

Chairman's Statement



I have the pleasure to present our Annual Report for the year ended 31 December 2004 and to report on the excellent corporate performance.

an impressive performance



The Mortgage Insurance Programme grew robustly, with the market penetration rate hitting 16%.

The Programme has helped to raise Hong Kong's home ownership rate from 52% in 1999 to 56% in 2003.

The HKMC purchased HK\$11.4 billion of mortgage loans in 2004, helping the Government to reduce the fiscal deficit through its assets disposal programme.

Record year for the Corporation

The results for 2004 set a new record for the financial performance of the Corporation. Profit after tax was HK\$664 million, an increase of 75.2% over 2003, mainly due to the substantial mortgage purchases in 2003 and 2004 and the favourable interest rate environment. The return on equity improved substantially from 11.5% to 17.1% and return on assets from 1.0% to 1.3%, whilst the cost-to-income ratio declined further from 17.4% to 12.2%. I am also pleased to report that this commendable performance was achieved without sacrificing asset quality, which remained excellent, with the 90-day delinquency ratio at 0.36% for the retained mortgage portfolio and 0.11% for the mortgage insurance portfolio. These figures compare very well with the banking industry performance and testify to the Corporation's success in managing business development without compromising on risk management.

Mortgage purchase and mortgage insurance programmes

The HKMC made a total purchase of HK\$11.4 billion of mortgage loans in 2004. Although less than the record amount of HK\$15 billion achieved in 2003, this was nevertheless a good performance in view of the difficulty to purchase mortgage assets in the current high liquidity environment. In early 2004, the Corporation revitalised the fixed-rate mortgage loan market through a successful re-launch of its Fixed Adjustable Rate Mortgage (FARM) Programme, offering loans with an interest rate fixed for periods of up to three years. This initiative triggered a flurry of fixed-rate product offerings from other banks, thereby offering homebuyers an additional choice in mortgage financing.

During 2004, the HKMC's Mortgage Insurance Programme (MIP) grew from strength to strength on the back of the recovery in the property market. Cover was issued in respect of mortgage loans totalling HK\$14.2 billion, an increase of 89.3% over 2003. The prudent operations of the HKMC and its product innovations have helped to raise the home ownership rate in Hong Kong from 52% in 1999 to 56% in 2003.

In view of Hong Kong's growing problem of urban decay and building dilapidation, urban renewal has become a matter of great urgency. The Hong Kong SAR Government has set up several initiatives to tackle this problem and the HKMC is pleased to be able to assist the process of urban renewal through its mortgage purchase and mortgage insurance programmes. First, mortgages secured on older properties are now eligible for sale to the Corporation and, secondly, the mortgage insurance programme has been expanded to older but well-maintained buildings so that their purchasers can secure mortgages with a higher loan-to-value (LTV) ratio, a longer repayment period and more favourable mortgage terms, thus supporting the market demand for such properties.

Debt market initiatives

The HKMC has taken advantage of the improving economic environment to further its mission to develop Hong Kong's debt and capital markets and enhance its role as a pivotal intermediary for channelling funds from the capital markets through the banks to homebuyers. Through its mortgage-backed securities and corporate debt issues, the HKMC provides a steady supply of long-term high quality paper to investors such as pension funds and insurance companies, thus enabling them to enhance portfolio diversification and obtain a reasonable investment return in the low interest rate environment.

CHAIRMAN'S STATEMENT

During 2004, the HKMC issued debt securities totalling HK\$11.4 billion and originated mortgage-backed securities of HK\$2.4 billion. For the fourth year running, we remained the largest local currency debt issuer in Hong Kong.

In June, the HKMC launched its HK\$20 billion retail bond issuance programme and, in a first for Hong Kong, pioneered the use of a plain language prospectus for the issuance of securities to the public. The plain language prospectus was well received by the investing public. The HKMC's user-friendly approach has subsequently been adopted by several other issuers, including the Hong Kong SAR Government, corporates and investment banks. In November, the HKMC extended the plain language approach to a retail issue of mortgage-backed securities, thus showing that even very complicated financial transactions can be made easily comprehensible to the average lay investor.

Risk management

The HKMC maintains a prudent and professional approach in the day-to-day management of the Corporation's risks, benchmarking it against best market practices. The HKMC's skill in managing its risk has been commended by the rating agencies. Moody's Investor Service, Inc. (Moody's) notes that the "HKMC's ability to assess and manage risks has resulted in acceptable risk levels well within the Corporation's own guidelines and, in some instances, superior than some of its larger international peers."

Corporate Governance Code

Corporate governance is increasingly regarded as an important aspect of a company's business. Good corporate governance demonstrates Management's commitment towards preserving

and adding to shareholder value through the maintenance of high ethical standards and carefully considered internal control and risk management. In July 2004, the Insurance Authority conducted a review of the HKMC's operations and corporate governance practices. I am pleased to report that the HKMC was assessed to have complied fully with the provisions of the Insurance Companies Ordinance and the Guidance Note on the Corporate Governance of Authorized Insurers.

From its inception, the Corporation has always adhered to the highest standards of corporate governance. In 2004, it decided to codify its widespread corporate governance practices by combining them into a single document. During this exercise, we took the opportunity to review and benchmark our corporate governance regime against applicable local and international best practices. We have also for the first time included a corporate governance report in the Corporation's Annual Report.

Challenges for 2005

For the coming year, the efforts of the HKMC will be concentrated on capitalising on the continued recovery of the property market through further enhancement of the mortgage insurance programme to meet the demands of the banks and homebuyers. Although the robust recovery of the Hong Kong economy will help to improve the credit quality of mortgage loans and boost the mortgage insurance business, competition in the mortgage market will continue to be keen in 2005 amidst ample liquidity in the market. As regards mortgage purchases, there will be continuing difficulties for the HKMC to make sizeable acquisition of mortgage loans. On the funding side, the coming interest rate hike cycle will present a challenge to the HKMC by

increasing overall funding costs and a tightening of the Prime-HIBOR spread will negatively impact profit margins.

New business opportunities

As part of its on-going review of the HKMC's business, the Board has carefully considered the challenges faced by the HKMC and consequently supported the expansion of the HKMC's business activities to potential new business opportunities, such as the acquisition of housing-related rental receipts and other assets of the Hong Kong SAR Government and public sector entities. I am confident that Management will continue to proactively introduce innovative products and seek out opportunities to further promote and expand the business activities of the HKMC in fulfilment of its goals.

Finally, I would like to thank my fellow Directors, Management and all staff for their hard work and dedication during 2004. As we look forward to the coming year, it will not be without challenges but I know that I can count on my colleagues' continued support to navigate successfully through 2005.



Henry Tang

Chairman