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Legislative Council Panel on Commerce and Industry

Further Support Measures for Small and Medium Enterprises (SMEs)

PURPOSE

SMEs are facing considerable difficulties, in particular with liquidity, in the current financial crisis. This note briefs Members on the further support measures to relieve their difficulties.

THE SUPPORT MEASURES

2. We intend to announce the implementation of the following two measures:

(a) Trade and Industry Department (TID) to launch a time-limited Special Loan Guarantee Scheme. The Government guarantee ratio will be 70% as compared with 50% under the existing scheme; and

(b) Export Credit Insurance Corporation (ECIC) to launch new enhanced measures including provision of higher cover for exports generally and in particular for emerging markets. The statutory maximum liability will need to be correspondingly increased.

3. Details of the measures are at Annexes A and B.

PUBLIC CONSULTATION

4. We sought Members' views and heard deputations at the meetings of the Legislative Council (LegCo) Panel on Commerce and Industry on 21 October and 27 October and the special meeting of the

Finance Committee on 28 October. The Secretary for Commerce and Economic Development also convened an SME Summit on 23 October, which was attended by more than 40 participants including LegCo Members, representatives of various trades, major chambers of commerce and SME associations. The trade in general hoped that the Government would assist SMEs in resolving their problems with raising funds, particularly by raising the Government's guarantee ratio and by providing higher cover for exports. The two support measures mentioned above are therefore proposed in response to their suggestions. We have also consulted the participating lending institutions (PLIs) of the SME Loan Guarantee Scheme and they have also reacted positively to these measures.

FINANCIAL IMPLICATIONS

5. The proposed Special Loan Scheme for SMEs will create contingent liability of up to $7 billion for the Government. With an assumed default rate of 10%[1] for planning purpose, the expected maximum expenditure on the part of the Government is estimated at $700 million, spreading over two or more financial years starting from 2010-11. Depending on the actual utilisation of the Government's guarantee commitment and overall economic situation in the next few months, there may be calls for more Government commitment. We will consider such requests on the basis of merits and the Government's financial position.

IMPLEMENTATION TIMETABLE

6. Subject to Members' views, we would proceed to seek Finance Committee's approval to the recommendations set out in paragraph 2(a) above. Subject to the approval of Finance Committee, we will

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[1] The default rates for existing or previous government loan guarantee schemes are as follows –
(a) 5.7% for the special loan guarantee scheme during the Asian financial crisis in 1998 (with 70% Government guarantee for SMEs in all business sectors);
(b) 4.9% for the special loan guarantee scheme during SARS in 2003 (with 100% Government guarantee for enterprises in 4 specific sectors); and
(c) 2.8% for the existing SGS (with 50% Government guarantee for SMEs in all business sectors).
In view of the uncertainties, both over economic outlook and SMEs' behaviour or business performance, it is considered not imprudent to assume a 10% default rate for the proposed scheme.

implement the enhancement measures as soon as possible upon completion of the necessary legal procedures with the PLIs.

ADVICE

7. We welcome Members’ views on the proposals in this note.

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Annex A

Special Loan Guarantee Scheme for Small and Medium Enterprises

Proposal

Subject to the approval of the Finance Committee of the Legislative Council, the Government will set up a $7 billion Special SME Loan Guarantee Scheme (the proposed Scheme) to provide up to 70% guarantee to the participating lending institutions (PLIs) in granting loans to eligible SMEs[1]. The proposed scheme, which is an addition to the enhanced SGS (para. 7 below), should further facilitate SMEs in obtaining immediate cashflow relief from the commercial lending market.

The proposed Scheme

Guiding principles

2. The operation of the proposed Scheme is guided by the following principles –

(a) Market driven – Similar to existing and previous government loan guarantee schemes for SMEs, the operation of the proposed Scheme must be market driven. The intention is to help SMEs which are creditworthy, have a good track record and can demonstrate reasonable business prospects but are unable to obtain adequate financing from lending institutions due to the credit crunch. We will rely on the PLIs to exercise their usual prudential professional judgement in assessing the loan applications. We will sign a deed with each PLI setting out the rights and obligations of each party;

[1] For the purpose of SME loan guarantee schemes, "SMEs" are defined as any manufacturing businesses which employ fewer than 100 employees in Hong Kong; or any non-manufacturing businesses which employ fewer than 50 employees in Hong Kong.

