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Office of Hon. IP LAU Suk Yee, Regina

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Chairman, Panel on Financial Affairs  
Legislative Council  
8 Jackson Road  
Hong Kong

**Hong Kong Mortgage Corporation**

I write to request that the Hong Kong Mortgage Corporation (HKMC), a limited liability company incorporated on 3 March 1997 under the Companies Ordinance and also a public sector entity, be put on the agenda of the next meeting of this Panel. It is 100% owned by the HKSARG through the Exchange Fund. All of its shares are beneficially owned by the Financial Secretary as Controller of the Exchange Fund.

I make this request that I have received multiple complaints of alleged anti-competitive practices on the part of the HKMC and involvement in high-risk investments which have gone far beyond the objects of its establishment. Some of these allegations have been reported in the press. In a LegCo brief on its establishment submitted to Members in December 1996, it is clearly stated that "the Company's business scope is defined in Object 1 as the acquisition of a portfolio or portfolios of mortgage loans on residential properties in Hong Kong and to hold and dispose of the same, This will prevent the HKMC from buying mortgages on commercial properties or properties outside Hong Kong, which may entail greater risk." Nevertheless, evidence abounds of the HKMC going beyond its original business scope and engaging in investments unrelated to its prime objective of assisting Hong Kong people to buy homes and promoting financial stability in Hong Kong. Some examples of such departures are set out below:

- a) Entry into a joint venture with the Shenzhen Financial Electronic Settlement Centre to provide "bridging financial guarantees" for secondary property market transactions,

initially in Shenzhen (reported in SCMP on 8 May 09). Why is the HKMC branching into providing "bridging financial guarantee" for secondary property market transactions in Shenzhen? Will it get involved in such business in other parts of Mainland China later on? How is such activity consistent with its objective of providing liquidity for Hong Kong markets and helping Hong Kong people to buy homes?

- b) An inaugural overseas purchase of HK\$5.5 billion of Korean residential mortgage loans in the form of mortgage-backed securities in 2007. Again how is this consistent with the principal objectives of the HKMC as stated above? Is it true that these securities have lost a significant amount of its values because of the depreciation of the Korean won?
- c) In 2007, setting up a joint venture with Cagamas Berhad (the national mortgage corporation of Malaysia) to develop mortgage guarantee business in Malaysia and other markets. The investment amounted to HK\$114 million at the end of 2008. Critics are of the view that such a joint venture will help Malaysia develop the domestic Islamic capital market and promote Malaysia as an international Islamic Finance Centre. This goes against the HKSARG's stated objective of promoting Hong Kong as an Islamic finance hub.
- d) August 2006: purchase of the first-ever taxi loans from an Approved Seller totaling HK\$1.4 billion. Again what has such activity got to do with helping Hong Kong people buy homes?

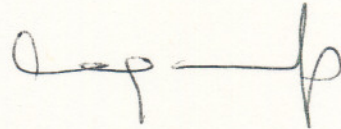
I attach a summary of highlights from HKMC's Annual Reports from 2000-2007, which gives a fair account of the expansion of HKMC's financing activities since its incorporation, many of which appear to go against its stated objects in its Memorandum and Articles of Association (M&A). Presumably the M&A have been amended and proper approval given, but has LegCo ever been briefed?

At the briefing on the work of the Hong Kong Monetary Authority (HKMA) on 21 May 2009, Mr. Joseph Yam, Chief Executive of the HKMA, expressed satisfaction with the HKMC on the ground of its profitability. But it should be borne in mind that the HKMC was established with a HK\$30 billion revolving credit provided by the Exchange Fund, and its triple-A rating is tied to the credit of the Exchange Fund. As its cost of capital is cheaper than that of commercial entities engaged in similar financing business, arguably the HKMC is engaging in unfair competition. I would like to know whether such subsidies provided by the HKMA by making use of the Exchange Fund is in breach of the World Trade Organization's Agreement on Subsidies and Countervailing Measures.

I am concerned that the executive pay system of the HKMA and HKMC, which is tied to profitability, has led HKMC to pursue profits at the expense of the private sector, in breach of the government's well-established principle of "Small Government, Big Market" and the original scope of business of the HKMC.

I would be grateful if you could seek answers to my questions above from the Financial Services and the Treasury Bureau, and arrange to have them discussed at the next meeting of this Panel.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Regina IP LAU Suk-yee', written in a cursive style.

