2008 was a turbulent year to say the least. No market was immune from the financial tsunami and scores of financial institutions were severely affected by the storm. Under such extreme and volatile market environment, the HKMC acted promptly to fulfil our core mission of promoting financial stability through the purchase of assets from banks in Hong Kong. The HKMA expanded the Revolving Credit Facility provided by the Exchange Fund to the HKMC from HK$10 billion to HK$30 billion to ensure that the HKMC would have sufficient standby liquidity to play the all-important role as liquidity provider to the banking sector.

BUSINESS OVERVIEW

Performance Highlights

As a result of the liquidity crunch, 2008 saw enhanced opportunities for the HKMC to provide liquidity to the banking sector. The Corporation adopted a commercial and arms-length approach in the purchase of assets and no subsidy was involved in such transactions.

The major achievements of the Corporation for the year comprise:

- Record purchase of a total of HK$26 billion of assets in a year, including HK$13.6 billion of residential mortgage loans and HK$0.2 billion of non-mortgage assets in Hong Kong as well as the overseas purchase of HK$12.2 billion of Korean residential mortgage loans in the form of mortgage-backed securities.
- Drawdown of mortgage insurance coverage for newly originated mortgage loans was a record total of HK$20.4 billion, achieving a market penetration of 16%.
- Issuance of a record of HK$24.4 billion debt securities in a cost-effective manner, maintaining the HKMC's position as the most active corporate issuer in the Hong Kong dollar debt market for eight consecutive years.
- Safeguarding excellent asset quality, with a combined delinquency ratio (above 90-day ratio and rescheduled loan ratio) of 0.02% for the mortgage insurance portfolio, 0.12% for the Hong Kong residential mortgage portfolio (compared to industry average of 0.19%), and 0.07% across all asset classes as at 31 December 2008.
- Maintaining long-term foreign and local currency debt ratings of Aaa/AA+ by Moody's Investors Service, Inc. ("Moody's") and Standard & Poor's ("S&P") respectively.

The Corporation registered very solid financial results for 2008:

- Profit after tax of HK$605 million, which is HK$136 million or 18% lower than that in 2007.
- Low funding costs from new debt issuances which helped to maintain the net interest spread at 1.1%, better than the 1% achieved in 2007.
- Return on assets of 1.1%, a decrease of 0.5% over 2007.
- Return on shareholder's equity of 10.5%, a decrease of 3.2% over 2007.
- Capital-to-assets ratio remaining strong at 8.7%, well above the minimum requirement of 5%.
- Cost-to-income ratio of 17.5%, significantly lower than the banking industry average of 45.2.

Operational Highlights

Overall Business Strategy

- The primary focus of the HKMC is, and has always been, the local market and banking stability. There was a particularly acute demand for our services in 2008. Our presence is especially valued by banks as other forms of asset sale such as securitisation or other market intermediaries were mostly unavailable due to volatile market conditions.
- Having served the local market, we have also maintained our prudent diversification strategy as endorsed by the Board of Directors to maintain a viable scale of operations so as to perform our strategic role as liquidity provider to the local banking community in an efficient and effective manner. The Corporation therefore implemented a progressive business expansion plan to ensure effective integration of overseas businesses with the existing local lines of businesses.

Mortgage Insurance

- The Corporation continued with its drive to develop new products under the Mortgage Insurance Programme ("MIP"). As a result of credit crunch and pessimistic market sentiment, towards the latter half of 2008, banks tightened their lending policies with respect to residential mortgage. To cater for the needs of eligible homebuyers to access high LTV ratio mortgages, the Corporation proactively devised an enhancement to the MIP in December 2008 by cascading the insurance coverage threshold downwards from 70% to 60% LTV ratio for mortgages up to 90% LTV ratio.
- The market penetration of the MIP increased by one-third from 12% for 2007 to 16% for 2008. This is a healthy improvement and a good indication of an increasing need for the mortgage insurance product by the public.
- The Corporation continued vigorously with training for frontline staff and credit personnel of MIP participating banks during the year. This is an integral part of the strong partnership between the Corporation and the banks in the promotion of mortgage insurance to the public.
- The Corporation was able to maintain a high degree of processing efficiency for MIP applications through automation and the use of internet platform.

Fund-raising

- Issuance of a record total of HK$24.4 billion corporate debts with tenor up to 15 years to support asset purchase activities and redemption of maturing debts in a prudent and cost-effective manner.
- For the eighth year in a row, the Corporation was the most active corporate issuer in the Hong Kong dollar debt market with issuance of HK$19.2 billion of debt securities in the local institutional market.
- Issuance of high-grade retail bonds for a total of HK$543 million to promote the local retail bond market development.
- Debut issuance of foreign currency corporate debts amounting HK$4.7 billion equivalent under the Medium Term Note Programme to raise funds in the international market and to broaden the Corporation's investor base and funding source.

Mortgage & Treasury Operations

- Completed the final phase integration between back-end treasury system and SWIFTNet, allowing better security with Public Key Infrastructure and scalability on interfacing with different SWIFT services.
- Implemented systems and operational measures to support the tracking and monitoring of assets acquired from overseas.
- Selected a new treasury system solution to further enhance the operational efficiency, products innovation and integrated risk management of treasury operations.

Market Overview

General Economic Conditions

On the back of a prolonged period of robust economic growth in the past few years, the Hong Kong economy still performed relatively well in the first half of 2008. However, with the deepening of the financial crisis in the US in the second half of 2008, economic conditions in Hong Kong were severely affected, particularly following the collapse of Lehman Brothers in September 2008 that triggered a financial tsunami across global markets. For 2008 as a whole, Hong Kong's Gross Domestic Product grew by 2.5% in real terms, representing a sharp slowdown from a solid growth of 6.4% in 2007. Along with the abrupt deterioration in the business conditions, the labour market was hard hit with unemployment rate rising from a decade-low of 3.2% in mid 2008 to 4.1% in the fourth quarter of year. Consumption spending also slowed appreciably in the latter part of 2008, due to weakening consumer sentiment as a result of deteriorating job prospects as well as the negative wealth effect arising from a nose-dive in the stock market. As a testimony to worsening economic conditions, the number of bankruptcy cases in 2008 has rebounded to a 4-year high since 2004.

Notwithstanding the global financial tsunami, the Hong Kong banking system has remained generally robust with systemic risk well contained. In the face of market turbulence, the Government has introduced a number of timely measures to shore up confidence through alleviating liquidity pressure and stabilising the deposit base in the banking system.

Interest Rate Environment

The best lending rates ("BLRs") in Hong Kong trended downwards on four occasions during the course of 2008 from 6.75%-7% at the start of the year to 5%-5.25% at the year-end. Following the movement in the BLRs, the gross mortgage rates (GMR) for new mortgage loans also went down steadily during the first half of 2008 from 3.5%-4% in January to 2.25%-2.75% in June. Thereafter, the GMR resumed an uptrend, as banks started to tighten their mortgage pricing in the face of deepening financial turmoil and worsening credit market conditions. At the end of the year, the BLR-based GMR stood in the range of 3.25%-3.75% [Figure 1].

