

The Hong Kong Mortgage Corporation Limited  
香港按揭證券有限公司

CB(1)687/09-10(01)

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James H. Lau Jr. JP 劉怡翔  
Chief Executive Officer 總裁

14 December 2009

Ms Rosalind Ma  
Clerk to Subcommittee  
Legislative Council  
Legislative Council Building  
8 Jackson Road  
Central  
Hong Kong

Dear Rosalind,

LegCo Panel on Financial Affairs  
Follow-up to Meeting on 2 November 2009

Thank you for your letter of 30 November 2009 conveying the request for further information from the HKMC to address the questions raised by the Hon Regina Ip in her letter of 27 November 2009.

We have consulted the HKMC Board of Directors and a copy of our response is at Annex A.

Yours sincerely,

A handwritten signature in black ink, consisting of a large, sweeping loop followed by a horizontal line.

Encl.

c.c. Ms Anna AU, Senior Executive Officer (Financial Services),  
Financial Services and the Treasury Bureau (Fax: 2528 3345)

**PANEL ON FINANCIAL AFFAIRS  
FOLLOW-UP TO MEETING ON 2 NOVEMBER 2009**

**RESPONSES FROM THE HKMC**

**1. HKMC's Operating Costs**

- (a) Information on the HKMC's Operating Costs is disclosed in the HKMC's Annual Report. For the year ended 31 December 2008, the total operating cost was HK\$142 million, comprising staff costs (HK\$97 million), premises (HK\$13 million), depreciation (HK\$9 million) and other expenses (HK\$23 million). The cost-to-income ratio as at 31 December 2008 was 17.5%.
- (b) The office premise at Two IFC is rented from The Financial Secretary Incorporated (i.e. the Exchange Fund) on a lease of 6 years from 1 January 2005 to 31 December 2010. The lease was negotiated in April 2003 and the rental was assessed by an independent property valuation advisor to be in line with the prevailing market rental in April 2003.
- (c) The HKMC has rented an offsite back-up and disaster recovery centre located in Quarry Bay.

**2. HKMC's staff compensation**

- (a) As explained in paragraphs 15 to 18 of LC Paper No. CB(1)2055/08-09(2), the remuneration of the HKMC personnel is determined in accordance with a framework approved by the Board of Directors, and with a fixed pay and a variable pay (i.e. bonus) for each staff. The HKMC does not encourage excessive risk taking. The Board evaluates the financial performance of the HKMC on a risk-adjusted basis. The "individual performance ratings" represent an evaluation of the core competence, skills and job performance of the staff concerned. The average bonus awarded to staff over the past 12 years was 1.65 months of fixed pay.
- (b) As at 1 December 2009, the HKMC has a permanent staff establishment of 144.

- (c) The current Chief Executive Officer (CEO)/HKMC and Secretary to CEO Office are seconded from the HKMA. All other HKMC staff members are recruited from the private sector.
- (d) the aggregate staff costs for key management personnel for 2008 was HK\$13.8 million – salaries and benefits: HK\$13 million (fixed pay of HK\$10.1 million, variable pay of HK\$2.6 million and other benefits of HK\$0.3 million) and retirement benefits of HK\$0.8 million. At end-2008, the key management personnel comprised the Chief Executive Officer, Senior Vice President (Operations), Senior Vice President (Finance) and General Counsel/Company Secretary.

