Business Overview

Business Overview

Performance Highlights

The major achievements of the Corporation for the year included:

- Purchasing a total of HK$3.2 billion loan assets.

- Helping homebuyers borrow a total of HK$13.3 billion mortgage loans through the Mortgage Insurance Programme (**MIP**), representing a usage rate of 8.4% (in terms of the total drawdown amount under the MIP against the total market mortgage drawdown amount).

- Implementing the Use of Enduring Power of Attorney/ Court Order under Part II of the Mental Health Ordinance by borrowers under the Reverse Mortgage Programme (**RMP**). Since inception up to the end of 2013, the Corporation approved more than 530 applications, with an average property value of around HK$4.5 million.

- Approving a total of HK$28.1 million loans since inception up to the end of 2013 through the Microfinance Scheme (**MF Scheme**) to business starters and self-employed persons from different backgrounds and professions.

- Extending the application period for the 80% guarantee products under the SME Financing Guarantee Scheme (**SFGS**) for one year to 28 February 2014 and relaxed the treatment of applications involving related entities, which better meet the financing needs of local small and medium-sized enterprises (**SMEs**). More than 8,000 applications for a total loan amount of approximately HK$33.9 billion were approved under the 80% guarantee products under the SFGS since the product launch in May 2012.

- Issuing HK$10.2 billion of debt securities (with maturity of 1-year and above) in a cost-effective manner, promoting the local debt market development as one of the most active issuers in Hong Kong.

- Safeguarding excellent credit quality, with (over 90-day) delinquency ratios of 0.006% for the mortgage insurance portfolio, 9.52% for the SME guarantee portfolio (excluding the 80% guarantee products under the SFGS), 0.06% for the Hong Kong residential mortgage portfolio (industry average of 0.02%), 1.3% for microfinance loan portfolio and 0.05% across all asset classes as at 31 December 2013.

- Maintaining the HKMC's long-term foreign and local currency ratings of AAA and Aa1 by Standard & Poor's (**S&P**) and Moody's Investors Service, Inc. (**Moody's**) respectively.

The Corporation achieved solid financial position for 2013:

- Profit attributable to shareholders of HK$982 million.

- Net interest margin of 1.4%.

- Return on assets of 1.9%.

- Return on shareholders' equity of 10.4%.

- Cost-to-income ratio of 18.1%.

- Capital adequacy ratio of 21%, well above the minimum requirement of 8% stipulated by the Financial Secretary.

Market Overview

General Economic Conditions

The Hong Kong economy grew moderately in 2013, by 2.9% year-on-year in real terms, compared with 1.5% growth in 2012. The solid domestic demand provided impetus to the local economy. Private consumption rose moderately amid strong labour market conditions. The unemployment rate stayed at a low level of around 3.2%–3.5%.

Nevertheless, the sluggish global economic growth continued to weigh on the Hong Kong economy. The housing and labour markets in the US improved towards the end of the year while the euro area economy showed signs of mild recovery in the second half of 2013. However, the global economic recovery was impeded by the fiscal standoff in the US. Moreover, the US Federal Reserve's earlier signal in June to curb its pace of asset purchases elevated global financial volatility and caused capital outflows from some developing countries, notably Brazil, India and Indonesia. The financial market stabilised in the fourth quarter, and was supported by better-than-expected data releases from Mainland China. The tapering of asset purchases by the US Federal Reserve began in January 2014 and was calmly received by the market.

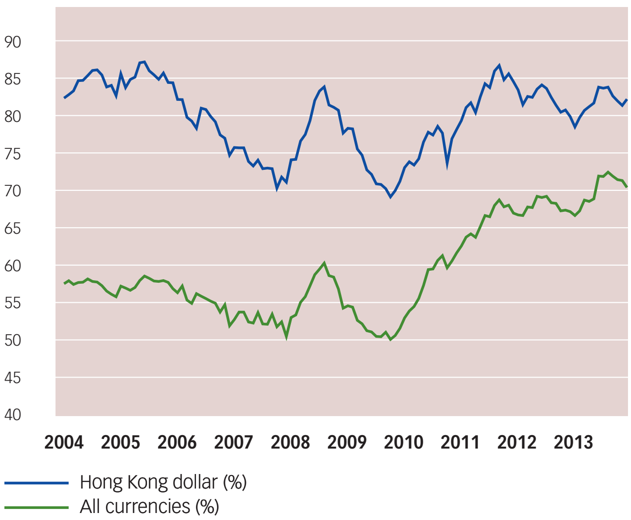
Liquidity and Interest-Rate Environment

Central banks across advanced economies continued to pursue monetary easing in an attempt to sustain the fragile economic recovery. In Japan, the Bank of Japan launched in April an aggressive reflationary policy plan which aimed to revitalise the economy. In Europe, the European Central Bank cut its refinancing rate to a historical low of 0.25% in November to combat rising deflation.

Though the US Federal Reserve maintained its easy monetary stance by keeping short-term interest rates low, it announced its intention in June to scale down its asset purchase plan. While the global financial conditions became volatile with the US Federal Reserve's asset tapering plan, the Hong Kong dollar exchange market continued to operate in an orderly manner. With limited capital outflow pressure, the liquidity in Hong Kong's banking sector remained healthy throughout 2013. Meanwhile, Mainland China-related demand for offshore lending in Hong Kong continued to stay high while deposit growth did not keep pace with loan growth. As a result, the Hong Kong dollar and the foreign currency loan-to-deposit ratio rose in 2013 **(Figure 1)**.

