

Commercial Credit Reference Agency to be Operational in 2004

by the Banking Development Department

Detailed arrangements for the establishment of Hong Kong's first commercial credit reference agency (CCRA) are well under way. This article describes the main features of the proposed CCRA scheme and the HKMA's proposed supervisory guidelines.

BACKGROUND

As part of the Banking Sector Reform Programme, the HKMA undertook a study in 2000 to evaluate the desirability of establishing a commercial credit reference agency (CCRA) in Hong Kong. A CCRA gathers and collates information about the indebtedness and credit history of business enterprises and makes the information available to lending institutions.

The study found that the establishment of a fully-fledged CCRA would bring significant benefits to Hong Kong. It would provide lending institutions with a fuller picture of the credit worthiness of their corporate customers, thus helping to strengthen their credit risk management. This would be conducive to the HKMA's efforts in maintaining the safety and soundness of the banking system. A CCRA would also improve the credit transparency of the corporate sector, thereby making it easier and cheaper for borrowers to seek bank finance.

These benefits were widely recognised by the banking industry and the corporate sector during the public consultation exercise following the study. There was general agreement the scheme would benefit small and medium-sized enterprises (SMEs) in particular, by improving their access to bank funding. In view of the broad support received during the consultation process, the HKMA, in 2001, convened a working group comprising representatives from the banking and corporate sectors as well as other relevant public organisations to pursue further the detailed arrangements for the establishment of a CCRA in Hong Kong.

Following a series of deliberations, the working group recommended a CCRA scheme targeted at SMEs based on voluntary participation by authorized institutions (AIs). This recommendation was supported by the Hong Kong Association of Banks and the DTC Association, which jointly formed a working party in May 2002, with participation from the HKMA, to consider how to take the initiative forward. The industry working party has since developed a set of recommendations on how the CCRA scheme should be structured. The salient features of the proposed scheme are discussed in the following section.

FEATURES OF THE SCHEME

A Non-statutory Scheme

Both the working group convened by the HKMA and the industry working party favour a non-statutory scheme based on voluntary participation by AIs. This, in part, reflects the increasing willingness of AIs to exchange credit information amongst themselves, as demonstrated by the industry's concerted efforts in the promotion of greater sharing of consumer credit data. Compared with a scheme established by legislation, a non-statutory scheme will be easier, quicker and less costly to implement. It will also be more flexible and thus more responsive to the changing needs of the banking sector.

Although participation in the CCRA is not mandatory, the HKMA expects all AIs involved in the provision of SME lending to participate as fully as possible in the sharing and use of commercial credit data through a CCRA. This will not only benefit the AIs themselves,

but is important to ensure the comprehensiveness of the CCRA database. As part of its regular supervision, the HKMA will monitor Als' participation in the scheme.

Coverage

The proposed CCRA will cover only the SME customers of Als. As shown in the public consultation conducted in 2000, credit assessment for the SME sector is hampered by the lack of reliable information. It is expected this sector will benefit most from a CCRA scheme in terms of enhanced credit transparency and improved access to bank funding.

For the purposes of the proposed scheme, a business enterprise will be regarded as an SME if it is an unlisted company with an annual turnover not exceeding HKD50 million.¹ Where the company belongs to a larger group, the HKD50 million limit will apply to the group as a whole. In order to expedite the implementation process, sole proprietors and partnerships will not be covered at the initial stage.

Scope of Data to be Reported and Shared

The proposed CCRA will cover all forms of credit granted to SMEs by Als' offices in Hong Kong. Facilities granted by overseas branches, subsidiaries or head offices of Als will not be included.

Both positive and negative credit information will be collected. The former will include the limits of the credit facilities granted by Als to the SME and the extent to which the facilities are supported by collateral.² As regards the latter, Als should report the amount of facilities that are overdue for at least 60 days. They should also report the amount of loans which have been written off.

It is important to note the proposed CCRA will collect data only from its start-up date onwards.

Default data of past facilities or overdue payments of current facilities that have been subsequently settled will, therefore, not be reported. Moreover, information such as the assets of the company or the personal wealth of the company's shareholders will not be covered.

The information contained in the CCRA will be updated by Als on a monthly basis. In general, credit information relating to each facility will be retained by the CCRA for five years from the date of full repayment of that particular facility.

Customer Consent

In keeping with their contractual duty to maintain customer data confidentiality, Als should seek SME customers' consent to disclose their credit data to the CCRA for the purpose of conducting credit checks or assisting other Als to conduct credit checks.

The efforts of Als in seeking customer consent are very important as the usefulness of a CCRA lies in the comprehensiveness of its database which, in turn, hinges on customers' willingness to allow their credit data to be reported to the CCRA. The HKMA will ensure a level playing field and the comprehensiveness of the CCRA database by monitoring, through a regular survey, that Als are not being selective in seeking the consent of customers. In this context, Als are required to observe the following ground rules:

- (i) Als should seek the consent of an SME customer upon application for new credit facilities (including application for an increase in the credit limit of existing facilities). Such consent should be incorporated as part of the terms and conditions of the facility, which is in line with the practice in relation to consumer lending;

¹ Should the turnover of an SME subsequently exceed HKD50 million, the information will remain in the CCRA and the relevant Als should continue to report the credit data of the SME to the CCRA.

² Als are required to state whether the facility is "fully secured", "partially secured" or "unsecured". They need not report the nature or the value of the collateral.

- (ii) Als should also seek the consent of an SME customer upon renewal of the customer's existing credit facilities. They should endeavour to incorporate the consent as part of the terms and conditions of the facility. Where an SME refuses to give consent, Als should inform the customer that this may provide grounds for lending institutions to decline to renew its facilities. However, in recognition of the fact that these are existing facilities which were previously granted with no such requirement in place, the HKMA accepts that it would be difficult for Als to insist on incorporating such a consent clause if the customer refused to do so. Although some flexibility is provided for these customers, the HKMA still expects Als to make their best efforts to persuade their customers to give consent and not to opt out of the reporting arrangement; and
- (iii) Als should also stand ready to revise their existing loan documentation on request by any SME customers who voluntarily approach them to seek to be included in the CCRA database before their current facilities are due for renewal.

Data Protection

For any credit information sharing arrangement to be effective and credible, the data must be properly safeguarded with respect to the confidentiality, accuracy, relevance and proper utilisation of the information. In relation to this, the HKMA will issue a statutory guideline under the Banking Ordinance setting out the data protection rules pertinent to the sharing and use of commercial credit data through a CCRA.

The rules will specify that Als can access the CCRA database only in relation to the grant, review or renewal of an SME's credit facilities. They should not access the database for other purposes such as marketing. The guideline will also require Als to maintain adequate systems of control to properly protect the data of their SME customers. Failure to comply with these rules will call into question the Al's

ability to satisfy the relevant authorisation criteria under the Banking Ordinance.

In addition, the guideline will require Als to use only the service of a CCRA that has taken appropriate steps to safeguard the security and accuracy of the data it holds, and to respond to an access or correction request by an SME promptly. These requirements will be incorporated in the terms of the CCRA's service agreement with Als. Non-compliance with the agreement will amount to a breach of contract that might result in Als terminating the services of the CCRA.

The HKMA will play an active role in ensuring that the data protection rules specified in the guideline are complied with by all Als and the CCRA by making sure that customer complaints in respect of the data sharing arrangements are properly handled.

IMPLEMENTATION

The industry working party has recently selected a service provider to operate the CCRA. It will work with the vendor to finalise other operational details, including the systems and reporting requirements of the scheme. If everything goes smoothly, the CCRA is expected to be up and running in the third quarter of 2004.