一九九八年年報 ANNUAL REPORT 1998

The Hong Kong Mortgage Corporation Limited

香港按揭證券有限公司

HKMC

CONTENTS

FINANCIAL HIGHLIGHTS

	1998	1997*
	HK$'000	HK$'000
For The Year		
Net interest income	**221,228**	18,354
Profit / (loss) after tax	**106,398**	(20,252)
Mortgage purchases	**11,440,327**	653,613
At Year End		
Mortgage portfolio, net	**11,376,485**	650,066
Total assets	**11,592,862**	983,607
Long-term debt securities	**5,191,000**	–
Shareholder's equity	**2,086,146**	979,748
Other Statistics		
Net interest margin	**4.9%**	7.6%
Capital-to-assets ratio	**9.0%**	99.6%
Cost-to-income ratio	**33.9%**	210.3%
Return on average assets	**2.1%**	N/A
Return on average shareholder's equity	**7.9%**	N/A

*For the period from 3 March 1997 (date of incorporation) to 31 December 1997

Chairman's Statement

The Honourable Donald TSANG, JP
Chairman
Financial Secretary

The Hong Kong Mortgage Corporation Limited (HKMC) went through a challenging but productive year in 1998. We successfully launched our core business of acquiring mortgages and funding the purchases through the issuance of debt securities, amidst the difficult operating environment created by the Asian financial turmoil. Notwithstanding the start-up costs in the first full year of operation, the HKMC achieved a low cost-to-income ratio of 33.9% and an after tax profit of HK$106 million.

While the Asian financial turmoil intensified in 1998, it highlighted the importance of the HKMC as a stabilizing force in the financial system. The banking sector felt an even greater need for a reliable avenue to offload its mortgages in order to enhance its liquidity and to reduce its risk concentration. The volatile interest rate environment and the sharp fall in property prices, however, presented a challenge for the HKMC to strike the right balance between accomplishing the business targets and containing the higher risk of borrower default in an economic downturn.

In close consultation with the Approved Sellers, the HKMC introduced a package of pragmatic measures in 1998 to facilitate the sale of mortgages to the Corporation. The Discount Pricing and Portfolio Pricing methods were introduced to enable Approved Sellers to sell mortgages at below the gross mortgage rate and net required yield specified by the HKMC. The negative equity warranty allows the HKMC to purchase mortgages which have higher current loan-to-valuation ratios without incurring excessive risk. The Forward Commitment Facility provides banks with greater certainty on the amount of mortgage loans they can sell to the HKMC and helps the Corporation to plan more effectively its funding activities.

As a pioneer institution, the HKMC has demonstrated its commitment and ability in product innovation in the mortgage market. With a view to promoting consumer choice, the HKMC launched the Pilot Scheme for Fixed Rate Mortgages in March 1998. The market responded well and the pre-commitment amount for the Pilot Scheme almost tripled from HK$500 million to HK$1,400 million within six months. The Scheme has also served as a catalyst leading to the offer of similar products by property developers and banks. In view of the success of the Pilot Scheme, it was converted into a regular programme in September 1998.

The HKMC bought a total of HK$11.4 billion of mortgages in 1998, exceeding the target of HK$10 billion set for the year. In building up its mortgage portfolio, the Corporation attaches great importance to maintaining asset quality. This is necessary to protect the long term profitability and credit standing of the Corporation, which in turn will also help to lower its funding costs. We have adopted prudent purchasing criteria and an effective post-purchase due diligence process. As a result, the HKMC's mortgage portfolio had no loan overdue for more than 90 days at the end of 1998. This compared favourably to the 0.84% ratio for the banking industry.

The mortgage purchase programme has helped us to gain some useful insights into best market practices in underwriting policy as well as legal documentation for mortgage loans. We have used various established effective channels to provide feedback on these best market practices with a view to cross-fertilization. These channels include the post purchase due diligence review meetings with individual Approved Sellers and the Bi-monthly Report published by the Corporation. Over time, this process should help to raise the overall standards of mortgage origination in Hong Kong.

On the funding side, the focus of 1998 was to establish our presence as an active issuer in the Hong Kong dollar debt market. In January 1998, the HKMC set up a HK$20 billion Note Issuance Programme ("NIP") which targets primarily the financial institutions. As the market making system for Exchange Fund Bills and Notes covers the notes issued under the Programme, the NIP Notes enjoy a high degree of secondary market liquidity. This enhances their attractiveness to financial institutions and helps to lower the Corporation's borrowing cost. With a view to broadening the investor base, the HKMC established in June 1998 a HK$20 billion Debt Issuance Programme ("DIP") which targets institutional investors. The design of the DIP enables the HKMC to make flexible offerings through a wide range of traditional and innovative distribution mechanisms, including book-building, syndication, bidding and private placements. The flexible arrangements allow the HKMC to offer customised products to match the investment requirements of a broad range of institutional investors with the Corporation's own funding needs.

With a combined total issuance of HK$5.2 billion under the two Programmes in 1998, the HKMC has firmly established itself as a high quality and active issuer in the Hong Kong dollar debt market. The good track record developed through these two Programmes should pave the way for the Corporation to explore the issuance of mortgage backed securities and to tap funds in the international capital markets in the future.

Looking ahead, the business plan for 1999 will focus on three areas. First, building on the solid foundation developed in 1998, the HKMC will continue to expand its core business of mortgage purchases. The speed of increasing the size of the mortgage portfolio has, however, slowed down since the beginning of 1999. The banks have become less keen to sell to the HKMC, as residential mortgages in Hong Kong have proved to remain high quality assets during the financial crisis and there are generally less lending opportunities to the corporate sector. If market conditions permit, the HKMC plans to buy another HK$10 billion of mortgages through the purchase Programme. To fund the mortgage acquisitions and to increase the depth of its debt issuance capability, the Corporation plans to issue about HK$5 billion of debt through the NIP and DIP in 1999.

Secondly, the Corporation will continue to innovate new products to promote and develop the home finance market. The Mortgage Insurance programme, which was launched in late March 1999, will enable home buyers to obtain mortgage loans from banks of up to 85% loan-to-value ratio. The Programme provides an innovative market solution to enable the banks to relax the ceiling for residential mortgage loans without taking on additional risks. The Programme should benefit all parties, including home buyers, banks, the insurance industry and the HKMC.

Thirdly, the HKMC will consider the feasibility of launching two new initiatives. These are the Multi-currency Medium Term Notes ("MTN") Programme and the issuance of Mortgage Backed Securities ("MBS"). The MTN Programme would further widen the HKMC's investor base to include overseas investors and raise the international profile of the Corporation. The introduction of a MBS Programme would be an important milestone in the development of the secondary mortgage market in Hong Kong.

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 dedication, hard work 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.

Donald Tsang
Chairman

Board of Directors

The Honourable Donald TSANG, JP
Chairman
Financial Secretary

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

Mr. Rafael HUI Si-yan, GBS, JP
Director
Secretary for Financial Services

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

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

Mr. Tom HSIAO Yao-hin
Director
Advisor to Tokyo-Mitsubishi
International (HK) Limited

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

The Honourable Ronald Joseph ARCULLI, JP
Director
Partner of Woo Kwan Lee & Lo, Solicitors

Ms. Anna WU Hung-yuk, JP
Director
Solicitor and Senior Partner of Robert W. H. Wang & Co.

Mr. Eddy FONG Ching, JP
Director
Certified Public Accountant and a senior partner of PricewaterhouseCoopers

Dr. HUANG Chen-ya
Director
Medical Practitioner

Mr. Peter WONG
Director
Head, Consumer Banking, Hong Kong & China, Standard Chartered Bank

The Honourable NGAN Kam-chuen
Director
Senior Manager of the Kwangtung Provincial Bank

Mr. Alex AU Mo-cheung
Director
Managing Director and Chief Executive Officer of Hung Kai Finance Company, Limited

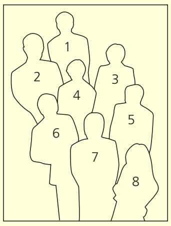
The Honourable Bernard Charnwut CHAN
Director
Deputy Managing Director, Asia Financial Group

Management Team

from left to right
Ms Pamela Lamoreaux, Mr Peter Pang, JP, Mr Philip Li, Ms Susie Cheung

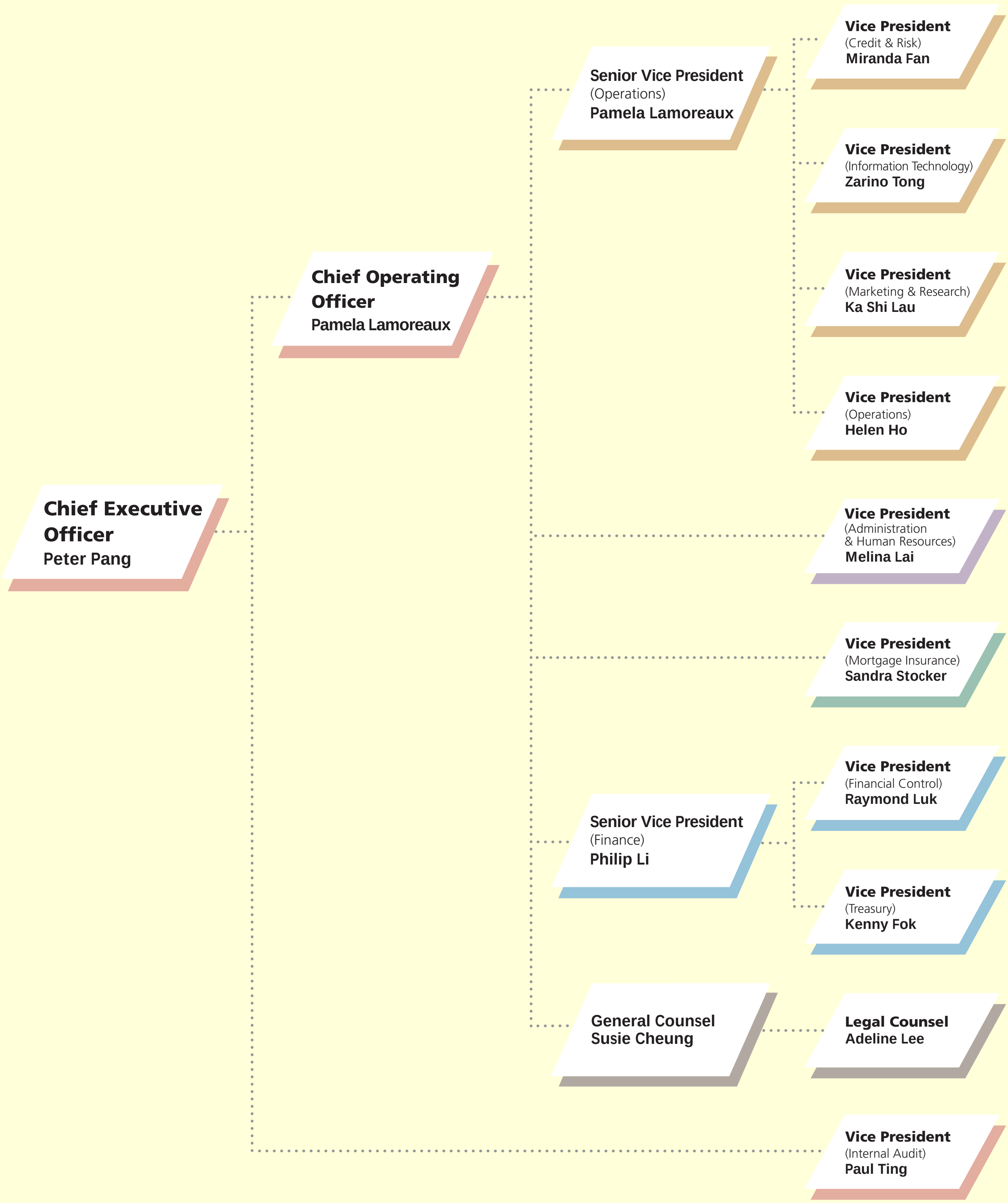
1. *Mr Kenny Fok*
2. *Mr Raymond Luk*
3. *Ms Melina Lai*
4. *Ms Sandra Stocker*
5. *Ms Helen Ho*
6. *Ms Ka Shi Lau*
7. *Mr Zarino Tong*
8. *Ms Adeline Lee*