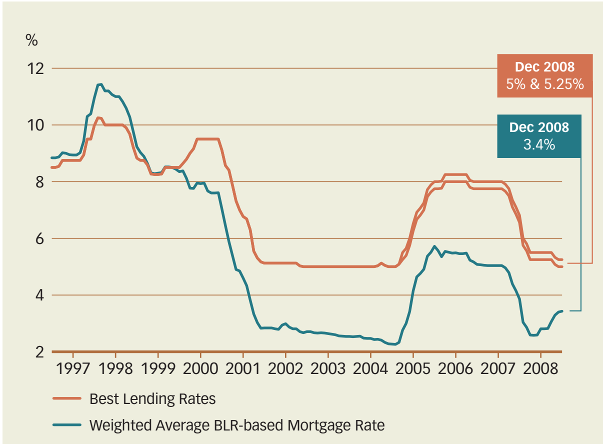
Property Market

The residential property market remained buoyant in the first quarter of 2008, but the transaction volume began to drop in the second quarter of 2008 whilst property prices started to fall around July. The situation worsened in late 2008, with both residential property prices and transactions tumbling in October and November, and eventually easing off towards the end of the year. According to the Private Domestic Price Index on overall housing published by the Rating and Valuation Department, residential property prices in December 2008 were on average down by 11.4% compared to a year ago, or by 17.5% compared to the peak recorded in June 2008 [Figures 2 and 3].

Based on the figures released by the Land Registry, the total volume and value of residential property transactions in 2008 plummeted substantially by 22.4% and 20.8% to about 95,900 cases and HK$344 billion respectively, compared with a year ago.

FIGURE 1

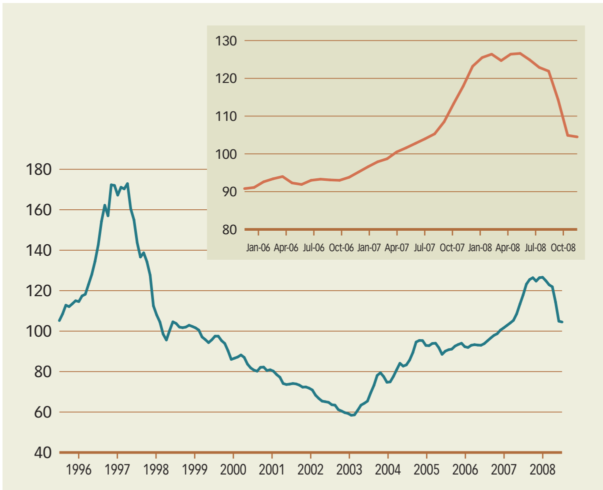
Best Lending Rates and Mortgage Rates



Sources: HKMA and HKMC

FIGURE 2

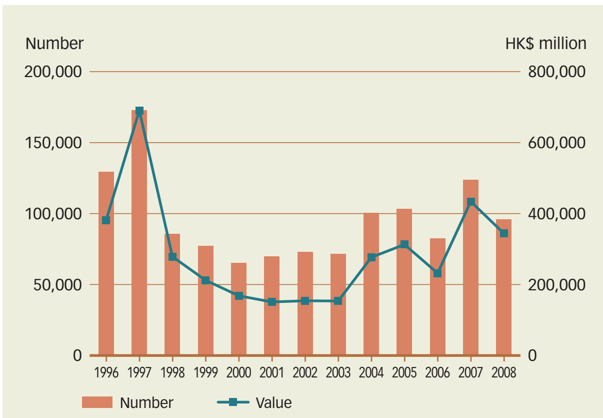
Private Domestic Price Index (1999=100)



Source: Rating and Valuation Department

FIGURE 3

Agreements of Sale and Purchase of Residential Building Units



Source: The Land Registry

Mortgage Market

The global financial turmoil has a strong contagion effect on the residential mortgage market in 2008. In view of the deteriorating financial market conditions, local banks became extremely cautious about the potential credit risk associated with the double impact of declining property values and rising borrowers' default. As a result, banks have notably tightened the pricing for the newly made mortgage loans in the fourth quarter of 2008. According to the HKMA's Monthly Residential Mortgage Survey, the proportion of newly approved mortgage loans priced at more than 2.5% below the BLR plunged from some 90% in the first quarter to 15% and 3.3% in November and December 2008 respectively. Banks are also increasing its product diversification by offering HIBOR-linked and Composite Rate-based mortgage loans to potential mortgage-borrowers [Figure 4].

In line with the abrupt shrinkage in property market activities, the growth in mortgage loan origination volume also slowed down significantly. Based on the HKMA Survey, the value of mortgage loan origination in the fourth quarter of 2008 dropped substantially by 57% compared to the first quarter of the year. Nonetheless, the total outstanding value of residential mortgage loans registered an increase to HK$650 billion at the end of 2008, a moderate growth of 4.4% year on year, largely due to receding prepayment activities [Figure 5].

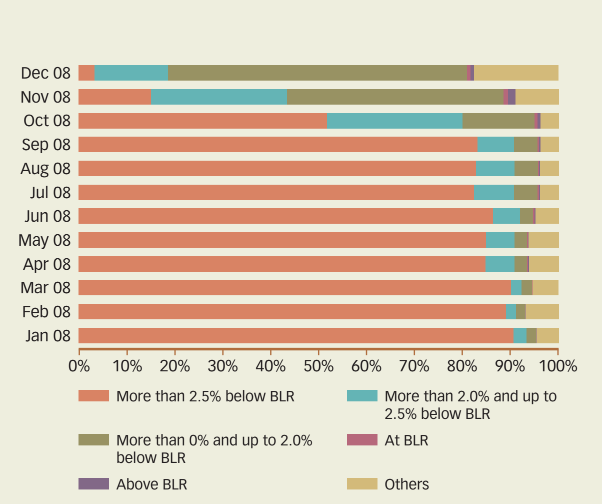
Despite the volatile market conditions, the asset quality with respect to the residential mortgage loans of the banking sector remained very good in 2008, owing to the prudent underwriting standards adopted in the market. The HKMA Survey showed that the delinquency ratio of mortgage loans overdue for more than 90 days remained stable at a record-low level of 0.05% in the second half of the year, while the combined ratio, which takes account of both delinquent and rescheduled loans, hovered around 0.19% over the same period [Figure 6].