Regina IP LAU Suk-yee (Mrs.)

c.c. Other Members of the Panel

# Hong Kong Mortgage Corporation Limited

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## *Highlights from HKMC Annual Reports*

### **2007**

27 June: Launch of US\$3 Billion Medium Term Note Programme

22 August: Enhancement of the Mortgage Insurance Programme to include 75% loan-to-value ratio product

20 December: Joint venture (50/50) between the HKMC and Cagamas Berhad (the national mortgage corporation of Malaysia), to develop Mortgage Guarantee Business in Malaysia and other markets

- i. Joint venture called Cagamas HKMC Berhad, incorporated in Malaysia
- ii. "Investment in a joint venture" by HKMC as at 31 December 2008 is HK\$114 million – most likely referring to Cagamas HKMC Berhad
- iii. Speaking during a briefing, Mr. Steven Choy, Executive Director of Cagamas HKMC said, "This new mortgage guarantee facility covering both conventional and Islamic mortgage finance, provides mortgage originators with a new portfolio and risk management tool. Our MGP is the first Islamic guarantee in the world and sets a new industry standard."
- iv. In addition to financial institutions in Malaysia, Cagamas HKMC Berhad is targeting other markets in the ASEAN region and the Middle East. The launch of the MGP is in line with Cagamas' objectives of developing the domestic Islamic capital market and promoting Malaysia as an International Islamic Finance Centre.

28 December: Launch of the non-owner occupied properties product under the Mortgage Insurance Programme

Date unknown: purchased HK\$1.1 billion taxi and public light bus hire purchase assets in Hong Kong

Date unknown: The Corporation had completed the first overseas mortgage acquisition of HK\$5.5 billion equivalent of Korean residential mortgages assets near Year-end 2007

- i. SCMP reported later that HKMC top the Korean MBS up to HK\$10.6 billion

## **2006**

23 February: Expanded the Mortgage Insurance Programme to cover mortgages secured by village houses with a loan-to-value ratio of up to 85%

23 March: Launched Composite Interest Rate mortgage product and issued the first-ever HK\$100 million 2-year Composite Interest Rate Notes

22 May: Launched Risk-Based Pricing Scheme and Loyalty Discount Scheme under the Mortgage Insurance Programme

25 August: Purchased the first-ever taxi loans from an Approved Seller

- i. Total taxi loan purchased in 2006 is HK\$1.4 billion

1 September: Issued HK\$1.3 billion of retail bonds with the first-ever Hong Kong dollar 10-year zero coupon bonds under the Retail Bond Issuance Programme

30 October: The HKMC became the first triple-A rated institution in Hong Kong with Moody's upgrade of HKMC's long-term local currency rating to "Aaa" from "Aa3" and foreign currency rating to "Aa1" from "Aa3"

27 November: Issued the first-ever partially guaranteed HK\$2 billion mortgage-backed securities with senior tranche rated "Aaa/AAA" and subordinated tranche rated "Aaa/AA" under the Bauhinia Mortgage-Backed Securitisation Programme

## **2005**

18 March: Modifications to the Mortgage Insurance Programme: increase in maximum loan size and maximum combined age of property and loan tenor to 75 years

22 April: HK\$250 million first dividend paid to the Exchange Fund

18 July: Issued retail bonds with the first-ever US dollar tranche under the HK\$20 billion Retail Bond Issuance Programme

3 November: Signing Ceremony and launch of a special 10-Year Fixed Rate Mortgage Scheme Programme for fixed-rate period ranging from 1-10 years

15 November: Issued HK\$1 billion Mortgage-Backed Securities under the Bauhinia Mortgage-Backed Securitisation Programme

## **2004**

19 January: Launched the 90% Fixed Adjustable Rate Mortgage Scheme

9 February: Issued HK\$1.2 billion retail bonds through 14 Placing Banks

24 May: Launched the HK\$20 Billion Retail Bond Issuance Programme accompanied by the inaugural issue under the Programme

29 June: Signing Ceremony for the issuance of Hk\$0.4 billion Series 2004-1 Mortgage-Backed Securities under the Bauhinia Mortgage-Backed Securitisation Programme through The Bank of East Asia as Lead Manager

28 July: Expanded the Mortgage Insurance Programme to cover mortgages with loan-to-value ratio of up to 95%

19 October: Issued the HK\$2 billion Mortgage-Backed Securities with the first-ever retail tranches of HK\$900 million offered in Hong Kong and the whole of Asia under the Bauhinia Mortgage-Backed Securitisation Programme

