

For information

Legislative Council Panel on Financial Affairs

The Role and Operation of
The Hong Kong Mortgage Corporation Limited

PURPOSE

In response to the request of a Member, this paper addresses the following issues in connection with the Hong Kong Mortgage Corporation Limited (“HKMC”):

- (a) the HKMC’s current business activities;
- (b) how the HKMC has evolved from the original objectives and why;
- (c) the impact of the change on relevant stakeholders in the business community and any other relevant parties;
- (d) the impact of the draft competition bill on the HKMC’s business activities; and
- (e) HKMC’s plans for business expansion in the future.

CORPORATE OBJECTIVES

2 The HKMC was established under the Companies Ordinance in 1997 with the principal policy objectives of maintaining banking and financial stability, promoting home ownership and developing the debt market in Hong Kong. While the HKMC is wholly owned by the Government through the

Exchange Fund, the Corporation operates in the market on the basis of prudent commercial principles.

HKMC'S BUSINESS ACTIVITIES

Purchase of mortgage loans

3 The HKMC's main business focus has always been on the purchase of mortgage loans from banks, in order to provide them with liquidity and assist them in divesting risk and in asset-liability management. The HKMC's role in providing liquidity to banks contributes to banking and financial stability, which is particularly important during times of crisis and stressful liquidity conditions – HK\$11.4 billion of mortgage loans were purchased in 1998 after the Asian Financial Crisis and HK\$13.8 billion of local assets were purchased during the global financial crisis in 2008. Altogether, the HKMC has acquired HK\$117.4 billion of local mortgage loans since inception. Such mortgage purchases also enable banks to recycle the liquidity for further mortgage lending and promote home ownership.

Debt Issuance

4 The HKMC has played an important role in promoting the development of the bond market in Hong Kong through active issuance and product innovation. Since inception, the Corporation has issued a total debt of HK\$202.9 billion and is the most active corporate issuer in the Hong Kong dollar debt market for 11 years. The HKMC promotes the local securitisation market by repackaging purchased mortgage loans into mortgage-backed securities for sale as marketable instruments to investors. With its very high credit ratings, the HKMC helps to meet the demand for high-quality debts, particularly from the insurance industry and pension funds when the Corporation extended the tenor of its bond issuance to 15 years. In 2001 the

HKMC pioneered the introduction of retail bonds in Hong Kong to meet investor demand.

Mortgage Insurance Programme (“MIP”)

5 The HKMC began mortgage guarantee as a new line of business in 1999 because there was a demand to assist aspiring homeowners to obtain mortgage loans with loan-to-value (“LTV”) ratio over 70%. Under the MIP, the HKMC insures mortgage loans with an LTV ratio that is currently up to 90%. In other words, homebuyers would only need to come up with down payment as low as 10% to obtain a mortgage loan to buy their own homes.

6 Since its inception, the MIP has helped over 97,000 families to realise their aspiration for home ownership. The average value of the properties insured under the MIP is HK\$2.4 million. Many MIP users are first-time homebuyers that seek to buy entry level properties for use as their own home. Without the MIP, many of these homebuyers would otherwise not be able to afford the down payment to purchase their own homes. As 89% of such loans are for the purchase of properties in the secondary market, the MIP has also helped to enhance the liquidity of the secondary property market.

Reverse mortgage

7 In July 2011 the HKMC launched another mortgage guarantee product, namely reverse mortgage, to meet the needs of elderly in Hong Kong. Reverse mortgage provides elderly people aged 60 or above with an option to take out a loan secured on their own self-occupied residential property in order to enhance their livelihood and quality of life. Reverse mortgage enables elderly homeowners to live in their own home while receiving stable monthly payout from banks. The elderly also have an option to receive a lump sum

under the reverse mortgage for specific purposes, although that would entail a reduction in their monthly payout amount.