Figure 1

Loan-to-Deposit Ratio

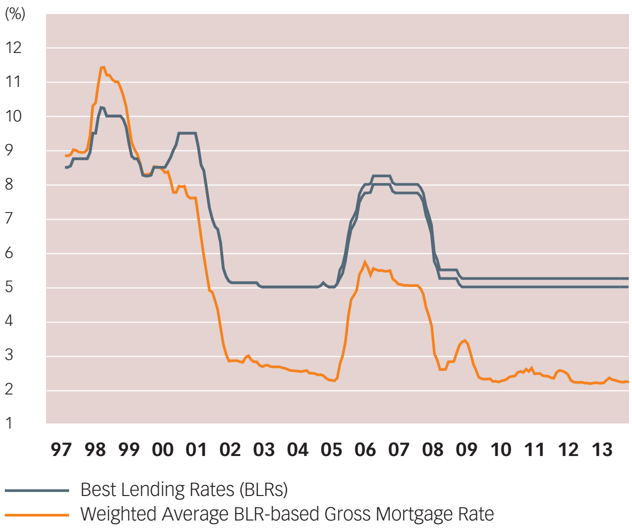


Source: HKMA

Impacted by the US Federal Reserve's gradual asset tapering plan, the global interest rate was trending up in 2013. Overall, the mortgage rate in Hong Kong remained low during the year. While the Best Lending Rates (**BLRs**) remained stable at 5% and 5.25% throughout the year, the Hong Kong Interbank Offered Rates (**HIBORs**) declined progressively, with the one-month HIBOR falling from 0.25% in January to 0.21% in December, in terms of the period average[1]. Although local major banks took the lead in March to raise mortgage rates by 0.25% in view of the increased cost of funding, they subsequently cut the mortgage rates back to the previous level as the competition for mortgage business was keen. As a result, the mortgage rates were little changed at the end of 2013 with BLR-based mortgage rates at about BLR-3.1% to BLR-1.85% and HIBOR-based mortgage rates at HIBOR+1.7% to HIBOR+3.15% **(Figure 2)**.

Figure 2

Best Lending Rates and Gross Mortgage Rate



Sources: HKMA, and HKMC estimates

[1] Source: HKMA Monthly Statistical Bulletin

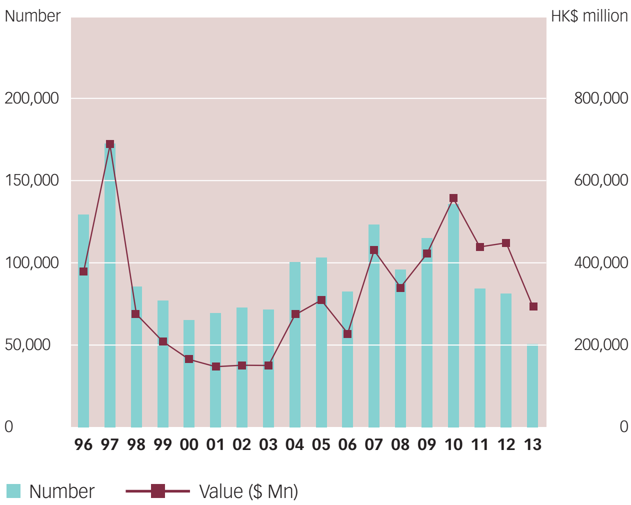
Property Market

With a series of government cooling measures remaining in force, the residential property market remained subdued with thin sales volume and slow price movement throughout 2013. The market began softening further in late February when the Government announced additional demand-side management measures by doubling the stamp duty on both residential and non-residential properties. Furthermore, the Residential Properties (First-hand Sales) Ordinance took effect in late April and led to a significant drop in primary market transactions. The residential property market showed signs of further softening after the US Federal Reserve announced the start of its asset purchase tapering in December.

Following the Government's introduction of another round of demand-side management measures in February, residential sales volume dropped significantly. In the fourth quarter, primary market turnover saw signs of picking up as a result of the developers' aggressive pricing packages and tax rebates for primary projects. However, secondary market activity was almost frozen as the primary market attracted most of the market attention. On the whole, property transactions in 2013 declined by 38% year-on-year to 50,676 while the total value of transactions fell by 34% **(Figure 3)**.

Figure 3

Agreements of Sale and Purchase of Residential Building Units

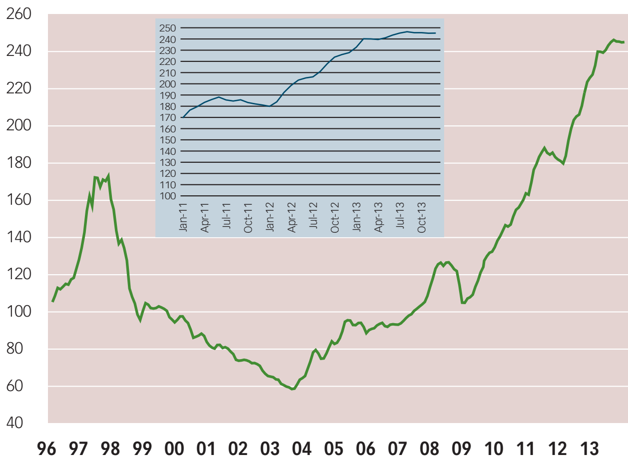


Source: Land Registry

The pace of growth in residential property prices showed visible moderation in 2013 along with subdued sales activities. The price surge decelerated from 3.2% in the first quarter to -0.1% in the fourth quarter. In general, residential property prices[2] recorded around 8% cumulative increase in 2013, compared with 26% increase in 2012. With the continued surge in prices in the past few years, residential property prices surpassed the 1997 peak by around 42% as at the end of 2013 **(Figure 4)**.

Figure 4

Private Domestic Price Index (1999 = 100)



Source: Rating and Valuation Department

Mortgage Market

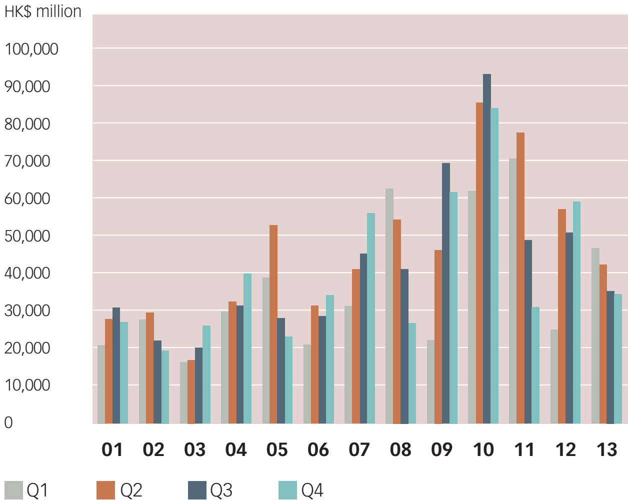
To strengthen the risk management of the banking sector's mortgage lending business, the Hong Kong Monetary Authority (**HKMA**) in February required banks to assume a higher mortgage rate increase for stress-testing the borrowers' repayment ability. The tightened lending criterion might further increase the down payment requirement of prospective buyers. In tandem with the reduction in residential property transactions, mortgage lending also declined in 2013, with the gross value of new loans drawn down[3] dropping by 17% year-on-year **(Figure 5)**. Along with the slower growth in new mortgage lending, the total outstanding value of all residential mortgage loans registered a moderate annual increase of 3.9% to HK$950.2 billion.

