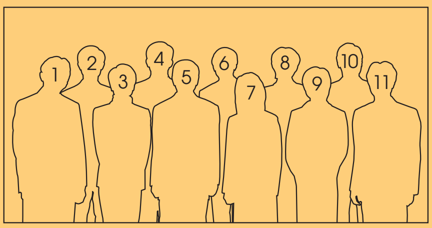
Mr. Brian YIU Chi-pang
Director
Head, Debt Capital Markets, Asian Fixed Income, Standard Chartered Bank



1. Mr. Peter Pang, JP
2. Mr. Philip Li
3. Mr. Kenny Fok
4. Ms. Susie Cheung

Management Team

1. Mr. Jonathan Chan
2. Mr. Raymond Luk
3. Ms. Angela Leung
4. Mr. Desmond Cheng
5. Mr. Nicholas Chan
6. Mr. Paul Ting
7. Ms. Irene Mok
8. Ms. Melina Lai
9. Ms. Celia Chau
10. Mr. Raymond Liu
11. Mr. Zarino Tong



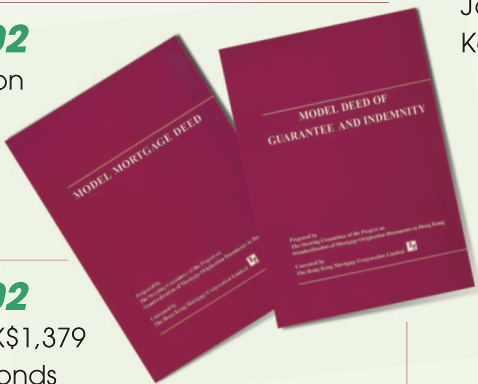
Organization Structure

- **Chief Executive Officer**
  Peter Pang
  - **Senior Vice President** *(Operations)*
    Kenny Fok
    - **Vice President** *(Credit & Risk)* Jonathan Chan
    - **Vice President** *(Operations)* Irene Mok
    - **Vice President** *(Marketing & Research)* Angela Leung
    - **Vice President** *(Pricing)* Desmond Cheng
  - **Vice President** *(Administration & Human Resources)* Melina Lai
  - **Vice President** *(Internal Audit)* Paul Ting
  - **Senior Vice President** *(Finance)*
    Philip Li
    - **Vice President** *(Information Technology)* Zarino Tong
    - **Vice President** *(Financial Control)* Raymond Luk
    - **Vice President** *(Treasury)* Raymond Liu
  - **General Counsel & Company Secretary**
    Susie Cheung
    - **Legal Counsel** Nicholas Chan
    - **Legal Counsel** Celia Chau

Calendar of Events

Jan 21 2002
Full launch of e-commerce platform to process mortgage insurance applications over the Internet

▼ Feb 4 2002
Implementation of the Model Mortgage Origination Documents



▼ Feb 5 2002
Issuance of HK$1,379 million retail bonds through 8 Placing Banks

Feb 18 2002
Issuance of HK$3 billion DIP notes, the largest HK$ fixed rate issue in the year

Mar 8 2002
Full launch of mortgage purchase and servicing functions of the Integrated Information Delivery System

▲ Mar 13 2002
Issuance of the debut HK$2 billion issue under the US$3 billion Bauhinia MBS Programme

▼ Mar 16 2002
Jointly organized a seminar on bond investment with the Hong Kong Capital Markets Association, Hong Kong Economic Journal, Airport Authority and the Hong Kong Polytechnic University

殖富聚財 投資講座

- 如何在全方位下跌的經濟環境下殖富?
- 如何在無所適從下聚財?
- 如何在心煩氣燥下回復心境平靜?
- 如何達至進取與保守投資的平衡點?
- 如何製訂個人投資組合?

強棒出擊 (排名不分先後)

李樹根先生	香港資本市場公會主席
馮孝忠先生	澳洲聯邦銀行亞洲區資金部主管
廖志強先生	香港按揭證券有限公司副總裁(司庫)
區景麟先生	匯豐投資管理(香港)有限公司董事客戶投資服務部主管
車淑梅小姐	香港電台「晨光第一線」主持
主持：鍾異軍博士	香港理工大學會計學系副教授

日　　期：2002年3月16日（星期六）
時　　間：上午九時至正午十二時
地　　點：香港理工大學鍾士元樓蔣震劇院
費　　用：全免
講授語言：粵語

參加辦法：
填妥下列表格並傳真至2547 9528或寄回香港德輔道中121號遠東發展大廈5樓501-3室香港資本市場公會收(信封面註明「殖富聚財投資講座」)。與會者將收到入場通知。

聯合主辦機構：

Apr 15 2002
Fifth Annual General Meeting

May 24 2002
22 banks confirmed adoption of the Model Mortgage Deed in response to HKMC's survey

▲ Jun 13 2002
Issuance of HK$2,298 million retail bonds through 3 Underwriting Banks and 12 Placing Banks

▼ Jun 24 2002

American Express Bank signed mortgage sale forward commitment agreement and joined the Home Owner Mortgage Enhancement Programme (HOME)

▼ Jun 28 2002

Participation in the Hong Kong Financial Sector Exhibition

▼ Jul 21 2002

Launch of the Pilot Scheme of the HOME Programme for borrowers in negative equity

Oct 18 2002

Issuance of HK$1,738 million retail bonds through 9 Underwriting Banks and 13 Placing Banks

▼ Nov 19 2002

Expansion of MIP to include 85% loan-to-value ratio equitable mortgages up to a maximum loan amount of HK$8 million

▼ Dec 8 2002

Introduction of the "One-stop 90% LTV Mortgage Service" under MIP

▲ Dec 12 2002

Issuance of the first syndicated DIP floating rate notes of HK$1.5 billion

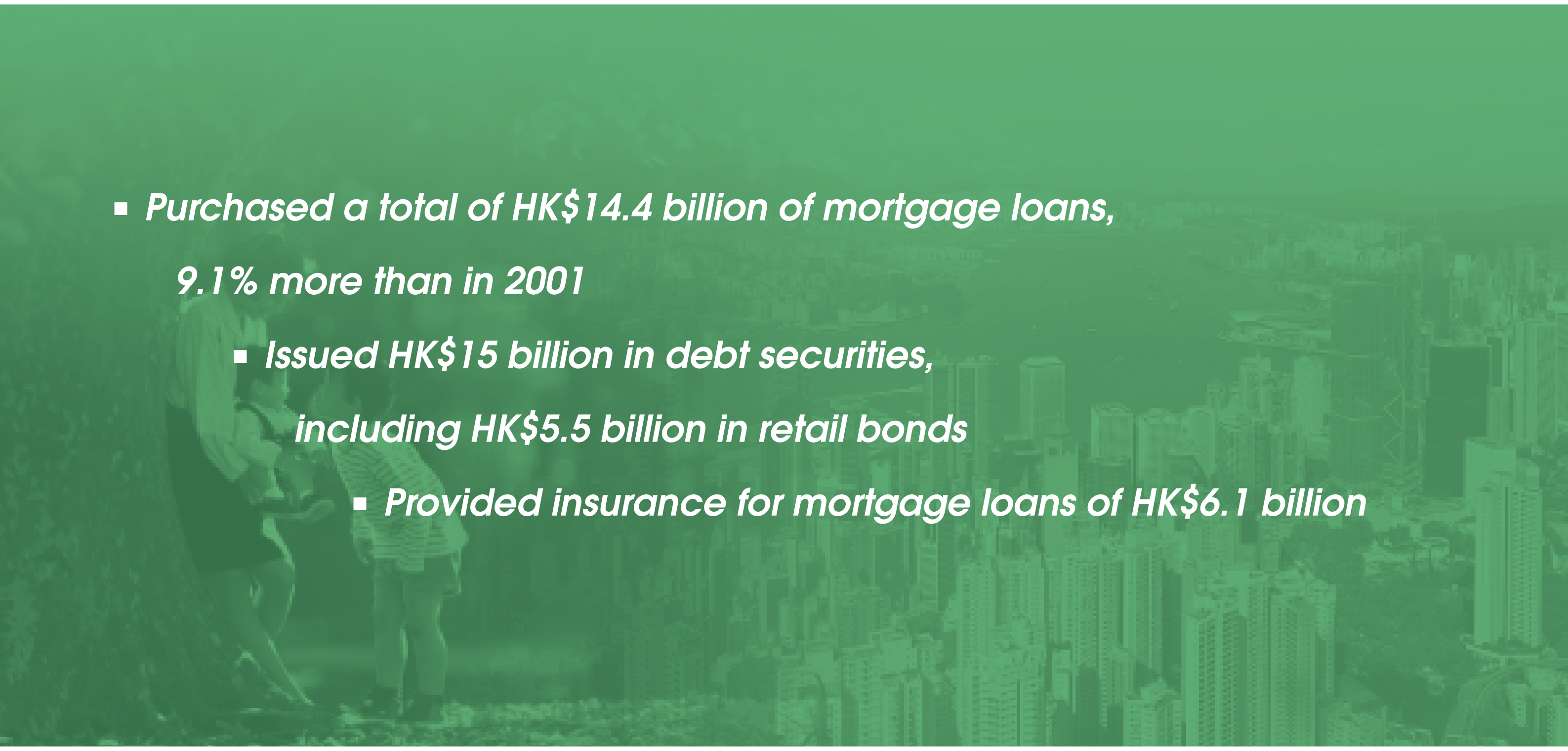
Business Review

During 2002, the Corporation was able to meet the challenges of a difficult operating environment to expand its business and contribute further to the development of Hong Kong's secondary mortgage market.

PERFORMANCE HIGHLIGHTS

The HKMC's operations fall principally into four areas: mortgage purchases, mortgage insurance, mortgage securitization and fund raising. During 2002, each of these areas performed well and made considerable progress in expanding the scope of their business. The key achievements of the Corporation in 2002 include:

- purchased a total of HK$14.4 billion of mortgage loans, 9.1% more than in 2001
- issued HK$15 billion in debt securities, including HK$5.5 billion in retail bonds
- provided insurance for mortgage loans of HK$6.1 billion
- maintained an excellent asset quality, with year-end figures of 0.31% and 0.17% for loans overdue for more than 90 days in the retained mortgage and mortgage insurance portfolios respectively, as compared with the industry average of 1.06%
- maintained its A3/A+ foreign-currency and Aa3/AA– local-currency long-term credit ratings from Moody's and Standard & Poor's, which are the same as those of the HKSAR Government



These and other achievements underpinned the Corporation's strong financial results:

- profit-after-tax of HK$263.8 million, HK$8.3 million or 3.2% more than in 2001 (HK$44.9 million or 20.5% after adjustment for tax write-back booked in 2001), reflecting the substantial mortgage purchase and a 0.2% increase in the net interest spread on its interest-bearing assets from 1.1% to 1.3%
- maintained a satisfactory return on shareholder's equity at 8.9%
- maintained a strong capital-to-assets ratio of 8.9%, well above the minimum guideline of 5%
- reduced the cost-to-income ratio from 28.2% to 23.1%, substantially below the banking industry average of 40.6%

PRODUCT INNOVATION

During 2002, the HKMC again broke new ground in its products and services:

- In March, we issued the first bond-style MBS under the Bauhinia MBS Programme, marking a further contribution to the development of the MBS market in Hong Kong
- In June, we issued a retail bond for a record amount of HK$2.3 billion subscribed by over 6,500 investors
- In July, we launched the Home Owner Mortgage Enhancement Programme (HOME) to help relieve the financial burden of homeowners in negative equity and to provide a tool for banks to hedge the risk of mortgages in negative equity
- In October, we introduced to the retail bond market a 5-year fixed-inverse floating rate note, marking the latest innovation in our debt issues
- In October, we introduced an incentive scheme under the Mortgage Insurance Programme (MIP), providing both volume and risk performance incentives to banks
- In November, the eligibility criteria under the MIP were expanded to include new product types, such as deferred principal repayment loans and a wider spectrum of borrowers
- In December, we implemented the "90% one-stop mortgage service" with banks, to provide greater transparency in mortgage pricing through building the insurance premium into the repayments

Business Review

REVIEW OF MORTGAGE MARKET

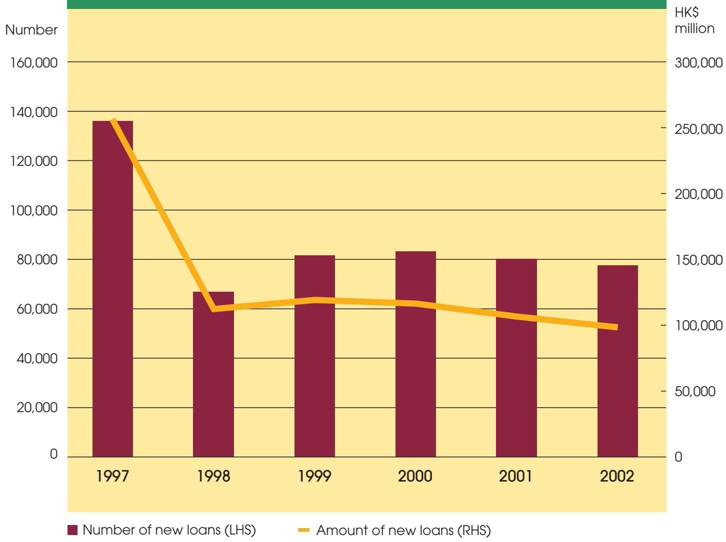
Residential Property Market Remained Weak

The property market remained sluggish. Prices and rentals continued their downward adjustment and the value of residential property transactions fell to a 12 year low of HK$185 billion. Sentiment of homebuyers continued to be affected by the high unemployment rate and concern over the possible adverse impact of the large supply of new housing units on property prices.

Falling Numbers of New Mortgage Loans

The weak market saw mortgage lending volumes decline further. According to the HKMA's monthly survey of 27 Authorized Institutions, the total number of new loans made in 2002 decreased by 3.4% to 77,741 loans (Figure 1).

Figure 1: Gross New Loans Made



Source: HKMA and HKMC

The total principal amount of new loans made also dropped by 7.5% to HK$98.5 billion. At year end, the total outstanding principal balance of residential mortgage loans showed a small increase of 1.0% to HK$533.7 billion. Of new loans approved during the year, those relating to new housing units accounted for 47.1%, compared with 36.3% in 2001, reflecting the dominance of the primary market (Figure 2). According to the Rating and Valuation Department, supply of completed new residential properties rose 29.6% to 34,035 units in 2002.

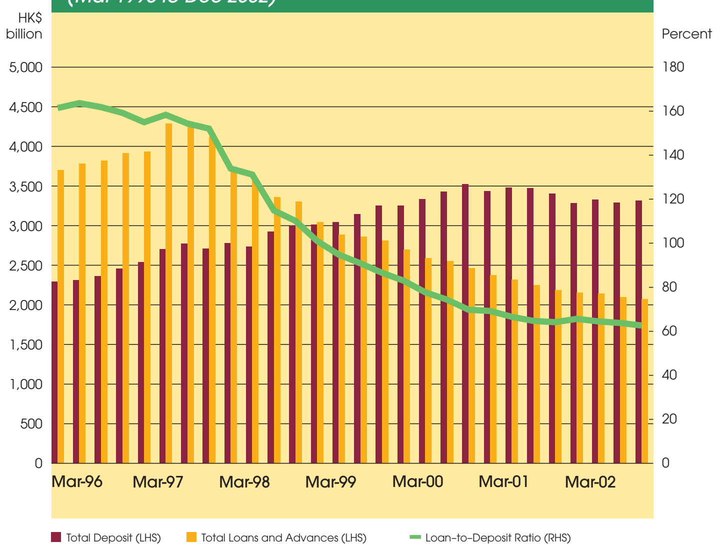
Figure 2: Breakdown of Newly-approved Mortgage Loans

	2001 HK$m	**2002 HK$m**	Change	Share 2001	Share 2002
Primary	44,368	**50,881**	14.7%	36.3%	47.1%
Secondary	49,444	**39,388**	-20.3%	40.5%	36.5%
Refinancing	28,333	**17,659**	-37.7%	23.2%	16.4%
	122,145	**107,923**			

Source: HKMA and HKMC

Figure 3: Total Loans and Deposits

(Mar-1996 to Dec-2002)



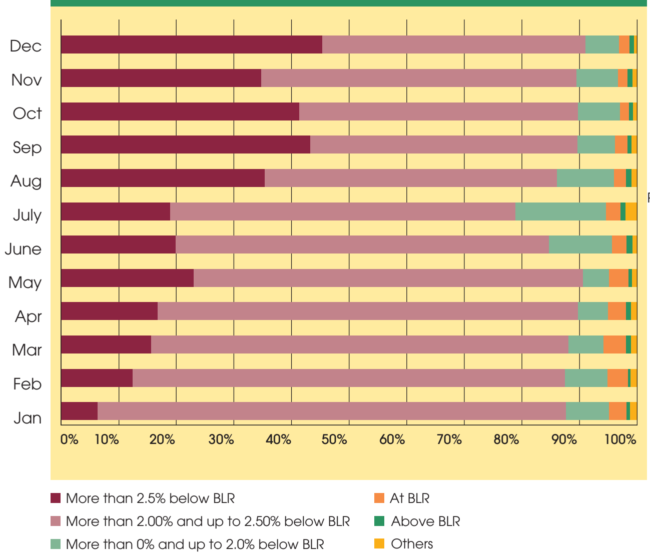
Source: HKMA and CEIC

Intense Competition for Mortgage Lending

With corporate borrowing subdued and the loan-to-deposit ratio hovering at around 63% (Figure 3), banks competed aggressively to secure consumer loans during 2002. Competition intensified for lower-risk residential mortgages, which appeared to better resist the wider credit pressures that affected credit card lendings. The delinquency ratio of mortgage loans overdue for more than 90 days again declined from 1.22% at end December 2001 to 1.06% at end December 2002.

