Diversification
in Business

Business Overview

Performance Highlights

The major achievements of the Corporation for the year include:

- Purchasing a total of HK$9.7 billion loan assets.
- Helping homebuyers borrow a total of HK$26.3 billion mortgage loans through the Mortgage Insurance Programme, representing a usage rate of 11.5% (in terms of the total drawdown amount under the MIP against the total market mortgage drawdown amount).
- Launching the SME Financing Guarantee Scheme on 1 January 2011 to assist local SMEs in obtaining sustainable bank financing.
- Launching the Reverse Mortgage Programme on 11 July 2011 to provide the elderly with an additional financing option.
- Submitting the Microfinance Study Group Report to the Financial Secretary in August 2011 on a feasibility study of the introduction of microfinance in Hong Kong.
- Issuing HK$28.5 billion of debt securities in a cost-effective manner, maintaining the Corporation's position as the most active corporate issuer in the Hong Kong dollar debt market for 11 consecutive years.
- Safeguarding excellent credit quality, with (over 90-day) delinquency ratios of zero for the mortgage insurance portfolio, 0.67% for the SME guarantee portfolio, 0.02% for the Hong Kong residential mortgage portfolio (vs. an industry average of 0.01%) and 0.01% across all asset classes as at 31 December 2011.
- Maintaining the HKMC's long-term foreign and local currency ratings of AAA and Aa1 by Standard & Poor's ("S&P") and Moody's Investors Service, Inc. ("Moody's") respectively.

The Corporation registered solid financial results for 2011:

- Profit after tax of HK$1,256 million, an increase of HK$22 million, or 1.8%, over that of 2010.
- Net interest spread was 1.6%.
- Return on assets of 2.3%, an increase of 0.1% over that of 2010.
- Return on shareholder's equity of 15.5%.
- Capital adequacy ratio of 19.7%, well above the minimum requirement of 8%.
- Cost-to-income ratio of 11.8%, significantly lower than the banking industry average of 46.8%.

Operational Highlights

Overall Business Strategy

Since its incorporation in 1997, the Corporation has strived to fulfil its three core missions: maintaining banking stability, promoting home ownership and developing Hong Kong's debt market. In 2011, the Corporation further boosted its strategic role by pursuing a business diversification strategy through a number of new initiatives, including the launch of the SME Financing Guarantee Scheme and the Reverse Mortgage Programme. Operating on the basis of prudent commercial principles, the Corporation is dedicated to complementing the Government's policies by playing its unique role for the betterment of Hong Kong.

Mortgage Insurance

In response to the prudential measures for residential mortgage loans initiated by the Hong Kong Monetary Authority in June 2011, the Corporation reduced the cap on property value from HK$6.8 million to HK$6 million and the maximum loan amount from HK$6.12 million to HK$5.4 million under the Mortgage Insurance Programme ("MIP"). The revision of eligibility criteria was intended to better manage the increased risk in high loan-to-value ("LTV") mortgage lending under the current market conditions and to help homebuyers avoid overstretching themselves.

In 2011, the MIP drawdown loan amount was HK$26.3 billion, and the usage rate stood at 11.5%. The Corporation continued to provide training seminars for frontline staff of banks and estate agents. This was an integral part of the strong partnership between the Corporation and banks and intermediaries in promoting mortgages to the public.

The Corporation maintained a high degree of processing efficiency for MIP applications through automation and the use of internet platforms. Most of the MIP applications were processed within two business days.

Fund-raising

The Corporation issued HK$28.5 billion of corporate debt in different currencies, including HK dollars, US dollars, renminbi, Japanese yen and Singapore dollars, in a prudent and cost-effective manner to support asset-purchase activities and redemption of maturing debt. For the 11th year in a row, the Corporation was the most active corporate issuer in the Hong Kong dollar debt market, with issuance of HK$14.2 billion of debt securities in the local institutional market.

Market Overview

General Economic Conditions

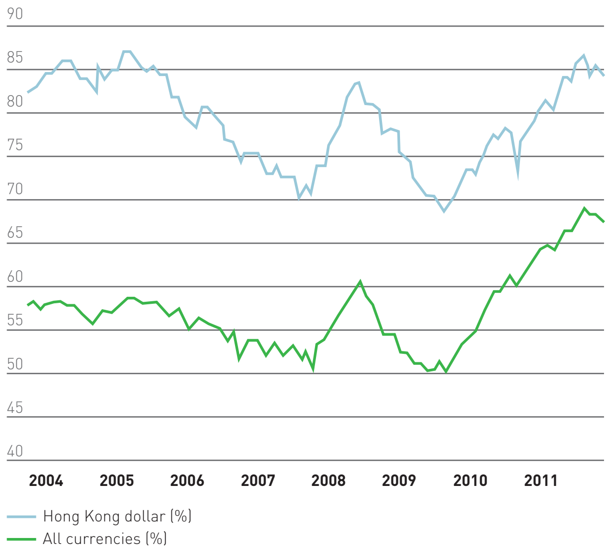
The growth momentum of the Hong Kong economy slowed markedly towards the latter part of 2011 due to continued slackening in external economic conditions, against the backdrop of the prolonged sovereign debt crisis in the Euro zone, unsteady recovery in the United States, and lingering macro-economic control measures in Mainland China. The already weak external market conditions worsened notably with the credit rating downgrades of the United States and a few European countries in the second half of 2011. Amid the uncertainties in the market, as a result of the unfavourable external environment, the Gross Domestic Product of Hong Kong grew slower at 5% year-on-year in real terms in 2011, compared with 6.8% growth in 2010. The local stock market also underwent a severe correction, in parallel with the adverse overseas market conditions since the third quarter of 2011. Notwithstanding the setback, local consumption sentiment remained buoyant, amid an active job market throughout 2011. The unemployment rate bottomed out at 3.2% in August and remained at the relatively low level of around 3.3% towards the year end, despite job-cutting plans unveiled by a few financial institutions. The Central Government announced a series of financial policy measures in August which aimed at strengthening Hong Kong's role as an offshore renminbi business center, providing solid support for the overall economic development of Hong Kong.

Liquidity and Interest-Rate Environment

The Federal Reserve announced in August 2011 that it would continue its ongoing accommodative monetary policy by keeping interest rates low till 2013. Notwithstanding this pledge, liquidity conditions in local markets tightened up towards the end of 2011, pushing deposit rates, mortgage rates and the funding spread for bond issuance higher. This phenomenon was attributable mainly to fast credit growth, which was supported by a number of factors, including robust economic growth, low interest rates, a buoyant property market, and strong Mainland-related loan demand during the first half of 2011. In particular, strong Mainland-related credit demand was evidenced by rapid increases in foreign currency lending and loans for use outside Hong Kong, which expanded much faster than Hong Kong dollar lending and loans for use in Hong Kong. The rapid pace of credit growth raised concerns about potential stress on banks' liquidity positions and credit risk controls, as both the Hong Kong dollar and foreign currency loan-to-deposit ratios had risen notably over the previous two years **(Figure 1)**. Nonetheless, the further announcement of the Federal Reserve in January 2012 to extend low rate commitment till late 2014 somewhat eased the credit situation.

Figure 1

Loan-to-Deposit Ratios



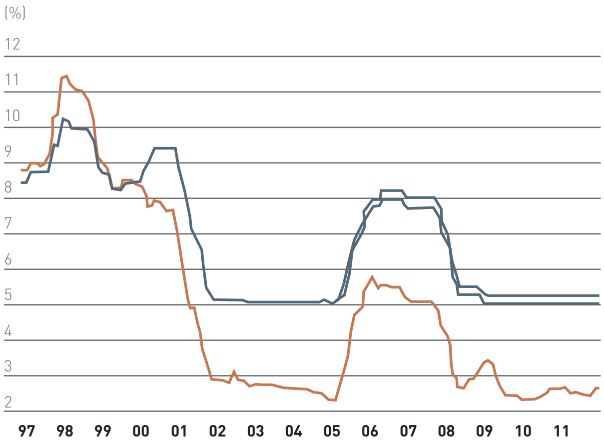
Source: HKMA

While the Best Lending Rates ("BLRs") remained stable at 5% and 5.25% throughout the year, the Hong Kong Interbank Offered Rates ("HIBORs") edged up gradually, with the one-month HIBOR rising from 0.16% in January to 0.29% in December, in terms of the period average[1]. Local banks also progressively raised the margin for new HIBOR-based mortgage loans in view of the increasing cost of funds and strong loan demand from other sectors. HIBOR-based mortgage rates rose to the range of H+2% to H+3% in the latter part of 2011, up from the range of H+0.6% to H+0.9% earlier in the year. As for BLR-based mortgage rates, the pricing levels for new mortgage loans also increased to the range of BLR-2% to BLR-2.5% towards the end of 2011 **(Figure 2)**.

