Financial Review

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The global economy encountered a synchronised slowdown in 2019 due to a broad-based deterioration of global trade, investment, manufacturing activities and even consumption, amidst uncertainties arising from US-China trade tensions, Brexit process and other geopolitical events. Most central banks have taken steps to reverse the tightening or normalisation stance towards monetary easing. In Mainland China, economic growth softened notably from 2018 despite remaining largely resilient.

Hong Kong's economic growth contracted by 2.9% year-on-year in the third quarterly of 2019, representing an abrupt deterioration from its mild growth of 0.5% in the first half of the year. The local social incidents took a heavy toll on the consumption- and tourism-related sectors, dealing a very severe blow to an economy already weakened by a synchronised global economic slowdown and escalated US-China trade tensions. External demand registered an enlarged decline in the third quarter, while domestic demand also worsened significantly. The unemployment rate edged up to 3.3% in the fourth quarter as the labour market eased along with the worsening economic conditions.

Income Statement

Financial Performance

Profit attributable to shareholder increased to HK$317 million (2018: HK$127 million) (**Table 1**). The increase in profitability was primarily attributable to the decrease in accounting loss as a result of the decrease in provisions for maintaining prudent statutory reserves based on actuarial assumptions for the Group's annuity business along with lower business intake during the year and the increase in investment return on the placements with the Exchange Fund. Notwithstanding that, the increase in profit was partly offset by additional resources utilised for the Group's missions and certain policy initiatives of the HKSAR Government. Accordingly, return on equity was 2.1% (2018: 0.9%) while cost-to-income ratio decreased to 58.7% (2018: 86.0%). Despite the reported accounting loss of annuity business, the embedded value of the annuity business was about HK$5.3 billion, indicating that the business should be profitable in the long term.

The capital adequacy ratio stood solid at 30.2% (2018: 26.8%) so as to preserve capital for business development. The respective solvency ratios of the Group's two insurance subsidiaries were about 39 times (2018: 42 times) for general insurance business and 22 times (2018: 34 times) for annuity business, each well above the relevant minimum regulatory requirements.

Table 1

Summary of financial performance	2019 HK$ million	2018 HK$ million
Operating profit before impairment	**337**	67
Profit before tax	**337**	67
Profit attributable to shareholder	**317**[1]	127[1]
Return on shareholder's equity	**2.1%**[1]	0.9%[1]
Cost-to-income ratio	**58.7%**[1]	86.0%[1]
Capital adequacy ratio	**30.2%**	26.8%

[1] After excluding an accounting loss for maintaining prudent statutory reserves based on actuarial assumptions for annuity business made by the HKMC Annuity Limited, a wholly-owned subsidiary of the HKMC, the adjusted attributable profit to shareholder, return on shareholder's equity and cost-to-income ratio for 2019 would be HK$443 million, 4.2% and 41.8% respectively (2018: HK$515 million, 5.1% and 36.7% respectively).

Net Interest Income

The HKMC Group earned a net interest income of HK$524 million, HK$12 million lower than that for 2018. The decrease was mainly due to the reduction of average mortgage loan portfolio as a result of loan repayment and prepayment, partially cushioned by the purchase of infrastructure loans during the year and increase in other average interest-earning assets (i.e., cash and debt investments). The net interest margin was maintained at 1.0% (**Table 2**).

Table 2

Net Interest Income	2019 HK$ million	2018 HK$ million
Net interest income	**524**	536
Average interest-earning assets	**53,839**	50,972
Net interest margin	**1.0%**	1.1%

Net Mortgage Insurance Premium Earned

New business underwritten under the MIP increased slightly to HK$33.3 billion in 2019 from HK$32.5 billion in 2018. The net premium receipts (after discount to customers) were amortised and recognised as income in accordance with the unexpired risks. Taking into account upfront incentives to banks, and claims incurred and provision of around HK$3 million (2018: HK$4 million), the net premium earned was HK$196 million (2018: HK$222 million).

Net Insurance-related Results for Annuity Business

Net insurance-related results for annuity business (i.e., the sum of net premiums earned, net claims incurred, benefits paid, movement in policyholders' liabilities, and commission and levy expenses) recorded a reduced loss of HK$387 million (2018: HK$550 million) amid the lower new business intake during the year. The accounting loss was mainly due to the prudent statutory reserving based on actuarial assumptions, whereas the investment returns on capital and premiums placed with the Exchange Fund were grouped under other income.

Other Income

Other income was HK$465 million (2018: HK$250 million), mainly representing investment income of HK$465 million (2018: HK$185 million) from placements with the Exchange Fund, net gain of HK$33 million (2018: net loss of HK$14 million) on investments at fair value through profit or loss, dividend income of HK$20 million (2018: HK$59 million) from investments, and exchange loss of HK$38 million (2018: gain of HK$12 million) arising primarily from US dollar exposures in cash and debt investments.

Operating Expenses

The Group continues to maintain stringent cost controls to contain expenses and improve operating efficiency. Amid the increase in resources utilised for supporting the Group's core missions and certain policy initiatives of the HKSAR Government, operating expenses rose to HK$480 million (2018: HK$412 million), less than budget. Staff costs, which were contained at 61.7% of total operating expenses, amounted to HK$296 million (2018: HK$258 million).