The severe competition put pressure on mortgage interest rates, with the proportion of new loans originated at 2.25% below Prime rising to 79.0% in December 2002, from a mere 7.2% in December 2000. The prevailing rate, however, appeared to stabilize at Prime-2.5% as the cost of fund of deposits was already close to zero. Reflecting the intense competition, the HKMA's monthly survey showed that the proportion of new loans originated at more than 2.5% below the Prime rate increased from 5.0% at end 2001 to 45.3% at end 2002 (Figure 4).

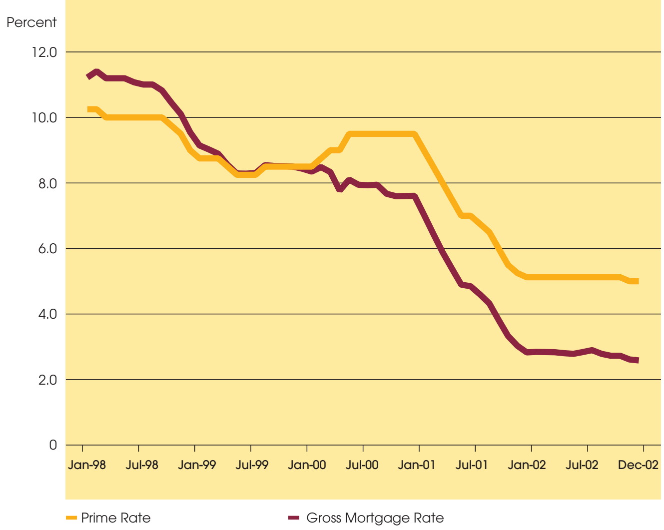
Figure 4: Trend of Pricing of New Mortgage Loans in 2002



Source: HKMA

Figure 5 shows the sharp drop in mortgage rates since 1998.

Figure 5: Comparison of Gross Mortgage Rate and Prime Rate

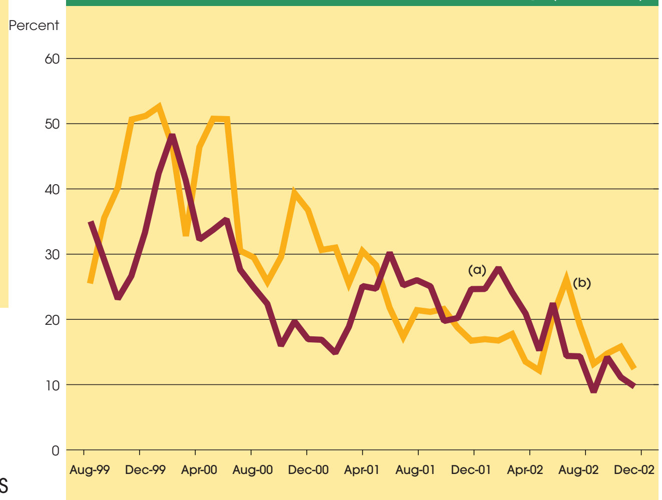


Source: HKMA and HKMC

Rising Numbers of Negative Equity Households

Following further declines in capital values, the number of mortgages estimated by the HKMA to be in negative equity rose further during 2002 to reach 77,935 by year-end, with a total outstanding principal balance of HK$129 billion and representing 24% of all mortgages outstanding (Figure 6).

Figure 6: (a) Full Prepayment Rate of the HKMC's Retained Protfolio; (b) Percentage of New Loans Associated with Refinancing (Market)



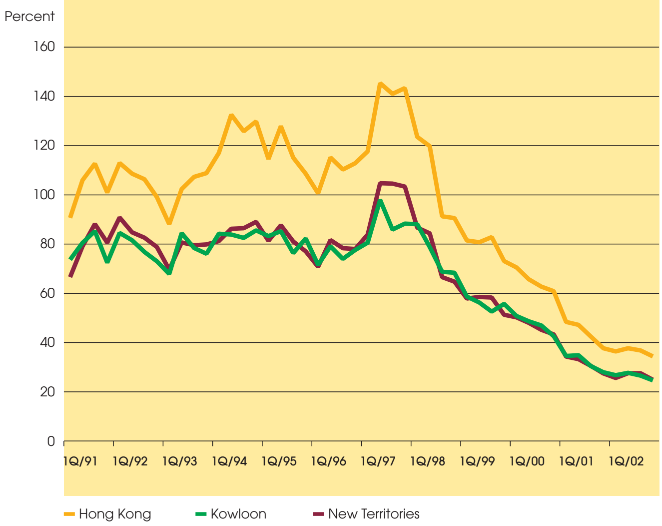
Source: HKMA and HKMC

Business Review

Further Slowdown in Mortgage Refinancing Activities

Despite fierce competition, mortgage refinancing activities slowed down considerably in 2002. According to HKMA's monthly survey, the proportion of new mortgage loans written owing to refinancing has fallen sharply from the peak of 52.6% in early 2000 to 12.4% in late 2002 (Figure 7). The refinancing activities in 2000 were triggered by the aggressive cutting of the mortgage rate by banks. The mortgage rate had since stabilized at around Prime-2.5% in 2002.

Figure 7: Affordability Ratio for Class B Properties



Note: *A rise in the ratio means deterioration in affordability; a fall in the ratio means improvement.*

Assumptions: *The calculation of the ratio uses unit size of 500 sq.ft., mortgage tenor of 20 years and down-payment of 30% of the property value.*

Source: *Calculated by the HKMC based on published data from various government departments.*

Continued Improvement in Affordability

The year witnessed a further improvement in levels of affordability as household income levels have in recent years declined much less than average selling prices.

According to the Rating and Valuation Department, average property prices were about HK$2,867 per square foot for Class B housing units on Hong Kong Island, HK$2,057 per square foot in Kowloon and HK$2,074 per square foot in the New Territories in the final quarter of 2002, respectively 13.5%, 16.3% and 14.3% below those of 2001.

This allowed the affordability ratio of Class B properties in Kowloon, for example, to be reduced to 25% in 2002, compared with 98% in 1997. In addition, the low mortgage rate means that mortgage repayments are currently lower than rental payments for the same property. It is expected that as overall sentiment improves, the high affordability level and low mortgage rates can be expected to drive demand for residential property and mortgage lending.

New Government Housing Policy

During the course of the year, the Government took steps to restore public confidence in the property market and introduced the following nine measures in November with the aim of invigorating the demand in the residential property market:

- Suspension of land auctions in fiscal year 2002/3 and the Application List until the end of 2003. Thereafter, the supply of new land will only be triggered from the Application List;
- Suspension of the tender of railway property developments in 2003, and improved coordination of further tenders to enable an orderly disposal of properties according to actual demand;
- Setting up a rolling Public Rental Housing (PRH) production programme that will be adjusted annually;

- Cessation of the production and sale of Home Ownership Scheme flats indefinitely from 2003 onwards;

- Flexible adjustment of the annual loan quota under the Home Assistance Loan Scheme to help eligible families buy their own homes;

- Termination of all the mixed development projects and the Private Sector Participation Scheme;

- Suspension of the sale of PRH units under the Tenant Purchase Scheme;

- Review the Landlord and Tenant (Consolidation) Ordinance with the objective of relaxing all excessive protection of security of tenure and reducing intervention in private tenancies; and

- Removal of two remaining anti-speculation measures introduced in the early 1990's.

Mortgage Purchase

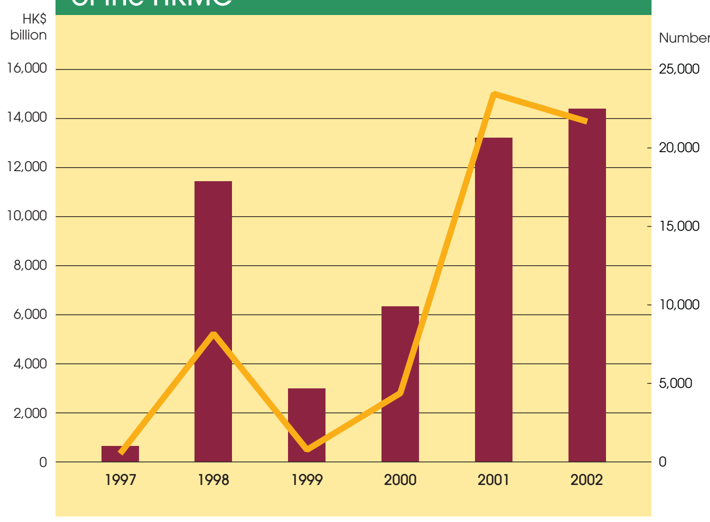
Purchase Activity

Maintaining a steady growth in mortgage purchases is crucial to the long-term development of the HKMC as interest income from the retained portfolio accounts for the bulk of its profits. The ability to acquire a steady stream of mortgage portfolios is also a prerequisite for the Corporation to achieve its other business objectives of developing the debt and MBS markets in Hong Kong.

The slow growth in the mortgage market presented considerable challenges to the Corporation as banks were less inclined to sell or securitize their portfolios. In order to address this problem, the Corporation decided in December 2000 to expand the scope of Approved Sellers to include Government housing agencies, other public bodies and property developers. Successful execution of this strategy enabled the HKMC to achieve a record mortgage purchase amount of HK$14.4 billion in 2002, exceeding both the HK$13.2 billion achieved in 2001 and the target of HK$13.5 billion set for 2002 (Figure 8). Of the loans purchased in 2002, HK$8.5 billion were from the Hong Kong Housing Authority and HK$0.1 billion from the Hong Kong Housing Society. The total size of the retained portfolio reached a new threshold of HK$28.3 billion at year-end.

The HKMC's mortgage purchase programme is a very efficient way for the Government housing agencies to replenish funding under their subsidized mortgage schemes. As such, the partnerships we have developed are enabling them to continue to support the goal

Figure 8: Mortgage Purchase Programme of the HKMC



Source: HKMC

Business Review

of wider home ownership among lower income groups in the context of revised policy of relying more on mortgage financing rather than building to sell. Equally, the HKMC benefits from a significant and enduring source of mortgage acquisition, which also supports its debt issuance and mortgage securitization programmes.

Also encouraging was the improved appetite of banks to offload their mortgage loans. The aggregate purchase from Authorized Institutions amounted to HK$5.3 billion, an almost five-fold increase compared with the HK$0.9 billion recorded in 2001. This reflects the efforts of the HKMA to increase awareness within Hong Kong's financial industry of managing credit risk and the efforts made by some banks to reallocate assets from mortgages to debt securities for yield enhancement.

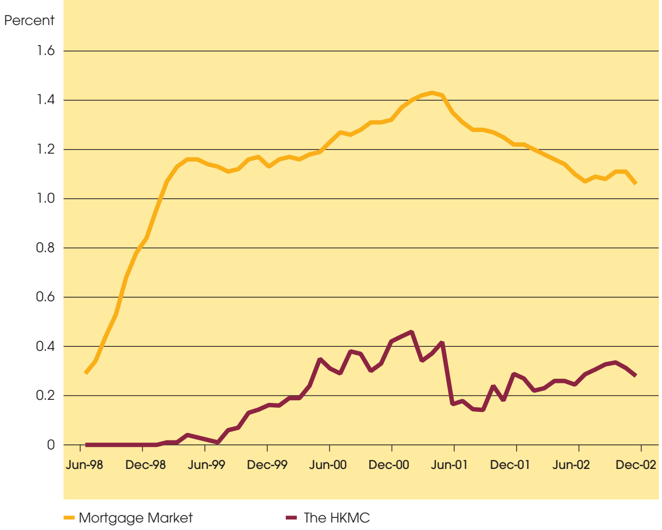
Portfolio Quality

Despite the rapid growth in the retained mortgage portfolio and against the background of the increased credit risks in the market, the quality of the HKMC's mortgage assets remained highly satisfactory. The 90-day delinquency ratio for the retained portfolio was 0.31% as of the end of December 2002. This is substantially lower than the delinquency ratio of 1.06% for the banking industry as a whole (Figure 9).

This testifies to the effectiveness of the company's risk management, with its five-pronged approach of:

- Careful selection of Approved Sellers
- Prudent mortgage purchasing criteria

Figure 9: Delinquency Ratio of the HKMC's Portfolio and the Mortgage Market



Note: A new charge off policy was adopted by the HKMC in June 2001

Source: HKMA and HKMC

- Prudent insurance eligibility criteria
- Effective due diligence process
- Adequate protection for higher risk mortgages

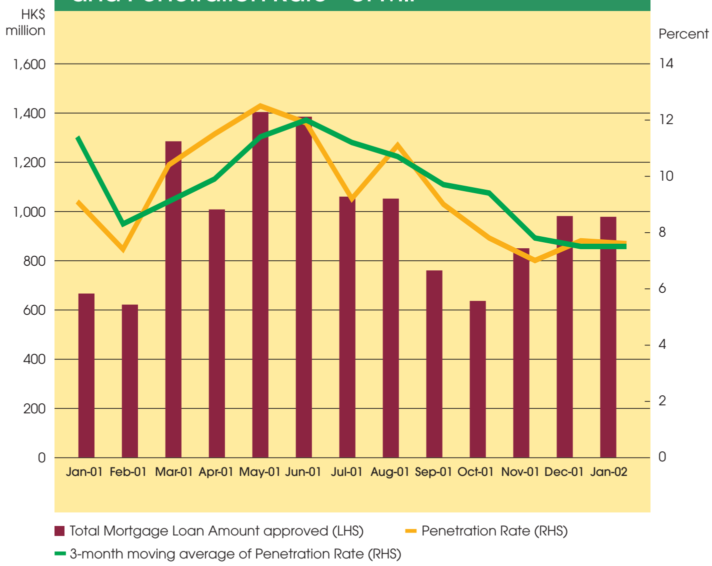
These principles, indeed, have been at the root of a consistent outperformance of the industry average since the HKMC came into being in 1997.

MORTGAGE INSURANCE PROGRAMME

The Mortgage Insurance Programme (MIP) achieved steady volume throughout 2002, maintaining a penetration rate of about 9% of new mortgage loans.

For the year, we received a total of 6,284 applications involving a total mortgage loan amount of HK$11.9 billion and a total insured loan amount of HK$2.8 billion. This takes to 21,438 the total number of applications received, with a total mortgage amount of HK$41.2 billion and a total insured amount of HK$8.8 billion since the programme began in April 1999. The loan volume in 2002 declined when compared to 2001. This is the direct result of the fall in residential property transactions and also the decision by one major bank to establish its own mortgage insurance programme. Nonetheless, it is encouraging to note that the market penetration rate of the MIP has improved from 7.5% for the last quarter of 2001 to 8.8% for the last quarter of 2002 (Figure 10).

Figure 10: Mortgage Loan Amount Approved and Penetration Rate* of MIP



*: Penetration Rate = Mortgage Loan Amount approved under MIP / Total Mortgage Loan Amount approved in the market (according to HKMA's Monthly Mortgage Survey)

Source: HKMC

One-stop 90% Mortgage Service

An important development in the MIP during the year was the introduction of the "one-stop 90% mortgage service" in December 2002. Since the launch of the programme, the eligibility criteria have been steadily and prudently expanded. The initial 85% loan-to-value (LTV) ratio ceiling was raised to 90% in 2000 for completed residential properties and in 2001 for equitable mortgage loans, allowing the banks to lend to this higher ratio without increasing their exposure. Throughout the past three years, the Corporation has been working closely with the banks to improve the understanding and reception of the MIP by the general public through advertising campaigns.

MIP product enquiry counter

Under this new one-stop service, a streamlined pricing arrangement was introduced whereby the banks build the insurance premium into the interest rate of their mortgage loans. This enables the retail customer to make proper comparisons of the effective cost of borrowing at different LTV ratios and with alternative products such as top-up loans from developers. As such, it is expected to create a much broader awareness of the competitive nature of the MIP. According to a survey conducted by the HKMC in December, a total of 25 banks intended to adopt this arrangement and a number have publicly announced the mortgage rates under their own "one-stop mortgage service" schemes before the year-end.

Business Review

Expanded MIP Pilot Scheme

The need for greater flexibility in the MIP for homebuyers falling outside the established criteria and to respond to new mortgage products introduced by banks led the HKMC to widen the eligibility criteria during 2002, following discussions with the reinsurers. The product types were widened to include mortgages such as deferred principal repayment loans (which allow borrowers to pay only interest for a specified initial period), fixed-rate loans and variable instalment repayment frequency loans such as bi-weekly instalment mortgages, designed to achieve savings in interest payment by speeding up the repayment of principal (Figure 11).

Figure 11: MIP Product Development

March 1999	Mortgage loans on completed residential properties with LTV ratio of up to 85% (maximum loan amount of HK$5 million)
August 2000	Mortgage loans on completed residential properties with LTV ratio of up to 90% (maximum loan amount of HK$5 million)
April 2001	Equitable mortgage loans on residential properties under construction with LTV ratio of up to 85% (maximum loan amount of HK$5 million)
July 2001	Equitable mortgage loans on residential properties under construction with LTV ratio of up to 90% (maximum loan amount of HK$5 million)
November 2001	Loan size ceiling increased from HK$5 million to HK$8 million for mortgage loans on completed residential properties with LTV ratio of up to 85%
July 2002	Launch of new product – Deferred Principal Repayment Loans (maximum loan amount of HK$2.5 million)
November 2002	Loan size ceiling increased from HK$5 million to HK$8 million for mortgage loans on residential properties under construction with LTV ratio of up to 85%
November 2002	Launch of Deferred Principal Repayment Loans (maximum loan amount of HK$5 million)
December 2002	Launch of "One-stop 90% Mortgage Service"

The scope of eligible borrowers was also expanded to include low risk borrowers with higher debt-to-income ratios, thus bringing the MIP in line with the HKMC's mortgage purchasing criteria, and also self-employed borrowers became eligible for the MIP up to 85% LTV ratio in respect of completed properties.

Incentive Scheme

To build support for the MIP among banks, in October we launched an Incentive Scheme. The scheme, consisting of a volume incentive and an underwriting incentive, was designed to encourage more pro-active promotion of the programme to retail customers and prudent loan underwriting by the banks.

