# The Hong Kong Mortgage Corporation Limited

# 香港按揭證券有限公司

Annual Report 2001 年報

# Contents





# Financial Highlights

| | 2001 HK$'000 | 2000 HK$'000 | 1999 HK$'000 |
|---|---|---|---|
| **FOR THE YEAR** | | | |
| Net interest income | **324,430** | 357,711 | 406,517 |
| Profit after taxation | **255,526** | 233,106 | 271,232 |
| Mortgage purchases [1] | **13,222,492** | 6,345,111 | 1,341,803 |
| Mortgage-backed securities issued | **632,690** | – | 1,635,760 |
| Debt issued | **15,583,550** | 6,625,000 | 6,250,000 |
| Mortgage insurance – net premiums underwritten | **58,742** | 29,174 | 6,526 |
| **AT YEAR END** | | | |
| Mortgage portfolio, net | **19,777,884** | 11,083,025 | 8,726,776 |
| Total assets | **23,219,832** | 14,844,616 | 13,980,627 |
| Debt securities | **20,058,550** | 11,621,000 | 11,441,000 |
| Mortgage insurance – risk in force [2] | **513,031** | 172,286 | – |
| **OTHER STATISTICS** | | | |
| Net interest margin | **1.5%** | 2.8% | 3.9% |
| Capital-to-assets ratio | **11.6%** | 13.5%[3] | 10.1% |
| Cost-to-income ratio | **28.2%** | 25.1% | 21.9% |
| Return on total assets | **1.2%** | 1.8% | 2.5% |
| Return on shareholder's equity | **9.4%** | 9.4% | 12.1% |

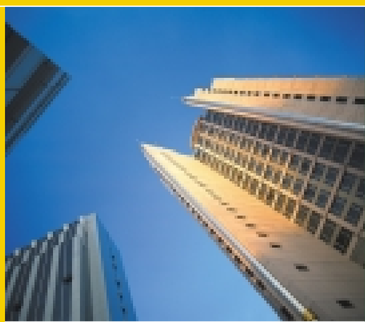
1 Mortgage purchases include loans purchased from banks for issuing back-to-back MBS from 2001 onwards.

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 at 12.3%.

# Chairman's Statement

The Corporation has responded swiftly and creatively to the challenging market conditions. By adapting the business strategy, we have exceeded most of our targets.



I am pleased to report that the Hong Kong Mortgage Corporation ("HKMC") has made significant progress in 2001 in advancing its missions to develop the secondary mortgage market and to promote home ownership in Hong Kong. The Corporation has responded swiftly and creatively to the challenging market conditions. By adapting the business strategy, we have exceeded most of our targets. More importantly, we have refined our business model to make it more effective as a platform to build a critical mass for the HKMC's core businesses and to support continuous growth in future years.

I am particularly proud of the HKMC's achievements in promoting wider homeownership. The strategic partnership formed with the Government housing agencies has created a new role for the Corporation in financing mortgage schemes that aim to help the lower income groups. The expanded Mortgage Insurance Programme ("MIP") has also helped more families to accelerate the purchase of their own flats. The Corporation continued to play a pioneering role in spearheading the development of the debt market. The introduction of a fully-fledged MBS programme and a highly effective new mechanism for offering retail bonds in 2001 has further widened the product range and the investor base for the benefit of market participants.

**The Honourable Antony LEUNG, GBS, JP**
**Chairman**
Financial Secretary

Through these efforts, the HKMC navigated well through the adverse market conditions and was able to strengthen its finances in 2001. Profit after tax recorded a 9.6% growth to HK$255.5 million, despite a significant drop of 46.4% in the net interest margin. The Corporation also produced a return on equity of 9.4% and a return on assets of 1.2%, broadly in line with those of local banks of comparable size. It did so whilst maintaining a strong capital-to-assets ratio of 11.6%.

The achievements in 2001 were set against a background of a difficult operating environment. Competition for mortgage loans continued to be fuelled by a sluggish mortgage market and a dwindling loan-to-deposit ratio of the banking industry, resulting in the mortgage rate falling to a low level of around Prime - 2.50%. The HKMC was faced with a dual challenge of the banks not being keen to offload mortgages and a sharp reduction in the profit margin of mortgage loans.

The HKMC tackled these challenges by expanding the scope of its Mortgage Purchase Programme ("MPP") to cover a wider range of Approved Sellers and eligible mortgage products. The Corporation achieved a major breakthrough by securing contracts to purchase HK$18 billion and HK$2.5 billion of mortgage loans from the Hong Kong Housing Authority ("Housing Authority") and Hong Kong Housing Society ("Housing Society") respectively. This partnership with the Government housing agencies produces considerable synergy in achieving the common objective of promoting home ownership in Hong Kong. The Government housing agencies are putting increasing emphasis on providing financing in the form of subsidized mortgage loans to promote home ownership for the lower income groups. The HKMC's MPP provides them with a reliable and efficient means to replenish funding for the subsidized mortgage schemes. The arrangement has also helped the Corporation to expedite the culmination of assets to support the launch of a fully-fledged MBS programme.

The HKMC has also responded promptly to the banks' requests for product diversification. In order to complement the efforts of the Hong Kong Monetary Authority ("HKMA") and the banks to relieve the financial burden of mortgage borrowers in negative equity, the mortgage purchasing criteria were relaxed to include mortgage loans refinanced at a loan-to-value ("LTV") ratio greater than 70% and up to 100%. In recognition of the aging of residential properties, the maximum of the combined age of property and loan tenor was increased from 40 years to 50 years. This measure helps homebuyers interested in buying older residential properties to obtain mortgage financing from banks and injects liquidity into the older housing stock.

These proactive measures have borne fruit in 2001. Despite the difficult market conditions, the Corporation achieved a record purchase amount of HK$13.2 billion of mortgage loans in 2001, more than double the figure of HK$6.35 billion for 2000. In anticipation of increasing interest of homebuyers to lock in the mortgage rate ahead of the expected rate hike in 2002, the HKMC decided in December 2001 to extend the maximum tenor of the fixed adjustable rate mortgages from 3 years to 10 years. This will help to position the Corporation for further mortgage purchases in 2002 and beyond.

The objective of promoting home ownership has also been advanced by an expansion of the MIP. Responding to the demand of homebuyers and the banks, the Programme was expanded in 2001 to include equitable mortgage loans on housing units under construction and the maximum loan size limit was raised from HK$5 million to HK$8 million. Through product diversification and proactive marketing, business volume recorded a sharp increase of 49% from 5,217 applications in 2000 to 7,787 applications in 2001, involving a total mortgage amount of HK$14.5 billion. In a short span of three years, the MIP has become an integral part of the mortgage market. Mortgage loans with insurance cover now account for about 10% of new mortgage loans. Since the inception of the Programme in 1999, the MIP has assisted more than 9,200 families to advance the purchase of their own flats.

On the funding side, the HKMC has maintained its momentum in enhancing the depth and product range of the debt market in Hong Kong. To finance the substantial mortgage acquisition, the Corporation raised a record amount of HK$15.6 billion through 26 issues of debt securities in 2001, making it the most active corporate issuer in the local debt market. The Corporation has further strengthened its fund raising capability by attaining credit ratings that are the same as those of the Hong Kong SAR Government.

The HKMC has also taken steps to enrich the product range of the debt market. We have successfully kick-started the retail bond market through the introduction of a new offering mechanism that allows retail investors to make use of the familiar and convenient branches of the placing banks, as well as their highly sophisticated telephone and Internet banking facilities, to subscribe for the bonds and to handle the subsequent trading. The inaugural issue launched in October 2001 attracted a record subscription amount of HK$651 million.

December 2001 marked the commencement of the second phase of the HKMC's business plan with the launch of the Bauhinia MBS Limited US$3 Billion Mortgage-Backed Securitisation Programme ("Bauhinia MBS Programme"). The launch of this multi-currency bond-style MBS programme represented a major milestone not only for the HKMC but also for the local financial industry as a whole. Through standardization of product structure and documentation, the Programme provides a convenient platform for the HKMC and banks to convert illiquid mortgage portfolios into liquid MBS in order to achieve their funding and balance sheet management objectives.

The launch of the new MBS Programme is the culmination of the building blocks that the HKMC has put in place to support the long-term development of the secondary mortgage market. One of the key building blocks is the standardization of mortgage origination documents. After months of hard work, and with the generous support of the legal fraternity and the banking industry, the HKMC introduced in July 2001 a set of model origination documents that represents the best market practice. Standardization of the mortgage origination documents will help to reduce the lead time and cost for the issuance of MBS by removing the need for due diligence review by investors and rating agencies. Responding to the HKMC's promotional efforts, the major banks have taken the lead in adopting the Model Documents. This should pave the way for general adoption by other banks in the near future.

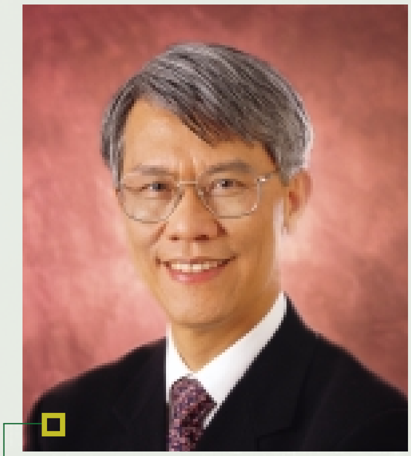
Moving in step with the banking industry, the HKMC rolled out its e-business platform, the Integrated Information Delivery System ("IIDS"), in December 2001. The IIDS is an Internet-based business platform that supports straight-through processing of transactions between the HKMC and its business partners. The system has enabled the HKMC and its business partners to substantially enhance efficiency by automating work processes, reducing operating costs and shortening the time-to-market of new products.

With the launch of the bond-style MBS Programme and the IIDS platform in 2001, the HKMC has put in place the business and operational platforms to build a critical mass for its core businesses covering mortgage purchase, mortgage insurance, mortgage securitisation and debt issuance. The strategic partnership formed with the Government housing agencies provides a new engine for sustainable growth in future years. We also expect the banks would revive interest in offloading mortgage portfolios to the HKMC when the economy is on a firm track to recovery.

Finally, I would like to pay tribute to my fellow Directors on the Board for their invaluable advice and contributions, without which the HKMC would not have been able to achieve so much within such a short time. I would also like to thank the Executive Directors and the staff of the HKMC for their hard work, dedication and innovative thinking. The HKMC will continue to work closely with the banks, the capital market participants and the insurance industry to further develop the secondary mortgage market in Hong Kong.

**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

**Mr. Dominic WONG Shing-wah,**
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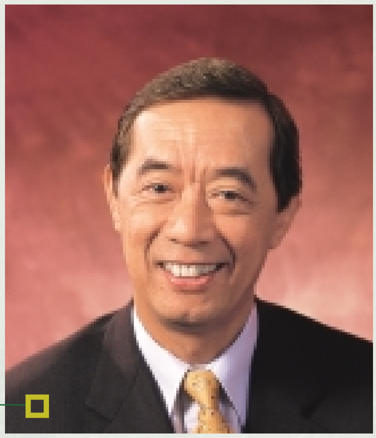
**Director**
*Secretary for Housing*

**Mr. Stephen IP Shu-kwan,**
GBS, JP
**Director**
*Secretary for Financial Services*

**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*

Mr. Eddy C. FONG, SBS, JP
Director
*Certified Public Accountant and*
*Partner of PricewaterhouseCoopers*

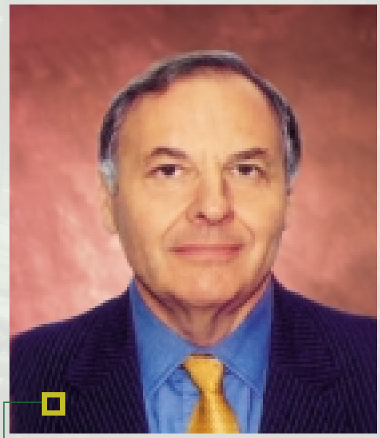
The Honourable Bernard Charnwut
CHAN
Director
*Legislative Councillor*
*Executive Director*
*Asia Financial Group*

The Honourable SIN Chung-kai
Director
*Legislative Councillor*

Ms. Anita FUNG
Director
*Head of Trading, Asia-Pacific,*
*Treasury and Capital Markets,*
*The Hongkong and Shanghai Banking*
*Corporation Limited*

The Honourable CHAN Kwok-keung
Director
*Legislative Councillor*

Professor Andrew Chi-fai CHAN,
Ph.D.
Director
*Associate Dean, B.A. Faculty,*
*The Chinese University of Hong Kong*
*Chairman of Consumer Council*



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

Mr. Andy HON Hak-keung
Director
*General Manager, Mortgages and*
*Auto Consumer Banking Division,*
*Standard Chartered Bank*

# MANAGEMENT TEAM

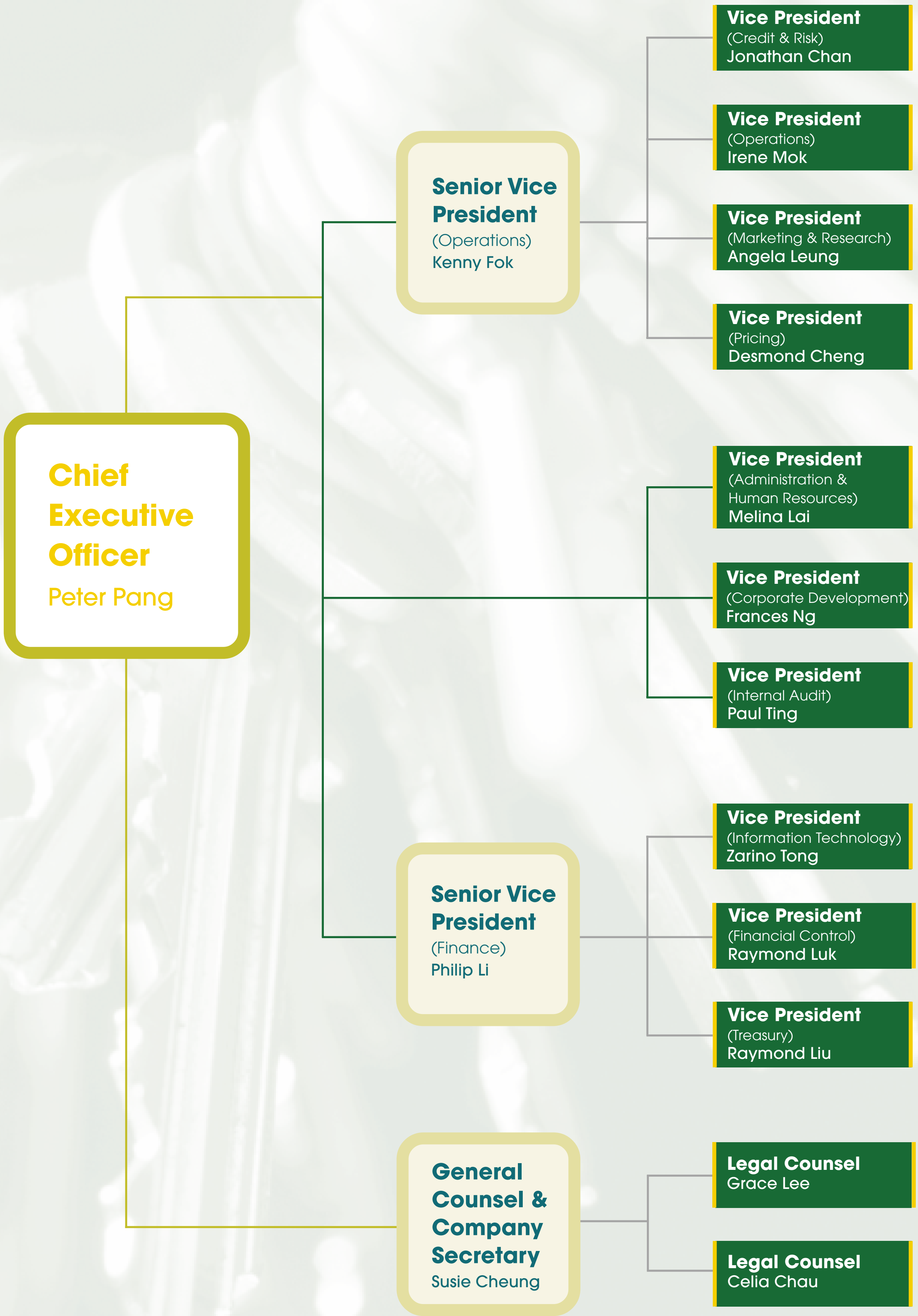
1 2 3 4 5 6 7 8 9 10 11

1. Mr. Jonathan Chan
2. Mr. Raymond Liu
3. Ms. Irene Mok
4. Ms. Frances Ng
5. Ms. Melina Lai
6. Mr. Paul Ting
7. Ms. Grace Lee
8. Mr. Zarino Tong
9. Ms. Celia Chau
10. Mr. Desmond Cheng
11. Mr. Raymond Luk
12. Ms. Angela Leung (Absent)

2 3
1 4

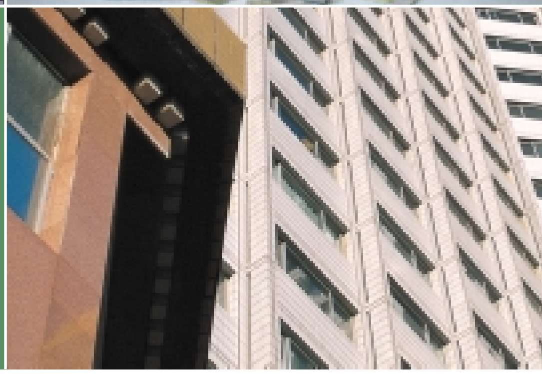
1. Mr. Peter Pang, JP
2. Mr. Kenny Fok
3. Mr. Philip Li
4. Ms. Susie Cheung

# Organisation Structure



# Business Review

Responding to the difficult business environment, the HKMC has been able to adapt its strategy to build a critical mass for its core businesses and lay down a solid foundation to support continuous growth in future years.



