



Hong Kong

June 2018

HKMA CIRCULAR ON CREDIT RISK MANAGEMENT FOR PERSONAL LENDING BUSINESS

Introduction

On 9 May 2018, the Hong Kong Monetary Authority (**HKMA**) issued a Circular on Credit Risk Management for Personal Lending Business¹ (**Circular**), allowing authorized institutions (**AIs**) to adopt credit risk management techniques and practices enabled by technology for personal lending business.

The HKMA will permit AIs to carve out a portion of their personal lending portfolio as New Personal-Lending Portfolio (**NPP**), which will not be required to adhere to conventional lending practices. Instead of obtaining borrowers' proof of income to evaluate their ability to repay, AIs can adopt new credit risk management techniques and practices supported by innovative technology to approve and manage credit risks.

This arrangement aims to improve customer banking experience while supporting prudent credit underwriting standards, and is part of the HKMA's objective of facilitating the application of financial technology (**FinTech**). However, according to Raymond Chan, Executive Director (Banking Supervision) at the HKMA, drawing on a study with AIs and tech firms, the HKMA recognises that certain existing supervisory requirements, such as income and address proof, "will remain firmly in place for some institutions".²

"New Personal-Lending Portfolio"

In September 2017, the HKMA announced seven initiatives to prepare Hong Kong for a "New Era of Smart Banking", as covered by Charltons' September 2017 newsletter.³ One of the seven initiatives was the HKMA's establishment of a "Banking Made Easy" taskforce to identify and streamline regulatory frictions in customers' digital experience. The taskforce will initially focus on remote onboarding, online finance and online wealth management.

The HKMA noted in its Circular that some current supervisory requirements, such as those relating to collection of borrowers' income and address proof, pose an obstacle to the adoption of new credit risk management techniques and practices facilitated by innovative technology including data analytics.

AIs will thus be allowed to depart from conventional lending practices in relation to their NPP. The NPP, should be small initially, but may be expanded in future if the new risk management practices are effective. The HKMA will regularly review the NPP arrangement.

AIs should discuss their proposals with the HKMA, and should consider the following guiding principles when devising their proposals:

¹ <http://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2018/20180509e1.pdf>

² South China Morning Post, "HKMA to waive proof of income and address for online, mobile loans", 9 May 2018 <http://www.scmp.com/business/banking-finance/article/2145430/hkma-waive-proof-income-and-address-online-mobile-loans>.

³ <https://www.charltonslaw.com/sfc-regulatory-sandbox-launched-and-hkma-announces-new-era-of-smart-banking/>

- i) initially, the NPP should not be greater than 10% of an AI's capital base (or for an overseas-incorporated AI, not greater than 10% of its personal loans portfolio);
- ii) credit granted to a borrower should generally be smaller than would have been granted under a conventional credit product (e.g. tax loans or revolving facilities under credit cards). If the new risk management practices are effective, this requirement may be relaxed;
- iii) the AI should take proactive steps to make sure that: (a) the lending business is being carried out in a responsible fashion; and (b) borrowers understand the key features, terms and conditions of the credit products, as well as their repayment obligations. AIs are expected to encourage responsible borrowing by customers and to comply with the applicable requirements of the Code of Banking Practice, including those relating to proper and timely disclosure of key product features. AIs should consider including tools such as pop-ups and hyperlinked text in their online finance platforms or applications. These tools may be used by AIs to provide customers with sufficient information and sufficient opportunity to consider the implications of their borrowing behaviour which should facilitate informed borrowing decisions;
- iv) adequate controls should be put in place to manage and, where appropriate, mitigate the risks associated with the NPP. If a credit assessment uses external models, the AI should ensure that it sufficiently understands the methodology, limitations and assumptions employed by these models; and
- v) following implementation, periodic reviews should be carried out in order to assess the effectiveness of the new credit risk management practices and compliance with responsible lending principles.

Although the new arrangements are framed in relation to personal lending, the HKMA will follow a similar approach for lending to small businesses, such as start-ups. Property mortgage lending is outside the Circular's scope of application.

General Personal Lending Business

The HKMA also made two clarifications in its Circular:

1. The HKMA's circular "Personal loans granted using available credit card limits" dated 4 November 2015, provides that where there is an increase in a credit cardholder's existing credit card limit which is associated with the granting of a loan-on-card, AIs should carry out a new credit assessment of the cardholder's ability to repay. AIs should collect the cardholder's up-to-date income proof, except where they have access to other information which allows them to complete the credit assessment, for example, payroll account information, a recent credit report or net assets information. The HKMA in its May 2018 Circular provided that "other information" may include estimation of a cardholder's income generated by statistical models, where such models have undergone a rigorous assessment and are regarded as sound and robust. Where AIs have not collected up-to-date income proof, they should maintain proper records.
2. Supervisory Policy Manual Module CR-S-5 on Credit Card Business, generally expects AIs to obtain address proof from borrowers for credit risk management and fraud control purposes. The HKMA states in the Circular that other measures may substitute the collection of address proof, provided that such other measures are just as effective in managing the relevant risks.

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