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

[3] Source: HKMA's Monthly Residential Mortgage Survey ("**The HKMA Survey**")

Figure 5

New Residential Mortgage Loans Drawn Down

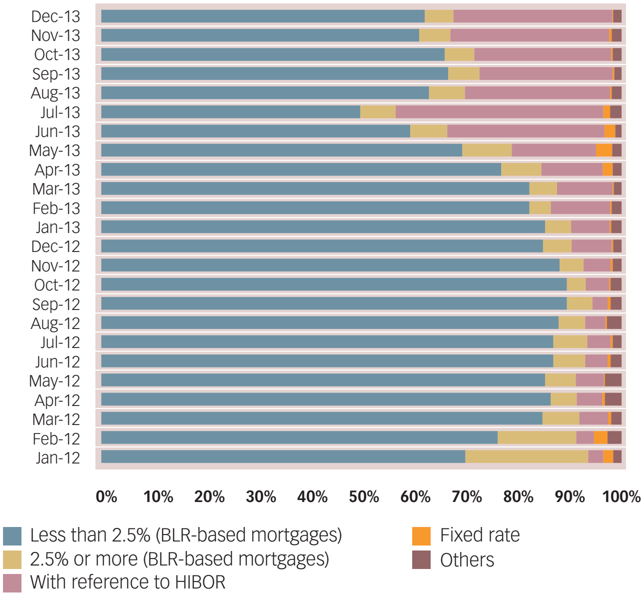


Source: HKMA

Although BLR-based mortgage plans remained the mainstream product in the mortgage market, the proportion of borrowers opting for HIBOR-based mortgage plans picked up during 2013 as banks reduced their HIBOR-based mortgage interest rates to compete for business. The proportion of new mortgage loans priced with reference to HIBOR rose to 30.5% in December from 7.7% a year earlier. The share of new BLR-based mortgages dropped to 67.7% from 90.4% during the same period, with the largest portion priced at a mortgage rate of 2% to below 2.25% **(Figure 6)**.

Figure 6

Pricing of New Residential Mortgage Loans Approved



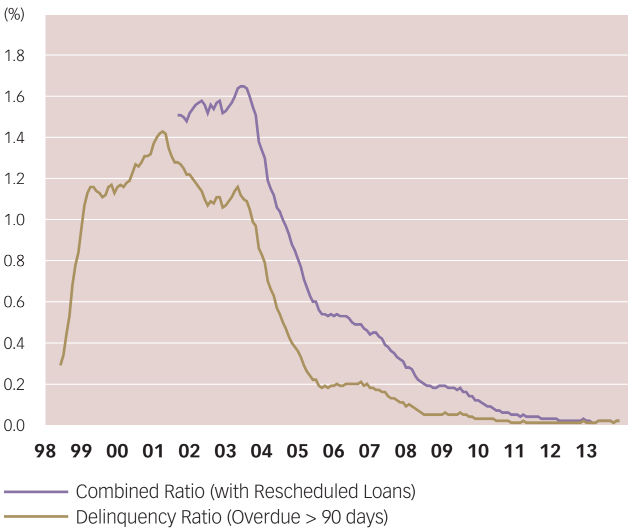
Source: HKMA

The concern that the US Federal Reserve might be curbing its pace of asset purchases triggered a rebound of market interest rates from the historical low level in the second quarter. To capture the potential market demand for fixed-rate mortgage products, banks and money lenders aggressively launched fixed-rate mortgages in the second quarter. In view of the earlier than expected timing of the US Federal Reserve's curbing of its asset purchases, competition in the fixed rate mortgage market subsided in the third quarter. The share of new fixed rate mortgages dropped to 0.2% in December after reaching the year high of 3.1% in May.

With the stable labour market and the HKMA's prudent supervision of the mortgage lending sector, the asset quality of residential mortgage loans remained excellent in 2013. The over-90-day delinquency ratio of mortgage loans[4] stayed at a historical low of 0.01%-0.02% for most of the year, reflecting the prudent underwriting standards adopted by the banks. The combined ratio, which takes into account both delinquent and rescheduled loans, also remained low at between 0.01% and 0.02% for most of 2013 **(Figure 7)**. Given high residential property prices, mortgage loans in negative equity remained at a low level of 26 cases at the end of December.

Figure 7

Delinquency Ratio of Residential Mortgage Loans



Source: HKMA

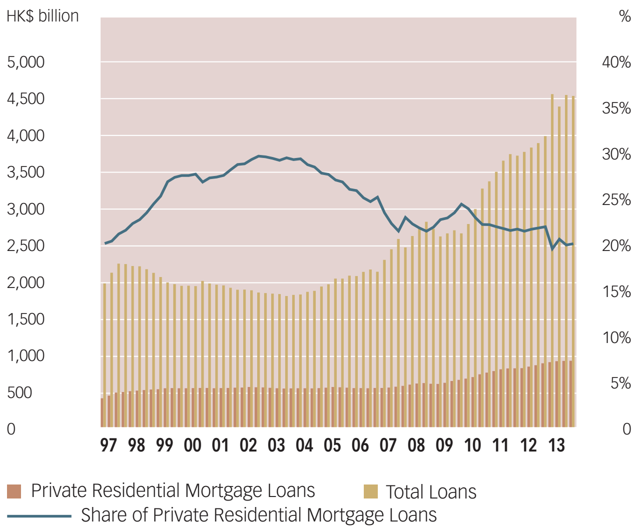
[4] Source: The HKMA Survey

Banking-Sector Exposure

The total outstanding value of mortgage loans for private residential properties increased to HK$908.7 billion at the end of 2013 (end-2012: HK$872.6 billion), accounting for more than one-fifth of total loans in Hong Kong **(Figure 8)**. Adding to this the lending for building and construction, along with property development and investment, the amount of property-related loans totalled HK$1,902 billion, representing about half the total loan book of banks. The outstanding value of mortgage loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme fell to HK$41.5 billion at the end of 2013 (end-2012: HK$41.9 billion).

