

ITEM FOR FINANCE COMMITTEE

HEAD 181 – TRADE AND INDUSTRY DEPARTMENT

Subhead 700 General non-recurrent

Item 802 Special Loan Guarantee Scheme for Small and Medium Enterprises

Members are invited to approve the following changes to Head 181 Trade and Industry Department Subhead 700 General non-recurrent -

Item 802 Special Loan Guarantee Scheme for Small and Medium Enterprises

- (a) increase the total loan guarantee commitment from \$7 billion by \$93 billion to \$100 billion, and to meet contingent liabilities arising from this guarantee;
- (b) extend the scheme to all companies registered and with substantive businesses in Hong Kong, except listed companies;
- (c) increase the maximum amount of loan that each enterprise may obtain from \$1 million to \$6 million. Within this ceiling, up to \$3 million may be used for a revolving credit line;
- (d) subject to the maximum loan guarantee ratio at 70%, increase the maximum amount of loan guarantee for each enterprise from \$700,000 to \$4.2 million. Within this ceiling, the maximum amount of loan guarantee in respect of the revolving credit line is \$2.1 million, or an amount equivalent to 70% of the approved loan under the revolving credit line, whichever is lower; and
- (e) extend the maximum guarantee period for each loan from 30 months to 36 months, or up to 30 June 2012, whichever is earlier.

PROBLEM

There are views that the Special Loan Guarantee Scheme for Small and Medium Enterprises (SpGS) cannot fully address the needs of the trade amidst the global financial crisis. In particular, the loan ceiling of \$1 million for each small and medium enterprise (SME) may not be adequate, and that companies in the services sector that employ more than 50 persons cannot benefit from the SpGS.

PROPOSAL

2. The Director-General of Trade and Industry, supported by the Secretary for Commerce and Economic Development, proposes to make the following changes to the SpGS -

- (a) increase the total loan guarantee commitment, hence the amount of contingent liabilities to be borne by the Government, from \$7 billion to \$100 billion at any particular time while the SpGS is in operation. Assuming a default rate of 10%, the expected maximum expenditure to be incurred by the Government for the settlement of loan defaults would increase from \$700 million (for the original loan guarantee commitment of \$7 billion) to \$10 billion;
- (b) extend, as an exceptional arrangement, the scheme to all companies registered and with substantive businesses in Hong Kong, except listed companies¹, irrespective of industry or size of business;
- (c) increase the maximum amount of loan that each enterprise may obtain from \$1 million to \$6 million. Within this ceiling, up to \$3 million may be used for a revolving credit line²;
- (d) subject to the maximum loan guarantee ratio at 70%, increase the maximum amount of loan guarantee for each enterprise from \$700,000 to \$4.2 million. Within this ceiling, the maximum amount of loan guarantee in respect of the revolving credit line is \$2.1 million, or an amount equivalent to 70% of the approved loan under the revolving credit line, whichever is lower; and

¹ Companies that are listed in or outside Hong Kong at the time of application are not eligible.

² Under a revolving credit line, a company may use the credit repeatedly up to a certain limit as long as payments are made. It may include overdraft facilities, revolving letters of credit line in support of trade finance, etc.

- (e) extend the maximum guarantee period for each loan from 30 months to 36 months, or up to 30 June 2012, whichever is earlier.

3. To reflect the proposed extension of the SpGS to cover larger companies in addition to SMEs, we also propose to retitle the commitment item, i.e. Item 802, as Special Loan Guarantee Scheme. Other features of the scheme, including the various safeguard measures³ put in place to prevent abuse, will remain unchanged. The enhanced scheme will supersede the SpGS approved by Members on 14 November 2008.

JUSTIFICATION

The increased loan guarantee commitment

4. We propose to increase the Government's total loan guarantee commitment to \$100 billion at any particular time while the SpGS is in operation. With the provision of 70% Government guarantee, this would help enable the participating lending institutions (PLIs) to make available loans of up to about \$142 billion. Depending on the actual loan size, we expect the enhanced scheme to benefit about 40 000 companies.

