Financial Review

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The global economic and financial conditions remained challenging and volatile in 2023. While inflation levels in major developed economies declined from their peak, they remained above the targets set by major central banks. Following an aggressive rate hike cycle, the US Fed paused rate hikes in the third quarter, and recently indicated that the policy rate was likely at or near its peak. Coupled with a resilient US economy, financial market sentiment has turned more optimistic in general. However, lingering geopolitical tensions and the outbreak of conflict in the Middle East during the year has added turbulence and uncertainties to the global financial market.

In Mainland China, weak demand in the advanced economies and geopolitical factors continued to weigh on exports. As the authorities gradually strengthened policy support to bolster the economy and market confidence, the Mainland's economic growth had regained momentum since August 2023. The strong economic fundamentals and various support measures helped the Mainland economy record a growth of 5.2% in the gross domestic product in 2023 over the previous year.

In Hong Kong, the full resumption of normal travel with Mainland China and the rest of the world in early 2023 helped put its economy on the road to post-pandemic normalcy. The Hong Kong economy registered positive growth of 3.2% in gross domestic product in 2023, following a contraction of 3.7% in 2022. The job market also improved, with the unemployment rate reported at 2.9% in the fourth quarter, and inflation remained mild. However, factors such as high global interest rates, geopolitical tensions and adjustments to the supply chain had put pressure on the momentum of Hong Kong's economic growth. Looking ahead, the external environment remains challenging, which will place a drag on Hong Kong's economic growth.

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$260 million (2022 restated: a net profit of HK$2,163 million, where the restatement was made in accordance with the retrospective application requirements of Hong Kong Financial Reporting Standard 17 "Insurance Contracts" (**HKFRS 17**) effective from January 2023) (**Table 1**). The accounting loss was primarily due to the increase in insurance finance expense for the annuity business as a result of an increase in insurance contract liabilities driven by the reduced discount rates reflecting the relatively lower market interest rates at the end of the year as compared to that of previous year, and the negative impact of property price drop on reverse mortgage insurance business. These were partly mitigated by the favourable return from placements with the Exchange Fund and the increase in amortisation of unearned profits from the accumulative mortgage insurance business.

For better assessment of the financial performance, after excluding (i) the accounting results of the annuity business; (ii) the impact of property price change on reverse mortgage insurance business; and (iii) effect of valuation and corresponding adjustments in respect of certain loan portfolios with insurance cover provided by the HKMCI driven by the aforementioned financial reporting standard at consolidation level, the adjusted profit for the year and return on equity would be HK$724 million (2022 restated: HK$445 million) and 5.3% (2022 restated: 3.2%) respectively. The embedded value of annuity business under the Insurance Ordinance basis was about HK$13.9 billion which comprised HK$11.4 billion of total equity and HK$2.5 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 21.6% (2022: 27.9%) so as to preserve capital for business development. The respective solvency ratios of the Group's two insurance subsidiaries were about 13 times (2022: 11 times) for general insurance business and 18 times (2022: 15 times) for annuity business, each well above the relevant minimum regulatory requirements.

Table 1

Summary of financial performance	2023 HK$ million	2022 (Restated) HK$ million
Operating (loss)/profit before impairment	**(393)**	2,526
(Loss)/profit before tax	**(413)**	2,520
(Loss)/profit for the year	**(260)**[1]	2,163[1]
Return on equity	**(1.0%)**[1]	10.0%[1]
Cost-to-income ratio	**(471.0%)**[1]	9.7%[1]
Capital adequacy ratio	**21.6%**	27.9%

1 After adjustments to exclude (a) the accounting results of the HKMCA; (b) the impact of property price change on the insurance result of the RMP; and (c) the valuation and corresponding adjustments after adoption of HKFRS 17 in respect of certain loan portfolios with insurance cover provided by the HKMCI, the adjusted profit for the year, return on equity and cost-to-income ratio for 2023 would be HK$724 million, 5.3% and 28.1% respectively (2022 restated: HK$445 million, 3.2% and 34.5% respectively).

Net Interest Income

The HKMC Group earned a net interest income of HK$397 million, HK$41 million higher than that for 2022. The increase was mainly attributable to the increase in debt investment riding on yield pick-up amid an interest rate hikes environment, partly offset by the tightening of net interest spread on mortgage loans. The net interest margin was 0.2% (2022: 0.2%) (**Table 2**).

Table 2

Net Interest Income	2023 HK$ million	2022 (Restated) HK$ million
Net interest income	**397**	356
Average interest-earning assets	**177,939**	152,458
Net interest margin[2]	**0.2%**	0.2%

2 After excluding the impact of the purchase of loans with the special 100% guarantee under the SFGS and the DLGS under which the Group only recovered the funding costs without any net interest margin earned, the adjusted net interest margin would be 0.5% (2022: 0.5%).

Insurance Service Result

Insurance service result, which reflected insurance revenue less insurance service expenses, taking into account the impact of reinsurance contracts, was a loss of HK$179 million for 2023 (2022 restated: a loss of HK$1,210 million). Insurance revenue mainly reflects the consideration to which the HKMC expects to be entitled in exchange for the provision of insurance contract services in the form of contractual service margin (CSM) release, while insurance service expenses comprise the incurred claims and other incurred insurance service expenses and losses on onerous groups of contracts and reversals of such losses. The improvement in insurance service results mainly reflected the lower losses from new policies written under the HKMC Annuity Plan driven by higher discount rates adopted in 2023 than those of 2022 and the higher release of the CSM due to growth of the CSM balance as a consequence of new MIP business.

Insurance Finance Expenses, Net

Insurance finance expenses, net amounted to HK$1,698 million for 2023 (2022 restated: an income of HK$3,041 million). The change in insurance finance expenses was mainly due to the unfavourable change in insurance contract liabilities driven by the decrease in discount rates adopted at the end of 2023 as compared to that of 2022.