## PERFORMANCE HIGHLIGHTS

The HKMC exceeded most of its business targets in 2001. Responding to the difficult business environment, the HKMC has been able to adapt its strategy to build a critical mass for its core businesses and lay down a solid foundation to support continuous growth in future years. The Corporation made further progress in fulfilling its three core missions:

- to enhance the stability of the banking sector through offering a reliable source of liquidity;
- to promote wider home ownership in Hong Kong; and
- to facilitate the growth and development of the mortgage-backed and debt securities markets in Hong Kong.

In 2001, the HKMC:

- purchased a total of HK$13.2 billion of mortgage loans - more than double the 2000 figure of HK$6.35 billion, despite a difficult market environment;
- issued a record amount of HK$15.6 billion of debts and achieved a significant saving in funding cost of about HK$40 million through adopting a pro-active pre-funding strategy;
- provided insurance for mortgage loans of HK$8.3 billion - exceeded the 2000 figure by 33%;
- maintained superb asset quality with, as of end December 2001, 0.29% and 0.03% of loans overdue for more than 90 days in the retained portfolio and the mortgage

insurance portfolio respectively, as compared with the industry average of 1.22%; and

- obtained credit ratings from Standard & Poor's and Moody's, which are the same as those of the Hong Kong SAR Government.

As a result, the HKMC succeeded in mitigating to a significant extent the severe adverse impact of the sharp fall in mortgage rates on the Corporation's profitability. Most notably, in 2001, the Corporation:

- achieved a profit after tax of HK$255.5 million, HK$22.4 million or 9.6% more than the 2000 figure of HK$233.1 million, despite a 46.4% drop in the net margin of its interest-bearing assets from 2.8% to 1.5%;

- maintained a return on shareholder's equity of 9.4% - at the same level as 2000;

- provided a return on total assets of 1.2% - as against 1.8% in 2000;

- maintained a strong capital-to-assets ratio of 11.6% - as against 13.5% in 2000; and

- achieved a cost-to-income ratio of 28.2% - substantially below the banking sector average of 42.3%.

**PRODUCT INNOVATION**

The Corporation responded swiftly and creatively to the challenging business environment in 2001:

- In February 2001, the Corporation signed an agreement with the Housing Authority, the first non-bank Approved Seller, to buy HK$17 - $18 billion of mortgage loans originated under the Home Purchase Loan Scheme.

- In April 2001, the Corporation expanded the MIP to provide cover for equitable mortgage loans with LTV ratio of up to 85% and, in July 2001, further expanded to LTV ratio of up to 90%. The maximum loan amount permitted under the MIP was increased from HK$5 million to HK$8 million in November 2001.

- In July 2001, the Corporation introduced a set of Model Mortgage Origination Documents that represents best market practice.

- In October 2001, the Corporation introduced a new arrangement of issuing bonds to retail investors through banks as placing agents. The debut issue attracted a record subscription amount of HK$651 million from retail investors.

- In December 2001, the Corporation expanded the MPP to include mortgage loans refinanced at LTV ratio greater than 70% and up to 100% and mortgage loans with a maximum combined age of property and loan tenor of up to 50 years.

- In December 2001, the Corporation rolled out an e-commerce platform that supports the processing of transactions with banks and mortgage reinsurers over the Internet.

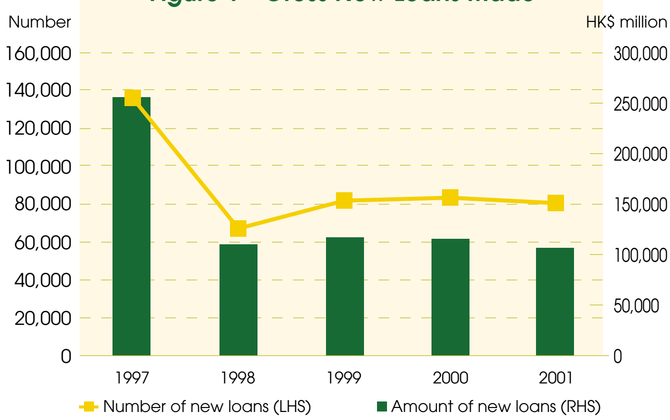
- In December 2001, the Corporation launched a multi-currency bond-style MBS Programme to promote the development of an active secondary mortgage market in Hong Kong.

## MORTGAGE PURCHASE ACTIVITIES

### Market Environment - slow growth in mortgage loans

The mortgage market remained sluggish in 2001. Sentiment of homebuyers continued to be affected by the rising unemployment rate and the concern about the possible adverse impact of the large supply of new housing units on property prices. According to the HKMA's monthly survey of 38 Authorized Institutions, the total number of new loans made in 2001 dropped by 3.4% to 80,489 loans (83,339 loans in 2000) (Figure 1). The total principal amount of new loans made also dropped by 7.9% to HK$106.5 billion (HK$115.6 billion in 2000). At year-end, the total outstanding principal balance of residential mortgage loans recorded a small increase of 1.3% to HK$528.5 billion.

Figure 1 - Gross New Loans Made




Source: HKMA

Of the new loans approved in 2001, those relating to new housing units increased to 36.3% (22.0% in 2000), reflecting the abundant supply of new housing units and the attractive financing packages offered by property developers (Figure 2).

**Figure 2 - Breakdown of Newly Approved Mortgage Loans**

| | 2000 HK$m | 2001 HK$m | Change |
|---|---|---|---|
| Primary | 30,132 | 44,368 | 47.2% |
| Secondary | 52,673 | 49,444 | -6.1% |
| Refinancing | 54,456 | 28,333 | -48.0% |
| | 137,261 | 122,144 | |

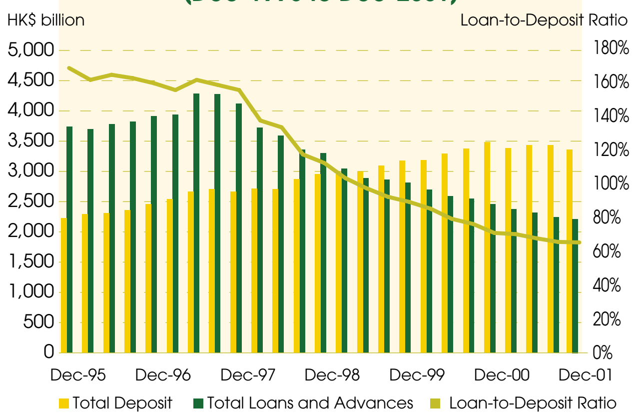
Source: *Compiled from the HKMA's Residential Mortgage Monthly Survey*

According to the Rating and Valuation Department, supply of new residential properties (completed) increased by 7.6% to approximately 27,800 units in 2001. To promote the sale of the new property units, the property developers often teamed up with banks to offer top-up loans with repayment holiday of up to 25% of the value of the property to the buyers.

### Intense competition for mortgage loans continued

The dwindling loan-to-deposit ratio of the banks and the slow recovery of corporate lending continued to exert strong pressure on the banks to compete for consumer lending, in particular low-risk mortgage loans. Figure 3 below shows that the loan-to-deposit ratio of all Authorized Institutions was slashed by 61% from 168% at the end of 1995 to 65% at the

Figure 3 - Total Loans and Deposits (Dec-1995 to Dec-2001)

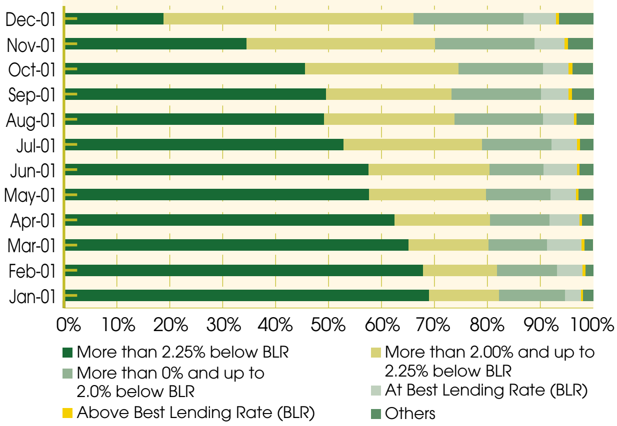



Source: HKMA/CEIC

end of December 2001. Despite the thin margin, mortgage loans remain attractive to banks due to their excellent asset quality. The delinquency ratio of mortgage loans overdue for more than 90 days actually improved from 1.43% in April 2001 to 1.22% in December 2001.

Reflecting the intense competition, the HKMA's monthly survey showed that the proportion of new loans originated at more than 2.25% below the Prime rate increased from 7.2% at end 2000 to 68.9% at end 2001 (Figure 4).

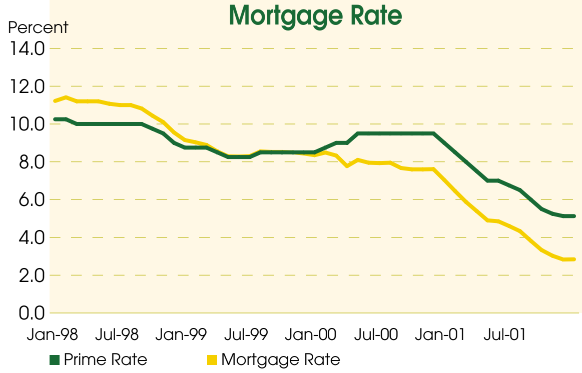
Figure 4 - Trend of Pricing of New Mortgage Loans in 2001




Source: HKMA

On the other hand, it appears that there is little room for mortgage rate to fall significantly below the prevailing level of Prime - 2.5% given that deposit rates are already close to zero. Figure 5 shows the sharp drop in mortgage rates since 1998.

Figure 5 - Comparison of Prime Rate and Mortgage Rate



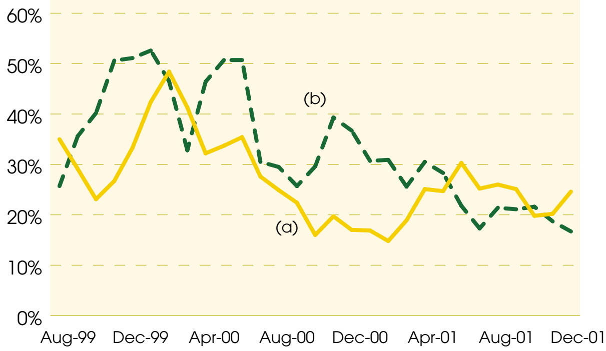

Source: HKMA/HKMC

## Slowdown in mortgage refinancing activities

Despite the fierce competition, mortgage refinancing activities slowed down considerably in 2001. According to HKMA's monthly survey, the portion of new mortgage loans due to refinancing fell sharply from the peak of 53% in early 2000 to 17% in late 2001 (Figure 6). 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 2001. A substantial portion of the rate reduction requests by borrowers would have been processed already in 2000. Furthermore, the ability of borrowers in negative equity to obtain refinancing is limited by the requirement to pay down the loan to an LTV ratio below 100%.

Figure 6 - Full Prepayment Rate of the HKMC's Retained Portfolio - (a)

Percentage of New Loans Associated with Refinancing (38 AIs) - (b)



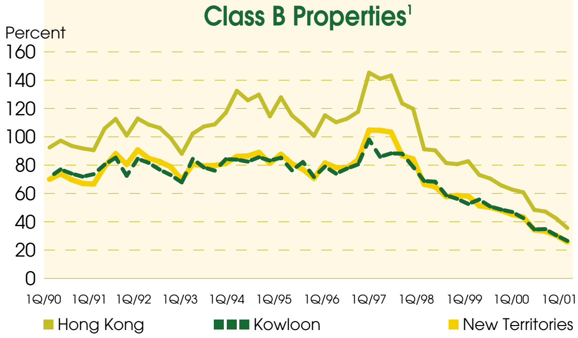

Source: HKMA/HKMC

## Improved affordability of homebuyers

Whilst the subdued economy and the high unemployment rate have had a dampening effect on the sentiment of homebuyers, this has been countered to some extent by an improving housing affordability. With both property prices and mortgage rates at low levels, there was a pickup in property transactions of 3% in 2001 to about 88,000 cases.

According to the statistics of the Rating and Valuation Department, average property prices were about HK$3,300 per square foot (psf) for Class B housing units on the Hong Kong Island, HK$2,450 psf in Kowloon and HK$2,400 psf in the New Territories in the last quarter of 2001, roughly 55% to 60% below their peak in 1997. With the median monthly household income declining at a slower pace, the affordability ratio has improved significantly, for example, the ratio improved from 98% in 1997 to 28% in late 2001 for Class B properties in Kowloon (Figure 7).

Figure 7 - Affordability Ratio for Class B Properties[1]




The strong affordability ratio will continue to provide support for the residential property market. This is particularly the case as the low mortgage rate has made the monthly repayment amounts lower than the monthly rental for residential properties in many locations.

## HKMC's response

The difficult business environment required the HKMC to adapt its business strategy in order to maintain a steady growth in its retained mortgage portfolio and to counter the tightening of profit margins by reducing costs. The Corporation tackled these challenges with a three-pronged strategy:

- to widen the source of mortgage acquisition by expanding the range of Approved Sellers and the scope of eligible mortgage loans;
- to minimize funding cost by adopting a pro-active pre-funding strategy to capture market opportunities to issue debts at low cost and issuing more retail bonds; and
- to reduce operating cost through automation and process re-engineering.

## Mortgage Purchase

Maintaining a steady growth in mortgage purchases is crucial to the long-term development of the HKMC. It provides the means for the Corporation to fulfill its objectives of enhancing monetary and banking stability by acting as liquidity provider for financial institutions and helping them manage the concentration and liquidity risks of their mortgage portfolios. The ability to acquire a steady stream of mortgage portfolios is also a prerequisite for the Corporation to achieve its other objectives of developing the debt and MBS markets in Hong Kong.

In view of the slow growth in mortgage loans, it would take some time for the banks to revive interest in offloading mortgage portfolios of a substantial scale. The HKMC needs to identify new sources of mortgage acquisition to maintain the momentum of growth. The Corporation decided in December 2000 to expand the scope of Approved Sellers to include Government housing agencies, other public bodies and property developers. With the successful execution of this strategy, the HKMC was able to achieve a record mortgage purchase amount of HK$13.2 billion in 2001 (Figure 8).