Coverage of the enhanced scheme

5. The original SpGS aims to help Hong Kong companies with good track record and reasonable business prospects in obtaining financing to carry on their business and tide over the immediate cashflow problem as a result of the credit crunch. In recent months, tightening of credit in the commercial lending market amidst the global financial crisis has presented serious liquidity problems for many companies in Hong Kong. While welcoming the various enhancement measures to the existing SME Loan Guarantee Scheme (SGS) approved by the Finance Committee (FC) on 28 October 2008 and the approval of the SpGS on 14 November 2008, the trade has pointed out that companies in the service sectors, particularly those in the retail, catering and logistics sectors, employing

³ The following safeguard measures will continue to be imposed to ensure that only enterprises with genuine need and a reasonable business prospect would benefit from the scheme –

- (a) personal guarantee is required from the company owner or, in the case of a limited company, shareholders together holding more than 50% of the equity interest of the company;
- (b) the company must have been in operation for at least one year on the date of implementation;
- (c) the company must have no default in other banks; and
- (d) the loans should not be used for repaying, restructuring or repackaging other loans.

more than 50 employees cannot benefit from the two schemes. Although the present definition of SME⁴ already encompasses 98% of the business establishments in Hong Kong, we consider it necessary to provide support to non-SMEs, which take up 50% of the employment in the private sector, during this difficult time as well. As such, as an exceptional arrangement, we propose to extend the coverage of the SpGS to all companies registered and with substantive businesses in Hong Kong, the only exception being listed companies since they are usually of larger scale and have additional means to raise capital.

Loan ceiling

6. There are calls for the Government to increase the loan ceiling of \$1 million for each company under the SpGS. Our previous consideration of setting the ceiling at \$1 million was to provide an immediate cashflow for SMEs to tide over the most difficult period in the coming few months. Having regard to SME's views that they would need further support from Government to tide over the credit crunch, we propose to increase the loan ceiling for each company from \$1 million to \$6 million, within which 50% can be used as a revolving credit line. With the offer of 70% Government guarantee, the maximum amount of guarantee for each company will be increased from \$700,000 to \$4.2 million, within which up to \$2.1 million or an amount equivalent to 70% of the approved revolving loan, whichever is lower, may be used to provide guarantee under the revolving credit line.

Guarantee period

7. With an increase in the loan size, we propose to extend the maximum guarantee period to 36 months⁵. A grace period of six months will continue to be allowed, during which the borrower may repay interest only. Thereafter, the loan should be repaid over a maximum of 30 months. As such, the maximum guarantee period for each loan, including both the term loan and the revolving credit line facility, should be 36 months, or up to 30 June 2012, whichever is earlier.

⁴ "SMEs" is defined as any manufacturing businesses which employ less than 100 employees in Hong Kong, or any non-manufacturing businesses which employ less than 50 employees in Hong Kong.

⁵ The maximum guarantee period for the original SpGS, which provides a maximum loan size of \$1 million, is 30 months.

Indicative guarantee ceiling for PLIs

8. In view of the increase in loan size and Government's total guarantee commitment, we consider it necessary to impose an indicative guarantee exposure ceiling for PLIs for risk management and better utilisation of the Government guarantee. Having regard generally to their sizes of operation in Hong Kong and the potential number of PLIs⁶, the indicative guarantee exposure ceilings for each participating licensed bank and restricted licensed bank/deposit taking company will be set at \$4 billion and \$2 billion respectively. The Director-General of Trade and Industry may revise the ceiling for individual PLIs having regard to their utilisation and other relevant factors pertinent to the best use of the resources of the SpGS.

9. In addition, in order to facilitate PLIs in granting loans, we would provide them with more flexibility in the loan assessment process⁷.

FINANCIAL IMPLICATIONS

10. With the implementation of the proposed enhancement measures, the Government's total loan guarantee commitment will be increased from \$7 billion by \$93 billion to \$100 billion. This represents the maximum liability to be borne by the Government, and the precise amount of expenditure to be incurred eventually by the Government within this limit would depend on the actual default rate. Assuming a default rate of 10%⁸, the expected maximum expenditure will be increased from \$700 million by \$9.3 billion to \$10 billion, which will likely spread over three or more financial years starting from 2010-11. For the sake of financial prudence, except with Members' further approval, we would not provide loan guarantee beyond the \$100 billion commitment or when expenditure for settling default claims from PLIs is about to reach \$10 billion, whichever happens first.