Absent: Ms Miranda Fan,
Mr Paul Ting



Organisation Structure

As at end March 1999



Business Review

PERFORMANCE HIGHLIGHTS

1998 was the first full year of operation for the HKMC. The Corporation has successfully launched the first phase of its business plan, involving the purchase of mortgages funded by the issuance of unsecured debt securities denominated in Hong Kong dollars. All the business targets were met, and the Corporation achieved an after tax profit exceeding HK$100 million despite a difficult operating environment:

Mortgage Purchase

- purchased a total of HK$11.4 billion of mortgages in 1998, exceeding the target of HK$10 billion set for the year;
- established an extensive network of 31 Approved Sellers, which together account for a market share of over 80% of the primary mortgage market in Hong Kong;
- introduced the ground breaking Pilot Scheme to promote Fixed Rate Mortgages and the various measures to facilitate the purchase of floating rate mortgages, such as the Forward Commitment Facility, portfolio and discount pricing to enable banks to sell mortgages at below the HKMC's net required yield and negative equity warranty to protect the HKMC in purchasing mortgages which are close to negative equity; and
- achieved and maintained excellent quality in its mortgage portfolio. At the end of 1998, there was no loan overdue for more than 90 days.

Funding

- successfully launched the Hong Kong dollar Note Issuance Programme and the Hong Kong dollar Debt Issuance Programme in 1998, which provide a comprehensive coverage of the investor base of the Hong Kong dollar debt market;
- despite a very difficult operating environment, issued a total of HK$5.2 billion debt securities under the two Hong Kong dollar debt issuance programmes, making the HKMC one of the top corporate issuers of Hong Kong dollar fixed rate notes in 1998; and
- through effective management of the debt issuance and treasury activities, achieved an average cost of fund of 7.1% in 1998, which was lower than the target of 7.5%, resulting in a healthy net interest spread of 2.9% between its interest bearing assets and liabilities.

Profitability

- achieved an after tax profit of HK$106.4 million in 1998, providing a 7.9% return on average shareholder's equity and a 2.1% return on average assets; and
- through effective cost control, the cost-to-income ratio was kept at a low level of 33.9%, well below the average of 48.2% for the banking industry.

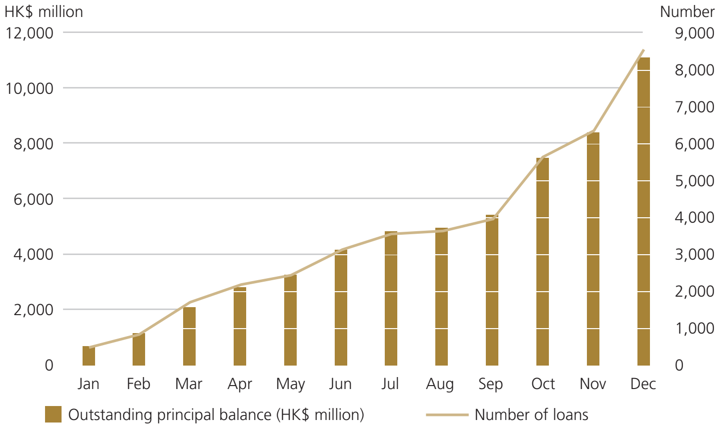
Corporate Governance

- established important systems and processes for ensuring effective internal controls and risk management. These include the Audit Committee, the Asset and Liability Committee and the Credit Committee;
- adopted a high level of transparency in conducting its business in accordance with best market practice. A Bi-monthly Report has been introduced to keep the market regularly updated on the asset quality of the HKMC's mortgage portfolio and business developments; and
- senior executives conducted regular media briefings on the Corporation's financial results and new business initiatives.

MORTGAGE PURCHASE PROGRAMME

The HKMC's mortgage purchase programme commenced in November 1997 with the purchase of HK$654 million of mortgages. The Corporation set a target of acquiring a minimum of HK$10 billion of mortgages in 1998. Despite the challenging operating environment, in particular the sharp correction of property prices and intensive price competition in the mortgage market, the Corporation purchased a total of 8,180 mortgages with a total value of HK$11.4 billion, exceeding the target set for the year.

Growth of HKMC's Mortgage Portfolio



Building a Network of Approved Seller/Servicers

A key component of a sustainable mortgage purchase programme is the establishment of an extensive network of Approved Seller/Servicers. This is important in enlarging the source of supply of mortgages for sale to the HKMC. Through an active marketing programme, the number of Approved Seller/Servicers increased substantially from 8 to 31 during the year. The network covers the majority of the authorized institutions which are active mortgage originators with a balanced

mix of local and overseas institutions. Together they account for over 80% of the outstanding principal balance of the primary mortgage market in Hong Kong.

The introduction of the Mortgage Insurance Programme (see page 19), which will enable authorized institutions to lend up to 85% loan-to-value ratio, provides further incentive for authorized institutions to become Approved Seller/Servicers. The number has reached 38 before the formal launch of the Mortgage Insurance Programme in late March 1999. A list of Approved Seller/Servicers as at end March 1999 is at Annex A.

Among the 31 Approved Seller/Servicers, 22 had sold mortgages to the HKMC in 1998, ranging from HK$25.0 million to HK$2.0 billion.

Floating Rate Mortgages

Reflecting their predominance in the local market, the bulk of the mortgages purchased in 1998 (7,280 loans with a total value of HK$10.3 billion) were floating rate mortgages. The Corporation has tried different approaches in building up its mortgage portfolio. The first block of HK$650 million mortgages, acquired in November/ December 1997, was purchased through the placement approach under which the mortgage yield was negotiated between the HKMC and the interested Approved Sellers but the same yield was applied to the whole block. The tender approach was adopted for the second tranche completed in February 1998, involving a total of HK$993.3 million. With the steady increase in the number of Approved Sellers, the private placement approach, which offers maximum flexibility in terms of pricing and amount for individual mortgage purchase, was adopted for the subsequent tranches.

There have only been minor changes to the purchasing criteria for floating rate mortgages during the year. These include a reduction in the seasoning requirement from 12 months to 6 months and the discretion for the HKMC to raise the debt-to-income ratio from 50% to 60% for high income borrowers. The core purchasing criteria are as follows:

Maximum loan size at origination	:	HK$5 million
Maximum loan-to-value at origination	:	70%
Maximum debt-to-income ratio at origination	:	50% (60% for high income borrowers)
Minimum seasoning	:	6 months
Maximum original term to maturity	:	30 years
Remaining term to maturity – maximum	:	29.5 years
Remaining term to maturity – minimum	:	3 years
Maximum sum of "original term" and "age of property"	:	40 years

The highly volatile mortgage market in 1997/98 presented major challenges to the HKMC in meeting the mortgage purchase target. Responding to these challenges and the individual business needs of the Approved Sellers, the HKMC introduced several innovative measures to facilitate the purchase of floating rate mortgages without compromising asset quality. These include Discount Pricing, Portfolio Pricing, Negative Equity Warranty and the Forward Commitment Facility.

Discount Pricing

Due to intensive price competition among banks, a substantial proportion of the mortgages originated in the twelve months prior to October 1997 had mortgage rates at Prime Rate or Prime Rate plus 25 basis points. These were lower than the gross mortgage rate specified by the HKMC, i.e. at net required yield (Prime Rate) plus 50 basis points. Several Approved Sellers requested the HKMC to consider purchasing mortgages that had a spread of less than 50 basis points between the mortgage rate and HKMC's net required yield. In response to these requests, the Corporation has developed a Discount Pricing Model that allows it to buy mortgages at below the specified gross mortgage rate without reducing the net required yield. The model uses a net present value approach to price the shortfall (difference between required spread of 50 basis points and the actual spread) in the future stream of cash flows. Instead of purchasing the mortgages at par with their outstanding principal balance, they are bought at a discount to maintain the same net required yield. About HK$1.2 billion mortgages were purchased using this pricing method in 1998.

Portfolio Pricing Approach

The Portfolio Pricing (or "bundled pricing") approach was another measure introduced by the HKMC in 1998 to enable the Approved Sellers to sell mortgages with mortgage rates below the gross mortgage rate specified by the HKMC. Under this approach, the Approved Seller can sell a portfolio of mortgages, including some with mortgage rates at below the gross mortgage rate, provided that the weighted average mortgage rate of the whole portfolio complies with the gross mortgage rate and the net required yield specified by the HKMC. Altogether 4,083 mortgage loans, with a total value of HK$6.0 billion were purchased using the Portfolio Pricing approach in 1998.

Negative Equity Warranty

Another major challenge in 1998 was the sharp correction in property prices. In order to contain the risk of negative equity to an acceptable level, the Negative Equity Warranty was introduced in June 1998. Under the arrangement, Approved Sellers may sell mortgages with current loan-to-value ratio above 90% provided that the Approved Sellers would agree to provide a warranty to repurchase such mortgages if they become overdue for more than 90 days in the subsequent 18 months after sale.

265 loans involving HK$576.8 million purchased by the HKMC in 1998 are covered by the negative equity warranty. Up to end December 1998, no loan had been bought back by Approved Sellers under the warranty.

