Diversification
in Business

Business Overview

Performance Highlights

The major achievements of the Corporation for the year include:

- Purchase of a total of HK$4.7 billion loan assets, which were all residential mortgage loans in Hong Kong.
- Drawdown of mortgage insurance coverage for newly originated mortgage loans reaching a record of HK$41 billion in total, achieving a usage rate (in terms of drawdown loan amount against total market mortgage drawdown) of 13%.
- Completion of the feasibility study, stakeholder consultation and preparatory work for the launch of the SME Financing Guarantee Scheme on 1 January 2011.
- Issuance of HK$8.3 billion of debt securities in a cost-effective manner, maintaining the Corporation's position as the most active corporate issuer in the Hong Kong dollar debt market for ten consecutive years.
- Safeguarding excellent asset quality, with delinquency ratios (above 90-day ratios) of 0.003% for the mortgage insurance portfolio, 0.05% for the Hong Kong residential mortgage portfolio (the industry average of 0.01%) and 0.03% across all asset classes as at 31 December 2010.
- Upgrade of the HKMC's long-term foreign and local currency ratings to AAA and Aa1 by Standard & Poor's ("S&P") and Moody's Investors Service, Inc. ("Moody's") respectively.

The Corporation registered solid financial results for 2010:

- Profit after tax of HK$1,234 million, which was HK$228 million, or 22.7%, up from 2009.
- Net interest spread improved to 1.8% amid favourable interest rate environment, compared to 1.7% in 2009.
- Return on assets of 2.2%, an increase of 0.6 percentage point over that of 2009.
- Return on shareholder's equity of 17.5%, an increase of 1.3 percentage point over that of 2009.
- Capital-to-assets ratio remained strong at 10.8%, well above the minimum requirement of 5%.
- Cost-to-income ratio of 11.0%, significantly lower than the banking industry average of 49.8%.

Operational Highlights

Overall Business Strategy

The Corporation is fully committed to its three core missions: maintaining banking stability, promoting home ownership and developing the Hong Kong's debt market. In 2010, the Corporation further boosted its strategic roles and pursued its business diversification strategy through the launch of the Premium Loan Guarantee Scheme, the SME Financing Guarantee Scheme, and the proposed Reverse Mortgage Pilot Scheme.

Mortgage Insurance

In light of the overheated property market climate, the Corporation took steps in August and November 2010 to tighten certain eligibility criteria for the Mortgage Insurance Programme ("MIP") to lower the risk of borrower over-extending themselves.

The Corporation introduced the Risk-based Scoring Model ("RBSM") in November 2010 as an enhancement to the MIP so that a greater number of homebuyers can be made eligible for premium discounts

The MIP loan drawdown reached a record high of HK$41 billion in 2010. This reflected an increasing demand for the MIP in attaining home ownership.

The Corporation launched a series of promotional activities on the MIP in order to raise public awareness of the programme and the products. Meanwhile, the Corporation continued to provide training seminars for the frontline staff of the MIP participating banks and estate agents. This was an integral part of the strong partnership between the Corporation, banks and intermediaries in promoting mortgage insurance to the public.

The Corporation maintained a high degree of processing efficiency for MIP applications through automation and the use of internet platforms.

SME Financing Guarantee Scheme

Upon the phasing out of the Special Loan Guarantee Scheme offered by the Government of the Hong Kong Special Administrative Region ("HKSAR") through the Trade and Industry Department for small- and medium-sized enterprises ("SMEs") as of 1 January 2011, there was extensive support from the general public and stakeholders to develop a sustainable market-oriented platform that provided financing guarantee for SME loans. The SMEs and banks believed that the HKMC's financial strength and track record in operating financing guarantee and insurance businesses would make the HKMC a good candidate to offer a sustainable, market-based SME financing guarantee scheme. This would help banks manage their lending risks more effectively and in turn provide SMEs with more stable financing.

The Corporation then carried out an in-depth study and extensive consultation in the market to explore the feasibility of providing a sustainable market-oriented financing guarantee scheme for SMEs.

With the approval obtained from the Board of Directors in November 2010, the Corporation was authorised to launch and operate the SME Financing Guarantee Scheme ("SFGS") based on prudent commercial principles from 1 January 2011.

Fund-raising

- Issuance of a total of HK$8.3 billion of corporate debts with tenor up to 15 years in a prudent and cost-effective manner to support asset purchase activities and redemption of maturing debts.
- For the tenth year in a row, the Corporation was the most active corporate issuer in the Hong Kong dollar debt market, with issuance of HK$7.8 billion of debt securities in the local institutional market.

Market Overview

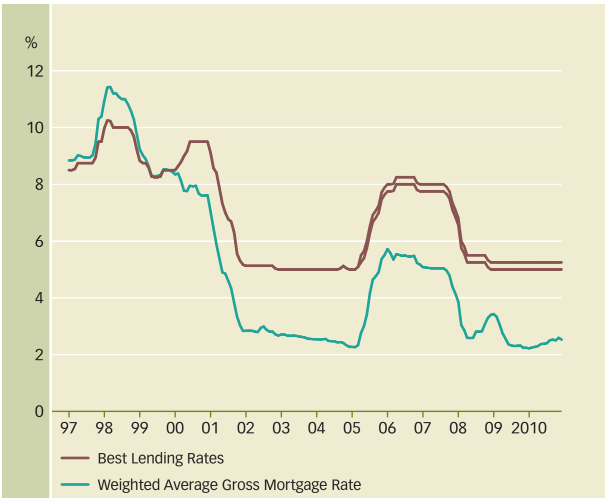
General Economic Conditions

The Hong Kong economy continued to rebound strongly during 2010, driven by robust domestic consumption and sustained growth in exports. The United States' new round of quantitative easing measures prolonged the low interest rate environment and boosted consumer spending, which was further underpinned by the wealth effect of surging local property and stock markets. Favourable Central Government policies related to Hong Kong, such as the development of Hong Kong as an offshore Renminbi Centre and the expanded Individual Visit Scheme allowing non-Shenzhen residents to visit Hong Kong, lent additional support to the overall economic performance of Hong Kong. Further resurgence in the economies of the United States and Europe provided added impetus to the vibrant pace of economic growth. As a result, Hong Kong's Gross Domestic Product ("GDP") expanded by 6.8% in real terms in 2010, in stark contrast to the 2.7% contraction in 2009. In tandem with the upbeat global business sentiment, the local labour market also improved on a broad front. The unemployment rate fell to a nearly two-year low of 4% in December from 4.9% in January, as the economy recovered robustly over the course of 2010.

Interest-Rate Environment

In addition to the quantitative easing measures in the United States, there was a remarkable inflow of funds to emerging markets in 2010. This led to excessive liquidity in the Hong Kong banking sector and drove down interest rates to very low levels. The one-month Hong Kong Interbank Offered Rate ("HIBOR") stayed below 0.2% throughout most of the year. Nonetheless, the Best Lending Rates ("BLRs") in the market remained stable in the range of 5% to 5.25% throughout the year. With the strong rebound of the economy and intensified competition in the mortgage market, banks offered increasingly favourable terms for mortgage loans to gain market share. HIBOR-based mortgage rates were as low as HIBOR + 0.7% by year-end, while the BLR-based mortgage rates for new mortgage loans stayed at BLR – 3% **(FIGURE 1)**.

