

Special Loan Guarantee Scheme (SpGS) General Guidelines on Submission of Default Claim

To facilitate the participating lending institutions (PLIs) in lodging a default claim under the Special Loan Guarantee Scheme (SpGS), the guidelines provide some general guiding principles adopted by the Trade and Industry Department (TID) in processing default claims, the claim procedures and the supporting documents required.

I. Principles adopted in Processing Default Claims

2. The Government places complete reliance on the PLIs in their professional skill, judgment and care as prudent lenders in assessing loan applications from borrowers. In order to expedite the approval process for loan guarantee applications, TID had not requested the PLIs to provide all the supporting documents for verification during the application stage. However, when a PLI submits a claim to TID after the loan is defaulted, the PLI is required to provide supporting documents to demonstrate that it had followed all the necessary procedures and complied with all the terms and conditions of the SpGS Deed ^(Note 1) when assessing the loan application.

3. Before effecting compensation payment for a default claim, TID has the duty to (i) ensure that the PLI had followed due procedure and complied with the terms and conditions of the SpGS Deed in processing the loan applications; (ii) ascertain the factual accuracy of the information provided; and (iii) ensure that recovery actions have been duly considered and conducted, and recovery proceeds properly applied towards repayment of indebtedness of the facility.

(i) Due Procedure

TID will –

- ascertain whether the PLI has exercised professional skill, judgment and care before granting approval to the loan application and in the subsequent monitoring of the facility;
- ascertain whether the PLI has exercised due diligence to ensure that the borrower has substantive business in Hong Kong;
- ascertain whether the PLI has complied with all the requirements as stipulated under the SpGS Deed;
- assess the consistency between the information and documents provided by the PLI at the time of application and after the default claim is lodged; and

- ensure that the PLI has taken practicable steps and actions for the purpose of recovering the outstanding indebtedness, and any amount recovered has been applied towards repayment of the indebtedness.

(ii) Eligibility and Factual Accuracy

Before submitting the claim, the PLI should ensure that -

- the default date falls within the guarantee period;
- the Payment Request Form is submitted within the period as specified in the SpGS Deed (Please refer to Part II below);
- the amount to be claimed excludes all outstanding interest, penalties, charges, capitalisation of interest and charges;
- in the event that the SpGS facility was drawn down in foreign currencies, the compensation amount is determined by the exchange rate which contributes the smallest compensation sum among the following four reference points –
 - (a) exchange rate as at the drawdown date (in the case of term loan facility) or the drawdown date of the first defaulted advance (e.g. in the case of trade finance related facility) in the currency quoted by the Hong Kong Association of Banks (HKAB) and the PLI respectively; and
 - (b) exchange rate as at the date of default quoted by HKAB and the PLI respectively.
- the particulars and current status of the following aspects are properly verified –
 - (a) the borrower (e.g. whether the borrower has liquidated, recovery actions on the borrower);
 - (b) the guarantor(s) (corporate / personal) (e.g. recovery actions on the guarantors);
 - (c) the guarantee/facility (e.g. amount of outstanding indebtedness and amount to be shared by the Government); and
 - (d) the collateral (e.g. proceeds realised from the collateral).

(iii) Recovery Proceeds

General principles are as follows –

- Proceeds realised from the collateral pledged/repayments designated to the SpGS facilities should be applied to settle the outstanding indebtedness of the defaulted SpGS facilities. Such proceeds may include but are not limited to proceeds upon realisation of property/fixe

deposits, payments received from the borrower and guarantor(s) as recorded in the designated accounts after the date of default of the SpGS facilities, etc.

