The Hong Kong Mortgage Corporation Limited

Bauhinia MBS Limited
US$3,000,000,000 Mortgage-Backed Securitisation Programme

Signing Ceremony
19 December 2001

Speech by
Tony Latter, Executive Director, HKMC

On behalf of the Hong Kong Mortgage Corporation I would like to welcome you all to this signing ceremony to launch the Bauhinia MBS Limited US$3 billion Mortgage-Backed Securitisation Programme.

This is a major milestone not only for the HKMC, but also the financial industry in general. The new Programme will provide the platform for the HKMC to develop an active secondary mortgage market in Hong Kong. MBS provide an efficient channel for long-term funds from the capital market to supplement bank financing of long-term mortgage loans. They also help banks to manage the liquidity and maturity mismatch risks inherent in their mortgage business. Development of an active MBS market will also broaden further the product range of the financial market in Hong Kong.

The HKMC has, since its inception in 1997, been gradually putting in place the building blocks to support the long-term development of the MBS market.

We made a modest start in October 1999 with the launch of the Guaranteed Mortgage-Backed Pass-Through Securitisation Programme, under which three series of MBS with an aggregate amount exceeding HK$2.2 billion have since been issued. The back-to-back structure of the MBS issued under that Programme allows the participating banks to keep a substantial portion of the cash flow from the mortgage pools, whilst reducing the credit risk and capital cost through HKMC's guarantee of the securities. It also provides them with the option at any time to off-load part or all of an issue to suit their liquidity or trading objectives.

Another major building block has been the standardization of mortgage origination documents. With the generous support of the legal fraternity and the banking industry, the HKMC introduced, in July 2001, the Model Mortgage Deed and the Model Deed of Guarantee and Indemnity. The three note-issuing banks are taking the lead in adopting these model documents. This should pave the way for general adoption by other banks. Over time, this will facilitate the mortgage securitisation process by removing the need for due diligence review of documentation by credit rating agencies and investors.

The third pre-requisite for a sustained MBS issuance programme is a regular source of sizeable mortgage purchases. To this end the HKMC achieved a major breakthrough earlier this year when it entered into agreements with the Housing Authority and the Housing Society to purchase over HK$20 billion of mortgage loans from them for settlement in 2001 and 2002.

With these building blocks in place, the HKMC is now ready to launch a fully fledged bond-style MBS programme. Great care has been taken to design the Programme in such a way as to provide a convenient, flexible and cost-efficient platform for the issuance of MBS. The multi-currency Programme supports the issuance of MBS denominated in Hong Kong dollars or other major currencies. The bond-style structure will facilitate the trading of MBS and hence enhance their liquidity in the secondary market. The Programme also provides extensive credit enhancement options, including credit guarantee, tranching, over-collateralization and reserve funds, to suit the investment and balance sheet management needs of individual investors and investors of different risk appetite.

In terms of issuing strategy, the HKMC intends to focus initially on the Hong Kong dollar market and to launch two products that are familiar to capital market participants. These products include a single class MBS with HKMC's guarantee on repayment of principal and interest of the mortgage pool, and a multi-class MBS with credit-enhancement provided through segmentation of the issue into senior and junior tranches, with reserve fund or over-collateralization arrangements.

The initial focus on the Hong Kong market is in line with our objective to promote an active MBS market locally. The intention of starting with simpler products is in recognition of the fact that MBS is a

relatively new financial instrument to the Hong Kong market and that it takes time for investors to familiarize themselves with the product features and their economics. Over time, and depending on investor demand, the Corporation may gradually introduce products with more complicated structures or denominated in other currencies.

For the year 2002, the HKMC plans to launch two or three issues under the new Programme with an aggregate issue amount of HK$3-4 billion. The debut issue, for an amount of about HK$2 billion, has been scheduled for the first quarter of next year.

The HKMC also welcomes banks to make use of the new Programme to arrange securitisation of their mortgage portfolios. Through standardization of product structure and legal documentation, the lead time for arranging an issue will be shortened substantially, from 6-9 months for a stand-alone issue to a few weeks under the HKMC Programme. This will provide a highly convenient platform for the banks to convert their illiquid mortgage portfolios into liquid MBS when required.

I would like to take this opportunity to thank Merrill Lynch International, the Arranger of the Programme, for their valuable advice and active participation in helping us to bring the Programme to the market. In addition, we are grateful to other members of the Dealer Group - Barclays Capital, Dao Heng Bank, Deutsche Bank, HSBC, JP Morgan, Salomon Smith Barney and UBS Warburg – for their staunch support. I look forward to their active participation in arranging both public issues and private placements under this Programme, to match the appetites of both local and overseas investors.