1 Source: HKMA Monthly Statistical Bulletin

Figure 2

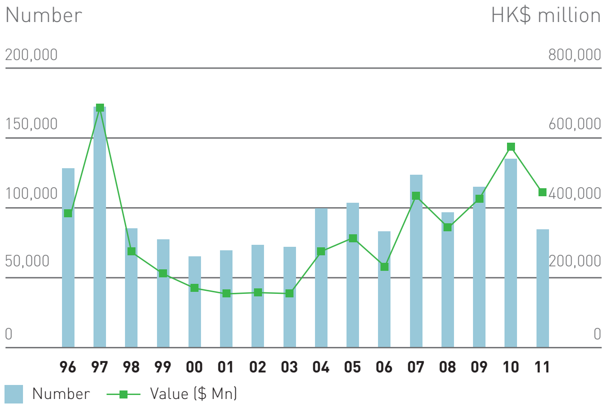
Best Lending Rates and Weighted Average Mortgage Rate



Source: HKMA

Figure 3

Agreements of Sale and Purchase of Residential Building Units



Source: Land Registry

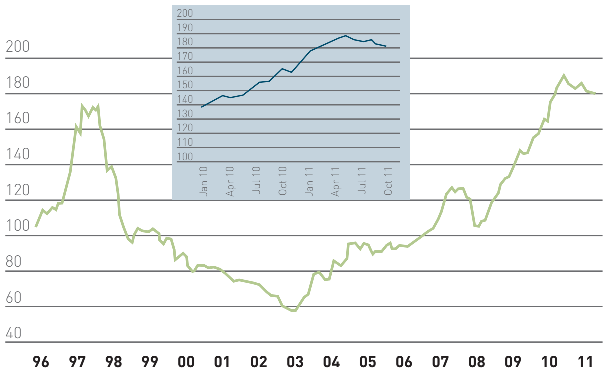
Property Market

Following the post-financial-tsunami rally over the previous two years, the residential property market continued to display buoyancy in early 2011. Compared with the 2008 trough, residential property prices nearly doubled. In the first half of 2011, the Government repeatedly pledged to maintain a healthy and stable property market, with a view to alleviating the risk of a property bubble burst by stepping up its efforts to increase land supply and also prudential measures to tighten mortgage lending in the banking sector. Mediocre land auction results early in the year appeared to indicate developers' pessimistic sentiment and presage a sign of imminent market adjustment. In parallel with the integrated effect of deteriorating global economic conditions, progressive rises in mortgage rates and the negative wealth effect due to the stock market correction, the residential property market cooled off markedly in a consolidation stage after mid-year, followed by a correction period towards the year end. The total number of property transactions in 2011 plummeted sharply by 38% year-on-year, while the aggregate transacted value fell by 21% **(Figure 3)**. In the second half of 2011, the corresponding declines expanded considerably to 58% and 44%, respectively.

Despite the sharp contraction in transaction activities, residential property prices remained relatively stable without undergoing a severe correction. Residential property prices[2] surged by more than 15% in the first six months of 2011 and reached a historical high around mid-year, surpassing the peak at the start of Asian financial crisis **(Figure 4)**. In his October Policy Address, the Chief Executive put forward two housing policy initiatives: the New Home Ownership Scheme and the enhanced My Home Purchase Plan. Subsequently, a more obvious property price adjustment was seen, with property developers increasingly keen to launch new projects at lower prices. At the end of 2011, the annual increase in residential property prices narrowed notably to 9% over that of the previous year.

Figure 4

Private Domestic Price Index (1999 = 100)



Source: Rating and Valuation Department

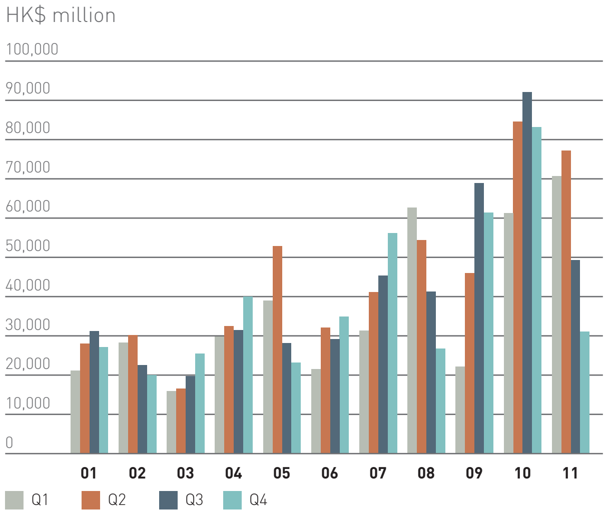
2 Source: The Private Domestic Price Index published by the Rating and Valuation Department

Mortgage Market

In June 2011, in view of market developments in early 2011 and to better enhance banks' credit risk management in their mortgage lending business, the Hong Kong Monetary Authority ("HKMA") issued further supervisory guidelines, tightening the maximum LTV ratio for residential properties under different transacted price ranges and according to nature of transaction. In tandem with the plunge in residential property transactions, mortgage lending declined visibly since the third quarter of 2011. The gross value of new loans[3] dropped sharply by 55% year-on-year in the second half of the year. For the whole year of 2011, it fell by 30% year-on-year **(Figure 5)**. Notwithstanding the contraction, the total outstanding value of all residential mortgage loans registered an annual increase of 6.7% to HK$850 billion at the end of 2011.

Figure 5

New Residential Mortgage Loans Made

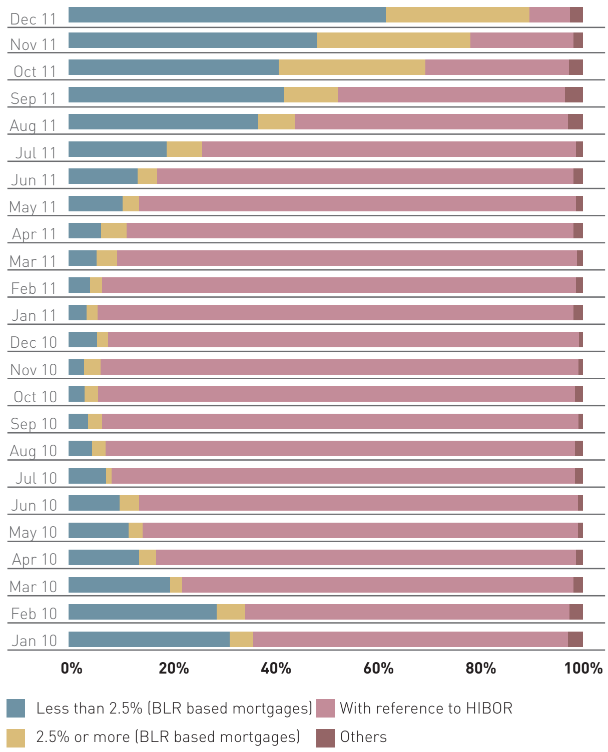


Source: HKMA

As for mortgage pricing, banks began reducing their offers of HIBOR-based mortgage loan plans and resumed promoting BLR-based plans in view of the rising cost of funds. The proportion of new mortgage loans priced with reference to the Prime rate increased from 6% in January 2011 to nearly 90% in December 2011, with the largest portion priced at a mortgage rate of 2.25% to 2.75%. HIBOR-based mortgages fell from 92% to 8% during the same period **(Figure 6)**.

Figure 6

Pricing of New Residential Mortgage Loans Approved



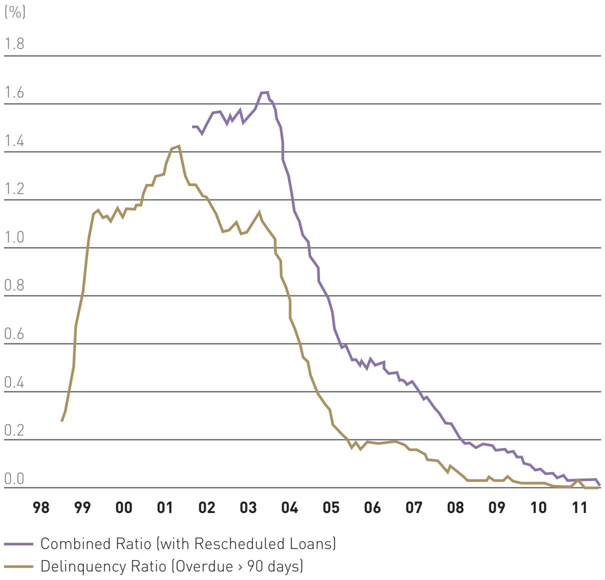
Source: HKMA

In light of the stable labour market and the HKMA's prudent supervision of the mortgage lending sector, the asset quality of residential mortgage loans remained excellent in 2011. The over-90-day delinquency ratio of mortgage loans[4] stayed at a historical low of 0.01% for most of 2011, reflecting the prudent underwriting standards adopted by the banks. The combined ratio, which takes into account both delinquent and rescheduled loans, also remained low, at between 0.02% and 0.04% for most of 2011 **(Figure 7)**. While the estimated number of mortgage loans in negative equity bounced to 1,465 cases (HK$3,647 million) at the end of December 2011 from 48 cases (HK$58 million) at the end of June 2011, no delinquency of more than three months was observed.