FIGURE 1
Best Lending Rates and Mortgage Rates



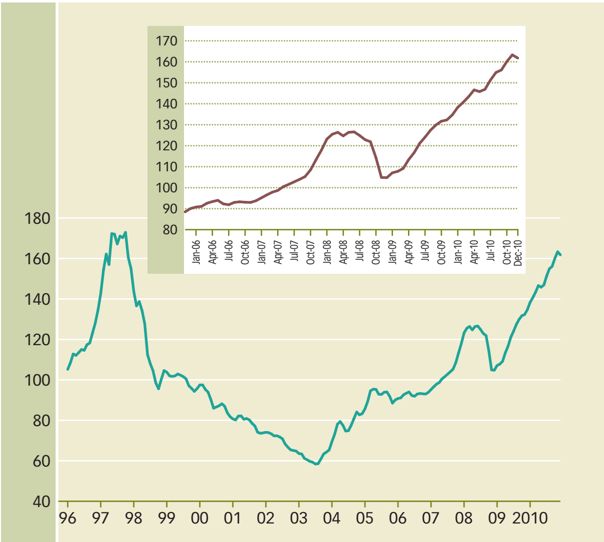
Source: HKMA

Property Market

Fuelled by ample global liquidity and a prolonged low-interest-rate environment, Hong Kong's property market

FIGURE 2

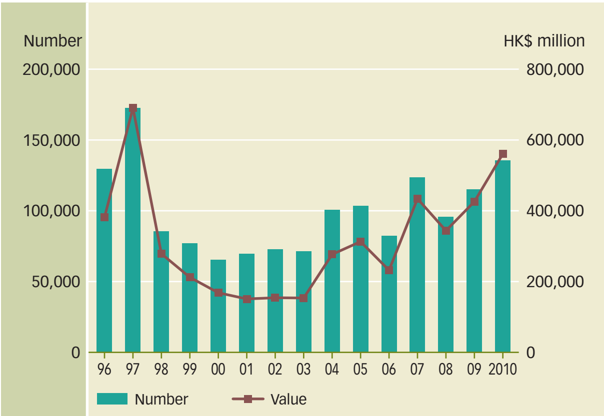
Private Domestic Price Index (1999=100)



Source: Rating and Valuation Department

FIGURE 3

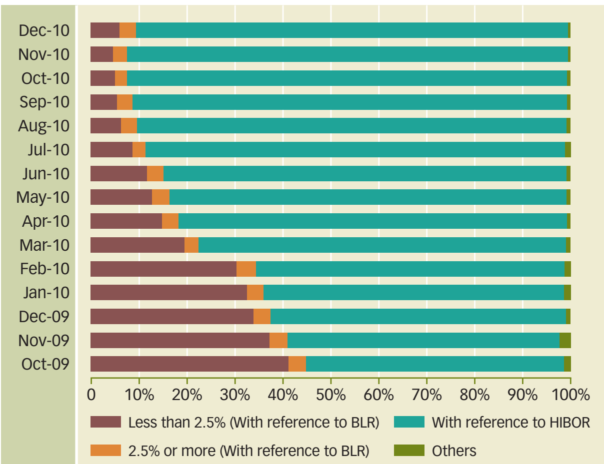
Agreements of Sale and Purchase of Residential Building Units



Source: Land Registry

FIGURE 4

Pricing of New Residential Mortgage Loans Approved



Source: HKMA

stayed buoyant throughout the year of 2010. Both property prices and the volume of transactions in the residential market rose significantly. To ensure healthy and stable development of the property market, Government launched a series of anti-speculation measures to forestall the risk of a property bubble. Property prices[1] in the residential market as a whole as of December 2010 surged 21% over those of the previous year **(FIGURE 2)**. The prices of small flats with a saleable area less than 40 square meters showed the largest appreciation in the residential market, gaining 24% year-on-year in December 2010, while those of large flats with a saleable area of 160 square meters or above rose 16% over the same period. Amid the bullish sentiment, the volume of residential property transactions advanced in tandem with property prices from the first quarter of 2010. The total volume and value of residential property transactions[2] surged by 18% and 32% respectively year-on-year to about 136,000 cases and HK$561 billion in 2010 **(FIGURE 3)**. Notably, private residential flat completions surged 87% to 13,410 units in 2010, while take-up declined 28% to 8,030 units over the period. As a result, the vacancy rate rose slightly to 4.7% at end-2010 from 4.3% at end 2009.

Mortgage Market

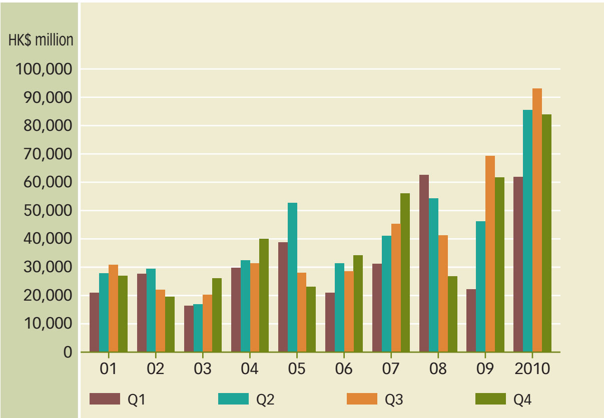
With abundant liquidity being parked in Hong Kong, banks were aggressive in lowering mortgage rates to scramble for higher business volume, as the property market experienced strong uptake in both transaction value and volume. Since the absolute interest rate of HIBOR-based mortgage loans remained much lower than that of BLR-based mortgage loans, HIBOR-based mortgage loans became more popular among property buyers. The proportion of newly approved HIBOR-based mortgage loans[3] was around 63% in early 2010, but rose appreciably to a record high of 90% by year-end **(FIGURE 4)**.

As risks in the residential mortgage market were increasing as a result of rising property prices, the HKMA issued a set of prudential measures for residential mortgage loans in August and November 2010. To ensure banks in Hong Kong adopted the necessary risk management standards and practices, the measures comprised more stringent debt-servicing ratios for mortgage applicants and the stress-testing of borrowers' repayment ability, together with stricter Loan-to-value ("LTV") ratios, with the lowest 50% LTV applying to both residential properties valued at HK$12 million or above and all non-owner-occupied residential properties.

1 Source: The Private Domestic Price Index published by the Rating and Valuation Department
2 Source: The Land Registry
3 Source: The HKMA's Monthly Residential Mortgage Survey ("The HKMA Survey")

FIGURE 5

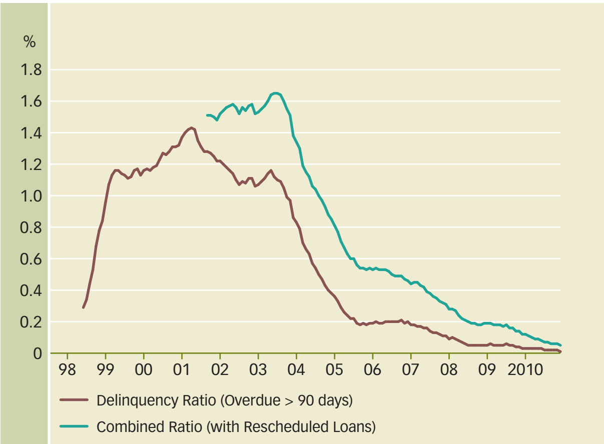
New Residential Mortgage Loans Made



Source: HKMA

FIGURE 6

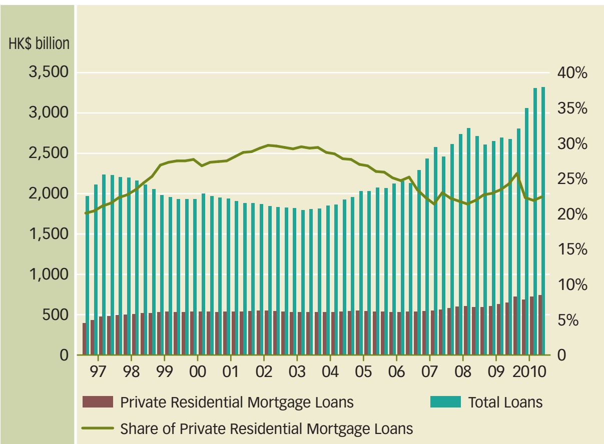
Delinquency Ratio of Residential Mortgage Loans



Source: HKMA

FIGURE 7

Total Loans and Private Residential Mortgage Loans of All Authorized Institutions



Source: HKMA

In line with the vibrant property market, the mortgage loan origination volume also picked up visibly in 2010. The value of mortgage loan origination[4] surged remarkably by 63% year-on-year **(FIGURE 5)**. The total outstanding value of all residential mortgage loans also registered an increase of 14% to HK$796 billion at the end of 2010, largely due to the sustained momentum of the buoyant property market.

Given the booming property market, the improved labour market and the HKMA's prudent oversight over the banking system, the asset quality of residential mortgage loans remained excellent in 2010, owing to the prudent underwriting standards widely adopted by the market players. The delinquency ratio of mortgage loans[5] more than 90 days overdue dropped to a record low level of 0.01% by the end of the year, from 0.03% in early 2010. The combined ratio, which takes into account both delinquent and rescheduled loans, declined from 0.12% to 0.05% over the same period **(FIGURE 6)**.

Banking-Sector Exposure

With the rebound in the property market, the total outstanding value of mortgage loans for private residential properties surged to HK$745 billion at the end of 2010 (end-2009: HK$647 billion), accounting for about one-fourth of total loans in Hong Kong **(FIGURE 7)**. Adding the loans for building and construction, as well as property development and investment, the amount of property-related loans totalled HK$1,589 billion, representing about half of the total loan book of banks. Such a high exposure to property-related lending indicates that a sharp downturn in the property market could have an adverse impact on the overall stability of the banking system, although banks in Hong Kong in general have an adequate capital base. The proportion of property-related loans has remained steady since 1999.