Figure 8

Total Loans and Private Residential Mortgage Loans of All Authorized Institutions



Source: HKMA

Asset Acquisition

The Corporation strives to perform its ongoing role of maintaining banking and financial stability in Hong Kong. A number of banks expressed their interest in offloading assets to the Corporation for liquidity and balance sheet management in 2013. During the year, the Corporation successfully acquired a total of HK$3.2 billion of assets, which included residential mortgage loans and other assets.

Extension and Enhancement of the 80% guarantee products under the SME Financing Guarantee Scheme (80% SFGS)

The 80% SFGS was part of the package of support measures announced by the Financial Secretary in the 2012–2013 Budget Speech for SMEs to tide over the uncertain global economic environment and the possible financing difficulties as a result of credit crunch. Supported with the Government's total guarantee commitment of up to HK$100 billion, the 80% SFGS aims to offer guarantee protection on 80% of eligible loan facilities approved by participating lenders to encourage lending to SMEs for general working capital or acquiring equipment or assets to support business operations. The application period of the 80% SFGS expired on 28 February 2013.

In the face of persistently weak export markets and the challenging external economic environment, the Financial Secretary announced in the 2013–2014 Budget Speech to extend the 80% SFGS for one year from 1 March 2013. The Corporation charges at substantially lowered guarantee fee rate to reduce the financing burden of SMEs and administers the 80% SFGS on prudent commercial principles. The guarantee fees are set aside to pay default claims from participating lenders and out-of-pocket expenses to be incurred under the arrangement.

In response to the feedback from the market participants to better meet the financing needs of SMEs, the Corporation announced in March 2013 the relaxation of the treatment of applications involving related entities when assessing whether to consider separately the maximum facility amount of HK$12 million. Such relaxation further assists SMEs in obtaining financing in the commercial lending market.

The 80% SFGS has been well received by the market. A total of 30 Authorized Institutions (**AIs**) have joined the SFGS as participating lenders. As at 31 December 2013, the Corporation approved more than 8,000 applications for a total loan amount of approximately HK$33.9 billion under the 80% SFGS, benefiting over 5,500 local SMEs and more than 144,000 related employees.

To promote public awareness of the SFGS, in particular the 80% SFGS, the Corporation distributes information leaflets and provides continuing support in introducing the special measures at SME seminars arranged by lenders, industrial and trade organisations and government agencies on top of a series of advertising campaign rolled out by the Government.

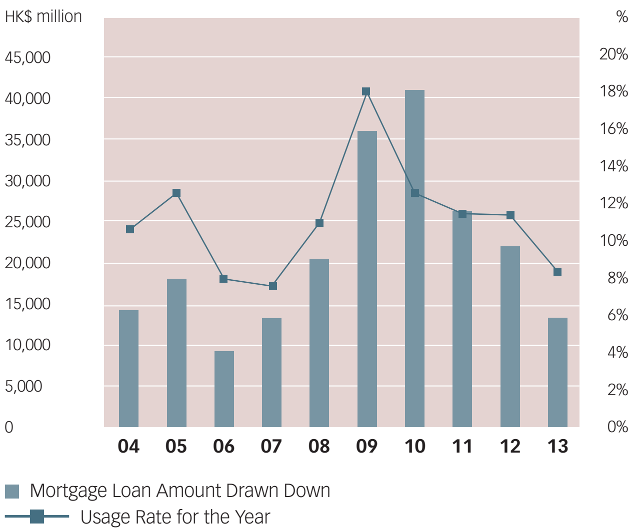
Mortgage Insurance

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

Since its inception in March 1999, the MIP has gained increasing public acceptance and has played a significant role in promoting home ownership in Hong Kong. Owing to slowdown of property market transactions and prudential measures on property and mortgage markets, the volume of loans drawn down under the MIP decreased to HK$13.3 billion in 2013 and the usage rate (in terms of the total drawdown amount under the MIP against the total market drawdown amount) stood at 8.4% **(Figure 9)**. It is notable that 84% of the MIP applications received were for secondary market properties, demonstrating that mortgage insurance has been crucial in assisting homebuyers in the secondary market.

Figure 9

Mortgage Loan Amount Drawn Down and Usage Rate* of MIP



Sources: HKMA and HKMC

$$\text{* Usage Rate} = \frac{\text{Total drawdown amount under the MIP}}{\text{Total market drawdown amount based on HKMA's Monthly Residential Mortgage Survey}}$$

Since 1999, the MIP has helped more than 107,000 families achieve the dream of home ownership, with aggregate loan drawdown of HK$245 billion.

Taking into consideration the market conditions and prudential approach to risk management on the exposure of high LTV mortgage lending, the Corporation tightened the eligibility criteria of the MIP in February 2013. After the revisions, only mortgage loan of properties with value at or below HK$4 million are eligible for the maximum LTV ratio of 90%. Properties with value above HK$4 million and below HK$4.5 million will be eligible for MIP cover up to HK$3.6 million, being 80% to 90% LTV, while properties with value at or above HK$4.5 million will only be eligible for the maximum LTV ratio of 80%. The cap on the value of properties under the MIP remains unchanged at HK$6 million. Owing to slowdown of property transactions and such tightening measures, the aggregate drawdown loan amount under the MIP decreased to HK$13.3 billion from HK$22 billion in 2012.

Reverse Mortgage Programme

The RMP has received good market reception since its launch in mid-2011, followed by the introduction of three enhancements in late 2012 which included: (1) lowering the minimum age of borrowers from 60 to 55, (2) increasing the maximum specified property value for payout calculation from HK$8 million to HK$15 million, and (3) increasing the maximum lump-sum payout amount. By the end of 2013, the Corporation had received over 6,000 public enquiries on reverse mortgage and approved more than 530 applications, with an average property value of around HK$4.5 million and an average monthly payout amount of HK$14,100. The average age of borrowers was 69 years old.

In 2013, the Corporation adopted a more focused strategy to promote better public awareness and understanding of the RMP. The Corporation has approached various target customer groups through a series of marketing initiatives including: advertising campaign using diverse media channels, joint promotion with banks, roving exhibition tour, education seminars with professional bodies, and public talks with non-governmental organisations (**NGOs**), retiree associations and residential clubhouses. Since the programme inception, a total of 77 talks and seminars have been organised, with attendance of more than 5,400 persons. In 2013, the Corporation held 26 public talks and seminars, and organised 3 training sessions for the frontline bank staff on the RMP. In November, the Corporation implemented an initiative of encouraging the use of Enduring Power of Attorney (**EPA**) by existing borrowers and new applicants under the RMP. A pamphlet introducing the EPA and related arrangements has been issued to raise public awareness.