⁶ For reference, as at 9 December 2008, 31 PLIs have joined the enhanced SGS.

⁷ This will include the following measures –

- (a) PLIs do not have to stop further lending to delinquent borrowers under the revolving credit line within a grace period of 30 days after the due date for debt repayment;
- (b) PLIs may make reference to financial information other than audited financial statements of latest financial year in making credit assessment, if this is consistent with prudent credit risk management principles as specified by Hong Kong Monetary Authority in its guidelines and circulars;
- (c) PLIs may provide credit facilities under the enhanced scheme to existing customers whose original unused credit line outside the scheme has been cut for one reason or another. Repackaging or restructuring of loans already drawn down would still not be permitted in line with Audit's recommendation on the loan guarantee scheme introduced during the Asian financial crisis in 1998.

⁸ Although the maximum amount of loan for each company will be increased, since Government's risk sharing ratio will remain at 70%, there should not be major changes to PLI's credit risk assessment process. Hence, we do not envisage a significant change in the level of risk for Government and the assumed default rate.

11. The Trade and Industry Department (TID), even with redeployment of existing resources, will require additional manpower at non-directorate levels to implement the enhanced scheme during the application period. Thereafter, some of the staff will continue to be required to support the scheme. We will seek additional manpower resources through established mechanism.

12. The proposal has no implication for the fees and charges of services provided by TID.

IMPLEMENTATION PLAN

13. Subject to Members' approval of the recommendations set out in paragraph 2 above and completion of the necessary procedures and legal documentation, the enhanced scheme is expected to come into operation next week.

PUBLIC CONSULTATION

14. We consulted the Legislative Council Panel on Commerce and Industry on the proposed enhancement measures on 10 December 2008. Members were supportive of the proposal. Some Members expressed concern that the PLIs may not have sufficient liquidity in providing credit. In this regard, it is noted that the Hong Kong Monetary Authority (HKMA) has taken a series of measures to maintain depositors' confidence and has injected a substantial amount of liquidity into the banking system, with a view to assisting banks in performing their essential financial intermediation role, which includes the provision of credit to SMEs. The HKMA has had discussions with banks active in SME lending. They generally indicated that liquidity is not a major issue in their provision of credit.

15. Some Members also raised concern about the interest rate charged by PLIs. As the Administration explained at the Panel meeting, interest rates are determined by individual PLIs in accordance with commercial principles, but according to the PLIs, lowering of credit risk as a result of the guarantee provided by Government would be suitably reflected in the interest rates. Government guarantee aside, in practice, in determining the interest levels, each borrower would be assessed individually against various relevant factors, including the borrower's business, its operational and financial strength, the type and nature of credit facility, the loan amount and repayment tenor, the cost of funds to the bank, the type, quality and marketability of any security pledged and availability of personal guarantees, the borrower's relationship with the bank, etc.

16. Members also requested for additional information relating to applications under previous loan guarantee schemes. The required information is provided in paragraphs 18 and 19 below.

BACKGROUND

Encl. 1 17. FC approved on 14 November 2008 the setting up of a time-limited Special Loan Guarantee Scheme for Small and Medium Enterprises with a total loan guarantee commitment of \$7 billion and an expected maximum expenditure of \$700 million. Major features of the scheme are summarised at Enclosure 1. The scheme was set to commence operation in December 2008.

Encl. 2 18. We obtained FC's approval on 28 October 2008 to introduce a series of enhancement measures to the SGS currently administered by TID. Details of the enhancement measures are set out at Enclosure 2. The enhancement measures were implemented on 6 November 2008. As at 9 December 2008, 31 PLIs have participated in the enhanced SGS. Between 6 November and 9 December 2008, TID has received 179 applications from the PLIs, among which 104 applications have been approved, involving a total loan amount of \$449.3 million approved by the PLIs. The remaining 75 applications are being processed by TID⁹.

Encl. 3 Detailed breakdown of the approved applications under SGS is at Enclosure 3.

Encls. 4&5 19. The Government introduced two special finance schemes in 1998 and 2003 to provide assistance to the trade in obtaining loans during the Asian financial crisis and SARS. The two schemes have a guarantee ratio of 70%¹⁰ and 100% respectively. Detailed breakdown of the approved applications under the two schemes are at Enclosures 4 and 5 respectively.

