Financial Review

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The global economy stayed benign in 2017 while the US economy expanded at a moderate pace. The ongoing economic recovery in the euro area has become more entrenched. Against these positive developments, the US Federal Reserve began trimming its balance sheet in October 2017, and the European Central Bank also announced it would reduce its monthly asset purchases from early 2018. The Mainland economy sustained its solid momentum and stable development.

In Hong Kong, the economy benefitted from a broad-based global economic upturn. The expansion in global demand boded well for Hong Kong's exports. Domestic demand also held up well, buttressed by sanguine consumption sentiment under the favourable employment and income conditions, as well as intensive building and construction activity.

Income Statement

Financial Performance

Against this backdrop, profit attributable to shareholders for 2017 was HK$806 million (2016: HK$604 million) **(Table 1)**. The increase in profitability was driven by an increase in other income which comprised mainly gains on disposal of investments as a result of portfolio rebalancing and the exchange gain from the revaluation of US dollar exposures in cash and debt investments. Accordingly, return on equity increased to 8.6% (2016: 6.8%) while cost-to-income ratio reduced to 26.8% (2016: 30.8%), notwithstanding the resources devoted to support policy initiatives. The capital adequacy ratio remained solid at 21.0% (2016: 21.3%), which was well above the minimum requirement of 8% stipulated by the Financial Secretary.

Table 1

Summary of financial performance	2017 HK$ million	2016 HK$ million
Operating profit before impairment	**829**	621
Profit before tax	**829**	622
Profit attributable to shareholders	**806**	604
Return on shareholders' equity	**8.6%**	6.8%
Return on assets	**1.6%**	1.1%
Cost-to-income ratio	**26.8%**	30.8%
Capital adequacy ratio	**21.0%**	21.3%

Net Interest Income

The net interest income for the year was HK$508 million (2016: HK$491 million). The increase was mainly due to cost-effective pre-funding, partially offset by the reduction of the average loan portfolio by HK$1.9 billion as a result of rundowns from loan repayment and prepayment. The net interest spread was maintained at 0.9%, while the net interest margin improved to 1.1% from 1.0% **(Table 2)**.

Table 2

Net Interest Income	2017 HK$ million	2016 HK$ million
Net interest income	**508**	491
Average interest-earning assets	**48,027**	49,281
Net interest margin	**1.1%**	1.0%
Net interest spread on interest-bearing liabilities[1]	**0.9%**	0.9%

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

Net Mortgage Insurance Premium Earned

New business underwritten under the MIP increased to HK$32.3 billion in 2017 from HK$24.6 billion in 2016. Net premium receipts, after reinsurance and discount to borrowers, increased by HK$55 million to HK$413 million in 2017. Meanwhile, net premium receipts were amortised and recognised as income in accordance with the unexpired risks. Taking into account upfront incentives to banks, and the provisions for outstanding claims of HK$1 million (2016: HK$3 million), the net premium earned was HK$196 million (2016: HK$190 million).

Other Income

Other income was HK$414 million (2016: HK$213 million). The major items included an exchange gain of HK$171 million (2016: an exchange loss of HK$21 million) arising mainly from the revaluation of US dollar exposures in cash and debt investments, net gains on disposal of investments of HK$164 million (2016: HK$160 million) as a result of investment portfolio rebalancing, and dividend income from investments of HK$83 million (2016: HK$83 million).

Operating Expenses

The Group continued to maintain stringent cost controls to contain expenses and improve operating efficiency. Operating expenses rose 9.7% year-on-year to HK$304 million, but this was HK$19 million less than the budget. Staff costs, which were contained at 64.5% of total operating expenses, amounted to HK$196 million (2016: HK$180 million). Premises rentals and related costs were contained at HK$39 million (2016: HK$37 million).

Allowance for Loan Impairment

Asset quality remained strong, with the delinquency ratio of the Group's mortgage portfolio staying low at 0.06% (2016: 0.03%). Taking into account the rundown in loan portfolio, and the low average current loan-to-value ratio of retained loan portfolio, a provision on collective assessment for loan impairment of HK$0.5 million was recorded in 2017 according to the approved prudent provisioning policy. During the year, loans written off were HK$2 million (2016: HK$1 million) with a recovery of HK$1 million (2016: HK$1 million).

Financial Position

Loan Portfolio

During the year, the Group purchased Hong Kong loan assets of about HK$0.3 billion (2016: HK$0.2 billion). After accounting for prepayments and repayments during the year, the outstanding balance of the loan portfolio recorded a rundown of HK$1.7 billion, leaving an outstanding balance of HK$7.8 billion.

Investment Securities

The Group adopts a prudent, low-risk approach in managing its surplus funds and investment activities in accordance with the investment guidelines approved by the Board. As at 31 December 2017, the total investment portfolio was HK$17.4 billion (2016: HK$16.9 billion), which included HK$10.3 billion of held-to-maturity investments and HK$7.1 billion of available-for-sale investments. There was no impairment loss from the investments.

Debt Securities Issued

In 2017, the Group issued HK$28.4 billion of debt securities under the MTN Programme. All the non-Hong Kong dollar debts issued under the MTN Programme were swapped into Hong Kong dollars or US dollars for hedging purposes. The Group continued to adopt a prudent pre-funding strategy, with the total outstanding balance of the debt securities maintained at HK$34.8 billion as at 31 December 2017 (2016: HK$34.2 billion).

Key Off-balance Sheet Exposure

Mortgage Insurance

The Group operates the MIP on a risk-sharing basis with approved reinsurers. At the end of 2017, the total risk-in-force was about HK$21.1 billion (2016: HK$16.8 billion), of which HK$3.5 billion (2016: HK$2.7 billion) was ceded to approved reinsurers. The off-balance sheet risk-in-force exposure borne by the Group increased to HK$17.6 billion (2016: HK$14.1 billion).

The provision for outstanding claims remained steady at 0.1% of the retained risk-in-force at year-end. The delinquency ratio remained healthy at 0.003% (2016: 0.01%).

Reverse Mortgage

The Group operates the RMP as an insurer to provide mortgage insurance cover for a premium on reverse mortgage loans advanced by participating banks in Hong Kong. After taking into account undrawn future payout of reverse mortgage loans, the risk-in-force exposure[1] borne by the Group increased to HK$6.9 billion (2016: HK$4.3 billion), with the corresponding outstanding loan balance of HK$1.1 billion as at 31 December 2017.

Dividend

Having considered the capital requirements for business development, no dividend was declared for 2017 (2016: Nil).

[1] The risk-in-force includes the outstanding balance and undrawn commitment of a reverse mortgage loan. Undrawn commitment refers to the amount of expected future payout to the borrower based on the payment term.

Events Occurring After The Reporting Period

The Group approved in June 2017 the plan for implementing the LAS in mid-2018. To comply with the relevant authorisation requirements, the Group has kick-started a corporate re-organisation and established two subsidiaries, HKMCI and HKMCA to apply for the necessary authorisation and respectively to take up the HKMC's general insurance business and to operate the LAS.

On 12 February 2018, the HKMC injected HK$2,999,999,900 to make up issued and paid-up capital of HK$3 billion of HKMCI without allotting and issuing new shares. On 14 February 2018, HKMCI was granted formal authorisation from the Insurance Authority to carry on general insurance business which will be transferred from the HKMC. After completion of the transfer, the HKMC will apply to the Insurance Authority for withdrawal of its authorisation to carry on general insurance business in or from Hong Kong.