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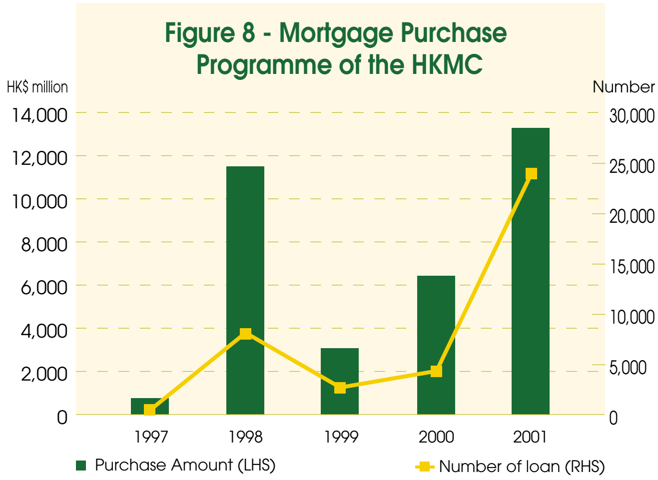
[1] **Note**: a fall in the ratio means improvement in the affordability
**Assumptions**: The calculation of the ratio uses unit size of 500 sq. ft., mortgage tenor of 20 years and down-payment of 30% of the property value.
Source: Calculated by the HKMC based on published data from various Government departments




*Source: HKMC*

### Diversification of the range of Approved Sellers to include Government housing agencies and property developers

Other than providing new impetus for growth in HKMC's business, the partnership with the Government housing agencies has created a new role for the Corporation to complement the Government's efforts to promote homeownership for the lower income groups. The partnership produces considerable synergy that benefits both parties. Responding to the changed market conditions, the Housing Authority and the Housing Society are relying more on providing subsidized mortgage loans instead of their "build-and-sell" programmes to promote homeownership for the lower income group. The HKMC's mortgage purchase programme provides an efficient mechanism for the agencies to replenish funding for the subsidized mortgage schemes. The strategic partnership also provides the HKMC a new and significant source of mortgage acquisition to support its mortgage securitization programmes. The initiative was well received by the Government housing agencies. The Housing Authority and the Housing Society respectively entered into agreements with the HKMC to sell HK$18 billion and HK$2.5 billion of mortgages in 2001 and 2002. An aggregate amount of HK$11.7 billion was settled in 2001.

In addition to purchases from Government housing agencies, the HKMC acquired about HK$600 million of mortgage loans from property developers. The offloading of mortgage loans to the Corporation enables the developers to release capital for their core business and relieve them of the administrative work related to the mortgage loans. To address the additional risk of these top-up loans, the developers are required to provide credit enhancement through warranty or reserve fund.

Notwithstanding the difficult market conditions, there are on-going mortgage purchases from banks that have liquidity and balance sheet management needs. In 2001, the HKMC acquired a total of HK$870 million of mortgage loans from the banks. After a cumulative drop of 4.375% in the Prime rate in 2001, it is generally expected that interest rate has bottomed out and is likely to rebound in 2002. As the inter-bank rates tend to price in the rate hike in advance, it is expected that the Prime-HIBOR spread would tighten in the near term. The Corporation expects that more banks may consider offloading mortgage loans to the Corporation as a means to contain the Prime-HIBOR basis risk of their mortgage portfolios.

### Diversification of eligible mortgage products

The Corporation has also taken active steps to expand the range of mortgage loans eligible for purchase under the MPP. In December, the Board approved an expansion of the Programme:

a) to include mortgage loans refinanced at an LTV ratio greater than 70% and up to 100%;

b) to extend the ceiling of the combined age of property and loan tenor from 40 years to 50 years; and

c) to extend the initial fixed-rate term of mortgages originated under the Fixed

Adjustable Rate Mortgage ("FARM") Programme from 3 years to 10 years.

Visit by Mr. Franklin Raines, Chairman & Chief Executive Officer of Fannie Mae in October 2001

In October 2001, the HKMA announced that it would not object if Authorized Institutions choose to depart from the 70% LTV ratio guideline in the case of refinancing residential mortgage loans for homeowners in negative equity. The move facilitates homeowners in negative equity to procure lower mortgage rates with the same bank or through refinancing with another bank for an LTV ratio of up to 100%. The HKMC expanded its MPP to include this type of mortgage product to complement the efforts of the HKMA and the banks to alleviate the financial burden of homeowners in negative equity. The new measure is not expected to affect the asset quality of the HKMC's retained portfolio. The HKMA's guidelines require banks to adhere to the normal prudent underwriting criteria, including compliance with the 50% debt-to-income ratio, in the origination of these loans. Furthermore, the refinanced loans are re-underwritten by banks based on an updated assessment on the repayment ability of the borrower.

The decision to extend the ceiling of the combined age of property and loan tenor from 40 years to 50 years will help homebuyers intending to acquire older residential properties to obtain mortgage finance from banks. The extension would facilitate homebuyers of older property units to secure mortgage loans of a longer tenor and reduce the monthly repayment amount. This would also widen the choice of properties for homebuyers and enhance the liquidity of the older housing stock. To guard against the dilapidation risk of the older properties, the sellers have to provide a satisfactory valuation report produced by a qualified valuer confirming that the underlying property is free of any material negative findings or unauthorized structural modifications.

The HKMC's FARM currently offers three initial fixed-rate periods, namely 1-year, 2-year and 3-year, to the borrowers. At the end of the fixed rate period, the borrower can choose either to re-fix the mortgage rate for another fixed term at the then prevailing FARM rates or to convert the loan to a floating-rate loan. The borrowers tend to prefer fixed-rate mortgage products when interest rates are expected to trend upwards. As there is a general expectation that interest rates will likely start to rebound in 2002, more homebuyers would prefer to lock in the mortgage rate, which is at a historical low level, for periods longer than three years. The HKMC's decision to extend the initial fixed rate period to 10 years is expected to generate the following benefits:

- it would strengthen the effectiveness of the Programme in achieving the objective of enhancing the stability of the monetary and banking system as both the banks and the borrowers will be better protected from interest rate fluctuations;
- it would offer more choices to homebuyers with different rate expectations and risk appetite; and
- it would enrich the available product range in the Hong Kong mortgage market.

Depending on the market conditions and the demand of homebuyers, the Corporation intends to introduce, on an incremental basis, new FARM products, with an initial fixed-rate period of beyond three years in 2002.

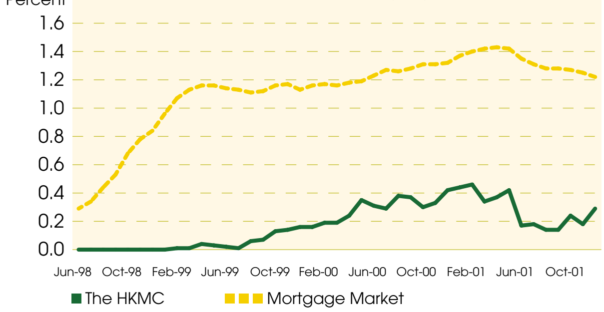
### High quality of the mortgage portfolio

The Corporation adopts a four-pronged approach in upholding the asset quality of its mortgage portfolio:

- Careful selection of Approved Sellers
- Prudent purchasing criteria
- Effective due diligence process
- Adequate protection for higher-risk mortgages (see page 32 for details)

The effectiveness of these risk management measures is borne out by the track record of the low delinquencies of mortgage loans in the HKMC's retained portfolio. It is noteworthy that the mortgage portfolios of banks in Hong Kong in general have performed very well by international standards - despite the recent economic downturn. The industry average of loans overdue for more than 90 days for the 38 Authorized Institutions surveyed by the HKMA was 1.22% in December 2001 (Figure 9). The HKMC's portfolio considerably out-performed this average with a ratio of 0.29% (0.50% including charge-offs made during the year).

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/HKMC*

## MORTGAGE-BACKED SECURITIZATION ACTIVITIES

The HKMC achieved a major breakthrough in its mission to develop the secondary mortgage market with the introduction of a multi-currency bond-style MBS Programme in 2001. The introduction of the Bauhinia MBS Programme was the result of the persistent efforts made by the Corporation to put in place the building blocks since its inception in 1997.

In 1999, the HKMC launched the Guaranteed Mortgage-Backed Pass-Through Securitization Programme. The back-to-back structure of the MBS issued under that Programme allows the participating banks to keep a substantial portion of the cash flow from the mortgage pools, whilst reducing the credit risk and capital cost through HKMC's guarantee of the securities. It also provides them with an option at any time to off-load part or all of an issue to suit their liquidity or trading objectives. Three issues with an aggregate amount exceeding HK$2.2 billion have since been issued under the back-to-back MBS programme. These include an issue of HK$633 million launched with American Express Bank in 2001.

Another prerequisite for a sustained MBS issuance programme is a regular source of sizeable mortgage purchases. This has been secured with contracts to purchase over HK$20 billion of mortgage loans from the Housing Authority and the Housing Society for settlement in 2001 and 2002.

The new Bauhinia MBS Programme provides a convenient, flexible and cost-efficient platform for the issuance of MBS. The features of the Programme are as follows:

- **Bond-style structure**: the coupon payment adopts the conventional bond-style computation to facilitate trading in the secondary market.

- **Multi-currency**: the Programme supports the issuance of MBS denominated in Hong Kong dollar and other major currencies.

- **Credit enhancement**: the flexible Programme enables the HKMC to devise various product structures. In particular, it allows for extensive credit enhancement options, including credit guarantee, tranching, over-collateralization and reserve funds, to suit the investment and balance sheet management needs of individual investors and investors of different risk appetites.

- **Offering mechanism**: the Corporation has appointed Merrill Lynch International as Programme Arranger, and Barclays Capital, Dao Heng Bank, Deutsche Bank, HSBC, JP Morgan, Merrill Lynch International, Salomon Smith Barney and UBS Warburg as Programme Dealers. The MBS issued under the Programme may take the form of a public issue or a private placement. Any bank or investor outside the above group of dealers may initiate an issue by invoking reverse enquiry.

- **Market making arrangements**: a dealer group will be formed to act as market makers to quote two-way prices to enhance liquidity of the MBS in the secondary market.

In terms of issuing strategy, the HKMC intends to focus initially on the Hong Kong dollar market and to launch two products that are familiar to the capital market participants. The first type is a single class MBS with the HKMC's guarantee on principal repayment and interest payment (Figure 10a). The second type is in the form of multi-class MBS with credit-enhancement provided through segmentation of the issue into senior and junior tranches, over-collateralization or reserve fund arrangements (Figure 10b).

Figure 10a

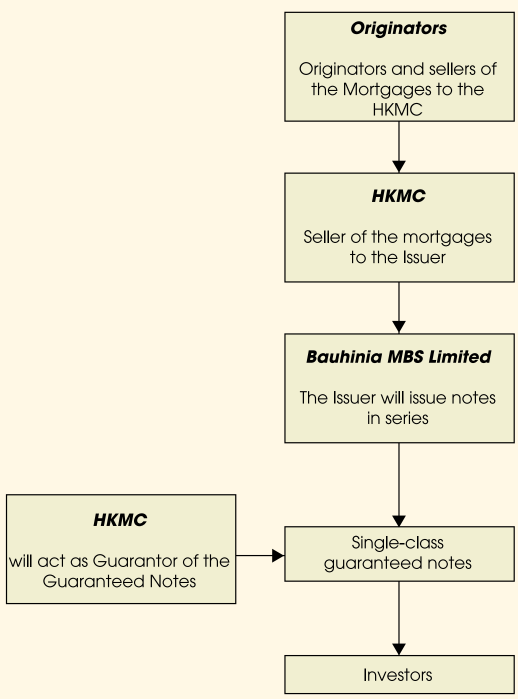
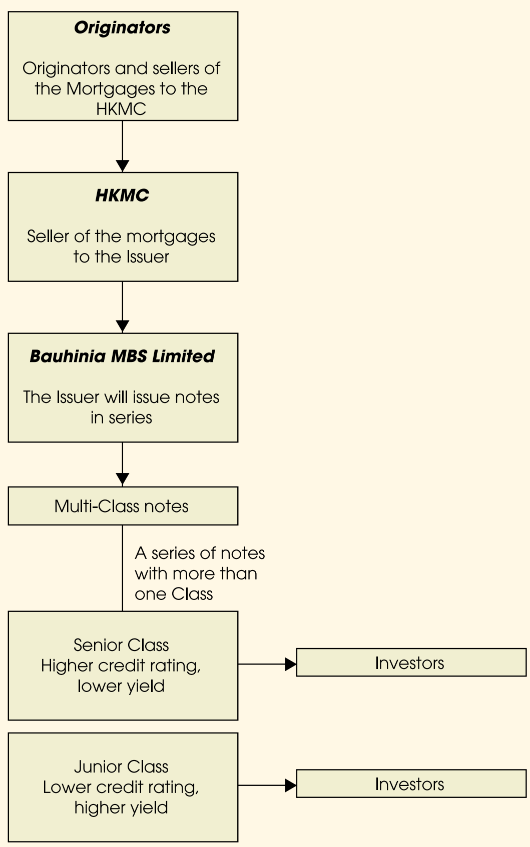



Figure 10b



The back-to-back guaranteed MBS Programme and the new bond-style MBS Programme will serve as the two main vehicles for the HKMC to promote the development of the MBS market in Hong Kong. The back-to-back MBS Programme targets banks that are interested in using it as a balance-sheet management tool, whilst the bond-style MBS Programme caters for a wider group of investors that are interested in the income stream from HKMC's high-quality mortgage assets. The HKMC intends to launch a debut issue of about HK$2 billion under the Bauhinia MBS Programme in the first quarter of 2002.

## MORTGAGE INSURANCE ACTIVITIES

The MIP was introduced in March 1999 with the following objectives:

- to enfranchise a new class of homebuyers who were previously unable to afford the downpayment to achieve property ownership;
- to allow banks to satisfy their clients' needs without exposing themselves to additional risk;
- to provide a new line of business to the local insurance industry; and
- to provide a new line of profitable business for the HKMC.


MIP product enquiry counter

Under the initial Programme, the HKMC provided insurance cover for a fee to its Approved Sellers for an amount up to 15% of the value of the property to enable homebuyers to secure mortgage loans up to an 85% LTV ratio. The HKMC hedges the exposure by taking out reinsurance with the Approved Reinsurers. In order to help more homebuyers to accelerate home purchase, the Programme has been expanded gradually to cover a wider range of mortgage products (Figure 11).

**Figure 11 - MIP Product Development**

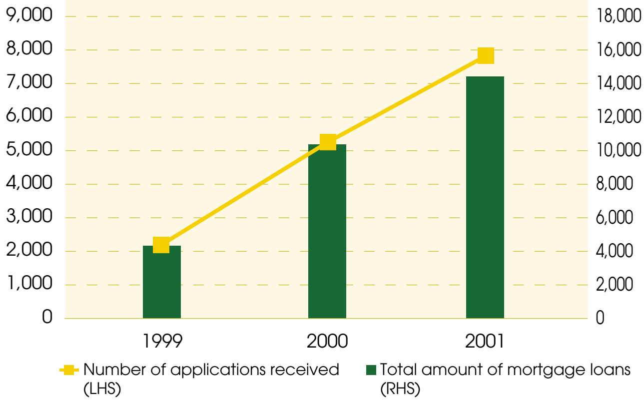
| Date | MIP Products |
|---|---|
| March 1999 | Mortgage loans on completed residential properties with LTV ratio of up to 85% |
| August 2000 | Mortgage loans on completed residential properties with LTV ratio of up to 90% |
| April 2001 | Equitable mortgage loans on residential properties under construction with LTV ratio of up to 85% |
| July 2001 | Equitable mortgage loans on residential properties under construction with LTV ratio of up to 90% |
| 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% |

Reflecting the active primary residential property market, the HKMC received numerous requests from homebuyers and banks for an expansion of the MIP to cover equitable mortgage loans secured on residential properties under construction. The HKMC decided in April 2001 to expand the MIP to cover equitable mortgages to assist homebuyers to purchase properties in the primary market. To address the project completion risk, eligible mortgages are confined to property developments covered by the Consent Scheme administered by the Government which provides protection to homebuyers in purchasing properties under construction. To avoid the Programme being used for property speculation, the borrowers are required to provide a written confirmation of having occupied the property for residential purposes within 3 months after completion of the property.

