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29 October 2008

The Chief Executive
All authorized institutions

Dear Sir/Madam,

Lending to Small and Medium-Sized Enterprises

The severity of the current global financial crisis is unprecedented in modern times. It is therefore understandable that in the face of a potential global economic recession, authorized institutions (AIs) have become more cautious in their approach to lending, including their lending to small and medium-sized enterprises (SMEs).

It must be borne in mind however that AIs play a crucial role in the intermediation of finance to support the functioning of the wider economy of Hong Kong. Unprecedented steps, such as the deposit guarantee and the establishment of the contingent bank capital facility, have been taken by the Hong Kong Monetary Authority (HKMA) to maintain confidence in the banking system. Measures have also been taken to provide liquidity assistance to licensed banks to ensure the continued effective operation of the banking system. All these steps have been taken to help ensure that AIs can continue to do business and carry out their financial intermediation role in a normal manner.

SMEs are an important part of Hong Kong's economy. They provide about 50% of the total employment in the private sector. Therefore, actions and circumstances affecting the economic prospects of SMEs will be keenly felt in Hong Kong. In recent months, the operating environment for SMEs has become more difficult and many of them are feeling the pain of the global financial crisis.

The provision of credit to SMEs and the terms upon which it is provided are, of course, commercial decisions of AIs. It is for AIs to manage credit risks and to price

credit flexibly in the light of changing conditions and changing risks. However, in these difficult times and following the unprecedented steps taken to support the banking system, the HKMA believes that it will be in the best long term interests of the economy and the banking industry, if AIs adopt a supportive attitude towards their SME customers. Accordingly, the HKMA urges all AIs involved in the provision of credit to SMEs to be as accommodative and flexible as possible to the funding needs of SMEs, within the bounds of prudent credit assessment.

AIs should, as far as practicable, assess individual cases on their merits. Any material, indiscriminate tightening of credit by an AI could have a significant adverse impact on the business and economic prospects of otherwise healthy SMEs. This could in turn ultimately have a knock-on effect on the quality of that AI's (and indeed other AIs') assets with the potential to create a vicious downward spiral if left unchecked. In this regard, AIs should, among other things, refrain from hasty and indiscriminate (i) withdrawal or reduction of lines of credit, (ii) shortening of trust receipt periods or (iii) extension of the period for making payments to retail outlets/merchants in respect of credit card transactions. Any actions which have the effect of tightening credit to SME customers should as far as practicable be considered on a selective and case by case basis in the light of the given customer's credit position rather than applied across the board to SMEs within the same industry or sector. Where necessary, the HKMA will review with AIs their actions taken in respect of groups or classes of SME customers or SME sectors to ascertain the manner in which they have been applied and whether this is sensible and reasonable.

If any tightening in the provision of credit to existing SME customers is considered necessary, AIs should be prepared to explain to the customers the rationale behind the changes and work with customers to identify whether there are other ways (e.g. more collaterals) in which AIs' credit or other concerns might be addressed. Wherever possible changes should be introduced in a gradual manner to lessen the immediate impact.

At times such as these, it is important that AIs' attitude to their customers be one of support. Whilst AIs should be prudent in assessing credit risks, it is not in the interests of AIs, nor of the wider community, for credit to be withdrawn or curtailed indiscriminately out of some generic fear over what the future may hold.

Where SME customers experience financial stress and run into difficulties as a result of the global financial crisis, AIs should remain supportive and adopt a sympathetic attitude towards requests for temporary relief arrangements, such as extensions of

repayment deadlines. Individual cases will of course need to be assessed on their merits but in general, a proactive approach will help to mitigate the wider financial consequences of the turmoil, including the risk of rising insolvencies/bankruptcies. AIs are also reminded to follow the principles laid down in the Hong Kong Approach to Corporate Difficulties issued by the HKMA and the Hong Kong Association of Banks in the event of a corporate workout.

Yours faithfully,

Y.K. Choi
Deputy Chief Executive