Forward Commitment Facility

The Forward Commitment Facility was introduced in July 1998 to streamline the mortgage purchase programme. Under this facility, the HKMC commits to purchase an agreed amount of mortgages from the Approved Sellers within a specified period of up to 12 months. The facility provides banks with greater certainty about the amount of loans they can sell to the HKMC within the specified period and help them to plan their new loan business more effectively. It also enables the HKMC to have a more accurate assessment of the selling interest of the Approved Sellers, which will improve the efficiency of the mortgage purchase operations and facilitate the planning of funding activities.

The Forward Commitment Facility was well received by the Approved Sellers. By the end of December 1998, 17 Approved Sellers had signed the facility agreement with the intention to sell HK$14.8 billion of mortgages in the 12 months period up to December 1999. About HK$6.2 billion of these had already been purchased by the Corporation as at 31 December 1998.

Fixed Rate Mortgages

Pilot Scheme to Promote Fixed Rate Mortgages

The primary mortgage market in Hong Kong has traditionally been dominated by floating rate mortgages. The HKMC has helped to break new ground through the promotion of fixed rate mortgages which widens the choice of home buyers. On 18 March 1998, a pilot scheme was launched to test the market response. Two Approved Sellers, namely Dao Heng Bank and

Chase Manhattan Bank, were appointed as participating banks. The framework of the Pilot Scheme is set out below.

a) Pre-commitment to Purchase

The HKMC gave a pre-commitment to the two participating banks to purchase from each of them up to HK$250 million of the eligible fixed rate mortgages. The banks originated fixed rate mortgages at an interest rate specified by the HKMC from time to time. The mortgages were purchased on a loan-by-loan basis soon after origination.

b) Mortgage Rate

Based on the funding cost of the inaugural debt issue, the mortgage rate was fixed for the first three years. The borrower was given a choice at the end of the 3-year period either to refix the mortgage rate for another term at the then prevailing fixed rate or to convert the mortgage to floating rate. To protect the HKMC from the prepayment risk, a fee will be charged on prepayment within the 3-year period.

c) Purchasing Criteria

Maximum loan size at origination	:	HK$4 million
Maximum loan-to-value ratio at origination	:	70%
Maximum debt-to-income ratio at origination	:	50% (60% for high income borrowers)
Term to maturity – maximum – minimum	: :	25 years 10 years
Maximum sum of "originalterm" and "age of property"	:	40 years

Reflecting the favourable market reception to fixed rate mortgages, the precommitment amount under the Pilot Scheme was increased from HK$500 million to HK$1,400 million. At the end of the Pilot Scheme period (September 1998), 855 loans involving HK$1,148.2 million had been originated under the Scheme. The favourable response to the Scheme has also stimulated the introduction of similar products in the market by a number of property developers and banks.

Regular Purchase Programme for Fixed Rate Mortgages

In view of the favourable market response, the HKMC decided in September 1998 to roll the Pilot Scheme into a regular programme and to offer fixed rate mortgages as one of its standard products. The number of participating banks has been increased from 2 to 8:

Bank of East Asia
Chase Manhattan Bank
Chekiang First Bank
Dao Heng Bank
First Pacific Bank
Hang Seng Bank
HSBC
Standard Chartered Bank

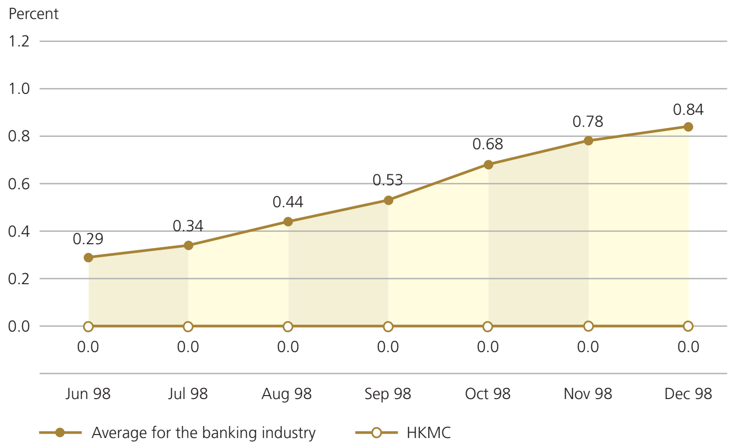
Over time, the purchase programme for fixed rate mortgages will increase substantially the supply of mortgages for sale to the HKMC and will enable the Corporation to achieve a diversified mix in its mortgage portfolio. It will also help to broaden the primary mortgage market by providing home buyers with an additional choice which can protect them from adverse interest rate movements.

QUALITY OF THE MORTGAGE PORTFOLIO

The HKMC attaches great importance to maintaining good asset quality in expanding its mortgage portfolio. This is necessary to protect the long-term profitability and credit standing of the Corporation, which in turn will help to lower its funding cost. The HKMC adopts a four-pronged approach in upholding the asset quality of its mortgage portfolio:

This prudent approach has proven to be highly effective in protecting the asset quality of the HKMC's mortgage portfolio. Despite the economic downturn (with the real GDP contracting by 5.1% in 1998) and rising unemployment (5.7% in the last quarter of 1998), the portfolio had no loan overdue for more than 3 months at the end of the year, which compared favourably to the 0.84% ratio for the banking industry.

Delinquency Ratio of Mortgages Overdue for more than 90 days



The good quality of the HKMC's portfolio is reflected in the following key indicators:

Weighted average debt-to-income ratio at origination	:	38.1%
Average loan size at origination	:	HK$1.36 million

The low debt-to-income ratio of 38.1% at year-end 1998 was substantially below the maximum limit of 50%. This reflects the strong debt servicing capability of the mortgagors and their ability to withstand adverse economic developments. Even in a distressed scenario under which the mortgagor's household income has dropped by 20%, the average debt-to-income would still be kept at below 50%.

Another factor contributing to the low delinquency ratio is the concentration of the portfolio in the small to medium sector of the residential market. Approximately 68% of the mortgages in the HKMC's portfolio have outstanding principal balance below HK$2.0 million, and the average for the whole portfolio was HK$1.34 million at the year end. The underlying properties are owner-occupied and, therefore, the mortgagors have a strong incentive to keep up with mortgage payments.

DUE DILIGENCE REVIEW

To ensure compliance with the mortgage purchasing criteria, the HKMC conducts due diligence on a sample of mortgages after each purchase. By end December 1998, a total of 666 loans, including floating and fixed rate mortgages had been reviewed. They accounted for about 8% of the total number of outstanding loans. The results were generally satisfactory. 77 loans

were considered to be non-conforming and required, in some cases, to be repurchased or substituted by the Approved Sellers concerned. The following table provides a breakdown of the main types of non-conformity of these cases:

Non-conforming attributes	Number of loans
Insufficient income proof	24
Debt-to-income ratio > 50%	22
Delinquency > 30 days during the seasoning period	9
Inadequate valuation report	5
Drawdown date earlier than Mortgage Deed date for more than 2 days	4
Others	13
Total	77

The non-conforming cases were mainly due to the Approved Sellers not being fully familiar with the finer details of the HKMC's purchasing criteria. The HKMC has provided feedback to the Approved Sellers through post due-diligence meetings and circulars to clarify the common misconceptions. The number of non-conforming cases is expected to diminish over time as the Approved Sellers become more familiar with the purchasing criteria.

DEBT ISSUANCE ACTIVITIES

The HKMC's substantial mortgage purchase programme requires efficient fund raising through issuance of debt securities. For the year 1998, the Corporation needed to raise a minimum of HK$5 billion to fund the mortgage purchase target of HK$10 billion. The Corporation adopts a step-by-step approach in developing its debt issuance capability, starting with raising funds in the Hong Kong dollar debt market. After building a track record in the local market, the Corporation will consider tapping overseas capital markets.

Hong Kong Dollar Note Issuance Programme

On 6 January 1998, the HKMC signed an agreement with the HKMA to appoint the latter as the arranger, agent and operator of a HK$20 billion HKMC Note Issuance Programme ("NIP"). Under the Programme, the HKMC Notes, in denomination of HK$50,000 are cleared through HKMA's Central Moneymarkets Unit. The HKMC Notes are covered by the market-making arrangements for the Exchange Fund Bills and Notes which help to enhance their liquidity in the secondary market. The Programme is an important vehicle for the HKMC to raise funds to support its mortgage purchase programme. It also provides a useful benchmark for Hong Kong dollar debt securities issued by the HKMC under the Debt Issuance Programme.

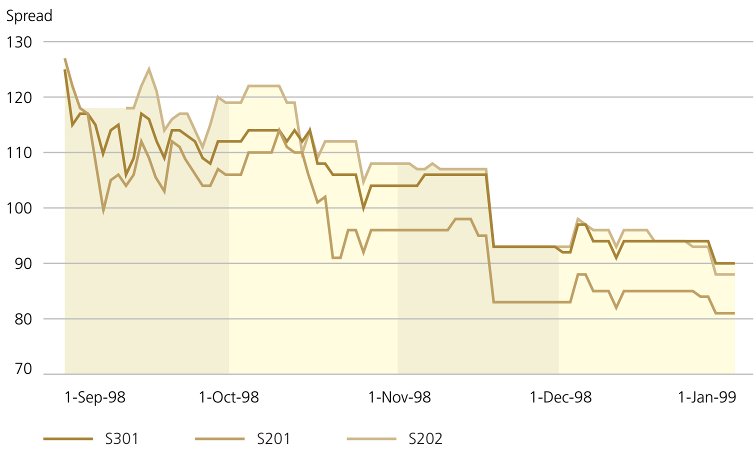
The HKMC launched its inaugural NIP issue in March and finished the year with six public NIP issues totalling HK$3 billion. Part of the proceeds were used to fund the purchase of fixed rate mortgages. The balance was swapped into floating rate through interest rates swaps to finance the purchase of floating rate mortgages.

Issues under the HK$ Note Issuance Programme

Series	Issue Amount (HK$ million)	Issue Date	Tenor (Years)	Coupon	Times Over-subscribed
S301	500	12-Mar-98	3	8.00%	5.44
S302	500	02-Apr-98	3	8.00%	5.54
S201	500	28-May-98	2	8.50%	3.30
S202	500	17-Sep-98	2	9.50%	4.05
S303	500	13-Nov-98	3	7.75%	4.04
S304	500	03-Dec-98	3	7.50%	4.67

Even though some issues were launched during times of exceptional market volatility, the NIP Notes performed well in both the primary tender and secondary market trading. With strong and sustained interest from investors and the liquidity provided by the market makers, the average monthly turnover of the NIP issues was 36% of the total outstanding amount in 1998 – just second to the Exchange Fund Notes. The spreads against the Exchange Fund Notes also showed a notable improvement in the last quarter of 1998.

