

ITEM FOR FINANCE COMMITTEE

HEAD 181 – TRADE AND INDUSTRY DEPARTMENT Subhead 700 General non-recurrent

Item 520 SME Loan Guarantee Scheme Item 524 SME Export Marketing and Development Funds Item 802 Special Loan Guarantee Scheme

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

Item 520 SME Loan Guarantee Scheme -

- (a) increase the loan guarantee commitment from \$12.6 billion by \$7.4 billion to \$20 billion, and to meet contingent liabilities arising from this guarantee;

Item 524 SME Export Marketing and Development Funds -

- (b) increase the approved commitment from \$1.75 billion by \$1 billion to \$2.75 billion;
- (c) expand the scope of the SME Export Marketing Fund;

Item 802 Special Loan Guarantee Scheme -

- (d) increase the maximum loan guarantee ratio from 70% to 80% for new loans to be approved;

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- (e) increase the maximum amount of loan that each enterprise may obtain from \$6 million to \$12 million; and within this ceiling, increase the amount of loan that may be used for revolving credit facilities from \$3 million to \$6 million;
- (f) subject to the maximum loan guarantee ratio at 80% for new loans, increase the maximum amount of loan guarantee for each enterprise from \$4.2 million to \$9.6 million. Within this ceiling, the maximum amount of loan guarantee in respect of the revolving credit facilities will be increased from \$2.1 million to \$4.8 million, or an amount equivalent to 80% of the approved loan under the revolving credit facilities, whichever is lower; and
- (g) for new loans to be approved, extend the maximum guarantee period from 36 months to 60 months after loan drawdown, or up to 60 months after the application deadline, whichever is earlier.

PROBLEM

The application period for the Special Loan Guarantee Scheme (SpGS) will expire on 14 June 2009. We need to extend the scheme with further enhancements to assist business enterprises in riding out the global financial crisis.

2. At the same time, the approved commitments for the SME Loan Guarantee Scheme (SGS) (i.e. the loan guarantee commitment) and the SME Export Marketing Fund (EMF)/SME Development Fund (SDF) will soon be exhausted. We need to increase the commitments to continue the operation of these schemes.

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PROPOSAL

3. The Director-General of Trade and Industry (DGTI), supported by the Secretary for Commerce and Economic Development, proposes to make the following changes -

For SGS

- (a) increasing the loan guarantee commitment, hence the amount of contingent liabilities for the Government, from \$12.6 billion by \$7.4 billion to \$20 billion;
- (b) consequential to (a), and assuming a default rate of 7.5%, increasing the expected maximum expenditure that could be incurred by the Government for the settlement of loan defaults from \$950 million by \$550 million to \$1.5 billion;

For EMF and SDF

- (c) increasing the commitment from \$1.75 billion by \$1 billion to \$2.75 billion;
- (d) expanding the scope of EMF to include advertisements placed on eligible trade websites approved by DGTI from time to time;

For SpGS

- (e) increasing the maximum loan guarantee ratio from 70% to 80% for new loans to be approved;
- (f) increasing the maximum amount of loan that each enterprise may obtain from \$6 million to \$12 million; and within this ceiling, increasing the amount of loan that may be used for revolving credit facilities from \$3 million to \$6 million;
- (g) subject to the maximum loan guarantee ratio at 80% for new loans, increasing the maximum amount of loan guarantee for each enterprise from \$4.2 million to \$9.6 million. Within this ceiling, the maximum amount of loan guarantee in respect of the revolving credit facilities will be increased from \$2.1 million to \$4.8 million, or an amount equivalent to 80% of the approved revolving credit facilities, whichever is lower;

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- (h) extending the maximum guarantee period from 36 months to 60 months for new loans to be approved, or up to 60 months after the application deadline, whichever is earlier; and
- (i) increasing the expected maximum expenditure that could be incurred by the Government for the settlement of loan defaults from \$10 billion by \$1.8 billion to \$11.8 billion, assuming a default rate of 12% for new loans to be approved with 80% guarantee.

JUSTIFICATION

SGS

4. The current loan guarantee commitment for SGS is \$12.6 billion. Since the implementation of enhancement measures in November 2008, the amount of loan guarantee granted under SGS has increased significantly. From 6 November 2008 to 31 May 2009, the Trade and Industry Department (TID) has granted \$1.74 billion of loan guarantee under SGS, representing an increase of about 220% compared with the same period in the previous year. As at 31 May 2009, we have already used up 96% of the guarantee commitment. Based on current projection, we expect the guarantee commitment to be fully utilised by July 2009.