Asset Acquisition

Throughout the year of 2010, the Corporation acquired a total of HK$4.7 billion of local mortgage assets. In spite of ample liquidity in the banking sector, some banks were interested in offloading assets for better risk and capital management or for reinforcement of their business strategies. The Corporation will continue to strengthen its role of maintaining banking and financial stability in Hong Kong by acting as a liquidity provider, particularly during times of crisis.

Mortgage Insurance

Over the years, the MIP has repeatedly demonstrated its effectiveness in assisting potential homebuyers in overcoming the hurdle of a substantial down payment requirement for the purchase of a property. From the

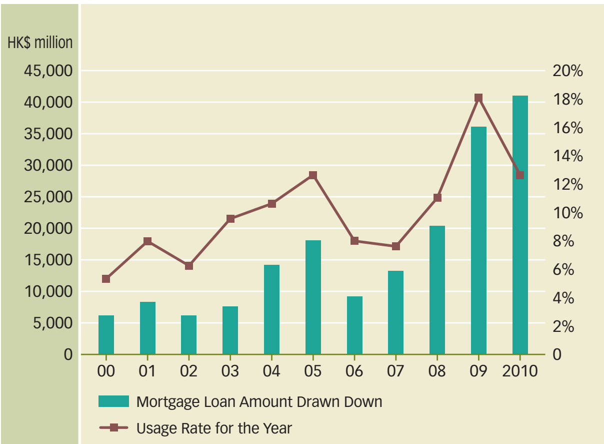
4 Source: The HKMA Survey
5 Source: The HKMA Survey

perspective of the banking industry as a whole, the MIP allows banks to engage in higher LTV lending without incurring additional credit risk and affecting the overall stability of the entire banking system. All in all, the programme creates a win-win situation for both the homebuyers and the banks.

Since its inception in March 1999, the MIP has gained increasing public acceptance and has played a significant role in promoting home ownership in Hong Kong. For 2010 as a whole, the volume of loans drawn down amounted to a record high of HK$41 billion and the usage rate (in terms of drawdown loan amount against total market mortgage drawdown) stood at 13% **(FIGURE 8)**. It is notable that 96% of MIP applications received were for secondary market properties, demonstrating that mortgage insurance has been crucial in assisting homebuyers in the secondary market.

FIGURE 8

Mortgage Loan Amount Drawn Down and Usage Rate* of MIP



Source: HKMA and HKMC

Usage Rate = Mortgage Loam Amount drawn down under MIP / Total Mortgage Loan Amount drawn down in the market based on HKMA's Monthly Residential Mortgage Survey.

Since 1999, the MIP has helped over 85,000 families establish home ownership, with loan drawdown totalling over HK$183 billion.

Refinements of MIP

In light of the then overheated property market climate, the Corporation took steps in August and November 2010 to tighten certain eligibility criteria for the MIP to lower the risk of borrower over-extending themselves. The Corporation suspended the MIP coverage of 95% LTV mortgages and reduced the maximum loan amounts of 90% of the LTV mortgages from HK$12 million to HK$6.12 million (Note: The property value was capped at HK$6.8 million).

The Corporation introduced the Risk-based Scoring Model ("RBSM") in November 2010 as an enhancement to its MIP. The RBSM replaced the Risk-based Pricing Scheme ("RBPS") and Loyalty Discount Scheme ("LDS"), which were both launched in 2006. The RBSM is a more robust and refined approach to implement risk-based pricing, which determines the applicable premium levels for MIP applications on the basis of homebuyers' credit quality and repayment capability. It is expected that more homebuyers will be eligible for MIP premium discounts, despite that the maximum discount rate under RBSM is 50%, which is same as the maximum aggregate discount rate available under the RBPS and LDS.

Training and Marketing

In order to raise public awareness of the MIP and its products, the Corporation launched a series of promotional activities on the MIP including advertising campaign, quiz game and publication of information leaflet, etc. Through these initiatives, members of the public were able to gain a better understanding of how the MIP could help people achieve home ownership.

Furthermore, the Corporation has always kept MIP participating banks well informed of any new developments, and consulted them for any new initiatives. It regularly organises MIP training seminars for banks and other market players such as estate agents and referral companies, so that their frontline staff can gain better understanding of the MIP and explain details of the programme to their customers when needed. A total of 12 training seminars were held in the year 2010.

Successful Launch of SME Financing Guarantee Scheme

SMEs are an important pillar of the economy and employment market in Hong Kong. About half of the total workforce in Hong Kong is employed by SMEs. To mitigate the impact of the 2008 global financial crisis, the Government swiftly rolled out the HK$100 billion Special Loan Guarantee Scheme in December 2008 to help SMEs resolve difficulties in obtaining bank financing and potential surge in unemployment problems that would arise from SMEs closing down. With the recovery of the local economy as well as the improved financing and cash flow for SMEs, the Special Loan Guarantee Scheme ceased to receive new applications from 1 January 2011.

Back in May 2010, many SMEs and think tanks proposed for a sustainable, market-oriented platform to be developed in

Hong Kong so that SME loans would be guaranteed upon the phasing out of the Special Loan Guarantee Scheme. This proposal gained extensive support from society. The SMEs and banks believed that the HKMC's financial strength and track record in operating financing guarantees and insurance businesses would make the HKMC a prime candidate for operating this sustainable, market-based SME financing guarantee scheme.

The HKMC therefore carried out an in-depth study and extensive consultations with stakeholders (including SME associations, banks and etc.) on the proposition. Eventually the Board of Directors gave approval on 15 November 2010 to launch the SME Financing Guarantee Scheme ("SFGS") based on prudent commercial principles from 1 January 2011. The Scheme effectively lowers banks' credit risks when lending to the SMEs. Hence it helps maintain the stability of the banking sector and is in line with the core objectives of the HKMC.

During the design stage of the Scheme, the Corporation made reference to various support schemes offered by the Government hoping that they could complement each others. Since the Scheme offers guarantee products with different guarantee protection coverages (50%, 60% and 70%), it provides more flexible options for helping SMEs in Hong Kong acquire more stable financing from banks to meet their funding needs for working capitals or acquisition of equipment and assets in support of business operation.

Premium Loan Guarantee Scheme

In September 2010, the Corporation launched the Premium Loan Guarantee Scheme ("PLGS") to complement the Government's initiative in revitalising the Home Ownership Scheme ("HOS") secondary market. The PLGS offers an additional means of financing to the HOS owners who needs flexibility in paying the premium to the Hong Kong Housing Authority. This scheme allows the HOS owners to repay the premium loan by instalments to banks under the Corporation's guarantee.

Reverse Mortgage Pilot Scheme

Reverse Mortgage is a desirable measure that should be introduced in Hong Kong to address the challenges that have arisen from the increasingly aging population, in particular those asset-rich-income-poor homeowners. The Corporation commissioned a city-wide survey in the fourth quarter of 2010 to gauge public opinions towards reverse mortgage among the elderly homeowner segment of the population. Given the positive findings of the survey, the Board of the Corporation approved in December 2010 a pilot scheme on reverse mortgage. The pilot scheme, to be launched in 2011, enables the elderly people to utilize their self-occupied and residential properties as collateral to borrow reverse mortgage loans in return for a stream of monthly payouts while staying at their original residences for the rest of life.

Joint Venture Outside Hong Kong

In 2010, the Central Government increased the down payment, interest rate and reserve requirement ratio, with a view to cooling down the overheated property market. Given these tightening policies to curb property prices, the Corporation is facing a harsh business environment. In Shenzhen, the short-term bridging guarantee business of the Bauhinia HKMC Corporation Limited ("BHKMC") has been progressing at a stable rate as a result of the Central Government's measures to rein in the property prices in 2010.

The Cagamas HKMC Berhad, incorporated in Malaysia in 2008, is a joint venture between the Corporation and Cagamas Berhad. The joint venture provided mortgage guarantee on conventional and Islamic mortgage portfolios. One transaction was concluded under the Mortgage Guarantee Programme in the second half of 2010 with a national oil company of Malaysia.

Funding

2010 continued to be a turbulent year for the local and global capital markets under the menace of the lingering European sovereign debt crisis and fragile recovery of the US economy. With the extension of liquidity and stimulus measures implemented by governments worldwide and in particular, the implementation of a new round of quantitative easing by the US that has led to abundant liquidity in the financial markets, debt market activities picked up and credit spreads continued to tighten in the second half of 2010. In spite of the volatile market conditions, the Corporation has managed to secure prudent pre-funding to cater for loan purchases and refinancing. Given the Corporation's strong background as a wholly government-owned entity and its solid credit ratings, as well as investors' flight-to-quality inclination, the Corporation continued to be the most active Hong Kong dollar corporate issuer for the tenth year. In 2010, a total amount of HK$8.3 billion of debts were raised. At the end of 2010, the Corporation's total outstanding debt amounted to HK$39.1 billion.