Under the volume incentive, banks are entitled to an incentive amount ranging from 2.5% to 7.5% of the gross premium paid to the HKMC, based on the volume of business generated in a calendar quarter. The underwriting incentive provides a rebate of up to 2.5% of the gross premium to the banks if the delinquency ratio of the loans drawn down in a calendar quarter is less than the specified threshold.

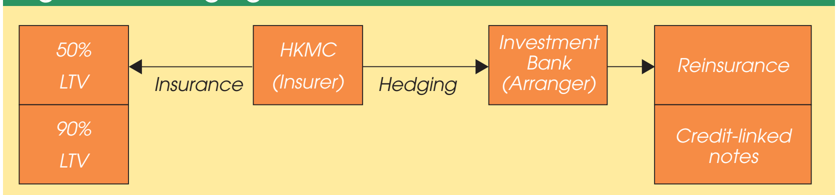
To raise public awareness of the benefits of mortgage insurance further, we mounted an extensive promotional campaign in the fourth quarter. Advertisements were placed through the mass media including television, radio and newspapers. Posters and pamphlets were also disseminated to branches of participating banks for distribution to potential customers.

HOME Programme

The decline in property values in recent years has led to a consequential rise in the number of homeowners in negative equity. This has raised concerns on the credit risk exposure of mortgage loans for the banking industry as a whole. The Corporation has been working assiduously to create a commercially viable solution with the dual objectives of alleviating the financial burden of homeowners in negative equity and also providing an effective tool for banks to reduce the credit risk of mortgage loans with current LTV ratio above 100%. The Corporation's efforts culminated in the launch of the pilot scheme of the Home Owner Mortgage Enhancement Programme (HOME) on 21 July 2002.

The HOME Programme provides insurance to cover losses in excess of 90% and up to 140% of the value of the property, allowing banks to convert a negative equity mortgage into a positive equity mortgage. The HKMC, as the primary insurer, disperses the credit exposure through reinsurance arrangement, backed by the issuance of credit-linked notes. The hedging structure is depicted in Figure 12 below:

Figure 12: Hedging Structure under HOME



Source: HKMC

From the borrowers' perspective, benefits are derived in the form of a reduction in monthly repayment amount, savings in aggregate interest payment and the removal of the pay-down requirement in seeking refinancing. The HOME Programme also offers benefits to participating banks, since the risk of default loss is reduced without a corresponding reduction in the size of its loan assets. In that case, banks would retain effective mortgage yields better than those of new mortgage loans originated at 90% LTV ratio with the MIP coverage.

The launch of HOME was supported by a media advertising campaign and training seminars for staff of participating banks. A total of 27 banks signed to participate in the programme. As of the end of the year, however, take-up of the programme was not extensive. This is primarily the result of banks reducing the mortgage rates of negative equity loans without seeking protection from the HOME Programme, a consequence of the continued low default rate of mortgage loans in Hong Kong and the keen competition in the mortgage market.

Despite initial lower-than-expected volume, the HOME Pilot Scheme has achieved the intended effect of encouraging banks to lower mortgage rates and hence alleviating the financial burden of homeowners in negative equity. According to HKMA's survey findings, the average interest rate of mortgages in negative equity has reduced from Prime-0.70% as at June 2002 to Prime-0.83% as at December 2002 and the proportion of loans in negative equity paying a mortgage rate of Prime or below has increased from 52% as at June 2002 to 58% as at December 2002. To further promote the programme, in December 2002 a HOME Incentive Scheme was introduced to reward banks for generating sizable volume of business under the programme.

MORTGAGE-BACKED SECURITIZATION

The HKMC has established two mortgage-backed securitization (MBS) programmes, namely, the Guaranteed Mortgage-Backed Pass-Through Securitization Programme (Guaranteed MBS Pass-Through Programme) in October 1999 and the Bauhinia Mortgage-Backed Securitization Programme in December 2001.

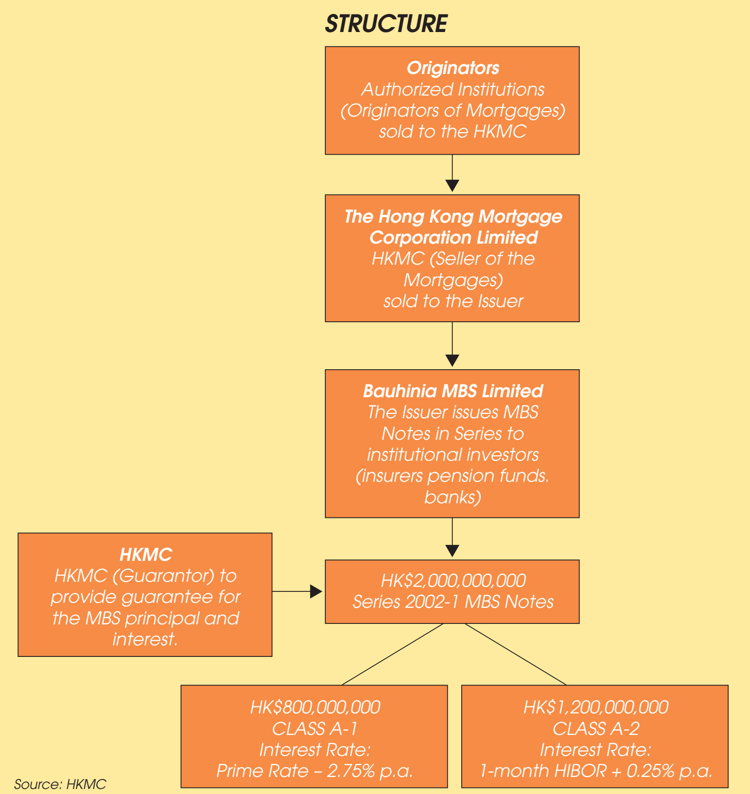
Guaranteed MBS Pass-Through Programme

MBS issued under this programme adopt a back-to-back structure that involves the HKMC acquiring mortgage loans from a bank and selling them directly to a bankruptcy remote special purpose company (SPC), the issuer of the MBS. The SPC then issues notes secured by the mortgage loans to the bank which initially sells the mortgage loans to the HKMC. This programme provides an alternative for banks in Hong Kong to liquefy their residential mortgage loans, thereby providing them with a powerful new balance sheet management tool. An MBS guaranteed by the HKMC carries a 20% risk weighting for capital adequacy treatment, instead of the usual 50% risk weighting for mortgage loans. Since the programme's inception, seven series of MBS have been issued with a total amount of HK$2.27 billion.

Bauhinia Mortgage-Backed Securitization Programme

The new Bauhinia MBS Programme, introduced in 2001, provides a convenient, flexible and cost-efficient platform for the issuance of MBS. It is a US$3 billion multi-currency programme under which MBS are issued in bond style using a bankrupty remote SPC to facilitate trading in the secondary market.

Figure 13: Bauhinia MBS Limited HK$2,000,000,000 Series 2002-1 Mortgage-Backed Securities due April 2023 issued under US$3 Billion Mortgage-Backed Securitization Programme



Source: HKMC

The debut MBS issue launched under the Bauhinia Programme was completed in March 2002, with an issue size of HK$2 billion and a maturity date of 2023. (Figure 13) The US$3 billion programme, using a bankruptcy remote SPC, Bauhinia MBS Limited, benefits from a guarantee of principal and interest payment by the HKMC, which greatly simplified the issuing mechanism and reduced its cost.

This issue was well received by the market, with a wide range of institutional investors participating, including insurance companies, pension and investment fund managers, private and commercial banks. It is the largest ever Hong Kong dollar denominated residential MBS transaction in Hong Kong and the first public MBS issue which offered investors the choice of a Prime-based or a HIBOR-based coupon.

Figure 14: HKD Debt Capital Market Issuer League Table (2002)

Rank	Issuer	Amount HKD million	Percentage
1	**Hong Kong Mortgage Corporation***	**16,956**	**9.3%**
2	Standard Chartered Bank	9,515	5.2%
3	Westpac Banking Corporation	5,557	3.1%
4	Australia & New Zealand Banking Group	5,475	3.0%
5	Bayerische Landesbank GZ	4,122	2.3%
6	Deutsche Bank AG	3,997	2.2%
7	Bank of East Asia Limited	3,938	2.2%
8	IntesaBCI SpA Hong Kong	3,652	2.0%
9	Bank of Scotland	3,586	2.0%
10	MTR Corp (Cayman Island) Limited	3,500	1.9%
	Total of top ten issuers	**60,298**	**33.2%**
	Others	121,466	66.8%
	TOTAL	**181,764**	**100.0%**

Source: MCM, including zero coupon bond but excluding commercial papers and Exchange Fund Bills/Notes

*Note: * Included HK$2,000 million mortgage-backed securities issued under Bauhinia MBS Programme*

The issue was collateralized by a pool of HKMC's residential mortgages. The HIBOR-based class amounted to HK$1.2 billion and the Prime Rate-based class amounted to HK$800 million. Since both classes carry the HKMC's guarantee and are tradable, they qualify for 20% capital risk weighting and as liquefiable assets under the Hong Kong Banking Ordinance.

FUNDING

The rapid growth in the HKMC's purchase activities in 2002 required a corresponding level of activity on the funding side. During the year, the HKMC raised about HK$15 billion through 45 issues of debt securities. As a result, at year-end the Corporation had 73 issues of debt securities with a total amount of over HK$28.6 billion outstanding. This once again made the HKMC the largest issuer of Hong Kong dollar debt for the year (Figure 14).

Supportive Credit Rating

Our ability to attract investors was underpinned by the reaffirmation of our high investment grade credit ratings by both Standard & Poor's and Moody's in November, which are the same as the ratings of the HKSAR Government (Figure 15). According to Standard & Poor's, the Corporation benefits from a "strong asset base, good asset quality, adequate profitability, and adequate financial flexibility" and is "expected to continue to benefit from its market position as the major purchaser of residential mortgages in Hong Kong, its strong financial profile, and its implied support from the Government of the HKSAR." Moody's notes that its rating "reflects its unique franchise in Hong Kong, its flexible business model, strong management and continued government support."

Figure 15: Credit Ratings of the HKMC

	Standard & Poor's		Moody's	
	Short-term	Long-term	Short-term	Long-term
Foreign currency (Outlook)	A-1 (stable)	A+ (stable)	P-1 (stable)	A3 (positive)
Local currency (Outlook)	A-1+ (stable)	AA- (negative)	P-1 (stable)	Aa3 (stable)

Business Review

Capital
With regard to capital, Moody's writes that "HKMC is funded through HK$2 billion of paid-up capital and retained earnings" while "an additional $1 billion of equity capital is callable on demand from the Exchange Fund".

Asset Quality
"The HKMC's asset quality is good" states Standard & Poor's and "the quality of the corporation's residential mortgage portfolio is expected to continue to outperform the Hong Kong banking industry average. HKMC protects itself against credit risk through conservative underwriting and stringent due diligence."

Management
Moody's notes that HKMC has "strong management" and Standard & Poor's recognizes that "the strategic initiatives of management are focused on how best to fulfil the Corporation's remit of providing liquidity to the mortgage market in a profitable way."

Earnings
"HKMC's low cost base has enabled the Corporation to reduce the impact of falling interest rate spreads," notes Standard & Poor's, thereby allowing the Corporation, in Moody's words, "to remain profitable despite the poor market."

Liquidity
Moody's "believes that HKMC's current liquidity arrangements are quite adequate for supporting its medium-term business plan" and Standard & Poor's notes that "HKMC's liquidity is well managed."

HK$9.5 billion Raised through DIP

The Debt Issuance Programme (DIP) remains the primary source of funding for the HKMC and during the year we raised HK$9.5 billion through 35 issues of DIP notes. Of these, 29 issues totalling HK$5.7 billion were fixed rate notes, while 6 issues totalling HK$3.8 billion were floating rate notes. Tenors of the notes were in the range of 1 to 7 years.

The DIP issues during 2002 brought the total outstanding amount under the programme to HK$17.5 billion, leaving only HK$2.5 billion headroom under the programme size of HK$20 billion. With a mortgage purchase target of HK$15 billion set for 2003, the Board of Directors in December approved an increase in the programme size from HK$20 billion to HK$40 billion to enable the Corporation to meet its future funding needs.

Record Retail Bond Issues

The Corporation continued to use the successful issuing mechanism through Placing Banks to issue three retail bonds in 10 tranches for a total amount of HK$5.5 billion during the year. The distribution network was expanded, adding electronic application through the Internet and telephone and increasing the number of Placing Banks from eight banks with 308 branches for the first issue in January to 13 banks with 625 branches for the last issue in October. The Corporation was the most active retail bond issuer during the year. The total issue amount of HK$5.5 billion accounted for about 25% of the total retail bond issued in Hong Kong in 2002.

Besides continued offerings of plain vanilla fixed rate bonds, as a pioneer in the retail bond market the Corporation also introduced a number of structured products, such as extendable and inverse-floating rate notes, to provide additional choices to more sophisticated investors in search of yield enhancement. With its high credit ratings, wide placing network and variety of bond products, the Corporation's retail bonds attracted over 12,000 retail investors in 2002.

Regulatory Framework

The success of the retail bond market was given considerable support by the improvement in the regulatory framework. Throughout 2001 and 2002, the HKMA, HKMC and the Hong Kong Capital Market Association worked closely, in consultation with the Government and members of the financial community, to make the regime governing the issuance of such bonds more friendly to issuers and investors.

As the market's most active issuer of Hong Kong dollar debt, the HKMC played an active role in the Working Group for Debt Market Development chaired by the Permanent Secretary for Financial Services and the Treasury.

In February 2003, based on the recommendations of the Working Group, the Securities and Futures Commission, in its new guidelines adopted a new framework for the retail bond market that increases its attraction to corporate issuers. The regulatory controls on the publicity for retail bonds, both during the period prior to registration of the prospectus and the subsequent offering period, have been modified. "Offer awareness materials" concerning the administrative aspects of an issue can now be distributed prior to the offer date, giving more time for sponsors to prepare for the issue and raising awareness in the general public of the offer. Summary disclosure materials are now permitted, which will help retail investors to understand offers more easily. Provision is made to allow for a dual prospectus, separating the programme prospectus and issue prospectus, which will facilitate the establishment of retail debt issue programmes, thereby shortening the lead-time and reducing costs.

Heightened Risk Management

The HKMC's asset base has grown rapidly in the past two years and with this substantial increase in business volume, it has taken steps to ensure that its credit and interest rate risk exposures are monitored in a timely and effective manner. During the year, the Corporation introduced a number of measures designed to mitigate our risk exposure including interest rate swaps, callable and extendable bonds and pass-through MBS.

To strengthen the Corporation's understanding of its risk position, in September 2002, the HKMC conducted a stress test based on the guidelines issued by the HKMA to Authorized Institutions. The results of the test showed that the HKMC will remain solvent even under the most severe interest rate and credit risk scenarios prescribed in the HKMA guidelines. Similar stress tests will henceforth be conducted on a quarterly basis in its monitoring efforts.

STANDARDIZATION OF MORTGAGE ORIGINATION DOCUMENTS

The Model Mortgage Deed and the Model Guarantee and Indemnity were launched in

2001. Since then, as a result of the HKMC's promotional efforts, these model documents have been widely adopted by the Authorized Institutions, with 22 banks confirming in a survey conducted by the HKMC their intention to adopt the Model Mortgage Deed for their mortgage transactions and another 8 Authorized Institutions giving serious consideration to adoption.

Following the introduction of the two-party Mortgage Deed, there has been a demand from the industry for a standardized three-party Mortgage Deed. The HKMC has also decided that the standardization process should cover the entire range of model mortgage origination documents. Encouraged by the success of the two original model documents, the HKMC launched Phase II of the standardization project in March 2003 with the aim by year-end of:

- developing a standardized three-party Mortgage Deed
- developing a further set of standardized documents, including loan applications, offer letters, instruction letters to solicitors and solicitors' title reports
- updating the original two model documents in the light of the legal developments since their implementation
- promoting wider adoption of the standardized mortgage origination documents

NEW INFORMATION TECHNOLOGY

Following the pilot launch to a selected group of banks and mortgage reinsurers, the Integrated Information Delivery System (IIDS) was rolled out in phases to all Approved Sellers, Servicers and Reinsurers during the first quarter of 2002. The system began to support the MIP operations in January and the mortgage settlement and servicing operations in March 2002. The new system has significantly enhanced the HKMC's operational efficiency, through streamlining of work processes, on-line processing of routine operations and improvements in data quality. A survey of sellers and servicers indicates that the external users have also achieved significant productivity gains.

At the same time, we conducted a process re-engineering review exercise, identifying areas in which we could streamline processes to reduce cost, improve service levels and strengthen oversight. The exercise covered the offer and acceptance procedures, the process for mortgage purchased and on-going loan servicing. Key elements of the re-engineering were to rationalize the data reported by servicers through simplifying or automating procedures, and to delegate authority for certain approvals, such as for loan restructurings, to streamline processes.

HKMC Music Group performing at Po Leung Kuk

STAFFING

The HKMC continued to attract, develop and retain professionals with expertise in the secondary mortgage market. The principles of our staffing policy are:

Staff attending team building training course

- to maintain a permanent establishment of the minimum size required to function efficiently
- to maximize the use of full technology and automation and to streamline work processes to maximize productivity
- to maintain a cost-to-income ratio below the average of banks and other financial institutions in Hong Kong

In response to the rapid expansion and diversification of the Corporation's business, the Board has approved an increase in the permanent establishment from 98 to100 for 2003.

During the year, the HKMC again held in-house and external courses designed to improve the managerial and technical skills of our employees. The more than 120 courses offered covered mortgage securitization, finance, information technology, credit control and other mortgage related issues.

2003 OUTLOOK

In 2003, we will build on the success of 2002 and endeavour to maintain the momentum to expand further the HKMC's scope of business. To this end, we will maintain our close co-operation with banks, insurance companies, Government agencies and regulators.

Our business projections reflect our confidence in the HKMC's ability to succeed in this endeavour:

- mortgage purchases to reach HK$15 billion;
- total mortgage loans drawn down under the MIP to reach HK$6.6 billion;
- net retained mortgage portfolio at end 2003 projected to reach HK$36 billion;
- arrange the issuance of HK$4 billion to HK$6 billion of MBS under the two MBS programmes; and
- raise HK$11 billion under the DIP and through retail bond issuance.