Yield Spreads between NIP Notes and Exchange Fund Notes



Hong Kong Dollar Debt Issuance Programme

Investors of the NIP Notes are mainly financial institutions which are attracted by the high degree of liquidity provided by the market making system. As a complement to the NIP, the HKMC launched a HK$20 billion Debt Issuance Programme ("DIP") in June 1998 which targets at institutional investors. In order to reach out effectively to the institutional investors, the design of the DIP enables the HKMC to make flexible offerings through a wide range of traditional and innovative distribution mechanisms, including book-building, syndication, bidding, private placement and reverse enquiry. These flexible offering mechanisms allow the HKMC to bridge the investment requirements of a broad range of institutional investors with its own funding needs.

The HKMC has appointed 5 Primary Dealers to perform the underwriting and market making functions for all public DIP issues. A Selling Group consisting of 11 major financial institutions has also been established to broaden the DIP's distribution network. A list of the Primary Dealers and Selling Group members for the Programme is at Annex B.

The inaugural DIP public issue was successfully launched on 29 October 1998. The 3-year issue attracted strong market demand and the issue size was increased by 40% from HK$500 million to HK$700 million. Following the inaugural public issue, active investor interest resulted in the completion of 9 DIP private placements up to end December 1998, involving a total of HK$1,491 million. Reflecting the versatility of the Programme, the tenor of the private placement issues ranged from 1.5 years to 3 years and the issue size ranged from HK$25 million to HK$500 million.

The HKMC has established itself as a high quality issuer in the Hong Kong dollar debt market. The Corporation issued a total of HK$5.2 billion of debt securities under the NIP and DIP in 1998, making it one of the top corporate issuers of HK$ fixed rate bonds for the year.

HKD Issuers League Table (1998)

Rank	Issuer	Amount (HK$ million)
1	HSBC	8,716
2	Hang Seng Bank	6,139
3	**Hong Kong Mortgage Corporation**	**5,191**
4	Mass Transit Railway Corporation	2,980
5	Citibank	1,605
6	Abbey National Treasury	1,450
7	Banque Nationale de Paris	1,370
8	Standard Chartered Bank	1,150
9	Wing Lung Bank	1,090
10	Airport Authority	1,000
	Top 10 HKD Debt Capital Market Domestic Issuers	**30,691**
	Other Domestic Issuers	8,899
	Offshore Issuers (e.g. Supranationals and others)	49,098
	TOTAL	**88,688**

Includes: HKD debt capital market issues including fixed-rate and floating-rate notes/MTNs/CDs and zero coupon bonds of at least 1 year maturity, including private placements and excluding Government Exchange Fund papers.
Source: Basis point

MORTGAGE INSURANCE PROGRAMME

The Mortgage Insurance Programme is a major initiative launched by the HKMC to promote home ownership in Hong Kong. It provides an innovative solution to bridge the gap between the public demand for authorized institutions to relax the ceiling for residential mortgage loans and the prudential requirement for authorized institutions to contain their maximum exposure

to 70% of the value of the property. Under the Programme, the HKMC will provide mortgage insurance coverage at a fee to Approved Sellers for an amount up to 15% of the value of the property. This will allow the banks to lend up to 85% loan-to-value ratio without taking on additional risk. The HKMC will offload that risk through taking out mortgage reinsurance from mortgage insurers on a back-to-back basis. The Board of Directors gave its approval in principle to the proposed framework in December 1998.

The Mortgage Insurance Programme is a win-win solution that will bring significant benefits to all parties concerned:

a) home buyers: the smaller down payment will make it easier for the home buyers to acquire a property, especially in the secondary property market where there are no "top-up" loans provided by the developers;

b) authorized institutions: the insurance provided by the HKMC will allow authorized institutions to lend beyond the 70% level without incurring additional risk;

c) HKMC: the mortgage insurance business will provide a new source of fee income for the HKMC at minimal risk through the back-to-back reinsurance arrangement;

d) insurance industry: mortgage insurance is a new line of business for the insurance industry in Hong Kong; and

e) property market: the arrangement will help to improve the liquidity of the secondary property market where there is no "top-up" loan provided by developers.

The Board approved in February 1999 the detailed design of the Programme which was developed in consultation with the Approved Sellers on the Consultative Group on the Mortgage Insurance Programme and prospective mortgage reinsurers. The details are set out at Annex C. The core eligibility criteria for the Programme are as follows:

Eligibility Criteria for Mortgage Insurance Programme

Eligible mortgage originator	HKMC's Approved Sellers
Product type	Floating rate mortgages Fixed rate mortgages
Maximum loan size at origination	Floating Rate: HK$5 million Fixed Rate: HK$4 million
Owner occupancy	Annual Certification by the mortgagor
Maximum loan-to-value ratio at origination	85%
Maximum debt-to-income ratio at origination	50%

The Programme offers two premium payment methods to suit the different needs of home buyers:

a) Single Premium Payment
The premium will be paid in one lump sum to the HKMC at the time of the loan drawdown.

b) Annual Premium Payment
The first premium payment will be paid to the HKMC at the time of loan drawdown. The subsequent annual payments will be paid on each successive anniversary date of the loan drawdown by the Approved Sellers to the HKMC until the expiry or termination of the mortgage insurance.

The HKMC adopts prudent criteria in selecting the Approved Reinsurers that will provide the back-to-back reinsurance under the Programme. This is necessary to contain the risk of a double default by both the mortgagor and the mortgage reinsurer to an acceptable level. The core selection criteria are as follows:

a) financial strength: the Approved Reinsurer should have at least a double "A" rating in the case of an overseas incorporated insurance company, and a "A" category rating in the case of a locally incorporated insurance company, from a reputable rating agency acceptable to the HKMC.

b) relevant experience: the Approved Reinsurer should have relevant experience and expertise in underwriting insurance related to residential properties; and

c) commitment: the Approved Reinsurer should demonstrate a long term commitment to the business relationship with the HKMC.

Based on the selection criteria, the Board approved in principle in February 1999 the appointment of four Approved Reinsurers for the Mortgage Insurance Programme, including three international and one local insurance companies.

The HKMC has obtained authorization as an authorized insurer under the Insurance Companies Ordinance. The mortgage insurance business will be subject to the regulatory requirements of the Ordinance and the prudential supervision of the Insurance Authority.

To prepare for the launch of the Programme, the HKMC has conducted a series of briefing and training sessions for the Approved Sellers in mid-March 1999 to help them become familiar with the Mortgage Insurance Operational Manual and the related application/claim settlement procedures. Following the signing of the Master Mortgage Insurance Policy with the Approved Sellers and the Master Mortgage Reinsurance Policy with the Approved Reinsurers, the Mortgage Insurance Programme was formally launched on 31 March 1999.

CORPORATE GOVERNANCE

One of the top priorities for 1998 was to put in place the key internal control systems to ensure that all aspects of the Corporation's businesses adopt and comply with prudent risk management measures. These include the Audit Committee, the Asset and Liability Committee and the Credit Committee.

The Audit Committee

The primary function of the Audit Committee is to review the effectiveness of the Corporation's financial reporting process and internal control systems. The Committee reports directly to the Board. It is chaired by a non-executive Director (Mr. Eddy C. Fong) and members include 2 Executive Directors (Mr. Norman Chan and Mr. Andrew Sheng) and 2 non-executive Directors (Mr. Ronald Arculli and Mr. David Li). The Committee met twice in 1998 to review the financial statements of the Corporation and the findings of the audits conducted by the Internal Audit Department.

The Asset and Liability Committee

The Asset and Liability Committee manages the market risks (i.e. interest rate risk, foreign exchange risk and liquidity risk) that may arise from changes in the structure and components of the Corporation's assets and liabilities. The Committee is chaired by the Chief Executive Officer and its members consist of the Chief Operating Officer, Senior Vice President (Finance), senior staff of the Treasury Department and Financial Control Department. The Committee meets weekly to review market conditions, analyses the market risks of its assets and liabilities and decide on the funding strategy.

The Credit Committee

The Credit Committee is responsible for developing and overseeing the implementation of the HKMC's policies for managing the credit risk of its business. The major tasks of the Committee include approving applications to become Approved Seller/Servicers under the Mortgage Purchase Programme and Approved Reinsurers under the Mortgage Insurance Programme; setting limits for individual Approved Sellers and Approved Reinsurers and counterparty limits for treasury activities; and reviewing from time to time the mortgage purchasing criteria. The Committee is chaired by the Chief Executive Officer and its members consist of the Chief Operating Officer, Senior Vice President (Finance), General Counsel and senior staff of the Operations Division.

TRANSPARENCY

In accordance with best market practice, the HKMC has adopted a high level of transparency in conducting its business. A Bi-monthly Report was launched in December 1998 to keep the market regularly updated on the asset quality of the HKMC's mortgage portfolio and business developments. Senior executives also conduct regular media briefings on the Corporation's financial results and new business initiatives.

STAFFING

The HKMC is committed to building up a strong team of professionals with expertise in secondary mortgage business. The staffing policy of the Corporation is based on the following principles:

a) maintenance of a lean, efficient and professional work force. The size of the permanent establishment will be kept to the minimum necessary to support the HKMC's business plan;

b) continued reliance on automation and information technology solutions, as well as streamlining of work processes, to maximize efficiency and contain staff costs; and

c) maintenance of cost-to-income ratio at a level below the average for banks as the HKMC does not operate retail business.

In recognition of the rapid expansion of the Corporation's business, the Board has approved an increase in the permanent establishment from 60 to 71 staff for 1999. The 11 additional staff include 7 staff to support the expansion of existing activities and 4 staff to operate the new business activities.

Establishment of the HKMC

Chief Executive Officer	1
Chief Operating Officer	1
Senior Vice President/General Counsel	3
Vice President/Associate Vice President/Legal Counsel	11
Manager	11
Associate	23
Secretary/Assistant	21
Total	71

INFORMATION TECHNOLOGY

Various computer systems have been developed to automate the routine operations of the HKMC in order to enhance efficiency and to minimise operational risks. The HKMC's operations rely heavily on the integrity and accuracy of its computer systems. An external consultant was appointed to perform an independent review of HKMC's computer environment from July 1998 to September 1998. The audit has confirmed that the system has adequate operational controls and the business critical systems provide reliable and accurate information.

Y2K COMPLIANCE

The HKMC adopts a systematic and comprehensive approach in checking Y2K compliance.

Subject to minor adjustments and upgrades, most of the computer hardware, software and embedded systems have been certified by their suppliers, vendors and developers to be Year 2000 compliant. So far no non-compliance has been encountered in the verification tests. The whole process is scheduled to be completed by April 1999.