The new product was implemented in two phases to cover initially equitable mortgages with LTV ratio of up to 85% in April 2001 and was later expanded to cover equitable mortgage loans with LTV ratio of up to 90% in July 2001. In November, the Corporation further expanded the MIP to increase the loan size ceiling from HK$5 million to HK$8 million for mortgage loans on completed properties with LTV ratio of up to 85%.

Through product diversification and effective marketing, the HKMC achieved a significant growth in business volume under the MIP in 2001. The Corporation received a total of 7,787 applications in 2001 involving a total mortgage amount of HK$14.5 billion, an increase of 49% over the corresponding figure of 5,217 applications and a total mortgage amount of HK$10.4 billion for 2000 (Figure 12). Mortgage loans with insurance cover now account for about 10% of new loans approved by the banks. Since the inception of the Programme in 1999 and up to end December 2001, the Corporation has provided insurance cover to more than 9,200 homeowners, involving total mortgage loan amount of around HK$17.4 billion.

**Figure 12 - MIP Activities**




*Source: HKMC*


MIP Advertising Promotion Campaign

Reflecting the prudent underwriting criteria and the effective due diligence process, the delinquency ratio of mortgage loans covered under the MIP was maintained at a low level of 0.03%.

## FUNDING ACTIVITIES

The HKMC has made significant strides in promoting the development of the debt market in Hong Kong through active issuance of debt securities and product innovation. In 2001, the Corporation issued a record amount of HK$15.6 billion through 26 issues of debt securities. This has further consolidated its status as the most active corporate issuer of Hong Kong dollar fixed rate debt securities (Figure 13).

**Figure 13 - HKD Fixed Rate Debt Issuers (2001)**

| RANK | ISSUER | AMOUNT HKD million | Percentage |
|---|---|---|---|
| 1 | Hong Kong Mortgage Corporation | 15,584 | 14.9% |
| 2 | MTR Corporation | 4,750 | 4.5% |
| 3 | Abbey National Treasury Services | 4,450 | 4.3% |
| 4 | Westpac Banking Corporation | 3,756 | 3.6% |
| 5 | Hang Seng Bank | 3,687 | 3.5% |
| 6 | BOS International (Australia) | 3,551 | 3.4% |
| 7 | Hongkong Bank | 3,189 | 3.0% |
| 8 | European Investment Bank | 3,000 | 2.9% |
| 9 | Australia & New Zealand Banking Group | 2,968 | 2.8% |
| 10 | Bayerische Hypo-und Vereinsbank AG HK | 2,682 | 2.6% |
| | Others | 57,022 | 54.5% |
| | **TOTAL** | 104,639 | 100.0% |

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

The HKMC's debt issuance capability has not been affected by the decision of the HKMA to phase out the Note Issuance Programme ("NIP"). In September 2001, the HKMA ceased to be the arranger for the NIPs of the HKMC, Airport Authority, Kowloon-Canton Railway Corporation and Mass Transit Railway Corporation in order to ensure strict adherence to the Currency Board discipline. Prior to that, the NIP notes were fungible with the Exchange Fund Bills and Notes.

Subsequent to that development, the Debt Issuance Programme ("DIP") became the key Hong Kong dollar funding vehicle for the HKMC. The Programme has a flexible structure that supports primary issuance through syndication, tender and private placement. The HK$5 billion 5-year DIP notes issued by the Corporation in 2001, the largest fixed-rate debt ever issued in the Hong Kong dollar debt market, has clearly demonstrated the capability of the Programme to raise sizable amounts at a low cost.

The HKMC's capability in debt issuance was further enhanced in 2001 with the attainment of credit ratings from Standard & Poor's and Moody's that are the same as those of the Hong Kong SAR Government (Figure 14). According to Moody's, the ratings of the HKMC "**reflects its unique franchise in Hong Kong, the sound business model, good performance management, and strong Government support and oversight**". Standard & Poor's justifies its ratings on the grounds that the "**HKMC has a sound capital base, strong asset quality, satisfactory profitability, and adequate financial flexibility**".

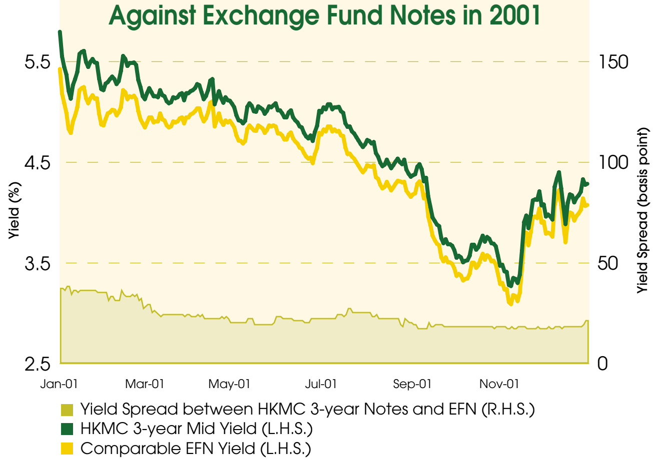
**Figure 14 - Credit Ratings of the HKMC**

| | 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- (stable) | P-1 (stable) | Aa3 (stable) |

The good credit ratings have helped to tighten the spreads of the HKMC's debt issues over those of the Exchange Fund Notes of the same maturity. For example, the yield spread of the

3-year NIP Notes tightened to end the year at 21 basis points compared to 37 basis points at the beginning of the year (Figure 15).

Figure 15 - HKMC NIP Notes Yield Spread Against Exchange Fund Notes in 2001




*Source: HKMC*

The Corporation continued to adopt a proactive pre-funding strategy to lower its funding costs. Reacting to the low interest rate environment, some institutional investors were prepared to invest in structured bonds to enhance investment return. The HKMC seized the opportunity to issue a number of callable debts to those investors. Through the pre-funding strategy and the issuance of callable bonds, the Corporation achieved significant savings in funding costs of about HK$40 million.

### Promotion of retail bonds

The HKMC had also taken a major step forward in 2001 to promote the development of an active retail bond market, taking full advantage of the prevailing favourable market conditions:

- **Low interest rate environment**: following the cumulative rate cut of 4.625% in 2001 and the general adoption of tiered pricing by banks after interest rate deregulation, the savings interest rate dropped to a historical low level of 0.125% in 2001. The HKMC notes offer retail investors a significant yield pick-up over savings and time deposits;

- **Banks are receptive to the development of a retail bond market**: with the slow-down in loan growth since the Asian financial crisis, the loan-to-deposit ratio of the banking industry contracted to a low level of 65% in 2001. Many banks were interested in expanding their security brokerage business to increase fee income.

As bond is a relatively new investment product for retail investors in Hong Kong, one of the pre-conditions was to put in place an offering mechanism that would be convenient for the retail investors. In October, the HKMC introduced a new mechanism that enables the retail investors to subscribe for bonds through banks acting as placing agents. The key features of the offering mechanism are as follows:

- **Multiple application channels**: major retail banks are appointed as placing agents for the HKMC bonds. Retail investors can apply for the bonds in person at any of the designated branches of the placing banks or make use of their convenient and familiar phone and Internet banking facilities;

- **More choices on tenor and return**: the new mechanism allows the HKMC to offer, under separate tranches of the same issues, bonds in different maturities and yields to suit the needs of individual investors;

- **Assured liquidity through a formal market making arrangement**: the placing banks are required to quote firm bid prices for the bonds until maturity date. To facilitate the placing banks in quoting offer prices, the HKMC reserves a percentage of the total issue amount for tapping by the placing banks to meet the demand of retail investors in the secondary market;

- **Small minimum denomination**: the minimum subscription amount is HK$50,000;
- **Low transaction fees**: subscription fee is set at 0.15% of the amount of subscription.

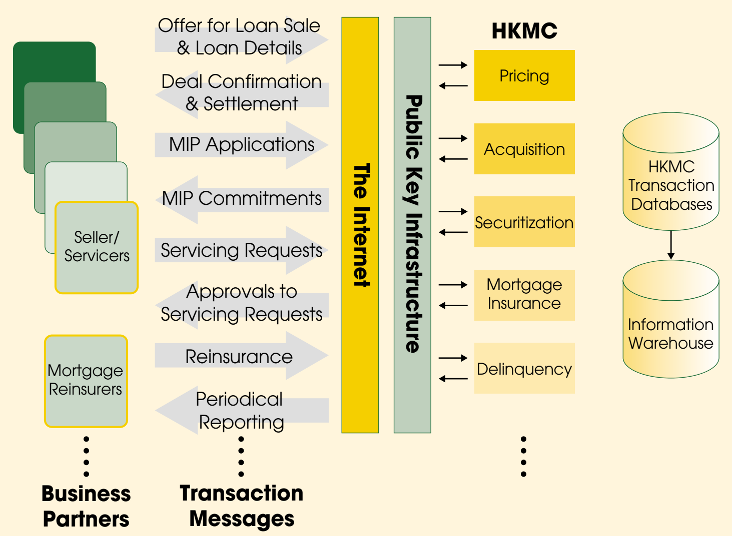
The debut issue launched in October under this new mechanism met with strong demand from the retail investors. A record amount of HK$651 million were placed through the three placing banks, namely, Dao Heng Bank, HSBC and Hang Seng Bank. The HKMC intends to make use of this mechanism to issue bonds to retail investors on a regular basis. The Corporation has also submitted a package of recommendations to the Government on ways to simplify the regulatory regime to make it more user-friendly for issuers of retail bonds.

## E-BUSINESS

A major project implemented by the HKMC in 2001 was the introduction of the Integrated Information Delivery System ("IIDS"), an online communication link with its business partners to conduct transactions over the Internet (Figure 16). The HKMC's mortgage purchase and mortgage insurance activities have become an integral part of the mortgage industry in Hong Kong. It is important for the Corporation to move in step with its business partners, to embrace the e-business technology as a means to enhance efficiency and contain cost as it further expands its business.

The first phase of IIDS was successfully rolled out to external users on a pilot basis in December 2001. A full launch of the system is scheduled for March 2002. With the cooperation of the HKMC's business partners, the system was rolled out smoothly according to the schedule.

Figure 16 - Integrated Information Delivery System




## STANDARDIZATION OF MORTGAGE ORIGINATION DOCUMENTS

With the aim of raising industry standards in mortgage origination, the HKMC launched a project in 2000 to standardize the mortgage origination documents in Hong Kong. The introduction of the standardized documents will reduce the lead time and cost for the issuance of MBS by removing the need for investors and credit rating agencies to conduct due diligence on the mortgage documents.

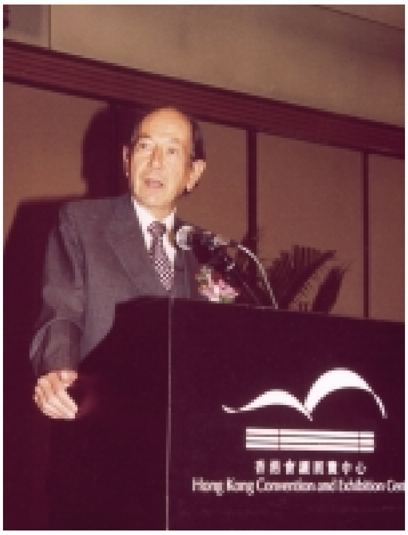
With the generous support of banking industry and the legal profession, the Model Mortgage Deed and the Model Guarantee and Indemnity (the "Model Documents") were introduced in July 2001 after extensive consultation with interested parties. The Model Documents contain the following features:

(a) **User-friendly language**: the two Model Documents are drafted in plain English and are each accompanied by a Chinese translation. This will enable the majority of homebuyers in Hong Kong to read and understand the contents of the documents;

(b) **Balanced rights and obligations**: in compliance with the Code of Banking Practice, the terms in the Model Documents establish a fair and balanced relationship between the borrower/ guarantor and the lending institution; and

(c) **Legal robustness**: apart from the direct involvement of the Law Society and the Bar Association in drafting the Model Documents, the HKMC also obtained the valuable assistance of the Honourable Mr. Justice Henry Litton to review the Model Documents in order to highlight any possible ambiguities caused by the use of plain English in the Model Documents.

The Model Documents are available for public review at the Home Affairs Department Public Enquiry Service Centres, offices of the Consumer Council and public libraries. The public may also view the Model Documents at the website of the HKMC (www.hkmc.com.hk).



"Do not cling to the old forms and precedents as if they were lifeboats in the stormy sea: They are nothing more than wreckage from the past: Approach the new forms with an open mind", said Mr. Justice Henry Litton.

The Corporation hosted a forum in November 2001 to promote the adoption of the Model Documents by the banks. The forum was well attended by over 400 representatives from banks and law firms.

Banks are responding positively to the Corporation's promotional efforts. HSBC took the lead to adopt the Model Mortgage Deed in March 2002. Responding to a survey conducted by the HKMC, 20 banks have confirmed their intention to adopt the Model Documents in 2002.

## STAFFING

The HKMC is committed to developing a team of professional staff with expertise in the secondary mortgage business. The Corporation's staffing policy is based on the following principles:

- The maintenance of a lean, efficient and professional workforce. The size of the permanent establishment will be kept to the minimum capacity necessary to support the Corporation's business activities.

- A continued adoption of automation and information technology solutions, as well as streamlining of work processes, to maximize efficiency and minimize costs.

- The maintenance of a cost-to-income ratio at a level below the average of banks and other financial institutions.

In response to the rapid expansion and diversification of the Corporation's business, the Board has approved an increase in the permanent establishment from 97 to 98 for 2002.

All staff members are encouraged to attend in-house and external courses that aim to enhance their management and technical capability. In 2001, staff members attended more than 90 external courses that covered mortgage securitization, finance, information technology, credit control and other mortgage-related technical courses.

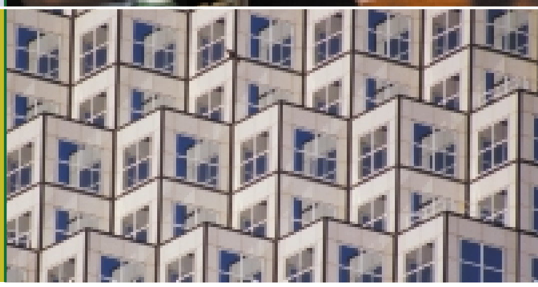
Staff attending in-house training programme

**OUTLOOK FOR 2002**

The HKMC will continue to develop its business in order to advance the missions to enhance banking stability, promote homeownership and developing the debt market. Working closely with banks, the insurance companies, the housing agencies, regulators and others, the Corporation plans to support the growth and development of the residential mortgage market and capital markets in Hong Kong by:

- purchasing HK$13.5 billion of mortgages for its retained portfolio;
- introducing new products under the FARM Programme with longer fixed rate tenor;
- issuing HK$12 billion DIP notes and retail bonds with new product features to meet the demands of investors;
- arranging the issuance of HK$4 billion of MBS under the HKMC's two MBS Programmes;
- providing mortgage insurance on mortgages with a principal amount of HK$6.6 billion; and
- implementing the IIDS to move the HKMC's operations onto an e-business platform.

# Financial Review

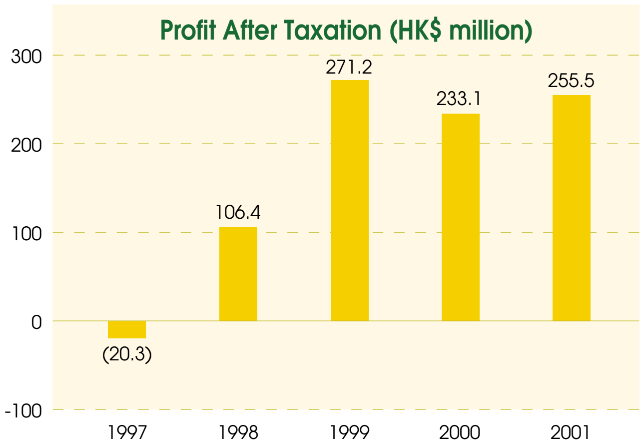


Despite the difficult business environment, the Corporation managed to mitigate the adverse impact on profitability by achieving a record purchase of HK$13.2 billion of mortgages, lowering funding cost through an active pre-funding strategy and generating additional fee income from its mortgage insurance and MBS programmes.