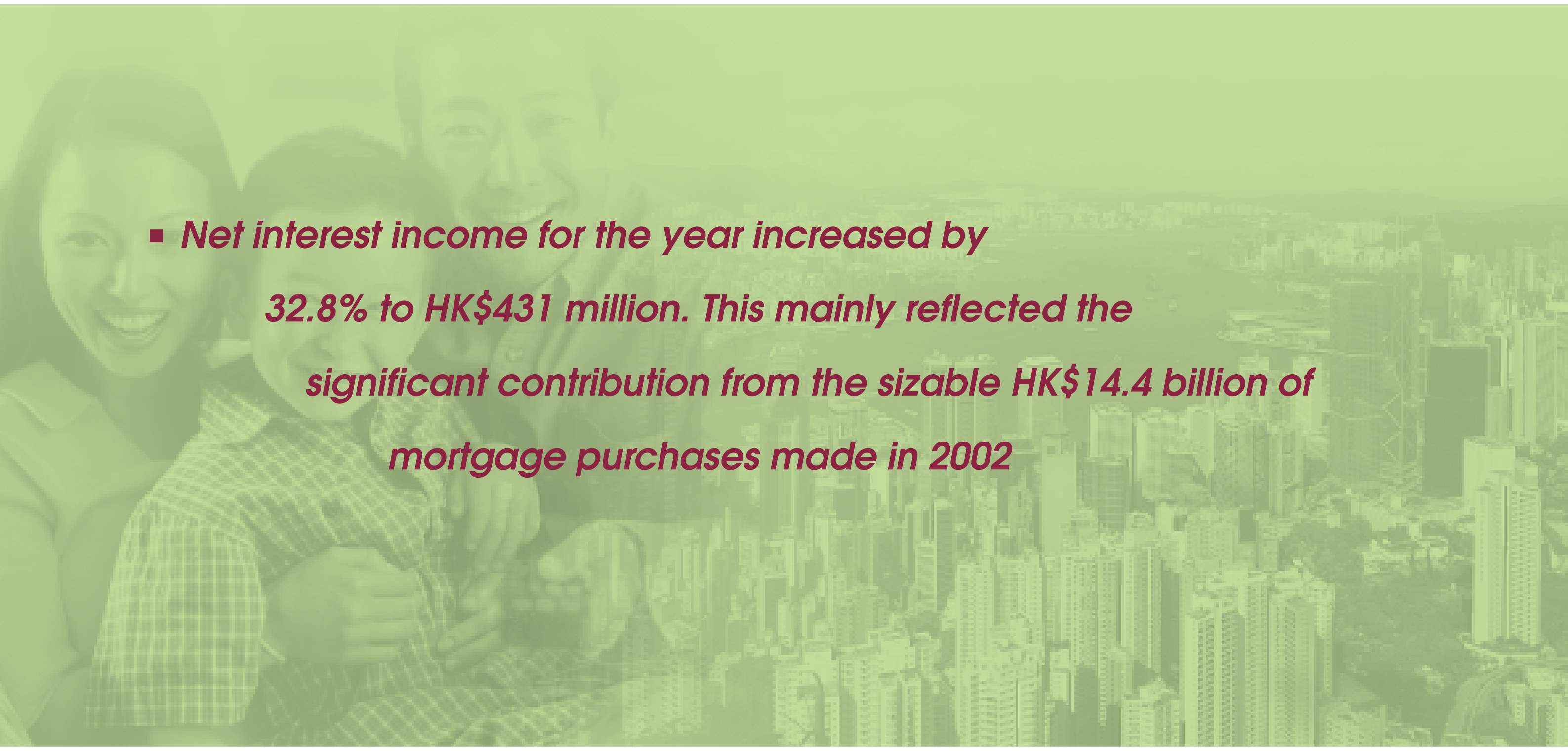
Financial Review

PROFIT AND LOSS ACCOUNT

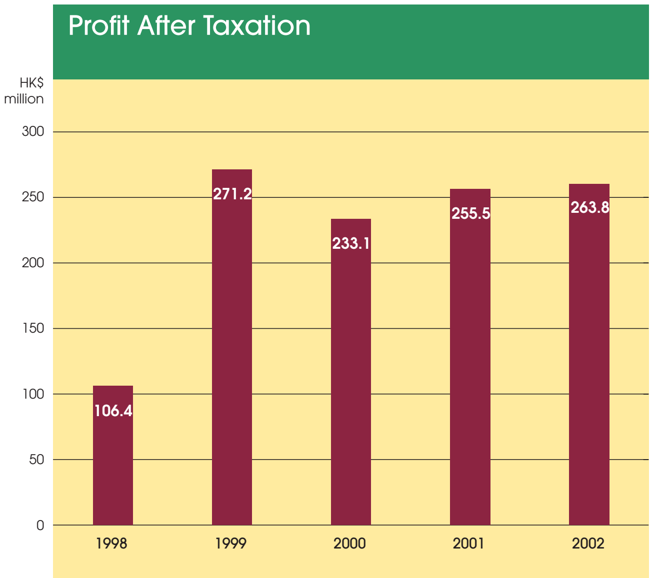
Operating results

The Hong Kong mortgage market remained sluggish during 2002. Gross mortgage loans originated by the 27 Authorized Institutions declined from HK$106.5 billion in the previous year to HK$98.5 billion. Despite the unfavourable market conditions, however, the Corporation made a number of achievements. These included a record purchase of HK$14.4 billion of mortgages, a record bond issuance of HK$15 billion at a reasonably low cost of funds, generation of additional fee income from mortgage securitization and insurance businesses, as well as mitigating the negative endowment effect of falling interest rates through the effective application of capital to fixed income investments.

Through its concerted efforts, the Corporation achieved a 3.2% growth in profit after tax to HK$263.8 million (2001: HK$255.5 million). After discounting the tax write-back of HK$36.6 million booked in 2001, the profit after tax for 2002 was higher by 20.5% or HK$44.9 million. Returns on assets and shareholder's equity were maintained at satisfactory levels of 0.9% (2001: 1.2%) and 8.9% (2001: 9.4%) respectively. Effective cost control resulted in a marked improvement in the cost-to-income ratio, which fell from 28.2% in 2001 to 23.1%. The capital-to-assets ratio remained strong at 8.9% (2001: 11.6%), well above the minimum 5% guideline set by the Financial Secretary.



- ***Net interest income for the year increased by 32.8% to HK$431 million. This mainly reflected the significant contribution from the sizable HK$14.4 billion of mortgage purchases made in 2002***



Net interest income

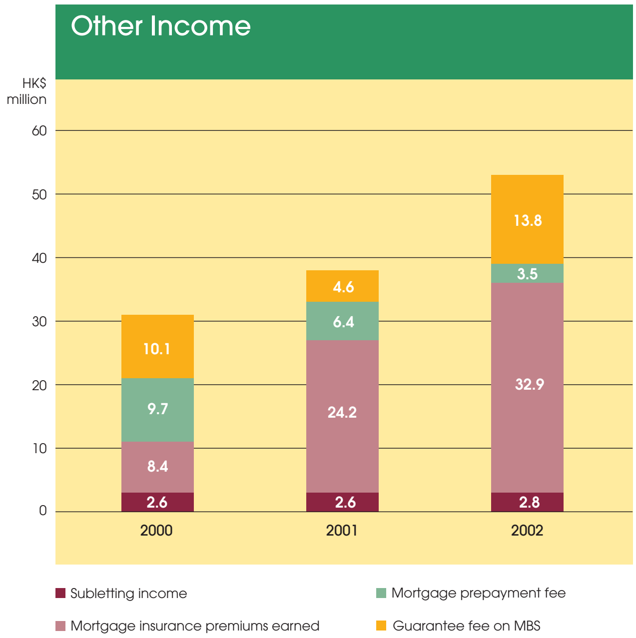
	2002 HK$'000	2001 HK$'000
Interest income	**908,495**	1,019,025
Interest expense	**(477,539)**	(694,595)
Net interest income	**430,956**	324,430
Average interest-earning assets	**28,037,176**	21,118,079
Net interest margin	**1.5%**	1.5%
Net interest spread on interest-bearing liabilities[1]	**1.3%**	1.1%

Net interest income for the year increased by 32.8% to HK$431 million. This mainly reflected the significant contribution from the sizable HK$14.4 billion of mortgage purchases made in 2002. Purchases of fixed rate debt securities for liquidity and capital management purposes increased in 2002 and the average net required yield of the retained mortgage portfolio improved by 0.05% from Prime –1.88% in 2001 to Prime –1.83%. As a result, the net interest spread on interest-bearing liabilities improved from 1.1% to 1.3%. Incorporating the profit contribution from investment of the shareholder's equity into the regular business return, the net interest margin of the average interest-earning assets remained stable at 1.5% in 2002.

Other net income

Other net income increased significantly by 65.9% to HK$57.9 million in 2002 (2001: HK$34.9 million). The major sources of such income were mortgage insurance premiums and MBS – related guarantee fees.

The net mortgage insurance premiums written declined by 8.1% to HK$54 million reflecting the 7.5% drop in total mortgage loans originated in 2002. However, net premiums earned for the year included a large contribution from the premiums written in prior years and increased from HK$24.2 million to HK$32.9 million.



[1] Net interest spread on interest-bearing liabilities = Return on interest-earning assets – Funding cost on interest-bearing liabilities

Financial Review

Total fee income generated from guaranteed MBS business rose from HK$4.6 million in 2001 to HK$13.8 million as a result of an increase in securitization of mortgage loans from HK$0.6 billion to HK$2 billion. Early prepayment fee income and income from subletting office premises were HK$3.5 million (2001: HK$6.4 million) and HK$2.8 million (2001: HK$2.6 million) respectively.

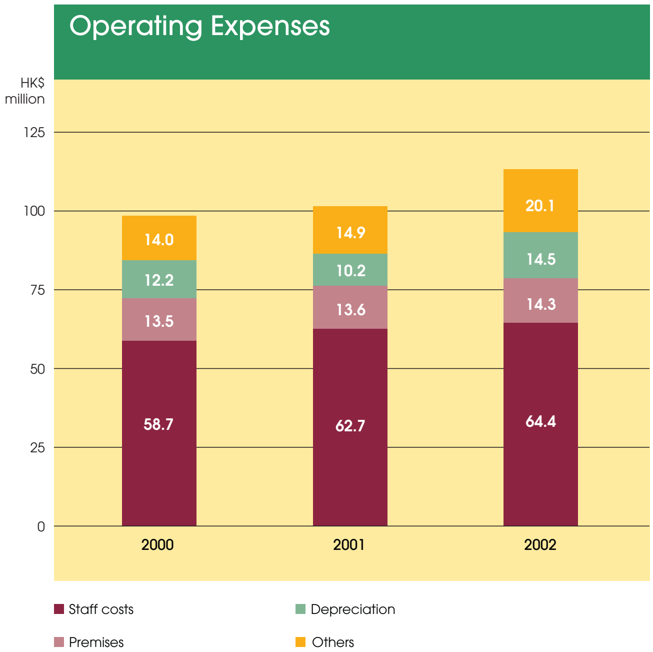
Operating expenses

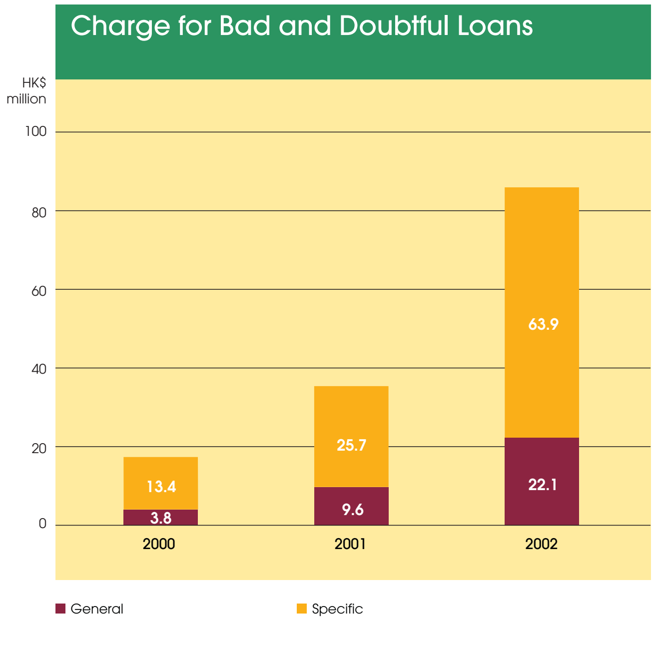
Operating expenses increased by 11.7% from HK$101.4 million to HK$113.3 million in 2002, mainly due to the expansion of business activities. These included the issuance of the first MBS from the retained portfolio, setting up the HOME programme and its reinsurance arrangement, and expansion of retail bond issuance. Staff costs of HK$64.4 million accounted for 56.8% of the total operating expenses (2001: HK$62.7 million and 61.8%). The permanent establishment of the Corporation increased from 97 to 98 in 2002 to support the increase in business activities. Premises' costs increased moderately by HK$0.7 million to HK$14.3 million. Depreciation charges on fixed assets rose by HK$4.3 million to HK$14.5 million, largely relating to the amortization of the development costs of the Integrated Information Delivery System.

Provisions for bad and doubtful loans

The Corporation made additional general and specific provisions for bad and doubtful loans of HK$22.1 million and HK$63.9 million respectively in 2002.

The increase in general provision from HK$9.6 million in 2001 to HK$22.1 million reflects the significant 42.9% growth in the retained mortgage portfolio from HK$19.8 billion to HK$28.3 billion during the year.





The increase in the size of the retained mortgage portfolio, the surge of personal bankruptcy, and further declines in property prices contributed to the increase in loan provisions and the Corporation made a specific provision of HK$63.9 million in the profit and loss account for 2002 (2001: HK$25.7 million).

Net Mortgage Portfolio	2002 HK$'000	2001 HK$'000
Gross mortgage portfolio	**28,318,693**	19,812,453
Provisions for bad and doubtful loans		
Specific	**(9,335)**	(2,002)
General	**(51,631)**	(32,567)
Net mortgage portfolio	**28,257,727**	19,777,884
Ratios[2]		
Delinquency ratio for loans overdue more than 90 days	**0.31%**	0.29%
Total provisions as a percentage of the gross mortgage portfolio	**0.22%**	0.17%

[2] The ratios for 2002 were calculated with exclusion of those loans overdue for 180 days or more, with collateral repossessed or borrowers having become bankrupt; all such loans were written down to the forced sale values of the properties and reclassified from "Mortgage portfolio, net" to "Other receivables, net". Without this reclassification, the delinquency ratio was 0.76% (2001: 0.50%) and loan provisioning was 0.40% (2001: 0.27%) of the outstanding principal balance of the total loans.

Total loan provisions accounted for 0.22% of the HK$28.3 billion outstanding principal balance of the retained mortgage portfolio at year-end.

BALANCE SHEET

In 2002, total assets grew by 38.8% from HK$23.2 billion to HK$32.2 billion. This reflected a HK$8.5 billion increase in the net mortgage portfolio to HK$28.3 billion, a HK$1.5 billion increase in investment in debt securities to HK$3.2 billion and a HK$1.0 billion reduction to HK$0.2 billion of cash and short-term funds.

The Corporation has adopted a pro-active approach to expanding the base of approved Sellers to include Government housing agencies and property developers since 2001. Despite difficult market conditions during 2002, the Corporation was successful in purchasing an aggregate amount of HK$14.4 billion of mortgages, HK$1.2 billion more than the total amount purchased in the previous year. The average prepayment rate of the retained mortgage portfolio stabilized at 18.9% for 2002 (2001: 24.5%)

The Corporation has established a set of prudent investment guidelines to invest its surplus cash and capital in approved instruments, such as certificates of deposit and notes with a high investment grade credit rating. The investment portfolio enables prudent liquidity and capital management to support the business operations of the Corporation. As at 31 December 2002, the investment portfolio increased from HK$1.7 billion to HK$3.2 billion.

Financial Review

The Corporation issued a total of HK$15 billion of Hong Kong dollar notes in 2002. Of these, HK$9.5 billion was issued under the DIP programme and HK$5.5 billion from three successful retail bond issues. As at 31 December 2002, the total outstanding balance of the notes issued had increased by 42.3% from HK$20.1 billion to HK$28.6 billion, sufficient to support the significant increase in mortgage purchases and to redeem HK$6.4 billion bonds that matured in 2002. About 88.3% of the outstanding debt securities will mature in the range of 1 to 5 years, a maturity profile that aims to match the average life of the mortgage portfolio.

CAPITAL-TO-ASSETS RATIO

In 2001 the Financial Secretary approved a revised capital requirement framework for the Corporation, to account for different levels of risk of products in the retained loan portfolio, mortgage insurance and MBS portfolio, as follows:

Product	**Minimum Capital-to-Assets Ratio (“CAR”)**
Mortgage Portfolio	5% of retained portfolio (based on notional amount).
Mortgage-backed Securities	2% of MBS portfolio (based on notional amount).
Mortgage Insurance	0% of risk-in-force value of exposure covered by the reinsurance arrangements with approved reinsurers. 5% of risk-in-force value of exposure not covered by reinsurance arrangements.

The capital base, defined as shareholder’s equity plus the general provision for bad and doubtful loans, grew by 10.3% from HK$2.9 billion to HK$3.2 billion in 2002. As at 31 December 2002, the total of on-balance-sheet assets and off-balance-sheet exposure of the Corporation was HK$35.5 billion, consisting mainly of HK$28.3 billion of mortgage loans, HK$779.8 million of mortgage insurance risk-in-force and HK$928.1 million of risk-adjusted MBS guarantees. The CAR was maintained at a healthy level of 8.9% (2001: 11.6%) as at 31 December 2002, equivalent to 16.6% (2001: 22.1%) calculated in accordance with the capital adequacy framework under the Banking Ordinance, well above the stipulated minimum of 5% stipulated by the Financial Secretary’s guideline.