BUSINESS PLAN FOR 1999

Building on the solid foundation established in 1998, the HKMC aims to further expand the business activities under Phase I of its business plan (i.e. purchase mortgages funded by the issue of unsecured debt securities), implement the Mortgage Insurance Programme and explore the possibility of launching the Multi-currency MTN Programme and the mortgage-backed securitization Programme in 1999.

- Mortgage Purchase Programmes: with HK$2 billion paid-up capital, the HKMC can acquire up to HK$40 billion of mortgages based on the minimum Capital-to-Assets Ratio of 5%. There is ample headroom above the existing mortgage portfolio of HK$11.4 billion for further expansion. If market conditions permit, the HKMC plans to buy another HK$10 billion of mortgage loans in 1999.

- Hong Kong Dollar Bond Issuance Programmes: to fund the mortgage acquisition and to increase the depth of its debt issuance capability. The HKMC plans to issue about HK$5 billion of debts through the NIP and DIP in 1999.

- Mortgage Insurance Programme: the HKMC signed the Master Mortgage Insurance Policy with 26 Approved Sellers in March 1999 prior to the formal launch of the Programme. According to a survey conducted by the HKMC, the Approved Sellers expect 10% of the mortgages originated by them in 1999 would be covered by the mortgage insurance.

- Multi-currency Medium Term Notes Programme: the HKMC will consider launching the Programme to further widen the investor base of its debt securities to include overseas investors and raise the international profile of the Corporation.

- MBS Programme: if market conditions permit, the HKMC will also consider the feasibility of launching its MBS Programme. Over time, the Programme will help to promote the development of the secondary mortgage market in Hong Kong through standardisation of the structure and documents for mortgage-backed securities.

Financial Review

FINANCIAL PERFORMANCE

a) Profit and Loss Account

Summary of financial performance	1998 HK$'000	1997 HK$'000
Operating profit / (loss) before loan provisions	**145,614**	(20,252)
Profit / (loss) before taxation	**128,322**	(20,252)
Profit / (loss) attributable to shareholder	**106,398**	(20,252)
Return on average assets	**2.1%**	N/A
Return on average shareholder's equity	**7.9%**	N/A

The HKMC produced a higher than projected return in its first full year of operation. Profit attributable to shareholder for 1998 amounted to HK$106 million (1997: an operating loss of HK$20 million), which is more than 6 times the projected level of HK$17 million. The result included general provision for bad and doubtful loans for a sum of HK$17 million and taxation of HK$22 million.

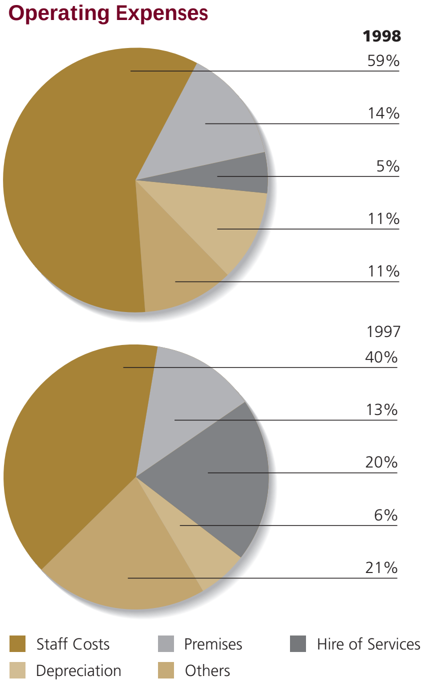
Net interest income	1998 HK$'000	1997 HK$'000
Interest income	**452,822**	18,354
Interest expense	**(231,594)**	–
Net interest income	**221,228**	18,354
Average interest-earning assets	**4,533,856**	240,159
Net interest margin	**4.9%**	7.6%
Return on interest earning assets	**10.0%**	7.6%
Funding costs on interest-bearing liabilities	**7.1%**	–
Net interest spread on interest-bearing liabilities	**2.9%**	7.6%
On a weighted-average basis:		
Net interest spread on interest-bearing liabilities	**2.1%**	N/A
Return on that portion of interest-earning assets funded by shareholder's equity	**2.8%**	N/A
Net interest margin	**4.9%**	N/A

Net interest income increased by HK$203 million to HK$221 million in 1998 mainly due to an increase in the mortgage portfolio from HK$654 million to HK$11,394 million during the year under review. On a weighted-average basis, the net interest margin was 4.9% p.a. in 1998 after accounting for the return of 2.8% p.a. on that portion of interest-earning assets funded by shareholder's equity.

Operating expenses	1998	1997
Cost-to-income ratio	33.9%	210.3%

Operating expenses increased by 93% to HK$75 million, reflecting a full year operation in 1998 as compared to the previous year. Staff costs accounted for 59% of the operating expenses in 1998. Staff costs rose by 186% to HK$44 million mainly due to an increase in headcount from 47 in 1997 to 59 in the year ended 31 December 1998. Costs in relation to premises increased by HK$6 million to HK$10 million. Depreciation charges on fixed assets grew from HK$2 million to HK$8 million. As a result of gradual establishment of the internal infrastructure within the HKMC, expenses in relation to hire of services were reduced from HK$8 million to HK$4 million.

Operating Expenses



Provisions for bad and doubtful loans

Mortgage portfolio and provisions	1998 HK$'000	1997 HK$'000
Gross mortgage portfolio	11,393,777	650,066
General provisions	(17,292)	–
Net mortgage portfolio	11,376,485	650,066
General provisions as a percentage of net mortgage portfolio	0.2%	–

General provisions for bad and doubtful loans were HK$17 million. No specific provision was made for the year ended 31 December 1998.

As at 31 December 1998, the ratio of general provisions to gross mortgage portfolio was 0.2%. There was no mortgage loan with delinquent payment over 90 days, reflecting the excellent quality of the HKMC's mortgage portfolio.

b) Balance Sheet

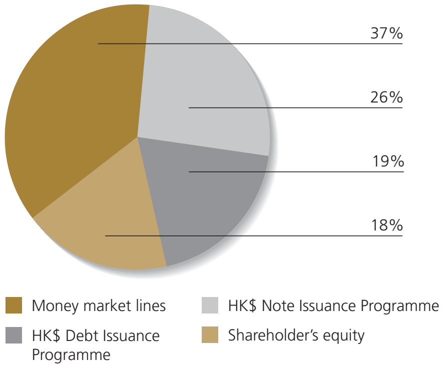
Total assets rose by HK$10,609 million to HK$11,593 million as at 31 December 1998. The net mortgage portfolio recorded a significant increase from HK$650 million to HK$11,376 million, accounting for 98% of total assets of the HKMC. The mortgage portfolio comprised 89.9% of floating rate mortgages and 10.1% of fixed rate mortgages. Cash and short-term funds were reduced from HK$308 million to HK$26 million as a result of purchasing mortgage loans from the Approved Sellers during the year. As a result of increased business activities, interest and remittance receivables increased from HK$5 million to HK$136 million for the year ended 31 December 1998.

The HKMC has been successful in tapping the local capital market by issuing fixed rate notes under the HK$ Note Issuance Programme (NIP) and the HK$ Debt Issuance Programme (DIP) for an aggregate of HK$5.2 billion as at 31 December 1998. Together with HK$4.2 billion funding from banks and HK$2 billion shareholder's equity, the HKMC secured sufficient funding resources to finance the purchase of mortgage loans from the Approved Sellers. As at 31 December 1998, the HKMC did not have any outstanding balance under the HK$10 billion Revolving Credit Facility.

Capital-to-assets ratio

The capital-to-assets ratio was 9.0% as at 31 December 1998 (1997: 99.6%). It was well above the minimum 5% ratio stipulated in the guidelines issued by the Financial Secretary of the Government of the Hong Kong Special Administrative Region.

Composition of external and internal funding mix as at 31 December 1998



LIQUIDITY MANAGEMENT

The HKMC adopts a balanced approach in its liquidity management by maintaining diversified liabilities to ensure that there is enough funds to meet all obligations in a timely and cost effective manner. The HKMC has established a cash flow management system to monitor and manage liquidity on a daily basis. Cash flow reports and projections are generated to analyse all the financial obligations over a specified future period of time. The Asset and Liability Committee (ALCO), chaired by the Chief Executive Officer, meets weekly to review the reports and formulate liquidity and risk management strategies in light of changing market conditions.

The HKMC has secured diversified sources of funding to support the future growth of its business:

a) HK$3 billion authorized capital, of which HK$2 billion has been paid up;

b) HK$ Note Issuance Programme and HK$ Debt Issuance Programme, with total programme size of HK$40 billion;

c) HK$10 billion Revolving Credit Facility, provided by the Exchange Fund on an evergreen basis; and

d) Money market lines, provided by local and international banks.

As of 31 December 1998, the HKMC issued a total HK$5.2 billion of debt securities under the two HK$ debt issuance programmes with maturity up to 3 years. Going forward, the HKMC's funding sources will be further strengthened by the launching of a Multi-currency Medium Term Note Programme and the issuing of mortgage- backed securities.

RISK MANAGEMENT

The HKMC's operation is subject to three major risks, namely interest rate risk, credit risk and operational risk. Effective management of these risks is important in maintaining a steady growth in earnings.

a) Interest Rate Risk Management

The HKMC's interest rate risk lies primarily in the mortgage asset and liability portfolios. Exposure to changes in interest rates such as Prime Rate and HIBOR is actively managed to contain the risk to a prudent level. The HKMC adopts two basic approaches in managing the interest rate risk: (a) to minimise the interest rate mismatch between the mortgages and the funding sources and (b) to assess the sensitivity of portfolio profitability and risk to changes in interest rates on an on-going basis.

The HKMC purchases two types of mortgages, namely, fixed rate mortgages and floating rate mortgages. The fixed rate mortgage offers an initial fixed rate for three years and the rate will be refixed at the prevailing rate for another three years or converted to floating rate at the mortgagor's option. To fund the fixed rate mortgage programme, the HKMC issues three-year fixed rate notes in order to close out the risk of interest rate mismatch. To fund the purchase of floating rate mortgages which are based on Prime Rate, the HKMC issues fixed rate notes and converts the fixed rate proceeds into floating rate funds, i.e. HIBOR based, by entering into interest rate swap transactions. The risk of interest rate mismatch is mitigated to a large extent by the matching of floating rate assets with floating rate liabilities. However, the basis risk between Prime Rate and HIBOR still exists. As in the case of authorized institutions, the HKMC cannot fully hedge the basis risk. This can be more effectively addressed if more mortgages are originated in HIBOR and when the Prime Rate/HIBOR basis swap market is well developed.

