

**For discussion on
17 March 2020**

**Legislative Council Panel on Commerce and Industry
SME Financing Guarantee Scheme – Special 100% Guarantee Product**

Purpose

This paper consults Members on the proposed introduction of a new 100% loan guarantee product under the SME Financing Guarantee Scheme (SFGS) administered by the HKMC Insurance Limited (HKMCI) and seeks Members' support for the funding proposal to be submitted for the approval of the Finance Committee of the Legislative Council (FC).

Background

2. Hong Kong's economy has been facing significant downward pressure since the third quarter of 2019, and has contracted by 1.2% for the year as a whole, the first annual decline since 2009. As the economic situation worsened, the labour market gradually slackened. The seasonally adjusted unemployment rate went up from 2.8% in the second quarter of 2019 to the latest 3.4%, the highest in more than three years.

3. Entering 2020, the novel coronavirus infections have further dealt a severe blow to the economic activities and business sentiment in Hong Kong. Many enterprises suffer from a further plunge in business turnover, resulting in liquidity problem. The situation is particularly acute amongst the small and medium enterprises (SMEs).

The SME Financing Guarantee Scheme

4. Due to their relatively small capacity, many SMEs have difficulty in obtaining loans from the commercial lending market, especially in times of economic downturn. The Hong Kong Mortgage Corporation Limited (HKMC) ¹ launched the market-based SFGS on 1 January 2011 with a view to helping Hong Kong enterprises, particularly SMEs, to obtain financing to meet their needs. In May 2012, the Government provided a total loan guarantee commitment of \$100 billion for the HKMC to launch the special

¹ To cope with the business development of the HKMC, effective from 1 May 2018, the SFGS business has been transferred to and carried out by the HKMCI, a wholly owned subsidiary of the HKMC. The transfer was reported to the Panel on Commerce and Industry on 20 March 2018 (LC Paper No. CB(1)684/17-18(03)).

concessionary measures under the SFGS by providing 80% guarantee on loans at a substantially reduced guarantee fee.

5. Since 2018, various enhancements have been implemented to the special concessionary measures, viz. the 80% Guarantee Product, including reducing the annual guarantee fee rates by 50%, increasing the maximum loan amount from \$12 million to \$15 million; and lengthening the maximum loan guarantee period from 5 years to 7 years. Response to the enhancements is very positive, as illustrated by the substantial increase in both the number of applications and the amount of loans approved. In 2019, as compared with the year before, the number of applications and amount of loans approved increased by 60% and 89%, totalled at 2 734 cases and \$13.77 billion respectively.

6. In December 2019, we further introduced the 90% Loan Guarantee Product under the SFGS, aiming to help smaller-sized enterprises and businesses with relatively less operating experience and professionals seeking to set up their own practices. The Government provides a total loan guarantee commitment of \$33 billion for launching the 90% Guarantee Product on 16 December 2019. As at end February 2020, the HKMCI has received 390 applications and approved 319 of them, involving a total loan amount of about \$528 million and a total guarantee amount of about \$475 million, benefitting more than 310 enterprises and 2 900 related employees.

The Special 100% Guarantee Product under the SFGS

7. With the novel coronavirus infections, there is an urgent need to further enhance our assistance to SMEs to help them stay afloat in this unprecedented difficult time, thereby minimising business closures and layoffs. The Financial Secretary announces in the 2020-21 Budget that the Government proposes introducing a concessionary low-interest loan under the SFGS.

8. The Government will provide 100% guarantee for approved loans taken out by eligible enterprises under this new concessionary low-interest loan (i.e. Special 100% Guarantee Product). The application period will last for six months from the launch of the product, which may be reviewed and extended if necessary. The Government will provide a total loan guarantee commitment of \$20 billion, with expected maximum expenditure of \$5.625 billion. Major features of the Special 100% Guarantee Product are set out below.

Eligibility

9. The Special 100% Guarantee Product is applicable to Hong Kong enterprises of all sectors, including those most affected by the novel coronavirus infections such as retail outlets, travel agents, restaurants, cinemas, karaoke establishments and transport operators. Loan applicants should have been operating and holding a valid Business Registration Certificate for at least three months by end December 2019. This special arrangement is intended to apply to those enterprises with genuine need, as such, loan applicants need to provide proofs that they have suffered at least a 30% decline in sales turnover in any month since February 2020 compared with the monthly average of any quarter in 2019.

Loan Ceiling and Maximum Loan Guarantee Period

10. The maximum amount of loan per enterprise under the Special 100% Guarantee Product is up to the total amount of employee wages and rents for six months per enterprise², or \$2 million, whichever is the lower. Enterprises are eligible for the Special 100% Guarantee Product regardless of its existing exposure under the 80% and 90% Guarantee Products, if any.