- If the collateral is pledged to other non-SpGS facilities held by the borrower, any residual amounts (after settlement of the relevant non-SpGS facilities) are required to be shared with the defaulted SpGS facilities.
- Collateral pledged to both SpGS and non-SpGS facilities held by the borrower, and general proceeds (including cash deposits, credit balances, payments / dividends, etc. received from the borrower and guarantor(s) after the date of default of the SpGS facilities) received which are not specifically pledged / designated to any facilities are required to be shared between SpGS and non-SpGS facilities on a pro-rata basis, normally based on the respective outstanding indebtedness of the SpGS and non-SpGS facilities as at the default date of the SpGS facilities after netting off subsequent repayments. The outstanding indebtedness could either be the outstanding principal or outstanding principal plus interest of the concerned facility. Irrespective of which option is chosen, the same should apply to all SpGS and non-SpGS facilities of the borrower involved in a default claim for the sake of fairness and consistency.

4. TID will effect payment to a default claim only after all the necessary information and documents are received from the PLI and checked to be in order as set out in paragraph 3 above. In the course of processing the default claim, it is imperative for the PLI to reply to all the questions raised by TID. In case the PLI cannot locate the relevant document or cannot provide the answer to a particular question, it should provide detailed explanation to TID. TID will consider such cases based on their individual merits. In case of doubt, the PLI should seek clarification from or discuss with TID. If a PLI fails to reply to any of TID's questions or requests for supporting documents without satisfactory explanation, TID will not be able to further process the claim, and may even close the case after a prolonged delay.

II. Default Claim Procedures

5. A PLI may lodge a default claim with TID in respect of a facility guaranteed under the SpGS if the borrower fails to repay the facility or any part of the facility on a repayment date ^(Note 2) according to the relevant facility letter, and such indebtedness ^(Note 3) remains outstanding **61 days** after the relevant repayment date.

6. The PLI is required to submit the Payment Request Form ^(Note 4), together with the Questionnaire on Default Claim and other supporting documents required (Please refer to Part III below) to TID **within six months** after the earliest relevant repayment date of the defaulted facility. Copies of the Payment Request Form (together with the specimen of a completed form) and the Questionnaire on Default Claim are at **Annexes I – III** respectively. For overdraft facilities, the Overdraft Default Claim Supplement Form, copy at **Annex IV**, may also be required for the purpose of deducting other interest and charges from the outstanding indebtedness.

III. Documents Required

7. Documents required to support a default claim are listed below. The list contains documents required in handling default claims, yet is not exhaustive. TID reserves all rights to request further information/documents/evidence/explanation, as and when it is considered necessary for the purpose of processing the default claims.

(A) Information on defaulted facility (for both term loan facility and credit line)
1. Facility letter
2. Deed of Guarantee obtained from the guarantor(s)
3. Statement of the borrower's designated bank account or sub-accounts ^(Note 5) in respect of the subject facility from the date of drawdown or when the facility was made available up to present. In respect of a revolving credit line with term-out arrangement at a certain juncture during the facility period, detailed information (e.g. records showing the term-out arrangement, repayment schedule, etc) should be provided If a grace period (up to 6 months) was provided during which the borrower was required to pay interest only, relevant information should be provided
4. Repayment schedule of the defaulted SpGS facility setting out the repayment date as well as breakdown of principal and interest (only applicable to term loan facility)
5. In respect of a limited company, documentary evidence showing that the facility was duly authorised by the borrower <u>Examples:</u> (i) Relevant minutes of meeting of board of directors / shareholders (ii) Director's Certificate (iii) Certified copy of board resolution
6. Credit assessment and review report(s) (if review(s) has/have been conducted during the tenor of the facility) The purpose of obtaining the credit assessment report is to ensure that in conducting credit assessment, the PLI had duly considered the following aspects – (i) Purpose of the facility

- (ii) Credit analysis on the repayment ability of the borrower, the guarantor(s), and the possible assets for recovery in case of default. The analysis should also show the credit criteria (as set out in the PLI's policy) the borrower has met, and justifications for allowing exceptions if such criteria are not met.
- (iii) Checking on the borrower to ascertain that no petition for winding-up or bankruptcy has been filed against the borrower (or where applicable, its partners, major shareholders and directors) ^(Note 6)
- (iv) The borrower's track record, business prospects and financial position (including assets and liabilities) ^(Note 6)
- (v) Business nature of the borrower
- (vi) The management abilities and determination of the senior management and shareholders of the borrower to continue the business.
- (vii) Company visit report prior to approval of loan application ^(Note 6), or written explanation in lieu
- (viii) The borrower's clientele
- (ix) Credit references from appropriate credit reference agencies ^(Note 6) or written explanation in lieu

The PLI may be required to complete the table (sample at **Annex V**) to facilitate TID's verification of the credit assessment report.

