Financial Review

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Global economic and financial conditions remain uncertain, hinging on factors such as the rising inflation pressure, the tightening monetary policies in major economies and ongoing geopolitical tensions. Economic growth in the major advanced economies remained modest amid elevated inflation and further monetary policy tightening by central banks in response. The Federal Reserve also signalled that US interest rates would go higher than earlier projection and cautioned against prematurely discussing a pause in hiking rates in the face of persistently high inflation.

In Mainland China, the economy showed a moderate revival with economic activities constrained by weak global demand and increased COVID-19 cases in various localities in the second half of the year. With the adoption of a series of monetary policy tools and introduction of fiscal measures to stimulate the economy, including lowering the reserve requirement ratios and loan interest rates, new tax and fee reductions, and special local government bonds issuance, the gross domestic product posted growth of 3.0% in 2022.

Hong Kong's economy contracted by 3.5% from a year earlier in 2022. The deterioration in the external environment and continued disruptions to cross-boundary land cargo flows dealt a serious blow to Hong Kong's exports. Tightened financial conditions resulting from the sharp interest rate hikes by the major central banks weighed heavily on domestic demand, though the generally stable COVID-19 situation, improved labour market conditions and the disbursement of consumption vouchers rendered support to private consumption. The unemployment rate improved to 3.5% in the last quarter of 2022. Notwithstanding that the economy would show a widened year-on-year contraction in 2022, the gradual return to normalcy around the world and the relaxation of quarantine requirements in the Mainland are expected to support Hong Kong's economy in 2023.

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 capital position.

Income Statement

Financial Performance

Net loss of the Group for the year was HK$319 million (2021: a net profit of HK$831 million) (**Table 1**). The accounting loss was primarily due to (a) the annuity business for the lower investment income from its placements with the Exchange Fund; and (b) a foreign exchange loss arising from strategic offshore renminbi exposures in cash and debt investments amid uncontrollable market conditions, partly offset by the increase in amortisation of net premium receipts from the significant growth in the mortgage insurance business in prior years, together with the drop in upfront commission expenses along with the decrease in MIP business in 2022.

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$680 million (2021: HK$868 million) and 5.3% (2021: 7.3%) respectively. The embedded value of annuity business was about HK$11.2 billion which comprised HK$8.9 billion of total equity and HK$2.3 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 27.9% (2021: 23.4%) so as to preserve capital for business development. The respective solvency ratios of the Group's two insurance subsidiaries were about 11 times (2021: 7 times) for general insurance business and 15 times (2021: 15 times) for annuity business, each well above the relevant minimum regulatory requirements.

Table 1

Summary of financial performance	2022 HK$ million	2021 HK$ million
Operating (loss)/profit before impairment	**(368)**	902
(Loss)/Profit before tax	**(374)**	894
(Loss)/Profit for the year	**(319)**[1]	831[1]
Return on equity	**(1.6%)**[1]	5.1%[1]
Cost-to-income ratio	**350.0%**[1]	35.3%[1]
Capital adequacy ratio	**27.9%**	23.4%

1 After (i) adjusting for amortisation impact of upfront MIP commissions to banks 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 2022 would be HK$680 million, 5.3% and 30.8% respectively (2021: HK$868 million, 7.3% and 25.2% respectively).

Net Interest Income

The HKMC Group earned a net interest income of HK$356 million, HK$99 million lower than that for 2021. The decrease was mainly due to the tightening of net interest spread amid the interest rate hike environment and the increase in 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, partly mitigated by the increase in purchase of infrastructure loans. The net interest margin was 0.2% (2021: 0.4%) (**Table 2**).

Table 2

Net Interest Income	2022 HK$ million	2021 HK$ million
Net interest income	**356**	455
Average interest-earning assets	**152,458**	113,918
Net interest margin[2]	**0.2%**	0.4%

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 0.5% (2021: 0.8%).