8 In the past, banks and insurers in Hong Kong did not offer any reverse mortgage product in Hong Kong due to the long tenor of such loans and the risks and uncertainties arising from the trend of property price, interest rates and life expectancy. The local community generally welcomes the HKMC's timely introduction of reverse mortgage as a major breakthrough in serving the elderly in Hong Kong. Up to 10 May 2012, 228 applications have been approved, with an average property value of HK\$3.7 million and the average monthly payout is HK\$13,500.

Expansion of HKMC's Businesses

9 Since its establishment in 1997, the HKMC's business priority has always been to meet its principal policy objectives (paragraph 2 above) and serve the needs of Hong Kong. Over the years, the HKMC has accumulated valuable experience and skills in credit assessment and risk management, and has built an efficient operating platform in conducting transactions with banks that can support policy initiatives that require a commercial solution that is linked to bank financing.

10 When developing new products, the HKMC engages in extensive consultation with relevant stakeholders such that the products developed can meet the market demands. The Corporation also consults its Board of Directors to ensure that the products are operated in line with the Corporation's policy objectives and based on prudent commercial principles. The Board would also consider, where appropriate, changes to the Memorandum and Articles of Association ("M&A") of the Corporation to reflect the new lines of business. For instance, the M&A of the Corporation was amended in 1999 so that the HKMC can undertake mortgage guarantee business and operate the

MIP to help entry level homebuyers in Hong Kong. The M&A was also amended in 2006 to expand the scope of its asset purchase to include taxi and public light bus (“PLB”) loans. A total of HK\$3.7 billion of taxi and PLB loans has been purchased but mortgage loans remain by far the principal assets sold by banks to obtain liquidity from the Corporation.

11 The Corporation’s development of businesses overseas helped strengthen its financial position and hence its ability to fulfil its policy objectives in Hong Kong. The purchase of Korean mortgage loans in 2007 to 2009 has generated a positive return for the Corporation. There was full compliance with risk management requirements and the foreign exchange risk exposure was fully hedged through cross-currency swaps. With continued development of its businesses in Hong Kong as aforementioned, the Corporation has no plan to acquire further overseas assets. The formation of joint ventures overseas was in the context of regional central bank cooperation, from which the Corporation has recorded reasonable returns.

12 In the course of its development, the Corporation also engages in other lines of business but these are generally limited in scale and scope, and do not detract from the HKMC’s principal businesses or objectives. Again, Board approval is always sought for such new ventures. Outlined below are two recent projects undertaken by the Corporation.

SME Financing Guarantee Scheme (“SFGS”)

13 Upon the closure of the application period for the Government’s Special Loan Guarantee Scheme at end-2010, the HKMC launched the SFGS in January 2011 as a market-oriented platform to assist local small and medium-sized enterprises (“SMEs”) to obtain sustainable bank financing. The SFGS is a self-financing loan guarantee scheme that encourages banks to provide liquidity to SMEs through the HKMC’s share of up to 70% of the risks

associated with such loans. By helping to reduce the banks' credit risks, such guarantee by the HKMC has not only contributed to the stability of the local banking system but also enabled SMEs to secure loans more easily at a competitive interest rate level and complemented the existing guarantee schemes available.

14 The SFGS has been well received by the market, including banks as well as SMEs who appreciate that the SFGS can help them obtain bank financing in the face of market stress and economic uncertainties. At 10 May 2012, 265 applications¹ with a total loan amount of HK\$913 million have been approved under the SFGS, benefitting over 220 SMEs in Hong Kong.

15 On the request of the Government, the HKMC will be introducing in May 2012 a new product under the SFGS, open for applications for nine months, to provide up to 80% risk guarantee for SME loans and with a reduced guarantee fee. The new product is a special concessionary measure that should help boost liquidity support for SMEs in the face of possible credit crunch arising from the uncertainties in the external economic environment. All losses and claims associated with such time-limited special concessionary measures will be borne by the Government. With the funding approval of the Finance Committee of the Legislative Council on 20 April 2012, the Government's total loan guarantee commitment for the 80% guarantee product is HK\$100 billion.

