

For discussion on 20 March 2012

Legislative Council Panel on Commerce and Industry

**SME Financing Guarantee Scheme –
Special Time-limited Concessionary Measures**

This paper seeks Members' support on the Administration's proposal to launch special time-limited concessionary measures under the SME Financing Guarantee Scheme (SFGS) operated by the Hong Kong Mortgage Corporation Limited (HKMC).

Proposed Special Time-limited Concessionary Measures under the SFGS

2. The HKMC launched the market-based and sustainable SFGS on 1 January 2011, with a view to providing Hong Kong enterprises, particularly small and medium enterprises (SMEs), an additional financing option in meeting their needs. In addition, the SFGS reduces the credit risks shouldered by the lending institutions and helps maintain the stability of the banking system. Under the SFGS, the HKMC acts as guarantor for up to 70% of the approved loans that enterprises obtain from participating lending institutions. An annual guarantee fee is payable by the lending institutions/enterprises.

3. In the light of the uncertain external economic environment, local enterprises, in particular SMEs, will likely be adversely affected by liquidity problems brought about by credit tightening. In order to tide enterprises over potential financing difficulties, the Financial Secretary has proposed in the 2012-13 Budget the introduction of special time-limited concessionary measures under the existing SFGS operated by the HKMC.

Under the special concessionary measures -

- (i) a new loan guarantee ratio of 80% will be introduced; and
- (ii) a low guarantee fee will be charged, which ranges from 0.1 to 0.12 of the annual interest rate of the loan.

4. The application period of the special concessionary measures will last for nine months. The Government will provide a total guarantee commitment of \$100 billion for the special concessionary measures. Details are set out in the ensuing paragraphs.

Increase in Loan Guarantee Ratio

5. Under the existing SFGS, the loan guarantee ratio offered ranges from 50% to 70%. The loan guarantee ratio under the special concessionary measures will be 80%. The increase in loan guarantee ratio under the special concessionary measures would provide greater incentive to lending institutions to make effective use of the SFGS to meet the financing needs of enterprises including SMEs, especially during times of lending market stress and adverse economic climate.

Low Guarantee Fee

6. The SFGS is a market-based and sustainable loan guarantee scheme, which aims to assist enterprises in meeting their financing needs in a rapidly changing business environment. Under the SFGS, lending institutions/enterprises have to pay a guarantee fee, the rate of which is linked to the annual interest rate of the loan and the loan guarantee ratio offered. For loans with an annual interest rate not exceeding 10%, the annual guarantee fee rate will range from 0.18 of the annual loan interest rate (for loan guarantee ratio of 50%) to 0.32 of the annual loan interest rate (for loan guarantee ratio of 70%); and for loans with an annual interest rate exceeding 10% but not more than 12%, the annual guarantee fee rate will

range from 0.2 of the annual loan interest rate (for loan guarantee ratio of 50%) to 0.35 of the annual loan interest rate (for loan guarantee ratio of 70%). Illustrations of the annual guarantee fee payable under the existing SFGS are at Annex I.

7. To relieve SMEs' burden, the guarantee fee under the special concessionary measures will be substantially reduced. For 80% loan guarantee, the annual guarantee fee rate will be reduced to 0.1 of the annual loan interest rate (for loans with an annual interest rate not exceeding 10%) and 0.12 of the annual loan interest rate (for loans with an annual interest rate exceeding 10% but not more than 12%) respectively.

8. For example, for a loan of \$1 million at an annual interest rate of 5%, the annual guarantee fee is \$16,000 under the existing SFGS for a 70% guarantee. The annual guarantee fee for an 80% loan guarantee will only be \$5,000 under the special concessionary measures, i.e. the guarantee fee has been substantially reduced by about 70 per cent. Different guarantee fees payable for different interest rates under the special concessionary measures are also set out at Annex I. Guarantee fee can be settled by way of a single upfront payment or an annual payment. We consider that a limited guarantee fee payable will help share the default risks amongst the lending institutions, enterprises and the Government.

Guarantee Period and Loan Ceiling

9. As with the existing SFGS, the maximum loan guarantee period is five years under the special concessionary measures. The maximum amount of loans, including those to be approved under the special concessionary measures, in respect of which each enterprise can obtain loan guarantee under the SFGS would be maintained at \$12 million (including both term loans and revolving facilities without any restriction on the proportion between the two).