Other Income

Other income was HK$1,411 million (2022 restated: HK$608 million), mainly comprising investment income of HK$1,268 million (2022: HK$533 million) from placements with the Exchange Fund, a gain of HK$52 million (2022 restated: HK$195 million) arising from fair valuation adjustments at consolidation level for the loans with insurance cover by the HKMCI, a gain of HK$43 million (2022: HK$145 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 and an exchange gain of HK$7 million (2022: loss of HK$268 million) arising primarily from revaluation of offshore renminbi and US dollar 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 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 and DLGS, and expenses directly attributable to the insurance cashflows incorporated in the insurance service result) increased by 20% to HK$324 million (2022 restated: HK$270 million), less than budget. Without the recovery of HK$162 million (2022: HK$128 million) from the special 100% guarantee under the SFGS and DLGS, and the incorporation of HK$261 million (2022 restated: HK$246 million) into insurance service result, the gross operating expenses for 2023 would be HK$747 million (2022 restated: HK$644 million). Staff costs, which were contained at 58.8% of gross operating expenses before taking into account the costs recovery from the Government and incorporation into insurance service result, amounted to HK$439 million (2022: HK$389 million).

Allowance for Impairment

Asset quality remained strong, with the delinquency ratio of the Group's mortgage portfolio staying low at 0.03% (2022: 0.16%). A provision on impairment allowance of HK$20.0 million was recorded in 2023 (2022: HK$6.0 million) in accordance with the approved provisioning policy. During the year, loans written off amounted to HK$0.3 million (2022: HK$0.1 million) with a recovery of HK$0.5 million (2022: HK$0.2 million) from loans written off previously.

Segmental Analysis

Table 3 below sets out the profit/(loss) before tax contributed by various business segments for 2023.

Table 3

	Asset Purchase and Servicing HK$ million	General Insurance HK$ million	Life Insurance HK$ million	Inter-segment Elimination HK$ million	Total HK$ million
Year ended 31 December 2023					
(Loss)/Profit before tax	**(34)**	**148**	**(804)**	**277**	**(413)**
Year ended 31 December 2022 (restated)					
(Loss)/Profit before tax	(118)	(125)	2,366	397	2,520

The loss before tax in 2023 for asset purchase and servicing was HK$34 million, mainly due to the resources utilised for supporting the Group's core missions and certain policy initiatives such as the issuance of ILBS and tightening of net interest spread amid the interest rate hike environment.

General insurance's profit before tax in 2023 was HK$148 million, mainly attributable to (a) net interest income earned from bank deposits and debt investments; (b) CSM amortisation from the MIP; (c) income from placement with the Exchange Fund; partly offset by (d) loss on onerous contracts from RMP as a result of the drop in overall value of secured properties.

Life insurance recorded a loss before tax of HK$804 million in 2023, mainly due to the unfavourable change in insurance contract liability driven by the decrease in discount rates at the end of 2023 as compared to that of 2022. The embedded value of the annuity business at the end of 2023 was about HK$13.9 billion, indicating that the business should be profitable in the long term.

Financial Position

Loan Portfolio

During the year, the Group acquired loans with the special 100% guarantee under the SFGS and DLGS of about HK$24.7 billion (2022: HK$33.4 billion), infrastructure loans of about HK$2.7 billion (2022: HK$4.0 billion) and residential mortgages of about HK$0.1 billion (2022: HK$0.3 billion). After accounting for prepayments and repayments of loan portfolios during the year, the outstanding balance of the loan portfolio was HK$109.5 billion (2022: HK$102.2 billion), comprising mainly loans with the special 100% guarantee under the SFGS and DLGS, infrastructure loans and residential mortgage portfolio at amortised cost of HK$97.4 billion, HK$7.4 billion and HK$2.8 billion respectively, and residential mortgages at fair value through profit or loss of HK$1.9 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 2023, the total investment portfolio was HK$17.1 billion (2022: 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 2023, the placements with the Exchange Fund was HK$34.1 billion (2022: HK$29.4 billion) which solely comprised the capital investments of the HKMCI and HKMCA and premium investments of the HKMCA. The placement made on the Government's behalf from advance funding received for purchase of PLGS loans has been fully withdrawn and repaid to the Government during the year (2022: HK$3.4 billion).

Insurance Contract Liabilities

Insurance contract liabilities, mainly consisting of the estimated present value of future cashflows, risk adjustment and the CSM, amounted to HK$19.4 billion (2022 restated: HK$15.8 billion) which comprised HK$5.0 billion (2022 restated: HK$3.7 billion) and HK$14.4 billion (2022 restated: HK$12.1 billion) for general and life insurance business respectively.

The Group operates the MIP on a risk-sharing basis with approved reinsurers. At the end of 2023, the total risk-in-force was about HK$121.1 billion (2022: HK$110.6 billion), of which HK$13.0 billion (2022: HK$11.5 billion) was ceded to approved reinsurers. The risk-in-force exposure borne by the Group increased to HK$108.1 billion (2022: HK$99.1 billion).

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$18.6 billion (2022: HK$16.3 billion), with the corresponding outstanding loan balance totalling HK$6.9 billion as at 31 December 2023.

Debt Securities Issued

In 2023, the Group issued HK$98.3 billion of debt securities under the MTN Programme, including the triple-currency issuance of HK$9.5 billion two-year, CNH 5 billion three-year and US$650 million five-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$161.7 billion as at 31 December 2023 (2022: HK$131.1 billion).

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 21.6% as at 31 December 2023, 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 13 times (2022: 11 times) for the general insurance business and 18 times (2022: 15 times) for the annuity business as at 31 December 2023, 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 2023 (2022: Nil).