HONG KONG MONETARY AUTHORITY
香港金融管理局

Our Ref.: B1/15C
B9/147C

9 May 2018

The Chief Executive
All Authorized Institutions

Dear Sir/Madam,

Credit Risk Management for Personal Lending Business

I am writing to inform you that authorized institutions (AIs) may adopt credit risk management techniques and practices enabled by technology for personal lending business.

“New Personal-Lending Portfolio”

As part of the seven initiatives to promote Smart Banking in Hong Kong, the Hong Kong Monetary Authority (HKMA) has established a “Banking Made Easy” taskforce to identify and streamline regulatory frictions to smooth online customer journeys. The taskforce will initially focus its work on three areas, namely remote onboarding, online finance and online wealth management.

With regard to online finance, the HKMA has completed a round of study together with AIs and tech firms. It is noted from this study that some of the HKMA’s existing supervisory requirements, such as those pertaining to the collection of borrowers’ income and address proof, may make it difficult for AIs to offer a smooth customer journey in the online environment. These conventional risk management practices, while still essential in respect of traditional lending products, present a barrier to the adoption of new credit risk management techniques and practices enabled by innovative technology such as data analytics.

To strike a better balance between improving customer banking experience and continuing to uphold prudent credit underwriting standards, the HKMA will allow AIs to carve out a portion of their personal lending portfolio, in respect of which departure from conventional lending practices will be permitted. This arrangement will enable AIs to explore new credit risk management practices, while keeping any possible financial and other impact under control.

This “New Personal-Lending Portfolio” (NPP) should be small initially, and may be expanded over time if the new risk management practices are proved to be effective. The HKMA will keep the NPP arrangement under regular review.

AIs intending to make use of this arrangement should discuss their proposals with the HKMA individually. In formulating their proposals, AIs should have regard to the following guiding principles:-

(i) The NPP should not exceed 10% of an AI’s capital base (or in the case of an AI incorporated outside Hong Kong, no more than 10% of its personal loans portfolio) initially;

(ii) The amount of credit extended to each borrower should generally be smaller than the amount of credit that would have been granted to the borrower in the case of a conventional credit product such as tax loans or revolving facilities under credit cards (this requirement may be relaxed if the new risk management practices are proved to be effective);

(iii) Proactive steps are taken by the AI to ensure that the lending business is being conducted in a responsible manner and that borrowers understand the key features, terms and conditions of the credit products, and their repayment obligations. In this regard, the HKMA expects AIs to follow the requirements as set out in the Code of Banking Practice (including those relating to proper and timely disclosure of key product features), and to further promote responsible borrowing by customers. When designing their online finance platforms or applications, AIs should consider the use of proper tools such as pop-ups and hyper-linked text to provide customers with adequate information and adequate chance to consider the implications of their borrowing behaviour in order to enable them to make informed borrowing decisions;

(iv) Adequate controls are in place to manage and, where appropriate, mitigate the risks associated with the NPP. In cases where external models are used in credit assessment, the AI should ensure that it has a sufficient understanding of the methodology, limitations and assumptions employed by these models; and

(v) Periodic post-implementation reviews should be undertaken to evaluate the effectiveness of the new credit risk management practices and compliance with responsible lending principles.

While the above arrangement is formulated with regard to personal lending, the HKMA will follow a similar approach in considering AIs' proposals for adopting new credit risk management practices for lending to small businesses, such as start-ups. Property mortgage lending, for which the HKMA has laid down clear supervisory requirements (including the countercyclical macroprudential measures) is outside the scope of application of this circular.

General Personal Lending Business

Taking the opportunity, we would also want to make two clarifications. First, as stated in the HKMA circular on "Personal loans granted using available credit card limits" dated 4 November 2015, where a loan-on-card to be granted to a credit cardholder involves an increase in his or her existing credit card limit, AIs should undertake a fresh credit assessment of the cardholder's repayment ability. To this end, AIs should obtain an up-to-date income proof from the cardholder unless they have access to other information such as payroll account information, recent credit report or net assets information, which enables them to complete the credit assessment. The HKMA will like to point out that "other information" in this context may include estimation of a cardholder's income generated by statistical models, provided that the models have been subject to a rigorous assessment and are considered to be sound and robust. AIs should maintain proper records of cases where they have not obtained up-to-date income proof from borrowers.

Secondly, while AIs are generally expected to collect address proof from borrowers for the purpose of credit risk management and fraud control (see SPM Module CR-S-5 on Credit Card Business), the collection of address proof may be replaced by other measures if AIs can demonstrate that the measures are equally effective in managing the relevant risks.

Should you have any questions about this circular, please contact Ms Sophia Chan on 2878 1169 or Ms Edith Tong on 2878 1567.

Yours faithfully,

Raymond Chan
Executive Director (Banking Supervision)