10. In addition, enterprises which have obtained loan guarantee under the existing SFGS may apply to switch the loan to 80% guarantee under the special concessionary measures during the application period. Upon the approval by the HKMC, the loans will be covered by an 80% guarantee and the relevant guarantee fee should be paid accordingly¹.

11. A comparison of the major features of the existing SFGS and the special concessionary measures under the SFGS is at Annex II.

Expected Benefits

12. The special concessionary measures would help tide enterprises, particularly SMEs (employing around 1.2 million people), over the potential financing difficulties which may arise as a result of a possible credit crunch under the uncertain external economic environment. Given the 80% loan guarantee is a new product under the SFGS, the number of beneficiaries would depend on various factors, such as the prevailing economic environment during the application period and the financing needs of individual enterprises, etc. On the assumption that the average loan amount to be guaranteed under the special concessionary measures per enterprise is \$3.4 million², the \$100 billion total loan guarantee commitment can benefit around 36 000 enterprises.

Financial Implications

13. All guarantee fees collected by the HKMC will be set aside to pay default compensations to lending institutions as well as related out-of-pocket expenses³ arising from defaulted loans under the special

¹ If an enterprise wishes to obtain a refund of the guarantee fee paid due to an early termination of a loan guarantee approved under the existing SFGS, the HKMC will process the request in accordance with the existing practice.

² The average loan amount of approved guarantee applications under the existing SFGS as at end of January 2012 is around \$3.4 million.

³ Out-of-pocket expenses to be incurred by the HKMC include relevant costs arising out of the

concessionary measures. The remaining balance of the guarantee fees, if any, will be returned to the Government. In the event of a shortfall, it would be borne by the Government.

14. The Government will provide a total guarantee commitment of \$100 billion for the special concessionary measures. The estimated guarantee fees to be collected by the HKMC will be around \$1.8 billion⁴. Based on the assumed default rate of 12% and the necessary out-of-pocket expenses to be incurred by the HKMC, which is estimated to be 4.5% of the total default claims, the Government's estimated maximum expenditure (net of guarantee fees collected) under the special concessionary measures will be around \$11 billion⁵.

15. The HKMC will meet the day-to-day administrative costs for operating the special concessionary measures under the SFGS. Additional work arising from the special concessionary measures would be absorbed by existing resources of the Commerce and Economic Development Bureau.

Public Consultation

16. We briefed members of the Small and Medium Enterprises Committee of the Trade and Industry Department on the special concessionary measures on 22 February 2012. Members were generally supportive of the proposal.

recovery actions made by the lending institutions or by the HKMC through its exercise of subrogation rights for the purpose of recovering the outstanding loans.

⁴ Assuming the total guarantee amount of \$100 billion will be fully granted under the special concessionary measures and the interest rate per annum of approved loans is 5%, by taking into account the factor of loan amortisation over the five-year period, the estimated guarantee fees to be collected by the HKMC under the measures will be around \$1.8 billion.

⁵ \$12 billion (\$100 billion x 12%) - \$1.8 billion + \$0.54 billion (\$12 billion x 4.5%) = \$10.74 billion, say \$11 billion.

Implementation Timetable

17. Subject to Members' views, we would seek funding approval from the Finance Committee of the Legislative Council on 13 April 2012. We aim to launch the measures in May 2012.

**Commerce and Economic Development Bureau
The Hong Kong Mortgage Corporation Limited
March 2012**

Comparison of Annual Guarantee Fee Payable
under the Existing SFGS and
the Special Concessionary Measures under the SFGS

Scenario A: Loan with interest rate charged by bank at 5% per annum

- Borrowed sum: \$1 million
- Loan interest per annum charged by bank: \$50,000

	Existing SFGS			Special Concessionary Measures under SFGS
Loan guarantee ratio	50%	60%	70%	80%
Guarantee fee factor	0.18	0.24	0.32	0.1
Annual guarantee fee rate*	5% x 0.18 = 0.9%	5% x 0.24 = 1.2%	5% x 0.32 = 1.6%	5% x 0.1 = 0.5%
Annual guarantee fee payable	\$9,000 (\$1m x 0.9%)	\$12,000 (\$1m x 1.2%)	\$16,000 (\$1m x 1.6%)	\$5,000 (\$1m x 0.5%)