(b) Risk sharing – the risk of default should be shared between the PLI and the Government, so that the former will exercise financial prudence in vetting the loan applications; and

(c) Time-limited – it should be a separate and time-limited scheme to address the immediate credit crunch problem, to supplement the existing SGS.

Major features

3. Based on the above principles, we propose that the Scheme should have the following major features –

(a) the Government's guarantee commitment will be capped at $7 billion at any particular point in time while the proposed Scheme is in operation;

(b) the Government will provide 70% guarantee to the loans granted by PLIs. The maximum amount of guarantee for each SME is $700,000 for a term loan. In other words, the maximum amount of loan that each SME may obtain from the PLI is $1 million;

(c) PLIs may provide a revolving credit line[2] for SMEs subject to the maximum guarantee ratio of 70% and a sub-ceiling of $350,000[3] within the maximum guarantee amount for each SME. That is, an SME may obtain from the PLI a revolving credit line of up to $500,000, within the maximum amount of credit facilities at $1 million. The provision of such a credit line will help inject more liquidity into the market to meet the needs of SMEs;

(d) all SMEs registered and with substantive business in Hong Kong are eligible to apply. There is no restriction to any specific industry or type of business;

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[2] Under a revolving credit line, an SME may use the credit repeatedly up to a certain limit as long as payments are made. This has an advantage over a term loan in that, other than a commitment or arrangement fee, interest is not usually charged on the unused part of the credit line, and that the borrower may draw on the credit line at any time that it needs to. Banks usually classify a revolving credit line as a demand loan, which means that any outstanding balance will have to be paid immediately upon request.

[3] A lower sub-ceiling is proposed for the revolving credit line in view of the higher risk involved, as the loan exposure would not diminish towards maturity.

(e) the application is open for six months starting from the date of implementation, which may be extended subject to review;

(f) a grace period of six months would 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 should be 30 months, or up to 31 December 2011, whichever is earlier; and

(g) the interest rate will be determined by individual PLIs in accordance with commercial principle.

4. Depending on the actual loan size, some 10 000 to 15 000 SMEs are expected to benefit from the proposed Scheme.

Safeguards Against Abuse

5. Given the higher guarantee ratio provided by Government, we consider it necessary to put in place adequate safeguards to ensure that only SMEs with genuine need and a reasonable business prospect would benefit from the proposed Scheme. In this light, we propose to build in the following requirements in the Scheme –

(a) personal guarantee is required of the SME owner or, in the case of a limited company, shareholders holding more than 50% of the equity interest of the SME;

(b) the SME must have been in operation for at least one year on the date of implementation of the proposed Scheme; and

(c) the SME must have no default in other banks; and

(d) the loans should not be used for repaying, restructuring or repackaging other loans.

Implementation

6. We would proceed to consult the LegCo Panel on Commerce and Industry, and seek the approval of the Finance Committee at the earliest opportunity. Subject to completion of necessary procedures and legal documentation, the Proposed Scheme is expected to come into operation in December 2008.

Background

7. The Trade and Industry Department currently administers an SME Loan Guarantee Scheme (SGS) to help SMEs obtain loans from the commercial lending market. Under the SGS, 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). As at end October 2008, Government has approved more than 20 000 applications under the SGS, involving a total guarantee of $10.36 billion.

8. We obtained the Finance Committee's approval on 28 October 2008 to introduce the following enhancement measures to the SGS, with a view to providing greater support and flexibility for SMEs in obtaining and repaying loans –

(a) to 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) to extend the maximum guarantee period for Working Capital Loan from 2 years to 5 years;

(c) to 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) to 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;

These enhancement measures were launched on 6 November 2008. In general, the enhancement measures are welcomed by the trade. However, there are different views on the expected effectiveness of the enhancement measures in addressing the liquidity crunch problem. In particular, many SMEs pointed out that the PLIs were unwilling to grant loans under the existing SGS when they had to shoulder 50% of the risk, and urged the Government to increase the guarantee ratio.