Microfinance

16 As part of the broad strategy to strengthen the social capital in Hong Kong, the Financial Secretary commissioned the HKMC in the 2012-13 Budget to introduce a microfinance scheme in collaboration with banks, voluntary organisations and other stakeholders to provide funding and ancillary

¹ Excluding applications which expire or are withdrawn after approval is granted

support to the borrowers. Under the scheme, loans will be provided to people who may 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 finance sources. The HKMC plans to launch the pilot scheme in mid-2012 for a trial period of three years with a tentative loan volume of \$100 million. Banks will be the lending institutions and the HKMC may participate in the loan funding alongside the banks. The HKMC will review the effectiveness of the scheme and assess its long-term prospect in due course.

IMPACT ON STAKEHOLDERS

17 In general, the HKMC launches a line of business only where there is unmet demand in the market. Often, the HKMC is a pioneer in such businesses in Hong Kong, e.g. the launch of the Mortgage Insurance Programme in 1999 to facilitate banks' lending to aspiring homeowners who need a high loan-to-value ratio mortgage and the introduction of reverse mortgage for the elderly in 2011.

18 For the latest new products, the SFGS benefits mainly the SMEs in Hong Kong and are welcome by the SME community and the banking sector, as the SFGS helps the SMEs to obtain liquidity support from banks. The reverse mortgages offered by banks are welcome by elderly homeowners. In fact, we understand that no reverse mortgage was offered in the past by banks or insurers in Hong Kong because no insurer was prepared to play the role currently assumed by the HKMC and insure the shortfall between the realised value of the elderly's home and the total outstanding debt under the elderly's reverse mortgage upon the demise of the elderly borrower(s).

GOVERNANCE STRUCTURE

19 The HKMC is governed by a Board of Directors chaired by the Financial Secretary, with the Chief Executive of the Hong Kong Monetary Authority as the Deputy Chairman. Directors of the HKMC are broadly based and representative of relevant sectors of the community. They come from the Government, regulatory bodies, political parties, financial services sectors, accounting and legal professions, and the Consumer Council. A list of the Board membership with effect from 30 April 2012 is at the annex. The wide range of representation on the HKMC Board is to ensure that the Corporation's business activities and proposals for new endeavours are examined with due regard to the public interest and in line with the Corporation's policy objectives.

COMPETITION ISSUES

20 The HKMC operates in the market on the basis of prudent commercial principles and does not have a monopoly or special franchise in its business activities. The Corporation in fact has a higher funding cost than banks in general. The Corporation provides commercial solutions that address the needs of banks, homebuyers and investors in an open market environment without artificial entry barriers. Indeed, banks, insurance companies and other market participants operate alongside the HKMC in the area of mortgage purchase, guarantee, debt issuance, mortgage securitisation and so forth. Some insurance companies also act as reinsurers for our MIP.

21 The HKMC will be subject to the proposed Competition Bill ("the Bill") before the Legislative Council. The HKMC will not engage in anti-competitive agreements or conduct; nor will the Corporation abuse its market power to prevent, restrict or distort competition in Hong Kong. The practical impact of the future competition law on the Corporation would be minimal, as the Corporation has always been mindful not to engage in anti-competitive behaviour.

WAY FORWARD

22 In the years ahead, the HKMC is committed to continuing the business activities set out in paragraphs 3-16 above. Due to the business diversification of the HKMC in response to market demand, there are suggestions that the HKMC should consider better reflecting in its corporate name the expanded scope of its business. The HKMC will carefully review such need, taking into account its long-term business strategy, the state of development of its evolving non-mortgage related businesses and their scale relative to its core businesses.

The Hong Kong Mortgage Corporation Limited

May 2012

The Hong Kong Mortgage Corporation Limited

Board of Directors (with effect from 30 April 2012)

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
The Hon Ms Eva CHENG, GBS, JP	Secretary for Transport and Housing
Professor the Hon Anthony CHEUNG Bing Leung, GBS, BBS, JP	Member of Executive Council Chairman, Consumer Council
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