## PROFIT AND LOSS ACCOUNT

### Operating results

In 2001, the tightening of profit margins on mortgage loans and the sharp fall in interest rate exerted pressure on HKMC's financial performance. During the year, the average gross mortgage rate of the Corporation's retained portfolio was reduced from 7.61% to 2.83%. Furthermore, the sharp fall in the prime rate from 9.5% to 5.125% caused a significant negative endowment effect on the Corporation's shareholder's equity of HK$2.8 billion. Despite the difficult business environment, the Corporation managed to mitigate the adverse impact on profitability by achieving a record purchase of HK$13.2 billion of mortgages, lowering funding cost through an active pre-funding strategy and generating additional fee income from its mortgage insurance and MBS programmes.



Through these efforts, the Corporation achieved a 9.6% growth in profit after tax to HK$255.5 million (2000: HK$233.1 million). Returns on assets and shareholder's equity were maintained at 1.2% (2000: 1.8%) and 9.4% respectively (2000: 9.4%), despite a sharp reduction in net interest margin from 2.8% to 1.5% in 2001. Through automation and effective cost control, the cost-to-income ratio only increased marginally to 28.2% (2000: 25.1%). The capital-to-assets ratio remained strong at 11.6% (2000: 13.5%).

### Net interest income

| | 2001 | 2000 |
|---|---|---|
| | HK$' 000 | HK$' 000 |
| Interest income | 1,019,025 | 1,009,737 |
| Interest expense | (694,595) | (652,026) |
| Net interest income | 324,430 | 357,711 |
| Average interest-earning assets | 21,118,079 | 12,882,363 |
| Net interest margin | 1.5% | 2.8% |
| Net interest spread on interest-bearing liabilities [1] | 1.1% | 1.6% |

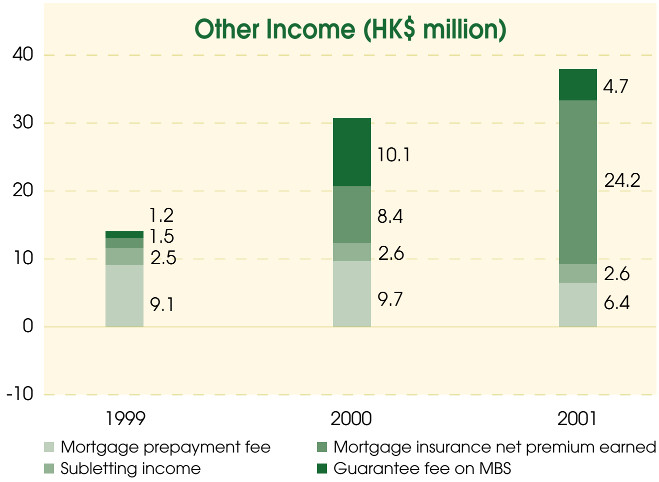
Net interest income for 2001 reduced by 9.3% to HK$324.4 million. It mainly reflected the downward adjustments in the mortgage rate of the Corporation's retained portfolio due to the keen competition in the residential mortgage market. The average net required yield of the mortgage portfolio was reduced from Prime - 0.73% in 2000 to Prime - 1.88% in 2001 and the net interest spread on interest-bearing liabilities from 1.6% to 1.1%.

### Other income, net

Other income (net) remained stable at HK$34.9 million in 2001 (2000: HK$34.4 million). The major income sources were mortgage insurance premiums and MBS guarantee fees.

Mortgage insurance business underwritten rose from HK$6.1 billion in 2000 to HK$8.3 billion in 2001, resulting in a sharp increase in net premium earned from HK$8.4 million to HK$24.2 million.

Total fee income generated from MBS business was reduced from HK$10.1 million to HK$4.6 million in 2001, following the normal run-off of the securitised mortgages. Early prepayment fee income and sub-letting income of office premises were HK$6.4 million (2000: HK$9.7 million) and HK$2.6 million (2000: HK$2.6 million) respectively.

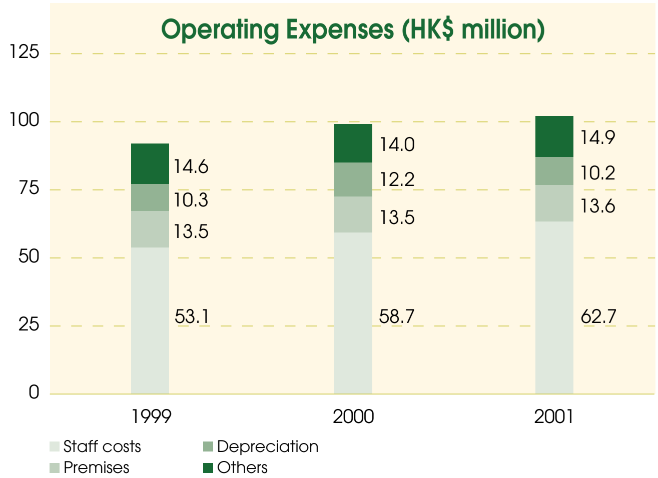



### Operating expenses

Operating expenses increased by 3% from HK$98.4 million to HK$101.4 million in 2001, mainly due to the expansion of business activities. These include the purchase of mortgage loans from Government housing agencies, the issuance of retail bonds, the seeking of credit ratings and the standardization of mortgage origination documents. Staff costs of HK$62.6 million accounted for 61.8% of the total operating expenses (2000: HK$58.7 million and 59.7%). The

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

permanent establishment of the Corporation increased from 97 to 98 in 2002 to support the expanded business operations. Premises costs were HK$13.6 million (2000: HK$13.5 million). Depreciation charges on fixed assets reduced slightly by HK$2 million to HK$10.2 million due to savings from fully depreciated assets.

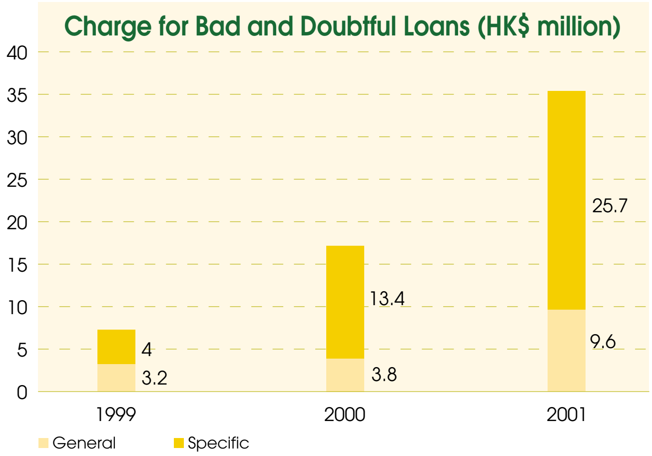



### Provisions for bad and doubtful loans

The Company made additional general and specific provisions for bad and doubtful loans of HK$9.6 million and HK$25.7 million respectively in 2001.

The increase in general provision from HK$3.8 million in 2000 to HK$9.6 million in 2001 reflects a significant growth of 78.4% in the retained mortgage portfolio from HK$11.1 billion to HK$19.8 billion during the year.

In line with an overall increase in the retained mortgage portfolio, the Corporation made a specific provision of HK$25.7 million for 2001 (2000: HK$13.4 million).




Total loan provisioning accounted for 0.17% of HK$19.8 billion of the outstanding principal balance of the Corporation's retained mortgage portfolio at the year-end (2000: 0.33%).

| | 2001 | 2000 |
|---|---|---|
| **Mortgage Portfolio, Net** | HK$'000 | HK$'000 |
| Gross mortgage portfolio | 19,812,453 | 11,119,240 |
| Provisions for bad & doubtful loans | | |
| Specific | (2,002) | (13,248) |
| General | (32,567) | (22,967) |
| Net mortgage portfolio | 19,777,884 | 11,083,025 |
| **Ratios**[2] | | |
| Delinquency ratio for loans overdue more than 90 days | 0.29% | 0.42% |
| Total provisions as a percentage of the above gross mortgage portfolio | 0.17% | 0.33% |

### Taxation

Provision for taxation recorded a net credit of HK$33 million. The Inland Revenue Department confirmed in November 2001 its acceptance of HKMC's proposal to adopt a higher level of tax exemption for net interest income earned from bank deposits and certificate of deposits in the previous year. The tax credit is non-recurring and was fully taken up in 2001.

[2] The ratios for 2001 were calculated after excluding mortgage loans overdue for 180 days or more, with properties repossessed or borrowers having become bankrupt. The outstanding principal balance (HK$43.3 million) of the mortgage loans was written down to the forced sale value of the properties after setting off specific provisions of HK$19.9 million. The net amount of HK$23.4 million was re-classified from "Mortgage portfolio, net" to "Other receivables, net". Without accounting for this re-classification, the delinquency ratio was 0.50% and loan provisioning was 0.27% of the outstanding principal balance of the total loans.

## BALANCE SHEET

In 2001, total assets grew by 56.8% from HK$14.8 billion to HK$23.2 billion. This reflected increases in the net mortgage portfolio by HK$8.7 billion to HK$19.8 billion and investment in debt securities by HK$0.4 billion to HK$1.7 billion and a reduction of HK$0.8 billion in cash and short-term funds.

Through expanding the range of Approved Sellers, the HKMC purchased an aggregate of HK$13.2 billion of mortgages which was more than double the figure for 2000. The average prepayment rate of the retained mortgage portfolio was stable at 24.5% for 2001 (2000: 31.8%).

The HKMC has established prudent investment guidelines to invest surplus cash and capital in high quality assets, for example bank deposits and certificates of deposit with a credit rating of at least investment grade. The investment portfolio also serves as a source of liquidity to support business operations. The investment portfolio increased by 30.8% from HK$1.3 billion to HK$1.7 billion in 2001.

The HKMC issued a total of HK$15.6 billion of notes under the NIP, DIP and others in 2001 to finance the mortgage purchases of its business operations. The total outstanding balance of the notes issued increased by 73% from HK$11.6 billion to HK$20.1 billion in 2001. About 68% of the outstanding debt securities would mature within 1 to 5 years, which is in line with the expected average life of the mortgages in the Corporation's retained portfolio.

## CAPITAL ADEQUACY RATIO

The Financial Secretary issued a set of revised guidelines on the HKMC's capital requirements in 2001 to address the different levels of risk of the products in the Corporation's retained loan, mortgage insurance and MBS portfolios 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 arrangement. |
| | 5% of risk-in-force value of exposure not covered by reinsurance arrangement. |

The capital base (shareholder's equity plus the general provision for bad and doubtful loans) grew by 11.5% from HK$2.6 billion to HK$2.9 billion in 2001. At 31 December 2001, the total on-balance-sheet assets and off-balance-sheet exposure of the HKMC was HK$24.7 billion, mainly consisting of HK$19.8 billion of mortgage loans, HK$513 million of mortgage insurance risk-in-force and HK$350.2 million of risk adjusted MBS guarantee exposure. The CAR of the Corporation was maintained at a healthy level of 11.6% as at 31 December 2001, well above the stipulated minimum of 5%.

## RISK MANAGEMENT

The HKMC is subject to three major areas of risk: interest rate risk, credit risk and operations risk. The Corporation adopts prudent policies and practices in managing these risks in the different areas of its business activities. The following highlights the Corporation's strategy in managing these risks.

### *Market Risk Management*

Market risk is the exposure to an adverse change in the value of the financial instruments caused by changes in market prices or rates, including changes in interest rates, foreign exchange rates and market prices of securities.

### *Asset and Liability Committee*

The HKMC has formed an Asset and Liability Committee ("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 risk management, financing, hedging, investment and securitization objectives of the Corporation. It also sets and monitors compliance with risk limits by the business units. The 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 meeting on a weekly basis.

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. Interest rate mismatch risk refers to the potential decline in net interest income ("NII") of the Corporation due to volatile and adverse movements of market interest rates. Interest rate mismatch risk arises mainly from the difference in the timing of re-pricing or the difference in the benchmark basis used for setting the interest rates of the assets, liabilities and related derivatives. For example, the Corporation's net interest income is affected by changes in the level of market interest rates, as the re-pricing characteristics of interest-earning assets (e.g. Prime or HIBOR-based mortgage loans) may not exactly match those of its interest-bearing liabilities.

The HKMC uses a variety of cash and derivative instruments to manage and hedge its exposure to fluctuations in market interest rates, including Interest Rate Swap, Basis Swap and Forward Rate Agreement and securitization. For example, HKMC uses interest rate swaps to convert its fixed-rate liabilities arising from bond issuance to a floating-rate basis to match its floating-rate mortgage assets.

In monitoring and managing interest rate exposure, the HKMC uses Duration Gap exposure to quantify its earnings at risk (the potential risk to NII from adverse movements in 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 ALCO. The Duration Gap was kept within 3 months in 2001.

2. *Basis Risk*

The HKMC is also exposed to basis risk as the 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 in an economical manner. This risk can be more effectively addressed as more mortgages are originated based on HIBOR and by the time that the Prime/HIBOR basis swap market or related risk management instrument become better developed in Hong Kong. Nevertheless, the 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 also uses Average-HIBOR swap and MBS to mitigate the basis risk of its Prime-based mortgage portfolio.

3. *Asset-Liability Maturity Mismatch Risk*

Asset-liability mismatch risk refers to the risk in maturity mismatch between assets and liabilities. Despite their long legal maturity, the average life of the mortgage assets depends on the actual prepayment speed. The retained mortgage portfolio of the Corporation has a shorter average life when the prepayment speed increases as the loans are repaid at a higher speed. Prepayment occurs for two main reasons in Hong Kong, namely housing turnover (i.e. borrowers repay the entire mortgages when they sell their homes) and refinancing (i.e. borrowers refinance their mortgage loans at lower mortgage rates).

The asset-liability mismatch risk can be defined more specifically into 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 assets is shorter than that of the liabilities. Refinancing risk refers the risk of refinancing liabilities at a higher cost of fund when the actual average life of assets is longer than that of the liabilities. To contain the reinvestment risk to acceptable level, the HKMC closely manages the average life of assets through ongoing purchases of mortgages to replenish the portfolio and diversifying its investment into high-grade debt securities and cash deposits to adjust the overall average life of its asset pool. The Corporation has also introduced prepayment fees and will consider the issuance of callable bonds to manage the prepayment risk of its retained mortgage portfolio. In managing refinancing risk, the Corporation issues bills and notes across a broad spectrum of maturities from 1 month 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 management refers to the HKMC's ability to repay obligations (including the redemption of debt issues and maturing money market drawings) and to fund the committed new mortgage purchases and investment as opportunity arises. The Corporation manages liquidity by monitoring the actual and expected inflows and outflows 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 business:

1. Capital: HK$3 billion authorized capital of which HK$2 billion has been paid up and HK$1 billion will be available on call from the shareholders.

2. HK$20 billion DIP: 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 13 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.

Investors completing application forms for HKMC retail bonds

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

5. Investment Portfolio: the Liquid Investment Portfolio includes high-quality short-term cash and cash equivalent, Certificates of Deposit, Notes and MBS that can be readily converted into cash.

6. Money Market lines: the HKMC has set up extensive money market lines with local and international banks for bridge financing. The Corporation's Public Sector Entity status under the Banking Ordinance has established a favourable 20% risk-weighting treatment for financial institutions investing in HKMC's debt securities or lending to the Corporation.

7. 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 mortgage portfolio when considered desirable.

## Credit Risk Management

The primary objective of credit risk management is to minimize losses due to the borrowers' failure to meet mortgage repayment obligations.