11. The maximum repayment period is three years from the first drawdown of the facility. To lessen the immediate repayment burden of enterprises, an option for principal moratorium for the first six months will be offered under which loan applicants will only be required to pay interest in the first six months and make repayments according to the amortization schedule until the end of the remaining 30 monthly instalments.

Interest Rate and Guarantee Fee

12. An interest rate of the Hong Kong Prime Rate³ minus 2.5% per annum (or equivalent), i.e. effective interest rate currently at 2.75% per annum will be charged. Guarantee fee will be waived.

Scheme Structure and Loan Recovery

13. Loans will be originated by participating lending institutions (PLIs), and the applications for the Special 100% Guarantee Product will be made by PLIs with the HKMCI. The HKMCI will rely on the professional skills, judgement and care of PLIs in checking the eligibility of loan applicants. At a suitable time after loan drawdown by the PLIs, the loans (and related guarantee together with the right and interest of the relevant guarantee under the Special 100% Guarantee Product) will be transferred to the HKMC without recourse to the PLIs.

² If an enterprise does not have employee(s) and rented office(s), proxy is made to half of the highest monthly net income in 2019 multiplied by six.

³ Hong Kong Prime Rate means the rate as specified by the HKMC from time to time.

14. For each loan transferred to the HKMC, an originating fee and an on-going loan servicing fee will be provided to the PLI. When a borrower defaults on repayment, the PLI as servicer of the loan will initiate recovery actions with regard to its own policy and usual commercial practice. Necessary enforcement and debt recovery expenses incurred by the PLI in relation to a defaulted loan will be reimbursed via the HKMC.

15. A comparison of major features of the existing products under the SFGS and the Special 100% Guarantee Product is at **Annex**.

Financial Implications of the Special 100% Guarantee Product

16. The Government will provide a total guarantee commitment of \$20 billion for the Special 100% Guarantee Product. On the basis of an overall assumed default rate of about 25%⁴, the originating and servicing fees payable to PLIs mentioned in paragraph 14 above, as well as the necessary out-of-pocket expenses to be incurred, which are estimated to be 4.5% of the total default claims, the Government's estimated maximum expenditure under the Special 100% Guarantee Product will be around \$5.625 billion.

17. All interest income received will be set aside to pay the cost incurred by the HKMC and the HKMCI, including cost of funding in respect of loans, administrative cost and expenditure including but not limited to manpower and management costs, related premises expenditure, and system development and maintenance costs⁵ under the Special 100% Guarantee Product. The remaining balance of interest income, if any, will be returned to the Government.

18. For the sake of financial prudence, except with the FC's prior approval, the HKMCI will not provide any loan guarantee beyond the \$20 billion loan guarantee commitment or when the expenditure for settling default claims and related costs is about to reach \$5.625 billion, whichever happens earlier.

⁴ The Assumed Default Rates (ADR) for the Special 100% Guarantee Product is 25% , which is higher than ADR for the 80% Guarantee Product (12%) and the 90% Guarantee Product (16%). The HKMCI does not have any experience or basis to estimate ADR for providing 100% loan guarantee for SMEs. Taking into account that no credit assessment would be carried out and the fact that applicants are SMEs hard hit by the economic downturn, a 25% is used as ADR for the estimation.

⁵ Including, among others, the expenses for the development and maintenance of relevant electronic application and administration systems and necessary hardware and software.

Implementation Timetable

19. Subject to Members' support of the proposal, we plan to seek funding approval from the FC within March 2020 with a view to launching the Special 100% Guarantee Product around one month after approval of the FC.

Public Consultation

20. We briefed the Trade and Industry Advisory Board (TIAB)⁶ on the proposed Special 100% Guarantee Product on 3 March 2020. TIAB members in general expressed support, and urged an early implementation of the proposal.

Advice Sought

21. Members' support is sought on the above proposal.

**Commerce and Economic Development Bureau
March 2020**

⁶ TIAB is established to advise the Secretary for Commerce and Economic Development on matters affecting Hong Kong's trade and industry.