The Corporation is committed to developing the local debt market through regular debt issuances and introduction of new debt products. As one of the most active bond issuers in Hong Kong, the Corporation will continue to issue debts in both local institutional and retail markets, and diversify its funding sources and investor base to overseas institutional markets. This will not only help broaden the Corporation's funding base, but also provide institutional and retail investors with high quality debt instruments to satisfy their need for portfolio diversification and yield enhancement.

The Corporation has three debt issuance programmes which allow the issuance of debt securities in an efficient and effective manner. With its strong credit ratings, the Corporation's debt issues are well received by the investing community such as pension funds, insurance companies, investment funds, charities, government-related funds as well as retail investors. The Corporation strives to maintain a pro-active approach by updating investors regularly in the local and regional markets, with Mainland China, Japan and Singapore, to name a few.

Debt Issuance Programme

The Debt Issuance Programme ("DIP") is the Corporation's main platform for raising Hong Kong dollar's funding. The DIP was established in July 1998 to target institutional investors in the Hong Kong dollar debt market. It was set up with an initial programme size of HK$20 billion, which was subsequently increased to HK$40 billion in 2003. The DIP has since provided a flexible and efficient platform for the Corporation to issue debts and transferable loan certificates with a tenor of up to 15 years. Apart from plain vanilla debts, the Corporation also issues high quality structured products to meet investor demand. A total of 6 Primary Dealers and 16 Selling Group Members appointed under the DIP provide wide distribution channels for both public and private debt issues.

During 2010, the Corporation issued 26 DIP debt securities for a total amount of HK$7.1 billion. The Corporation continued to issue long-term debts, such as 15-year callable zero coupon bonds, to meet the growing demand for long-term high-grade debt products from insurance and pension funds in Hong Kong. At the end of 2010, the total outstanding amount of DIP debt securities reached HK$26.7 billion.

Retail Bond Issuance Programme

The Corporation is dedicated to promoting the local retail bond market with the objective of extending the Corporation's investor base beyond its already strong institutional investor community. In November 2001, the Corporation successfully pioneered a new offering mechanism for the retail bond market in Hong Kong.

To further spur the development of the retail bond market, the Corporation established the HK$20 Billion Retail Bond Issuance Programme and made its debut issuance in June 2004. Under this programme, banks acting as placing banks use their retail branch networks, telephone and electronic banking facilities to place debt securities issued by the Corporation to retail investors. To ensure the liquidity of the aforementioned retail bonds, the placing banks are committed to making firm bid prices for the bonds in the secondary market. Over the years, the Corporation's retail bonds have gained widespread recognition as a safe and simple investment choice with reasonably attractive returns, giving retail investors an opportunity to invest in high-grade debt securities issued by a wholly government-owned corporation. When the market environment is conducive, the Corporation aims to issue retail bonds regularly to provide an additional investment tool for Hong Kong's retail investors.

Since 2001, the Corporation has issued a total amount of HK$13.7 billion retail bonds. At the end of 2010, the total outstanding amount of retail bonds stood at HK$0.9 billion.

Medium Term Note Programme

The Corporation established the multi-currency US$3 Billion Medium Term Note ("MTN") Programme in June 2007 to raise funds in the international market and broaden its investor base and funding sources. The multi-currency feature of the programme enables the Corporation to issue notes in major currencies, including the Hong Kong dollar, US dollar, euro and yen to meet the demands of both local and overseas investors. All foreign currency denominated MTN debts are fully hedged into either the US dollar or Hong Kong dollar. The programme incorporates flexible product features and offering mechanisms for both public issuances and private placements so as to increase its appeal to investors with different investment horizons and requirements. An extensive dealer group comprising 10 major international and regional financial institutions has been appointed to support future MTN issuance and provide secondary market liquidity.

During 2010, the Corporation launched three MTN private debt issues, including debts denominated in the US dollar and the Singapore dollar, totalling an equivalent of HK$1.2 billion. At the end of 2010, the total outstanding amount of MTN debts was HK$11.6 billion.

Revolving Credit Facility provided by the Exchange Fund

During the Asian Financial Crisis, the Exchange Fund extended a HK$10 billion Revolving Credit Facility through the Hong Kong Monetary Authority to the Corporation in January 1998. The Facility enables the Corporation to maintain smooth operation under exceptional circumstances, so that it can better fulfill its mandate of promoting banking and financial stability in Hong Kong. While the Corporation obtains long-term funding from local and international debt markets to fund its operation, the Facility also stands as a liquidity fallback for the Corporation. In light of the global financial crisis in 2008, the size of the Facility was subsequently increased to HK$30 billion in December 2008, which demonstrated the HKSAR Government's recognition of the importance of and further support to the Corporation.

The Corporation made drawings of the Revolving Credit Facility during times of market stress in 1998 and 2008 to partially fund the acquisition of Hong Kong residential mortgage assets from local banks. At both times, the Revolving Credit Facility was fully repaid by the funds raised from the Corporation's cost-effective debt issuance when the market returned to stable conditions. At the end of 2010, there were no more drawdowns made under the Revolving Credit Facility.

Credit Ratings

The Corporation's ability to attract investment in its debt securities is underpinned by its strong credit ratings, equivalent to those of the HKSAR Government according to Moody's and S&P.

Credit Ratings of the HKMC

	Standard & Poor's		Moody's	
	Short-term	Long-term	Short-term	Long-term
Local Currency (Outlook)	A-1+	AAA (Stable)	P-1	Aa1 (Positive)
Foreign Currency (Outlook)	A-1+	AAA (Stable)	P-1	Aa1 (Positive)

On 11 November 2010, Moody's raised the HKMC's long-term local and foreign currency rating from "Aa2" to "Aa1" with a positive outlook, along with its rating upgrade of the Hong Kong SAR Government.

On 16 December 2010, S&P upgraded the long-term local and foreign currency ratings of the Corporation from "AA+" to "AAA" with a stable outlook, also in line with its rating upgrade of the Hong Kong SAR Government.

Both credit rating agencies have made very positive comments on the Corporation's credit standing. The following comments are extracts from the credit rating reports of Moody's and S&P after their annual surveillance in May 2010:

S&P

"The ratings on HKMC are equalized with the sovereign credit ratings on the Hong Kong Special Administrative Region. This reflects S&P's expectation of an almost certain likelihood of timely and sufficient extraordinary support from the Hong Kong government to the HKMC in the event of financial distress. The critical importance of the Corporation's policy roles and integral link with the government support this view."

"On a standalone basis, the ratings reflect the HKMC's prudent credit risk management, strong liquidity, and satisfactory capital base."

"The HKMC has a traditional and generally prudent approach to risk management. Recognising credit risk as its focus of risk appetite, the Corporation has adopted stringent policies, a simple and effective business model and management structure, and various hedging tools to largely mitigate other types of risks."

"The HKMC's liquidity position is adequately managed... The Corporation also maintains a reasonably high level of liquid assets in the form of marketable debt securities, cash and bank deposits, which provides a liquidity fallback."

Moody's

"There is strong intrinsic economic relationship between the HKMC and the HKSAR Government, given its status as a mortgage product provider and the importance of land and property in the Hong Kong economy."

"The expected high level of (government) support reflects the HKMC's status as a wholly-owned Government entity to carry out critical functions in enhancing financial and banking stability in Hong Kong by providing liquidity for the mortgage and property markets via banks and housing agencies, promoting home ownership, and spearheading the development of the debt markets in Hong Kong."

"The HKMC's asset-liability management is well developed within the constraints of the local markets in terms of the availability of tools and long-term funding. Its ability to assess and manage risk has resulted in risk levels well within its own guidelines and, in some cases, superior to some of its larger international peers."

"Over the years, the HKMC has demonstrated a strong ability to secure funding, even when liquidity in the system had shrunk during unexpected circumstances, thanks to special exemptions or privileges for its securities and its strong fundamentals."

Mortgage-Backed Securitisation

The Corporation has established two mortgage-backed securitisation programmes for issuing the mortgage-backed securities ("MBS") in an efficient and effective manner. These two programmes - the Guaranteed Mortgage-Backed Pass-Through Securitisation Programme and the Bauhinia Mortgage-Backed Securitisation Programme - were the first securitisation programmes ever set up in the Hong Kong debt market.