The HKMC adopts a four-pronged approach in maintaining the asset quality of its mortgage portfolio:

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

*Careful selection of Approved Sellers*

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

*Prudent purchasing criteria*

The HKMC adopts prudent purchasing criteria that confine its retained portfolio to mortgages on owner-occupied properties and 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 review on a sample of the mortgage loans before and after the purchase to ensure compliance with the Corporation's purchasing criteria.

*Adequate protection for higher-risk mortgages*

For products that involve higher credit risk such as top-up loans originated by property developers, the HKMC has put in place credit enhancement arrangements, such as re-purchase warranty or reserve funds, to mitigate the additional risk.

*Credit Committee*

The HKMC has set up a Credit Committee to develop and oversee 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. It 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 current 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 Executive Directors for final approval.

**Operational Risk Management**

The HKMC has established policies and guidelines to manage the operational risk of its business units. The key operational systems and procedures are subject to regular audits performed by both the internal and external auditors to ensure adequate compliance.

The HKMC applies extensively technology solutions to its business operations area with a view to enhancing efficiency and reducing the likelihood of errors due to human intervention. As the operations become more technology-dependent, the HKMC has established a comprehensive disaster recovery plan to ensure that disruptions to the critical operations are minimized in the event of system breakdowns or other disastrous events.

*Audit Committee*

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

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 Mr. Eddy Fong and its members include Dr. David Li, Mr. Ronald Arculli, Mr. Tony Latter and Mr. Norman Chan. The Committee met twice in 2001 to review the financial accounts and other on-going audit work of the internal and external auditors.

Audit Committee Meeting

# Report of the Directors

The Directors have pleasure in presenting their report together with the audited financial statements for the year ended 31 December 2001.

## PRINCIPAL ACTIVITIES

The principal activities of the Company are (i) to purchase portfolios of mortgages or other loans, according to predetermined prudent and stringent purchasing criteria, secured by residential properties situated in Hong Kong from the approved sellers including institutions authorized under the Banking Ordinance of Hong Kong ("Authorized Institutions"), government bodies and agencies and related organisations, statutory bodies, public bodies (as such entities are designated under the Prevention of Bribery Ordinance) and property developers (or a financing entity affiliated to any such property developer); (ii) to raise financing for its purchase of mortgage loans through the issuance of debt securities to banks, institutional and retail investors; (iii) to securitize mortgage portfolios by issuing mortgage-backed securities to investors; and (iv) to provide mortgage insurance according to predetermined insurance eligibility criteria for Authorized Institutions in their business of granting mortgage loans secured by residential properties or those under construction located in Hong Kong.

## RESULTS AND APPROPRIATIONS

The results for the year ended 31 December 2001 are set out on page 38 of the financial statements.

The Directors do not recommend the payment of a final dividend, and recommend that the retained profit of HK$840,059,000 at 31 December 2001 be carried forward.

## FIXED ASSETS

Details of the movements in fixed assets during the year are set out in Note 15 to the financial statements.

## DEBT SECURITIES ISSUED

The Company issued bills and notes to banks and institutional investors under the Note Issuance Programme ("NIP") and Debt Issuance Programme ("DIP") and also offered notes to retail investors through the Placing Banks during the year ended 31 December 2001, totalling HK$15,583,550,000, details of which are set out in Note 20 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* (appointed on 1 May 2001)
The Honourable Donald TSANG, JP, *Chairman and Executive Director* (resigned on 1 May 2001)
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*
Mr. Ronald Joseph ARCULLI, GBS, JP, *Director*
The Honourable Bernard Charnwut CHAN, *Director*
Professor Andrew CHAN Chi-fai, Ph.D., *Director*
The Honourable CHAN Kwok-keung, *Director*
Mr. Eddy FONG Ching, SBS, JP, *Director*
Mr. Clifford Rowland FORSTER, *Director* (appointed on 26 March 2001)
Ms. Anita FUNG, *Director*
Mr. Andy HON Hak-keung, *Director* (appointed on 26 March 2001)

Mr. Stephen IP Shu-kwan, GBS, JP, *Director*
Dr. the Honourable David LI Kwok-po, GBS, LLD (Cantab), JP, *Director*
Mr. NG Kwok-wai, *Director* (retired on 26 March 2001)
The Honourable SIN Chung-kai, *Director*
Mr. Paul THURSTON, *Director* (retired on 26 March 2001)
Mr. Dominic WONG Shing-wah, GBS, OBE, JP, *Director*

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 NIP until 31 August 2001. At 31 December 2001, the outstanding balance of the notes under the NIP was HK$10.5 billion. The Monetary Authority also acts as the custodian and clearing agent for the Company's HK$20 billion DIP. At 31 December 2001, the outstanding balance of the notes under the DIP was HK$8.9 billion. In addition, the Company has a revolving credit facility of HK$10 billion from the Exchange Fund through the Monetary Authority. At 31 December 2001, there was no outstanding balance.

(2) Mr. Ronald Joseph Arculli is a director of Sino Land Company Limited, the shareholding company of 8 affiliate companies from which the HKMC has purchased mortgage loans of around HK$300 million in 2001.

(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") and (c) an approved Authorized Institution under the Mortgage Insurance Programme ("MIP"). Dr. Li is also the Chairman and a director of First Pacific Bank Limited, which is (a) an approved seller/servicer under the MPP and (b) an approved Authorized Institution under the MIP.

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

(5) Mr. Dominic Wong is the Secretary for Housing of Hong Kong, and a Member and the Policy Secretary of The Hong Kong Housing Authority. The Hong Kong Housing Authority is an approved seller/servicer under the MPP and has entered into an agreement with the HKMC on 28 March 2001 to sell mortgage loans of around HK$18 billion to the HKMC by September 2002. Mr. Wong is also a Member of the Supervisory Board and Executive Committee Member of the Hong Kong Housing Society which is an approved seller/servicer under the MPP from which the HKMC purchased mortgage loans of around HK$2.3 billion in September 2001.

(6) Mr. Eddy Fong is a Member of The Hong Kong Housing Authority with which the HKMC has entered into a transaction as described in the preceding paragraph.

(7) The Hon. Sin Chung-kai is a Member of The Hong Kong Housing Authority with which the HKMC has entered into transaction as described in paragraph 5.

Except for the above disclosure and the related party transactions as stated in Note 24 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 2001.

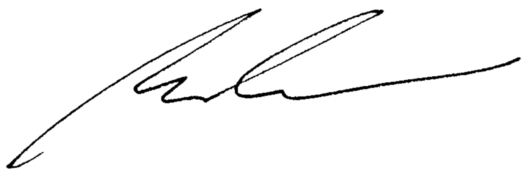
The Company has not carried on insurance business relating to liabilities or risks in respect of which persons are required by any Ordinance to be insured.

Under the back-to-back mortgage insurance business, the Company reinsures the risk exposure with the approved reinsurers on a 100% basis. The approved reinsurers include Asia Insurance Company, Limited, Hang Seng Insurance Company Limited, HSBC Insurance (Asia) Limited, PMI Mortgage Insurance Co. and United Guaranty Mortgage Indemnity Company. In 2001, the Company has retained up to 50% of the risk exposure under its mortgage insurance covers before ceding the remaining risk exposure to the above approved reinsurers. At 31 December 2001, the total risk-in-force was approximately HK$2.85 billion (2000: HK$1.55 billion) of which HK$2.34 billion (2000: HK$1.38 billion) risk exposure was ceded to the approved reinsurers, and the balance of HK$513 million (2000: HK$172 million) was retained by the Company.

## AUDITORS

The financial statements have been audited by Arthur Andersen & Co. A resolution for their reappointment as auditors for the following year is to be proposed at the forthcoming annual general meeting.

On behalf of the Board of Directors



**Antony Leung**
*Chairman*

Hong Kong,
15 April 2002

ANDERSEN

**Arthur Andersen & Co**

21st Floor Edinburgh Tower
15 Queen's Road Central
Hong Kong

Tel 852 2852 0222
Fax 852 2815 0548

**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 of The Hong Kong Mortgage Corporation Limited (the "Company") on pages 38 to 60, which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

**RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS**

The Companies Ordinance requires the directors to prepare financial statements that 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, 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 as at 31 December 2001 and of its profit and cash flows for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

Arthur Andersen & Co

*Certified Public Accountants*
Hong Kong,
15 April 2002.

# Profit and Loss Account

For the year ended 31 December 2001

| | Notes | 2001 HK$'000 | 2000 HK$'000 |
|---|---|---|---|
| Interest income | *3* | **1,019,025** | 1,009,737 |
| Interest expense | *4* | **(694,595)** | (652,026) |
| **Net interest income** | | **324,430** | 357,711 |
| Other income, net | *5* | **34,855** | 34,359 |
| **Operating income** | | **359,285** | 392,070 |
| Operating expenses | *6* | **(101,424)** | (98,427) |
| Operating profit before provisions | | **257,861** | 293,643 |
| Provisions for bad and doubtful loans | *7* | **(35,299)** | (17,229) |
| **Profit before taxation** | | **222,562** | 276,414 |
| Taxation | *8(a)* | **32,964** | (43,308) |
| **Net profit for the year** | | **255,526** | 233,106 |
| Retained profit brought forward | | **589,814** | 357,378 |
| Transfer to contingency reserve | *25* | **(5,281)** | (670) |
| **Retained profit carried forward** | | **840,059** | 589,814 |

A separate statement of recognised gains and losses is not presented because there were no recognised gains or losses other than the net profit for the year.

# Balance Sheet

As at 31 December 2001

| | Notes | 2001 HK$'000 | 2000 HK$'000 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and short-term funds | 10, 17 | **1,256,740** | 2,068,134 |
| Interest and remittance receivables | 11 | **337,176** | 249,112 |
| Prepayments, deposits and other assets | 12 | **36,326** | 5,636 |
| Tax recoverable | 8(b) | **5,109** | – |
| Deferred expense, net | 13 | **38,273** | 112,879 |
| Mortgage portfolio, net | 14(a) | **19,777,884** | 11,083,025 |
| Investment in debt securities | 16, 17 | **1,736,266** | 1,304,753 |
| Fixed assets | 15 | **32,058** | 21,077 |
| | | **23,219,832** | 14,844,616 |
| **LIABILITIES** | | | |
| Short-term bank loans | 17 | **-** | 427,200 |
| Interest payable | 18 | **194,216** | 120,240 |
| Accounts payable, accrued expenses and other liabilities | 19 | **60,755** | 45,646 |
| Provisions for taxation | 8(b) | **-** | 14,152 |
| Unearned premiums | 9 | **60,301** | 25,894 |
| Debt securities | 17, 20 | **20,058,550** | 11,621,000 |
| | | **20,373,822** | 12,254,132 |
| **SHAREHOLDER'S EQUITY** | | | |
| Share capital | 22 | **2,000,000** | 2,000,000 |
| Retained profit | | **840,059** | 589,814 |
| Contingency reserve | 25 | **5,951** | 670 |
| | | **2,846,010** | 2,590,484 |
| | | **23,219,832** | 14,844,616 |

Approved by the Board of Directors on 15 April 2002 and signed on behalf of the Board by:

**Yam Chi Kwong, Joseph**
*Deputy Chairman*

**Anthony Robert Latter**
*Executive Director*

# Cash Flow Statement

For the year ended 31 December 2001

| | Notes | 2001 HK$'000 | 2000 HK$'000 |
|---|---|---|---|
| **Net cash outflow from operating activities** | 23 | **(8,247,032)** | (1,969,797) |
| **Taxation** | | | |
| Hong Kong profits tax paid | | **(12,171)** | (71,580) |
| Hong Kong profits tax refunded | | **25,874** | – |
| Net tax refunded/(paid) | | **13,703** | (71,580) |
| **Investing activities** | | | |
| Purchase of fixed assets | | **(21,208)** | (8,402) |
| Purchase of investment in debt securities | | **(1,406,381)** | (1,740,733) |
| Proceeds from redemption of investment in debt securities | | **974,678** | 436,000 |
| Net cash outflow from investing activities | | **(452,911)** | (1,313,135) |
| **Net cash outflow before financing** | | **(8,686,240)** | (3,354,512) |
| **Financing** | | | |
| Proceeds from issue of debt securities | | **15,448,046** | 6,443,708 |
| Redemption of debt securities | | **(7,146,000)** | (6,445,000) |
| Net cash inflow/(outflow) from financing | | **8,302,046** | (1,292) |
| **Decrease in cash and cash equivalents** | | **(384,194)** | (3,355,804) |
| **Beginning cash and cash equivalents** | | **1,640,934** | 4,996,738 |
| **Ending cash and cash equivalents** | | **1,256,740** | 1,640,934 |
| **Analysis of the balance of cash and cash equivalents** | | | |
| Cash and short-term funds | 10 | **1,256,740** | 2,068,134 |
| Short-term bank loans | 17 | **-** | (427,200) |
| | | **1,256,740** | 1,640,934 |

## 1. BASIS OF PREPARATION

The financial statements of The Hong Kong Mortgage Corporation Limited (the "Company") 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. Adoption of Statements of Standard Accounting Practice ("SSAPs")

In the current year, the Company has adopted, for the first time, the following SSAPs issued by the Hong Kong Society of Accountants:

| | |
|---|---|
| SSAP 14 (revised) | Leases |
| SSAP 32 | Consolidated financial statements and accounting for investments in subsidiaries. |

There were no 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.

### b. Income and expense recognition

Provided it is probable that the economic benefits associated with a transaction will flow to the Company and the income and costs, if applicable, can be measured reliably, interest income, interest expense and others are recognised 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(g)).

(ii) Fee income and expense

Fee income and expense are recognised when earned or incurred.

### c. 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 | 33⅓% |
| Office equipment | 33⅓% |
| Motor vehicle | 25% |

d. **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.

e. **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 recognised unless the related benefits are expected to crystallize in the foreseeable future.

f. **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 recognised on a straight-line basis over the lease term.

g. **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 recognised 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.

h. **Investment in debt securities**

Held-to-maturity investments are investments which the Company 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 recognised 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.

i. **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 recognised in the profit and loss account in the year in which the redemption/repurchase takes place.

j. **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 recognised in the profit and loss account when the underlying assets/liabilities are early disposed of/redeemed.

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

k. **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 through the Authorized Institutions during an accounting period. The gross premiums include a major portion of reinsurance premiums paid to approved reinsurers and the net premiums including risk premium portion and/or servicing fee to be earned by the Company. The net premiums are recognised 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, loss reserve and unexpired risk 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.

l. **Guaranteed mortgage-backed pass-through securitization**

Upon completion of the sale of a mortgage pool to a third party Special Purpose Entity ("SPE") under the Guaranteed Mortgage-Backed Pass-Through Securitization Programme ("MBS Pass-Through 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 SPE 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, it adheres to the loan provisioning guidelines in Note 2(g) approved by the Board of Directors for making necessary provisions in the profit and loss account.

## 3. INTEREST INCOME

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Mortgage portfolio | **776,631** | 736,337 |
| Cash and short-term funds | **191,442** | 187,367 |
| Investment in debt securities – listed | **5,760** | 1,935 |
| Investment in debt securities – unlisted | **45,192** | 84,098 |
| | **1,019,025** | 1,009,737 |

## 4. INTEREST EXPENSE

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Bank loans, short-term bills and debt securities wholly repayable within 5 years | **689,616** | 638,164 |
| Debt securities not wholly repayable within 5 years | **4,979** | 13,862 |
| | **694,595** | 652,026 |

## 5. OTHER INCOME, NET

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Early prepayment fees and late charges | **6,435** | 9,706 |
| Subletting income of office premises (Note 24) | **2,640** | 2,640 |
| Net premiums earned (Note 9) | **24,163** | 8,352 |
| Guarantee fee income on MBS | **3,318** | 6,060 |
| Excess servicing receipts on MBS | **1,329** | 4,053 |
| Issuance costs of debt securities | **(2,829)** | (1,823) |
| Others | **(201)** | 5,371 |
| | **34,855** | 34,359 |

## 6. OPERATING EXPENSES

| | 2001 HK$'000 | 2000 HK$'000 |
|---|---|---|
| Staff costs | | |
| Salaries and benefits | **62,647** | 58,736 |
| Premises | | |
| Rental | **10,422** | 10,422 |
| Others | **3,188** | 3,118 |
| Directors' emolument | **–** | – |
| Depreciation | **10,227** | 12,181 |
| Consultancy fee | **2,776** | 3,450 |
| Auditors' remuneration | **250** | 250 |
| Other operating expenses | **11,914** | 10,270 |
| | **101,424** | 98,427 |

## 7. PROVISIONS FOR BAD AND DOUBTFUL LOANS

| | 2001 HK$'000 | 2000 HK$'000 |
|---|---|---|
| Provisions against mortgage portfolio | | |
| – specific | **25,712** | 13,418 |
| – general | **9,587** | 3,811 |
| | **35,299** | 17,229 |

## 8. TAXATION

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

| | 2001 HK$'000 | 2000 HK$'000 |
|---|---|---|
| Hong Kong profits tax | | |
| Provision for the year | **1,414** | 44,012 |
| Overprovision in respect of prior years | **(36,620)** | (328) |
| | **(35,206)** | 43,684 |
| Deferred taxation | **2,242** | (376) |
| | **(32,964)** | 43,308 |

Hong Kong profits tax has been provided at the rate of 16% (2000: 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 2001.