The purpose of obtaining the review reports is to ensure that the PLI had taken due considerations in reviewing the credit quality of the borrower during the tenor of the facility.

(B) Information on the Borrower

7. Background search on the borrower with the Companies Registry / Inland Revenue Department / Land Registry / private company search agency at the time of credit assessment ^(Note 6).
8. For borrower that had been established for 18 months or more as at the date on which its loan application was received by the PLI: –
 - Limited company – audited account of its latest financial year at the time of application duly certified by the auditor of the borrower; or if it is consistent with the prevailing practice of the PLI in respect of facilities granted outside the SpGS, the latest available audited account duly certified by the auditor of the borrower ^(Note 6).

- Unlimited company - (sole-proprietor / partnership) – financial statements of its latest financial year at the time of application including a certified balance sheet and profit and loss account; or if it is consistent with the prevailing practice of the PLI in respect of facilities granted outside the SpGS, the latest available financial statements including a certified balance sheet and profit and loss account ^(Note 6)

If only latest available audited accounts / financial statements can be provided, the PLI should also confirm in writing that it is consistent with its prevailing practice in respect of facilities granted outside the SpGS. If necessary, additional information will be required.

9. Documentary evidence showing that the borrower has substantive business in Hong Kong (e.g. MPF contribution, tax demand note, etc.)

10. Information on the borrower's current status (e.g. whether the borrower is still in operation or has liquidated, etc.)

11. Records on the company visit conducted ^(Note 6)

(C) Information on recovery action(s)

12. If applicable, demand / termination letters issued to the borrower and guarantor(s)

13. Evidence showing the recovery action(s) taken or to be taken against the borrower and guarantor(s)

Examples:

- (i) Company visit report after default
- (ii) Appointment of debt collection agent
- (iii) Writ of Summons, Judgment, Bankruptcy Order, Proof of Debt together with receipt, and other legal action(s) taken or to be taken inside and / or outside Hong Kong (where appropriate) etc.
- (iv) Documents showing the outcome of recovery actions

The PLI should provide detailed justifications in case it decides not to take any recovery action against the borrower and / or guarantor(s)

14. If applicable, attempt(s) or action(s) to realise the collateral and details of proceeds

Examples:

- (i) Correspondence with the borrower on the realisation of the collateral
- (ii) Legal documents relating to the realisation of the collateral
- (iii) Valuation of the collateral
- (iv) Documents on the resale of the collateral and the proceeds generated

The PLI should provide detailed justifications in case it decides not to take any action to realise the collateral.

15. If applicable, details with justifications on payment(s) received / security(ies) realised by the PLI from the borrower and guarantor(s) after the date of default but **not** applied to reduce the outstanding indebtedness in respect of the subject defaulted SpGS facility (e.g. in case the payments are used to repay other non-SpGS facility). Please refer to Part I paragraph 3 (iii) above for the general principles to be adopted by PLIs in handling recovery proceeds.

(D) Information on the Questionnaire on Default Claim

16. (If the answer to Question 5 of Questionnaire is “yes”) Elaborations on the exception to the relevant guidelines and policies of the PLI’s internal operation manual, the considerations for allowing such exception and whether proper approval had been obtained on the grant of the subject facility.

17. (If the answer to Question 6 of Questionnaire is “yes”) Statement(s) of bank accounts in respect of facilities (other than the defaulted SpGS facility) already granted to the borrower or related companies at the time when the borrower submitted the application for the defaulted SpGS facility, from two months before the grant of the defaulted SpGS facility up to present.