To offer greater flexibility and benefits to both existing and prospective borrowers, the Corporation has been studying a new enhancement which allows a borrower to assign his/her life insurance policy to the bank as an additional security under the reverse mortgage, thereby obtaining a higher monthly payout and lump sum payouts during the payment term. This initiative will serve to provide an additional collateral buffer for improving the risk management position of the HKMC under the RMP.

Microfinance Scheme

The Corporation continued to run the MF Scheme for a trial period of three years with a tentative maximum loan amount of HK$100 million. The MF Scheme offers three categories of loans, namely Micro Business Start-up Loan, Self-employment Loan and Self-enhancement Loan. The target borrowers are business starters, self-employed persons and those wanting to achieve self-improvement through training, upgrading of skills or securing professional certification. Apart from extending loans, the MF Scheme also provides mentoring services, entrepreneurial training and ancillary support to the borrowers to improve their business viability.

The MF Scheme has operated smoothly since its launch in June 2012. By the end of 2013, the MF Scheme had approved a total of 106 loans with a total loan amount of HK$28.1 million.

The MF Scheme has a good mix of borrowers from different backgrounds and professions, such as young beauticians, fashion designers, IT graduates, middle-aged Chinese medicine practitioners, reinvigorated rehabilitated offenders and native English speaking foreigners, etc.

The Corporation launched a series of promotional activities including advertising campaigns, media interviews, exhibition, in-class introductory talks to students of different training courses and public seminars to raise public awareness and understanding of the MF Scheme. The Corporation also participated in trade exhibitions to promote the MF Scheme. The Corporation continued to work closely with the scheme participants to enhance the MF Scheme. Frequent and regular dialogue was maintained with banks and NGOs to improve the efficiency and effectiveness of the MF Scheme. In 2013, the Corporation held 21 sharing sessions and public seminars on the MF Scheme.

Joint Ventures Outside Hong Kong

The Corporation's Board gave approval in September 2012 for the Corporation to dispose of its stake in its overseas joint venture, Bauhinia HKMC Corporation Limited (**BHKMC**). The Corporation signed an agreement in 2013 with a buyer, which was an associated company of its joint venture partner Shenzhen Financial Electronic Settlement Centre to sell the Corporation's entire stake. The sale of the Corporation's stake in BHKMC was completed in January 2014.

Funding

The global financial markets remained volatile in 2013, as affected by the uneven economic recovery in the US and the still weak economy in Europe as well as the US Federal Reserve's decision to scale back its asset purchase programme. In spite of the challenging market conditions, the Corporation managed to secure prudent pre-funding to cater for loan purchases and refinancing activities. Given the Corporation's strong background as a wholly government-owned entity and its solid credit rating, the Corporation raised a total of HK$10.2 billion of debts (with maturity of 1-year and above) in 2013. At the end of 2013, the Corporation's total outstanding debt amounted to HK$31.4 billion.

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

The Corporation has three debt issuance programmes, which allow the issuance of debt securities in an efficient and effective manner. With its strong credit rating, the Corporation's debt issues are well received by the investment community, such as pension funds, insurance companies, investment funds, charities, government-related funds and retail investors. The Corporation undertakes proactive investor communications to meet and update investors regularly.

Medium Term Note Programme

The Corporation established the multi-currency Medium Term Note (**MTN**) Programme in June 2007 to broaden its investor base and funding sources in international market. It was set up with an initial programme size of US$3 billion, which was subsequently increased to US$6 billion in July 2011 to meet growing demand from overseas investors. The multi-currency feature of the programme enables the Corporation to issue notes in major currencies, including Hong Kong dollars, US dollars, renminbi, Australian dollars, euro and Japanese yen, to meet demand from both local and overseas investors. All foreign currency-denominated MTN debt is fully hedged into either US dollars or Hong Kong dollars. The programme incorporates flexible product features and offering mechanisms for both public issuances and private placements to increase its appeal to investors with different investment horizons and requirements. As at the end of 2013, an extensive dealer group comprising 10 major international and regional financial institutions had been appointed to support future MTN issuance and provide secondary market liquidity.

In 2013, the Corporation launched 16 MTN private debt issues, including debt denominated in Hong Kong dollars, US dollars, Australian dollars and British pounds, totalling an equivalent of HK$10.2 billion (with maturity of 1-year and above).

Debt Issuance Programme

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

Retail Bond Issuance Programme

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

To support the development of the retail bond market, the Corporation established the HK$20 Billion Retail Bond Issuance Programme and made its debut issuance in June 2004. Under this programme, placing banks use their retail branch networks, telephone and electronic banking facilities to place debt securities issued by the Corporation with retail investors. To ensure the liquidity of the aforementioned retail bonds, the placing banks are committed to making firm bid prices for the bonds in the secondary market. Since 2001, the Corporation has issued a total amount of HK$13.7 billion retail bonds. Over the years, the Corporation's retail bonds have gained widespread recognition as a safe and simple investment choice, with reasonably attractive returns, giving retail investors an opportunity to invest in high-grade debt securities issued by a wholly government-owned corporation. When the market environment is conducive, the Corporation aims to issue retail bonds regularly to provide an additional investment tool for Hong Kong's retail investors.

Revolving Credit Facility Provided by the Exchange Fund

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

The Corporation used the Revolving Credit Facility during times of market stress in 1998 and 2008 to partially fund the acquisition of Hong Kong residential mortgage assets from local banks. At both times, the Revolving Credit Facility was fully repaid by funds raised from the Corporation's cost-effective debt issuance when the markets stabilised. In 2013, there were no drawdowns under the Revolving Credit Facility.

Credit Rating

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

Credit Ratings of the HKMC

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

The credit rating agencies have made very positive comments on the Corporation's credit standing. The following comments are extracts from the credit rating reports of S&P and Moody's after their annual surveillance in May 2013:

S&P

"S&P equalises the ratings on HKMC with the rating on Hong Kong (Special Administrative Region). This reflects our expectation of an 'almost certain' likelihood of timely and sufficient extraordinary support from the Hong Kong government — the sole owner of HKMC — in events of financial distress… In our view, HKMC's undertaking of additional policy initiatives over the past three years has a mildly solidifying effect on HKMC's ties with the Hong Kong government, and reinforced its integral link with the government."

