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Panel on Financial Affairs

Meeting on 10 July 2012

**Background brief on role and functions
of Hong Kong Mortgage Corporation Limited**

Purpose

This paper provides background information on the role and functions of the Hong Kong Mortgage Corporation Limited ("HKMC"), and summarizes the major views and concerns expressed by members during the relevant discussions at the Panel on Financial Affairs ("the Panel").

Background

2. HKMC, established in March 1997 under the Companies Ordinance (Cap. 32), is wholly owned by the Hong Kong Special Administrative Region Government through the Exchange Fund. The Financial Secretary beneficially owns all the shares of the Corporation in his capacity as Controller of the Exchange Fund. HKMC operates on the basis of prudent commercial principles and have the following core missions:

- (a) to enhance the stability of the banking sector by offering a reliable source of liquidity;
- (b) to promote wider home ownership in Hong Kong; and
- (c) to facilitate the growth and development of the debt securities and mortgage-backed securities markets in Hong Kong.

3. HKMC is governed by a Board of Directors ("the HKMC Board") chaired by the Financial Secretary, with the Chief Executive of the Hong Kong Monetary Authority ("HKMA") as the Deputy Chairman. The HKMC Board consists of officials from the Government and regulatory bodies, and representatives from political parties, the financial services sectors, the accounting and legal professions as well as the Consumer Council. The membership list of the HKMC Board is at the **Appendix**.

4. The HKMC Board meets in person at least once every three months to oversee HKMC's business strategy and policies, budgeting and planning, organizational and financial performance, risk management, human resources as well as community relations. The Chief Executive Officer is accountable to the Board, and is responsible for implementing the Board's decisions.

5. According to its 2011 annual report, the general principal activities of HKMC are:

- (a) to purchase portfolios of mortgages or loans secured on properties or other collateral situated in Hong Kong or elsewhere and to acquire other debentures, receivables, financial assets and choses in action of all kinds from their originators, issuers, owners or vendors;
- (b) to acquire, by purchase or otherwise, any assets from government bodies and agencies and related organizations, statutory bodies and public bodies and to hold, sell, transfer, dispose of and deal in any such assets so purchased or acquired;
- (c) to issue notes or debt securities to institutional investors or retail investors;
- (d) to securitize mortgage portfolios through special purpose entities by way of issuing mortgage-backed securities to investors;
- (e) to provide mortgage insurance cover to Authorized Institutions ("AIs") in respect of mortgage loans and reverse mortgage loans originated by such AIs and secured by residential properties;

- (f) to provide financial guarantee cover to AIs in respect of:
 - (i) second mortgage loans originated by such AIs and secured by residential properties for payment of premium to the Hong Kong Housing Authority and the Hong Kong Housing Society; and
 - (ii) loans originated by such AIs to small and medium-sized enterprises and non-listed enterprises in Hong Kong.

Expansion of HKMC's businesses

6. HKMC pursued business diversification beyond Hong Kong after a strategic business development review conducted in 2006 by a management consultant ("the 2006 review").¹ According to HKMC, the Board accepted the consultant's recommendation and pursued business diversification to strengthen the HKMC's financial position and hence its ability in executing its policy objectives in Hong Kong for the benefit of the local financial community as a whole. In the same year, the Exchange Fund Advisory Committee endorsed an extension of the purpose of the capital injection to the HKMC to include section 3(2) of the Exchange Fund Ordinance (Cap. 66) ("EFO") which provides for the use of the Exchange Fund for investment purposes, in addition to section 3(1A) under EFO for purpose of maintaining the stability and integrity of the monetary and financial systems of Hong Kong. HKMC diversified overseas in some cases for commercial reasons² and in some cases also in the context of regional bank cooperation³.

7. Apart from the development of overseas business, HKMC launched the SME Financing Guarantee Scheme ("SFGS") and the Reverse Mortgage Programme ("RMP") in January 2011 and July 2011 respectively. The Financial Secretary also commissioned HKMC in the 2012-13 Budget to introduce a microfinance scheme in collaboration with banks, voluntary organizations and other stakeholders to provide funding and ancillary support to borrowers who wish to start their own businesses or receive self-enhancement training but cannot do so due to a lack of financial means or difficulties in obtaining loans from traditional financial sources. HKMC plans to launch the microfinance scheme in mid-2012.

¹ HKMC provided a summary of the consultancy report to the Panel vide LC Paper No. CB(1)686/09-10(01).

