Financial Review

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The global economy stayed on the path of recovery in 2021 after experiencing economic contraction in the preceding year, though the growth was constrained by the still evolving pandemic, supply bottlenecks and restrictions on international travel. The surge in energy prices and elevated inflation pressures in the US has cast uncertainties over the future course of US monetary policies. Along with the ongoing US-China geopolitical uncertainties, the global financial market remained challenging. In Mainland China, the economy posted solid growth of 8.1% in 2021, though growth moderated in the second half of the year as economic activities were affected by the COVID-19 situation in some cities, extreme weather, and electricity rationing measures.

Hong Kong's economy recovered visibly during the year and the recovery became more entrenched in the third quarter along with the continued revival of global economic activity and stable local epidemic situation. Real gross domestic product grew by 5.4% in the third quarter of 2021 over a year earlier, though the pace of expansion was more moderate than in the second quarter on account of the base effect and stronger-than-expected performance in the first half of the year. The labour market improved continuously from early 2021 amid the sustained economic recovery, resulting in the unemployment rate falling markedly to 3.9% in the last quarter.

Amid uncertain market conditions, the Group's core operations remain resilient and stand ready to face any financial turbulence ahead in performing its strategic policy roles and attaining its social objectives with strong financing capability and solid financial position.

Income Statement

Financial Performance

The profit after tax of the Group for the year was HK$831 million (2020: a net loss of HK$362 million) (**Table 1**). The improvement in profitability was mainly attributable to (a) the annuity business's turn into profit from the preceding year's accounting loss as a result of higher investment returns under favourable market conditions from placements with the Exchange Fund; (b) a foreign exchange gain arising from US dollar and strategic offshore renminbi exposures in deposits and debt investments; (c) an increase in net premium earned from the amortisation of new premium receipts amid significant growth of MIP business since 2020; and (d) a decrease in net loss on investments in listed real estate investment trusts and exchange-traded bond funds following the rebalancing of investment portfolio.

For better assessment of the financial performance, after adjusting for the amortisation impact of upfront MIP commission expenses to match with premium income being recognised and excluding the financial results of the annuity business, the adjusted profit for the year and return on equity would be HK$868 million (2020: HK$376 million) and 7.3% (2020: 3.5%) respectively. The embedded value of annuity business was about HK$9 billion which comprised HK$7.2 billion of total equity and HK$1.8 billion of present value of future profits, indicating that the business should be profitable in the long term.

The capital adequacy ratio of the Group stood solid at 23.4% (2020: 37.3%) so as to preserve capital for business development. The respective solvency ratios of the Group's two insurance subsidiaries were about 7 times (2020: 12 times) for general insurance business and 15 times (2020: 12 times) for annuity business, each well above the relevant minimum regulatory requirements.

Table 1

Summary of financial performance	2021 HK$ million	2020 HK$ million
Operating profit/(loss) before impairment	**902**	(435)
Profit/(loss) before tax	**894**	(440)
Profit/(loss) for the year	**831**[1]	(362)[1]
Return on equity	**5.1%**[1]	(2.4%)[1]
Cost-to-income ratio	**35.3%**[1]	640.8%[1]
Capital adequacy ratio	**23.4%**	37.3%

1 After (i) adjusting for amortisation impact of upfront commissions to banks arising from significant surge in the volume of new mortgage insurance underwritten to match with premium income being recognised over the loan life; and (ii) excluding the financial results of the annuity business, the adjusted profit for the year, return on equity and cost-to-income ratio for 2021 would be HK$868 million, 7.3% and 25.2% respectively (2020: HK$376 million, 3.5% and 44.8% respectively).

Net Interest Income

The HKMC Group earned a net interest income of HK$455 million, HK$33 million lower than that for 2020. The decrease was mainly due to the deployment of surplus funds to support the policy initiative of purchasing loans with the special 100% guarantee under the SFGS which is non-profit making, and reduction of other average interest-earning assets, partly mitigated by the increase in purchase of infrastructure loans. The net interest margin was 0.4% (2020: 0.8%) (**Table 2**).

Table 2

Net Interest Income	2021 HK$ million	2020 HK$ million
Net interest income	**455**	488
Average interest-earning assets	**113,918**	62,447
Net interest margin[2]	**0.4%**	0.8%

[2] After excluding the impact of the purchase of loans with the special 100% guarantee under the SFGS under which the Group only recovered the funding costs without any net interest margin earned, the adjusted net interest margin would be 0.8% (2020: 1.0%).