9. The Government introduced two special finance schemes in 1998 and 2003 respectively 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%[4] and 100% respectively.

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

Annex B

Enhanced Services of the
Export Credit Insurance Corporation (ECIC)

Proposed Enhanced Measures

To further assist the small and medium enterprises (SMEs) in their efforts in maintaining their business and developing new markets in face of the current financial crisis, ECIC will launch the enhanced measures set out in para. 3 to 7 below in addition to those already announced (see para. 9 below). The enhanced measures in paragraphs 3 and 4 will be subject to review in two years' time.

(a) Higher cover for exports

2. To limit its exposure to individual overseas buyers, ECIC assesses the credit worthiness of each buyer using a set of objective criteria and determine a credit limit for each of them. Some exporters expressed concern that sometimes these credit limits are too low and inadequate to cover their business risks.

3. To offer better protection for exporters and assist them acquire funding from the banks during the current credit crisis, ECIC has agreed to be as accommodating and flexible as possible to the SMEs' requests for export credit insurance and increase the cover, within the bounds of prudent credit assessment and risk management. Furthermore, ECIC will introduce a mechanism under which deductibles for claims and lower-than-usual indemnity ratios for the insurable exports (the usual indemnity ratio being 90%) will apply, if necessary, for sharing out the risks.

(b) Higher cover for emerging markets

4. To assist Hong Kong exporters to develop emerging markets, ECIC has reviewed its country/market ratings of 15 emerging markets

and upgraded 6 of them, namely the United Arab Emirates, Kuwait, Chile, Brazil, the Czech Republic and Malaysia. ECIC will provide more country cover for the six markets and will, where risks allow, provide higher credit limits for exporters to these markets. The premium rates for the upgraded markets will also be lowered.

(c) Expediting and facilitating the processing of small credit limit applications

5. ECIC will expedite the processing of applications for small credit limit of $0.5 million or below to 2-3 days upon the receipt of adequate information (normal processing time is 4 days). Moreover, ECIC will be as accommodating as possible when processing such applications.

Increase in Statutory Maximum Liability

6. The ECIC's aggregate maximum liability arising from its insurance business currently amounts to $13.52 billion. To strengthen ECIC's underwriting capacity, the Government will increase the Statutory Maximum Liability (SML)[1] from $15 billion to $30 billion. While it is a commitment on the part of the Government to guarantee ECIC's contingent liabilities arising from its insurance business, the proposed increase in SML will not involve actual government funding until ECIC has exhausted all its reserves. As at 30 September 2008, the balance of its net assets and reserves was $1,137 million.

7. Under the ECIC Ordinance, the increase in SML requires a positive resolution by the LegCo. We plan to introduce the resolution into LegCo in early 2009.

Background

8. ECIC was established under the ECIC Ordinance with the aim

[1] The SML is the maximum amount which the ECIC can be contractually liable to indemnify its policyholders if all risks materialize at the same time.

of encouraging and supporting export trade by providing exporters with insurance protection against non-payment risks arising from commercial and political events. Its capital is wholly owned by the Government, which also guarantees its contingent liability with the SML currently standing at $15 billion. ECIC is required to pursue a policy towards financial self-sufficiency.

9. To strengthen our support for SMEs in the midst of the financial turmoil, we announced on 23 October 2008 a series of measures adopted by ECIC as set out below -

(a) ECIC will continue to provide cover for the payment risks arising from the buyers' failure to take delivery of goods which are usually not covered by other insurance companies in the market;

(b) despite the rising credit risks involved in selling to overseas markets, ECIC will not increase the premiums for its insurance facilities;

(c) as of 1 October 2008, ECIC has shortened the processing time in handling exporters' credit limit applications to 4 days upon receipt of adequate information. In urgent situations, ECIC will further speed up the process;

(d) ECIC will provide each Hong Kong exporter a limited number of free buyer credit assessment service, whether or not it is an ECIC policyholder; and

(e) ECIC will organize more seminars/forums to share with the industry experiences in risk management, enhance their knowledge on the latest developments in overseas markets and understand the needs of exporters.

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