5. As a standing supportive measure for SMEs, we propose to increase the Government's loan guarantee commitment under SGS from \$12.6 billion by \$7.4 billion to \$20 billion to sustain its operation. Based on current projection, the additional commitment should allow new loan guarantees to be approved until mid-2011.

EMF and SDF

6. The number of applications under EMF has increased considerably following the implementation of enhancement measures in November 2008. From 3 November 2008 to 31 May 2009, TID received over 18 000 applications, representing an increase of about 120% compared with the same period in the previous year.

7. Based on current projection, we expect the approved commitment for EMF/SDF to be used up by September 2009. Given their usefulness and popularity, we propose to increase the approved commitment from \$1.75 billion by \$1 billion to \$2.75 billion to enable the two schemes to continue to operate in support of SMEs. Based on current projection, the proposed injection of additional funding into EMF/SDF would enable the Funds to run until mid-2011.

8. In addition, to provide greater flexibility to SMEs, we propose to expand the scope of reimbursable items under EMF to include advertisements placed on trade websites. In view of the large number of websites on the internet and for the sake of accountability, DGTI will publish a list of websites for which EMF may be used. The list of websites may be revised by DGTI from time to time having regard to the bona fides of the websites concerned.

SpGS

9. The SpGS has been in operation for almost six months. During this period, the number of applications received is growing steadily. As at 31 May 2009, TID has received 9 784 applications from participating lending institutions (PLIs), of which 8 950 have been approved, involving a total loan amount of over \$16.8 billion and total loan guarantee commitment of about \$11.8 billion. Beneficiary enterprises concerned provide a total employment of over 138 000. No default claims have been received so far.

Application period

10. The application period for SpGS will expire on 14 June 2009. It is a time-limited scheme introduced to tackle the credit crunch problem arising from the global financial crisis to supplement the existing SGS. As the economy remains sluggish and as the demand for the scheme remains strong, we will extend the scheme for about six months until 31 December 2009, which may be further extended subject to review.

Government loan guarantee ratio

11. The number of applications and the amount of loans approved under SpGS thus far suggest that the 70% guarantee ratio is working positively to facilitate business enterprises in securing commercial credit facilities. This notwithstanding, there is feedback from the trade that some enterprises are still

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encountering difficulties in obtaining loans. To encourage PLIs to lend and to address the concerns of the trade, we propose to increase the Government's guarantee ratio from 70% to 80% for new loans to be approved. This should provide further incentive for PLIs in granting loans, especially in marginal cases, whilst maintaining the principle of risk-sharing between the Government and PLIs.

Loan ceiling

12. Although the average size of loans approved thus far is about \$2 million, about 17% of the SpGS beneficiaries, most of which are the relatively larger enterprises, have borrowed up to the loan ceiling of \$6 million. To support the financing need of enterprises which have reached the ceiling, or those wishing to obtain a bigger loan, we propose to raise the loan ceiling for each borrowing enterprise from \$6 million to \$12 million. Consequentially, we propose to increase the loan ceiling for revolving credit facilities from \$3 million to \$6 million. These proposals should be welcomed by the larger enterprises which tend to provide more employment. At the same time, with signs of more orders being received, SMEs are also expected to make more use of the scheme and thus should benefit from the higher loan ceilings.

13. With the proposed guarantee ratio increased to 80% for new loans to be approved, the maximum amount of guarantee applicable to each enterprise will be increased from \$4.2 million to \$9.6 million¹, and that for revolving credit facilities will be increased from \$2.1 million to \$4.8 million¹, or an amount equivalent to 80% of the approved revolving credit facilities, whichever is lower.

Loan guarantee period

14. With an increase in the loan ceiling, we propose to consequentially extend the maximum loan guarantee period from 36 to 60 months for new loans approved to alleviate the repayment burden of borrowing enterprises. 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 54 months. As such, the maximum guarantee period for each loan, including both term loan and revolving credit facilities, should be 60 months after first drawdown, or up to 60 months after the application deadline, whichever is earlier.

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¹ The maximum amount of loan guarantee an enterprise may obtain under SpGS depends on whether it has taken out loans before implementation of the 80% guarantee ratio. For example, if an enterprise has already taken out a \$6 million loan under 70% guarantee ratio, the maximum amount of loan guarantee that it may obtain with the \$12 million loan ceiling would be \$6 million x 70% + \$6 million x 80% = \$9 million.