MBS is a powerful financial instrument that can channel long-term funding from the debt market to supplement the need for long-term financing generated by mortgage loans. Banks and financial institutions can make use of MBS to manage risks inherent in mortgage loans, such as credit risks, liquidity risks, interest rate risks and asset liability maturity mismatch risks. A deep and liquid MBS market can help enhance the development of an efficient secondary mortgage market and further promote Hong Kong as an international financial centre.

The Corporation made no MBS issuances in 2010 due to a fall in investor demand and the unfavourable market conditions that followed the global financial crisis.

Guaranteed Mortgage-Backed Pass-Through Securitisation Programme

This first MBS securitisation programme of the Corporation, established in October 1999, targets banks that not only want to off load mortgage loans but also wish to enjoy the benefits of holding MBS guaranteed by the Corporation.

The back-to-back structure under this programme allows the Corporation to acquire mortgage loans from a bank and then sell the mortgage loans directly to a bankruptcy remote special purpose entity ("SPE"). The SPE in turn issues MBS to the bank as an investor of the security. Through this back-to-back exercise, the bank can convert illiquid mortgage loans into liquid MBS. Furthermore, as far as the capital adequacy requirement is concerned, MBS guaranteed by the Corporation are assigned a 20% risk asset weighting under the Banking (Capital) Rules as opposed to 35% - 100% for mortgage loans, thereby allowing banks to utilise their capital more efficiently. Since the inception of the programme, four series of MBS with a total amount of HK$2.8 billion have been issued.

Bauhinia Mortgage-Backed Securitisation Programme

The Bauhinia Mortgage-Backed Securitisation Programme established in December 2001 is a US$3 billion multi-currency mortgage-backed securitisation programme. The programme provides a convenient, flexible and cost-efficient platform for the Corporation to issue MBS with various product structures, credit enhancements and distribution methods. MBS issued under the Bauhinia Mortgage-Backed Securitisation Programme have the trading and settlement characteristics of a eurobond. Trading of the MBS in the secondary market is therefore more convenient and efficient.

Since the inception of the Bauhinia Mortgage-Backed Securitisation Programme, the Corporation has successfully securitised HK$10.4 billion of mortgage loans through five public issues and one private placement issue. The debut MBS issuance of HK$2 billion under the programme, took place in March 2002. The second issue of HK$3 billion in November 2003 was the largest ever Hong Kong dollar denominated residential MBS. The third public issue of HK$2 billion, split into two portions for institutional and retail investors respectively, was delivered in November 2004. This was the first time in Asia that retail investors were given the opportunity to invest in MBS. The fourth MBS issue of HK$1 billion was done in November 2005. The fifth public issue of HK$2 billion, split into three senior tranches rated "Aaa/AAA" and one subordinated tranche rated "Aaa/AA", was delivered in November 2006. This was the first partially guaranteed MBS that was executed under the programme.

Risk Management

The Corporation operates under prudent commercial principles, and the principle of "prudence before profitability" guides the design of the overall risk management framework and discipline it uses in day-to-day business execution. Over the years, the Corporation has also continuously made refinements to its well-established, robust and time-tested risk management framework to reflect changes in markets and business strategies.

Restructuring of Risk Division

In 2009, a new division called Risk Oversight and Management was established with the aim to further enhance corporate risk governance through the strengthening of risk oversight and risk management. The division was subsequently repositioned in 2010 to attain a better balance between oversight and execution; hence it was renamed Risk Division. The new division now aims to enhance the risk management and business execution capabilities of the Corporation, and is comprised of three functions: mortgage insurance, pricing & quantitative risk and risk management.

Corporate Risk Management Committee

The Board is the highest decision making authority of the Corporation and holds the ultimate responsibility for risk management. The Board, with the assistance of the Corporate Risk Management Committee ("CRC"), has the primary responsibility for the formulation of risk management strategies and for ensuring that the Corporation has an effective risk management system to implement these strategies.

The CRC is responsible for overseeing the Corporation's various types of risks, reviewing and approving high-level risk-related policies, overseeing their implementation, and monitoring improvement efforts in governance, policies and tools. It also assigns priorities and responsibilities to individual departments to enhance the risk management framework. The Committee is chaired by an Executive Director, with members including another Executive Director, Chief Executive Officer, Senior Vice President (Operations), Senior Vice President (Finance), General Counsel and Senior Vice President (Risk).

The five major areas of risk the Corporation faces comprise credit risk, market risk, operational risk, legal risk and leveraging risk.

(a) Credit Risk

Credit risk is the Corporation's primary risk exposure. It represents the default risk presented by loan borrowers and counterparties.

(i) Default risk

To address default risk effectively, the Corporation adheres to a four-pronged approach that safeguards and maintains the quality of its assets and MIP portfolios:

- Careful selection of Approved Sellers/Servicers/Reinsurers
- Prudent asset purchase and insurance application eligibility criteria
- Effective due diligence process
- Enhanced protection for higher-risk mortgages and transactions

Losses may arise if there are shortfalls in the recovery amount received for defaulted loans that are under the Mortgage Purchase Programme ("MPP"). To mitigate this default risk, the Corporation adopts a set of prudent loan purchase criteria and conducts effective due diligence review as part and parcel of the loan purchase process in order to maintain the credit quality of loans. In addition, depending on the projected risk exposure of each underlying loan portfolio, credit enhancement arrangements such as reserve funds for absorbing credit losses will be agreed upon with the seller on a deal-by-deal basis so as to reduce the potential credit losses that could arise from the borrower's default.

Similarly, losses may also arise from default on loans under the MIP's insurance coverage. Each MIP application is underwritten by the Corporation in accordance with a set of eligibility criteria, and each claim from a participating bank is audited by the Corporation to ensure the fulfillment of all MIP coverage conditions and to detect any fraud elements. As a result, the default risk for loans with MIP coverage has been greatly reduced. To reduce possible concentration of the aforementioned default risk, the Corporation transfers a portion of the risk-in-force to Approved Reinsurers via reinsurance risk-sharing and excess-of-loss arrangements.

(ii) Seller/Servicer counterparty risk

Counterparty risks may arise from the failure of a seller/servicer of an acquired portfolio to remit scheduled payments to the Corporation in a timely and accurate manner. The Corporation has adopted a counterparty risk limit framework that limits the aggregate amount of assets it can purchase from Approved Sellers. There are also individual limits set on the maximum amount of assets that the Corporation can purchase from a counterparty. The risk limit framework acts as a beneficial device for managing counterparty exposure on the risk profile basis of each Seller/Servicer and for avoiding the concentration of acquisition from a few sellers only.

(iii) Reinsurer counterparty risk

Reinsurer counterparty risk refers to the failure of an Approved Reinsurer to make claim payments to the Corporation. In order to mitigate counterparty risk effectively, the Corporation has established a framework for the assessment of mortgage reinsurers' financial strengths, credit ratings and their relevant experiences in mortgage insurance.

(iv) Treasury counterparty risk

Treasury counterparty risk arises when there is a delay or failure from treasury counterparties to make payments with respect to treasury instruments transacted with the Corporation. Hence, the Corporation has adopted a prudent treasury counterparty limit framework, under which each potential treasury counterparty is assessed on the basis of its credit ratings, financial strengths and capability in treasury products, etc. Based on the evaluation results, a treasury counterparty limit is assigned to each specific type of treasury instrument exposure.

(v) Control mechanisms

Portfolio performance and analysis reports are compiled on a regular basis to provide the management with up-to-date information on critical credit risk indicators, such as loan delinquency ratios, equity positions and cumulative credit losses, so as to enable timely reviews and swift responses to changes in the operating environment. Stress tests on retained portfolios and mortgage insurance portfolios are conducted to analyse the Corporation's financial capability to weather extreme scenarios when they arise.

The counterparty limits of all Sellers and Servicers are subject to regular review, where their financial strengths, management capabilities, loan servicing quality and transaction experience are taken into consideration for renewal and/or adjustment in limit. The limits for treasury counterparties are reviewed and adjusted on a regular basis, which are based on their financial strengths, and the capital base of the Corporation at the time. To date, the Corporation has not experienced any losses on a treasury transaction due to credit defaults by a counterparty.

The Corporation also performs an annual review of the approved reinsurers' financial strengths, business proposals, reinsurance arrangements and management capabilities. The review results are used to determine the on-going businesses' allocations and risk-sharing portions.

(vi) Governance

At the heart of the Corporation's credit risk management framework are two committees: the Credit Committee and the Transaction Approval Committee.