Banking Sector Exposure

For the banking sector as a whole, mortgage loans for private residential properties amounted to HK$593 billion at the end of 2008, accounting for 23.5% of the total loans for use in Hong Kong. Adding the loans for property development and investment, property-related loans totaling HK$1,269 billion on top of this, the combined figure represented 50.3% of the total loan book of the banks. Such a high exposure to

FIGURE 4

Pricing of New Residential Mortgage Loans Approved

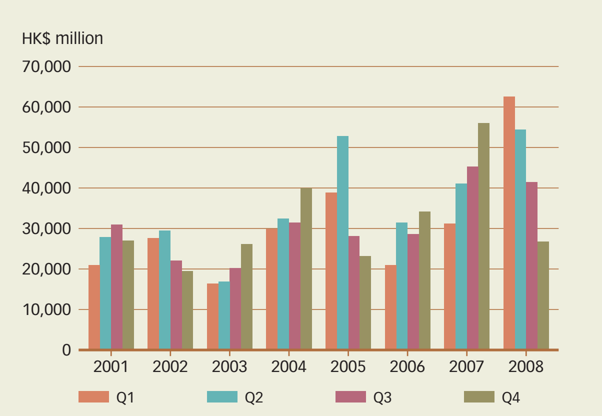


BLR: Best Lending Rate

Source: HKMA

FIGURE 5

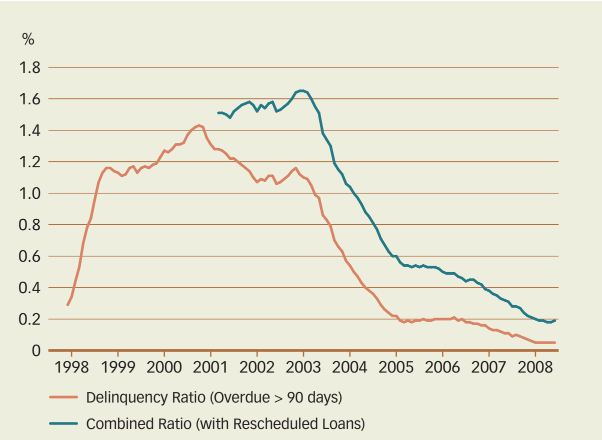
New Residential Mortgage Loans Made



Source: HKMA

FIGURE 6

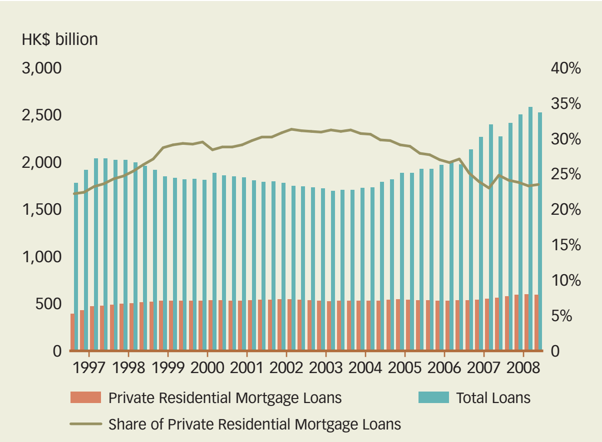
Delinquency Ratio of Residential Mortgage Loans



Source: HKMA

FIGURE 7

Total Loans and Private Residential Mortgage Loans of All Authorized Institutions



Source: HKMA

property-related lending indicated that a sharp downturn in the property market could have an adverse impact on the overall stability of the banking system. Nonetheless, given banks in Hong Kong in general have an adequate capital base, the downside effects of a property downturn are not deemed significant [Figure 7].

Strategic Positioning

At the instruction of the Board of Directors, the Corporation commissioned a consultancy firm in late 2006 to conduct a strategic review of the Corporation's businesses with the aim of assisting the Corporation in developing a long-term vision and business direction for the future. The consultancy firm concluded that there is an ongoing need for the HKMC to be a liquidity provider to the banking system to contribute to banking and financial stability. The Corporation will have a critical role to perform – in adverse circumstances rather than in "fair weather". This observation turned out to be well fulfilled in year 2008.

The Board accepted the assessment that without substantial asset acquisition by the Corporation, there would be little room for the Corporation to remain a viable entity and continue to provide liquidity to banks when needed and to promote home ownership and debt market development. The Corporation needed to expand its business horizon in light of changes in market conditions. After the Board's endorsement of the consultant's recommendations on the strategic positioning and future development of the Corporation's businesses, the Corporation embarked on the course of broadening its businesses through exploring the purchase of non-mortgage assets in Hong Kong and expanding its businesses activities in other countries. This move has enabled the Corporation to be financially more robust with a more viable scale of operations.

Asset Acquisition

The Corporation acquired a total of HK$13.8 billion of mortgage and non-mortgage assets from local financial institutions in 2008. As the global financial crisis swiftly set in the local financial sector in the second half of 2008, the Corporation performed the important role as a liquidity provider to the local banking sector by providing an essential avenue for our Approved Sellers to satisfy their needs for liquidity and balance sheet management. In December 2008, the Revolving Credit Facility granted by the Exchange Fund to the Corporation was increased from HK$10 billion to HK$30 billion. This enhancement has further strengthened the ability of the Corporation to perform its on-going role of maintaining banking and financial stability in Hong Kong, in particular under adverse market conditions.

Following the first cross-border mortgage loan purchase transaction in 2007, the Corporation concluded further mortgage purchase transactions with leading financial institutions in Korea for an aggregate amount of HK$12.2 billion in 2008. These overseas purchase transactions took the form of private bilateral mortgage-backed securitisation.

In all the total purchase for year 2008 amounted to a record high of HK$26 billion.

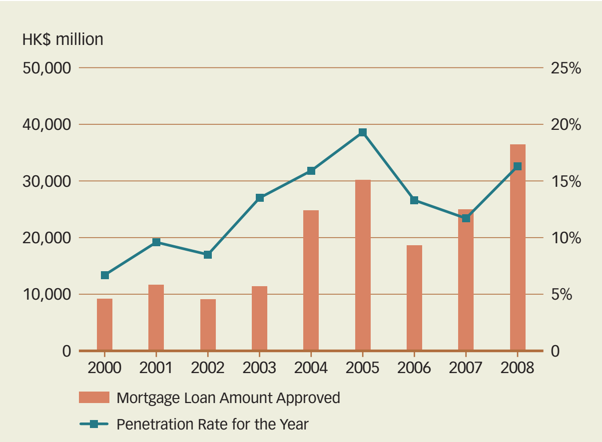
Mortgage Insurance

Over the years the MIP has repeatedly demonstrated its effectiveness in assisting potential homebuyers to overcome the hurdle of requiring a substantial down payment for the purchase of a property. From the perspective of the banking industry as a whole, the programme allows the banks to engage in higher LTV lending without incurring additional credit risk and affecting the stability of the banking system. In all, the programme creates a win-win situation for both the homebuyers and the banks.

Since its inception in March 1999, the programme has gained increasing public acceptance and now plays an instrumental role in promoting home ownership in Hong Kong. For 2008 as a whole, the Corporation received a total of 21,477 applications with an aggregate mortgage loan amount of HK$50 billion. The volume of loans drawn down in 2008 amounted to a record high of HK$20.4 billion and the market penetration rate increased from 12% for 2007 to 16% in 2008. It is also notable that 93% of MIP loans received is for secondary market properties. The figure goes

FIGURE 8

Mortgage Loan Amount Approved and Penetration Rate* of MIP



Sources: HKMA and HKMC

* Penetration Rate = $\frac{\text{Mortgage Loan Amount approved under MIP}}{\text{Total Mortgage Loan Amount approved in the market based on HKMA's Monthly Residential Mortgage Survey}}$

to demonstrate that mortgage insurance provides good assistance to potential buyers of properties in the secondary market [Figure 8].