RISK MANAGEMENT

The active management of risk is an integral part of the Corporation’s operations and a key factor in its ability to maintain steady earnings growth. The HKMC is subject to four major areas of risk: interest rate risk, liquidity risk, credit risk and operational risk. The Corporation adopts prudent policies and best market practices in managing these risks in its operations.

Interest Rate Risk Management

The HKMC is exposed to interest rate risk because changes in interest rates may affect cash flows of its asset-liability portfolio in a way that adversely affects earnings and stable growth over time. The primary objective of interest rate risk management is therefore to limit potential adverse effects of interest rate movements on net interest income. The specific interest rate risks the HKMC faces are:

1. *Interest Rate Mismatch Risk*

Interest rate mismatch risk is the most significant type of market risk exposure arising from the Corporation's core businesses. It refers to the potential decline in the net interest income of the Corporation resulting from volatile and adverse movements of market interest rates. Interest rate mismatch risk arises mainly from the difference in the timing of re-pricing of interest rates on the Corporation's assets, liabilities and related derivatives or in the benchmark basis used for setting these rates. For example, the re-pricing characteristics of the HKMC's interest-earning assets, such as Prime or HIBOR-based mortgage loans, may not exactly match those of its interest-bearing liabilities, such as retail bonds and DIP notes.

The Corporation uses a variety of cash and derivative instruments to manage and hedge its exposure to fluctuations in market interest rates, including interest rate swaps, basis swaps and forward rate agreements, as well as mortgage-backed securitization. For example, using interest rate swaps, the HKMC converts its fixed-rate payment liabilities arising from bond issuance to a floating-rate basis, in order to match its floating-rate income from the mortgage assets.

In monitoring and managing interest rate exposure, the HKMC uses duration gap exposure to quantify its earnings-at-risk, which is the potential risk to the net interest income from adverse movements in interest rates. Depending on the prevailing interest rate outlook and market conditions, the Corporation proactively rebalances the duration gap of the asset-liability portfolio under the guidance and supervision of the Asset and Liability Committee (ALCO). The duration gap was kept within three months in 2002.

2. *Basis Risk*

The HKMC is exposed to basis risk as its Prime-based mortgage assets are financed by HIBOR-based liabilities. While there has been a healthy Prime-HIBOR spread, as in the case of Authorized Institutions in Hong Kong, the Corporation currently cannot fully hedge the Prime-HIBOR basis risk. This risk will be more effectively addressed once more mortgages are originated based on HIBOR and as the Prime/HIBOR basis swap market and related risk management instruments become better developed in Hong Kong. Nevertheless, basis risk has been substantially reduced in the case of mortgages acquired from the Government housing agencies, as the Net Required Yield was set by reference to HIBOR. In addition, the Corporation uses Average-HIBOR swaps and Prime-based MBS issuance to mitigate the basis risk of its Prime-based mortgage portfolio.

3. *Asset-Liability Maturity Mismatch Risk*

The HKMC faces the risk of a maturity mismatch between assets and liabilities. Despite their typically long contracted maturities, the average life of mortgage assets depends on the actual speed of payment. Accordingly, the average life of the retained mortgage portfolio shortens

Financial Review

when prepayments occur, and the higher the rate of prepayment, the shorter the average life. Prepayment occurs for two main reasons in Hong Kong: housing turnover, when borrowers repay their entire mortgages upon selling their homes; and refinancing, when borrowers refinance their mortgage loans at lower mortgage rates.

The asset-liability mismatch risk can be defined more specifically as reinvestment risk and refinancing risk. Reinvestment risk refers to the risk of reinvesting the proceeds from assets at a lower return, when the actual average life of the assets in shorter than that of the liabilities. Refinancing risk is the risk of refinancing liabilities at a higher cost of funds, when the actual average life of the assets is longer than that of the liabilities.

To contain the reinvestment risk within an acceptable level, the HKMC closely manages the average life of assets through ongoing purchases of mortgages to replenish its portfolio and through diversifying its investments into high-grade debt securities and cash deposits to adjust the overall average life of its asset pool.

To manage the prepayment risk of the retained mortgage portfolio, the Corporation has introduced prepayment fees and issued callable bonds.

In managing refinancing risk, the Corporation issues notes across a broad spectrum of maturities from 1 year to 10 years, with a view to achieving the optimal average life for its overall liability portfolio. If necessary, refinancing risk can also be mitigated by adjusting the maturities of assets in the investment portfolio and selectively offloading mortgage assets through securitization.

Liquidity Risk Management

Liquidity risk management refers to the HKMC's ability to repay obligations, including the redemption of debt issues, and to fund committed new mortgage purchases and investments as opportunities arise. The HKMC manages liquidity by monitoring the actual and expected inflow and outflow of funds on a daily basis, by projecting longer-term inflows and outflows across the entire maturity spectrum, and by developing diversified sources of funding with the objective of maintaining stable financing at low funding costs.

The Corporation has secured diversified funding sources to support the future growth of its businesses:

1. Capital: HK$3 billion authorized capital, of which HK$2 billion is paid up and HK$1 billion is available on call from the shareholders.

2. HK$40 billion Debt Issuance Programme: the Corporation has appointed 5 Primary Dealers to perform underwriting and market-making activities for public issues drawn under the DIP. A Selling Group consisting of 15 major financial institutions has also been established to broaden the DIP's distribution network.

3. Retail Bonds: the Corporation has successfully launched a new offering mechanism that enables retail investors to subscribe for the HKMC's bonds through placing banks.

4. US$3 billion Bauhinia MBS Programme: the Programme is a multi-currency, bond-style securitization programme, which can be utilized to facilitate securitization of the Corporation's retained portfolio when necessary.

5. Debt Investment Portfolio: the Liquid Debt Investment Portfolio includes cash and high-quality short-term cash equivalent, certificates of deposit, notes and MBS that can be readily converted into cash.

6. HK$10 billion Revolving Credit Facility: the Exchange Fund has provided a HK$10 billion revolving credit facility to the HKMC since January 1998.

7. Money Market Lines: the HKMC has established extensive money market lines with local and international banks for bridge financing. The Corporation's "public sector entity" status under the Banking Ordinance gives a favourable 20% risk-weighting treatment for financial institutions investing in the HKMC's debt securities or lending to the Corporation.

Asset and Liability Committee (ALCO)

The HKMC has formed an ALCO to manage its asset-liability portfolio according to prudent risk management principles, with the aim of avoiding excessive risk exposure while maximizing the return for the Corporation. The Committee formulates strategies to achieve the Corporation's risk management, financing, hedging, investment and securitization objectives. It also sets risk limits for the business units and monitors compliance. ALCO is chaired by the Chief Executive Officer and its members consist of the Senior Vice President (Finance), Senior Vice President (Operations), and senior staff of the Treasury, Financial Control and Pricing Departments. The Committee holds meetings on a weekly basis.

Credit Risk Management

Credit risk, as assumed by the HKMC, is the primary exposure to the risk that the Corporation may not recover amounts due from borrowers. The HKMC has a prudent policy for managing credit risk and adopts a five-

Financial Review

pronged approach to maintaining the high asset quality of its mortgage portfolio through:

- careful selection of Approved Sellers;
- prudent mortgage purchasing criteria;
- prudent insurance eligibility criteria
- effective due diligence process; and
- adequate protection for higher-risk mortgages.

Careful selection of Approved Sellers

The HKMC conducts a due diligence review of potential sellers of mortgage loans prior to their appointment as Approved Seller/Servicers. The review focuses in particular on the seller's mortgage loan underwriting policies, delinquency ratio and loan servicing capabilities. Once approved, Approved Seller/Servicers are subject to periodic review.

Prudent mortgage purchasing criteria

The HKMC adopts prudent mortgage purchasing criteria that confine its retained portfolio to mortgages related to owner-occupied properties and to borrowers with a debt-to-income ratio below 50%. Other relevant criteria are in line with best market practices adopted by the banking industry.

Effective due diligence process

As an integral part of the risk management process, the HKMC conducts due diligence reviews of a sample of acquired mortgage loans before and after their purchase to ensure compliance with the Corporation's mortgage purchasing criteria.

Credit Committee Meeting

Adequate protection for higher-risk mortgages

For products that involve higher credit risk, such as top-up loans originated by the Housing Society and property developers, the HKMC has established higher return criteria and credit enhancement arrangements, such as repurchase warranties or reserve funds, to mitigate the additional risk.

Credit Committee

The Credit Committee develops and oversees the implementation of the Corporation's policies for managing all aspects of the underlying credit risks of its business. Its major tasks include approving applications to become Approved Seller/Servicers under the MPP and Approved Reinsurers under the MIP. The Committee also sets limits for individual Approved Sellers and Approved Reinsurers and counterparty limits for treasury activities and reviews the Corporation's mortgage purchasing criteria.

The Credit Committee is chaired by the Chief Executive Officer and its members include the Senior Vice President (Finance), Senior Vice President (Operations), General Counsel and senior staff of the Operations and Finance Divisions.

Pricing Committee

The Pricing Committee meets weekly in conjunction with the ALCO to review the pricing for products under the MPP, MBS Programme and MIP in the light of current market conditions and business strategies. It also reviews all risk-based pricing transactions prior to submission to the Executive Directors for final approval.

Stress Test

Given the substantial increase in business volume, during 2002 the Corporation began to take additional steps to ensure the Corporation's credit and interest rate risk exposure was monitored in a timely and effective manner. In September, the Corporation conducted a stress test using the framework introduced by the HKMA to test the resilience of Authorized Institutions under adverse economic conditions. The results show that the HKMC will remain solvent even under the most severe interest rate and credit risk scenarios prescribed in the HKMA guidelines. Similar stress tests are now being conducted on a quarterly basis.

Operational Risk Management

Operational risk is the potential for losses arising from internal operation activities and external events. The HKMC seeks to mitigate this by maintaining a comprehensive system of internal controls to manage the operational risk of its business units. To ensure adequate compliance, the Corporation's key operating systems and procedures are subject to regular audit and review by both internal and external auditors.

To reduce possible errors due to human intervention, the HKMC applies extensive technology solutions to its business operations, including those based on the Internet. The Corporation has established a comprehensive disaster recovery plan, including the establishment of an offsite back-up centre, to ensure that its IT systems can continue operating even in the event of a core system's failure or other such event.

Audit Committee

The Audit Committee plays a central role in assisting the Board of Directors to fulfill its corporate governance and oversight responsibilities in relation to the HKMC's financial reporting, internal control structure, business policies and practices, as well as internal and external audit functions. Members of the Audit Committee ensure that the intended systems of internal control, checks and balances are properly implemented, and that checking procedures are constantly upgraded to match changes in the business.

Audit Committee Meeting

Appointed by the Board, the HKMC Audit Committee comprises not less than four Directors, one of whom must be an Executive Director. The Committee is currently chaired by Dr. David Li, who succeeded Mr. Eddy Fong (who resigned from the position on 28 June 2002), and its members include Mr. Ronald Arculli, Mr. David Sun, Mr. Norman Chan and Mr. Tony Latter (who resigned on 4 January 2003). The Committee met twice in 2002 to review the financial accunts and other on-going audit work of the internal and external auditors.

Report of the Directors

The Directors have pleasure in presenting their report together with the audited financial statements of the Company and the Group for the year ended 31 December 2002.

PRINCIPAL ACTIVITIES

The principal activities of the Company are:

A. to purchase portfolios of mortgage loans, secured by residential properties situated in Hong Kong from approved sellers, including authorized institutions authorized under the *Banking Ordinance* of Hong Kong ("Authorized Institutions"), subsidiaries or affiliated companies of Authorized Institutions, government bodies and agencies and related organizations, statutory bodies, public bodies, property developers, and any financing entity affiliated to such property developer;

B. to raise financing for its purchase of mortgage loans through the issuance of debt securities to banks, institutional and retail investors;

C. to securitize mortgage portfolios by way of issuing mortgage-backed securities to investors; and

D. to provide mortgage insurance cover to Authorized Institutions in respect of mortgage loans originated by such Authorized Institutions and secured by residential properties.

The corporate information and principal activities of the subsidiary are shown in Note 19 to the financial statements.

RESULTS AND APPROPRIATIONS

The results of the Group for the year ended 31 December 2002 are set out in the consolidated profit and loss account on page 43.

The Directors do not recommend the payment of a dividend.

RESERVES

Movements in the reserves of the Group and the Company during the year are set out in Note 28 to the financial statements.

FIXED ASSETS

Details of the movements in fixed assets of the Group and of the Company during the year are set out in Note 17 to the financial statements.

DEBT SECURITIES ISSUED

The Company issued notes to banks and institutional investors under its HK$40 billion Debt Issuance Programme ("DIP") and also offered notes to retail investors through various placing banks during the year ended 31 December 2002, totalling HK$14,956,450,000, details of which are set out in Note 23 to the financial statements.

DIRECTORS

The Directors of the Company during the year and up to the date of this report are as follows:

The Honourable
Antony LEUNG Kam-chung, GBS, JP
Chairman and Executive Director
Mr. Joseph YAM Chi-kwong, GBS, JP
Deputy Chairman and Executive Director

Mr. Norman CHAN Tak-lam, SBS, JP
Executive Director
Mr. Tony LATTER, JP
Executive Director (resigned with effect from 4 January 2003)
Mr. Ronald Joseph ARCULLI, GBS, JP
Director
The Honourable Bernard Charnwut CHAN, JP
Director
Professor Andrew CHAN Chi-fai, Ph.D.
Director
The Honourable CHAN Kwok-keung
Director
Mr. Eddy FONG Ching, SBS, JP
Director (resigned on 28 June 2002)
Mr. Clifford Rowland FORSTER
Director
Ms. Anita FUNG
Director (retired on 15 April 2002)
Mr. Andy HON Hak-keung
Director (retired on 15 April 2002)
Mr. Stephen IP Shu-kwan, GBS, JP
Director (resigned on 1 July 2002)
Mr. LAM Yim-nam
Director (appointed on 15 April 2002)
Dr. the Honourable David LI Kwok-po, GBS, LLD (Cantab), JP
Director
The Honourable Frederick MA Si-hang, JP
Director (appointed on 22 July 2002)
The Honourable SIN Chung-kai
Director
The Honourable Michael SUEN Ming-yeung, GBS, JP
Director (appointed on 22 July 2002)
Mr. David SUN Tak-kei
Director (appointed on 22 July 2002)
Mr. Dominic WONG Shing-wah, GBS, OBE, JP
Director (retired on 15 April 2002)
Mr. Brian YIU Chi-pang
Director (appointed on 15 April 2002)

In accordance with Article 109 of the Company's Articles of Association, all those directors who are not Executive Directors shall retire but shall be eligible for re-election at the next annual general meeting.

DIRECTORS' INTERESTS IN TRANSACTIONS AND CONTRACTS

The following Directors may be deemed to be interested in any contracts which have been entered, or may be entered, into between the Company and them for the reasons set out below:

(1) The Hon. Antony Leung is the Financial Secretary of Hong Kong as Controller of the Exchange Fund. Mr. Joseph Yam is the Monetary Authority appointed by the Financial Secretary under the Exchange Fund Ordinance. The Monetary Authority acted as the arranger, agent and operator in respect of the Company's HK$20 billion Note Issuance Programme (the "NIP") until 31 August 2001. The Monetary Authority also acts as the custodian and clearing agent for the Company's HK$40 billion DIP. At 31 December 2002, the outstanding balance of the notes under the DIP was HK$17.5 billion. On 27 January 1998, the Company entered into an agreement with the Monetary Authority through which the Exchange Fund has provided a HK$10 billion revolving credit facility to the Company. This credit facility provides a fallback for the Company in terms of access to short-term funding for the purposes of bridging the gap between the purchase of mortgage loans and the issuance of debt securities. At 31 December 2002, there was no outstanding balance.

(2) Mr. Ronald Joseph Arculli is a director of Sino Land Company Limited. The Company purchased a total of HK$593 million of mortgage loans from the 9 affiliated companies of Sino Land Company Limited up to 31 December 2002.

(3) Dr. the Hon. David Li is the Chairman and Chief Executive of The Bank of East Asia, Limited which is (a) a selling group member under the DIP; (b) an approved seller/servicer under the Mortgage Purchase Programme ("MPP"); (c) an approved Authorized Institution under the Mortgage Insurance Programme ("MIP"); (d) a placing bank in the Company's retail note issuance in May 2002; (e) a placing bank and an underwriting bank in the Company's retail note issuance in October 2002; (f) a co-lead manager in the Series 2002-1 issue of the Company's US$3 billion Mortgage-Backed Securitization Programme (the "Bauhinia MBS Programme"); and (g) an approved Authorized Institution under the Home Owner Mortgage Enhancement Programme (the "HOME Programme"). Dr. Li is also a director of Tengis Limited which is the corporate services provider of HKMC Funding Corporation (1) Limited, a special purpose entity formed for the purpose of the Guaranteed Mortgage-Backed Pass-Through Securitisation Programme. In 2002, the Company purchased HK$2 billion of mortgages from the bank.

(4) The Hon. Bernard Chan is a director of (a) Asia Commercial Bank Limited which is an approved seller/servicer under the MPP; (b) an approved Authorized Institution under the MIP and (c) an approved Authorized Institution under the HOME Programme. He is also a director of Asia Insurance Company, Limited which is an approved reinsurer under the MIP.

(5) The Hon. Frederick Ma is the Secretary for Financial Services and the Treasury Bureau of Hong Kong and the Hon. Michael Suen is the Secretary for Housing, Planning and Lands of Hong Kong. Both Mr. Ma and Mr. Suen are members of The Hong Kong Housing Authority which is an approved seller/servicer under the MPP from which the Company purchased mortgage loans of around HK$18 billion up to 31 December 2002.

(6) Mr. David Sun is a Partner of Ernst & Young which acts as consultant to Merrill Lynch Reinsurance Solutions Ltd. ("ML Re"). The Company has entered into reinsurance arrangements with ML Re in July 2002 under the HOME Programme in which ML Re acts as the arranger and reinsurer to the Company thereunder.