Credit Committee

The Credit Committee is responsible for setting the Corporation's overall credit policies and eligibility criteria, particularly for asset acquisition and mortgage insurance. The Committee operates under the framework that has been approved by the Board. It is the approval authority for accepting applications to become Approved Sellers/Servicers under the MPP, Approved Reinsurers under the MIP and eligible treasury counterparties. It is also responsible for setting risk exposure limits for the counterparties. Should the business and operating environment change drastically, credit policies will be immediately subject to review and timely measures based on the findings will be presented to the Committee for approval.

Transaction Approval Committee

The Transaction Approval Committee is the forum for the in-depth analysis of pricing economics and associated credit risks for business transactions, whilst taking into consideration the latest market conditions and business strategies approved by the Board. Major transactions approved by the Committee are subject to endorsement by an Executive Director.

The Credit Committee and the Transaction Approval Committee are both chaired by the Chief Executive Officer with members including Senior Vice President (Operations), Senior Vice President (Finance), General Counsel, Senior Vice President (Risk) and senior staff from the relevant functional departments.

(b) Market Risk

Market risks arise when the Corporation's income or the value of its portfolios decrease due to movements in market prices. Market risk consists of interest rate risk, asset-liability maturity mismatch risk, liquidity risk and currency risk.

(i) Interest rate risk

Net interest income is the predominant source of earnings for the Corporation. It represents the excess of interest income (from the Corporation's loan portfolio, cash and debt investments) over interest expenses (from debt issuance and other borrowings). Interest rate risks arise when changes in market interest rates affect the interest income associated with the assets and/or interest expenses associated with the liabilities.

The primary objective of interest rate risk management is therefore to limit the potential adverse effects that could arise from interest rate movements on interest income/expense, while maintaining a stable earnings growth. The interest rate risk faced by the Corporation is two-fold, namely interest rate mismatch risk and basis risk. Interest rate mismatch risk is the most substantial risk affecting the Corporation's net interest income. It arises mainly as a result of the differences in the timing of interest rate re-pricing for the Corporation's interest-earning assets and interest-bearing liabilities. Interest rate mismatch risk is most evident in the loan portfolios where the majority of the loans earn a floating interest rate (benchmarked against the Prime rate, the HIBOR or Composite Interest Rate), whilst the majority of the Corporation's liabilities are fixed-rate debt securities. The Corporation therefore makes prudent use of a range of financial instruments, such as interest rate swaps, interest rate swaptions, basis swaps, forward rate agreements and issuances of MBS, to manage interest rate mismatch risk. The proceeds of the fixed-rate debt securities are generally swapped into HIBOR-based funds via interest rate swaps in order to better match the floating-rate incomes from mortgage assets.

The Corporation also uses duration gap as an indicator to monitor, measure and manage interest rate mismatch risks. A duration gap measures the difference in interest rate re-pricing intervals between assets and liabilities. The wider the duration gap, the higher the interest rate mismatch risk, and vice versa. A positive duration gap means that the duration of assets is longer than that of the liabilities, and therefore represents a greater risk exposure to rising interest rates. On the other hand, a negative duration gap indicates a greater risk exposure to declining interest rates. Depending on the prevailing interest rate outlook and market conditions, the Corporation proactively re-balances the duration gap of its asset-liability portfolio under the guidance and supervision of the Asset and Liability Committee ("ALCO"). A cap of three months for the duration gap has been set to limit interest rate mismatch risks. In 2010, the average duration gap was kept at below one month, indicating that the Corporation handles interest rate mismatch risk in a very effective manner.

Basis risk represents the difference in the Corporation's prime-based interest-earning assets and its HIBOR-based interest-bearing liabilities. However, there are only limited financial instruments currently available in the market to hedge the Prime-HIBOR basis risk fully. In general, basis risk can only be effectively addressed when mortgage assets and non-mortgage assets are based on HIBOR to match the funding base, or when related risk management instruments become more prevalent or economical. Over the past few years, the Corporation has consciously adopted a strategy that acquires more HIBOR-based assets. At the end of 2010, about 60% of the Corporation's mortgage assets and non-mortgage assets were HIBOR-based loans. As a result, the Prime-HIBOR basis risk for the Corporation has been substantially reduced. In addition, the issuance of Prime-based MBS and the use of hedging derivatives have also been deployed to mitigate the basis risks in the Prime-based portion of the Corporation's loan portfolio.

(ii) Asset-liability maturity mismatch risk

Even though the contractual maturity of a mortgage loan can go up to 30 years, the actual average life of a portfolio of mortgage loans is much shorter. The average life depends on the speed of scheduled mortgage repayments and unscheduled prepayments. Higher prepayment rates shorten the average life of a portfolio of mortgage loans. In Hong Kong, prepayment occurs for two main reasons: (i) housing turnover - borrowers repaying their mortgage loans upon the sale of the underlying property, and (ii) refinancing - borrowers refinancing their mortgage loans to obtain lower mortgage rates.

Asset-liability maturity mismatch risk can be more specifically characterised as reinvestment risk and refinancing risk. Reinvestment risk refers to the risk of a lower return from the reinvestment of proceeds that the Corporation receives from prepayments and repayments of its loan portfolio. Refinancing risk is the risk of refinancing liabilities at a higher level of interest rate or credit spread. The Corporation is exposed to refinancing risk (in both funding amount and cost of funds) when it uses short-term liabilities to finance long-term floating-rate loan portfolios.

Reinvestment risk is managed through on-going efforts of purchasing new loans to replenish the rundown in the retained portfolios and through the investment of surplus cash in debt securities or cash deposits to fine-tune the average life of the overall assets pool.

Refinancing risk is managed through the issuance of callable bonds and transferable loan certificates. The call option included in callable bonds and transferable loan certificates allows the Corporation to adjust the average life of its liabilities to match more closely with that of the overall pool of assets. In this regard, the Corporation also has the flexibility of issuing debt securities on a broad spectrum of maturities, ranging from one month to 15 years. This again serves to adjust the average life of the overall liability portfolio in a dynamic fashion. In addition, refinancing risk can be mitigated by adjusting the maturities of assets in the investment portfolio and off-loading mortgage assets through securitisation of mortgage loans into MBS.

Asset-liability maturity gap ratio (ratio of the average life of the total interest earning assets to average life of the total interest bearing liabilities), is used to monitor and manage maturity mismatch risk, with a target ratio set by the ALCO to ensure a proper balance between the average life of the Corporation's assets and liabilities.

(iii) Liquidity risk

Liquidity risk represents the risk of the Corporation not being able to repay its obligations, such as the redemption of maturing debt, or to fund the committed purchases of loan portfolios. Liquidity risk is managed by the monitoring of daily inflow and outflow of funds and by projecting the longer-term inflows and outflows of funds across a full maturity spectrum. The Corporation measures its liquidity risk with a target liquid asset ratio (ratio of liquid asset to total assets), which was set by the ALCO to monitor and manage its liquidity position. The Corporation manages pre-funding prudently through well-diversified funding sources, so that all foreseeable funding commitments are met when they fall due, in order to support the growth of its business and the maintenance of a well-balanced liability portfolio. Such diversification allows the Corporation to pursue a pre-funding strategy at the lowest possible cost, whilst at the same time offering safeguards against the inability to raise funds in distorted market conditions. The current funding sources include:

- Shareholders' Capital: an authorised capital of HK$3 billion, of which HK$2 billion is fully paid up. Accumulated shareholders' funds amounted to HK$7.6 billion as of 31 December 2010.
- HK$40 Billion Debt Issuance Programme: there are 6 Primary Dealers and 16 Selling Group Members which underwrite and distribute debts to institutional investors under the DIP. The Transferable Loan Certificate Sub-Programme under the DIP provides a further diversification of its funding sources and broadening of investor base.
- HK$20 Billion Retail Bond Issuance Programme: this debt issuance programme has 19 Placing Banks which assist in offering retail bonds to investors.
- US$3 Billion Medium Term Note Programme: there are 10 Dealers who underwrite and distribute local and foreign currency debts to the international institutional investors under the programme.
- US$3 Billion Bauhinia Mortgage-Backed Securitisation Programme: with a total of eight Dealers, this multi-currency mortgage-backed securitisation programme permits the Corporation to originate MBS in both the local and international markets.
- Cash and Debt Investment Portfolio: the portfolio comprises mainly cash and bank deposits, commercial papers, high-quality certificates of deposits and notes that can be readily converted into cash.
- HK$30 Billion Revolving Credit Facility: the Exchange Fund commits to providing the Corporation with HK$30 billion in revolving credit.
- Money Market Lines: the Corporation has procured money market lines from a large number of local and international banks for short-term financing.