Net Mortgage Insurance Premium Earned

New business underwritten under the MIP was HK$107.2 billion in 2022 (2021: HK$132.6 billion). 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 surged to HK$1,072 million (2021: HK$765 million) as a result of the increase in amortised premium receipts associated with significant growth in the MIP business in prior years. The net upfront commission expenses to banks was HK$720 million (2021: HK$961 million), in line with the change in new business 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$1,017 million (2021: a loss of HK$1,048 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$413 million (2021: HK$2,146 million), mainly comprising investment income of HK$533 million (2021: HK$1,991 million) from placements with the Exchange Fund and a gain of HK$145 million (2021: HK$44 million) from change in fair value of financial instruments which largely represented the marked-to-market gain of derivatives for the purpose of hedging interest rate risk, partly offset by exchange loss of HK$268 million (2021: gain of HK$117 million) arising primarily from revaluation of strategic offshore renminbi exposures in cash and debt investments. The above 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 derivatives 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 (net of recovery of operating expenses from the special 100% guarantee under the SFGS) increased by 4.7% to HK$515 million (2021: HK$492 million), less than budget. Without the recovery of HK$128 million (2021: HK$87 million) from the special 100% guarantee under the SFGS, the operating expenses for 2022 would be HK$643 million (2021: HK$579 million). Staff costs, which were contained at 60.5% of total operating expenses before taking into account the costs recovery from the Government, amounted to HK$389 million (2021: HK$349 million).

Allowance for Impairment

Asset quality remained strong, with the delinquency ratio of the Group's mortgage portfolio staying low at 0.16% (2021: 0.11%). Taking into account the combined effect of the increase in outstanding infrastructure loans and the decrease in cash and short-term funds balance, a provision on impairment allowance of HK$6.0 million was recorded in 2022 (2021: HK$8.2 million), in accordance with the approved provisioning policy. During the year, loans written off amounted to HK$0.1 million (2021: Nil) with a recovery of HK$0.2 million (2021: HK$0.4 million) from loans written off previously.

Segmental Analysis

Table 3 below sets out the profit/(loss) before tax contributed by various business segments for 2022.

Table 3

	Asset Purchase and Servicing HK$ million	General Insurance HK$ million	Life Insurance HK$ million	Total HK$ million
Year ended 31 December 2022				
(Loss)/Profit before tax	**(118)**	**595**	**(851)**	**(374)**
Year ended 31 December 2021				
Profit/(Loss) before tax	426	(152)	620	894

The loss before tax in 2022 for asset purchase and servicing was HK$118 million, mainly due to the foreign exchange loss arising from revaluation of strategic offshore renminbi exposures in cash and debt investments, resources utilised for supporting the Group's core missions and certain policy initiatives and tightening of net interest spread amid the interest rate hike environment, partly offset by the net interest income contribution from the enlarged infrastructure loan portfolio.

General insurance's profit before tax in 2022 was HK$595 million, mainly attributable to increase in net mortgage insurance premiums earned as a result of the significant growth in the MIP business in prior years and the drop in upfront commission expenses along with the decrease in MIP business in 2022.

Life insurance recorded a loss before tax of HK$851 million in 2022, mainly due to the prudent statutory reserving based on actuarial assumptions and the lower investment income from the placements with the Exchange Fund in the light of uncertain and volatile market conditions. The embedded value of the annuity business at the end of 2022 was about HK$11.2 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$33.4 billion (2021: HK$42.9 billion), infrastructure loans of about HK$4.0 billion (2021: HK$2.9 billion) and residential mortgages of about $0.3 billion (2021: HK$0.2 billion). After accounting for prepayments and repayments of loan portfolios during the year, the outstanding balance of the loan portfolio was HK$101.6 billion (2021: HK$79.6 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 2022, the total investment portfolio was HK$14.4 billion (2021: HK$14.9 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 2022, the placements with the Exchange Fund was HK$32.8 billion which comprised the capital investments of the HKMCI and HKMCA and premium investments of the HKMCA amounting to HK$29.4 billion (2021: HK$23.9 billion), and the fund of HK$3.4 billion (2021: HK$4.7 billion) placed on the Government's behalf from advance funding received for purchase of PLGS loans.

Debt Securities Issued

In 2022, the Group issued HK$97.6 billion of debt securities under the MTN Programme, including the inaugural dual-tranche HK$8 billion two-year and CNH 3 billion three-year social bonds. 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$131.1 billion as at 31 December 2022 (2021: HK$115.7 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 2022, the total risk-in-force was about HK$110.6 billion (2021: HK$88.9 billion), of which HK$11.5 billion (2021: HK$8.3 billion) was ceded to approved reinsurers. The off-balance sheet risk-in-force exposure borne by the Group increased to HK$99.1 billion (2021: HK$80.6 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% (2021: 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$16.3 billion (2021: HK$14.0 billion), with the corresponding outstanding loan balance totalling HK$5.3 billion as at 31 December 2022.

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 27.9% as at 31 December 2022, 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 11 times (2021: 7 times) for the general insurance business and 15 times (2021: 15 times) for the annuity business as at 31 December 2022, 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 2022 (2021: Nil).