Enhancement Scheme

In late 2008, a gap emerged in the local mortgage market as some banks were unwilling to lend above a LTV ratio of 60% for some homebuyers. In response to the market demand for the availability of high LTV mortgage financing, the Corporation launched an enhancement of the MIP in December 2008 to specifically cater for that financing gap.

Under this enhancement, mortgage insurance is offered at above the LTV ratio of 60%, subject to a maximum LTV ratio of 90% and a maximum loan amount of HK$8 million. It provides banks with a greater degree of flexibility in conducting their mortgage business and thereby helps to lessen the impact of a credit crunch in the mortgage financing to potential homebuyers.

Training and Marketing

The Corporation has always kept participating banks closely informed of all new developments under the MIP and sought their feedback prior to launch. We have also proactively invited banks and other market players such as estate agents and referral companies to send their staff to attend seminars organised by the Corporation. These seminars serve the purpose of providing thorough training on product features and eligibility criteria so that the attendees are sufficiently equipped to expound the details of various MIP products to their customers.

Regional and China Development

Since its inception in 1997, the Corporation has established a strong rapport with central banks, regulatory authorities and various mortgage corporations in the Asian region, in particular China. These fruitful interactions have given rise to potential business opportunities between the Corporation and various renowned Asian financial institutions, including research projects on analysis of financial and mortgage markets, regulatory framework, risk management tools and practices in the respective overseas markets, culminating in the eventual establishment of business partnerships.

The successful completion of a consultancy project by the HKMC for the China Development Bank in 2007 on the development of the housing finance market in Mainland China has significantly raised the profile of the Corporation in China. Since then, we have conducted further research studies on business potential and opportunities in the Mainland market. In the latter half of the year, the Corporation has taken active steps to explore the viability of establishing a joint venture company with reputable partner institution(s) in the Mainland. A business joint venture is expected to materialise in 2009, and this will form a good platform for the Corporation to build up its presence in the Mainland.

Overseas Joint Venture Cooperation

The incorporation of the joint venture company with Cagamas Berhad ("Cagamas"), named as "Cagamas HKMC Berhad" ("JV"), was completed in April 2008. The JV launched a Mortgage Guarantee Programme ("MGP") in July 2008 to provide guarantee coverage to banks in Malaysia for both conventional and Shariah-compliant mortgage loans. The Launch Ceremony in July 2008 was well received by the Malaysian banking sector and signified the commencement of a strategic collaboration between the two government-owned mortgage corporations in the Asian region. Going forward, the JV is expected to provide a robust platform for the development of potential business opportunities in other Islamic countries.

Funding

Amid the ongoing global credit crunch in 2008, the local and global capital markets were seriously distorted and almost frozen since the bankruptcy of Lehman Brothers in September 2008. The stressed market conditions began to ease somewhat after various liquidity injection and bailout measures taken by governments worldwide. Notwithstanding the distressed market conditions, the Corporation continued with its prudent pre-funding strategy to make funding available for loan purchase and refinancing. Given the HKMC's strong government background, solid credit ratings and investors' flight-to-quality inclination, the Corporation has continued to be the most active Hong Kong Dollar corporate issuer for the eighth year. A record amount of HK$24.4 billion of debts were raised in 2008, an increase of 49% compared with 2007. At the end of 2008, the Corporation had a total outstanding debt amounting to HK$42.8 billion.

The HKMC is committed to developing the local debt market through regular debt issuance as well as introduction of new debt products. As one of Hong Kong's most active bond issuers, the HKMC will continue to issue debts in both local institutional and retail markets, and diversify its funding sources and investor base to overseas institutional markets as well. This will not only help to 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 the HKMC's strong credit ratings, its debt issues are well received by the investing community such as pension funds, insurance companies, investment funds, charity and government-related funds as well as retail investors. The Corporation adopts pro-active communication to update investors regularly in the local and regional markets such as Mainland China, Japan and Singapore.

Debt Issuance Programme

The Debt Issuance Programme ("DIP") is the HKMC's major platform for raising Hong Kong dollar funds. The DIP was established in July 1998, targeting 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 provides a flexible and efficient platform for the Corporation to issue debts and transferable loan certificates with tenor up to 15 years. Apart from plain vanilla debts, the HKMC also issued high quality structured products to meet investor demand. A total of 6 Primary Dealers and 15 Selling Group Members appointed under the DIP provided wide distribution channel for both public and private debt issues.

During 2008, the Corporation drew down altogether 86 DIP debt issues for a total amount of HK$19.2 billion. At the end of 2008, the total outstanding amount of DIP debt securities was HK$35.0 billion.

Retail Bond Issuance Programme

The Corporation is committed to promote the local retail bond market along with the objective of broadening the HKMC's investor base outside 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 solid development of the retail bond market, the Corporation established a HK$20 Billion Retail Bond Issuance Programme and made a debut issue 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 such retail bonds, the Placing Banks have committed to making firm bid prices for the bonds in the secondary market. Over the years, the HKMC'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-owned Hong Kong SAR Government corporation. The Corporation is committed to launch retail bond issue regularly to provide additional investment tool for the general public in Hong Kong.

The retail bond issue launched by the Corporation in 2008 attracted participation from 17 Placing Banks. The Placing Banks together constituted a network of as many as 880 branches to accept retail investors' applications. An aggregate amount of HK$543 million was raised in this issue which brought the total amount of HKMC's retail bond issuance to HK$13.7 billion since 2001. At the end of 2008, the total outstanding amount of retail bonds issued by the Corporation stood at HK$3.1 billion.

Medium Term Note Programme

The Corporation established the multi-currency US$3 Billion Medium Term Note Programme ("MTN") in June 2007 to raise funds in the international market and to broaden its investor base and funding sources. The MTN helps to set a quasi-sovereign benchmark for Hong Kong to further promote the development of the regional bond market. 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 domestic and overseas investors. All foreign currency denominated MTN debts are fully hedged into either US dollar or Hong Kong dollar. The programme also incorporates flexible product features and offering mechanisms that allow public issues as well as private placements, which will 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.

The HKMC launched its debut foreign currency debts under the MTN in early 2008. With the global credit crunch that increases investors' demand for high-quality regional investments, the HKMC's MTN issues are popular among regional government entities, pension funds, insurance companies and investment funds due to the Corporation's top credit rating and strong financial performance. During 2008, the Corporation launched 13 MTN debt issues totaling HK$4.7 billion equivalent, including US dollar, Singapore dollar and Japanese yen.

Revolving Credit Facility provided by the Exchange Fund

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

At the end of 2008, the Corporation had drawn HK$8 billion under the Revolving Credit Facility to partially fund the acquisition of Hong Kong residential mortgage assets from local banks amid the distorted debt capital market.

Credit Ratings

The Corporation's ability to attract investors to invest in our debt securities is underpinned by strong credit ratings accorded by Moody's and S&P.

On 31 July 2008, S&P upgraded the HKMC's long-term local and foreign currency ratings from "AA" to "AA+" with stable outlook, following its upgrade of Hong Kong SAR Government.