"Our view is based on the Corporation's prudent credit and market risk management, very good asset quality, and strong liquidity and capital profiles."

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

"In our view, risk associated with funding and liquidity are well managed... The Corporation also maintains significant levels of liquid assets in the form of marketable debt securities, cash and bank deposits, which provides a liquidity fallback."

Moody's

"HKMC is fully owned by the government, and carries out public policy functions in its daily operations. HKMC's policy mandates include enhancing financial and banking stability in Hong Kong, promoting home ownership, and facilitating the development of the local debt market. As part of its mandate to promote banking stability, HKMC acts as an alternative 'lender of last resort' by standing ready to purchase residential mortgages from Hong Kong banks during times of stress."

"The government provides HKMC with a HKD30 billion revolving credit facility, a paid-up capital of HKD2 billion, and HKD1 billion of capital callable on demand. In the event HKMC's credit profile is weakened in a stress scenario, we expect the government to provide timely extraordinary support."

"HKMC has maintained very sound asset quality metrics since its establishment… Hong Kong residential mortgages have historically performed very well through economic cycles. Even when property price fell by up to 70% between 1997 and 2003, overall mortgage delinquencies never exceeded 2%. Current average loan to value ratios on HKMC's Hong Kong mortgage portfolio is below 40%."

"As a wholesale funded entity with no customer deposits, HKMC relies on ongoing access to the debt capital markets to fund its operation. Nevertheless, the company executes prudent pre-funding and maintains a very strong liquidity profile during normal economic conditions. It has very good access to capital markets due to its strong financial fundamentals and government affiliation. HKMC has a HKD30 billion revolving credit facility from the government's Exchange Fund. The company has sufficient liquid assets and government revolving credit facility to repay all of its outstanding debts as of end-2012."

Mortgage-Backed Securitisation

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

The Corporation has issued a total of HK$13.2 billion MBS since 1999. The US$3 billion Bauhinia Mortgage-Backed

Securitisation Programme was established in 2001 to provide a convenient, flexible and cost-efficient platform for the Corporation to issue MBS with various product structures, credit enhancements and distribution methods.

Risk Management

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

Corporate Risk Management Committee

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

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

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

Credit Risk

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

(a) *Default risk*

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

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

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

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

The Corporation adopts a three-pronged approach to manage the default risk under the MF Scheme, which includes: (a) prudent assessment of borrowers' repayment capability; (b) a vetting panel to consider business viability and approval of the loan applications; and (c) provision of training and mentoring support to borrowers.

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

Stress tests are also conducted to analyse the Corporation's financial capability to weather extreme scenarios when they arise.

(b) Seller/Servicer counterparty risk

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

The Sellers/Servicers are subject to regular review, where their financial strengths, management capabilities, loan servicing quality and transaction experience are taken into consideration in the review.

(c) Reinsurer counterparty risk

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

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

(d) Treasury counterparty risk

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

(e) Lender risk

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

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

Credit Committee

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

Transaction Approval Committee

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

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

Market Risk

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

(a) *Interest rate risk*

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

The primary objective of interest rate risk management is therefore to limit the potential adverse effects of interest rate movements on interest income/expense, while maintaining stable earnings growth. The interest rate risk faced by the Corporation is two-fold, namely interest rate mismatch risk and basis risk. Interest rate mismatch risk is the most substantial risk affecting the Corporation's net interest income. It arises mainly as a result of the differences in the timing of interest rate re-pricing for the Corporation's interest-earning assets and interest-bearing liabilities. Interest rate mismatch risk is most evident in the loan portfolios where the majority of the loans earn a floating interest rate (benchmarked against the Prime rate, HIBOR or Composite Interest Rate), whilst the majority of the Corporation's liabilities are fixed-rate debt securities. The Corporation therefore makes prudent use of a range of financial instruments, such as interest rate swaps, interest rate swaptions, basis swaps, forward rate agreements and issuances of MBS, to manage interest rate mismatch risk. The proceeds of the fixed-rate debt securities are generally swapped into HIBOR-based funds via interest rate swaps in order to better match the floating-rate incomes from mortgage assets.

The Corporation also uses duration gap as an indicator to monitor, measure and manage interest rate mismatch risks. A duration gap measures the difference in interest rate re-pricing intervals between assets and liabilities. The wider the duration gap, the higher the interest rate mismatch risk. A positive duration gap means that the duration of assets is longer than that of the liabilities, and therefore, represents greater risk exposure to rising interest rates. A negative duration gap, in contrast, indicates greater risk exposure to declining interest rates.

Depending on the prevailing interest rate outlook and market conditions, the Corporation proactively re-balances the duration gap of its asset-liability portfolio under the guidance and supervision of the Asset and Liability Committee (**ALCO**).

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

(b) Asset-liability maturity mismatch risk

The actual average life of a portfolio of mortgage loans, which is usually shorter than the contractual maturity of the mortgage loans, depends on the speed of scheduled mortgage repayments and unscheduled prepayments. Higher prepayment rates shorten the average life of a portfolio of mortgage loans. In Hong Kong, prepayment occurs for two main reasons: (i) housing turnover — borrowers repaying their mortgage loans upon the sales of the underlying properties, and (ii) refinancing — borrowers refinancing their mortgage loans to obtain lower mortgage rates.

Asset-liability maturity mismatch risk can be more specifically characterised as reinvestment risk and refinancing risk. Reinvestment risk refers to the risk of a lower return from the reinvestment of proceeds that the Corporation receives from prepayments and repayments of its loan portfolio. Refinancing risk is the risk of refinancing liabilities at a higher level of interest rate or credit spread. The Corporation is exposed to refinancing risk (in both funding amount and cost of funds) when it uses short-term liabilities to finance long-term, floating-rate loan portfolios. Reinvestment risk is managed through the ongoing purchase of new loans to replenish the rundown in the retained portfolios and through the investment of surplus cash in debt securities or cash deposits to fine tune the average life of the overall assets pool. In addition, the Corporation makes use of the issuance of callable bonds and transferable loan certificates to mitigate reinvestment risk. The call option included in callable bonds and transferable loan certificates allows the Corporation to adjust the average life of its liabilities to match more closely that of the overall pool of assets.