The HKMC also needs to manage the interest rate risk as measured by the duration gap arising from the temporary use of short term bank borrowing to finance the mortgage purchase before the issuance of securities. Based on analysis provided by the Treasury Department, the ALCO monitors and determines the mix of long term and short term funding with the aim of minimising funding cost under a prudent duration gap between its interest bearing assets and liabilities. In 1998, the average duration gap was kept within a very prudent range of plus and minus half a month, close to the risk free level of a zero duration gap.

b) Credit Risk

The HKMC needs to address the credit risks that may arise from default by mortgagors of the mortgages in its portfolio and by the counterparties of its treasury transactions. The HKMC adopts a four-pronged approach to address the credit risk of its mortgage portfolio focusing on careful selection of Approved Sellers, adopting prudent purchasing criteria, an effective due diligence process and the appropriate use of repurchase warranty to protect the Corporation against higher risk mortgages (see page 16).

The HKMC adopts a set of prudent criteria which takes into account relevant credit ratings in the selection of counterparties for its treasury activities and in setting limits for individual financial institutions. The framework and any significant modifications to it will require the approval of the Board of Directors. Issues relating to the operation of the risk management framework are regularly addressed by the ALCO and the Credit Committee.

c) Operational Risk

The HKMC has put in place internal control systems and processes to address the operational risk due to human errors, system failure, fraud and natural disaster. The HKMC has developed written internal control policies and procedures which clearly spell out each department's area of responsibilities and each officer's limit of authority. Most of the procedural steps have been automated to reduce the chances of committing human errors. The policy of segregation of duty is fully implemented to ensure adequate checks and balances. In the higher risk area such as the treasury function, market values are checked by the middle office on daily marked-to-market basis and transactions are double confirmed and settled with the counterparties by the Operations Department. The Internal Auditors review all the operational procedures, systems and make recommendations to the Chief Executive Officer on improvements, where appropriate. The findings of the internal audits are also reviewed by the Audit Committee, which is chaired by a Director and reports directly to the Board of Directors. To minimise the adverse impacts and interruptions to business due to system break down and natural disasters, back-up systems and a disaster recovery site have already been established off site.

Report of the Directors

The Directors are pleased to present their report of The Hong Kong Mortgage Corporation Limited (the "Company") together with the audited financial statements for the year ended 31 December 1998.

Principal Activities

The principal activities of the Company are (i) to purchase portfolios of mortgages or other loans, pursuant to predetermined prudent and stringent purchasing criteria, secured by residential properties situated in Hong Kong from institutions authorized under the Banking Ordinance of Hong Kong ("Authorized Institutions"); (ii) to raise financing for its purchase of mortgages through the issuance of debt securities in the capital markets; and (iii) to securitize mortgage portfolios by way of issuing mortgage-backed securities to investors.

Results and Appropriations

The results for the year ended 31 December 1998 are set out on page 33 of the financial statements.

The Directors do not recommend the payment of a final dividend, and recommend that the retained profit of HK$86,146,000 at 31 December 1998 be carried forward.

Fixed Assets

Details of the movement in fixed assets during the year are set out in Note 13 to the financial statements.

Share Capital

Details of the movement in share capital of the Company are set out in Note 17 to the financial statements.

Directors

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

Hon Tsang Yam Kuen, Donald, *Chairman*

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

Mr. Sheng Len Tao, *Executive Director*
(resigned with effect from 30 September 1998)

Mr. Chan Tak Lam, Norman, *Executive Director*

Hon Arculli, Ronald Joseph, *Director*

Mr. Au Mo Cheung, *Director*

Hon Chan Bernard Charnwut, *Director*
(appointed with effect from 1 January 1999)

Mr. Fong Ching, Eddy, *Director*

Mr. Hsiao Yao Hin, Tom, *Director*

Dr. Huang Chen Ya, *Director*

Mr. Hui Rafael Junior, *Director*

Mr. Lau Chi Kit, *Director*
(resigned with effect from 31 March 1998)

Dr. Hon Li Kwok Po, David, *Director*

Hon Ngan Kam Chuen, *Director*

Mr. Wong Shing Wah, Dominic, *Director*

Mr. Wong Tung Shun, Peter, *Director*
(appointed with effect from 31 March 1998)

Ms. Wu Hung Yuk, Anna, *Director*

In accordance with Article 109 of the Articles of Association, all those Directors who are not Executive Directors shall retire but shall be eligible for re-election.

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) Mr. Hsiao Yao Hin, Tom is a Director of Tokyo-Mitsubishi International (HK) Limited which entered into agreements with the Company as one of the Primary Dealers and Market Makers under the Debt Issuance Programme of the Company pursuant to the Distribution Agreement made between the Company and the Primary Dealers named therein dated 17 June 1998 and an appointment letter issued by the Company in favour of the Tokyo-Mitsubishi International (HK) Limited dated 17 June 1998;

2) Dr. Hon Li Kwok Po, David is a Director of The Bank of East Asia, Limited which is an approved Seller/Servicer of the Company in relation to the sale of mortgage loans by it to the Company;

3) Mr. Wong Tung Shun, Peter is a Director of Standard Chartered Bank which is also an approved Seller/Servicer of the Company in relation to the sale of mortgage loans by it to the Company; and

4) Hon Chan Bernard Charnwut is a Director of Asia Commercial Bank Limited which is also an approved Seller/Servicer of the Company in relation to the sale of mortgage loans by it to the Company.

In addition, Mr. Yam Chi Kwong, Joseph is the Monetary Authority appointed by the Financial Secretary under the Exchange Fund Ordinance, and Mr. Chan Tak Lam, Norman is his officer in his capacity as the Deputy Chief Executive of the Hong Kong Monetary Authority. Hence, Messrs. Yam Chi Kwong, Joseph and Chan Tak Lam, Norman are deemed to be interested in the transactions as stated in Note 20 entered into between the Company and the Hong Kong Monetary Authority.

Except for the above disclosure and Note 20, the Company has not entered into any contract, commitment or agreement with any other company in which any of the Company's Directors or members of its management has an interest, either directly or indirectly; nor has the Company made any arrangement to enable any of the Company's Directors or members of its management to obtain benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

Auditors

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

On behalf of the Board of Directors

Donald Tsang
Chairman

Hong Kong,
24 February 1999

Report of the Auditors

ARTHUR ANDERSEN

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 33 to 45, 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 judgements 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 1998 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.

Hong Kong,
24 February 1999

Profit and Loss Account

For the year ended 31 December 1998

	Notes	1998 HK$'000	From 3 March 1997 (the date of incorporation) to 31 December 1997 HK$'000
Interest income	2	**452,822**	18,354
Interest expense	3	**(231,594)**	–
Net interest income		**221,228**	18,354
Other expenses, net	4	**(940)**	(1)
Operating income		**220,288**	18,353
Operating expenses	5	**(74,674)**	(38,605)
Operating profit / (loss) before provisions		**145,614**	(20,252)
Provisions for bad and doubtful loans	6	**(17,292)**	–
Profit /(loss) before taxation		**128,322**	(20,252)
Taxation	7	**(21,924)**	–
Profit /(loss) after taxation		**106,398**	(20,252)
Accumulated loss brought forward		**(20,252)**	–
Retained profit / (accumulated loss) carried forward		**86,146**	(20,252)

Balance Sheet

As at 31 December 1998

	Notes	1998 HK$'000	1997 HK$'000
Assets			
Cash and short-term funds	8	**26,098**	307,502
Interest and remittance receivables	9	**135,878**	5,035
Prepayments, deposits and other assets	10	**4,859**	2,657
Deferred expense	11	**25,691**	–
Mortgage portfolio, net	12	**11,376,485**	650,066
Fixed assets	13	**23,851**	18,347
		11,592,862	983,607
Liabilities			
Short-term bank loans	18	**4,182,000**	–
Interest payable	14	**81,266**	–
Accounts payable, accrued expenses and other liabilities	15	**30,526**	3,859
Provisions for taxation	7	**21,924**	–
Long-term debt securities	16	**5,191,000**	–
		9,506,716	3,859
Shareholder's equity			
Share capital	17	**2,000,000**	1,000,000
Retained profit / (accumulated loss)		**86,146**	(20,252)
		2,086,146	979,748
		11,592,862	983,607

Approved by the Board of Directors on 24 February 1999 and signed on behalf of the Board by:

Directors:

Yam Chi Kwong, Joseph
Deputy Chairman

Chan Tak Lam, Norman
Executive Director

Cash Flow Statement

For the year ended 31 December 1998

	Notes	1998 HK$'000	From 3 March 1997 (the date of incorporation) to 31 December 1997 HK$'000
Net cash outflow from operating activities	19	**(10,614,757)**	(671,119)
Investing activities			
Purchase of fixed assets		**(13,956)**	(20,709)
Purchase of corporate club debentures		**–**	(670)
Net cash outflow from investing activities		**(13,956)**	(21,379)
Net cash outflow before financing		**(10,628,713)**	(692,498)
Financing			
Issue of ordinary share capital		**1,000,000**	1,000,000
Proceeds from issue of notes		**5,165,309**	–
Net cash inflow from financing		**6,165,309**	1,000,000
(Decrease) / increase in cash and cash equivalents		**(4,463,404)**	307,502
Beginning cash and cash equivalents		**307,502**	–
Ending cash and cash equivalents		**(4,155,902)**	307,502
Analysis of the balance of cash and cash equivalents			
Cash and short-term funds	8	**26,098**	307,502
Short-term bank loans	18	**(4,182,000)**	–
		(4,155,902)	307,502

1. Principal Accounting Policies

Basis of preparation

The financial statements have been prepared in accordance with the provisions of the Hong Kong Companies Ordinance and generally accepted accounting principles in Hong Kong.

a) Recognition of interest and fees

Interest income and expense are accrued on a time-apportioned basis on the principal outstanding and at the rate applicable, except in case of doubtful loans (Note 1(f)). Fee income and expenses are recognised when earned or incurred.

b) Fixed assets and depreciation

Fixed assets are stated at cost less accumulated depreciation.

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
Computers and related software	33-1/3%
Office equipment	33-1/3%
Motor vehicle	25%

c) 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.

d) 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 crystallise in the foreseeable future.

e) 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.

f) 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. 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 a mortgage loan, it will be written off at the discretion of the Credit Committee.

The accrual of interest on mortgage loans is discontinued when they become overdue for 90 days or more. Any previously accrued and uncollected interests on the loans are reversed against current period's interest income. Interest income on the overdue loans is only recognized when cash payment is received.

g) Notes issued under the HK$ Note Issuance Programme ("NIP") & HK$ Debt Issuance Programme ("DIP")

The notes issued under the NIP and DIP are stated at par value under long-term 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 Agent Fee paid under the NIP and DIP is amortized to the profit and loss account over the life of the notes issued.