Credit Rating of the HKMC

	Moody's		Standard & Poor's	
	Short-term	Long-term	Short-term	Long-term
Local Currency	P-1	Aaa	A-1+	AA+
Foreign Currency	P-1	Aa1*	A-1+	AA+

* Long-term foreign currency debt rating assigned by Moody's is "Aaa".

The credit rating agencies have made very positive comments on the credit standing of the HKMC. The following comments are extracts from their credit rating reports after the annual surveillance conducted by Moody's and S&P in May 2008 and rating affirmation report by S&P in December 2008:

Moody's

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

"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, 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."

"HKMC has adopted a Corporate Governance Code that is benchmarked against the Code on Corporate Governance Practices issued by The Stock Exchange of Hong Kong Ltd for listed companies and the Hong Kong Insurance Authority's corporate governance guidelines. This ensures its staff adheres to best practices in corporate governance. Moody's is confident that HKMC will continue to function according to the highest possible international standards."

S&P

"The rating affirmation reflects S&P's acknowledgement of the increasingly explicit direct and indirect governmental support available to HKMC and the company's sound creditworthiness on a standalone basis."

"The ratings reflect HKMC's prudent credit risk management, solid capital base, and strong financial flexibility."

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

"Outlook: The stable outlook on the HKMC reflects the stable outlook on both the HKSAR government and HKMC on a standalone basis. We expect HKMC's credit profile to continue to benefit from the government 's support on top of its sound standalone financial profile."

Mortgage-backed Securitisation

The Corporation has established two mortgage-backed securitisation programmes for issuance of 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-ever securitisation programmes set up in the Hong Kong debt market.

MBS are powerful financial instruments that can channel long-term funding from the debt market to supplement the need for the 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, liquidity, interest rate and asset liability maturity mismatch. A deep and liquid MBS market can help to enhance the development of an efficient secondary mortgage market and further promote Hong Kong as an international financial centre.

The Corporation made no MBS issuance in 2008 due to a fall in investor demand and unfavourable market conditions following the global financial crisis.

Guaranteed Mortgage-backed Pass-through Securitisation Programme

This first MBS securitisation programme of the HKMC was established in October 1999 and targeted banks that did not just want to offload mortgage loans but also wished to enjoy the benefits of holding MBS guaranteed by the HKMC.

The back-to-back structure under this programme allows the HKMC 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 investor of the security. Through this back-to-back exercise, the bank can convert illiquid mortgage loans into liquid MBS. Furthermore, as far as capital adequacy requirement is concerned, the MBS guaranteed by the HKMC are assigned a 20% risk asset weighting under the Banking (Capital) Rules as opposed to 35%-100% for mortgage loans, thereby allowing the banks to utilise their capital more efficiently. Since the inception of the programme, four series of MBS for 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 to the HKMC for the issuance of MBS with various product structures, credit enhancement 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 made 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 Bauhinia MBS issue with a size of HK$2 billion was done in March 2002. The second issue of HK$3 billion done 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 done in November 2004. This was the first time in the whole of 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 done in November 2006. This was the first-ever partially guaranteed MBS under the Bauhinia Programme.

Risk Management

Prudent risk management is a fundamental cornerstone of the HKMC's operations. It is a crucial factor in sustaining the continuous growth in corporate earnings and profits. Over the years, the Corporation has made continuous refinements and has managed to establish a robust and time-tested risk management framework. The five major risk areas facing the HKMC comprise credit risk, market risk, operational risk, legal risk and leveraging risk.

(a) Credit Risk

Credit risk is the primary risk exposure for the Corporation. It represents the risk of default of loan borrowers or counterparties which could lead to potential losses for the Corporation.

(i) Default risk

To address default risk effectively, the Corporation adheres to a four-pronged approach to maintain the quality of its asset and MIP portfolios:

- Careful selection of Approved Sellers/Servicers/ Reinsurers
- Prudent asset purchasing criteria and insurance eligibility criteria
- Effective due diligence review process
- Adequate protection for higher-risk mortgages or transactions

Losses can be incurred due to the shortfall in the recovery amount for defaulted loans under the Mortgage Purchase Programme ("MPP"). To mitigate against such default risk, the Corporation has adopted a set of prudent loan purchasing criteria and conducts effective due diligence review as part and parcel of the loan purchase process in order to uphold the credit quality of loans purchased. In addition, depending on the projected risk exposure of the underlying loan portfolio, credit enhancement arrangements such as reserve fund for absorbing credit losses will be agreed with the seller on a deal-by-deal basis so as to reduce the potential credit losses arising from borrower's default.

Similarly, losses can also arise from defaulted loans under the insurance coverage of the MIP. Each MIP application is underwritten by the Corporation in accordance with a set of prudent eligibility criteria and each claim from a participating bank will be audited by the Corporation to ensure the fulfilment of all MIP coverage conditions and to detect any fraud elements. As a result, the default risk for MIP loans is greatly reduced. To mitigate against possible concentration of such default risk, the HKMC transfers a portion of the risk-in-force to Approved Reinsurers by way of a re-insurance risk-sharing arrangement.

(ii) Seller/Servicer counterparty risk

Counterparty risk can arise when there is a failure by the Seller/Servicer of an acquired portfolio to remit scheduled payments to the Corporation in a timely and accurate manner. The HKMC adopts a counterparty risk limit framework that limits the aggregate amount of assets that the Corporation can purchase from the Approved Sellers and there are also individual limits on the maximum amount of assets that the Corporation can purchase individually from each of the counterparties. The limit framework acts as a good device for managing the counterparty exposure on the basis of risk profile of each Seller/Servicer and to avoid concentration of acquisition from a few sellers only.

(iii) Reinsurer counterparty risk

Reinsurer counterparty risk relates to the failure of an Approved Reinsurer to make claims payment to the Corporation. The HKMC has established a framework for evaluation of a mortgage reinsurer in respect of its financial strength, credit ratings and relevant experience in mortgage insurance, and for mitigation of counterparty risk.

(iv) Treasury counterparty risk

Potential losses could be incurred as a result of a delay or failure in payments by a treasury counterparty in respect of the underlying treasury instruments. The Corporation adopts a prudent Treasury Counterparty Limit Framework, under which each potential treasury counterparty is assessed on the basis of its credit ratings, financial strength, capability in treasury products etc. Based on the evaluation results, a treasury counterparty limit will be assigned to specific types of treasury instruments exposure.

(v) Control mechanism

Portfolio performance and analysis reports are compiled on a regular basis to provide 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 review and swift response to changes in the operating environment. Stress tests on the retained portfolio and mortgage insurance portfolio are conducted to analyse the Corporation's financial capability to weather extreme scenarios.

The counterparty limits of all Sellers and Servicers are subject to regular review whereby their financial strength, management capabilities, loan servicing quality and transaction experiences are taken into consideration for renewal and/or adjustment in limit. The limit for each treasury counterparty is reviewed and adjusted on a regular basis based on the financial strength of the counterparty and the capital base of the Corporation. To date, the Corporation has not experienced any loss on a treasury transaction due to credit default by a counterparty. In view of the challenging credit market conditions, the Corporation is in the progress of implementing collateral arrangements with its treasury counterparties by requiring collateral on interest rate and foreign currency derivative contracts in net gain positions based upon the counterparties' credit ratings.