Given its strong background as a wholly government-owned entity and its solid credit ratings, the Corporation is efficient in raising funds from the debt market with both institutional and retail funding bases. This advantage is supplemented by the Corporation's portfolios of highly liquid investments, which are held to enable swift and smooth responses to unforeseen liquidity requirements. The HK$30 billion Revolving Credit Facility from the Exchange Fund further provides the Corporation with a liquidity fallback even when exceptional market strains last for a prolonged period of time.

The Corporation implements its liquidity risk management framework in response to changes in market conditions. The Corporation has continuously monitored the impact of recent market events on its liquidity positions, and has pursued a prudent pre-funding strategy which has helped to contain the impact the global financial turmoil had on its liquidity.

(iv) Currency risk

Currency risk arises from the impact of foreign exchange rate fluctuations on the Corporation's financial position and foreign currency denominated cash flows. The Corporation manages its currency risk in strict accordance with the investment guidelines approved by the Board and under the supervision of the ALCO, which sets daily monitoring limits on currency exposure.

In accordance with this prudent risk management principle, the net exposure of the foreign currency denominated debts issued under the MTN Programme and the overseas residential mortgage loans purchased is fully hedged by the use of cross-currency swaps.

(v) Control mechanism

Transaction execution is segregated among the front, middle and back offices to ensure adequate checks and balances. The Treasury Department, acting as the front office, is responsible for monitoring financial market movements and executing transactions in the cash, derivatives, debt and securitisation markets in accordance with the strategies laid down by the ALCO. The Financial Control Department assumes the middle office role and monitors compliances with treasury counterparties and market risk limits. The Operations Department, acting as the back office, is responsible for deal verification, confirmation, settlement and payment process.

(vi) Governance

Asset & Liability Committee

The ALCO manages the Corporation's asset-liability portfolio with prudent risk management principles. It has the authority to set market risk management policies and limits to facilitate day-to-day market risk management. Regular meetings are held to review the latest financial market developments and the asset-liability portfolio mix. Furthermore, it also oversees the implementation of risk management and investment guidelines approved by the Board.

The ALCO is chaired by the Chief Executive Officer, with members including Senior Vice President (Finance), Senior Vice President (Operations), Senior Vice President (Risk) and senior staff from the relevant functional departments.

(c) Operational Risk

Operational risk represents the risk of losses arising from inadequacies or the failure of internal processes, people, systems or external interruptions.

(i) Control mechanism

The Corporation adopts a bottom-up approach in identifying operational risk by carrying out in-depth analysis on new products, business activities, processes, system enhancements and due diligence reviews of new operational flows. Comprehensive validation rules, management information system reports and audit trails are put in place to track and report any errors or deficiencies.

The Corporation actively manages operational risk with its comprehensive systems of well-established internal controls, authentication structures and operational procedures. Operational infrastructures are well designed to support the launches of new products in different business areas, including asset acquisition, mortgage insurance, treasury operations, bond issuances, securitisations and overseas businesses. Rigorous review is conducted before the implementation of operational or system infrastructures in order to identify possible operational risk and to ensure adequate segregation of duties.

To prevent potential human errors and to ensure an efficient and effective discharge of daily operations, the Corporation pursues advanced technological solutions alongside robust business logics and controls to carry out its operational activities and business processes. Steps have been taken to ensure the accuracy, availability and security of these systems, as they are critical to business operations and risk managements.

The Corporation has also taken careful steps to institute adequate checks and balances in financial controls to ensure that its operations are properly directed and controlled. Effective financial controls also help to minimise the financial risks and safeguard its assets against inappropriate use or loss, including prevention and detection of fraud.

The Corporation's Information Security Manual ("ISM") documents security standards and practices relating to information and data security for observance by all staff. All system security measures must follow the requirements stated in the ISM. The Corporation implements various security measures, such as double firewall protections, intrusion detection systems, virus alerts, quarantine systems and vulnerability scanning systems so as to minimise its exposure to external attacks. Internally, the Corporation also has a virtual Local Area Network with workstation security policies, to reduce damages in the event of a malicious intrusion. The Corporation engages external consultants for intrusion vulnerability tests in order to enhance system security when appropriate.

To ensure a high degree of compliance, the Corporation's core operating systems and processes are subject to regular audit and review by internal and external auditors. Furthermore, all staff are required to sign an undertaking to comply with the requirements in the ISM every year. The ISM is updated whenever there is a new security measure or a new system. Any changes to the ISM require approval from senior management.

To ensure that business recovery procedures are practical and to facilitate continuous improvement, a business recovery drill is conducted by both IT and user departments every year. Daily back-ups and off-site storages of back-up tapes were put into place to protect the Corporation from IT disasters.

Product Sign-off Mechanism

To ensure that all risk factors are considered when designing and implementing a new product, the Corporation developed a new product development management framework under which proper sign-off of product specification is conducted prior to the new product launch. The product driver is clearly assigned upfront at the start of the product development process to be responsible to institute the sign-off process. Products can only be launched after all functional departments have signed-off and confirmed functional readiness.

(ii) Governance

Operational Risk Committee

The Operational Risk Committee ("ORC") is responsible for ensuring that all business entities and line functions in the HKMC maintain an effective operational risk and internal control framework. Furthermore, it is also responsible for providing directions and resolving issues related to policies, controls and management of operational issues referred to by line functions as well as ensuring prompt and appropriate corrective actions upon audit findings related to operational risks and internal controls.

The ORC is chaired by the Chief Executive Officer, with members including Senior Vice President (Operations), Senior Vice President (Finance), General Counsel, Senior Vice President (Risk) and senior staff in the relevant functional departments.

(d) Legal Risk

Legal risk is the risk arising from uncertainty in the application or interpretation of laws, regulations and legal documents, or failure to comply with the statutory, regulatory or legal obligations.

(i) Control mechanism

The Legal Office, headed by General Counsel and Company Secretary, advises the Corporation on legal matters with a view to controlling legal risk. When new products or business activities are considered, the Legal Office will advise on the relevant laws and regulatory environment, as well as the legal documentation, and identify possible legal pitfalls with a view to protecting the best interests of the Corporation. Where appropriate, external counsel will be engaged to assist the Legal Office in providing full legal support to the Corporation. The Legal Office also works closely with the other departments of the Corporation to advise on legal issues and documentation.

The General Counsel and Company Secretary ensures that company secretarial arrangements, for example, arrangements relating to the holding of Board meetings and general meetings, distribution of Board papers, passing of resolutions and the maintenance of meeting minutes etc., comply with the applicable laws and regulations, as well as the constitutional documents of the Corporation and the Code on Corporate Governance. The General Counsel and Company Secretary also provides advice and support to the Directors so as to ensure that best practices relating to Board procedures, avoidance of conflicts of interest and other aspects of corporate governance are observed.

(ii) Governance

The ORC is the governance committee for legal risks.

(e) Leveraging Risk

To ensure that the Corporation does not engage in excessive leveraging by expanding its business activities to over a certain proportion of its capital base, the Financial Secretary of the HKSAR Government has issued Guidelines on the Capital-to-Assets Ratio ("CAR") of the Corporation. The minimum CAR stipulated in the Guidelines is 5%.

In accordance with the capital requirement laid down in the Guidelines, the Corporation's maximum leverage should also be maintained at a healthy and low level. As at 31 December 2010, the Corporation has a capital base of HK$7.6 billion and a CAR at 10.8% which is well above the minimum requirement of 5%.

Capital adequacy and prudent use of regulatory capital are monitored daily by Management in accordance with the Guidelines issued by the Financial Secretary. The Chief Executive Officer is required to submit a quarterly report to the Board by reference to the Guidelines. An early warning system will alert Management when the ratio drops below 6%. Any breach or likely breach of the Guidelines must be reported to the Financial Secretary.

Process Management and Information Technology

Automation is instrumental in ensuring efficiency and accuracy in daily operations. Since its inception, the Corporation has devoted substantial resources and efforts to developing and upgrading its business operations, internal controls and application systems.

In 2010, the Corporation revamped its treasury system, with a view to making further enhancements in the timeliness of developing new treasury and hedging products; better risk management integration across various products, counterparts and regions; better integration and more reliable collaboration among front, middle and back offices; and more robust and responsive adaptations to meet future regulatory and reporting requirements. The new treasury system is now in its final stage of development, and will be launched by the end of 2011 after a comprehensive trial.