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

h) Interest Rate Swap ("IRS") contracts for hedging purposes

Since the IRS contracts are solely used to hedge interest rate risk on the notes issued under the NIP and DIP, mark-to-market on the IRS contracts is not required for accounting purposes.

The net interest payable or receivable arising from the IRS contracts is recorded on an accrual basis and charged against the interest expense of the notes for the period.

Gains and losses on early termination of the IRS contracts are immediately recognized in the profit and loss account when the underlying debt is early redeemed.

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

2. Interest Income

	1998	From 3 March 1997 to 31 December 1997
	HK$'000	HK$'000
Mortgage portfolio	**427,214**	5,531
Cash and short-term funds	**25,608**	12,823
	452,822	18,354

3. Interest Expense

	1998 HK$'000	From 3 March 1997 to 31 December 1997 HK$'000
Short-term bank loans	109,804	–
Long-term debt securities	121,790	–
	231,594	–

4. Other Expenses, Net

	1998 HK$'000	From 3 March 1997 to 31 December 1997 HK$'000
Early prepayment fees and late charges	663	2
Issuance costs of long-term debt securities	(1,624)	–
Others	21	(3)
	(940)	(1)

5. Operating Expenses

	1998 HK$'000	From 3 March 1997 to 31 December 1997 HK$'000
Staff costs		
Salaries and benefits	43,938	15,365
Premises		
Rental	8,685	3,671
Others	1,705	1,201
Directors' emolument	–	–
Depreciation	8,452	2,362
Consultancy fee	3,518	7,670
Preliminary expenses	–	3,445
Auditors' remuneration	50	10
Other operating expenses	8,326	4,881
	74,674	38,605

6. Provisions for Bad and Doubtful Loans

	1998 HK$'000	From 3 March 1997 to 31 December 1997 HK$'000
General provisions against mortgage portfolio	17,292	–

7. Taxation

	1998 HK$'000	From 3 March 1997 to 31 December 1997 HK$'000
Hong Kong profits tax	**18,313**	–
Deferred taxation	**3,611**	–
	21,924	–

Hong Kong profits tax has been provided at the rate of 16% (1997: 16.5%) 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.

8. Cash and Short-term Funds

	1998 HK$'000	1997 HK$'000
Cash at banks	**224**	4,375
Time deposits with banks	**25,874**	303,127
	26,098	307,502

9. Interest and Remittance Receivables

	1998 HK$'000	1997 HK$'000
Interest receivable from mortgage portfolio	**42,758**	2,631
Interest receivable from interest rate swap contracts	**34,330**	–
Interest receivable from time deposits with banks	**39**	734
Loan instalments, in transit, from the Servicers	**58,751**	1,670
	135,878	5,035

10. Prepayments, Deposits, and Other Assets

	1998 HK$'000	1997 HK$'000
Office rental deposit	**2,239**	1,725
Corporate club debentures	**670**	670
Others	**1,950**	262
	4,859	2,657

11. Deferred Expense

	1998 HK$'000	1997 HK$'000
Discount on long-term debt securities	25,691	–

12. Mortgage Portfolio, Net

	1998 HK$'000	1997 HK$'000
Outstanding principal balance of mortgage portfolio	11,393,777	650,066
General provisions for bad and doubtful loans	(17,292)	–
	11,376,485	650,066

The mortgage portfolio has a weighted average remaining term of 16 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 2028.

13. Fixed Assets

	Leasehold improvements	Furniture and fixtures	Computer & related software	Office equipment	Motor vehicle	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Cost						
As at 1 January 1998	5,950	1,117	11,827	1,276	539	20,709
Additions	388	92	13,476	–	–	13,956
As at 31 December 1998	6,338	1,209	25,303	1,276	539	34,665
Accumulated depreciation						
As at 1 January 1998	969	157	962	207	67	2,362
Charge for the year	2,223	447	5,222	425	135	8,452
As at 31 December 1998	3,192	604	6,184	632	202	10,814
Net book value						
Ending balance as at 31 December 1998	3,146	605	19,119	644	337	23,851
Ending balance as at 31 December 1997	4,981	960	10,865	1,069	472	18,347

14. Interest Payable

	1998 HK$'000	1997 HK$'000
Short-term bank loans	16,219	–
Long-term debt securities	65,047	–
	81,266	–

15. Accounts Payable, Accrued Expenses and Other Liabilities

	1998 HK$'000	1997 HK$'000
Accounts payable and accrued expenses	28,334	3,859
Other provisions	2,192	–
	30,526	3,859

16. Long-term Debt Securities

	1998 HK$'000	1997 HK$'000
Fixed-rate notes issued under the		
– HK$ Note Issuance Programme	3,000,000	–
– HK$ Debt Issuance Programme	2,191,000	–
	5,191,000	–

17. Share Capital

	1998 HK$'000	1997 HK$'000
Authorized		
3,000,000,000 ordinary shares (1997: 1,000,000,000) of HK$1 each	3,000,000	1,000,000
Issued and fully paid		
2,000,000,000 ordinary shares (1997: 1,000,000,000) of HK$1 each	2,000,000	1,000,000

On 21 September 1998, the authorized share capital was increased from HK$1,000,000,000 to HK$3,000,000,000 by the creation of 2,000,000,000 ordinary shares of HK$1 each. On 22 September 1998, 1,000,000,000 ordinary shares were allotted at par for cash to the Financial Secretary of the Government of the Hong Kong Special Administrative Region as Controller of the Exchange Fund.

The Company intends to use the proceeds of the above funding for its general working capital or for any other purposes permitted by its memorandum and articles of association.

18. Maturity Profile for 1998

	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets					
– Mortgage portfolio	103,397	321,922	2,067,753	8,900,705	11,393,777
Liabilities					
– Short-term bank loans	4,182,000	–	–	–	4,182,000
– Long-term debt securities	–	–	5,191,000	–	5,191,000
	4,182,000	–	5,191,000	–	9,373,000

19. Notes to the Cash Flow Statement

Reconciliation of operating profit/(loss) to net cash outflow from operating activities:

	1998	From 3 March 1997 to 31 December 1997
	HK$'000	HK$'000
Operating profit/(loss)	128,322	(20,252)
Purchase of mortgage loans	(11,440,327)	(653,613)
Proceeds from mortgage principal repayment	696,616	3,547
Depreciation	8,452	2,362
Provisions for bad and doubtful loans	17,292	–
Increase in interest and remittance receivables	(130,843)	(5,035)
Increase in prepayments, deposits and other assets	(2,202)	(1,987)
Increase in accounts payable and accrued expenses	26,667	3,859
Increase in interest payable	81,266	–
Net cash outflow from operating activities	(10,614,757)	(671,119)

20. Related Party Transactions

On 6 January 1998, the Company executed a Programme, Agency and Operations Agreement with the Hong Kong Monetary Authority in its capacity as arranger, agent and operator in respect of a HK$20,000,000,000 Note Issuance Programme ("NIP"). Mr. Yam Chi Kwong, Joseph is the Monetary Authority appointed by the Financial Secretary under the Exchange Fund Ordinance and Mr. Chan Tak Lam, Norman is his officer in his capacity as the Deputy Chief Executive of the Hong Kong Monetary Authority. As at 31 December 1998, the outstanding balance of the notes under the NIP was HK$3,000,000,000.

On 27 January 1998, the Company obtained a revolving credit facility of HK$10,000,000,000 from the Exchange Fund through the Hong Kong Monetary Authority. During the year, the Company made a few drawdowns under the facility. As at 31 December 1998, there was no outstanding balance.

On 26 October 1998, the Company entered into a CMU Membership Agreement with the Hong Kong Monetary Authority through its Central Moneymarkets Unit ("CMU") in respect of a HK$20,000,000,000 Debt Issuance Programme ("DIP"). As at 31 December 1998, the outstanding balance of the notes under the DIP was HK$2,191,000,000.

Mr. Hsiao Yao Hin, Tom is a Director of Tokyo-Mitsubishi International (HK) Limited which entered into agreements with the Company as one of the Primary Dealers and Market Makers under the Debt Issuance Programme of the Company pursuant to the Distribution Agreement made between the Company and the Primary Dealers named therein dated 17 June 1998 and an appointment letter issued by the Company in favour of the Tokyo-Mitsubishi International (HK) Limited dated 17 June 1998.

Dr. Hon Li Kwok Po, David and Mr. Wong Tung Shun, Peter are the Directors of The Bank of East Asia, Limited and Standard Chartered Bank respectively. During the year, the Company purchased mortgage portfolios from the two banks which are the approved Seller/Servicers of the Company. The above purchases were conducted on an arm's length basis.

Mr. Chan Bernard Charnwut is a Director of Asia Commercial Bank Limited which is also an approved Seller/Servicer of the Company in relation to the sale of mortgage loans by it to the Company.

21. Commitments

	1998	1997
	HK$'000	HK$'000
a) Capital		
Authorized and contracted for	**415**	9,065
Authorized but not contracted for	**18,819**	12,835
	19,234	21,900

b) Operating Lease

Operating lease commitments at 31 December 1998 amounted to HK$62,464,000 (1997: HK$20,264,000) of which HK$10,356,000 is payable in the next twelve months. Such operating lease commitments at 31 December 1998 payable in the next twelve months, analysed according to the period in which the operating lease expires, are as follows:

	1998	1997
Land and buildings		
expiring in the first year	**327**	–
expiring in the second to fifth years	**–**	8,685
expiring after the fifth year	**10,029**	–
	10,356	8,685

22. Forward Commitment Facility

Under this facility, the Company has committed to purchase from the approved Seller/Servicers an agreed amount of eligible floating rate mortgages at a specified price within a specified period of up to twelve months. The pricing of the mortgages is based on two pricing approaches: stand-alone approach and bundle approach. As at 31 December 1998, the outstanding commitment amount to purchase floating rate mortgages was HK$8,526,206,000.

23. Fixed Rate Mortgage ("FARM") Regular Programme

The Company has engaged eight banks to provide an option to homebuyers for mortgage financing at a fixed rate under the FARM regular programme. As at 31 December 1998, the outstanding commitment amount to purchase FARM was HK$3,111,795,000.

24. Staff Retirement Benefit Scheme

The Company operates a defined contribution provident fund scheme (the "Scheme"). The benefits under the Scheme are paid on retirement or on leaving employment. Contributions to the Scheme applicable to each year are charged to the profit and loss account for the year. The assets of the Scheme are held separately from those of the company in independently administered funds. The contributions are made by the Company based on 5% of employees' monthly salaries. The employees of the Company also contribute another 5% of their monthly salaries to the Scheme.

25. Off-balance-sheet Exposures

Interest rate swap contracts are used solely for hedging the fixed rate notes issued under the NIP and DIP.