The Corporation also performs annual review of Approved Reinsurers' financial strength, business proposal, reinsurance arrangement and management capability. The result of the review is used for determining the on-going business allocation and risk-sharing portion.

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

Credit Committee

The setting of the Corporation's overall credit policies and eligibility criteria, in particular for asset acquisition and mortgage insurance, is the responsibility of the Credit Committee. The Committee operates under the credit policies approved by the Board. The Committee is the approval authority for accepting applications to become Approved Sellers/Servicers under the MPP and Approved Reinsurers under the MIP. It is also vested with the authority for the setting of risk exposure limits for the counterparties. In response to significant changes in business and operating environment, credit policies will be immediately subject to ad hoc review and timely changes will be presented to the Credit Committee for approval.

Transaction Approval Committee

The Transaction Approval Committee is the forum for in-depth analyses of pricing economics and associated credit risk for business transactions, 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.

Both committees are chaired by the CEO and its members include Senior Vice President (Operations), Senior Vice President (Finance), General Counsel and relevant senior staff of the Operations Division and the Finance Division.

(b) Market Risk

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 the Corporation's earnings. It represents the excess of interest income (from the HKMC's loan portfolio, cash and debt investments) over interest expenses (from debt issuance and other borrowings). Interest rate risk arises when changes in market interest rates affect the interest income or interest expenses associated with the assets and liabilities respectively.

The primary objective of interest rate management is therefore to limit the potential adverse effects arising from interest rate movements on interest income/expenses and, at the same time, achieve a stable growth in earnings. The interest rate risks faced by the Corporation are two-fold – interest rate mismatch risk and basis risk. Interest rate mismatch risk is the most substantial risk affecting the HKMC'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 portfolio where the majority of the loans earn floating interest rate (benchmarked against the Prime rate, the Hong Kong Interbank Offered Rate ("HIBOR") or Composite Interest Rate) whilst the majority of HKMC'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 the issuance of MBS to manage the interest rate mismatch risk. The proceeds of the fixed-rate debt securities are generally swapped into HIBOR-based funds via interest rate swaps. Through the use of such swaps, interest expenses arising from the issuance of debt securities will be changed from a fixed-rate basis to a floating-rate basis in order to better match the floating-rate income from the mortgage assets.

The Corporation also uses the duration gap as an indicator to monitor, measure and manage interest rate mismatch risk. Duration gap measures the difference in interest rate re-pricing intervals between assets and liabilities. The wider the duration gap, the higher is 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 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 by ALCO to limit the interest rate mismatch risk. In 2008, the average duration gap has been kept around one month, indicating that the Corporation is handling interest rate mismatch risk in a very prudent manner.

Basis risk represents the difference in basis of the Corporation's interest-earning assets that are Prime-based and interest-bearing liabilities that are HIBOR-based. There are 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 the strategy of acquiring more HIBOR-based assets and as at the end of 2008, about 60% of the Corporation's mortgage assets and non-mortgage assets are 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 risk of the Prime-based portion of the Corporation's loan portfolio.

(ii) Asset-liability maturity mismatch risk

While the contractual maturity of a mortgage loan can go up to 30 years, the average life of a portfolio of mortgage loans is in reality much shorter. The average life will depend on the speed of scheduled mortgage repayments and unscheduled prepayments. Higher prepayment rates will 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 mortgages 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 received by the HKMC 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 will be 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 portfolio.

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

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 will allow the Corporation to adjust the average life of its liabilities to match more closely that of the overall pool of assets. In this regard, the Corporation has the flexibility of issuing debt securities on a broad spectrum of maturities ranging from 1 month to 15 years. This will again serve 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 as MBS.

Asset-liability maturity gap ratio (ratio of average life of total assets to average life of total liabilities) is used to monitor and manage the maturity mismatch risk, with a target ratio set by ALCO to ensure a proper balance in 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 redemption of maturing debt or to fund the committed purchases of loan portfolio. Liquidity risk is managed through monitoring daily the inflow and outflow of funds and projecting longer-term inflows and outflows of funds across a full maturity spectrum. The HKMC measures its liquidity risk with a target liquid asset ratio (ratio of liquid asset to total assets) set by ALCO to monitor and manage the liquidity situation of the Corporation. The HKMC has successfully established well-diversified funding sources to ensure that all foreseeable funding commitments can be met when due, to support the growth of its business and the maintenance of a well-balanced portfolio of liabilities. The diversification allows the Corporation to pursue a strategy of funding business activities at the lowest possible cost and the most favourable terms whilst at the same time offering safeguards against the inability to raise funds in distorted market conditions. The funding sources currently comprise:

- Shareholders' Capital: authorised capital of HK$3 billion, of which HK$2 billion is fully paid up. Accumulated shareholders' funds amounted to HK$5.8 billion as at 31 December 2008.
- HK$40 Billion Debt Issuance Programme: there are 6 Primary Dealers and 15 Selling Group Members which will underwrite and distribute debts to institutional investors under the DIP. The Transferable Loan Certificate Sub-Programme under the DIP provides a further diversification of funding sources and broadening of investor base.
- HK$20 Billion Retail Bond Issuance Programme: this debt issuance programme has 19 Placing Banks which will assist in offering retail bonds to investors.
- US$3 Billion Medium Term Note Programme: there are 10 Dealers which will underwrite and distribute local and foreign currency debts to the international institutional investors under the MTN.
- US$3 Billion Bauhinia Mortgage-Backed Securitisation Programme: with a total of 8 Dealers, this multi-currency mortgage-backed securitisation programme permits the HKMC to originate MBS in the local and international markets.
- Cash and Debt Investment Portfolio: the Portfolio mainly comprises cash and bank deposits, commercial papers, high-quality certificates of deposit and notes that can be readily converted into cash.
- HK$30 Billion Revolving Credit Facility: the Exchange Fund commits to provide 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.

With strong government background and solid credit ratings, the Corporation enjoys funding advantage in the debt market with both institutional and retail funding base. This is supplemented by the HKMC's portfolios of highly liquid investments which are held to enable the Corporation to respond quickly and smoothly to unforeseen liquidity requirements. The HK$30 Billion Revolving Credit Facility from the Exchange Fund further provides the Corporation a liquidity fallback even when the exceptional market strains last for a prolonged period of time.

The Corporation adapts its liquidity risk management framework in response to changes in the market conditions. The HKMC has continuously monitored the impact of recent market events on the Corporation's liquidity positions and has pursued prudent pre-funding strategy, so that the effect of market turmoil on liquidity to the HKMC has been well contained.

(iv) Currency risk

Currency risk represents the impact of fluctuations in foreign exchange rates on the Corporation's financial position and cash flows denominated in foreign currency. The HKMC manages its currency risk in strict accordance with the investment guidelines approved by the Board of Directors and under the supervision of ALCO which sets daily monitoring limits on currency exposure. So far, the Corporation has primarily limited its net foreign currency exposure to US dollar only.