3 Source: The HKMA's Monthly Residential Mortgage Survey ("The HKMA Survey")
4 Source: The HKMA Survey

Figure 7

Delinquency Ratio of Residential Mortgage Loans



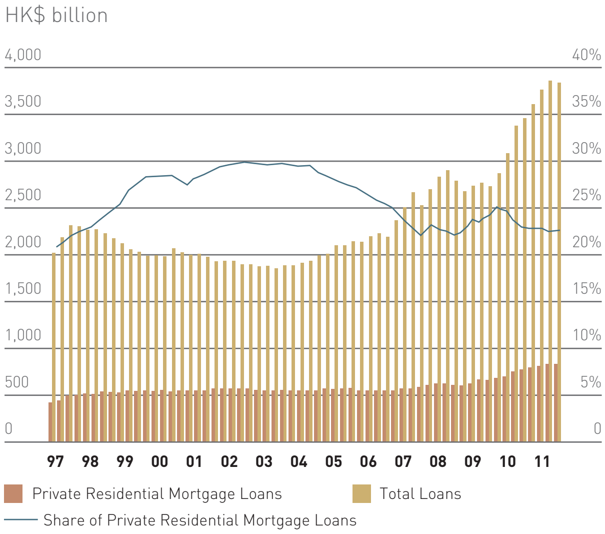
Source: HKMA

Banking-Sector Exposure

The total outstanding value of mortgage loans for private residential properties increased to HK$805 billion at the end of 2011 (end-2010: HK$745 billion), accounting for more than one-fifth of total loans in Hong Kong **(Figure 8)**. Adding to this the lending for building and construction, along with property development and investment, the amount of property-related loans totalled HK$1,762 billion, representing about half the total loan book of banks. Such high exposure to property-related lending indicates that a sharp downturn in the property market could have an adverse impact on the overall stability of the banking system, although banks in Hong Kong, in general, have an adequate capital base.

Figure 8

Total Loans and Private Residential Mortgage Loans of All Authorized Institutions



Source: HKMA

Market Outlook

In view of the heightened likelihood of financial turbulence and contagion affecting Hong Kong and the Asia-Pacific region, further tightening of liquidity conditions may be inevitable. To tackle the difficult money market conditions, banks may be more eager to offload assets with a view to increasing liquidity, reducing their loan-to-deposit ratio and improving their balance sheet management. Despite the uncertainties in the external environment ahead, the Corporation remains cautiously optimistic about Hong Kong's 2012 market outlook and will operate its business under prudent commercial principles.

Asset Acquisition

Given the uncertain external economic conditions, banks in Hong Kong were generally more eager to offload assets to the Corporation in 2011, in return for liquidity and prudent balance sheet management. During the year, the Corporation acquired assets worth a total of HK$9.7 billion, which included residential mortgage loans and other assets. By providing liquidity to the banks, the Corporation has demonstrated its importance in maintaining Hong Kong's banking and financial stability.

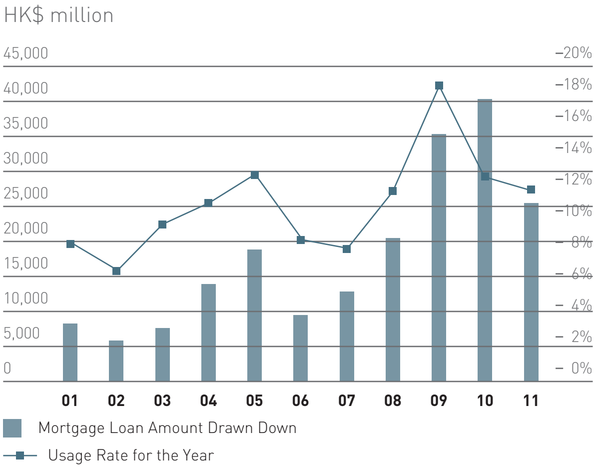
Mortgage Insurance

Over the years, the MIP has repeatedly demonstrated its effectiveness in helping potential homebuyers overcome the hurdle of meeting the substantial down payment required to purchase a property. From the perspective of the banking industry as a whole, the MIP allows banks to engage in higher LTV lending without incurring additional credit risks and affecting the overall stability of the entire banking system. All in all, the programme creates a win-win situation for both homebuyers and banks.

Since its inception in March 1999, the MIP has gained increasing public acceptance and has played a significant role in promoting home ownership in Hong Kong. For 2011 as a whole, the volume of loans drawn down amounted to HK$26.3 billion and the usage rate (in terms of the total drawdown amount under the MIP against the total market drawdown amount) stood at 11.5% **(Figure 9)**. It is notable that 97% of the MIP applications received were for secondary market properties, demonstrating that mortgage insurance has been crucial in assisting homebuyers in the secondary market.

Figure 9

Mortgage Loan Amount Drawn Down and Usage Rate* of MIP



Source: HKMA and HKMC

* Usage Rate = Total drawdown amount under the MIP / Total market drawdown amount based on HKMA's Monthly Residential Mortgage Survey

Since 1999, the MIP has helped over 95,000 families achieve the dream of home ownership, with loan drawdown totalling over HK$209 billion.

MIP Refinements

In response to prudential measures for residential mortgage loans initiated by the HKMA, the Corporation reduced the cap on property value from HK$6.8 million to HK$6 million and the maximum loan amount from HK$6.12 million to HK$5.4 million under the MIP. The purpose of the revision of eligibility criteria was to better manage the increased risks of high LTV mortgage lending under current market conditions and to help homebuyers avoid overstretching themselves.

Launch of SME Financing Guarantee Scheme

The Corporation launched the SME Financing Guarantee Scheme ("SFGS") on 1 January 2011 to help local small and medium-sized enterprises ("SMEs") obtain sustainable bank financing. Joined by 23 banks as participating lenders, the Scheme also allows the banks to better manage their risk exposure to corporate loans. It was welcomed by SMEs and banks, particularly because the Government's Special Loan Guarantee Scheme stopped accepting applications from 2011.

In October 2011, to encourage banks to make more use of the SFGS so that they could be more responsive in meeting the financing needs of SMEs, especially during times of market stress and an adverse economic climate, the Corporation rolled out a handful of enhancements to the SFGS. For example, it raised the interest rate limit on the loans and the total limit of high interest rate loans per bank. During the year, the SFGS received 235 applications for a total loan amount of approximately HK$800 million, benefiting over 180 local SMEs.

Launch of Reverse Mortgage Programme

After conducting a series of in-depth research studies, a city-wide survey and a consultation with stakeholders, the Corporation launched the Reverse Mortgage Programme ("RMP") on 11 July 2011 to provide the elderly with an additional financial planning option to enhance their quality of life. To help the elderly better understand this brand-new financial product in Hong Kong, the Corporation put a lot of effort into promoting the RMP through different channels, including advertising, talks and information leaflets.

The RMP was well received by the market and got over 170 applications during the year, with an average property value of about HK$3.8 million. The borrowers, on average, received a monthly payout of HK$13,900, which provided them a certain degree of assistance to meet daily expenses.

Microfinance

In the 2011-12 Budget, the Financial Secretary ("FS") requested the Corporation to study the feasibility of establishing a sustainable microfinance scheme in Hong Kong and the demand for such facilities. The Corporation therefore set up a study group in March 2011 with the Executive Director, Peter Pang, as the chairman, and members from the banking sector, voluntary agencies, academia and the Government.

The study went smoothly and a report with findings and recommendations was submitted to the Financial Secretary in August 2011. Overseas experience indicated that a successful and sustainable microfinance scheme would provide comprehensive support to help boost the credit standing of prospective borrowers so that they could obtain bank loans at a relatively low interest rate. Such a comprehensive support system would help borrowers develop a business plan, provide entrepreneurial training and offer mentorship after the launch of business.