Except for the above disclosure and the related party transactions as stated in Note 27 to the financial statements, no contracts of significance in relation to the Company's business to which the Company was a party and in which any of the Directors or members of its management had a material interest, either directly or indirectly, subsisted at the end of the year or at any time during the year.

At no time during the year was the Company a party to any arrangement to enable any of its Directors or members of its management to acquire benefits by means of the acquisition of shares in, or debt securities of, the Company or any body corporate.

ADDITIONAL DISCLOSURES IN COMPLIANCE WITH THE PROVISIONS OF THE INSURANCE COMPANIES ORDINANCE (“ICO”)

The Controllers of the Company as defined in the ICO are the Hon. Antony Leung and Mr. Pang Sing Tong. Mr. Leung is the Chairman of the Company. Mr. Pang is the Chief Executive Officer of the Company, and he did not have any interests in the transactions or the contracts which the Company had entered into during the year ended 31 December 2002.

The Company has not carried on insurance business relating to liabilities or risks in respect of which persons are required by any Ordinance to be insured.

Initially the Company reinsured 100% of its risk exposure with approved reinsurers on a back-to-back basis. Subsequently, the Company began to operate the mortgage insurance business on a risk-sharing basis, and now retains up to 50% of the risk exposure under its mortgage insurance covers with the remaining risk exposure ceded to approved reinsurers. Approved reinsurers during the year included Asia Insurance Company, Limited, Hang Seng Insurance Company, Limited, HSBC Insurance (Asia) Limited, PMI Mortgage Insurance Co. and United Guaranty Mortgage Indemnity Company.

During the year, the Company launched the HOME Programme under which the Company retained 50% of risk exposure under its mortgage insurance cover before ceding the remaining risk exposure to ML Re.

HKMC Mortgage Management Limited is a wholly owned subsidiary of the Company as set out in Note 19 to the financial statements.

AUDITORS

The accounts have been audited by PricewaterhouseCoopers (having previously been appointed by the Board to fill the casual vacancy arising by reason of the resignation of Arthur Andersen & Co with effect from 1 July 2002) who retire and, being eligible, offer themselves for re-appointment.

On behalf of the Board of Directors

Antony Leung
Chairman

Hong Kong,
8 April 2003.

Report of the Auditors

AUDITORS' REPORT TO THE SHAREHOLDER OF THE HONG KONG MORTGAGE CORPORATION LIMITED (Incorporated in Hong Kong with limited liability)

We have audited the financial statements on pages 43 to 73, which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Hong Kong Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

BASIS OF OPINION

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2002 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong,
8 April 2003.

Consolidated Profit and Loss Account

For the year ended 31 December 2002

	Notes	**2002 HK$'000**	2001 HK$'000
Interest income	3	**908,495**	1,019,025
Interest expense	4	**(477,539)**	(694,595)
Net interest income		**430,956**	324,430
Other income, net	5	**57,917**	34,855
Operating income		**488,873**	359,285
Operating expenses	6	**(113,330)**	(101,424)
Operating profit before provisions		**375,543**	257,861
Provisions for bad and doubtful loans	7	**(86,054)**	(35,299)
Operating profit		**289,489**	222,562
Net gain on disposal of investment in debt securities	8	**2,580**	–
Profit before taxation		**292,069**	222,562
Taxation	9(a)	**(28,260)**	32,964
Net profit for the year	11	**263,809**	255,526

Consolidated Balance Sheet

As at 31 December 2002

	Notes	2002 HK$'000	2001 HK$'000
ASSETS			
Cash and short-term funds	12, 20	212,863	1,256,740
Interest and remittance receivables	13	310,551	337,176
Prepayments, deposits and other assets	14	110,755	36,326
Tax recoverable	9(b)	–	5,109
Deferred expense, net	15	21,876	38,273
Mortgage portfolio, net	16	28,257,727	19,777,884
Investment in debt securities	18, 20	3,244,520	1,736,266
Fixed assets	17	28,323	32,058
		32,186,615	23,219,832
LIABILITIES			
Interest payable	21	223,122	194,216
Accounts payable, accrued expenses and other liabilities	22	136,079	60,755
Provisions for taxation	9(b)	23,151	–
Unearned premiums	10	79,444	60,301
Debt securities	20, 23	28,615,000	20,058,550
		29,076,796	20,373,822
SHAREHOLDER'S EQUITY			
Share capital	25	2,000,000	2,000,000
Retained profits	28	1,093,842	840,059
Contingency reserve	28	15,977	5,951
		3,109,819	2,846,010
		32,186,615	23,219,832

Yam Chi Kwong, Joseph
Deputy Chairman

Chan Tak Lam, Norman
Executive Director

Balance Sheet

As at 31 December 2002

	Notes	2002 HK$'000	2001 HK$'000
ASSETS			
Cash and short-term funds	12, 20	212,863	1,256,740
Interest and remittance receivables	13	310,551	337,176
Prepayments, deposits and other assets	14	110,755	36,326
Tax recoverable	9(b)	–	5,109
Deferred expense, net	15	21,876	38,273
Mortgage portfolio, net	16	28,257,727	19,777,884
Investment in debt securities	18, 20	3,244,520	1,736,266
Investment in a subsidiary	19	30	–
Fixed assets	17	28,323	32,058
		32,186,645	23,219,832
LIABILITIES			
Interest payable	21	223,122	194,216
Accounts payable, accrued expenses and other liabilities	22	136,079	60,755
Provisions for taxation	9(b)	23,151	–
Unearned premiums	10	79,444	60,301
Debt securities	20, 23	28,615,000	20,058,550
		29,076,796	20,373,822
SHAREHOLDER'S EQUITY			
Share capital	25	2,000,000	2,000,000
Retained profits	28	1,093,872	840,059
Contingency reserve	28	15,977	5,951
		3,109,849	2,846,010
		32,186,645	23,219,832

Yam Chi Kwong, Joseph
Deputy Chairman

Chan Tak Lam, Norman
Executive Director

Consolidated Statement of Changes in Equity

For the year ended 31 December 2002

	Notes	2002 HK$'000	2001 HK$'000
Total equity as at 1 January	28	2,846,010	2,590,484
Net profit for the year	28	263,809	255,526
Total equity as at 31 December	28	3,109,819	2,846,010

Consolidated Cash Flow Statement

For the year ended 31 December 2002

	Notes	2002 HK$'000	2001 HK$'000
Net cash outflow from operating activities	26	**(8,058,702)**	(8,233,329)
Investing activities			
Purchase of fixed assets		**(10,799)**	(21,208)
Purchase of investment in debt securities		**(2,290,843)**	(1,406,381)
Proceeds from redemption of investment in debt securities		**781,334**	974,678
Net cash outflow from investing activities		**(1,520,308)**	(452,911)
Net cash outflow before financing		**(9,579,010)**	(8,686,240)
Financing			
Proceeds from issue of debt securities		**14,935,133**	15,448,046
Redemption of debt securities		**(6,400,000)**	(7,146,000)
Net cash inflow from financing		**8,535,133**	8,302,046
Decrease in cash and cash equivalents		**(1,043,877)**	(384,194)
Beginning cash and cash equivalents		**1,256,740**	1,640,934
Ending cash and cash equivalents		**212,863**	1,256,740
Analysis of the balance of cash and cash equivalents			
Cash and short-term funds	12	**212,863**	1,256,740

Notes to the Financial Statements

1. BASIS OF PREPARATION

The financial statements of The Hong Kong Mortgage Corporation Limited (the "Company") and its subsidiary (collectively the "Group") have been prepared under the historical cost convention, and in accordance with the provisions of the Hong Kong Companies Ordinance and accounting principles generally accepted in Hong Kong.

2. PRINCIPAL ACCOUNTING POLICIES

a. Consolidation

The consolidated accounts include the accounts of the Company and its subsidiary made up to 31 December. A subsidiary, in accordance with the Hong Kong Companies Ordinance, is a company in which the Company, directly or indirectly, holds more than half of the issued share capital, or controls more than half of the voting power, or controls the compositions of the Board of Directors. In the Company's balance sheet, an investment in a subsidiary is stated at cost less any impairment losses.

All significant intercompany transactions and balances within the Group are eliminated on consolidation.

b. Adoption of Statements of Standard Accounting Practice ("SSAPs")

In the current year, the Group has adopted the following SSAPs issued by the Hong Kong Society of Accountants which are effective for accounting periods commencing on or after 1 January 2002:

SSAP 1 (revised):	Presentation of financial statements
SSAP 15 (revised):	Cash flow statements
SSAP 34:	Employee benefits

There were no material effects on net profit and opening balance of retained profit for the current year and prior year from the adoption of the above accounting standards.

c. Income and expense recognition

Provided it is probable that the economic benefits associated with a transaction will flow to the Group and the income and costs, if applicable, can be measured reliably, interest income, interest expense and others are recognized on the following bases:

(i) Interest income and expense
Interest income and expense are accrued on a time-apportioned basis on the principal outstanding and at the rate applicable, except in case of bad and doubtful loans (Note 2(h)).

(ii) Fee income and expense

Fee income and expense are recognized when earned or incurred.

d. Fixed assets and depreciation

Fixed assets are stated at cost less accumulated depreciation. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after the fixed assets have been put into operation, such as repairs and maintenance and overhaul costs, is normally charged to the profit and loss account in the year in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of fixed assets, the expenditure is capitalized as an additional cost of the fixed asset.

Depreciation is calculated on a straight-line basis at annual rates estimated to write off the cost of each asset over its expected useful life.

The annual rates are as follows:

Leasehold improvements	over the unexpired period of the lease
Furniture and fixtures	over the unexpired period of the lease
Computer and related software	33-1/3%
Office equipment	33-1/3%
Motor vehicle	25%

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that furniture and equipment and other fixed assets are impaired. If any such indication exists, the recoverable amount of the assets is estimated and where relevant, an impairment loss is recognized to reduce the asset to its recoverable amount. Such impairment losses are recognized in the profit and loss account.

The gain or loss on disposal of a fixed asset is the difference between the net sales proceeds and the carrying amount of the relevant assets, and is recognized in the profit and loss account.

e. Foreign currencies

The books and records are maintained in Hong Kong dollars. Transactions in other currencies during the year are translated into Hong Kong dollars at exchange rates prevailing in effect at the time of the transactions. Monetary assets and liabilities denominated in other currencies at the balance sheet date are translated into Hong Kong dollars at rates of exchange in effect at the balance sheet date. Exchange differences are dealt with in the profit and loss account.

f. Deferred taxation

Deferred taxation is provided under the liability method at the current tax rate in respect of significant timing differences between profit as computed for taxation purposes and profit as stated in the financial statements, except where it is considered that no liability will arise in the foreseeable future.

Deferred tax assets are not recognized unless the related benefits are expected to crystallize in the foreseeable future.

g. Operating leases

Leases where substantially all the rewards and risks of ownership remain with the leasing company are accounted for as operating leases. Rental payments under operating leases are charged to the profit and loss account on a straight-line basis over the period of the relevant leases. Lease income from operating sub-leases is recognized on a straight-line basis over the lease term.

h. Bad and doubtful loans

Provisions for bad and doubtful loans are charged to the profit and loss account on a monthly basis in accordance with the guidelines approved by the Board of Directors. General provision relates to exposures not separately identified but known from experience to exist in the mortgage portfolio. Specific provision for bad and doubtful loans generally applies to a mortgage loan that is overdue for more than 90 days and the current market value of the underlying property is less than the outstanding principal balance ("OPB") of the mortgage loan. When there is no longer any realistic prospect of recovery of the OPB of the mortgage loan, it will be written off at the discretion of the Credit Committee.

The accrual of interest on mortgage loans is discontinued when they become overdue for 90 days or more. Any previously accrued and uncollected interests on the loans are reversed against current period's interest income. Interest income on the overdue loans is only recognized when all arrears of principal and interest from the borrowers have been cleared and it is probable that the customer is capable of fully servicing his obligations under the terms of the loans for the foreseeable future.

i. Repossessed assets

Assets acquired by repossession of collateral for realization are reclassified from "Mortgage portfolio, net" to "Other receivables, net" which are written down to forced sale value of the repossessed properties by setting off related specific provisions against the OPB of the mortgage loans.

j. Investment in debt securities

Held-to-maturity investments are investments which the Group has the expressed intention and ability to hold to maturity. They are carried at amortized cost less any provision for impairment in value.

The carrying amounts of held-to-maturity securities are reviewed at each balance sheet date to assess the credit risk and whether the carrying amounts are expected to be recovered. Provisions are made when the carrying amounts are not expected to be recovered and are recognized as an expense in the profit and loss account.

Provision against the carrying value of held-to-maturity securities are reversed to the profit and loss account when the circumstances and events that led to the write-downs or write-offs cease to exist and there is persuasive evidence that the new circumstances and events will persist in the foreseeable future.

Upon disposal or transfer of held-to-maturity securities, any profit and loss thereon is accounted for in the profit and loss account.

k. Notes issuance

The notes issued under the Note Issuance Programme ("NIP") and Debt Issuance Programme ("DIP") and notes offered to retail investors through the placing banks are stated at par value under debt securities in the balance sheet. Interest on the notes is accrued on a daily basis and charged to the profit and loss account. Discount on the notes is regarded as deferred expense whereas premium is accounted for as deferred income. Discount and premium are amortized over the entire life of the notes on an effective interest rate method and are accounted for as adjustment to the interest expense of the notes. The arranger and custodian fees paid under the NIP and DIP are amortized to the profit and loss account over the life of the notes issued.

On redemption/repurchase of the notes, the resulting gains or losses, being the difference between the redemption/repurchase amount and the carrying amount, are recognized in the profit and loss account in the year in which the redemption/repurchase takes place.

l. Interest rate swap ("IRS") contracts for hedging purposes

The IRS contracts are solely entered into as a hedge against interest rate risk on the assets and liabilities.

The net interest payable or receivable arising from the IRS contracts is recorded on an accrual basis and charged against interest income or interest expenses of the underlying assets and liabilities.

Gains and losses on early termination of the IRS contracts are immediately recognized in the profit and loss account when the underlying assets or liabilities are early disposed of or redeemed.

Gains and losses on early termination of the IRS contracts originally accounted for as a hedge to an asset or a liability are amortized over the remaining original life of the IRS contracts when the underlying asset and liability is not early disposed of or redeemed.

m. Mortgage guarantee business

The mortgage guarantee business of the Company is accounted for on the annual accounting basis. Under the annual accounting approach, the Company makes provisions based on credible estimates of future income and outgoings to determine the underwriting result for the current accounting period. The underwriting result includes any adjustments arising from the correction of the previous estimates.

Gross premiums represent direct business written with the Authorized Institutions during an accounting period. The gross premiums include the reinsurance premiums to be paid to the approved reinsurers for reinsurance cover. The net premiums received by the Company comprise the risk premiums and servicing fees earned by the Company. The net premiums are recognized as income on a time-apportioned basis when the insurance coverage has been effective.

Unearned premiums represent that portion of net premiums written which are estimated to relate to risks and services subsequent to the balance sheet date.

Provisions are made for outstanding claims, claims incurred but not reported and loss reserve at the end of each year. For risk sharing business, 50% of the net risk premiums earned is set aside as a Contingency Reserve for a reasonable period of time in accordance with relevant regulatory guidelines and considered by directors as appropriate.

n. Guaranteed mortgage-backed pass-through securitization

Upon completion of the sale of a mortgage pool to a third party Special Purpose Company ("SPC") under the Guaranteed Mortgage-Backed Pass-Through Securitization Programme ("MBS Pass-Through Programme") and the US$3 Billion Mortgage-Backed Securitization Programme ("Bauhinia MBS Programme"), the Company derecognizes the applicable mortgage pool from its balance sheet; recognizes all assets obtained and liabilities incurred in consideration as proceeds of the sale, including cash and contingent liability in respect of guarantee on timely payment of principal and interest on the MBS; and recognizes in the profit and loss account any gain or loss on the sale.

In the event that the Company guarantees the collectibility of the mortgage pool, it recognizes a monthly guarantee fee income from the SPC in the profit and loss account on a time-apportioned basis. Since the Company assumes all credit risks arising from the mortgage loans under the MBS Pass-Through Programme and the Bauhinia MBS Programme, it adheres to the loan provisioning guidelines in Note 2(h) approved by the Board of Directors for making necessary provisions in the profit and loss account.

o. Employee benefits

(i) Employee leave entitlements

Employee entitlements to annual leave are recognized when they accrue to employees. An accrual is made for the estimated liability for annual leave and long-service leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave, maternity or paternity leave are recognized when the absence occurs.

(ii) Bonus plans

Liabilities for bonus plans due wholly within twelve months after the balance sheet date are recognized when the Group has a present or constructive obligation as a result of services rendered by employees and a reliable estimate of the obligation can be made.

(iii) Pension obligations

The Group offers a mandatory provident fund scheme and a defined contribution plan, the assets of which are generally held in separate trustee-administered funds. These pension plans are generally funded by payments from employees and by the relevant Group companies.

The Group's contributions to the mandatory provident funds scheme and defined contribution retirement schemes are expensed as incurred and are reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions.

p. Contingent liabilities and contingent assets

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognized because it is not probable that an outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognized but is disclosed in the notes to the accounts. When a change in the probability of an outflow occurs so that outflow is probable, it will then be recognized as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Group.

Contingent assets are not recognized but are disclosed in the notes to the accounts when an inflow of economic benefits is probable. When inflow is virtually certain, an asset is recognized.

q. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition including cash, balances with banks and other financial institutions, treasury bills, other eligible bills and certificates of deposit.