Scenario B: Loan with interest rate charged by bank at 10% per annum

- Borrowed sum: \$1 million
- Loan interest per annum charged by bank: \$100,000

	Existing SFGS			Special Concessionary Measures under SFGS
Loan guarantee ratio	50%	60%	70%	80%
Guarantee fee factor	0.18	0.24	0.32	0.1
Annual guarantee fee rate*	10% x 0.18 = 1.8%	10% x 0.24 = 2.4%	10% x 0.32 = 3.2%	10% x 0.1 = 1%
Annual guarantee fee payable	\$18,000 (\$1m x 1.8%)	\$24,000 (\$1m x 2.4%)	\$32,000 (\$1m x 3.2%)	\$10,000 (\$1m x 1%)

Scenario C: Loan with interest rate charged by bank at **12%** per annum

- Borrowed sum: \$1 million
- Loan interest per annum charged by bank: \$120,000

	Existing SFGS			Special Concessionary Measures under SFGS
	50%	60%	70%	80%
Loan guarantee ratio	50%	60%	70%	80%
Guarantee fee factor	0.20	0.26	0.35	0.12
Annual guarantee fee rate*	12% x 0.2 =2.4%	12% x 0.26 = 3.12%	12% x 0.35 = 4.2%	12% x 0.12 = 1.44%
Annual guarantee fee payable	\$24,000 (\$1m x 2.4%)	\$31,200 (\$1m x 3.12%)	\$42,000 (\$1m x 4.2%)	\$14,400 (\$1m x 1.44%)

* The annual guarantee fee payable is obtained by multiplying the annual guarantee fee rate and the loan amount. In turn, the annual guarantee fee rate depends on the annual interest rate of the loan and the loan guarantee ratio offered.

**Comparison of the Existing SFGS and
the Special Concessionary Measures under the SFGS**

Feature	Existing SFGS	Special Concessionary Measures under SFGS (i.e. 80% guarantee ratio with reduced guarantee fee)
(a) Target Segment and Eligibility	Eligible enterprises must have business operation in Hong Kong and be registered in Hong Kong under the Business Registration Ordinance (Chapter 310). They must also have business operation for at least one year on the date of guarantee application, and have good loan repayment record. Listed companies, lending institutions and affiliates of lending institutions are not eligible for the Scheme.	No change
(b) Approval of Credit Facility	To be done by the lending institutions	No change
(c) Guarantee Coverage	50%, 60% or 70%	80%
(d) Maximum Guarantee Period	5 years	No change

Feature	Existing SFGS	Special Concessionary Measures under SFGS (i.e. 80% guarantee ratio with reduced guarantee fee)
(e) Maximum Amount of Credit Facility Per Enterprise (including its related companies) at any point in time	\$12 million	No change (Note: the limit includes loans approved under the existing SFGS)
(f) Use of Repaid Credit Facility	Unlimited reuse of guarantee amount after loan repayment, subject to the loan ceiling of \$12 million at any point in time (per (e))	No change
(g) Form of Credit Facilities	Term loans and revolving credit lines, without any restriction on the proportion between the two	No change
(h) Use of Credit Facilities	The credit facility must be used for providing general working capital for the enterprise's business operations, or acquisition of equipment or assets (excluding residential properties) in relation to the enterprise's business.	No change

Feature	Existing SFGS	Special Concessionary Measures under SFGS (i.e. 80% guarantee ratio with reduced guarantee fee)
	The credit facility must not be used for repaying, restructuring or repackaging existing debts (except for allowing refinancing of facilities guaranteed under the Special Loan Guarantee Scheme of the Trade and Industry Department or SFGS upon the expiry of such guarantees).	No change. Enterprises with credit facilities guaranteed under the existing SFGS may make new applications for switching to an 80% guarantee coverage for the loans concerned during the application period of the special concessionary measures.
(i) Maximum Loan Interest Rate	10% per annum in general (loans with interest rate over 10% but not more than 12% will be considered on a case-by-case basis)	No change
(j) Personal Guarantee by Individual Shareholder(s)	Personal guarantee by individual shareholder(s), directly or indirectly, holding more than 50% of the equity interest of the enterprise is required	No change
(k) Guarantee Fee	Guarantee fee should be paid	Guarantee fee should be paid but is substantially reduced. Lending institutions / enterprises can obtain an 80% loan guarantee by paying about 30% of the existing

Feature	Existing SFGS	Special Concessionary Measures under SFGS (i.e. 80% guarantee ratio with reduced guarantee fee)
		guarantee fee for a 70% guarantee for approved loans.
(1) Maximum Guarantee Commitment	No ceiling	\$100 billion (as provided by the Government)