To support the launch of the SME Financing Guarantee Scheme in 2011, the Corporation also worked on the development of the Guarantee Information Processing System, a new application system that would provide internal control and process automation for application processing, post-commitment monitoring, guarantee fee administration, claim processing and management reporting, etc. This system will be phased in over 2011.

Automation also enables the introduction of more sophisticated products to meet market needs. In November 2010, the Corporation introduced a Risk-based Scoring Model, which replaced the Risk-based Pricing Scheme and Loyalty Discount Scheme as an enhancement of the Mortgage Insurance Program ("MIP"). The calculation and processing have become more comprehensive, and the turnaround time for the underwriting processes have improved.

Given the Corporation's know-how and expertise on document imaging and paperless operations adopted for the MIP operations, the Corporation had on trial an IT infrastructure to streamline the treasury and mortgage operations in order to better cope with the increasing transaction volume and sophistication. This automation on indexing, filing and retrieval of vast amount of paper documents is essential for timely transaction management and operational control. It also provides the extra benefit of unifying the filing and retrieval process for the straight-through-processing of trade confirmations, securities settlement, payment authentication and document storage. It is envisaged that the entire project will be launched in the first half of 2011. If necessary, it can be extended to document imaging needs for other new business operational areas.

Business Continuity Plan

As a business continuity plan is crucial to the sustainability of a corporate during disasters or damage of resources, the Corporation regularly reviews its corporate-wide business continuity plan, as well as the business continuity plans of its respective business and operational units, to ensure an effective and efficient decision-making and reporting framework in response to potential disastrous events.

In 2010, the Corporation revised the methodology of conducting drills on its business continuity plan. Instead of a well-planned and well-organised disaster recovery drill, the annual drill was triggered without prior notification to participating staff. This "surprise" drill was successful, as normal operations resumed within two hours.

Corporate Social Responsibility

In recognition of the Corporation's contribution to the community and its commitment to corporate social responsibility in the past year, the Hong Kong Council of Social Service awarded the Corporation the honour "Caring Organisation 2010/11" under its Caring Company Scheme for the third year.

同心展關懷
caringorganisation 2008-11
Awarded by The Hong Kong Council of Social Service
香港社會服務聯會頒發

Caring Company Recognition Ceremony

As a socially responsible organisation, the Corporation cares for both its staff and the community. The Corporation has underlined its commitment to corporate social responsibility by caring for its employees' well-being, participating in charity activities and implementing environmental protection measures.

Care for Employees

Staffing and Remuneration

With the Corporation's core mission of enhancing stability in the banking sector, promoting wider home ownership and facilitating the development of the debt securities market, it attracts and grooms talent in its key business areas of asset purchase, mortgage insurance and debt issuance. The Corporation provides its staff with competitive remuneration packages and fringe benefits, a promising career path and development opportunities, and a healthy and safe working environment. It also adopts family-friendly practices by offering a five-day week to help employees maintain a good work-life balance, as well as comprehensive medical and dental insurance plans which cover both the employees and their family members.

Through systems automation and process re-engineering, the Corporation has maintained a lean and efficient workforce, despite an increase in the scope of purchases and the complexity of the products it offers. In 2010, the permanent establishment of the Corporation was 146, and it recorded a staff turnover rate of 19%.

Training and Development

The Corporation recognises the importance of on-going training and has devoted considerable resources to the continuous enhancement of its employees' professional knowledge and skills. In 2010, the Corporation arranged both internal and external courses to help employees enhance their product knowledge, and strengthen their managerial and technical competence. The in-house training sessions on product training covered a range of topics from securitisation and credit approval/loan underwriting to bank lending to SMEs. There were in-house training workshops on soft skills, including team building, coaching skills, time management, effective writing skills and Putonghua training. The Corporation also sponsored employees who attended external courses covering a wide range of topics, from mortgage-related issues, risk management, finance and accounting, and corporate governance to information technology and management skills. In addition, all new staff were provided with an induction session to give them an overview of the Corporation's operations, as well as their specific scope of work.


Bank Lending to SMEs Workshop


Teamwork and Trust Building Workshop


Team Building Workshop for Management Team


Customer Service via Better Communication Training Workshop

Health and Safety

As a caring organisation, the Corporation is dedicated to looking after both the physical and mental health of its staff. An Employee Support Programme is in place to provide confidential external counseling and consultation services to employees and their family members if needed. A vaccination programme for the prevention of influenza and a health check programme at privileged rates were also offered to staff.

The Corporation has further reviewed and strengthened its contingency plans, such as split-team arrangements, to ensure a swift response to a possible outbreak of influenza. The contingency plans aim to prevent the spread of communicable diseases among staff and to minimise any unexpected or sudden disruption to business operations. Periodic drills are organised to make sure staff are conversant with the activation of the back-up facilities, contingency plans and communication arrangements in case of emergency.

Employee Relations and Staff Activities

To promote a better work-life balance and foster a family-friendly working place, the HKMC Staff Club, composed of members from various departments, regularly organises various staff activities to cultivate better relationships and communication among employees. Just some examples of the activities were Bowling Fun Day, Work-Life Balance Day, the New Life Farm visit and other staff gatherings, of which all were well received by staff and their family members. Staff have also participated in friendly soccer games with other organisations for fun and team building.

Bowling Fun Day

Visit to New Life Farm

To ensure effective communication within the Corporation, the Corporation's intranet Staff Homepage is frequently updated so that useful information can be shared across different departments. There is also the Staff Suggestion Scheme, which encourages staff to make suggestions for improvements on the work flow and the work place. In 2010, the Corporation also set up a "Mind Channel" that regularly disseminates short stories, epigrams and health tips to all staff, hoping to promote a work-life balance.

Work-Life Balance Day

Dress Special Day 2010

Care for the Community

Charities and Social Activities

The Corporation promotes charitable and community functions, such as fund-raising events, donation campaigns and voluntary services, from time to time. Staff are encouraged to support charity activities and do voluntary work. In 2010, donations were made to victims of the Haiti earthquake and the Qinghai earthquake. Other charity donation campaigns during the year included the Dress Special Day 2010 for the Community Chest, and the HKMC charity concert for education projects in the Mainland. And similarly, the annual Blood Donation Day for the Hong Kong Red Cross took place once again in 2010.

The staff are keen to participate in voluntary services, always willing to devote time and effort to showcase their concern for the needy in the society. In 2010, active volunteers from different departments came together to form a "Caring League" (meaning a group of people sharing a common goal and having a team spirit in caring our community). With the efforts of the Caring League, the Corporation has partnered with several social service organisations in a number of voluntary services including:

- Care for the environment and the children – a guided eco-tour to Fung Yuen Butterfly Reserve, followed by voluntary work of removing weeds with child volunteers from the Hong Kong Family Welfare Society;
- Care for the elderly – a visit to the HKYWCA Ming Yue District Elderly Centre and a visit to the elderly living alone organised by The Boys' & Girls' Clubs Association of Hong Kong during Mid-autumn Festival; and
- Care for the disabled – participation in International White Cane Day 2010 organised by Hong Kong Blind Union to help members of the public in understanding the difficulties that the visually impaired people would encounter in their daily lives.

Going Green – Butterfly Fantasy

Visit to elderly living alone

Student Programmes

To help nurture talents for the future, the Corporation provides a number of internship and placement programmes for undergraduates to give them a taste of the real business world and better prepare themselves for their future careers. The students who have joined the programmes have all left with the valuable learning experiences and work opportunities that they had been exposed to.

Visit to the HKYWCA Ming Yue District Elderly Centre

International White Cane Day 2010

Environmental Protection

The Corporation continuously supports and implements various green measures to create a more environmentally-friendly office and raise staff awareness of waste reduction and energy conservation. Staff are encouraged to adopt a paperless working practice by using more electronic communication means. They are also encouraged to collect waste paper and used toner cartridges for recycling, and are reminded to switch off their computers before leaving the office. Since 2006, the Corporation has put effort in taking various measures including better control of office temperature in the interest of energy efficiency. The Corporation welcomes suggestions from the staff for green office ideas, and encourages its suppliers to use or offer more environmentally-friendly products whenever possible.

2011 Outlook

While the Hong Kong economy has rebounded, the Corporation remains vigilant at all times and keeps abreast of all developments in the property and financial markets. Given the uncertainties of the global economy, as well as the launch of new projects – the SME Financing Guarantee Scheme, the Reverse Mortgage Pilot Scheme and the study of microfinance – it is expected that the year of 2011 will be another challenging year for the Corporation. Therefore, to fulfill its core missions and strengthen its strategic role in Hong Kong, the Corporation will continue to review its well-established business programmes from time to time, and enhance its products when appropriate to effectively meet the needs of the market.