Annex

**Comparison of the Guarantee Products under
the SME Financing Guarantee Scheme (SFGS)**

Feature	80% Guarantee Product	90% Guarantee Product	Special 100% Guarantee Product
(a) Target Segment	Local SMEs and non-listed enterprises	Local SMEs with relatively less operating experience as well as professionals seeking to set up their own practices	Local enterprises most affected by the novel coronavirus infections
(b) Eligible Borrower	Eligible enterprises must have business operation in Hong Kong and be registered in Hong Kong under the Business Registration Ordinance (Chapter 310). Listed companies, lending institutions and affiliates of lending institutions are not eligible for the Scheme.	Eligible enterprises must have business operation in Hong Kong and be registered in Hong Kong under the Business Registration Ordinance (Chapter 310). Listed companies, lending institutions and affiliates of lending institutions are not eligible for the Scheme.	Eligible enterprises must have business operation in Hong Kong and be registered in Hong Kong under the Business Registration Ordinance (Chapter 310). Listed companies, lending institutions and affiliates of lending institutions are not eligible for the Scheme. In addition, applicants need to provide proofs that they have suffered at least a 30% decline in sales turnover in any month since February 2020 compared with the monthly average of any quarter in 2019.
(c) Business Operation History	They must have business operation for at least one year on the date of guarantee application.	The requirements of having business operation for at least one year on the date of guarantee application, and financial statement are removed.	They must have business operation for at least three months by December 2019.

Feature	80% Guarantee Product	90% Guarantee Product	Special 100% Guarantee Product
(d) Approval of Credit Facility	By the lending institutions	By the lending institutions	By the lending institutions, based on the relevant eligibility criteria
(e) Guarantee Coverage	80%	90%	100%
(f) Maximum Guarantee Period	7 years	5 years	3 years
(g) Maximum Amount of Credit Facility Per Enterprise (including its related companies) at any point in time	\$15 million, including credit facilities guaranteed under any guarantee products under the SFGS	\$6 million, including credit facilities guaranteed under any guarantee products under the SFGS	<p>Up to the total amount of employee wages and rents for six months, or \$2 million, whichever is the lower.</p> <p>Six months' rent can be taken as 50% of the rateable value of business premises.</p> <p>For enterprises that do not have employee(s) and rented office(s), proxy is made to half of the highest monthly net income in 2019 multiplied by six.</p> <p>Enterprises are eligible for the Special 100% Guarantee Product up to the maximum of \$2 million regardless of its related companies (whether with the same business nature or otherwise) or its existing credit facilities guaranteed under the</p>

Feature	80% Guarantee Product	90% Guarantee Product	Special 100% Guarantee Product
			80% or 90% Guarantee Products, if any.
(h) Reuse of Guarantee Amount after Loan Repayment	Unlimited reuse of guarantee amount after loan repayment, subject to the loan ceiling of \$15 million at the time of application (per (g))	Unlimited reuse of guarantee amount after loan repayment, subject to the loan ceiling of \$6 million at the time of application (per (g))	Not applicable
(i) Form of Credit Facilities	Term loans and revolving credit lines, without any restriction on the proportion between the two.	Term loans only	Term loans only
(j) Use of Credit Facilities	<p>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.</p> <p>The credit facility must not be used for repaying, restructuring or repackaging existing debts (except for allowing refinancing of facilities guaranteed under the SFGS).</p>	<p>Same as the 80% Guarantee Product.</p> <p>Enterprises with credit facilities guaranteed under the existing SFGS may make new applications for switching to 90% guarantee coverage for the loans concerned during the application period of the 90% Guarantee Product.</p>	The credit facility must not be used for repaying, restricting or repackaging existing debts due by the borrower to the PLI.

Feature	80% Guarantee Product	90% Guarantee Product	Special 100% Guarantee Product
(k) Maximum Loan Interest Rate, which will be reviewed from time to time	10% per annum in general (loans with annual interest rate over 10% but not more than 12% will be considered on a case-by-case basis).	8% per annum for enterprises with operating history of more than 3 years. 10% for enterprises with operating history of 3 years or less.	Interest rate fixed at Hong Kong Prime Rate minus 2.5% per annum (or equivalent).
(l) 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.	Personal guarantee by individual shareholder(s), directly or indirectly, holding more than 50% of the equity interest of the enterprise is required.	Personal guarantee by individual shareholder(s), directly or indirectly, holding more than 70% of the equity interest of the enterprise is required.
(m) Guarantee Fee	Guarantee fee is payable	Guarantee fee is payable	Nil
(n) Principal Moratorium	Starting from 4 September 2019, both existing and new SME borrowers may apply to their PLIs for principal moratorium of up to 6 months which is renewable, subject to a maximum of 12 months in total.	Existing and new SME borrowers may apply to their PLIs for principal moratorium of up to 12 months.	New SME borrowers may apply to their PLIs for principal moratorium of up to 6 months from the drawdown of the loans.
(o) Application Period	Until 30 June 2022	Until 30 June 2022	Six months after the launch of the Special 100% Guarantee Product

Feature	80% Guarantee Product	90% Guarantee Product	Special 100% Guarantee Product
(p) Maximum Guarantee Commitment as Provided by the Government	\$100 billion	\$33 billion	\$20 billion
(q) Total Guarantee Committed (as at end February 2020)	\$59 billion	\$0.48 billion	Not applicable