Given the Corporation's rich experience in loan underwriting, well-established reputation and good network in the banking industry, the Financial Secretary commissioned the Corporation to develop a pilot scheme for a trial period of three years and a maximum loan amount of HK$100 million tentatively in the 2012-13 Budget. The Corporation swiftly commenced preparatory work with the aim of launching the scheme around mid-2012. Under the preliminary framework, the pilot scheme would cater to three categories of borrowers: those aspiring to start their own businesses, those wishing to become self-employed and those wanting to achieve self-enhancement through training, upgrading skills or securing professional certification.

Training and Marketing

Throughout the year, the Corporation worked closely with banks to organise training courses for their frontline staff on its new and existing programmes, namely the MIP, the SFGS and the RMP. This helped the banks prepare well for launching their products for the Corporation's new programmes and provided the banks with updates on the Corporation's existing programmes from time to time.

In addition, the Corporation held talks with various professional bodies to further enhance awareness of its programmes and forge relationships with different stakeholders. For example, it gave talks on the RMP to the Law Society of Hong Kong, the Hong Kong Institute of Surveyors and the Estate Agents Authority.

Joint Ventures Outside Hong Kong

With tightened policies on the property market and banking sector in Mainland China remaining in force throughout 2011, the Bauhinia HKMC Corporation Limited ("BHKMC"), a joint venture incorporated in Mainland China, faced a harsh business environment. Such policies seriously affected the business volume for the bridging guarantee business undertaken by the BHKMC. The Board of Directors of the BHKMC reviewed the prospect of the bridging guarantee business and decided to suspend this business until market conditions improve. The BHKMC will keep an eye out for suitable business opportunities.

The Cagamas HKMC Berhad, incorporated in Malaysia in 2008, is a joint venture between the Corporation and Cagamas Berhad. The joint venture provides mortgage guarantees for conventional and Islamic mortgage portfolios. Two transactions were concluded under the Mortgage Guarantee Programme in 2011 with a national oil company in Malaysia.

Funding

The year 2011 continued to be a turbulent one for local and global capital markets under the menace of the lingering eurozone crisis and sluggish US economic recovery. In spite of the challenging market conditions, the Corporation managed to secure prudent pre-funding to cater for loan purchases and refinancing. Given the Corporation's strong background as a wholly government-owned entity and its solid credit rating, as well as investors' flight-to-quality inclination, the Corporation continued to be the most active Hong Kong dollar corporate issuer for the 11th straight year. In 2011, a total amount of HK$28.5 billion of debts were raised. At the end of 2011, the Corporation's total outstanding debt amounted to HK$41.1 billion.

The Corporation is committed to developing the local debt market through regular debt issuances and the introduction of new debt products. As one of the most active bond issuers in Hong Kong, the Corporation will continue to issue debt in both local institutional and retail markets, and diversify its funding sources and investor base to overseas institutional markets. This will not only help broaden the Corporation's funding base, but also provide institutional and retail investors with high quality debt instruments to satisfy their need for portfolio diversification and yield enhancement.

The Corporation has three debt issuance programmes, which allow the issuance of debt securities in an efficient and effective manner. With its strong credit rating, the Corporation's debt issues are well received by the investment community, such as pension funds, insurance companies, investment funds, charities, government-related funds and retail investors. The Corporation maintains a pro-active approach, updating investors regularly in local and regional markets. In 2011, for example, the Corporation met with investors in Singapore and Australia.

Debt Issuance Programme

The Debt Issuance Programme ("DIP") was established in July 1998 to target institutional investors in the Hong Kong dollar debt market. It was set up with an initial programme size of HK$20 billion, which was subsequently increased to HK$40 billion in 2003. The DIP has since provided a flexible and efficient platform for the Corporation to issue debt and transferable loan certificates with a tenor of up to 15 years. In addition to plain vanilla debts, the Corporation issues high quality structured products to meet investor demand. A total of six Primary Dealers and 16 Selling Group Members appointed under the DIP provide wide distribution channels for both public and private debt issues.

During 2011, the Corporation issued 30 DIP debt securities for a total amount of HK$6.9 billion.

Retail Bond Issuance Programme

The Corporation is dedicated to promoting the local retail bond market with the objective of extending the Corporation's investor base beyond its already strong institutional investor community. In November 2001, the Corporation successfully pioneered a new offering mechanism for the retail bond market in Hong Kong.

To further spur the development of the retail bond market, the Corporation established the HK$20 Billion Retail Bond Issuance Programme and made its debut issuance in June 2004. Under this programme, placing banks use their retail branch networks, telephone and electronic banking facilities to place debt securities issued by the Corporation with retail investors. To ensure the liquidity of the aforementioned retail bonds, the placing banks are committed to making firm bid prices for the bonds in the secondary market. Over the years, the Corporation's retail bonds have gained widespread recognition as a safe and simple investment choice, with reasonably attractive returns, giving retail investors an opportunity to invest in high-grade debt securities issued by a wholly government-owned corporation. When the market environment is conducive, the Corporation aims to issue retail bonds regularly to provide an additional investment tool for Hong Kong's retail investors.

Since 2001, the Corporation has issued a total amount of HK$13.7 billion retail bonds.

Medium Term Note Programme

The Corporation established the multi-currency Medium Term Note ("MTN") Programme in June 2007 to raise funds in the international market and broaden its investor base and funding sources. It was set up with an initial programme size of US$3 billion, which was subsequently increased to US$6 billion in July 2011 to meet growing demand from overseas investors. The multi-currency feature of the programme enables the Corporation to issue notes in major currencies, including the Hong Kong dollar, US dollar, renminbi, euro and Japanese yen, to meet demand from both local and overseas investors. All foreign currency-denominated MTN debt is fully hedged into either US dollars or Hong Kong dollars. The programme incorporates flexible product features and offering mechanisms for both public issuances and private placements to increase its appeal to investors with different investment horizons and requirements. An extensive dealer group comprising 10 major international and regional financial institutions has been appointed to support future MTN issuance and provide secondary market liquidity.

In 2011, the Corporation launched 52 MTN private debt issues, including debt denominated in Hong Kong dollars, US dollars, renminbi, Japanese yen and Singapore dollars, totalling an equivalent of HK$21.6 billion. The Corporation made a debut issue of RMB600 million of MTN debt during the year, helping to promote Hong Kong as an offshore renminbi business centre.

Revolving Credit Facility Provided by the Exchange Fund

In January 1998, during the Asian Financial Crisis, the Exchange Fund extended a HK$10 billion Revolving Credit Facility to the Corporation through the HKMA. This Facility enables the Corporation to maintain smooth operation under exceptional circumstances, so that it can better fulfil its mandate to promote banking and financial stability in Hong Kong. While the Corporation obtains long-term funding from local and international debt markets to fund its operations, the Facility also stands as a liquidity fallback for the Corporation. In light of the global financial crisis in 2008, the size of the Facility was subsequently increased to HK$30 billion in December 2008, which demonstrated the HKSAR Government's recognition of the importance of, and further support for, the Corporation.

The Corporation used the Revolving Credit Facility during times of market stress in 1998 and 2008 to partially fund the acquisition of Hong Kong residential mortgage assets from local banks. At both times, the Revolving Credit Facility was fully repaid by funds raised from the Corporation's cost-effective debt issuance when the markets stabilised. As at the end of 2011, there were no draw downs under the Revolving Credit Facility.

Credit Rating

The Corporation's ability to attract investment in its debt securities is underpinned by its strong credit rating, equivalent to that of the HKSAR Government according to Moody's and S&P.

Credit Ratings of the HKMC

	Standard & Poor's		Moody's	
	Short-term	Long-term	Short-term	Long-term
Local Currency (Outlook)	A-1+	AAA (Stable)	P-1	Aa1 (Positive)
Foreign Currency (Outlook)	A-1+	AAA (Stable)	P-1	Aa1 (Positive)

The credit rating agencies have made very positive comments on the Corporation's credit standing. The following comments are extracts from the credit rating reports of S&P and Moody's after their annual surveillance in May 2011:

S&P

"S&P equalises the ratings on HKMC with the rating on the Hong Kong Special Administrative Region. This reflects our expectation of an almost certain likelihood of timely and sufficient extraordinary support from the Hong Kong government, as a sole owner, to the HKMC in events of financial distress. The critical importance of the Corporation's policy roles and its integral link with the government support this view."

"In our view, HKMC's prudent credit risk management, good asset quality, and strong liquidity support its stand-alone credit profile. The Corporation also has a sound capital base, which its strong earnings in recent years have enhanced."

"The HKMC has a traditional and generally prudent approach to risk management. Recognising credit risk as its focus of risk appetite, the Corporation has adopted stringent policies, a simple and effective business model and management structure, and various hedging tools to largely mitigate other types of risks."