The HKMC does not speculate in foreign currencies and all foreign currency exposure in the asset-liability portfolio must be fully hedged into either Hong Kong dollar or US dollar. In accordance with this prudent risk management principle, the foreign currency denominated debts issued under the Medium Term Note Programme and the asset purchase of residential mortgage loans in Korea were fully hedged through cross-currency swaps.

(v) Control mechanism

ALCO is established with the CEO as Chairman, and Senior Vice President (Finance), Senior Vice President (Operations), and senior staff of Treasury, Financial Control, Marketing and Business Development, Credit Approval and Risk Management and Pricing and Structuring Departments as members. ALCO performs the important task of managing the Corporation's asset-liability portfolio based on prudent risk management principles. Strategies on interest rate risk management, financing, hedging, investments are formulated by the Committee. Regular meetings are held to review the latest conditions in the financial markets and the asset-liability portfolio mix.

ALCO oversees the implementation of risk management and investment guidelines approved by the Board of Directors. Transaction execution is segregated through 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 ALCO. The Financial Control Department assumes the middle office role and monitors the compliance of counterparty and transactions risk limits. The Operations Department, acting as the back office, is responsible for deal verification, confirmation, settlement and payment process.

(c) Operational Risk

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

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

The Corporation actively manages operational risk by maintaining comprehensive systems with well-established internal controls, authentication structure and operational procedures. Operational infrastructures are in place to support launch of new products in different business areas, including asset acquisition, mortgage insurance, treasury operations, bond issuance, securitisation and overseas business. It is an established practice of the Corporation to undertake rigorous review to identify possible operational risks and to ensure adequate segregation of duties before the implementation of operational or system infrastructure.

To mitigate against potential human errors and to ensure the efficiency and effectiveness of our daily operations, the Corporation applies extensive technology solutions with robust business logics and controls to 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 management.

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

The Corporation has an Information Security Manual ("ISM") that documents the security standards and practices relating to information and data security for observance by all staff. All system security measures are in compliance and at least achieve the requirements stated in the ISM. The double firewall protections, the intrusion detection systems, virus alert and quarantine system and vulnerability scanning system are among the security measures the Corporation employs to minimise exposure to external attacks. Internally, the Corporation also has a virtual Local Area Network and workstation security policies to reduce the damages in the event of a successful intrusion. The Corporation retains external consultants for testing out the intrusion vulnerability in order to enhance system security as appropriate.

To ensure that adequate compliance, the Corporation's core operating systems and processes are subject to regular audit and review by both internal and external auditors. Each year, all staff are required to sign an undertaking to comply with requirements in the ISM together with the Code of Conduct. The ISM is kept up-to-date when there is new security measure or new system. Any changes to the ISM need senior management's approval.

To ensure the business recovery procedure is practical and to facilitate continual improvement, business recovery drill is conducted by both IT and user departments every year. Daily backup and offsite storage of backup tapes are also in place to protect the HKMC from a smaller scale disaster.

(d) Legal Risk

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

In relation to the MPP, Seller/Servicer assessment and annual certification by the Seller/Servicer are reviewed in conjunction with the Legal Office to ensure that the forms of mortgage origination documents are in a form approved by the Corporation and the seller's practice in mortgage origination conform with the required standards. Legal documents for transactions are prudently reviewed by the Legal Office, and where necessary, advice will be sought from external counsel with relevant expertise and experience.

The Memorandum and Articles of Association of the Corporation set out the objects of the Corporation and other internal procedures. The Legal Office checks that the scope of business of the Corporation does not exceed the permitted objects as set out in the Memorandum of Association and that internal procedures as set out in the Articles of Association are adhered to.

For cross-border transactions, external counsel of the relevant countries are engaged to identify potential legal issues and advise the Corporation on local laws and regulations to ensure that the transactions comply with local laws. The Legal Office works closely with external counsel to ensure that legal issues are properly addressed in the transaction documents to the extent possible. On major transactions, the Corporation ensures that its own external counsel advises in the best interest of the Corporation and acts solely for the Corporation; the Corporation does not rely solely on the advice of external counsel acting for other parties.

The Legal Office maintains a monitoring system to ensure that statutory and regulatory requirements are complied with in a timely manner. The Legal Office keeps a checklist of the statutory and other legal requirements to monitor compliance with applicable laws and regulations as regards the work of the Legal Office. The Legal Office advises the Corporation on internal housekeeping matters, for example, legal requirements relating to document retention. The Legal Office also frequently advises the Directors of their statutory and non-statutory duties to help ensure that the Directors are made aware of their statutory duties.

The Corporation maintains a robust framework of corporate governance as contained in a Corporate Governance Code (the "Code") approved by the Board, which is premised on the principles of fairness, transparency, accountability and responsibility to all stakeholders. All departments are required to report annually with a "Self-Assessment Form for Compliance with the Corporate Governance Code" and identify any situation of non-compliance.

Apart from ensuring that all board and shareholders' meetings are properly convened, the Company Secretary also maintains full minutes of meetings and resolutions of the Board, Audit Committee and Shareholders. The Company Secretary ensures that all Board resolutions are properly drafted to clearly record any authority conferred by the Board of Directors.

Staff members are required to abide by the Code of Conduct to comply with legal obligations and other requirements, including those relating to conflict of interests and the obligations under the Prevention of Bribery Ordinance and Copyright Ordinance.

(e) Leveraging Risk

To ensure the HKMC will not engage in excessive leveraging in expanding its business activities as a proportion to its capital base, the Financial Secretary of the Government of the Hong Kong Special Administrative Region ("Financial Secretary") has issued Guidelines on Capital-to-Assets Ratio ("CAR") of the HKMC. The minimum CAR stipulated in the Guidelines is 5%.

In accordance with the capital requirement laid down in the Guidelines, the maximum leverage of the HKMC is to be maintained at a healthy and low level. The Corporation currently has a capital base of HK$5.6 billion and is required to maintain a minimum CAR 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 CEO is required to submit a quarterly report to Directors by reference to the Guidelines. An early warning system alerts 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

A well-tested operational framework supported by robust and innovative business processes, systems automation and control are the key to ensure efficiency and effectiveness in the Corporation's daily operations. Since inception, the Corporation has continuously devoted resources and attention in developing and upgrading its business operations and application systems.

In line with the strategy of the Corporation, resources have been devoted to develop the operations and system infrastructure to support its business expansion outside Hong Kong. The Corporation has completed a feasibility study to enhance its core operation systems to support multi-currency application. The treasury system has also been upgraded to support various financial products such as USD zero coupon bonds, HKD extendable range accrual notes, USD callable range accrual notes, debt issuance and ancillary hedging under the Medium Term Note Programme, floating-rate notes and amortised cross currency swaps.

On the asset acquisition front, a new monitory framework has been drawn up to manage mortgage assets acquired from overseas markets. To support this framework, the final phase of development of a Portfolio Information Processing System ("PIPS") was completed in June 2008. Going forward, in 2009 the Corporation will continue to devote efforts and resources to further enhance this monitoring framework to cater for deal-specific or market-specific needs.