3. INTEREST INCOME

	The Group	
	2002	2001
	HK$'000	HK$'000
Mortgage portfolio	**771,720**	776,631
Cash and short-term funds	**39,939**	191,442
Investment in debt securities – listed	**22,838**	5,760
Investment in debt securities – unlisted	**73,998**	45,192
	908,495	1,019,025

4. INTEREST EXPENSE

	The Group	
	2002	2001
	HK$'000	HK$'000
Bank loans, short-term bills and debt securities wholly repayable within 5 years	**474,842**	689,616
Debt securities not wholly repayable within 5 years	**2,697**	4,979
	477,539	694,595

5. OTHER INCOME, NET

	The Group	
	2002	2001
	HK$'000	HK$'000
Early prepayment fees and late charges	**3,497**	6,435
Subletting income of office premises *(Note 27)*	**2,760**	2,640
Net insurance premiums earned *(Note 10)*	**32,931**	24,163
Guarantee fees income on MBS	**7,676**	3,318
Excess servicing receipts on MBS	**6,122**	1,329
Issuance costs of debt securities and MBS	**(3,604)**	(2,829)
Others	**8,535**	(201)
	57,917	34,855

6. OPERATING EXPENSES

	The Group	
	2002	2001
	HK$'000	HK$'000
Staff costs		
Salaries and benefits	**61,493**	60,269
Pension costs – defined contribution plans	**2,867**	2,378
Premises		
Rental	**11,001**	10,422
Others	**3,348**	3,188
Directors' emolument	**–**	–
Depreciation	**14,534**	10,227
Consultancy fees	**7,227**	2,776
Auditors' remuneration	**230**	250
Other operating expenses	**12,630**	11,914
	113,330	101,424

7. PROVISIONS FOR BAD AND DOUBTFUL LOANS

	The Group	
	2002	2001
	HK$'000	HK$'000
Provisions against mortgage portfolio		
– specific	**63,945**	25,712
– general	**22,109**	9,587
	86,054	35,299

8. NET GAIN ON DISPOSAL OF INVESTMENT IN DEBT SECURITIES

	The Group	
	2002	2001
	HK$'000	HK$'000
Net gain on disposal of investment in debt securities	**2,580**	–

During the year, investment in debt securities classified as held-to-maturity amounting to HK$300,000,000 was sold due to the deterioration in the credit ratings of the issuers.

9. TAXATION

(a) Taxation charge/(credit) in the profit and loss account represents:–

	The Group	
	2002	2001
	HK$'000	HK$'000
Hong Kong profits tax		
Provision for the year	**29,448**	1,414
Overprovision in respect of prior years	**(849)**	(36,620)
	28,599	(35,206)
Deferred taxation	**(339)**	2,242
	28,260	(32,964)

Hong Kong profits tax has been provided at the rate of 16% (2001: 16%) on the estimated assessable profit for the year. Deferred taxation has been provided on the timing difference arising from tax allowance in excess of depreciation. There is no significant unprovided deferred taxation as at and for the year ended 31 December 2002.

(b) Provisions/(Tax recoverable) for taxation in the balance sheet represents:–

	The Group & the Company	
	2002	2001
	HK$'000	HK$'000
Tax recoverable for Hong Kong profits tax	**–**	(9,991)
Hong Kong profits tax	**18,608**	–
Deferred taxation	**4,543**	4,882
	23,151	(5,109)

10. REVENUE ACCOUNT FOR MORTGAGE GUARANTEE BUSINESS

	The Group	
	2002	2001
	HK$'000	HK$'000
Gross premiums written	**158,025**	204,791
Reinsurance premiums	**(104,041)**	(146,049)
Net premiums written	**53,984**	58,742
Add: unearned premiums brought forward	**60,301**	25,894
unearned premiums carried forward	**(79,444)**	(60,301)
Increase in unearned premiums	**(19,143)**	(34,407)
Net premiums earned before provision	**34,841**	24,335
Provisions for outstanding claims and loss reserve *(Note 24)*	**(1,910)**	(172)
Net premiums earned *(Note 5)*	**32,931**	24,163
Management expenses	**(3,287)**	(3,320)
Underwriting profit	**29,644**	20,843

The management expenses formed part of the operating expenses in Note 6.

11. NET PROFIT FOR THE YEAR

The net profit for the year is dealt with in the accounts of the Company to the extent of HK$263,839,000 (2001: HK$255,526,000).

12. CASH AND SHORT-TERM FUNDS

	The Group & the Company	
	2002	2001
	HK$'000	HK$'000
Cash at banks *(Note 20)*	**1,042**	2,664
Time deposits with banks *(Note 20)*	**211,821**	1,254,076
	212,863	1,256,740

13. INTEREST AND REMITTANCE RECEIVABLES

	The Group & the Company	
	2002	2001
	HK$'000	HK$'000
Interest receivable from mortgage portfolio	**50,753**	34,749
Interest receivable from interest rate swap contracts	**200,741**	244,674
Interest receivable from investment in debt securities	**36,559**	3,038
Interest receivable from time deposits with banks	**63**	1,638
Loan instalments, in transit, from the Servicers	**22,435**	53,077
	310,551	337,176

14. PREPAYMENTS, DEPOSITS, AND OTHER ASSETS

	The Group & the Company	
	2002	2001
	HK$'000	HK$'000
Office rental deposit	**2,293**	2,293
Corporate club debentures	**670**	670
Other receivables, net	**78,245**	23,401
Others	**29,547**	9,962
	110,755	36,326

The Group reclassified mortgage loans from "Mortgage portfolio, net" (Note 16(a)) to "Other receivables, net" of which the mortgage loans were overdue for 180 days or more, or the collateral properties were repossessed, or the mortgagors became bankrupt. The net amount represented the forced sale value of the collateral properties after setting off specific provisions of HK$53,081,000 (2001: HK$19,894,000) against the outstanding principal balance of the mortgage loans of HK$131,326,000 (2001: HK$43,295,000).

As at 31 December 2002, the forced sale value of the repossessed properties under "other receivables, net" amounted to HK$32,067,000 (2001: HK$14,814,000).

15. DEFERRED EXPENSE, NET

	The Group & the Company	
	2002	2001
	HK$'000	HK$'000
Deferred expenses/(income) arising on issuance of debt securities		
At 1 January	**38,273**	112,879
Additions for the year		
– deferred expenses	**40,273**	137,459
– deferred income	**(18,956)**	(1,955)
Less: amortization	**(37,714)**	(210,110)
At 31 December	**21,876**	38,273

16. MORTGAGE PORTFOLIO, NET

(a) Mortgage portfolio less provisions

	The Group & the Company	
	2002	2001
	HK$'000	HK$'000
Outstanding principal balance of mortgage portfolio *(Note 20)*	**28,318,693**	19,812,453
Provisions for bad and doubtful loans		
– specific	**(9,335)**	(2,002)
– general	**(51,631)**	(32,567)
	28,257,727	19,777,884

At 31 December 2002, the mortgage portfolio had a weighted average remaining term of 13 years on a contractual basis, without taking into account any prepayment of the mortgage loans. Final maturity of the mortgage portfolio is in the year 2038.

(b) Provisions for bad and doubtful loans

	The Group & the Company			
	Specific HK$'000	General HK$'000	Total HK$'000	Suspended Interest HK$'000
At 1 January 2002	**2,002**	**33,894**	**35,896**	**4,214**
Amounts written off	**(56,612)**	**(59)**	**(56,671)**	**(4,500)**
Charge to profit & loss account	**63,945**	**22,109**	**86,054**	**–**
Interest suspended during the year	**–**	**–**	**–**	**4,841**
Suspended interest recovered	**–**	**–**	**–**	**(992)**
At 31 December 2002	**9,335**	**55,944**	**65,279**	**3,563**

	The Group & the Company			
	Specific HK$'000	General HK$'000	Total HK$'000	Suspended Interest HK$'000
At 1 January 2001	13,248	24,307	37,555	2,958
Amounts written off	(36,958)	–	(36,958)	(4,325)
Charge to profit & loss account	25,712	9,587	35,299	–
Interest suspended during the year	–	–	–	6,755
Suspended interest recovered	–	–	–	(1,174)
At 31 December 2001	2,002	33,894	35,896	4,214

As regards the loan provisioning on the guaranteed mortgage loans under the two MBS programmes, a sum of HK$4,313,000 general provision was grouped under "Other provisions" (Note 22). (2001: HK$1,327,000).

(c) The total mortgage loans on which interest has been placed in suspense or has ceased to accrue are as follows:–

	The Group & the Company	
	2002 HK$'000	2001 HK$'000
Gross mortgage loans	**88,644**	49,920
Specific provisions	**(8,668)**	(2,002)
	79,976	47,918

Specific provisions were made after taking into account the current market value of the collateral of the delinquent loans.

17. FIXED ASSETS

	The Group & the Company					
	Leasehold improvements	Furniture and fixtures	Computers & related software	Office equipment	Motor vehicle	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Cost						
As at 1 January 2002	11,240	1,783	59,812	2,190	539	75,564
Additions	175	–	10,343	281	–	10,799
Disposal /write-offs	–	–	(40)	–	–	(40)
As at 31 December 2002	**11,415**	**1,783**	**70,115**	**2,471**	**539**	**86,323**
Accumulated depreciation						
As at 1 January 2002	6,889	1,127	33,277	1,674	539	43,506
Charge for the year	1,494	219	12,594	227	–	14,534
Disposal /write-offs	–	–	(40)	–	–	(40)
As at 31 December 2002	**8,383**	**1,346**	**45,831**	**1,901**	**539**	**58,000**
Net book value						
Ending balance as at 31 December 2002	**3,032**	**437**	**24,284**	**570**	**-**	**28,323**
Ending balance as at 31 December 2001	4,351	656	26,535	516	–	32,058

18. INVESTMENT IN DEBT SECURITIES

	The Group & the Company	
	2002	2001
	HK$'000	HK$'000
Investment in debt securities		
Listed outside Hong Kong	**1,047,040**	90,235
Unlisted	**2,197,480**	1,646,031
	3,244,520	1,736,266

	The Group & the Company	
	2002	2001
	HK$'000	HK$'000
Market value of listed securities		
Issued by:		
– corporate entities	1,072,647	31,545
– others	31,568	60,322
	1,104,215	91,867

The investment in debt securities included above are issued by:

	The Group & the Company	
	2002	2001
	HK$'000	HK$'000
Banks and other financial institutions	2,362,022	1,646,031
Corporate entities	850,949	29,961
Others	31,549	60,274
	3,244,520	1,736,266

19. INVESTMENT IN A SUBSIDIARY

	The Company	
	2002	2001
	HK$'000	HK$'000
Unlisted shares, at cost	1,000	–
Due to a subsidiary	(970)	–
	30	–

The amount due to a subsidiary is unsecured, interest free and has no fixed terms of repayment.

The details of the subsidiary at 31 December 2002 are:

Name	Place of Incorporation	Principal activities	Nominal value of issued capital	Class of shares held	% of ordinary shares directly held
HKMC Mortgage Management Limited	Hong Kong	Mortgage purchases	HK$1,000,000	Ordinary	100%

20. MATURITY PROFILE

	The Group & the Company						
	2002						
	Repayable on demand HK$'000	3 months or less HK$'000	1 year or less but over 3 months HK$'000	5 years or less but over 1 year HK$'000	After 5 years HK$'000	Undated HK$'000	Total HK$'000
Assets							
- Cash and short-term funds	212,863	-	-	-	-	-	212,863
- Mortgage portfolio	13,509	707,390	1,607,070	9,071,777	16,912,400	6,547	28,318,693
- Investment in debt securities	-	454,235	386,359	1,926,145	477,781	-	3,244,520
	226,372	1,161,625	1,993,429	10,997,922	17,390,181	6,547	31,776,076
Liabilities							
- Debt securities	-	130,000	3,127,550	25,257,450	100,000	-	28,615,000

	The Group & the Company						
	2001						
	Repayable on demand HK$'000	3 months or less HK$'000	1 year or less but over 3 months HK$'000	5 years or less but over 1 year HK$'000	After 5 years HK$'000	Undated HK$'000	Total HK$'000
Assets							
– Cash and short-term funds	2,664	1,254,076	–	–	–	–	1,256,740
– Mortgage portfolio	10,133	453,827	1,004,146	5,744,416	12,598,484	1,447	19,812,453
– Investment in debt securities	–	399,994	50,037	1,286,235	–	–	1,736,266
	12,797	2,107,897	1,054,183	7,030,651	12,598,484	1,447	22,805,459
Liabilities							
– Debt securities	–	2,750,000	3,650,000	13,558,550	100,000	–	20,058,550

21. INTEREST PAYABLE

	The Group & the Company	
	2002 HK$'000	2001 HK$'000
Debt securities	223,122	194,216

22. ACCOUNTS PAYABLE, ACCRUED EXPENSES AND OTHER LIABILITIES

	The Group & the Company	
	2002 HK$'000	2001 HK$'000
Accounts payable and accrued expenses	127,015	55,411
Other provisions (Note 29)	9,064	5,344
	136,079	60,755

23. DEBT SECURITIES

	The Group & the Company	
	2002	2001
	HK$'000	HK$'000
Bills and notes issued under the		
– NIP	5,000,000	10,500,000
– DIP	17,491,000	8,896,000
Other notes	6,124,000	662,550
	28,615,000	20,058,550
At 1 January	20,058,550	11,621,000
Issuance for the year	14,956,450	15,583,550
Less: Redemption for the year	(6,400,000)	(7,146,000)
At the end of the year	28,615,000	20,058,550

Notes and bills issued during the year comprise:

	The Group & the Company		
	NIP	DIP	Other notes
	HK$'000	HK$'000	HK$'000
Amount issued	–	9,495,000	5,461,450
Consideration received	–	9,494,712	5,440,421

All the debt securities issued are unsecured obligations of the Group, and are issued for the purposes of providing general working capital and refinancing.

24. PROVISIONS FOR MORTGAGE GUARANTEE BUSINESS

Provisions for outstanding claims under the MIP are recorded net of recoveries from the approved reinsurers. At 31 December 2002, a loss reserve of HK$403,000 (2001: nil) was set up for risk sharing business. For the year ended 31 December 2002, the gross claim was HK$9,295,000 (2001: HK$1,864,000), of which HK$7,788,000 (2001: HK$1,692,000) was recovered from the approved reinsurers.

25. SHARE CAPITAL

	2002 & 2001 HK$'000
Authorized	
3 billion ordinary shares of HK$1 each	3,000,000
Issued and fully paid	
2 billion ordinary shares of HK$1 each	2,000,000

26. NOTE TO THE CASH FLOW STATEMENT

Reconciliation of profit before taxation to net cash outflow from operating activities:

	The Group 2002 HK$'000	The Group 2001 HK$'000
Profit before taxation	292,069	222,562
Depreciation	14,534	10,227
Amortization of deferred expenses	37,714	210,110
Provisions for bad and doubtful loans	86,054	35,299
Mortgage portfolio written off net of recoveries	(56,671)	(36,958)
Amortization of investment in debt securities	3,835	190
Net gain on disposal of investment in debt securities	(2,580)	–
Operating cash inflow before changes in operating assets and liabilities	374,955	441,430
Decrease / (increase) in interest and remittance receivables	26,625	(88,064)
Increase in prepayments, deposits and other assets	(74,429)	(30,690)
Increase in mortgage portfolio	(8,506,240)	(8,693,213)
Increase in interest payable	28,906	73,976
Increase in accounts payable, accrued expenses and other liabilities	72,338	15,122
Increase in unearned premiums	19,143	34,407
Net cash outflow from operating activities before taxation	(8,058,702)	(8,247,032)
Hong Kong profits tax paid	–	(12,171)
Hong Kong profits tax refunded	–	25,874
Net cash outflow from operating activities	(8,058,702)	(8,233,329)

27. RELATED PARTY TRANSACTIONS

Both Mr. Norman Chan and Mr. Tony Latter are the Deputy Chief Executives of the Hong Kong Monetary Authority. (Mr. Tony Latter resigned as Deputy Chief Executive of the Hong Kong Monetary Authority and Executive Director of the Company with effect from 4 January 2003.) The Company is a member under the Central Moneymarkets Unit ("CMU") Membership Agreement with the Monetary Authority through his CMU in respect of the Company's HK dollar debt issuance and securities investment.

On 12 February 1999, the Company entered into a sub-tenancy agreement with Exchange Fund Investment Limited ("EFIL") in which EFIL occupied part of the Company's office premises at a fair market price. EFIL is wholly owned by the Exchange Fund. The sub-letting income was approximately HK$2.8 million for the year ended 31 December 2002 (2001: HK$2.6 million). Mr. Norman Chan is a director of EFIL. The Company and EFIL terminated the sub-tenancy agreement with effect from 1 February 2003.

Mr. Lam Yim Nam is the Deputy Chief Executive of Bank of China (Hong Kong) Limited, which is (a) an approved seller/servicer under the MPP; (b) an approved Authorized Institution under the MIP; (c) a placing bank in the Company's retail note issuance in January 2002; (d) an underwriting bank, a placing bank and principal paying agent in the Company's retail note issuance in May 2002 and October 2002; (e) a co-lead manager in the Series 2002-1 issue of the Company's Bauhinia MBS Programme; and (f) an approved Authorized Institution under the HOME Programme.

Mr. Brian Yiu is the Head, Debt Capital Markets, Global Markets – Asian Fixed Income of Standard Chartered Bank, which is (a) selling group member under the DIP; (b) an approved seller/servicer under the MPP; (c) an Approved Authorized Institution under the MIP; (d) a placing bank in the Company's retail note issuance in January 2002; (e) an underwriting bank and a placing bank in the Company's retail note issuance in May 2002 and October 2002; and (f) an approved Authorized Institution under the HOME Programme.

The Hon. Sin Chung Kai is an Assistant IT Project Manager of The Hong Kong and Shanghai Banking Corporation Limited which is (a) a primary dealer under the DIP; (b) an approved seller/servicer under the MPP; (c) an approved Authorized Institution under the MIP; (d) a placing bank in the Company's retail note issuances in October 2001 and January 2002; (e) an underwriting bank and a placing bank in the Company's retail note issuance in May 2002 and October 2002; (f) a dealer in the Company's Bauhinia MBS Programme and a co-lead manager in the Series 2002-1 issue of such programme; and (g) an approved Authorized Institution under the HOME Programme.

The Hon. Sin Chung-kai is also a Member of The Hong Kong Housing Authority which is an approved seller/servicer under the MPP from which the Company has purchased mortgage loans of around HK$18 billion.