"The HKMC's liquidity position is adequately managed... The Corporation also maintains a reasonable level of liquid assets in the form of marketable debt securities, cash and bank deposits, which provides a liquidity fallback."

Moody's

"HKMC's long-term issuer rating incorporates very high probability of support from the Hong Kong government, reflecting HKMC's status as a wholly-owned government entity mandated to enhance financial and banking stability in Hong Kong, to promote home ownership and the development of local debt capital markets."

"In times of crisis, HKMC can be expected to provide liquidity to the mortgage market and the SME sector and support the financial system. The company may require support from the government to carry out such activities, and we expect the government to support HKMC as it carries out its policy functions."

"HKMC has maintained outstanding credit quality thanks to its prudent credit policies and practices, which include careful selection of approved sellers, stringent purchasing criteria, thorough assessment of borrower repayment abilities, limits for different types of portfolios, effective due diligence, and adequate monitoring and protection for riskier mortgages (such as a reserve fund from sellers to absorb default losses)."

"HKMC maintains sound liquidity profile, with sizable holdings of highly liquid securities and access to revolving credit facility from the Exchange Fund and money market lines from commercial banks. Thanks to the implicit strong government backing, HKMC has good access to the capital markets and has consistently been the largest issuer of debt securities in the HK dollar capital markets."

Mortgage-Backed Securitisation

The Corporation strives to promote the development of the mortgage-backed securities ("MBS") market in Hong Kong. MBS is an effective financial instrument that can channel long-term funding from the debt market to supplement the need for long-term financing generated by mortgage loans. Banks and financial institutions can make use of MBS to manage risks inherent in mortgage loans, such as credit risks, liquidity risks, interest rate risks and asset liability maturity mismatch risks. A deep and liquid MBS market can help enhance the development of an efficient secondary mortgage market and further promote Hong Kong as an international financial centre.

The Corporation has issued a total of HK$13.2 billion MBS since 1999. In December 2001, the US$3 billion Bauhinia Mortgage-Backed Securitisation Programme was established to provide a convenient, flexible and cost-efficient platform for the Corporation to issue MBS with various product structures, credit enhancements and distribution methods.

Risk Management

The Corporation operates under prudent commercial principles, and the principle of "prudence before profitability" guides the design of the overall risk management framework and discipline it uses in its day-to-day business execution. Over the years, the Corporation has continuously made refinements to its well-established, robust and time-tested risk management framework to reflect changes in the markets and business strategies.

Corporate Risk Management Committee

The Board is the highest decision making authority of the Corporation and holds the ultimate responsibility for risk management. The Board, with the assistance of the Corporate Risk Management Committee ("CRC"), has the primary responsibility for formulating risk management strategies in the risk appetite statement and for ensuring that the Corporation has an effective risk management system to implement these strategies. The risk appetite statement defines the constraints for all risk-taking activities and these constraints are incorporated into risk limits, risk policies and control procedures that the Corporation follows to ensure that the risks are properly managed.

The CRC is responsible for overseeing the Corporation's various types of risks, reviewing and approving high-level risk-related policies, overseeing their implementation, and monitoring improvement efforts in governance, policies and tools. It also assigns priorities and responsibilities to individual departments to enhance the risk management framework. The Committee is chaired by an Executive Director, with members including another Executive Director, as well as a Chief Executive Officer, Senior Vice President (Operations), Senior Vice President (Finance), General Counsel, Senior Vice President (Risk), and senior staff from the Risk Management Department.

The major types of risk the Corporation manages are credit risk, market risk, operational risk, legal risk, leveraging risk and longevity risk.

Credit Risk

Credit risk is the Corporation's primary risk exposure. It represents the default risk presented by loan borrowers and counterparties.

(a) Default risk

To address default risk effectively, the Corporation adopts a four-pronged approach to safeguard and maintain the quality of its assets, MIP and SME guarantee portfolios:

- Careful selection of Approved Sellers, Servicers, Reinsurers and Lenders
- Prudent asset purchase, insurance and guarantee application eligibility criteria
- Effective due diligence process for mortgage purchase, default loss, insurance and guarantee claims
- Enhanced protection for higher-risk mortgages and transactions

Losses may arise if there are shortfalls in the recovery amount received for defaulted loans that fall under the Mortgage Purchase Programme ("MPP"). To mitigate this default risk, the Corporation adopts prudent loan purchase criteria and conducts effective due diligence reviews as part and parcel of the loan purchase process in order to maintain the credit quality of loans. In addition, depending on the projected risk exposure of each underlying loan portfolio, credit enhancement arrangements, such as reserve funds for absorbing credit losses, are agreed upon with sellers on a deal-by-deal basis to reduce the potential credit losses that could arise from the borrower's default.

Losses may also arise from default on loans under the MIP's insurance coverage. Each MIP application is underwritten by the Corporation in accordance with a set of eligibility criteria, and each claim from a participating bank is audited by the Corporation to ensure the fulfilment of all MIP coverage conditions and to detect any fraud elements. As a result, the default risk for loans with MIP coverage has been greatly reduced. To reduce the risk of possible concentration of this default risk, the Corporation transfers a portion of the risk-in-force to Approved Reinsurers via reinsurance risk-sharing and excess-of-loss arrangements.

Portfolio performance and analysis reports are compiled on a regular basis to provide management with updated information on critical credit risk indicators, such as loan delinquency ratios, equity positions and cumulative credit losses, to enable timely reviews and a swift response to changes in the operating environment.

Stress tests on mortgage portfolios, mortgage insurance portfolios and SME guarantee portfolios are conducted to analyse the Corporation's financial capability to weather extreme scenarios when they arise.

(b) Seller/Servicer counterparty risk

Counterparty risks may arise from the failure of a Seller/Servicer of an acquired portfolio to remit scheduled payments to the Corporation in a timely and accurate manner. The Corporation has adopted a counterparty risk limit framework that limits the aggregate amount of assets it can purchase from the Approved Sellers. There are also individual limits set on the maximum amount of assets that the Corporation can purchase from a counterparty. The risk limit framework acts as a beneficial device for managing counterparty exposure on the risk profile basis of each Seller/Servicer and for avoiding the concentration of acquisition from only a few Sellers.

The counterparty limits of all Sellers/Servicers are subject to regular review, where their financial strengths, management capabilities, loan servicing quality and transaction experience are taken into consideration for reviewing their limits.

(c) Reinsurer counterparty risk

Reinsurer counterparty risk refers to the failure of an Approved Reinsurer to make claim payments to the Corporation. In order to mitigate reinsurer counterparty risk effectively, the Corporation has established a framework for the assessment of each mortgage reinsurer's financial strength, credit rating and relevant experience in mortgage insurance.

The Corporation performs an annual review of each Approved Reinsurer's financial strength, business proposal, reinsurance arrangements and management capabilities. The review results are used to determine the on-going business allocation and risk-sharing portions. The Corporation also has collateral arrangements with Approved Reinsurers to reduce counterparty risk exposures.

(d) *Treasury counterparty risk*

Treasury counterparty risk arises when there is a delay or failure from treasury counterparties to make payments with respect to treasury instruments transacted with the Corporation. Hence, the Corporation has adopted a prudent treasury counterparty limit framework, under which each potential treasury counterparty is assessed on the basis of its credit rating, financial strength and capability in treasury products, etc. Based on the evaluation results, a treasury counterparty limit is assigned for each specific type of treasury instrument exposure. The limits for treasury counterparties are reviewed and adjusted on a regular basis, which are based on their financial strength and the capital base of the Corporation. To date, the Corporation has not experienced any loss on a treasury transaction due to a credit default by a counterparty.

(e) *Lender risk*

The Corporation is exposed to lender risk in SME lending that arises from: (a) a lender's underwriting being incompliant with its credit policy; (b) a lender's loosely formulated credit policy which is not specific enough or sufficiently defined for compliance; and (c) the moral hazard of a lender being less prudent in underwriting a guarantee protected application. The Corporation adopts prudent eligibility criteria for application vetting, monitors delinquency and workout plans, and conducts due diligence reviews on claims to mitigate default risk on the part of borrowers and moral hazard on the part of lenders.

At the heart of the Corporation's credit risk management framework are two committees: the Credit Committee and the Transaction Approval Committee.

Credit Committee

The Credit Committee is responsible for setting the Corporation's overall credit policies and eligibility criteria, particularly for asset acquisition, mortgage insurance and SME guarantee business. The Committee operates under a framework that has been approved by the Board. The Committee is the approval authority for accepting applications to become Approved Sellers/Servicers under the MPP, Approved Reinsurers under the MIP, Approved Lenders under SFGS and eligible treasury counterparties. It is also responsible for setting risk exposure limits for the counterparties. Should the business and operating environment change drastically, credit policies will be immediately subject to review and timely measures based on the findings will be presented to the Committee for approval.