### **3. Mortgage Insurance Programme**

- (a) Mortgage insurance is a specialised form of insurance business which is very capital intensive and requires economy of scale. The Insurance Authority is the licensing authority for mortgage insurers. We are aware of at least six mortgage insurers/reinsurers operating in Hong Kong (including the HKMC). The HKMC has no knowledge on the business strategy or market share of other mortgage insurers.
- (b) The HKMC operates its Mortgage Insurance Programme (“MIP”) to fulfil the objective of promoting homeownership in Hong Kong. The HKMC manages its risk exposure under the MIP prudently. It sets strict MIP eligibility and underwriting criteria, and underwrites each and every MIP application received from banks, and does not outsource loan underwriting as is the case in the United States for FannieMae and FreddieMac. The HKMC also reinsures risks under the MIP to share the risks with reinsurers. The MIP experienced the severe property market downturn and negative equity situation in 2003. Due to its prudent risk management framework, the MIP delinquency ratio peaked only at 0.39%, compared to the peak of 1.43% for the banking sector during the same period.
- (c) The MIP usage rate is 18.6% for the first ten months of 2009. In other words, for every HK\$100 of mortgage loans drawn down by homebuyers from banks in Hong Kong, HK\$18.6 are under the coverage of the MIP.
- (d) The total amount of the risk-in-force (i.e. the insured portion above 70% loan-to-value ratio for mortgage loans) assumed by the HKMC is HK\$11.2 billion as at October 2009. The HKMC has a strong capital base of around HK\$6.6 billion, and also a callable capital of HK\$1 billion from the Exchange Fund.

#### 4. Overseas businesses (Korea, Malaysia and Shenzhen/China)

- (a) Disclosure of data relating to pricing and the Return on Investment of the HKMC's overseas business transactions is inappropriate. They are commercially sensitive, not only for the HKMC but also for the relevant counterparties or partners.

##### Korea

- (b) The HKMC has acquired a total of HK\$ 20.8 billion Korean mortgage loans, in four separate transactions since 2007.
- (c) As regards risk management arrangement, as reported to the Panel in LC Paper No. CB(1)145/09-10(05), the Corporation has adopted a very prudent and conservative approach in the purchase of Korean mortgage loans – low loan-to-value ratio of around 50%, prudent seasoning requirements (weighted average seasoning of 16.5 months), and sizeable equity piece by the seller under the mortgage-backed securitisation structure to absorb first losses. Foreign exchange and interest rate risks have been hedged through currency and interest rate swaps. Furthermore, pre-payment risk, collateral risk, legal risk, regulatory risk etc have been duly analysed and reflected in the acquisition price. Weighted average life is around three years. No losses have been incurred by the Corporation on the Korean transactions to date.

##### Malaysia

- (d) The capital of Cagamas HKMC Berhad is MYR 100 million. The HKMC has a 50% share, i.e. MYR 50 million or HK\$121 million (ref. page 153 of the 2008 Annual Report).
- (e) As advised in LC Paper No. CB(1)205508-09(02), the joint venture was launched in the context of regional cooperation. The Mortgage Guarantee Programme launched by Cagamas HKMC Berhad provides mortgage guarantee in Malaysia, covering both conventional and Islamic type of mortgage loans. The joint venture engages in retail level Islamic banking business and is not in conflict with Hong Kong's goal to develop Islamic finance at the wholesale level. The HKMC has gained a good insight into the underwriting standards and market practices of Islamic mortgage financing. This will serve to enhance the HKMC's knowledge and pave the way for the development of Islamic finance in Hong Kong.

- (f) The Cagamas HKMC Berhad conducts no other business.

Shenzhen

- (g) As announced in a press release on 10 July 2009, the total capital of the joint venture company in Shenzhen is RMB 100 million. The HKMC has invested RMB 90 million (equivalent to HK\$102 million).
- (h) Bauhinia HKMC Limited has only just commenced the business of providing bridging guarantee (i.e. guarantee for the completion of secondary property market transactions) to banks in Shenzhen. This product is quite common in Shenzhen for facilitating the sale and purchase of residential properties.

**5. Memorandum and Articles of Association**

- (a) The Memorandum and Articles of Association have been changed 13 times since 1997.
- (b) Copy of the latest Memorandum and Articles of Association is attached.

**6. 2006 Consultancy Report**

Further information on the consultancy report is given separately in reply to the FAP secretariat letter of 3 November 2009.

**7. The Way Forward**

The HKMC currently has no further plan for overseas expansion.