The Corporation manages its refinancing risk through the flexible debt securities issuance with a broad spectrum of maturities. This again serves to adjust the average life of the overall liability portfolio in a dynamic fashion. In addition, refinancing risk can be mitigated by adjusting the maturities of assets in the investment portfolio or off-loading mortgage assets through securitisation of mortgage loans into MBS.

The Corporation uses asset-liability maturity gap ratio to measure, monitor and manage asset-liability maturity mismatch risk, to ensure a proper balance between the average life of the Corporation's assets and liabilities.

(c) Liquidity risk

Liquidity risk represents the risk of the Corporation not being able to repay its obligations, such as the redemption of maturing debt, or to fund the committed purchases of loan portfolios. The Corporation implements its liquidity risk management framework in response to changes in market conditions. The Corporation has continuously monitored the impact of recent market events on its liquidity positions, and has pursued a prudent pre-funding strategy which has helped to contain the impact the global financial turmoil had on its liquidity. Liquidity risk is managed by monitoring the daily inflow and outflow of funds, and by projecting the longer-term inflows and outflows of funds across the full maturity spectrum. The Corporation uses liquid asset ratio to measure, monitor and manage liquidity risk.

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

The Corporation manages pre-funding prudently through well-diversified funding sources, so that all foreseeable funding commitments are met when they fall due, in order to support the growth of its business and the maintenance of a well-balanced liability portfolio. Such diversification allows the Corporation to pursue a pre-funding strategy at the lowest possible cost, whilst at the same time offering safeguards against the inability to raise funds in distorted market conditions. The current funding sources are illustrated in Table 1 below:

Table 1: Current Funding Sources for the HKMC

Funding Source	Description
US$6 Billion Medium Term Note (MTN) Programme	There are 10 Dealers who underwrite and distribute local and foreign currency debt to international institutional investors under the programme
HK$40 Billion Debt Issuance Programme (DIP)	There are 6 Primary Dealers and 16 Selling Group Members which underwrite and distribute debt to institutional investors under the DIP. The Transferable Loan Certificate Sub-Programme under the DIP provides further diversification of its funding sources and broadening of its investor base
HK$20 Billion Retail Bond Issuance Programme	This debt issuance programme has 19 Placing Banks which assist in offering retail bonds to investors
US$3 Billion Bauhinia Mortgage-Backed Securitisation Programme	With a total of 8 Dealers, this multicurrency mortgage-backed securitisation programme permits the Corporation to originate MBS in both the local and international markets
Cash and Debt Investment Portfolio	This portfolio comprises mainly cash and bank deposits, commercial paper, high-quality certificates of deposit, and notes that are readily convertible into cash
Money Market Lines	The Corporation has procured money market lines from a large number of local and international banks for short-term financing
HK$30 Billion Revolving Credit Facility	The Exchange Fund commits to providing the Corporation with HK$30 billion in revolving credit

(d) *Currency risk*

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

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

Control mechanism

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

Asset and Liability Committee

The ALCO is responsible for the overall management of market risks of the Corporation. It follows the prudent risk management principles and the investment guidelines approved by the Board. It is responsible for reviewing and managing the market risk of interest rate risk, asset-liability maturity mismatch risk, currency risk, and liquidity and funding risk of the Corporation. Regular meetings are held to review the latest financial market developments and formulate relevant asset-liability management strategies for the Corporation.

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

Operational Risk

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

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

The Corporation actively manages operational risk with its comprehensive system of well-established internal controls, authentication structures and operational procedures. The operational infrastructure is well designed to support the launch of new products in different business areas. Rigorous reviews are conducted before the implementation of operational or system infrastructure in order to identify possible operational risks and to ensure adequate segregation of duties.

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

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

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

Business Continuity Plan

The Corporation's business recovery plan ensures that maximum possible service levels are maintained at all units to support business continuity and minimise the impact of business disruption from different disaster scenarios. Each business unit assesses the impact of disaster scenarios and updates recovery procedures from time to time. To ensure that business recovery procedures are practical, a business recovery drill is conducted annually. Daily back-ups and offsite storage of back-up tapes are in place to protect the Corporation from IT disasters.

Product Sign-off Mechanism

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

Complaint Handling Mechanism

The Corporation makes continuous effort to improve its core processes to ensure that its products and services meet customers' expectations. To make sure customers' feedback is attended to in a timely and appropriate manner, the Corporation has put in place a formal complaint handling mechanism to improve the tracking, reporting and handling of complaints.

Operational Risk Committee

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

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

Legal Risk

Legal risk arises from uncertainty in the application or interpretation of laws, regulations or legal documents, or failure to comply with statutory, regulatory or legal obligations. Legal risk also arises from any unenforceability of or ineffectiveness of legal documents in safeguarding the interests of the Corporation.

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

In view of the increasing complexity of the Corporation's products and developments in the external regulatory environment, Management decided, in 2013, to establish a dedicated Compliance Function within the Legal Office for the better management of the legal, regulatory and compliance risks. The Compliance Function within the Legal Office had undertaken preparatory and planning work for the roll-out of its support services over the course of 2014 and 2015. For a more detailed description of the Compliance Function and its work, please refer to the Internal Control section of the Corporate Governance Report.

The ORC is the governance committee for legal risks.

Leveraging Risk

In order to ensure that the Corporation would not incur excessive risk when expanding its business and balance sheet in relation to its own capital base, the Financial Secretary, in his capacity as Financial Secretary and not the shareholder, acted as the regulator of the Corporation, by issuing a set of guidelines on capital-to-assets ratio for compliance by the Corporation upon the establishment of the Corporation in 1997. The guidelines have since been updated from time to time to take account of new products launched by the Corporation. The Financial Secretary issued in October 2011 a new set of guidelines by reference principally to the Basel II risk-based capital adequacy framework, the Guidelines on Capital Adequacy Ratio (**CAR**), which took effect on 31 December 2011. The minimum CAR stipulated in the new Guidelines is 8%, which is the same minimum capital requirement under the Basel II. As at 31 December 2013, the Corporation's CAR was 21%.

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

Longevity Risk

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

Annual risk analysis is conducted in order to assess the potential financial impact of longevity risk for reverse mortgage loans, as well as the interaction among the various risk factors under the RMP. The mortality assumptions are reviewed on a regular basis by the Transaction Approval Committee.

