Financial Review

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The novel coronavirus which began to spread across the globe at the start of the year has posed significant challenges to the world economy in 2020. After major corrections and disruptions in the first quarter of the year, asset markets rebounded quickly amid the ultra-loose monetary policies implemented by major central banks and a series of relief measures launched by various governments. With the ongoing US-China geopolitical uncertainties and evolving global pandemic situation, the global financial market remains challenging. In Mainland China, the economy bounced back in the second quarter to achieve an overall growth of 2.3% for the whole year after the coronavirus had been well contained from March 2020.

Hong Kong's economic recession deepened in the first half of 2020 amid the COVID-19 outbreak and recorded a contraction of 9.0%. There was some improvement in the third quarter and the decline of real gross domestic product narrowed to 3.5%. However, a fourth wave of coronavirus infections local epidemic that started in the latter part of November added further pressure on the economy, resulting in the unemployment rate edging up to 6.6% in the fourth quarter as the labour market deteriorated again.

Against this backdrop, the operations of the Group's core business operations remain resilient with solid financial position to stand ready to face any financial turbulence ahead in performing its strategic policy roles and attaining its social objectives.

Income Statement

Financial Performance

Net loss for the year was HK$362 million (2019: net profit of HK$317 million) (**Table 1**). The decrease in profitability was primarily attributable to the booking of increasing upfront commission expenses arising from significant surge in the volume of new mortgage insurance underwritten in one-go whereas the corresponding premium income was amortised over the life of the respective loans, and the Group's annuity business development which continued to record an accounting loss as a result of maintaining prudent statutory reserves. Adjusting for amortisation impact of upfront commission expenses to match with premium income being recognised and the accounting loss of annuity business, the adjusted profit for the year and return on equity would be HK$376 million and 3.5% respectively. Notwithstanding the reported accounting loss of annuity business, the embedded value of this business was about HK$5.4 billion, indicating that the business should be profitable in the long term.

The capital adequacy ratio stood solid at 37.3% (2019: 30.2%) so as to preserve capital for business development. The respective solvency ratios of the Group's two insurance subsidiaries were about 12 times (2019: 39 times) for general insurance business and 12 times (2019: 22 times) for annuity business, each well above the relevant minimum regulatory requirements.

Table 1

Summary of financial performance	2020 HK$ million	2019 HK$ million
Operating (loss)/profit before impairment	**(435)**	337
(Loss)/profit before tax	**(440)**	337
(Loss)/profit for the year	**(362)**[1]	317[1]
Return on equity	**(2.4%)**[1]	2.1%[1]
Cost-to-income ratio	**640.8%**[1]	58.7%[1]
Capital adequacy ratio	**37.3%**	30.2%

[1] After (i) adjusting for amortisation impact of upfront commissions to banks arising from significant surge in the volume of new mortgage insurance underwritten in 2020 to match with premium income being recognised over the loan life; and (ii) excluding an accounting loss for maintaining prudent statutory reserves based on actuarial assumptions for annuity business made by the HKMCA, the adjusted profit for the year, return on equity and cost-to-income ratio for 2020 would be HK$376 million, 3.5% and 44.8% respectively (2019: HK$443 million, 4.2% and 41.8% respectively after excluding an accounting loss for maintaining prudent statutory reserves based on actuarial assumptions for annuity business made by the HKMCA).

Net Interest Income

The HKMC Group earned a net interest income of HK$488 million, HK$36 million lower than that for 2019. The decrease was mainly due to the deployment of surplus funds to support the policy initiative of purchasing loans with the Special 100% Loan Guarantee under the SFGS which is non-profit making, and reduction of other average interest-earning assets. The net interest margin was 0.8% (2019: 1.0%) (**Table 2**).

Table 2

Net Interest Income	2020 HK$ million	2019 HK$ million
Net interest income	**488**	524
Average interest-earning assets	**62,447**	53,839
Net interest margin	**0.8%**	1.0%

Net Mortgage Insurance Premium Earned

New business underwritten under the MIP increased to HK$98.3 billion in 2020 from HK$33.3 billion in 2019. The net premium receipts (after discount to customers) were amortised and recognised as income in accordance with the unexpired risks. Net mortgage insurance premiums earned, after income amortisation and provision was HK$398 million (2019: HK$334 million). The net upfront commission expenses to banks surged to HK$666 million (2019: HK$138 million) amid the significant increase in new loans underwritten.