The outstanding contracted notional amount of the interest rate swap contracts at 31 December 1998 is as follows:

	1998	1997
	HK$'000	HK$'000
Interest rate swap contracts	**4,141,000**	–

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 counter-parties.

	1998		1997	
	Replacement cost	**Credit risk-weighted amount**	Replacement cost	Credit risk-weighted amount
	HK$'000	**HK$'000**	HK$'000	HK$'000
Interest rate swap contracts	**161,075**	**20,705**	–	–

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 26). The Company has not experienced any non-performance by its counter-parties.

26. 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. The minimum CAR stipulated in the guidelines is 5%.

As at 31 December 1998, the CAR was 9.0% (1997: 99.6%).

27. Comparative Figures

Certain comparative figures have been reclassified to conform to current year's presentation.

The Company has voluntarily adopted the "Best Practice Guide on Financial Disclosure by Authorized Institutions" issued by the Hong Kong Monetary Authority in 1998, with the exception that the corresponding amounts for the period ended 31 December 1997 have not been disclosed in respect of the maturity profile of major assets and liabilities.

28. Subsequent Events

On 15 January 1999, the Company executed a Tenancy Agreement on the existing office premises and additional office space at Gloucester Tower with the Landlord for a lease term up to 31 December 2004.

On 3 December 1998, the Board of Directors approved in principle a framework for the Company to provide mortgage insurance to the approved Seller/Servicers of the Company. On 15 January 1999, the Company submitted an application to the Insurance Authority for authorization as an authorized insurer under the Insurance Companies Ordinance. The mortgage insurance scheme is scheduled to be launched in the first quarter of 1999.

Calendar of Events

6 January 1998

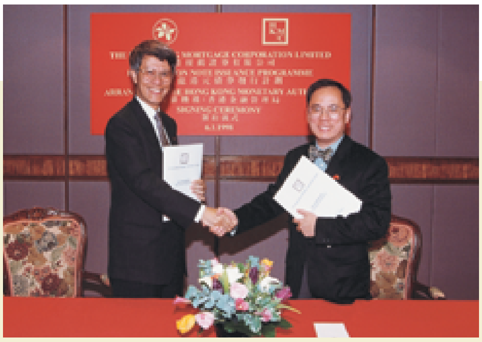
Established the HK$20 billion Note Issuance Programme with the Hong Kong Monetary Authority acting as Arranger, Agent and Operator

12 March 1998

Issued the HK$500 million inaugural issue under the Note Issuance Programme

31 March 1998

First Annual General Meeting was held



A HK$10 billion Revolving Credit & Facility was provided by the Exchanged Fund

27 January 1998

Established the Credit Committee

13 February 1998

Signing ceremony to launch Fixed Rate Mortgage Pilot Scheme with Chase Manhattan Bank and Dao Heng Bank

18 March 1998

Signing ceremony for the HK$20 billion Debt Issuance Programme

17 June 1998

18 June 1998

Launched Forward Commitment Facility with 17 Approved Sellers to purchase HK$14.8 billion eligible mortgages in the next 12 months

14 September 1998

Rolled the Fixed Rate Mortgage Pilot Scheme into a regular programme

Bank of East Asia

CHASE

CHEKIANG FIRST BANK LTD.

DaoHengBank

First Pacific Bank

HANG SENG BANK

HSBC

Standard Chartered

29 October 1998

Issued the HK$700 million inaugural issue under the Debt Issuance Programme

Established the Audit Committee

21 July 1998

Announced interim results with an unaudited operating profit before tax of HK$28.2 million for the six months ended 30 June 1998

14 September 1998

Approval granted by the Board of Directors to launch the Mortgage Insurance Programme

3 December 1998

Share capital increased to HK$2 billion

22 September 1998

Annex A

List of Approved Seller/Servicers

As at end March 1999

1 ABN AMRO Bank
2 American Express Bank
3 Asia Commercial Bank
4 Bank of America (Asia)
5 Bank of China
6 Bank of East Asia
7 Chase Manhattan Bank
8 Chekiang First Bank
9 Chiyu Banking Corporation
10 Citibank
11 CITIC Ka Wah Bank
12 Dah Sing Bank
13 Dao Heng Bank
14 First Pacific Bank
15 GE Capital Finance Limited
16 Generale Belgian Bank
17 Hang Seng Bank
18 Hang Seng Finance Limited
19 Hang Seng Credit Limited
20 Hua Chiao Commercial Bank
21 Hongkong Chinese Bank
22 HSBC
23 International Bank of Asia
24 Kincheng Banking Corp
25 Kwong On Bank
26 Liu Chong Hing Bank
27 Nanyang Commercial Bank
28 ORIX Asia Limited
29 Overseas Trust Bank
30 Shanghai Commercial Bank
31 Sin Hua Bank
32 SPC Credit Limited
33 Standard Chartered Bank
34 Union Bank of Hong Kong
35 United Chinese Bank
36 Wing Hang Bank
37 Wing Lung Bank
38 Yien Yieh Commercial Bank

Annex B

List of Primary Dealers and Selling Group Members of the HK$ Debt Issuance Programme

Primary Dealers

Dao Heng Bank Limited
HSBC Markets
Merrill Lynch Far East Limited
Tokyo-Mitsubishi International (HK) Limited
Union Bank of Switzerland, Hong Kong Branch

Selling Group Members

The Bank of East Asia, Limited
Chase Manhattan Asia Limited
Citicorp International Limited
Commonwealth Bank of Australia
Deutsche Morgan Grenfell Capital Markets Limited
Goldman Sachs (Asia) L.L.C.
Hang Seng Bank Limited
Jardine Fleming Bank Limited
J.P. Morgan Securities Asia Ltd.
Société Générale Asia Limited
Standard Chartered Bank, Hong Kong

Annex C

Technical Note on the Mortgage Insurance Programme

Framework

Under the Mortgage Insurance Programme the HKMC provides mortgage insurance to Approved Sellers for an amount up to 15% of the value of the property. The Programme allows banks to lend up to 85% of LTV ratio without taking on additional risk. Approved Sellers are required to obtain pre-approval from the HKMC on a loan-by-loan basis. These mortgages may be sold to the HKMC at the Approved Sellers' discretion subject to the mortgage purchasing criteria stipulated in the HKMC's Mortgage Sale & Purchase Manual. To hedge the risk, the HKMC will reinsure the exposure with Approved Reinsurers on a back-to-back basis.

Eligible Mortgage Originators

- All Approved Sellers of the HKMC.
- The HKMC will reserve the right to terminate the arrangement with individual Approved Sellers if their mortgage underwriting standards are considered not satisfactory after the launch of the Programme.

Eligible Mortgages

Mortgages that meet HKMC's eligibility criteria for:

- Floating Rate Mortgages; and
- Fixed Rate Mortgages (FARM).

Every mortgage applying for mortgage insurance under the Programme must meet the insurance eligibility criteria comprising:

1) Mortgage Conditions as set out in the Mortgage Insurance Operational Manual; and
2) Underwriting Criteria:

Eligible mortgage originator	HKMC's Approved Seller
Product type	Floating rate mortgages Fixed rate mortgages (FARM)
Maximum loan size at origination	Floating Rate: HK$5 million FARM: HK$4 million
Loan-to-value determination: • Maximum loan-to-value ratio (LTV) at origination • Valuation report	 85% (unless the financed premium may cause LTV to go slightly over 85%) Written valuation report prepared by internal valuers or qualified external surveyors.
Maximum debt-to-income ratio at origination	50%
Maximum original term to maturity	30 years
Minimum original term to maturity	10 years
Maximum sum of "remaining term to maturity" and "age of property" at origination and throughout the term of the mortgage	40 years
Owner occupancy	At least one of the mortgagor(s) must occupy the property as a primary residence
Legal charge	First fixed legal charge
Refinancing	Refinanced mortgages with no cash-out
Insurance required on property	Fire insurance

Coverage Amount

Eligible claims will cover any loss of principal above 70% property value at origination and a portion of accrued interest and repossession costs from the date of delinquency to the date of the claim settlement. The claim amount applicable to a defaulted mortgage loan is calculated in accordance with the following formula:

(Outstanding Principal Balance at time of claim - 70% x Property Value at origination) x 105%

Coverage Period

Insurance cover will take effect from the loan drawdown date of the insured mortgage provided that the premium is received by the HKMC on or before that date and will remain in force on the earliest happening of the following events:

1) full repayment of the mortgage loan;
2) the ratio of outstanding principal balance to property value at origination reaches 70% or below; or
3) the occurrence of other trigger events as stipulated in the Mortgage Insurance Operational Manual.

Insurance Premium

Premium rates vary in accordance with the mortgage type (e.g. floating rate or FARM), level of LTV (two tiers: 80% and 85%), loan tenor and payment method.

Premium Payment Options

Two payment options will be offered to the borrowers under the Programme:

1) Single Premium Payment
   The premium will be paid in one lump sum to the HKMC at the time of the loan drawdown.
2) Annual Premium Payment
   The first premium payment will be paid to the HKMC at the time of loan drawdown. The subsequent annual payments will be paid on each successive anniversary date of the loan drawdown by the Approved Sellers to the HKMC until the expiry or termination of the mortgage insurance.

Refund of Premium

Refund of premium is only allowable under the Single Premium Payment method and is subject to the following conditions:

1) The mortgage loan has not been delinquent for more than 60 days from the Instalment Due Date during the 12 months prior to borrowers' request for refund; and
2) No claim has been paid or to be paid in respect of the mortgage.

% of Premium Refundable	Time of Full Repayment of the Mortgage Loan
40%	Within the first year from the loan drawdown date
25%	Within the 13th month to 24th month from the loan drawdown date
15%	Within the 25th month to 36th month from the loan drawdown date
Nil	From the 37th month onward

Application

Approved Sellers will be required to seek the HKMC's approval for mortgage insurance on a loan-by-loan basis. The HKMC will review certain loan documentation and pre-approve each mortgage prior to granting mortgage insurance cover.

Claim

The HKMC will accept a claim from an Approved Seller within 40 days from the following dates whichever is the earliest.

1) peaceful possession of the property by the Approved Seller;
2) application to Court for an 'Order For Possession'; and
3) title to the relevant Property has been conveyed to a third party following a default, with the prior consent of the HKMC.

Owner Occupancy Requirement

The owner-occupancy requirement, which is important in ensuring a low default rate, will be strictly enforced. At least one of the mortgagors will be required to certify on an annual basis that he/she continues to occupy the property as his/her primary place of residence.

Treatment of Non-conforming Mortgages

The HKMC may take the following action(s) if a mortgage loan is found to be non-conforming with the HKMC's criteria for the mortgage insurance:

1) increase the insurance premium to reflect the higher risk; or
2) require the borrower through the lending bank to reduce the size of the mortgage and cancel the insurance.

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HKMC