Commerce and Economic Development Bureau
Trade and Industry Department
December 2008

⁹ TID pledges to process applications within three working days after receipt of applications with all necessary information from the PLIs. Among the 75 outstanding applications, 38 require submission of further information by the PLIs.

¹⁰ The initial guarantee ratio was 50% when the scheme was first introduced, and was later increased to 70%.

Major features of the Special Loan Guarantee Scheme for Small and Medium Enterprises approved by FC on 14 November 2008

- (a) The Government will provide 70% guarantee to the loans granted by the participating lending institutions (PLIs). The maximum amount of guarantee for each SME is \$700,000. In other words, the maximum amount of loan that each SME may obtain is \$1 million.
- (b) Within the \$1 million loan ceiling, an SME may obtain from the PLI a revolving credit line of up to \$500,000. Subject to the maximum guarantee ratio of 70%, the Government's maximum guarantee for an SME in respect of the revolving credit line is \$350,000 or an amount equivalent to 70% of the approved revolving loan, whichever is lower.
- (c) All SMEs registered and with substantive business in Hong Kong are eligible to apply.
- (d) The application is open for six months starting from the date of implementation, which may be extended subject to review.
- (e) A grace period of six months will be allowed, during which the borrower may repay the interest only. Thereafter, the loan should be repaid over a maximum of 24 months. As such, the maximum guarantee period for each loan, including both the term loan and revolving credit line facility, should be 30 months, or up to 31 December 2011, whichever is earlier.
- (f) The interest rate will be determined by individual PLIs in accordance with commercial principle.

**Enhancement measures to the SME Loan Guarantee Scheme
approved by FC on 28 October 2008**

- (a) remove the sub-ceilings for the Business Installations and Equipment Loan and Working Capital Loan, while maintaining the overall maximum amount of guarantee for each SME at \$6 million;
- (b) extend the maximum guarantee period for Working Capital Loans from two years to five years;
- (c) allow each SME to recycle the guarantee once after it has fully paid up the loan backed up by the guarantee (i.e. each SME will be able to obtain a maximum amount of guarantee of \$12 million in its lifetime); and
- (d) increase the indicative ceiling of guarantee exposure for each PLI from \$1.25 billion to \$1.5 billion to provide more “quota” for the PLIs in granting loans.

Statistics of the SME Loan Guarantee Scheme (SGS)

The SGS (with government guarantee ratio of 50% and loan ceiling of \$12 million) was administered by the Trade and Industry Department (TID). Since the Scheme was launched in December 2001 and up to 30 November 2008, TID has received a total of 20 781 applications. Amongst them, 20 606 applications are approved. Of the remaining 175 applications, 118 are rejected¹¹ and 57 are being processed. The total amount of guarantee approved by the Government is \$10.45 billion (representing a utilisation rate of 83% based on the approved guarantee commitment of \$12.6 billion), and the total amount of loans approved by PLIs is \$23.11 billion. Detailed breakdown of the successful applications is set out below.

Year-by-year breakdown of applications approved under SGS

	2001	2002	2003	2004	2005	2006	2007	2008 (up to 30 Nov 08)	Total
No. of applications approved	11	3 126	4 743	4 335	3 174	2 761	1 346	1 110	20 606
Amount of guarantee involved (\$M)	5	1,103	2,003	2,151	1,734	1,505	947	1,002	10,450

Breakdown by industries

Manufacturing	:	78%
<i>Plastics</i>	:	14%
<i>Metal Products</i>	:	12%
<i>Printing and publishing</i>	:	12%
<i>Textiles and clothing</i>	:	11%
<i>Electronics</i>	:	8%
<i>Toys</i>	:	3%
<i>Others</i>	:	18%
Non-manufacturing	:	22%
<i>Import & Export trade</i>	:	7%
<i>Construction</i>	:	3%
<i>Transportation</i>	:	2%
<i>Wholesale and retail</i>	:	2%
<i>Others</i>	:	8%

¹¹ The major reasons for rejection include the amount of government guarantee required for the loan has exceeded the guarantee ceiling, the applicant has previous history of default under the SGS or other government guarantee schemes, etc.

