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Panel on Commerce and Industry
Meeting on 21 October 2008

Follow-up information

The actual loan default rate for the Loan Guarantee Scheme for Severe Acute Respiratory Syndrome Impacted Industries

Following the outbreak of the Severe Acute Respiratory Syndrome (SARS) in March 2003, the tourism, restaurant, retail and entertainment industries experienced significant business downturn and serious cash-flow problems. In April 2003, the Finance Committee approved a commitment of $3.5 billion for the Government to set up a "Loan Guarantee Scheme for Severe Acute Respiratory Syndrome Impacted Industries" to provide 100% guarantee for loans extended by lending institutions to the establishments in the following four industries, with a view to helping the latter to preserve jobs –

(i) restaurants and hotels;

(ii) travel agents and tourist coach operators;

(iii) retail; and

(iv) cinemas and karaokes.

2. This measure was an industry-specific and short-term arrangement. The application period lasted for only three months (from May to July 2003). Moreover, loans under the scheme must be used for payment of employees' salaries[1], and applicants had to prove that they had suffered at least 30% decline in their business during that period and to provide personal guarantee for the loans concerned.

3. A total of 1 560 applications were approved under the Scheme, involving an aggregate loan amount of about $500 million. The Government received and effected payment to 162 claims from the lending institutions. Parties concerned have taken appropriate actions to recover the loans from the borrowers and guarantors. As at end September 2008, the default rate is 4.9%.

[1] The Government subsequently relaxed this requirement. Apart from payment of salaries, the establishments were allowed to use the loan to cover other operating costs such as rental.

The estimated utilization of the funding commitment (including the financial/guarantee commitment) under the three funding schemes following the implementation of the proposed enhancement measures and having regard to the possibility of a higher default rate amidst the financial turmoil

4. Following the Finance Committee's approval in January 2008 to inject $500 million to the three SME funding schemes, the loan guarantee commitment for SME Loan Guarantee Scheme (SGS) has increased from $10.6 billion to $12.6 billion, while the expected maximum expenditure for SGS has increased from $800 million to $950 million. For SME Export Marketing Fund (EMF) and SME Development Fund (SDF), the approved commitment has increased from $1.4 billion to $1.75 billion.

5. Based on our earlier projection, the funding commitment for SGS and EMF/SDF will be used up in early and mid 2011 respectively. With the implementation of the enhancement measures, the existing funding commitment will likely be utilized at a quicker pace. Based on our current projection, we expect the existing funding/ guarantee commitment for EMF/SDF and SGS will be used up by mid-2010[2]. Whilst we do not propose a further increase in financial commitment at this stage, we will monitor the spending position closely and will review the commitment ceilings of the respective SME funding schemes as and when necessary.

6. For SGS, any increase in default rate will not affect the speed of utilisation of the guarantee commitment, as long as the actual default rate is not higher than 7.5% (as at 30 September 2008, the actual default rate is 2.8%). Under the current mechanism, the SGS is capped by two commitment limits, viz. the guarantee commitment of $12.6 billion and the expenditure commitment of $950 million. Finance Committee's approval is required if either is exceeded. In other words, once the total amount of guarantee granted by the Government has reached $12.6 billion, we would need to seek the Finance Committee's approval to increase the guarantee commitment, even if the actual compensation claim is way below $950 million. On the other hand, if the default rate has exceeded 7.5% and Government's actual compensation is about to exceed $950 million, we would need to seek the Finance Committee's

[2] The projection has made reference to the number of successful applications in recent months, and the amount of grant (in respect of EMF and SDF) and guarantee (in respect of SGS) involved.

approval to increase the expenditure commitment, even if the total amount of guarantee granted is below $12.6 billion.

The regulatory framework, assessment criteria and mechanism in place for the Government and participating lending institutions to vet and approve applications for loans and guarantee from the SMEs, if any

7. The Government has put in place mechanism to monitor and manage the default risk to ensure the proper use of public money. For example, when applying to Government for loan guarantee, the participating lending institutions (PLIs) are required to confirm in the application forms whether they have taken into account considerations such as the track record, business prospect and financial position of the borrower when assessing the borrowers' credit worthiness and repayment ability. Moreover, companies established for 18 months or longer are required to provide audited accounts/financial statements when applying for the loans.

8. When processing the default claims, Trade and Industry Department (TID) will require the PLIs to provide documentary proof (including credit assessment report) to demonstrate that the PLI has taken all the necessary steps as stated in the application form, and has made reasonable efforts in recovering the loan. In addition, there is an express provision in the deed signed between the Government and the PLIs that the borrower cannot use the scheme for repaying, restructuring or repackaging other loans, credit facilities or payment obligations. The Government also has the right to terminate the deed with a PLI if the PLI has breached any terms and conditions, including the obligation that the lender shall at all times act in accordance with prevailing good banking practice for the banking sector.

Trade and Industry Department
24 October 2008