28. RESERVES

	The Group			
	Share capital HK$'000	Contingency reserve HK$'000	Retained profits HK$'000	Total HK$'000
Balance at 1 January 2001	2,000,000	670	589,814	2,590,484
Net profit for the year	–	–	255,526	255,526
Transfer of 50% of net risk premium earned from retained profits to contingency reserve	–	5,281	(5,281)	–
Balance at 31 December 2001	2,000,000	5,951	840,059	2,846,010
Net profit for the year	–	–	263,809	263,809
Transfer of 50% of net risk premium earned from retained profits to contingency reserve	-	10,026	(10,026)	–
Balance at 31 December 2002	**2,000,000**	**15,977**	**1,093,842**	**3,109,819**

	The Company			
	Share capital HK$'000	Contingency reserve HK$'000	Retained profits HK$'000	Total HK$'000
Balance at 1 January 2001	2,000,000	670	589,814	2,590,484
Net profit for the year	–	–	255,526	255,526
Transfer of 50% of net risk premium earned from retained profits to contingency reserve	–	5,281	(5,281)	–
Balance at 31 December 2001	2,000,000	5,951	840,059	2,846,010
Net profit for the year	–	–	263,839	263,839
Transfer of 50% of net risk premium earned from retained profits to contingency reserve	-	10,026	(10,026)	–
Balance at 31 December 2002	**2,000,000**	**15,977**	**1,093,872**	**3,109,849**

29. EFFECTS ON THE CONSOLIDATED FINANCIAL STATEMENTS OF SPECIAL PURPOSE ENTITIES

In October 1999, the Company launched the MBS Pass-Through Programme under which the Company, in return for a guarantee fee, guarantees the timely payment of principal and interest in respect of the MBS issued by HKMC Funding Corporation (1) Limited, a Hong Kong special purpose company ("SPC") formed for the purpose of this programme.

In December 2001, the Company also launched the Bauhinia MBS Programme, under which Bauhinia MBS Limited, an SPC incorporated in the Cayman Islands for the purpose of this programme, will from time to time issue mortgage-backed securities. MBS will be issued by Bauhinia MBS Limited in different currencies under different tranches.

The above two SPCs are considered to be bankruptcy remote "orphan" companies. In the context of section 2(4) of the Hong Kong Companies Ordinance, the two SPCs are not construed as the Group's subsidiaries. In accordance with the provisions of paragraph 27 of SSAP 32 "Consolidated financial statements and accounting for investments in subsidiaries", the financial statements of these two SPCs have therefore not been consolidated into the Group's financial statements for the year ended 31 December 2002. With regard to the mortgage loans sold by the Company to the two SPCs, this would be effected by way of a "clean sale" of such mortgage loans to the SPCs. All the mortgage loans sold to the SPCs will no longer be recognized as an asset in the balance sheet of the Group.

Up to 31 December 2002, HKMC Funding Corporation (1) Limited had issued 7 series of MBS totalling HK$2,268 million in respect of which the Company had guaranteed the timely payment of principal and interest. At 31 December 2002, the aggregate security principal balance of MBS guaranteed by the Company under the MBS Pass-Through Programme was HK$626.1 million. As regards the Company's loan provisioning on the guaranteed mortgage loans under the MBS Pass-Through Programme, a sum of HK$1,498,000 (2001: HK$1,327,000) was grouped under "Other provisions" (Note 22). The loan provision of HK$171,000 (2001: HK$13,000 written back) was charged to the profit & loss account of the Group.

In February 2002, Bauhinia MBS Limited issued its debut MBS totalling HK$2 billion in respect of which the Company had guaranteed the timely payment of principal and interest. At 31 December 2002, the aggregate security principal balance of MBS guaranteed by the Company under the Bauhinia MBS Programme was HK$1,690 million. As regards the Company's loan provisioning on the guaranteed mortgage loans under the Bauhinia MBS Programme, a sum of HK$2,815,000 was grouped under "Other provisions" (Note 22) and charged to the profit & loss account of the Group. No financial accounts had been prepared for Bauhinia MBS Limited at 31 December 2001.

The operating profit after tax and the major assets and liabilities of HKMC Funding Corporation (1) Limited and Bauhinia MBS Limited are set out below:

	HKMC Funding Corporation (1) Limited HK$'000	Bauhinia MBS Limited HK$'000
For the year ended 31 December 2002		
Operating profit after tax	22	3
As at 31 December 2002		
Mortgage portfolio, net	620,701	1,642,612
Total Assets	627,707	1,693,082
Debt securities	626,064	1,690,456
Total Liabilities	627,643	1,693,071
Total Shareholders' Equity	64	11

In accordance with paragraph 46 of SSAP 32, the Group has set out below the significant items of the pro-forma consolidated profit and loss account and balance sheet of the Group, HKMC Funding Corporation (1) Limited and Bauhinia MBS Limited for the year ended 31 December 2002 & 2001:

	2002 HK$'000	2001 HK$'000
Net interest income for the year	443,803	327,842
Net profit for the year	263,834	255,546
Mortgage portfolio, net	30,516,727	20,635,473
Cash and short-term funds	215,562	1,268,523
Interest and remittance receivables	336,995	343,999
Total Assets	34,474,398	24,095,571
Debt securities	30,931,520	20,932,372
Total Liabilities	31,364,504	21,249,519
Total Shareholder's Equity	3,109,894	2,846,052
Capital-to-Assets ratio	8.5%	11.4%

30. COMMITMENTS

	The Group & the Company	
	2002	2001
	HK$'000	HK$'000
(a) Capital		
Authorized and contracted for	–	–
Authorized but not contracted for	7,025	9,165
	7,025	9,165

(b) Operating lease

Total future minimum lease payments under non-cancellable operating leases at the balance sheet date are analyzed as follows:

	The Group & the Company	
	2002	2001
	HK$'000	HK$'000
Office premises		
not later than one year	11,001	11,001
later than one year and not later than five years	11,001	22,001
	22,002	33,002

31. OPERATING SUBLEASE ARRANGEMENT

At the balance sheet date, the Group's total future minimum sublease payments expected to be received under the operating sublease in respect of the premises were HK$190,000 (2001: HK$6,840,000).

32. MORTGAGE GUARANTEE BUSINESS

The Company offers mortage insurance which provides cover to the approved seller/servicers for credit loss of up to 20% of the property value of a mortgage loan when the loan amount has exceeded 70% of the property value at origination.

The Company reinsures the risk exposure with the approved reinsurers on both back-to-back and risk sharing bases. Under the risk sharing mortgage insurance business, the Company has retained up to 50% of the risk exposure with the remaining risk exposure ceded to the approved mortgage reinsurers.

Under the HOME programme, the Company provides mortgage insurance to cover credit loss in excess of 90% and up to 140% of the property value at the time of refinancing.

At 31 December 2002, the total risk-in-force was approximately HK$3.39 billion (2001: HK$2.85 billion) of which HK$2.59 billion (2001: HK$2.34 billion) risk for credit loss was ceded to the approved reinsurers and the balance of HK$780 million (2001: HK$513 million) was assumed by the Company.

33. OFF-BALANCE-SHEET EXPOSURES

(a) Contingent liabilities

	The Group & the Company	
	2002	2001
	HK$'000	HK$'000
Guarantees under MBS programme	**2,316,520**	873,822

(b) Financial contracts

Interest rate swap contracts are entered into for hedging the interest rate risk of the assets and liabilities.

i) The outstanding contracted notional amount of the interest rate swap contracts is as follows:

	The Group & the Company	
	2002	2001
	HK$'000	HK$'000
Interest rate swap contracts	**24,845,000**	20,547,550

ii) The replacement costs and potential future credit exposure amounts of the interest rate swap contracts are as follows. These amounts do not take into account the effects of bilateral netting arrangements with the counterparties.

	The Group & the Company			
	2002		2001	
	Replacement cost	**Potential future credit exposure**	Replacement cost	Potential future credit exposure
	HK$'000	***HK$'000***	*HK$'000*	*HK$'000*
Interest rate swap contracts	**1,401,061**	**123,970**	527,257	78,443

The replacement costs represent the cost of replacing all interest rate swap contracts that have a positive value when marked to market. The potential future credit exposure amounts refer to the amount as computed in accordance with the Capital-to-Assets ratio guidelines (Note 34). The Group has not experienced any non-performance by its counterparties.

34. CAPITAL-TO-ASSETS RATIO

To ensure that the Company is managed in a prudent manner, the Financial Secretary of the Government of the Hong Kong Special Administrative Region approved the revised guidelines in 2001 in respect of the minimum Capital-to-Assets ratio ("CAR") to be maintained by the Company. The minimum CAR stipulated in the guidelines is 5%.

	The Group & the Company	
	2002	2001
Capital-to-Assets ratio	**8.9%**	11.6%

The Capital-to-Assets ratio is calculated as a ratio, expressed as a percentage, of the Company's total capital base to the sum of its total on-balance sheet assets and total off-balance sheet exposures.

35. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the Board of Directors on 8 April 2003.

Annex A

List of Approved Seller/Servicers as at end December 2002

1. ABN AMRO Bank N. V.
2. AIG Finance (Hong Kong) Limited
3. American Express Bank Ltd.
4. Asia Commercial Bank Limited
5. Bank of America (Asia) Limited
6. Bank of China (Hong Kong) Limited
7. Bank of Communications
8. The Bank of East Asia, Limited
9.* Brilliant Oscar Limited
10. Canadian Eastern Finance Limited
11. Chekiang First Bank Limited
12. Chiyu Banking Corporation Limited
13. Citibank, N.A.
14. CITIC Ka Wah Bank Limited
15. Dah Sing Bank, Limited
16. Dao Heng Bank Limited
17. DBS Kwong On Bank Limited
18. Fortis Bank Asia HK (also known as Wa Pei Fu Tong Yin Hang)
19. GE Capital (Hong Kong) Limited
20. Hang Seng Bank Limited
21. Hang Seng Credit Limited
22. Hang Seng Finance Limited
23. The Hong Kong Housing Authority
24. Hong Kong Housing Society
25. The Hongkong & Shanghai Banking Corporation Limited
26. Inchroy Credit Corporation Limited
27. Industrial and Commercial Bank of China (Asia) Limited
28. International Bank of Asia Limited
29. Liu Chong Hing Bank Limited
30. Nanyang Commercial Bank, Limited
31. ORIX Asia Limited
32.** ORIX Finance Services Hong Kong Limited
33. Overseas Trust Bank, Limited
34. Shanghai Commercial Bank Limited
35. Standard Chartered Bank
36. Wing Hang Bank, Limited
37. Wing Lung Bank, Limited

* *Approved as Servicer only*
** *Approved as Seller only*

Annex B

List of Mortgage Reinsurers, DIP Primary Dealers, Selling Group Members, Placing Banks for Retail Bonds and Programme Arranger and Dealer Group of Bauhinia MBS Programme

Mortgage Reinsurers

- Asia Insurance Company, Limited
- Hang Seng Insurance Company Limited
- HSBC Insurance (Asia) Limited
- PMI Mortgage Insurance Co.
- United Guaranty Mortgage Indemnity Company

DIP Primary Dealers

- Dao Heng Bank Limited
- The Hongkong and Shanghai Banking Corporation Limited
- Merrill Lynch Far East Limited
- Tokyo-Mitsubishi International (HK) Limited
- UBS AG Hong Kong

DIP Selling Group Members

- ABN AMRO Bank N.V.
- The Bank of East Asia, Limited
- Barclays Bank PLC, Hong Kong Branch
- BNP Paribas
- BOCI Capital Limited
- Citicorp International Limited
- Commonwealth Bank of Australia
- Credit Lyonnais, S.A., Hong Kong Branch
- Deutsche Bank AG, Hong Kong Branch
- Goldman Sachs (Asia) L.L.C.
- Hang Seng Bank Limited
- J.P. Morgan Securities (Asia Pacific) Limited
- Société Générale Asia Limited
- Standard Bank Asia Limited
- Standard Chartered Bank

Placing Banks for Retail Bonds

- Bank of China (Hong Kong) Limited
- Bank of Communications Hong Kong Branch
- The Bank of East Asia, Limited
- Chiyu Banking Corporation Limited
- Citibank, N.A., Hong Kong Branch
- CITIC Ka Wah Bank Limited
- Dao Heng Bank Limited
- The Hongkong and Shanghai Banking Corporation Limited
- Hang Seng Bank Limited
- International Bank of Asia Limited
- Nanyang Commercial Bank, Limited
- Shanghai Commercial Bank Limited
- Standard Chartered Bank
- Wing Lung Bank Limited

Bauhinia MBS Programme

Programme Arranger

- Merrill Lynch International

Dealer Group

- Barclays Bank PLC, Hong Kong Branch
- Dao Heng Bank Limited
- Deutsche Securities Limited
- The Hong Kong and Shanghai Banking Corporation Limited
- JP Morgan Securities (Asia Pacific) Limited
- Merrill Lynch International
- Salomon Brothers International Limited
- UBS Warburg

Annex C

KEY STATISTICS OF THE HKMC'S 2002 MORTGAGE PORTFOLIO

Retained portfolio	**Jan-02**	**Feb-02**	**Mar-02**	**Apr-02**
Aggregate				
Number of Approved Seller/Servicers	37	37	37	36
Number of active Sellers	26	26	26	25
Geographical distribution				
Number of loans	29,266	37,677	35,755	35,685
– Hong Kong	4,931	5,989	5,565	5,552
– Kowloon	5,386	7,080	6,714	6,734
– New Territories	18,949	24,608	23,476	23,399
Outstanding principal balance (HK$million)	19,259	23,152	20,928	20,704
– Hong Kong	4,087	4,473	3,894	3,835
– Kowloon	3,556	4,345	3,934	3,917
– New Territories	11,617	14,334	13,100	12,952
Delinquency (%)				
– > 90 days	0.27	0.22	0.23	0.26
Charge-off Ratio (%)	0.05	0.02	0.07	0.02
Weighted Average##				
LTV ratio at origination (%)	63.9	63.9	64.8	64.8
Estimated current LTV ratio (%)	96.6	95.8	102.5	103.2
DTI at origination (%)	37.9	38.0	38.3	38.3
Remaining contractual term to maturity (months)	161	160	169	170
Seasoning (months)	51	52	53	54
Contractual life (months)	212	212	222	224
Aggregate#				
Monthly Prepayment (%)				
– Partial	0.20	0.16	0.27	0.20
– Full	2.33	2.69	2.28	1.93

Mortgage Insurance Programme

	Jan-02	**Feb-02**	**Mar-02**	**Apr-02**
Number of Participating Banks	32	32	32	31
Applications received				
Number of applications	15,773	16,207	16,773	17,431
Total amount of mortgage loans (HK$ million)	30,546	31,451	32,537	33,920
Total risk in force (HK$ million)	6,368	6,579	6,829	7,145
Average size of mortgage loan (HK$ million)	1.9	1.9	1.9	1.9
LTV ratio at origination				
– 80% or below (%)	14	14	14	14
– above 80% and up to 85% (%)	44	43	42	41
– above 85% and up to 90% (%)	42	43	44	45
Applications approved				
Number of approved applications	13,420	13,769	14,184	14,694
Total amount of mortgage loans (HK$ million)	25,958	26,660	27,480	28,513
Total risk in force (HK$ million)	5,378	5,536	5,726	5,964
Types of property transaction				
Primary (%)	17	17	18	19
Secondary (%)	83	83	82	81
Choice of premium payment method				
Single payment (%)	93	93	93	93
Annual payment (%)	7	7	7	7

Notes:

Excludes mortgage loans with co-financing arrangements

Excludes the Hong Kong Housing Authority loans

May-02	Jun-02	Jul-02	Aug-02	Sep-02	Oct-02	Nov-02	Dec-02
36	36	36	36	37	37	37	37
25	25	25	25	26	26	26	26
35,488	35,285	43,739	44,198	45,490	47,279	47,107	46,921
5,516	5,481	6,190	6,285	6,570	7,058	7,112	7,073
6,703	6,665	8,065	8,181	8,445	8,784	8,709	8,671
23,269	23,139	29,484	29,732	30,475	31,437	31,286	31,177
20,429	20,127	24,449	24,908	26,840	28,693	28,418	28,072
3,778	3,714	4,064	4,193	4,704	5,310	5,341	5,262
3,869	3,803	4,581	4,727	5,088	5,406	5,312	5,243
12,782	12,611	15,804	15,987	17,048	17,977	17,765	17,567
0.31	0.25	0.29	0.31	0.33	0.33	0.34	0.31
0.09	0.02	0.03	0.05	0.04	0.05	0.20	0.08
64.9	64.9	65.0	65.3	66.7	66.5	66.5	66.5
103.1	103.3	104.5	100.8	108.7	103.1	105.5	106.2
38.3	38.3	38.0	37.8	41.3	40.6	40.6	40.6
169	168	170	171	175	168	167	167
55	56	57	52	54	56	57	58
224	224	226	224	228	224	224	225
0.13	0.18	0.12	0.12	0.15	0.08	0.12	0.18
1.37	2.10	1.29	1.28	0.77	1.27	0.98	0.85

May-02	Jun-02	Jul-02	Aug-02	Sep-02	Oct-02	Nov-02	Dec-02
31	31	31	31	31	31	30	30
18,071	18,546	18,881	19,387	20,072	20,636	21,003	21,438
35,133	36,054	36,679	37,621	38,839	39,785	40,372	41,203
7,425	7,633	7,776	7,996	8,291	8,516	8,651	8,845
1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
14	14	14	14	14	14	13	13
40	39	39	38	37	36	36	36
46	47	47	48	49	50	51	51
15,183	15,611	15,898	16,237	16,706	17,195	17,464	17,787
29,421	30,274	30,770	31,408	32,253	33,109	33,523	34,128
6,175	6,369	6,483	6,631	6,834	7,038	7,133	7,276
19	20	20	21	22	23	23	23
81	80	80	79	78	77	77	77
93	93	93	93	93	93	94	94
7	7	7	7	7	7	6	6