Transaction Approval Committee

The Transaction Approval Committee conducts an in-depth analysis of pricing economics and associated credit risks for business transactions, whilst taking into consideration the latest market conditions and business strategies approved by the Board. Major transactions approved by the Committee are subject to endorsement by an Executive Director.

The Credit Committee and the Transaction Approval Committee are both chaired by the Chief Executive Officer, with members including Senior Vice President (Operations), Senior Vice President (Finance), General Counsel, Senior Vice President (Risk) and senior staff from the relevant functional departments.

Market Risk

Market risks arise when the Corporation's income or the value of its portfolios decreases due to movements in market prices. Market risk consists of interest rate risk, asset-liability maturity mismatch risk, liquidity risk and currency risk.

(a) *Interest rate risk*

Net interest income is the predominant source of earnings for the Corporation. It represents the excess of interest income (from the Corporation's loan portfolio, cash and debt investments) over interest expenses (from debt issuance and other borrowings). Interest rate risks arise when changes in market interest rates affect the interest income associated with the assets and/or interest expenses associated with the liabilities.

The primary objective of interest rate risk management is therefore to limit the potential adverse effects of interest rate movements on interest income/expense, while maintaining stable earnings growth. The interest rate risk faced by the Corporation is two-fold, namely interest rate mismatch risk and basis risk. Interest rate mismatch risk is the most substantial risk affecting the

Corporation's net interest income. It arises mainly as a result of the differences in the timing of interest rate re-pricing for the Corporation's interest-earning assets and interest-bearing liabilities. Interest rate mismatch risk is most evident in the loan portfolios where the majority of the loans earn a floating interest rate (benchmarked against the Prime rate, HIBOR or Composite Interest Rate), whilst the majority of the Corporation's liabilities are fixed-rate debt securities. The Corporation therefore makes prudent use of a range of financial instruments, such as interest rate swaps, interest rate swaptions, basis swaps, forward rate agreements and issuances of MBS, to manage interest rate mismatch risk. The proceeds of the fixed-rate debt securities are generally swapped into HIBOR-based funds via interest rate swaps in order to better match the floating-rate incomes from mortgage assets.

The Corporation also uses duration gap as an indicator to monitor, measure and manage interest rate mismatch risks. A duration gap measures the difference in interest rate re-pricing intervals between assets and liabilities. The wider the duration gap, the higher the interest rate mismatch risk. A positive duration gap means that the duration of assets is longer than that of the liabilities, and therefore, represents greater risk exposure to rising interest rates. A negative duration gap, in contrast, indicates greater risk exposure to declining interest rates. Depending on the prevailing interest rate outlook and market conditions, the Corporation proactively re-balances the duration gap of its asset-liability portfolio under the guidance and supervision of the Asset and Liability Committee ("ALCO"). A cap of three months for the duration gap has been set to limit interest rate mismatch risks. In 2011, the average duration gap was kept at about one month, indicating that the Corporation handles interest rate mismatch risk in a very effective manner.

Basis risk represents the difference in the Corporation's Prime-based interest-earning assets and its HIBOR-based interest-bearing liabilities. However, there are only limited financial instruments currently available in the market to hedge the Prime-HIBOR basis risk fully. In general, basis risk can be effectively addressed only when mortgage assets and non-mortgage assets are based on HIBOR to match the funding base, or when related risk management instruments become more prevalent or economical. Over the past few years, the Corporation has consciously adopted a strategy that acquires more HIBOR-based assets. At the end of 2011, about 70% of the Corporation's mortgage assets and non-mortgage assets were HIBOR-based loans. As a result, the Prime-HIBOR basis risk for the Corporation has been substantially reduced. In addition, the Corporation had issued Prime-based MBS and used hedging derivatives in the past to mitigate such basis risk.

(b) Asset-liability maturity mismatch risk

Even though the contractual maturity of a mortgage loan can be up to 30 years, the actual average life of a portfolio of mortgage loans is much shorter. The average life depends on the speed of scheduled mortgage repayments and unscheduled prepayments. Higher prepayment rates shorten the average life of a portfolio of mortgage loans. In Hong Kong, prepayment occurs for two main reasons: (i) housing turnover – borrowers repaying their mortgage loans upon the sale of the underlying property, and (ii) refinancing – borrowers refinancing their mortgage loans to obtain lower mortgage rates.

Asset-liability maturity mismatch risk can be more specifically characterised as reinvestment risk and refinancing risk. Reinvestment risk refers to the risk of a lower return from the reinvestment of proceeds that the Corporation receives from prepayments and repayments of its loan portfolio. Refinancing risk is the risk of refinancing liabilities at a higher level of interest rate or credit spread. The Corporation is exposed to refinancing risk (in both funding amount and cost of funds) when it uses short-term liabilities to finance long-term, floating-rate loan portfolios.

Reinvestment risk is managed through the on-going purchase of new loans to replenish the rundown in the retained portfolios and through the investment of surplus cash in debt securities or cash deposits to fine tune the average life of the overall assets pool.

Refinancing risk is managed through the issuance of callable bonds and transferable loan certificates. The call option included in callable bonds and transferable loan certificates allows the Corporation to adjust the average life of its liabilities to match more closely that of the overall pool of assets. In this regard, the Corporation also has the flexibility of issuing debt securities with a broad spectrum of maturities, ranging from one month to 15 years. This again serves to adjust the average life of the overall liability portfolio in a dynamic fashion. In addition, refinancing risk can be mitigated by adjusting the maturities of assets in the investment portfolio or off-loading mortgage assets through securitisation of mortgage loans into MBS.

The asset-liability maturity gap ratio (ratio of the average life of the total interest-earning assets to the average life of the total interest-bearing liabilities) is used to monitor and manage maturity mismatch risk, with a target ratio set by the ALCO to ensure a proper balance between the average life of the Corporation's assets and liabilities.

(c) *Liquidity risk*

Liquidity risk represents the risk of the Corporation not being able to repay its obligations, such as the redemption of maturing debt, or to fund the committed purchases of loan portfolios. The Corporation implements its liquidity risk management framework in response to changes in market conditions. The Corporation has continuously monitored the impact of recent market events on its liquidity positions, and has pursued a prudent pre-funding strategy which has helped to contain the impact the global financial turmoil had on its liquidity. Liquidity risk is managed by monitoring the daily inflow and outflow of funds, and by projecting the longer-term inflows and outflows of funds across the full maturity spectrum. The Corporation measures its liquidity risk using a target liquid-asset ratio (ratio of liquid assets to total assets), set by the ALCO to monitor and manage its liquidity position. The Corporation manages pre-funding prudently through well-diversified funding sources, so that all foreseeable funding commitments are met when they fall due, in order to support the growth of its business and the maintenance of a well-balanced liability portfolio. Such diversification allows the Corporation to pursue a prefunding strategy at the lowest possible cost, whilst at the same time offering safeguards against the inability to raise funds in distorted market conditions. The current funding sources include:

- Shareholders' Capital: an authorised capital of HK$3 billion, of which HK$2 billion is fully paid up. Accumulated shareholders' funds amounted to HK$8.6 billion as at 31 December 2011.

- HK$40 Billion Debt Issuance Programme: there are 6 Primary Dealers and 16 Selling Group Members which underwrite and distribute debt to institutional investors under the DIP. The Transferable Loan Certificate Sub-Programme under the DIP provides further diversification of its funding sources and broadening of its investor base.

- HK$20 Billion Retail Bond Issuance Programme: this debt issuance programme has 19 Placing Banks which assist in offering retail bonds to investors.

- US$6 Billion Medium Term Note Programme: there are 10 Dealers who underwrite and distribute local and foreign currency debt to international institutional investors under the programme.

- US$3 Billion Bauhinia Mortgage-Backed Securitisation Programme: with a total of 8 Dealers, this multicurrency mortgage-backed securitisation programme permits the Corporation to originate MBS in both the local and international markets.

- Cash and Debt Investment Portfolio: this portfolio comprises mainly cash and bank deposits, commercial paper, high-quality certificates of deposit, and notes that are readily convertible into cash.

- HK$30 Billion Revolving Credit Facility: the Exchange Fund commits to providing the Corporation with HK$30 billion in revolving credit.

- Money Market Lines: the Corporation has procured money market lines from a large number of local and international banks for short-term financing.

Given its strong background as a wholly government-owned entity and its solid credit rating, the Corporation is efficient in raising funds from debt markets with both institutional and retail funding bases. This advantage is supplemented by the Corporation's portfolio of highly liquid investments, which are held to enable a swift and smooth response to unforeseen liquidity requirements. The HK$30 billion Revolving Credit Facility from the Exchange Fund further provides the Corporation with a liquidity fallback even if exceptional market strains last for a prolonged period.