15. The enhancement measures for SpGS will apply to applications for new loans submitted to TID on or after the implementation date².

FINANCIAL IMPLICATIONS

16. The Government's total loan guarantee commitment under SGS will increase from \$12.6 billion by \$7.4 billion to \$20 billion. With the assumed default rate remaining at 7.5%, the expected maximum expenditure would increase from \$950 million by \$550 million to \$1.5 billion. Default payments arising from new loan guarantees to be approved would likely spread over five or more financial years starting from 2012-13.

17. The Government's total loan guarantee commitment under SpGS will remain at \$100 billion. The default risk is expected to be higher as the Government loan guarantee ratio is increased from 70% to 80% for new loans to be approved. With an assumed default rate of 12% for new loans granted under 80% Government guarantee (against 10% for loans under 70% Government guarantee), the expected maximum expenditure would increase from \$10 billion by \$1.8 billion to \$11.8 billion³. Default payments arising from new loan guarantees to be approved under the revised SpGS would likely spread over five or more financial years starting from 2011-12.

18. For SGS and SpGS, the loan guarantee commitment applicable to the respective scheme represents the maximum liability to be borne by the Government under that scheme; the precise amount of expenditure to be incurred eventually by the Government within this limit would depend on the actual default rate. For financial prudence, except with Members' further approval, we would not provide loan guarantee beyond the guarantee commitment or when expenditure for settling default claims from PLIs is about to reach the expected maximum expenditure, whichever happens first.

19. As for EMF and SDF, with the injection of an additional provision of \$1 billion, the approved commitment will increase from \$1.75 billion to \$2.75 billion. The cash flow requirements are contingent upon demand from SMEs.

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² This refers to the date when the PLI has signed and returned the necessary legal documents to TID. Different PLIs may have different implementation dates.

³ Assuming that around \$12 billion of loan guarantee would have been granted by mid-June 2009 with 70% Government guarantee, the expected maximum expenditure to be incurred would be \$12 billion x 10% default rate + \$88 billion x 12% default rate = \$11.76 billion, say \$11.8 billion.

20. TID will continue to closely monitor the number of applications under SGS, EMF/SDF and SpGS, and will seek additional manpower resources through established mechanism as and when necessary.

21. The proposals have no implication for the fees and charges of services provided by TID.

IMPLEMENTATION PLAN

22. Subject to Members' approval of the recommendations set out in paragraph 3 above and completion of the necessary procedures and legal documentation, we aim to implement the enhanced measures for EMF and SpGS with effect from 15 June 2009.

PUBLIC CONSULTATION

23. We consulted the Small and Medium Enterprises Committee on 27 May 2009. Members generally welcomed the proposals.

24. We consulted the Legislative Council Panel on Commerce and Industry on 1 June 2009. Members were supportive of the proposals. Some Members expressed concern about PLIs' willingness to lend to business enterprises and the interest rate charged under SpGS. As we explained at the meeting, about 75% of the loans approved thus far were charged an interest rate effectively at 7% or below (roughly equivalent to prime lending rate + 2% or below). The proposal to increase Government's loan guarantee ratio from 70% to 80% should further encourage PLIs to lend to business enterprises as PLIs' risk exposure will be reduced. This reduction in risk to be borne by PLIs would normally be suitably reflected in the interest rates.

25. Members also suggested that PLIs be encouraged to review individual loan applications rejected under the current phase of SpGS, and to examine whether any such applications might be more favourably considered with 80% Government guarantee. TID would follow up with PLIs.

26. In response to Members' enquiry about the number of beneficiaries under the enhanced SpGS, we have clarified that SpGS is demand-driven. In other words, the actual number of beneficiaries will depend on market demand and the actual amount of loan guarantee granted in each case. As a planning assumption and not a target, the enhanced SpGS might support an additional 30 000 applications, assuming full utilisation of the unused loan guarantee commitment and an average guarantee of \$3 million.

BACKGROUND

27. Apart from the SpGS, the TID currently administers three funding schemes in support of SMEs, namely SGS, EMF and SDF. We obtained FC's approval on 28 October 2008 vide FCR (2008-09)42 to introduce a series of enhancement measures to SGS and EMF. The enhancement measures were implemented in November 2008.

28. FC approved on 14 November 2008 vide FCR (2008-09)43 the introduction of a time-limited SpGS to help SMEs secure commercial loans to tide over the liquidity problem during the global financial crisis. On 12 December 2008, FC approved a series of enhancement measures to SpGS vide FCR (2008-09)52. SpGS commenced operation on 15 December 2008.