Allowance for Loan Impairment

Asset quality remained strong, with the delinquency ratio of the Group's mortgage portfolio staying low at 0.02% (2018: 0.02%). Taking into account the purchase of infrastructure loans generally at high credit quality of about HK$1.9 billion during the year, a provision on loan impairment allowance of HK$0.9 million was recorded in 2019 (2018: HK$0.02 million), in accordance with the approved prudent provisioning policy. During the year, loans written off amounted to HK$0.5 million (2018: HK$0.6 million) with a recovery of HK$0.5 million (2018: HK$0.9 million).

Segmental Analysis

Table 3 below sets out the profit before tax contributed by various business segments for 2019.

Table 3

	Asset Purchase and Servicing HK$ million	General Insurance HK$ million	Life Insurance HK$ million	Total HK$ million
Year ended 31 December 2019				
Profit/(Loss) before tax	**302**	**163**	**(128)**	**337**
Year ended 31 December 2018				
Profit/(Loss) before tax	360	173	(466)	67

The profit before tax in 2019 for asset purchase and servicing was HK$302 million, mainly arising from net interest income of the loan and investment portfolios. General insurance's profit before tax in 2019 was HK$163 million, mainly attributable to net premiums earned from MIP and RMP. Life insurance recorded a loss before tax of HK$128 million in 2019, mainly due to the prudent statutory reserves based on actuarial assumptions provided for the annuity business of the HKMCA, partially offset by the investment returns from capital and premium placements with the Exchange Fund. Notwithstanding the reported loss of the HKMCA, the embedded value[2] of its annuity business at the end of 2019 was about HK$5.3 billion indicating that the business should be profitable in the long term.

[2] The embedded value is the sum of the total equity and the present value of future profits. The total equity includes HK$5 billion of capital injected to the HKMCA in April 2018.

Financial Position

Loan Portfolio

During the year, the Group purchased infrastructure loans of about HK$1.9 billion (2018: HK$0.3 billion of Hong Kong loan assets). After accounting for prepayments and repayments of mortgage loan portfolios during the year, the outstanding balance of the loan portfolio was HK$6.9 billion (2018: HK$6.4 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 2019, the total investment portfolio was HK$17.3 billion (2018: HK$17.2 billion), which included debt investments of HK$16.9 billion and exchange-traded bond funds and real estate investment trusts of HK$0.4 billion. There was no default loss from debt investments.

Placements with the Exchange Fund

As at 31 December 2019, the placements with the Exchange Fund arising from the capital investments of the HKMCI and HKMCA and premium investments of the HKMCA amounted to HK$12.9 billion (2018: HK$7.7 billion), of which the capital investment of the HKMCI was commenced in 2019.

Debt Securities Issued

In 2019, the Group issued HK$31.9 billion of debt securities under the MTN Programme. All the non-Hong Kong dollar debts issued under the MTN Programme were hedged into Hong Kong dollars or US dollars. The Group continued to adopt a prudent pre-funding strategy, with the total outstanding balance of the debt securities maintained at HK$39.7 billion as at 31 December 2019 (2018: HK$37.3 billion).

Key Off-balance Sheet Exposure

Mortgage Insurance Programme

The Group operates the MIP on a risk-sharing basis with approved reinsurers. At the end of 2019, the total risk-in-force was about HK$27.9 billion (2018: HK$23.7 billion), of which HK$4.8 billion (2018: HK$4.0 billion) was ceded to approved reinsurers. The off-balance sheet risk-in-force exposure borne by the Group increased to HK$23.1 billion (2018: HK$19.7 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% (2018: 0.002%).

Reverse Mortgage Programme

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 the undrawn future payout of reverse mortgage loans along with the reinsurance arrangement executed in 2019, the risk-in-force exposure borne by the Group increased to HK$11.2 billion (2018: HK$9.6 billion), with the corresponding outstanding loan balance totalling HK$2.3 billion as at 31 December 2019.

Capital Management

In order to ensure that the Group would not incur excess risk when expanding its business and balance sheet in proportion to its capital base, capital adequacy and the use of capital were monitored closely by the Group. During the year, the Group was in compliance with the Guidelines on Capital Adequacy Ratio (**Guidelines**) issued by the Financial Secretary with reference to the Basel II risk-based capital adequacy framework.

In accordance with the Guidelines, the calculation of the CAR follows the basis of consolidation for financial reporting with the exclusion of regulated subsidiaries which are subject to separate requirements on the maintenance of adequate capital (i.e., the HKMCI and the HKMCA, as regulated by the Insurance Authority). After excluding the investment cost of these unconsolidated regulated subsidiaries, the CAR remained solid at 30.2% as at 31 December 2019, well above the minimum ratio of 8% stipulated in the Guidelines on CAR.

The solvency ratios of the HKMCI and the HKMCA as at 31 December 2019 were about 39 times and 22 times respectively, well above the respective 200% and 150% minimum regulatory requirements stipulated by the IA.

Dividend

Having considered the capital requirements for business development, no dividend was declared for 2019 (2018: Nil).