(d) *Currency risk*

Currency risk arises from the impact of foreign exchange rate fluctuations on the Corporation's financial position and foreign-currency-denominated cash flows. The Corporation manages its currency risk in strict accordance with the investment guidelines approved by the Board and under the supervision of the ALCO, which sets daily monitoring limits on currency exposure.

In accordance with this prudent risk-management principle, the net exposure of the foreign currency denominated debts issued under the MTN Programme and the overseas residential mortgage loans purchased is fully hedged by the use of cross-currency swaps.

Control mechanism

Transaction execution is segregated among the front, middle and back offices to ensure adequate checks and balances. The Treasury Department, acting as the front office, is responsible for monitoring financial market movements and executing transactions in the cash, derivatives, debt and securitisation markets, in accordance with the strategies laid down by the ALCO. The Financial Control Department, assuming the middle-office role, monitors compliance with treasury counterparties and market risk limits. The Operations Department, acting as the back office, is responsible for deal verification, confirmation, settlement and the payment process.

Asset & Liability Committee

The ALCO manages the Corporation's asset-liability portfolio with prudent risk-management principles. It has the authority to set market-risk management policies and limits to facilitate day-to-day market-risk management. Regular meetings are held to review the latest financial market developments, the asset-liability portfolio mix, stress tests on interest rate risk and liquidity risk. It also oversees the implementation of risk management and investment guidelines approved by the Board.

The ALCO is chaired by the Chief Executive Officer, and has among its members a Senior Vice President (Finance), Senior Vice President (Operations), Senior Vice President (Risk) and senior staff from the relevant functional departments.

Operational Risk

Operational risk represents the risk of losses arising from external interruptions, or inadequacies or the failure of internal processes, people or systems.

The Corporation adopts a bottom-up approach in identifying operational risk by carrying out an in-depth analysis of new products, business activities, processes, system enhancements and due diligence reviews of new operational flows. Comprehensive validation rules, management information system reports and audit trails are in place to track and report any errors or deficiencies.

The Corporation actively manages operational risk with its comprehensive system of well-established internal controls, authentication structures and operational procedures. The operational infrastructure is well designed to support the launch of new products in different business areas, including asset acquisition, mortgage insurance, SME guarantee, reverse mortgages, treasury operations, debt issuances and overseas businesses. Rigorous reviews are conducted before the implementation of operational or system infrastructure in order to identify possible operational risks and to ensure adequate segregation of duties.

To prevent potential human error, and to ensure an efficient and effective discharge of daily operations, the Corporation pursues advanced technological solutions alongside robust business logistics and controls to carry out its operational activities and business processes. Steps have been taken to ensure the accuracy, availability and security of these systems, as they are critical to business operations and risk management. The Corporation has also taken careful steps to institute adequate checks and balances in financial controls to ensure that its operations are properly directed and controlled. Effective financial controls also help to minimise financial risk and safeguard its assets against inappropriate use or loss, including the prevention and detection of fraud.

The Corporation's Information Security Manual ("ISM") documents security standards and practices relating to information and data security for observance by all staff. All system security measures must follow the requirements stated in the ISM. The Corporation implements various security measures, such as double firewall protection, intrusion-detection systems, virus alerts, quarantine systems and vulnerability scanning systems to minimise its exposure to external attacks. Internally, the Corporation also has a virtual Local Area Network with workstation security policies to reduce damage in the event of a malicious intrusion. The Corporation engages external consultants when appropriate to conduct intrusion vulnerability tests in order to enhance system security.

To ensure a high degree of compliance, the Corporation's core operating systems and processes are subject to regular audit and review by internal auditors. As part of the annual statutory audit, these systems are also subject to external auditors' review. Furthermore, every year all staff are required to sign an undertaking to comply with the requirements in the ISM. The ISM is updated whenever there is a new security measure or system. Any changes to the ISM require approval from senior management.

To ensure that business-recovery procedures are practical and to facilitate continuous improvement, a business recovery drill is conducted by both IT and user departments every year. Daily back-ups and offsite storage of back-up tapes are in place to protect the Corporation from IT disasters.

Product Sign-off Mechanism

To ensure that all risk factors are considered when designing and implementing a new product, the Corporation developed a new product development management framework under which proper sign-off of product specification is conducted prior to any new product launch. The product driver is clearly assigned up front at the start of the product development process to be responsible for instituting the sign-off process. Products can be launched only after all functional departments have signed-off and confirmed functional readiness.

Operational Risk Committee

The Operational Risk Committee ("ORC") is responsible for ensuring that all business entities and line functions in the Corporation maintain an effective operational risk and internal control framework. The ORC is also responsible for providing directions and resolving issues related to policies, controls and management of operational issues referred to by line functions, as well as ensuring prompt and appropriate corrective action in response to audit findings related to operational risks or internal controls.

The ORC is chaired by the Chief Executive Officer. Other members of the committee include Senior Vice President (Operations), Senior Vice President (Finance), General Counsel, Senior Vice President (Risk) and senior staff in the relevant functional departments.

Legal Risk

Legal risk arises from uncertainty in the application or interpretation of laws, regulations or legal documents, or failure to comply with the statutory, regulatory or legal obligations. Legal risk also arises from the enforceability or effectiveness of legal documents to safeguard the interest of the Corporation.

The Legal Office, headed by the General Counsel and Company Secretary, advises the Corporation on legal matters with a view to controlling legal risk. When new products or business activities are considered, the Legal Office will advise on the relevant laws and regulatory environment, as well as the legal documentation, and identify possible legal pitfalls with a view to protecting the best interests of the Corporation. Where appropriate, external counsel will be engaged to assist the Legal Office in providing full legal support to the Corporation. The Legal Office also works closely with the other departments of the Corporation to advise on legal issues and documentation.

The ORC is the governance committee for legal risks.

Leveraging Risk

In order to ensure that the Corporation would not incur excessive risk when expanding its business and balance sheet in relation to its own capital base, the Financial Secretary, in his capacity as Financial Secretary and not the shareholder, acted as the regulator of the Corporation, by issuing a set of guidelines on capital-to-assets ratio for compliance by the Corporation upon establishment of the Corporation in 1997. The guidelines have since been updated from time to time to take account of new products launched by the Corporation. The Board of Directors approved in December 2009 Management's proposal to further strengthen the Corporation's capital management framework by replacing the then existing Guidelines on capital-to-assets ratio with a new set of guidelines by reference largely to the Basel II risk-based capital adequacy framework. The Financial Secretary issued in October 2011 the new Guidelines on Capital Adequacy Ratio ("CAR"), which took effect on 31 December 2011. The minimum CAR stipulated in the new Guidelines is 8%, which is the same minimum capital requirement under the Basel II. As at 31 December 2011, the Corporation had a capital base of HK$7.9 billion and a CAR of 19.7%.

The prudent use of regulatory capital is monitored daily in accordance with the new capital guidelines. The Chief Executive Officer (CEO) reports the CAR and the daily minimum ratio to the Board of Directors on a quarterly basis. An early warning system is also in place. If the CAR drops to the threshold level of 14%, the CEO will alert the Executive Directors. If the CAR falls to 12% or below, the Board of Directors will be informed and appropriate remedial actions will be taken.

Longevity Risk

Longevity risk refers to the heightening risk of larger payouts under the Reverse Mortgage Programme. The longer the payout period is, the larger the loan balance will be over time, and the less buffer there will be for the sale of the property to cover the outstanding loan balance. A loss may arise if there is a shortfall in the recovery amount after the disposal of the property. The termination rate of the loans depends largely on the mortality rate (i.e. life expectancy) of the borrowers.

In order to assess the potential financial impact of longevity risk for Reverse Mortgage loans, as well as the interaction among the various risk factors under the Reverse Mortgage Programme, a sensitivity analysis was conducted. The mortality assumptions are reviewed on a regular basis by the Transaction Approval Committee.

Process Management and Information Technology

Automation is instrumental in ensuring efficiency and accuracy in daily operations. Since its inception, the Corporation has devoted substantial resources and effort to developing and upgrading its business operations, internal controls and application systems.

The Corporation has been upgrading its treasury system, with a view to making further enhancements in the timeliness of developing new treasury and hedging products; better risk management integration across various products, counterparts and regions; better integration and more reliable collaboration among front, middle and back offices; and more robust and responsive adaptations to meet future regulatory and reporting requirements. The migration to the new treasury system is now in the final stage. The new system will be launched in 2012 after satisfactory completion of comprehensive testing and a parallel run with the existing system.