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

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Tax recoverable for Hong Kong profits tax | **(9,991)** | – |
| Hong Kong profits tax | **-** | 11,512 |
| Deferred taxation | **4,882** | 2,640 |
| | **(5,109)** | 14,152 |

## 9. REVENUE ACCOUNT FOR MORTGAGE GUARANTEE BUSINESS

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Gross premiums written | **204,791** | 122,698 |
| Reinsurance premiums | **(146,049)** | (93,524) |
| Net premiums written | **58,742** | 29,174 |
| Add: unearned premium brought forward | **25,894** | 5,018 |
| unearned premium carried forward | **(60,301)** | (25,894) |
| Increase in unearned premiums | **(34,407)** | (20,876) |
| Net premiums earned before provision | **24,335** | 8,298 |
| (Provisions)/write-back for outstanding claims (Note 21) | **(172)** | 54 |
| Net premiums earned (Note 5) | **24,163** | 8,352 |
| Management expenses | **(3,320)** | (2,554) |
| Underwriting gains | **20,843** | 5,798 |

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

## 10. CASH AND SHORT-TERM FUNDS

| | 2001 HK$'000 | 2000 HK$'000 |
|---|---|---|
| Cash at banks (Note 17) | **2,664** | 2,393 |
| Time deposits with banks (Note 17) | **1,254,076** | 2,065,741 |
| | **1,256,740** | 2,068,134 |

## 11. INTEREST AND REMITTANCE RECEIVABLES

| | 2001 HK$'000 | 2000 HK$'000 |
|---|---|---|
| Interest receivable from mortgage portfolio | **34,749** | 36,298 |
| Interest receivable from interest rate swap contracts | **244,674** | 124,715 |
| Interest receivable from investment in debt securities | **3,038** | 22,618 |
| Interest receivable from time deposits with banks | **1,638** | 6,638 |
| Loan instalments, in transit, from the Servicers | **53,077** | 58,843 |
| | **337,176** | 249,112 |

## 12. PREPAYMENTS, DEPOSITS, AND OTHER ASSETS

| | 2001 HK$'000 | 2000 HK$'000 |
|---|---|---|
| Office rental deposit | **2,293** | 2,239 |
| Corporate club debentures | **670** | 670 |
| Other receivables, net | **23,401** | – |
| Others | **9,962** | 2,727 |
| | **36,326** | 5,636 |

The Company reclassified a net amount of HK$23,401,000 from "Mortgage portfolio, net" (Note 14(a)) to "Other receivables, net" in 2001, 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$19,894,000 against the outstanding principal balance (HK$43,295,000) of the mortgage loans.

## 13. DEFERRED EXPENSE, NET

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Deferred expenses/(income) arising on issuance of debt securities | | |
| At 1 January | **112,879** | 39,050 |
| Additions for the year | | |
| – deferred expenses | **137,459** | 182,447 |
| – deferred income | **(1,955)** | (1,155) |
| Less: amortization | **(210,110)** | (107,463) |
| At 31 December | **38,273** | 112,879 |

## 14. MORTGAGE PORTFOLIO, NET

(a) Mortgage portfolio less provisions

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Outstanding principal balance of mortgage portfolio (Note 17) | **19,812,453** | 11,119,240 |
| Provisions for bad and doubtful loans | | |
| – specific | **(2,002)** | (13,248) |
| – general | **(32,567)** | (22,967) |
| | **19,777,884** | 11,083,025 |

At 31 December 2001, 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.

The Company reclassified mortgage loans of HK$43,295,000 and specific provision of HK$19,894,000 from the "Mortgage portfolio, net" to "Other receivables, net" with a net balance of HK$23,401,000 in 2001 (Note 12).

(b) Provisions for bad and doubtful loans

| | **Specific** | **General** | **Total** | **Suspended Interest** |
|---|---|---|---|---|
| | ***HK$'000*** | ***HK$'000*** | ***HK$'000*** | ***HK$'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** |

| | Specific | General | Total | Suspended Interest |
|---|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| At 1 January 2000 | 4,042 | 20,496 | 24,538 | 661 |
| Amounts written off | (4,212) | – | (4,212) | (1,137) |
| Charge to profit & loss account | 13,418 | 3,811 | 17,229 | – |
| Interest suspended during the year | – | – | – | 4,042 |
| Suspended interest recovered | – | – | – | (608) |
| At 31 December 2000 | 13,248 | 24,307 | 37,555 | 2,958 |

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

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Gross mortgage loans | **49,920** | 46,148 |
| Specific provisions | **(2,002)** | (11,392) |
| | **47,918** | 34,756 |

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

## 15. FIXED ASSETS

| | Leasehold improvements HK$'000 | Furniture and fixtures HK$'000 | Computers & related software HK$'000 | Office equipment HK$'000 | Motor vehicle HK$'000 | Total HK$'000 |
|---|---|---|---|---|---|---|
| *Cost* | | | | | | |
| As at 1 January 2001 | 11,233 | 1,775 | 39,060 | 1,749 | 539 | 54,356 |
| Additions | 7 | 8 | 20,752 | 441 | – | 21,208 |
| **As at 31 December 2001** | **11,240** | **1,783** | **59,812** | **2,190** | **539** | **75,564** |
| *Accumulated depreciation* | | | | | | |
| As at 1 January 2001 | 5,440 | 909 | 24,965 | 1,493 | 472 | 33,279 |
| Charge for the year | 1,449 | 218 | 8,312 | 181 | 67 | 10,227 |
| **As at 31 December 2001** | **6,889** | **1,127** | **33,277** | **1,674** | **539** | **43,506** |
| *Net book value* | | | | | | |
| **Ending balance as at 31 December 2001** | **4,351** | **656** | **26,535** | **516** | **-** | **32,058** |
| Ending balance as at 31 December 2000 | 5,793 | 866 | 14,095 | 256 | 67 | 21,077 |

## 16. INVESTMENT IN DEBT SECURITIES

| | **2001 HK$'000** | 2000 HK$'000 |
|---|---|---|
| Held-to-maturity securities | | |
| Listed outside Hong Kong | **90,235** | 129,832 |
| Unlisted | **1,646,031** | 1,174,921 |
| | **1,736,266** | 1,304,753 |
| Market value of listed securities | | |
| Issued by: | | |
| – corporate entities | **31,545** | 30,912 |
| – others | **60,322** | 99,900 |
| | **91,867** | 130,812 |

The held-to-maturity securities included above are issued by:

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Banks and other financial institutions | **1,646,031** | 1,174,921 |
| Corporate entities | **29,961** | 29,931 |
| Others | **60,274** | 99,901 |
| | **1,736,266** | 1,304,753 |

## 17. MATURITY PROFILE

| | 2001 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Repayable on demand | 3 months or less | 1 year or less but over 3 months | 5 years or less but over 1 year | After 5 years | Undated | Total |
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *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** | | | | | | | |
| - Short-term bank loans | - | - | - | - | - | - | - |
| - Debt securities | - | 2,750,000 | 3,650,000 | 13,558,550 | 100,000 | - | 20,058,550 |
| | - | 2,750,000 | 3,650,000 | 13,558,550 | 100,000 | - | 20,058,550 |

| | 2000 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Repayable on demand | 3 months or less | 1 year or less but over 3 months | 5 years or less but over 1 year | After 5 years | Undated | Total |
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| Assets | | | | | | | |
| – Cash and short-term funds | 2,393 | 2,065,741 | – | – | – | – | 2,068,134 |
| – Mortgage portfolio | 1,696 | 132,880 | 401,722 | 2,431,559 | 8,133,774 | 17,609 | 11,119,240 |
| – Investment in debt securities | – | 649,954 | 125,023 | 429,875 | 99,901 | – | 1,304,753 |
| | 4,089 | 2,848,575 | 526,745 | 2,861,434 | 8,233,675 | 17,609 | 14,492,127 |
| Liabilities | | | | | | | |
| – Short-term bank loans | – | 427,200 | – | – | – | – | 427,200 |
| – Debt securities | – | 2,600,000 | 4,546,000 | 4,275,000 | 200,000 | – | 11,621,000 |
| | – | 3,027,200 | 4,546,000 | 4,275,000 | 200,000 | – | 12,048,200 |

## 18. INTEREST PAYABLE

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Short-term bank loans | **-** | 251 |
| Debt securities | **194,216** | 119,989 |
| | **194,216** | 120,240 |

## 19. ACCOUNTS PAYABLE, ACCRUED EXPENSES AND OTHER LIABILITIES

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Accounts payable and accrued expenses | **55,411** | 39,942 |
| Other provisions (Note 26) | **5,344** | 5,704 |
| | **60,755** | 45,646 |

## 20. DEBT SECURITIES

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Fixed-rate bills and notes issued under the | | |
| – NIP | **10,500,000** | 9,000,000 |
| – DIP | **8,896,000** | 2,621,000 |
| Other notes | **662,550** | – |
| | **20,058,550** | 11,621,000 |
| At 1 January | **11,621,000** | 11,441,000 |
| Issuance for the year | **15,583,550** | 6,625,000 |
| Less: Redemption | **(7,146,000)** | (6,445,000) |
| At the end of the year | **20,058,550** | 11,621,000 |

Notes and bills issued during the year comprise:

| | **NIP** | **DIP** | **Other notes** |
|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* |
| Amount issued | 7,500,000 | 7,421,000 | 662,550 |
| Consideration received | 7,364,333 | 7,421,000 | 662,713 |

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

## 21. PROVISIONS FOR OUTSTANDING CLAIMS

Provisions for outstanding claims under the MIP are recorded net of recoveries from the approved reinsurers. At 31 December 2001, there was no loss reserve made for risk sharing business and no provision made in respect of "claims incurred but not reported" for both back-to-back and risk sharing businesses. For the year ended 31 December 2001, the gross claim was HK$1,864,000 (2000: HK$497,000), of which HK$1,692,000 (2000: HK$497,000) was recovered from the approved reinsurers.

## 22. SHARE CAPITAL

| | **2001 & 2000** |
|---|---|
| | *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** |

## 23. NOTE TO THE CASH FLOW STATEMENT

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

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Profit before taxation | **222,562** | 276,414 |
| Depreciation | **10,227** | 12,181 |
| Amortization of deferred expenses | **210,110** | 107,463 |
| Provisions for bad and doubtful loans | **35,312** | 17,833 |
| Mortgage portfolio written off net of recoveries | **(36,958)** | (4,212) |
| Amortization of investment in debt securities | **190** | (20) |
| Increase in interest and remittance receivables | **(88,064)** | (64,060) |
| (Increase)/ decrease in prepayments, deposits and other assets | **(30,690)** | 2,519 |
| Increase in mortgage portfolio | **(8,693,213)** | (2,369,870) |
| Increase in interest payable | **73,976** | 23,470 |
| Increase in accounts payable and accrued expenses and other liabilities | **15,109** | 7,609 |
| Increase in unearned premiums | **34,407** | 20,876 |
| Net cash outflow from operating activities | **(8,247,032)** | (1,969,797) |

## 24. RELATED PARTY TRANSACTIONS

Both Mr. Norman Chan and Mr. Tony Latter are the Deputy Chief Executives of the Hong Kong Monetary Authority. 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 occupies 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$2.6 million for the year ended 31 December 2001 (2000: HK$2.6 million). Both Mr. Norman Chan and Mr. Eddy Fong are the directors of EFIL.

Ms. Anita Fung is the Head of Trading, Asia Pacific, Treasury and Capital Markets of HSBC, and The Hon. Sin Chung-kai is an Assistant IT Project Manager of HSBC. HSBC is (a) a primary dealer under the Company's DIP; (b) an approved seller/servicer under the MPP; (c) an approved Authorized Institution under the MIP; (d) an adviser to the HKMC in connection with credit rating of the HKMC by Standard & Poor's and Moody's in 2001; and (e) one of the Placing Banks in the HKMC's issuance of retail notes in October 2001.

Mr. Andy Hon is the General Manager, Mortgages and Auto, Consumer Banking Division of Standard Chartered Bank which is (a) a selling group member of the DIP; (b) an approved seller/servicer under the MPP; and (c) an approved Authorized Institution under the MIP.

## 25. CONTINGENCY RESERVE

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| At 1 January | **670** | – |
| Transfer of 50% of the net risk premiums earned from retained profits | **5,281** | 670 |
| At the end of the year | **5,951** | 670 |

## 26. 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 entity ("SPE") formed for the purpose of this programme.

In December 2001, the Company also launched the US$3 Billion Mortgage-Backed Securitization Programme, under which Bauhinia MBS Limited, a SPE 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 two SPEs are bankruptcy remote "orphan" companies. In the context of section 2(4) of the Companies Ordinance, the two SPEs are not construed as the Company'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 SPEs have therefore not been consolidated into the Company's financial statements for the year ended 31 December 2001. With regard to the mortgage loans sold by the Company to the two SPEs, this would be effected by way of a "clean sale" of such mortgage loans to the SPEs. All the mortgage loans sold to the SPEs will no longer be recognised as an asset in the balance sheet of the Company.

Up to 31 December 2001, HKMC Funding Corporation (1) Limited had issued 7 series of MBS totalling HK$2,268 million and the Company had guaranteed the timely payment of principal and interest of the MBS. At 31 December 2001, the aggregate security principal balance of MBS guaranteed by the Company under the MBS Pass-Through Programme was HK$873.8 million. As regards the Company's loan provisioning on the guaranteed mortgage loans under the MBS Pass-Through Programme, a sum of HK$1,327,000 (2000: HK$1,340,000) was grouped under "Other provisions" (Note 19). The loan provision written back amounting to HK$13,000 (2000: HK$604,000) was included in the profit & loss account of the Company.

Bauhinia MBS Limited had not issued any MBS up to 31 December 2001. No financial accounts had been prepared for Bauhinia MBS Limited at 31 December 2001.

The operating profit after tax of HKMC Funding Corporation (1) Limited was HK$20,000 for the year ended 31 December 2001. At 31 December 2001, HKMC Funding Corporation (1) Limited reported total assets of HK$876,219,000 and total liabilities of HK$876,177,000 with the shareholder's equity of HK$42,000. Its total assets and total liabilities consisted mainly of HK$857,589,000 of securitized mortgage loans and HK$873,822,000 of debt securities respectively.

In accordance with paragraph 46 of SSAP 32, the Company has set out below the significant items of the pro-forma consolidated profit and loss account and balance sheet of the Company and HKMC Funding Corporation (1) Limited for the years ended 31 December 2001 and 2000:

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Net interest income | **327,842** | 363,771 |
| Net profit for the year | **255,546** | 233,124 |
| Mortgage portfolio, net | **20,635,473** | 11,700,766 |
| Cash and short-term funds | **1,268,523** | 2,087,559 |
| Interest and remittance receivables | **343,999** | 259,483 |
| Total Assets | **24,095,571** | 15,491,764 |
| Debt securities | **20,932,372** | 12,263,546 |
| Total Liabilities | **21,249,519** | 12,901,258 |
| Total Shareholder's Equity | **2,846,052** | 2,590,506 |
| Capital-to-Assets ratio | **11.4%** | 13.2% |

## 27. COMMITMENTS

(a) Capital

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Authorized and contracted for | **-** | 4,774 |
| Authorized but not contracted for | **9,165** | 17,378 |
| | **9,165** | 22,152 |

(b) Operating lease

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

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Office premises | | |
| not later than one year | **11,001** | 10,422 |
| later than one year and not later than five years | **22,001** | 31,264 |
| | **33,002** | 41,686 |

## 28. OPERATING SUBLEASE ARRANGEMENT

At the balance sheet date, the total future minimum sublease payments expected to be received under the non-cancellable operating subleases in respect of the premises were HK$6,840,000 (2000: HK$2,160,000).