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 an increased loss of HK$980 million (2019: a loss of HK$387 million) as a result of the prudent provisions for statutory reserves for policy written and increase in annuity payments. The 2020 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$808 million (2019: HK$465 million), mainly representing investment income of HK$889 million (2019: HK$465 million) from placements with the Exchange Fund, dividend income of HK$18 million (2019: HK$20 million) from investments, net loss of HK$65 million (2019: net gain of HK$33 million) on investments at fair value through profit or loss and exchange loss of HK$44 million (2019: HK$38 million) arising primarily from US dollar exposures in cash and debt investments. The exchange loss was largely the net results represented by the exchange difference from the financial assets and the marked-to-market revaluation on the corresponding hedging swaps for managing foreign currency exposures.

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$515 million (2019: HK$480 million), less than budget. Staff costs, which were contained at 64.8% of total operating expenses, amounted to HK$334 million (2019: HK$296 million).

Allowance for Impairment

Asset quality remained strong, with the delinquency ratio of the Group's mortgage portfolio staying low at 0.05% (2019: 0.02%). Taking into account the deterioration in the economy and market conditions during the year, a provision on impairment allowance of HK$5.2 million was recorded in 2020 (2019: HK$0.9 million), in accordance with the approved prudent provisioning policy. During the year, loans written off amounted to HK$0.5 million (2019: HK$0.5 million) with a recovery of HK$0.5 million (2019: HK$0.5 million).

Segmental Analysis

Table 3 below sets out the profit/(loss) before tax contributed by various business segments for 2020.

Table 3

	Asset Purchase and Servicing HK$ million	General Insurance HK$ million	Life Insurance HK$ million	Total HK$ million
Year ended 31 December 2020				
Profit/(loss) before tax	**200**	**(269)**	**(371)**	**(440)**
Year ended 31 December 2019				
Profit/(loss) before tax	302	163	(128)	337

The profit before tax in 2020 for asset purchase and servicing was HK$200 million, mainly arising from net interest income of the loan and investment portfolios. General insurance's loss before tax in 2020 was HK$269 million, mainly attributable to the booking of increasing upfront commission expenses to banks arising from significant surge in the volume of new mortgage insurance underwritten in one-go whereas the corresponding premium income was amortised over the life of the respective loans. Life insurance recorded a loss before tax of HK$371 million in 2020, 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 2020 was about HK$5.4 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.

Financial Position

Loan Portfolio
During the year, the Group purchased loans with the Special 100% Loan Guarantee under the SFGS of about HK$37.6 billion (2019: Nil) and infrastructure loans of about HK$1.3 billion (2019: HK$1.9 billion). After accounting for prepayments and repayments of loan portfolios during the year, the outstanding balance of the loan portfolio was HK$43.1 billion (2019: HK$6.9 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 2020, the total investment portfolio was HK$14.4 billion (2019: HK$17.3 billion), which included debt investments of HK$14.1 billion and exchange-traded bond funds and real estate investment trusts of HK$0.3 billion. There was no default loss from debt investments.

Placements with the Exchange Fund
As at 31 December 2020, 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$16.3 billion (2019: HK$12.9 billion).

Debt Securities Issued
In 2020, the Group issued HK$58.4 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$61.9 billion as at 31 December 2020 (2019: HK$39.7 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 2020, the total risk-in-force was about HK$54.5 billion (2019: HK$27.9 billion), of which HK$6.9 billion (2019: HK$4.8 billion) was ceded to approved reinsurers. The off-balance sheet risk-in-force exposure borne by the Group increased to HK$47.6 billion (2019: HK$23.1 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 0.01% (2019: 0.003%).

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 lenders in Hong Kong. After taking into account the undrawn future payout of reverse mortgage loans along with the reinsurance arrangement, the risk-in-force exposure borne by the Group increased to HK$12.3 billion (2019: HK$11.2 billion), with the corresponding outstanding loan balance totalling HK$3.1 billion as at 31 December 2020.

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 37.3% as at 31 December 2020, well above the minimum ratio of 8% stipulated in the Guidelines on CAR.

The solvency ratios of both the HKMCI and the HKMCA were about 12 times as at 31 December 2020, well above the respective 200% and 150% minimum regulatory requirements stipulated by the Insurance Authority.

Dividend
Having considered the capital requirements for business development, no dividend was declared for 2020 (2019: Nil).