Encls. 1&2 29. Existing features and the funding position of the above schemes are at Enclosures 1 and 2.

30. The Financial Secretary announced on 26 May 2009 a package of relief measures to assist different sectors of the economy to ride out the global financial crisis, including enhancement measures for the above funding schemes in support of business enterprises.

Commerce and Economic Development Bureau
Trade and Industry Department
June 2009

Funding schemes administered by TID

SME Loan Guarantee Scheme (SGS)

- SGS helps SMEs secure loans from participating lending institutions (PLIs). Under the SGS, the Government acts as guarantor for up to 50% of the approved loans. The maximum amount of loan guarantee for each SME is \$6 million (i.e. each SME can borrow up to \$12 million from the PLIs).
- SGS consists of two types of loans: (i) a Business Installations and Equipment Loan (BIE); and (ii) a Working Capital Loan (WCL). The sub-ceilings for the two types of loans have been removed since November 2008. In other words, Government's guarantee can be used to secure loans for either BIE only or WCL only, or a combination of both, provided that the guarantee ceiling for each SME does not exceed \$6 million.
- Each SME is allowed to recycle the guarantee once after it has fully paid up the loan backed up by the guarantee.
- The maximum guarantee period is five years.
- All SMEs with valid business registrations and substantive business in Hong Kong are eligible to apply.
- All applications must be lodged through the PLIs.

SME Export Marketing Fund (EMF)

- EMF supports SMEs' export promotion activities, including participation in exhibitions and business missions, and placing advertisements on printed trade publications targeting export markets and websites of exhibition organisers.
- For each successful application, the maximum amount of grant is 50% of the total approved expenditure (e.g. exhibition fees, costs for construction of booths, air ticket and hotel charges for exhibitions held outside Hong Kong, etc.), subject to a ceiling of \$50,000. The maximum cumulative amount of grant an SME may obtain is \$150,000.

SME Development Fund (SDF)

- SDF supports non-profit-distributing organisations (such as industrial and trade organisations, professional bodies, research institutes, etc.) in carrying out projects to enhance the competitiveness of SMEs in general or in specific sectors. Examples of project include seminars, workshops, code of best practices, database etc.
- The maximum amount of grant for each project is 90% of the total approved project expenditure, subject to a ceiling of \$2 million.

Special Loan Guarantee Scheme (SpGS)

- The SpGS commenced operation on 15 December 2008.
- Government has pledged to provide a total loan guarantee of up to \$100 billion in support of enterprises in obtaining credit facilities from PLIs.
- SpGS is open to all enterprises with substantive business in Hong Kong and registered in Hong Kong under the Business Registration Ordinance (except listed companies).
- The loans should be used for meeting the needs of general business use of the applicants.
- The guarantee ratio is 70% of the approved loan, subject to a maximum loan amount of \$6 million for each enterprise. Within this limit, an enterprise may obtain a revolving credit facilities of up to \$3 million.
- The maximum guarantee period for each loan is 36 months or up to 30 June 2012, whichever is earlier.
- Certain safeguard measures are put in place to prevent abuse. For example, all applying enterprises must be in operation for at least one year when the scheme was launched; the applicant must have no outstanding default; and the owners or major shareholders of the enterprises are required to provide personal guarantee. The loans obtained under SpGS cannot be used to repay other loans.

**Funding position of the funding schemes in support of enterprises
(as at 31 May 2009)**

	Loan Guarantee		Cash Grant		
	Special Loan Guarantee Scheme	SME Loan Guarantee Scheme	SME Export Marketing Fund	SME Development Fund	SME Training Fund*
Applications approved	8 950	21 639	73 953	125	68 677
Approved commitment (a)	\$100 billion	\$12.6 billion	\$1.75 billion		
Amount of guarantee/grant approved (b)	\$11.78 billion	\$12.07 billion	\$1.19 billion	\$0.14 billion	\$0.26 billion
Amount of loans approved	\$16.83 billion	\$26.36 billion	N/A	N/A	N/A
Remaining balance (a) – (b)	\$88.22 billion	\$0.53 billion	\$0.16 billion		
Utilisation rate (b)/(a)	12%	96%	91%		
Amount of default claims	Nil	\$0.36 billion	N/A	N/A	N/A
Number of beneficiaries	7 132	11 535	24 366	N/A	30 498

* The SME Training Fund has ceased to receive new applications as from 1 July 2005.