² HKMC purchased mortgage loans in Korea in 2007 to 2009.

³ In April 2008, HKMC established a joint venture in Malaysia with Cagamas, the national mortgage corporation in Malaysia. In June 2009, HKMC set up a joint venture in Shenzhen in partnership with Shenzhen Financial Electronic Settlement Center to provide mortgage guarantee.

Deliberations of the Panel on Financial Affairs

Panel meeting on 2 November 2009

8. The Panel discussed the role and operation of the Hong Kong Mortgage Corporation Limited (HKMC) on 2 November 2009. Noting that the core missions of HKMC were to enhance banking stability through providing liquidity to banks, promote home ownership in Hong Kong and facilitate the development of the debt markets, some members queried whether HKMC's engagement in investments in mortgage loan business outside Hong Kong, such as Malaysia, Korea and Shenzhen, had gone beyond its core missions. HKMC explained that its overseas activities, which were often undertaken in collaboration with the relevant central banks, were intended to strengthen HKMC's financial position and hence its ability in achieving its core missions in Hong Kong. HKMC's business diversification beyond Hong Kong had been pursued following a strategic business development review conducted in 2006 by a management consultant, the recommendations of which had been endorsed by HKMC's Board. In 2006, the Financial Secretary had authorized under section 3(2) of the EFO that capital injection to HKMC could be used for investment purposes.

9. Noting that HKMC was initially set up with reference to the business model of Fannie Mae and Freddie Mac (Fannie/Freddie), some members were concerned whether the business operation of HKMC would be at risk like that of Fannie/Freddie during the sub-prime crisis. HKMC advised that while reference had been made to the business model of Fannie/Freddie back in 1997 when the Corporation was established, HKMC had adopted a much more prudent risk management framework. Unlike the "originate-and-sell" model adopted by Fannie/Freddie for profit maximization, HKMC had adopted a passive approach in making purchases from banks.

10. Some members expressed concern on whether HKMC's Mortgage Insurance Programme was in line with the principle of "Small Government, Big Market", and had any crowding out effect in the mortgage insurance market. HKMC explained that its business activities would not lead to market monopoly. Interested enterprises which could meet the relevant regulatory requirements were free to enter the mortgage insurance market. HKMC's role was to act as a provider of mortgage insurance in order to promote wider home ownership in Hong Kong, and at the same time its stringent underwriting practice served as a model for prudent risk management in mortgage insurance business.

Panel meeting on 7 March 2011

11. At its meeting on 7 March 2011, the Panel discussed the SFGS and the RMP to be launched by HKMC. Some members expressed concern that by implementing the SFGS and the RMP, HKMC would be diverting from its core businesses and competing with the private sector for business opportunities. A member opined that the Administration should review the role of HKMC and consult the Legislative Council before widening the scope of HKMC's businesses.

12. HKMC responded that the operation of HKMC, as a limited company, was governed by the HKMC Board. HKMC would provide insurance coverage for the RMP against the risk of shortfall in property price. Based on the findings of the opinion survey conducted in 2010, almost a quarter of the respondents expressed interest in joining the RMP. One of the core missions of HKMC was to provide support to the banks in risk management in order to ensure the stability of the financial sector. SMEs usually lacked the required collateral to obtain loans from banks to support their business. The SFGS would enable SMEs to obtain loans from banks even during a credit crunch. The SFGS was introduced as a pre-cautionary measure to mitigate the risk exposure for banks at times of market volatility.

Panel meeting on 2 March 2012

13. At the Panel meeting on 2 March 2012 when HKMA briefed the Panel on its work, a member remarked that since its incorporation in 1997, HKMC had progressively diversified its business portfolio offering a variety of new financial services. The enactment of the Competition Bill might also impact on HKMC's operation. The member asked whether the Government would review the name and functions of HKMC. HKMA responded that since its incorporation in 1997, HKMC had strategically developed new business initiatives to meet the needs of Hong Kong. HKMC would give due consideration to the question on the need for changing its name in light of the broadening of its scope of business.