Breakdown by loan types

	Business Installation and Equipment Loan	Working Capital Loan	Associated Working Capital Loan¹²	Accounts Receivable Loan¹²	Total
No. of applications approved	17 758	191	1 184	1 473	20 606
Amount of guarantee (\$M)	9,045	167	285	953	10,450
Amount of loans involved (\$M)	20,158	335	589	2,027	23,109

Defaulted cases

3. As at 30 November 2008, of the 20 606 approved applications, 1 380 default claims have been received from the PLIs. 336 claims were withdrawn because the borrowers had subsequently settled the loans in full. Based on the total amount of guarantee approved and the amount of claims submitted by the PLIs, the default rate is 2.85%.

¹² The Associated Working Capital Loan was used to meet SMEs' additional operational expenses arising from or in relation to the business installations and equipment acquired under SGS; while the Accounts Receivable Loan was used to meet the working capital needs of SMEs arising from the provision of credit terms to their customers. These two loans have been replaced by the Working Capital Loan since March 2008. For details, please refer to FCR(2007-08)44.

Special Finance Scheme for Small and Medium Enterprises in 1998

The Special Finance Scheme for Small and Medium Enterprises launched in 1998 (with government guarantee ratio of 50% initially and later increased to 70% and loan ceiling of \$2 million) during the Asian Financial Crisis was administered by the Treasury. According to the information provided by the Treasury, during the application period from 24 August 1998 to 8 April 2000, there were a total of 9 912 successful applicants and 2 unsuccessful applicants. The total amount of approved guarantee commitment was \$5 billion, and the total amount of guarantee approved was \$5.81 billion, representing a utilisation rate of 116.2%¹³. Detailed breakdown of the successful applicants by business sectors is set out below.

Business Sectors	No. of successful applicants
Agriculture & Fishing	6
Mining & Quarrying	2
Manufacturing	3 996
Construction	427
Wholesale & Retail	1 662
Import & Export Trades	2 215
Restaurants & Hotels	144
Transport, Storage & Communication	518
Financing, Insurance & Business Services	547
Community, Social & Personal Services	395
Total	9 912

2. Two applicants were rejected as they had a record of default payment for over 100 days, which had exceeded the 60-day limit imposed when the Scheme was launched.

Defaulted cases

3. Of the 11 968 approved applications (lodged by the 9 912 successful applicants), 2 147 default claims have been received from the lending institutions. 697 claims were subsequently withdrawn because the borrowers had fully settled the loans after the loan maturity date.

4. As at 24 November 2008, of the remaining 1 450 claims, 1 417 have been fully settled, 17 were rejected and 16 are cases where the lending institutions have yet to provide all supporting documents or where further processing of the claims have been suspended as requested by the lending institutions as the borrowers have resumed repayment. Based on the total amount of guarantee provided and the amount of claims paid to the lending institutions, the default rate is 5.7%.

¹³ The cumulative Government guarantee granted exceeded the approved commitment because the Scheme was a facility of a revolving nature.

**Loan Guarantee Scheme for
Severe Acute Respiratory Syndrome (SARS) Impacted Industries in 2003**

The Loan Guarantee Scheme for SARS Impacted Industries launched in 2003 (with government guarantee ratio of 100% and loan ceiling of \$1 million for restaurants and hotels, \$500,000 for travel agents and tourist coach operators, and \$300,000 for retail, cinema and karaoke) was administered by the Labour Department. According to the information provided by the Labour Department, during the application period from 5 May to 31 July 2003, there were a total of 1 802 loan applications and 1 559 were approved. The total amount of approved guarantee commitment was \$3.5 billion, and the total amount of guarantee approved was \$0.5 billion, representing a utilisation rate of 14.3%. Detailed breakdown of the approved applications by business sectors is set out below.

Business Sector	Number of applications approved
Retailing Business	890
Restaurant and Hotel / Guesthouse	466
Travel Agent and Tourist Coach Operator	202
Karaoke and Cinema	1
Total	1 559

2. No information was kept on unsuccessful loan applications.

Defaulted cases

3. As at 20 November 2008, 162 default claims have been received from the lending institutions. Payment has been effected to all these claims. The default rate was 4.9%.