Net Mortgage Insurance Premium Earned

New business underwritten under the MIP increased to HK$132.6 billion in 2021 from HK$98.3 billion in 2020. 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$765 million (2020: HK$398 million). The net upfront commission expenses to banks surged to HK$961 million (2020: HK$666 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 a net loss of HK$1,048 million (2020: a loss of HK$980 million) as a result of 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$2,146 million (2020: HK$808 million), mainly representing investment income of HK$1,991 million (2020: HK$889 million) from placements with the Exchange Fund and exchange gain of HK$117 million (2020: loss of HK$44 million) arising primarily from revaluation of US dollar and strategic offshore renminbi exposures in cash and debt investments. The above exchange gain 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. Operating expenses (net of recovery of operating expenses from the special 100% guarantee under the SFGS) dropped 4.5% year-on-year to HK$492 million (2020: HK$515 million), less than budget. The recovery of operating expenses from the special 100% guarantee under the SFGS for 2021 was HK$87 million (2020: HK$22 million). Staff costs, which were contained at 60.2% of total operating expenses before taking into account the costs recovery from the Government, amounted to HK$349 million (2020: HK$334 million).

Allowance for Impairment

Asset quality remained strong, with the delinquency ratio of the Group's mortgage portfolio staying low at 0.11% (2020: 0.05%). Amid the increase in purchase of infrastructure loans during the year, a provision on impairment allowance of HK$8.2 million was recorded in 2021 (2020: HK$5.2 million), in accordance with the approved prudent provisioning policy. During the year, there were no loans written off (2020: HK$0.5 million) with a recovery of HK$0.4 million (2020: HK$0.5 million) from loans written off previously.

Segmental Analysis

Table 3 below sets out the profit/(loss) before tax contributed by various business segments for 2021.

Table 3

	Asset Purchase and Servicing HK$ million	General Insurance HK$ million	Life Insurance HK$ million	Total HK$ million
Year ended 31 December 2021				
Profit/(Loss) before tax	**426**	**(152)**	**620**	**894**
Year ended 31 December 2020				
Profit/(Loss) before tax	200	(269)	(371)	(440)

The profit before tax in 2021 for asset purchase and servicing was HK$426 million, mainly arising from net interest income of the loan and investment portfolios. General insurance's loss before tax in 2021 was HK$152 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 profit before tax of HK$620 million in 2021, mainly due to higher investment returns from capital and premium placements with the Exchange Fund. The embedded value of the annuity business at the end of 2021 was about HK$9 billion indicating that the business should be profitable in the long term.

Financial Position

Loan Portfolio

During the year, the Group purchased loans with the special 100% guarantee under the SFGS of about HK$42.9 billion (2020: HK$37.6 billion), infrastructure loans of about HK$2.9 billion (2020: HK$1.3 billion) and residential mortgages of about $0.2 billion (2020: HK$0.04 billion). After accounting for prepayments and repayments of loan portfolios during the year, the outstanding balance of the loan portfolio was HK$79.6 billion (2020: HK$43.1 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 2021, the total investment portfolio was HK$14.9 billion (2020: HK$14.4 billion), which largely comprised high-quality debt investments. There was no default loss from debt investments.

Placements with the Exchange Fund

As at 31 December 2021, the placements with the Exchange Fund was HK$28.6 billion which comprised the capital investments of the HKMCI and HKMCA and premium investments of the HKMCA amounting to HK$23.9 billion (2020: HK$16.3 billion), and the fund of HK$4.7 billion (2020: nil) placed on the Government's behalf from advance funding received for purchase of PLGS loans.

Debt Securities Issued

In 2021, the Group issued HK$109.5 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$115.7 billion as at 31 December 2021 (2020: HK$61.9 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 2021, the total risk-in-force was about HK$88.9 billion (2020: HK$54.5 billion), of which HK$8.3 billion (2020: HK$6.9 billion) was ceded to approved reinsurers. The off-balance sheet risk-in-force exposure borne by the Group increased to HK$80.6 billion (2020: HK$47.6 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% (2020: 0.01%).

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$14.0 billion (2020: HK$12.3 billion), with the corresponding outstanding loan balance totalling HK$4.0 billion as at 31 December 2021.

Capital Management

To ensure 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 23.4% as at 31 December 2021, well above the minimum ratio of 8% stipulated in the Guidelines on CAR.

The respective solvency ratios of the Group's two insurance subsidiaries were 7 times (2020: 12 times) for the general insurance business and 15 times (2020: 12 times) for the annuity business as at 31 December 2021, 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 2021 (2020: Nil).