

Our Ref : CB/POL/5/43

7 November, 1994

The Chief Executive
All authorized institutions

Dear Sir/Madam,

Loan Classification System

The HKMA issued in September a Policy Paper setting out the new loan classification system on which authorised institutions are required to base their reporting of loans, advances and provisions in the new return on “Quarterly analysis of loans and advances and provisions”.

Since the issue of the paper, we have received a number of enquiries seeking clarification on the loans that should be reported under the “Special Mention” category. Paragraph 7.3 in the Completion Instructions to the new return recommends that loans which have been overdue for 3 months or less should be reported as “Special Mention” loans. A common enquiry was whether an institution might have some discretion to report loans which have been overdue for a short period (say for only 1 month) as “Performing” rather than under the “Special Mention” category.

The purpose of the “Special Mention” category is to include information in the reporting framework that can provide early warning of potential deterioration in the creditworthiness of the loan book. I am sure you would agree that a delay in the servicing of loans can be an early sign of possible delinquency and, as is explained in paragraph 7.2.2 of the Completion Instructions, such delay is therefore one of the factors which should be taken into account in identifying “Special Mention” loans for closer monitoring by the lending institution

Having said that, we recognise that it could be inappropriate to require loans to be reported as “Special Mention” simply because of isolated missed service payments, or repayments overdue for a brief period, where these are due to technical factors (e.g. postal delay) or simple oversight. However before taking the decision to omit such overdue loans from the “Special Mention” category, institutions should have regard to the other factors specified in paragraph 7.2.2. If any of these other factors are present, such as poor performance in the industry in which the borrower operates, a missed service payment may take on greater significance and should be the signal for the loan to be reported under the “Special Mention” category without delay.

The guiding principle is that institutions should exercise prudent judgement in classifying loans based on their knowledge of their customer, including the present state of his affairs and his past payment record. At the very least, a missed service payment should be regarded a warning signal for closer monitoring of the current status of the loan, which includes taking into account the factors mentioned in paragraph 7.2.2. In general, institutions should not feel reluctant to report loans under the "Special Mention" category.

Should you have any queries regarding this letter, please feel free to contact Ms Brenda Tao (878 1622) or Ms. Irene Sy (878 82 10).

Yours faithfully,

D T R Carse
Deputy Chief Executive (Banking)

c.c. The Chairman, HKAB
The Chairman, DTC Association
President, Hong Kong Society of Accountants
Auditors of Authorised Institutions
The Chairman, Securities & Futures Commission