Requests for information relating to HKMC

14. At the special meeting of the Panel on 21 May 2009, Hon Mrs Regina IP expressed concern about media reports on significant investment losses incurred from high-risk investments undertaken by HKMC, and asked whether such investments had gone far beyond the objectives of the establishment of

HKMC. Mrs IP subsequently wrote to the Panel Chairman on 1 June 2009 and 2 September 2009 requesting for provision of relevant information by HKMC. Following the Panel discussion on the role and operation of HKMC on 2 November 2009, Mrs IP wrote to the Panel Chairman on 27 November 2009, 5 August 2010, 21 December 2010 and 28 March 2012 requesting for updated information on HKMC's business developments and for the Administration to brief the Panel on the relevant new initiatives. The issues raised by Mrs IP in her letters include the following:

- (a) details of HKMC's investments in overseas assets and whether such investments had gone beyond HKMC's original business scope;
- (b) whether HKMC had been engaging in anti-competitive practices in its business activities;
- (c) whether the remuneration system for HKMC staff, which was tied to profitability of the organization, might have driven HKMC to pursue benefits outside its original scope of business at the expense of the private sector;
- (d) details of the 2006 consultancy review on HKMC's business strategy;
- (e) details of the Mortgage Insurance Programme, the SFGS and RMP; and
- (f) impacts of the Competition Bill on HKMC's business activities.

The web links of Mrs IP's letters and the written responses of the Administration/HKMC are provided in paragraph 16 below.

Latest development

15. The Panel will discuss the role and functions of HKMC at the Panel meeting on 10 July 2012.

References

16. The relevant papers are available at the following web links:

Panel meeting on 6 January 1997	Paper provided by HKMA Annexes of the paper by HKMA Minutes (paragraphs 18-26)
Panel meeting on 21 May 2009	Minutes (paragraphs 12-13)
Panel meeting on 1 June 2009	Minutes (paragraphs 7-8)
Panel meeting on 2 November 2009	Agenda Minutes (paragraphs 39-60) Follow-up paper
Panel meeting on 7 March 2011	Minutes (paragraphs 45-46 and 52-53)
Panel meeting on 2 March 2012	Minutes (paragraphs 42-43) Follow-up paper
Hon Mrs Regina IP's letters to the Panel Chairman and the written response provided by the Administration / HKMC	Mrs IP's letter dated 1 June 2009 and the Administration's written response Mrs IP's letter dated 2 September 2009 and HKMC's written response Mrs IP's letter dated 27 November 2009 and HKMC's written response Mrs IP's letter dated 5 August 2010 and HKMC's written response Mrs IP's letter dated 21 December 2010 Mrs IP's letter dated 28 March 2012 and HKMC's written response
HKMC's Annual Report 2011	Report

Appendix

The Hong Kong Mortgage Corporation Limited

Board of Directors*

The Hon John TSANG Chun Wah, GBM, JP (Chairman and Executive Director)	Financial Secretary
Mr Norman T L CHAN, SBS, JP (Deputy Chairman and Executive Director)	Chief Executive Hong Kong Monetary Authority
Mr Peter PANG Sing Tong, JP (Executive Director)	Deputy Chief Executive Hong Kong Monetary Authority
Mr Eddie YUE Wai Man, JP (Executive Director)	Deputy Chief Executive Hong Kong Monetary Authority
Ms Diana CESAR	Head of Retail Banking and Wealth Management Hong Kong The Hongkong and Shanghai Banking Corporation Limited
Professor the Hon K C CHAN, SBS, JP	Secretary for Financial Services and the Treasury
The Hon CHAN Kin Por, JP	Member of Legislative Council Member of the China Advisory Board Munich Reinsurance Company Hong Kong Branch
The Hon Ms Tanya CHAN	Member of Legislative Council
Professor the Hon. Anthony CHEUNG Bing Leung, GBS, BBS, JP	Secretary for Transport and Housing
Mr Eddy FONG Ching, GBS, JP	Chairman Securities and Futures Commission
Mr Andrew FUNG Hau Chung, JP	Executive Director and Head of Treasury and Investment Hang Seng Bank Limited

Mr Lester Garson HUANG, JP	Partner, P. C. Woo & Co.
Mr LEE Huat Oon	General Manager/Chief Executive Public Finance Limited
The Hon Ms Starry LEE Wai King, JP	Member of Legislative Council
The Hon Andrew LEUNG Kwan Yuen, GBS, SBS, JP	Member of Legislative Council Chairman, Sun Hing Knitting Factory Limited
Dr the Hon David LI Kwok Po, GBM, GBS, Hon. LLD (Cantab), JP	Member of Legislative Council Chairman and Chief Executive The Bank of East Asia, Limited
The Hon Abraham SHEK Lai Him, SBS, JP	Member of Legislative Council

*Based on the information set out in the website of HKMC on 6 July 2012
(at: <http://www.hkmc.com.hk/eng/legal/thecompany/director.html>)