Property Risk

Property risk arises from the fluctuation in the value of property which acts as collateral for the Corporation's loan and guarantee portfolios under the MPP, MIP and RMP. The Corporation manages the risk by setting prudent assumption in the recoverable value of the collateralized property, restricting maximum LTV ratios of the loans under the programmes and conducting stress test to examine the impact under adverse market scenarios.

Process Management and Information Technology

Since its inception, the Corporation has devoted substantial resources and effort to continuously improve its business operations, to strengthen its internal controls and to enhance its application systems. The past year is no exception.

In 2013, by leveraging the advances in information technology and keeping abreast of times, the Corporation upgraded its information system infrastructure including the implementation of new computer room to cope with the business growth and to equip staff with the tools to embrace the opportunities ahead. Infrastructural improvements benefited the public as well. The Corporation has joined the Government's Web Accessibility Campaign to ensure our public website complies with the Web

Content Accessibility Guidelines (**WCAG**) 2.0. This ensures that the Corporation's public information is accessible to people from all walks of life, including those with disabilities such as blindness and deafness. The project is scheduled for completion in early 2014.

Apart from IT infrastructure upgrade, the Corporation continued to improve process automation, data integrity, system resilience and information security through systems development and enhancements to support various corporate and business initiatives, e.g. the SFGS, the RMP, the MF Scheme, the MIP, and the treasury operations. Such steps are vital in ensuring efficiency, accuracy and robustness in business operations that translate into better services to the community. In addition, our system enhancements and process re-engineering measures also aim to achieve paperless operations that help contribute to a better and greener environment.

Corporate Social Responsibility

In recognition of the Corporation's contribution to the community and its commitment to corporate social responsibility (**CSR**) in the past years, the Corporation has been awarded the Caring Organisation Logo by the Hong Kong Council of Social Service since 2008 and has now stepped into the sixth year of CSR participation.

Caring Company Recognition Ceremony

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

Care for Employees

Staffing and Remuneration

The Corporation attracts and grooms talent to ensure the efficient performance of its core mission of enhancing stability in the banking sector, promoting wider home ownership and facilitating the development of the debt securities market. Employees are provided with competitive remuneration packages and fringe benefits, a promising career path and development opportunities, and a healthy and safe working environment. The Corporation has also adopted family-friendly practices by offering a five-day week to help employees maintain a good work-life balance, as well as comprehensive medical and dental insurance plans which cover both the employees and their family members.

Through systems automation and process re-engineering, the Corporation has maintained a lean and efficient workforce, despite an increase in the scope of operations and the complexity of the products it offers. In 2013, the permanent staff establishment of the Corporation was 178, and the staff turnover rate was 10.64%.

Training and Development

The Corporation recognises the importance of ongoing training and has devoted considerable resources to the continuous enhancement of its employees' professional knowledge and skills. In 2013, the Corporation arranged different programmes and workshops to help employees enhance their product knowledge, and strengthen their managerial and technical competence and soft skills.

The in-house training workshops covered a wide range of topics such as effective communication, risk management, complaint handling and business writing. During the year, seminars on Competition Ordinance, Prevention of Bribery Ordinance, and Equal Opportunities Legislation were also held. IT workshops were organised on software applications.

Effective Communication training

Training on the New Companies Ordinance

Training on the Prevention of Bribery Ordinance

Equal Opportunities Legislation and its application in the Workplace

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

In addition, all new employees were provided with an induction session to provide them with a foundation of knowledge about the Corporation's organisation structure, functions and policies.

Health and Safety

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

The Corporation has from time to time reviewed and strengthened its contingency plans which aim to minimise any unexpected or sudden disruption to business operations, such as from an outbreak of communicable disease among employees. Periodic drills are organised to make sure employees are conversant with the activation of the back-up facilities, contingency plans and communication arrangements in case of emergency.

Employee Relations and Staff Activities

To promote a healthy work-life balance and foster a family-friendly working environment, the HKMC Staff Club regularly organises staff activities to cultivate better relationships and communication among employees. In 2013, these activities included hiking, interest classes, Work-Life Balance Week, outings and other staff gatherings, all of which were well received by employees and their families. Our employees also participated in Hong Kong Monetary Authority House Competition for fun and team building. The e-newsletter "Mind Channel" regularly disseminates short stories, epigrams and health tips to all employees to create and maintain an optimum work-life balance and fulfilment. The in-house staff publication "HKMConnection" recaps snapshots of the HKMC staff activities.

Hiking on the Dragon Back Trail

Work-life Balance Week

Eco Tour to Hong Kong Global Geopark of China

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

Care for the Community

Charities and Social Activities

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

In 2013, the Corporation organised donation campaigns, such as Dress Casual Day 2013 for the Community Chest, and held its annual Blood Donation Day event for the Hong Kong Red Cross.

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

- Care for the environment — a recycling campaign in partnership with the Salvation Army to collect books, stationery, toys, etc.

- Care for the elderly — organised by the Mongkok Kai Fong Association Ltd — Chan Hing Social Service Centre and HOPE Worldwide respectively, involving our volunteers visiting Ngong Ping 360 with elderly people, visiting the homes of elderly people living alone and bringing them "lucky bags" with daily necessities to welcome the Chinese New Year and Mid-Autumn Festival.

Dress Casual Day

Blood Donation

Outing to Ngong Ping 360 with the elderly

Home visit to elderly living alone before Mid-Autumn Festival

Seniors Day 2013

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

In 2011, the Corporation launched the Executive Trainee Programme with the objective of attracting young executives with good potential to meet the Corporation's operational needs and long-term staff development plan. Throughout the two-year programme, the Executive Trainees have the opportunity to undergo job rotations and attend structured learning and development programmes from time to time. The first batch of Trainees completed their two-year programme in August 2013 and joined the Corporation's treasury and risk management functions for further career development.

Environmental Protection

The Corporation continuously supports and implements various green measures to create a more environmentally friendly office and raise employees' awareness of methods of waste reduction and energy conservation. In 2013, the Corporation continued a Green Office Campaign during which useful green tips were shared among employees. Employees are encouraged to adopt paperless working practices by using more electronic communication. They are also encouraged to collect waste paper and used toner cartridges for recycling. Since 2006, the Corporation has taken various measures, including better control of office temperature, in the interest of energy efficiency. The Corporation welcomes suggestions from employees on green office ideas and encourages its suppliers to use and offer more environmentally friendly products whenever possible.