18. (If the answer to Question 7 of Questionnaire is “yes”) Statement(s) of bank accounts in respect of facilities (other than the defaulted SpGS facility) granted to the borrower or related companies after the borrower submitted the application for the defaulted SpGS facility, from grant of the concerned facilities up to present.

19. If applicable, credit limits and outstanding indebtedness of all facilities (both SpGS and non-SpGS) granted to the borrower at the time of default, tabulated for easy reference.

20. (If the answer to Questions 10 and/or 11 of Questionnaire is/are “yes”) Credit review report(s) conducted during the tenor of the SpGS facility.

8. Some common problems observed in the default claims lodged by PLIs under the SpGS are listed at **Annex VI**.

IV. Refund to the Government

9. In connection with the compensation payment for a default claim and the contribution to the recovery costs and expenses made by the Government under the SpGS, the PLI would be required to refund immediately the relevant amount paid by the Government together with interest on such amount upon demand under the following circumstances in accordance with Clause 8 of the SpGS Deed –

- (a) the PLI has provided false, fraudulent or misleading information, or acted in bad faith, in connection with any claim for payment under the SpGS Deed or its guarantee;

- (b) the PLI fails to comply with any of its obligations under Clause 6 of the SpGS Deed; or
- (c) it is discovered that the PLI is not entitled to any amount paid by the Government under or in connection with the SpGS Deed or its guarantee for any other reason.

Interest rate of 1% per calendar month (or such other rate as the PLI and the Government may from time to time agree in writing) would be charged on the amount to be refunded from the date on which the Government pays the relevant amount up to the date immediately preceding the date on which the Government actually receives the refund in full (both dates inclusive). Extracts of Clause 8 of the SpGS Deed are at **Annex VII**.

V. Important Note

10. The PLI is required to fill out the Payment Request Form and the Questionnaire on Default Claim, and provide all the necessary supporting documents as set out under Part III above when lodging a default claim with TID. TID will effect payment to a default claim only after all the necessary documents or information are received and checked in order. Special attention should be paid to the text of Declaration of Lender under Part (F) of the Payment Request Form. Making a false declaration will have legal consequences.

11. The guidelines are prepared for the PLI's internal reference only. It shall not limit TID's right to request any information or raise questions not mentioned in the guidelines. TID reserves the absolute right to approve or reject any default claims in accordance with the provisions of the SpGS Deed.

12. The guidelines will be updated from time to time in the light of experience. PLIs are advised to make reference to the latest version of the guidelines on TID's website.

Notes

- (1) The SpGS Deed herein refers to the Original Deed, the Supplemental Deed and the Second Supplemental Deed signed between the Government and individual PLIs of the SpGS.
- (2) “Repayment date”, as defined in Clause 1.1 of the SpGS Deed, means the date on which that facility, or any part of it, becomes due according to the relevant facility letter.
- (3) Indebtedness means, in relation to a facility under SpGS, the amount from time to time outstanding from the relevant borrower to the PLI in respect of that facility which constitutes only the outstanding principal of that facility, i.e. all outstanding interest, penalties, charges and capitalisation of interest and charges, if any, shall be excluded.
- (4) PLI is required to use the Payment Request Form for Special Loan Guarantee (TID655).
- (5) The statement provided should show all account transactions (e.g. partial payment, overdue interest payment, etc) with breakdown of principal and interest of each instalment, date and amount of drawdown and repayment. For trade finance related facilities, due date of each advance should be shown on the statement, and loan advices of defaulted advances should be provided. If the bank statement does not provide a detailed breakdown on the amount of principal and interest for each instalment, the PLI should provide supplementary information to show the breakdown separately. The breakdown is essential for calculating Government’s share of payment as Government’s guarantee only covers the principal.
- (6) Information as declared by the PLI in the SpGS application form.

Trade and Industry Department
March 2016