In 2011, the Corporation also put effort into further developing the Guarantee Information Processing System, an application system that would provide internal control and process automation for application processing, post-commitment monitoring, guarantee fee administration, claim processing and management reporting for SFGS. The Corporation has enhanced the existing internet-based business platform to facilitate straight-through processing for SFGS applications. This e-platform system has enabled the Corporation and SFGS participating banks to increase efficiency by automating some workflows, enhancing the quality of the application process and shortening application turnaround time.

To support the launch of the Reverse Mortgage Programme in July 2011, the Corporation developed the Reverse Mortgage System to facilitate the workflow of the loan application process and servicing operations for the pilot banks and the Corporation. The system allows the pilot banks to generate a loan schedule with monthly payout details, and to validate and process applications in accordance with the established policies. Further system enhancements will be implemented in 2012.

Business Continuity Plan

As a business continuity plan is crucial to the sustainability of a corporation during disasters or damage of resources, the Corporation regularly reviews its business continuity plan to ensure an effective and efficient decision-making and reporting framework in response to potential disastrous events.

In response to ongoing changes in the business environment and new office arrangements in the near future, the Corporation has been revising its business continuity plan. In 2011, the annual "surprise" drill served as an effective tool for promoting staff awareness of a business continuity culture and readiness in response to potential business disruption events.

Corporate Social Responsibility

In recognition of the Corporation's contribution to the community and its commitment to corporate social responsibility in the past year, the Hong Kong Council of Social Service awarded the Corporation the honour "Caring Organisation 2011/2012" under its Caring Company Scheme for the fourth year.

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caringorganisation
Awarded by The Hong Kong Council of Social Service
香港社會服務聯會頒發

Caring Company Recognition Ceremony

As a socially responsible organisation, the Corporation cares for both its employees and the community. The Corporation has underlined its commitment to corporate social responsibility by caring for its employees' well-being, participating in charity activities and implementing environmental protection measures.

Care for Employees

Staffing and Remuneration

With the Corporation's core mission of enhancing stability in the banking sector, promoting wider home ownership and facilitating the development of the debt securities market, it attracts and grooms talent in its key business areas of asset purchases, mortgage insurance, reverse mortgages and debt issuance. The Corporation provides its employees with competitive remuneration packages and fringe benefits, a promising career path and development opportunities, and a healthy and safe working environment. It has also adopted family-friendly practices by offering a five-day week to help employees maintain a good work-life balance, as well as comprehensive medical and dental insurance plans which cover both the employees and their family members.

Through systems automation and process re-engineering, the Corporation has maintained a lean and efficient workforce, despite an increase in the scope of purchases and the complexity of the products it offers. In 2011, the permanent establishment of the Corporation was 172, and the staff turnover rate was 9.88%.

Training and Development

The Corporation recognises the importance of on-going training and has devoted considerable resources to the continuous enhancement of its employees' professional knowledge and skills. In 2011, the Corporation arranged different programmes and workshops to help employees enhance their product knowledge, and strengthen their managerial and technical competence.

Credit Risk Management Training Workshop

Creative Problem Solving and Decision Making Workshop

The in-house training workshops on product covered a range of topics, from credit-risk management to bank lending to SMEs. In-house workshops covered soft skills such as problem solving, decision making, creative thinking and effective communication. Language courses were held on business writing and Putonghua, and IT desktop workshops were organised on software applications.

The Corporation also sponsored employees for external job-related training and development courses covering a wide range of topics, from mortgage-related issues, risk management, corporate governance, finance and accounting to information technology and leadership training.

In addition, all new employees were provided with an induction session to help them develop a positive working relationship by building a foundation of knowledge about the Corporation's organisation structure, functions and policies.

Health and Safety

As a caring organisation, the Corporation is dedicated to looking after both the physical and mental health of its employees. An Employee Support Programme is in place to provide confidential external counselling and consultation services to employees and their family members, if needed. Also offered to employees were a vaccination programme for the prevention of influenza and a health-check programme at privileged rates.

The Corporation has further reviewed and strengthened its contingency plans, such as split-team arrangements, to ensure an immediate response to a possible outbreak of influenza. The contingency plans aim to prevent the spread of communicable diseases among employees and to minimise any unexpected or sudden disruption to business operations. Periodic drills are organised to make sure employees are conversant with the activation of the back-up facilities, contingency plans and communication arrangements in case of emergency.

Effective Communication Skills Workshop

Eco Tour to Hong Kong Geopark

Bowling Fun Day

Employee Relations and Staff Activities

To promote a healthy work-life balance and foster a family-friendly working environment, the HKMC Staff Club, composed of members from various departments, regularly organises staff activities to cultivate better relationships and communication among employees. In 2011, these activities included Bowling Fun Day, an Eco Tour to Hong Kong Global Geo-park, Family Photo-taking Fun Day, Work-Life Balance Week, and other staff gatherings, all of which were well received by both employees and their families. Our employees also participated in friendly table-tennis games with other organisations for fun and team building. The e-newsletter "Mind Channel" regularly disseminates short stories, epigrams and health tips to all employees to create and maintain an optimum work-life balance and fulfilment.

To facilitate effective communication within the Corporation, the intranet Staff Homepage is frequently updated so that useful information can be shared among different departments. There is also the Staff Suggestion Scheme, which encourages staff to make suggestions for improvements in work flow and the work place.

Care for the Community

Charities and Social Activities

The Corporation promotes various charitable and community functions, such as fund-raising events, donation campaigns and voluntary services. Employees are encouraged to support charity activities and join voluntary work organised by the HKMC Volunteers Team, Caring League.

In 2011, the Corporation organised donation campaigns, such as Dress Casual Day 2011 for the Community Chest and the HKMC charity concert for education projects in the Mainland, and held its annual Blood Donation Day event for the Hong Kong Red Cross, part of the Corporation's community programme.

Dress Casual Day

Employees have been keen to participate in voluntary services, demonstrating their concern for the needy by dedicating time and effort to various causes. The Caring League has partnered with several social service organisations to participate in a number of voluntary services, including the following:

- Care for the environment – a recycling campaign in partnership with the Salvation Army to collect books, stationery, toys, etc., and International Coastal Cleanup 2011 Hong Kong, organised by the Green Council to collect litter and clean up the marine environment on a beach in Stanley.

Recycling Campaign

International Coastal Cleanup

Birthday Party for Children

- Care for the elderly – organised by the HKYWCA Ming Yue District Elderly Centre, involving our volunteers visiting the homes of elderly people living alone and helping them with home cleaning before Chinese New Year.

- Care for the children – organised by HOPE *worldwide*, involving a visit to the HOPE *worldwide* Centre for Kids to host a birthday party to celebrate birthdays of children from low income families.

Student Internship and Executive Trainee Programmes

To help nurture talent for the future, the Corporation provides a number of internship and placement programmes for undergraduates to give them a taste of the real business world and help them better prepare themselves for their future careers. The students who joined the programmes appreciated the learning experience and incredible work opportunities they were exposed to.

In 2011, the Corporation introduced its first Executive Trainee Programme with the objective of attracting young executives with good potential to meet the Corporation's operational needs and long-term staff development plan. Throughout the two-year programme, the Executive Trainees have the opportunity to undergo job rotations and attend structured learning and development programmes from time to time.

Environmental Protection

The Corporation continuously supports and implements various green measures to create a more environmentally friendly office and raise employees' awareness of methods of waste reduction and energy conservation. Employees are encouraged to adopt paperless working practices by using more electronic communication. They are also encouraged to collect waste paper and used toner cartridges for recycling, and are reminded to switch off their computers before leaving the office. Since 2006, the Corporation has taken various measures, including better control of office temperature, in the interest of energy efficiency. The Corporation welcomes suggestions from employees for green office ideas and encourages its suppliers to use and offer more environmentally friendly products whenever possible.

2012 Outlook

Hong Kong has shown great resilience during the global financial crisis but, according to the International Monetary Fund, external shocks emanating from Europe remain a key risk ahead. If the external economic environment deteriorates significantly, Hong Kong could be adversely affected through both trade and financial channels. Therefore, in 2012, the Corporation will remain highly vigilant and closely monitor market changes. It will maintain close dialogue with banks and stand ready to meet their demand for liquidity. It will also remain active in the bond market and issue different forms of bonds to satisfy both investors' appetite and its own business needs.

The Corporation is committed to further developing and promoting two new significant initiatives launched in 2011 – the SFGS and the RMP. It will also set up a microfinance scheme to help aspiring entrepreneurs acquire the capital for small businesses or self-enhancement.

Despite the uncertainty in the economic outlook, the Corporation will strive to fulfil its policy mission to contribute to Hong Kong.