Utilising our know-how and expertise on document imaging and paperless operations adopted for MIP operations, the Corporation has completed a feasibility study to extend such usage to streamline treasury operations in order to cope with the anticipated increase in volume and sophistication. This automation on indexing, filing and retrieval of vast amount of paper documents received from counterparts should provide a reliable platform for timely settlement and operational risk control. It also provides the added benefit of unifying the filing and retrieval process of the straight-through-processing of trade confirmations, securities settlement and payment authentication. A scaleable design will be adopted for this new document imaging module to apply to other business areas where appropriate.

In light of the increasing sophistication of treasury products and corresponding risk management, the Corporation conducted a study to replace the existing treasury operation system with the latest market technology and more robust system solution. Following approved tendering and evaluation procedures, Management completed the evaluation of the new solution and finally signed an implementation contract with a software vendor. The new solution would bring in further enhancement on the timeliness of developing new treasury and hedging products, well-integrated risk management across various products, counterparts and regions, better integration and more reliable collaboration between front, middle and back offices, and more robust and responsive adaptations to meet future regulatory and reporting requirements. It is expected that the new treasury system would be launched, after adequate testing, in the 3rd quarter of 2010.

Business Continuity Plan

The Corporation has put in place a comprehensive disaster recovery plan and business continuity plan, including the establishment of an offsite back-up and disaster recovery centre, to ensure that its information technology systems can continue to operate even in the event of a core system failure or other unexpected major disruptions. To cater for a contingency situation that restricts staff access to the office, arrangements have also been made for certain staff members to work from home with computer access to maintain key operations of the Corporation. Such operational risk mitigation measures are tested periodically with staff participation by rotation so as to strengthen staff awareness and operational robustness.

Corporate Social Responsibility

In recognition of the HKMC's community involvement and commitment to fulfilling corporate social responsibility in the past year, the Hong Kong Council of Social Service has awarded the HKMC the Caring Organisation 2008/09 under its Caring Company Scheme.

同心展關懷
caringorganisation 2008/09
Awarded by The Hong Kong Council of Social Service
香港社會服務聯會頒發

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

Care for Employees

Staffing and Remuneration

As the HKMC promotes the development of the secondary mortgage market, it attracts and also trains up professionals with expertise in its key business areas of mortgage purchase, mortgage insurance and debt issuance. The HKMC provides employees with appropriate remuneration, staff benefits, development opportunities, a healthy and safe work place. The Corporation also adopts family friendly practices by offering a five-day week which has considerably improved employees' balanced life of work, and by providing comprehensive insurance on medical and dental which covers the employees and their family members.

Through system automation and process re-engineering, the Corporation maintains a lean and efficient workforce, notwithstanding the increase in the scope of purchase and the complexity of the products offered by the Corporation. The permanent establishment was 134 in 2008. For 2008, the HKMC recorded a staff turnover rate of 8.7%.

Training and Development

The HKMC devotes considerable training resources to equip its staff with professional knowledge and skills. During the year, the HKMC arranged both in-house and external courses to improve the managerial and technical competence of the staff. In-house training sessions on credit rating and securitisation, structured communication workshops and practical Putonghua lessons were arranged. The Corporation also arranged staff to attend external courses

Credit Rating and Securitisation Training

Caring Company Recognition Ceremony

Putonghua Lesson

covering mortgage-related issues, credit management, risk management, finance and accounting, corporate governance, information technology and management skills. In addition, new staff attended an induction programme which gave them an overview of the Corporation's operations as well as their own area of work.

Health and Safety

As a caring employer, the HKMC continued to look after the health and emotional well-being of its staff. An Employee Support Programme is in place to provide confidential external counseling and consultation services to the employees and their family members. A vaccination programme for prevention of influenza and medical check-up programme at special rates were also arranged for employees.

The HKMC has further reviewed and strengthened its contingency plans to prepare for and respond to a possible outbreak of pandemic influenza including a split-team arrangement, to prevent the spread of communicable diseases among the employees and to minimise unexpected or sudden disruptions to business operations. Periodic drills were organised for staff to be conversant with the activation of the back-up facilities, the contingency plans and communication arrangements in case of emergency.

Employee Relations and Staff Activities

The HKMC Staff Club, which is composed of members from various departments, organised a number of staff activities to cultivate better employee relationships and communication. The activities, which include bowling fun day, scenic tour and gathering, are all well received by staff. The HKMC also participated in friendly table tennis and soccer games with other public organisations for the enjoyment of staff and building team solidarity.

To further enhance effective communication within the Corporation, the Staff Homepage was regularly updated to facilitate sharing of useful information among departments. The HKMC also offered Staff Suggestion Scheme to encourage staff to suggest ways to improve the work flow or the work place.

Dress Special Day

Soccer Game

Bowling Competition

Scenic Tour to the Hong Kong Wetland Park

Voluntary Service – Wish Challenge Day

Voluntary Service – Visiting the Elderly

Care for the Community

Charity and Social Activities

The HKMC strongly encouraged staff to support various charitable and fund-raising activities. In 2008, the HKMC staff made donation for the victims of Myanmar Cyclone disaster and Sichuan earthquake. Charity donation campaigns were also organised for the Community Chest through the Dress Special Day and for education projects in Mainland China. Same as previous years, Blood Donation Day for the Hong Kong Red Cross was also held to support the community.

To fulfill our corporate social responsibility the HKMC, in partnership with some social service organisations, has organised volunteer activities with keen staff participation during the year. To show our concern for children in need and the elderly, the HKMC volunteer team gave a hand to the fund-raising event "The Wish Challenge Day" organised by Make-A-Wish Hong Kong and joined the voluntary services organised by Hong Kong Family Welfare Society to visit the home of the elderly.

To nurture talents within the community, the HKMC took on board a secondary school student under a Work Experience Programme during the year. The student had the opportunity to work in various departments under the guidance of staff assigned as mentors. In addition, a number of undergraduates were employed as summer interns, winter interns or as one-year placement student trainee. All the students were pleased with the learning opportunities offered and valuable working experiences gained with the HKMC.

Environmental Protection

The HKMC continued to support and implement green office measures to make the office more environmentally friendly. Staff awareness was raised through increased use of electronic communications, recycling of waste paper and used toner cartridge. Since 2006, the Corporation has adopted new measures in setting office temperature in the interest of energy efficiency. The HKMC also encouraged its staff to make suggestions for a greener office and its suppliers to use or offer more environmentally friendly products whenever possible.

2009 Outlook

2008 was an exceptional year which turned out to be a good demonstration of the unique policy role played by the HKMC in helping to maintain banking and financial stability. As it seems likely that the challenging economic and market environment would continue well into 2009, the HKMC will stay vigilant to opportunities for the Corporation to play its proper role, especially under adverse and volatile market conditions. Local banking institutions can count on the Corporation being there to provide them with a readily available avenue to meet their liquidity and risk management needs. The Corporation will continue to seek diversification of its businesses both locally and overseas in order to maintain a viable scale of operations so that the Corporation will have the necessary capacity to continue to provide liquidity to banks and contribute to banking stability, promote homeownership and facilitate the development of the local debt and securitisation markets.