19 November: Expanded the 95% LTV Mortgage Insurance to cover loan size up to HK\$8 million

6 December: Expanded the Mortgage Insurance Programme to cover cash-out refinancing mortgages with a loan-to-value ratio of up to 85%

14 December: Expanded the Mortgage Insurance Programme to cover loans with maximum combined age of property and loan tenor of up to 60 years

## **2003**

9 January: Increased the programme size of the HK\$20 billion Debt Issuance Programme to HK\$40 billion

23 June: Issued the first 15-year notes under the Debt Issuance Programme

13 August: Promotion of "One-Stop 90% Mortgage Services"

30 October: Signing Ceremony for the issuance of HK\$3 billion Series 2003-1 Guaranteed Mortgage-Backed Securities under the Bauhinia MBS Programme through HSBC as Lead Manager and Bookrunner

7 May: Established the Transferable Loan Certificate Sub-Programme (TLC Sub-Programme) under the Debt Issuance Programme (DIP) and issued the debut HK\$1 billion Transferable Loan Certificate under the TLC Sub-Programme with Bank of China (Hong Kong) as Arranger

30 May: Signing Ceremony – Purchase of Civil Servant Housing Loans

2 December: Signing Ceremony – Purchase of HK\$15.7 billion of Home Starter Loans (HSL) and Sandwich Class Housing Loans (SCHL) from the Government

8 December: Issued HK\$1.3 billion of Retail Bonds through HSBC as Underwriting Bank and 12 Placing Banks

## **2002**

In March, we issued the first bond-style MBS under the Bauhinia MBS Programme, marking a further contribution to the development of the MBS market in Hong Kong

In June, we issued a retail bond for a record amount of HK\$2.3 billion subscribed by over 6,500 investors

In July, we launched the Home Owner Mortgage Enhancement Programme (HOME) to help relieve the financial burden of homeowners in negative equity and to provide a tool for banks to hedge the risk of mortgages in negative equity

In October, we introduced to the retail bond market a 5-year fixed-inverse floating rate note, marking the latest innovation in our debt issues

In October, we introduced an incentive scheme under the Mortgage Insurance Programme (MIP), providing both volume and risk performance incentives to banks

In November, the eligibility criteria under the MIP were expanded to include new product types, such as deferred principal repayment loans and a wider spectrum of borrowers

In December, we implemented the “90% one-stop mortgage service” with banks, to provide greater transparency in mortgage pricing through building the insurance premium into the repayments

## **2001**

In February 2001, the Corporation signed an agreement with the Housing Authority, the first non-bank Approved Seller, to buy HK\$17 - \$18 billion of mortgage loans originated under the Home Purchase Loan Scheme.

In April 2001, the Corporation expanded the MIP to provide cover for equitable mortgage loans with LTV ratio of up to 85% and, in July 2001, further expanded to LTV ratio of up to 90%. The maximum loan amount permitted under the MIP was increased from HK\$5 million to HK\$8 million in November 2001.

In July 2001, the Corporation introduced a set of Model Mortgage Origination Documents that represents best market practice.

In October 2001, the Corporation introduced a new arrangement of issuing bonds to retail investors through banks as placing agents. The debut issue attracted a record subscription amount of HK\$651 million from retail investors.

In December 2001, the Corporation expanded the MPP to include mortgage loans refinanced at LTV ratio greater than 70% and up to 100% and mortgage loans with a maximum combined age of property and loan tenor of up to 50 years.

In December 2001, the Corporation rolled out an e-commerce platform that supports the processing of transactions with banks and mortgage reinsurers over the Internet.

## **2000**

In June 2000, it introduced the Mortgage-Bond Asset Swap Programme for banks to swap mortgage loans with the debt securities issued by the Corporation. This enables the banks to sell mortgage loans to the HKMC without depleting their pool of assets. The inaugural deal of HK\$600 million was arranged with Dao Heng Bank in July.

In August 2000, the Corporation expanded the Mortgage Insurance Programme ("MIP") which allows homebuyers to obtain mortgage loans up to 90% of the value of the property. This has resulted in an increase in market penetration rate of the MIP from 4.3% to 8%.

In December 2000, the Corporation widened the scope of Approved Sellers under the Mortgage Purchase Programme ("MPP") to include Government housing agencies, other public bodies and property developers. This achieves the dual objectives of helping the Government housing agencies meet their financing needs and enlarging the source of mortgage purchase for the HKMC.