## 29. FIXED ADJUSTABLE RATE MORTGAGES ("FARM") PROGRAMME

The Company has committed to purchase a certain amount of eligible FARM from the approved seller/servicers on a first come, first served loan-by-loan basis. The gross mortgage rates are fixed for a period of one, two or three years. At 31 December 2001, there was no outstanding commitment amount to purchase FARM (2000: HK$3.45 billion).

## 30. MORTGAGE INSURANCE PROGRAMME ("MIP")

The Company offers mortgage 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.

Under the back-to-back arrangement, the Company reinsures the risk exposure with the approved reinsurers on a 100% basis. The Company expanded risk sharing in mortgage insurance business from 20% to 50% with some approved reinsurers in 2001. At 31 December 2001, the risk-in-force was approximately HK$2.85 billion (2000: HK$1.55 billion) of which HK$2.34 billion (2000: HK$1.38 billion) risk for credit loss was ceded to the approved reinsurers and the balance of HK$513 million (2000: HK$172 million) was assumed by the Company.

## 31. OFF-BALANCE-SHEET EXPOSURES

### (a) Contingent liabilities

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Guarantees under MBS programme | **873,822** | 642,546 |

### (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:

| | **2001** | 2000 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Interest rate swap contracts | **20,547,550** | 11,228,000 |

ii) The replacement costs and credit risk-weighted 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.

| | **2001** | | 2000 | |
|---|---|---|---|---|
| | **Replacement cost** | **Credit risk-weighted amount** | Replacement cost | Credit risk-weighted amount |
| | ***HK$'000*** | ***HK$'000*** | *HK$'000* | *HK$'000* |
| Interest rate swap contracts | **527,257** | **78,443** | 247,323 | 24,225 |

The replacement costs represent the cost of replacing all interest rate swap contracts that have a positive value when marked to market. The credit risk-weighted amounts refer to the amount as computed in accordance with the Capital-to-Assets ratio guidelines (Note 32). The Company has not experienced any non-performance by its counterparties.

### 32. 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 issued guidelines in 1997 in respect of the minimum Capital-to-Assets ratio ("CAR") to be maintained by the Company. With the Board of Directors' approval in October 2000, the Company proposed to the Financial Secretary to modify the guidelines to account for the different levels of risk of the products in the MBS guaranteed by the Company, retained mortgage portfolio and mortgage insurance. The revised guidelines were approved in April 2001. The minimum CAR stipulated in the guidelines is still at 5%. The CARs as at 31 December were calculated under the revised framework (31 December 2000: previously reported at 12.3%).

| | **2001** | 2000 |
|---|---|---|
| Capital-to-Assets ratio | **11.6%** | 13.5% |

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

### 33. COMPARATIVE FIGURES

Certain comparative figures for 2000 have been reclassified to conform to the current year's presentation as a result of adopting the latest SSAPs issued by the Hong Kong Society of Accountants.

### 34. SUBSEQUENT EVENT

On 13 March 2002, the Company sold HK$2 billion of mortgage loans from its retained mortgage portfolio at par to Bauhinia MBS Limited (the "Issuer") on a clean sale basis under the US$3 Billion Mortgage-Backed Securitization Programme (the "Bauhinia MBS Programme"). The sale proceeds were used to meet general working capital requirements of the Company.

The Issuer issued mortgage-backed securities ("MBS") to fund the purchase of the above-mentioned mortgage loans from the Company on 13 March 2002. As a guarantor under the new issue, the Company guarantees timely repayment of the principal and interest of the MBS when they are contractually due in consideration of guarantee fee income. The contingent liability of the Company under the Bauhinia MBS Programme was approximately HK$2 billion at 15 April 2002.

### 35. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the Board of Directors on 15 April 2002.

# Calendar of Events

## 26 Mar 2001

- Fourth Annual General Meeting

## 30 Mar 2001

- Settlement of the first tranche of the HK$18 billion of mortgage loans purchased from the Hong Kong Housing Authority

## 20 Apr 2001

- Issued a HK$5 billion Fixed-Rate bond through HSBC as Lead Manager

## 27 Apr 2001

- Expanded the MIP to provide insurance cover for equitable mortgage loans with loan-to-value ratio up to 85%

## 1 May 2001

- Appointment of The Honourable Antony Leung, GBS, JP as new Chairman

## 17 May 2001

- First mortgage purchase from a property developer


## 20 Jul 2001

- Further expanded the MIP to provide insurance cover for equitable mortgage loans wth LTV ratio of up to 90%

## 26 Jul 2001

| | 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- (stable) | P-1 (stable) | Aa3 (stable) |

- Obtained issuer's credit ratings from Moody's and Standard & Poor's that are the same as those of the Hong Kong SAR Government


## 26 Jul 2001

- Introduced the Model Mortgage Origination Documents

## 18 Aug 2001

- Jointly organized a seminar on bond investment with The Hong Kong Capital Markets Association, Hong Kong Economic Times, Hong Kong Investment Funds Association and The Hong Kong Polytechnic University

## 29 Aug 2001

- Issued the fourth listed NIP notes of HK$500 million with a retail portion of HK$250 million

# Calendar of Events (continued)

05 Sep 2001

- Signing Ceremony with American Express Bank to mark the issuance of HK$633 million of MBS under the Guaranteed Mortgage-Backed Pass-Through Securitization Programme

20 Sep 2001

- Introduction of the Delegated Underwriting Arrangement under the MIP

28 Sep 2001

- Settlement of HK$2.5 billion of mortgage loans purchased from Hong Kong Housing Society


05 Nov 2001

- Expanded the maximum loan size under the MIP from HK$5 million to HK$8 million


07 Nov 2001

- Launched the inaugural over-the-counter retail bonds through Dao Heng Bank, HSBC and Hang Seng Bank as placing banks


19 Nov 2001

- Forum on Implementation of the Model Mortgage Origination Documents

4 Dec 2001

- Pilot launch of the Integrated Information Delivery System to a pilot group of banks and re-insurers

12 Dec 2001

- Inaugural use of title insurance to support the purchase of mortgage loans from Cheung Kong's Subsidiaries


19 Dec 2001

- Established the US$3 billion Bauhinia MBS Limited Mortgage-Backed Securitization Programme

20 Dec 2001

- Expanded the Mortgage Purchase Programme to cover loans with 100% loan-to-value ratio at origination and loans with a combined loan tenor and property age of up to 50 years

**List of Approved Seller/Servicers**

1. ABN AMRO Bank N. V.
2. AIG Finance (Hong Kong) Limited
3. American Express Bank Limited
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. Chekiang First Bank Limited
11. Chiyu Banking Corporation Limited
12. Citibank, N.A.
13. CITIC Ka Wah Bank Limited
14. Dah Sing Bank, Limited
15. Dao Heng Bank Limited
16. DBS Kwong On Bank Limited
17. First Pacific Bank Limited
18. Fortis Bank Asia HK
19. GE Capital (Hong Kong) Limited
20. Hang Seng Bank Limited
21. Hang Seng Credit Limited
22. Hang Seng Finance Limited
23. The Hongkong Chinese Bank, Limited
24. The Hong Kong Housing Authority
25. Hong Kong Housing Society
26. The Hongkong and Shanghai Banking Corporation Limited
27. Inchroy Credit Corporation Limited
28. Industrial and Commercial Bank of China (Asia) Limited
29. International Bank of Asia Limited
30. Liu Chong Hing Bank Limited
31. Nanyang Commercial Bank, Limited
32. ORIX Asia 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*

# 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 Branch

### DIP Selling Group Members

ABN AMRO Bank N.V.

The Bank of East Asia, Limited

Barclays Bank PLC, Hong Kong Branch

BNP Paribas

Citicorp International Limited

Commonwealth Bank of Australia

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

Dao Heng Bank Limited

The Hongkong and Shanghai Banking Corporation Limited

Hang Seng 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 2001 Mortgage Portfolio

| **Retained portfolio** | **Jan** | **Feb** | **Mar** | **Apr** |
|---|---|---|---|---|
| *Aggregate* | | | | |
| Number of Approved Sellers/Servicers | 44 | 44 | 46 | 46 |
| Number of active Sellers | 25 | 25 | 26 | 26 |
| *Geographical distribution* | | | | |
| Number of loans | 8,469 | 8,334 | 15,962 | 15,769 |
| – Hong Kong | 2,294 | 2,266 | 2,981 | 2,935 |
| – Kowloon | 1,785 | 1,751 | 2,911 | 2,872 |
| – New Territories | 4,390 | 4,317 | 10,070 | 9,962 |
| Outstanding principal balance (HK$million) | 10,917 | 10,704 | 14,636 | 14,313 |
| – Hong Kong | 3,442 | 3,383 | 3,730 | 3,642 |
| – Kowloon | 2,216 | 2,161 | 2,750 | 2,682 |
| – New Territories | 5,260 | 5,160 | 8,156 | 7,989 |
| Delinquency (%) | | | | |
| – > 90 days | 0.44 | 0.46 | 0.34 | 0.37 |
| Charge-off Ratio (%) | – | – | – | – |
| *Weighted Average##* | | | | |
| LTV ratio at origination (%) | 63.2 | 63.2 | 63.2 | 63.3 |
| Estimated current LTV ratio (%) | 87.0 | 87.8 | 86.6 | 88.1 |
| DTI at origination (%) | 37.6 | 37.6 | 37.7 | 37.7 |
| Remaining contractual term to maturity (months) | 174 | 174 | 170 | 169 |
| Seasoning (months) | 39 | 39 | 40 | 42 |
| Contractual life (months) | 213 | 213 | 210 | 211 |
| *Aggregate#* | | | | |
| Prepayment (%) | | | | |
| – Partial | 0.13 | 0.23 | 0.26 | 0.20 |
| – Full | 1.53 | 1.33 | 1.73 | 2.38 |

| **Key statistics of the Mortgage Insurance Programme** | **Jan** | **Feb** | **Mar** | **Apr** |
|---|---|---|---|---|
| Number of Participating Banks | 40 | 40 | 41 | 41 |
| *Applications received* | | | | |
| Number of applications | 7,852 | 8,403 | 9,279 | 9,957 |
| Total amount of mortgage loans (HK$ million) | 15,674 | 16,609 | 18,171 | 19,338 |
| Total risk in force (HK$ million) | 2,997 | 3,208 | 3,554 | 3,826 |
| Average size of mortgage loan (HK$ million) | 2.0 | 2.0 | 2.0 | 1.9 |
| LTV ratio at origination | | | | |
| – 80% or below (%) | 18 | 17 | 17 | 17 |
| – above 80% and up to 85% (%) | 63 | 61 | 57 | 55 |
| – above 85% and up to 90% (%) | 19 | 22 | 26 | 28 |
| *Applications approved* | | | | |
| Number of approved applications | 6,981 | 7,357 | 8,100 | 8,671 |
| Total amount of mortgage loans (HK$ million) | 13,938 | 14,559 | 15,844 | 16,852 |
| Total risk in force (HK$ million) | 2,655 | 2,792 | 3,080 | 3,301 |
| *Types of property transaction* | | | | |
| Primary (%) | 13 | 13 | 14 | 15 |
| Secondary (%) | 87 | 87 | 86 | 85 |
| *Choice of premium payment method* | | | | |
| Single payment (%) | 90 | 90 | 90 | 90 |
| Annual payment (%) | 10 | 10 | 10 | 10 |

*Notes:*

## *Figures excluding mortgage loans with co-financing arrangements*

\# *Figures excluding the HKHA loans*

| May | Jun | Jul | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|---|
| 46 | 46 | 46 | 46 | 46 | 37 | 37 | 37 |
| 26 | 27 | 27 | 27 | 27 | 26 | 26 | 26 |
| 15,581 | 15,776 | 15,648 | 24,506 | 29,584 | 29,705 | 29,416 | 29,475 |
| 2,880 | 2,848 | 2,847 | 4,420 | 5,013 | 5,034 | 4,985 | 4,995 |
| 2,817 | 2,808 | 2,777 | 4,359 | 5,442 | 5,464 | 5,411 | 5,422 |
| 9,884 | 10,120 | 10,024 | 15,727 | 19,129 | 19,207 | 19,020 | 19,058 |
| 13,997 | 13,825 | 13,613 | 18,507 | 20,441 | 20,305 | 19,901 | 19,635 |
| 3,536 | 3,421 | 3,413 | 4,571 | 4,376 | 4,346 | 4,260 | 4,203 |
| 2,611 | 2,570 | 2,522 | 3,439 | 3,776 | 3,751 | 3,676 | 3,627 |
| 7,849 | 7,834 | 7,678 | 10,496 | 12,290 | 12,208 | 11,965 | 11,805 |
| 0.42 | 0.17 | 0.18 | 0.14 | 0.14 | 0.24 | 0.18 | 0.29 |
| – | 0.30 | 0.04 | 0.02 | 0.03 | 0.01 | 0.09 | 0.00 |
| 63.2 | 63.4 | 63.6 | 63.7 | 63.5 | 63.8 | 63.8 | 63.9 |
| 89.6 | 90.3 | 90.3 | 91.3 | 93.3 | 95.6 | 96.2 | 96.4 |
| 37.6 | 37.7 | 37.7 | 37.8 | 37.8 | 37.8 | 37.8 | 37.9 |
| 166 | 167 | 168 | 167 | 164 | 163 | 162 | 161 |
| 43 | 44 | 44 | 46 | 47 | 49 | 49 | 50 |
| 209 | 211 | 212 | 213 | 211 | 212 | 211 | 211 |
| 0.25 | 0.24 | 0.22 | 0.27 | 0.15 | 0.14 | 0.14 | 0.18 |
| 2.34 | 2.96 | 2.39 | 2.48 | 2.38 | 1.82 | 1.87 | 2.33 |

| May | Jun | Jul | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|---|
| 41 | 41 | 41 | 41 | 41 | 32 | 32 | 32 |
| 11,006 | 11,809 | 12,450 | 13,064 | 13,535 | 13,993 | 14,609 | 15,154 |
| 21,295 | 22,844 | 24,102 | 25,273 | 26,177 | 26,967 | 28,802 | 29,276 |
| 4,238 | 4,585 | 4,875 | 5,148 | 5,356 | 5,537 | 5,794 | 6,084 |
| 1.9 | 1.9 | 1.9 | 1.9 | 1.9 | 1.9 | 1.9 | 1.9 |
| 16 | 16 | 15 | 15 | 15 | 15 | 15 | 14 |
| 54 | 52 | 51 | 49 | 48 | 47 | 46 | 45 |
| 30 | 32 | 34 | 36 | 37 | 38 | 39 | 41 |
| 9,439 | 10,169 | 10,718 | 11,268 | 11,664 | 12,020 | 12,496 | 12,948 |
| 18,256 | 19,641 | 20,701 | 21,753 | 22,513 | 23,149 | 23,999 | 24,980 |
| 3,609 | 3,913 | 4,158 | 4,402 | 4,578 | 4,724 | 4,920 | 5,151 |
| 16 | 17 | 17 | 17 | 17 | 16 | 16 | 17 |
| 84 | 83 | 83 | 83 | 83 | 84 | 84 | 83 |
| 91 | 91 | 92 | 92 | 92 | 92 | 92 | 92 |
| 9 | 9 | 8 | 8 | 8 | 8 | 8 | 8 |

of Bretagne,
HOME. n. s.
I. His own house
I'm now from
Which shall be
Something like