



Supervisory Policy Manual

CR-G-10

Problem Credit Management

V.1 – 29.06.01

This module should be read in conjunction with the [Introduction](#) and with the [Glossary](#), which contains an explanation of abbreviations and other terms used in the Manual. If reading on-line, click on blue underlined headings to activate hyperlinks to the relevant module.

Purpose

To provide guidance to Als on the management of problem credits

Classification

A statutory guideline issued by the MA under the Banking Ordinance, §7(3)

Previous guidelines superseded

Circular "Loan Recovery" dated 02.06.99

Application

To all Als

Structure

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4. Management of accounts written off
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1. Introduction

- 1.1 Problem credits¹ need to be managed carefully because they can potentially:
 - depress profitability, both through the need to make provisions or write-offs and through the carrying cost;
 - affect an AI's liquidity; and
 - consume a significant amount of management time and attention.
- 1.2 Unless corrective action is taken promptly the position of a problem account may deteriorate further. Therefore, AIs should have in place a robust system for:
 - identifying problem credits as soon as possible; and
 - managing out such credits quickly and efficiently in order to minimise credit losses.

2. Policy and strategy for managing problem credits

- 2.1 AIs should have a clearly defined policy and strategy, documented in writing and approved by the Board of Directors, the Credit Committee or senior management with delegated authority, for the management of problem credits.

¹ The term "problem credits" in this module refers to credits which have developed irregularities and which merit special measures rather than being managed under the same arrangements as for regular credits. This will usually be the case with credits adversely classified under the HKMA's loan classification system.



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2.2 Such policy and strategy would normally cover the following areas:

- authority and responsibilities for problem credit management;
- collection approach and procedures adopted for different portfolios, e.g. corporate versus retail;
- handling of restructuring and work-outs for problem credits;
- management of repossessed collateral;
- use of external debt collection agencies, if applicable;
- criteria for seeking professional advice on problem credits;
- supervision and monitoring of debt recovery performance; and
- relevant management information to be produced.

2.3 Where appropriate, there should be detailed manuals and checklists to supplement the policy and strategy so that no relevant steps and precautions are omitted.

2.4 The policy and strategy should be communicated to and understood by all staff concerned with managing problem credits.

3. Problem credit management function

3.1 Application

3.1.1 The level of sophistication of an AI's problem credit management function should be commensurate with its scale of operation and the size, complexity and severity of its problem credits. The HKMA will have regard to such factors in assessing the adequacy of this function.

3.2 Structure

3.2.1 There is no typical structure for a problem credit management function. Traditionally, debt recovery has been handled by either the Credit Department or the relevant account officers. It is, however, preferable for AIs to have an independent and dedicated unit to handle the restructuring, work-out and recovery of problem credits. This is because:



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- the management of problem credits requires special expertise, particularly in corporate work-outs and business restructuring;
- account officers are likely to be too close to the borrowers and thus not impartial in how they view and handle the accounts; and
- similarly, credit officers who previously approved the problem credits are unlikely to be dispassionate as they may view the borrowers' difficulties as a reflection on themselves.

3.2.2 As a general principle, therefore, account officers should not have the primary responsibility for debt recovery, except for the less serious cases (also see para. 3.3.2 below).

3.2.3 Als should also ensure that:

- there is an independent team, or a separate unit within the Credit Department, for the management and recovery of problem credits;
- the unit is adequately staffed and the officers responsible for debt recovery have the requisite skills and experience; and
- the officers are independent of the marketing and credit approval functions.

3.2.4 Irrespective of how it is structured or named, the problem credit management unit should have clearly defined responsibilities, reporting line and authorities, e.g. limits for additional financing, powers to give concessions, enforce guarantees and foreclose collateral. It should report to the Al's senior management, who should be kept informed of its activities on a regular basis.

3.3 Process

3.3.1 Als should ensure that there is an effective means of identifying problem accounts at an early stage so that corrective action can be taken promptly before the position of these accounts deteriorates further.

3.3.2 While account officers may follow up on less serious accounts, the problem credit management unit should handle more serious cases. There should be clear



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guidelines, criteria and trigger points for identifying and transferring credits to the problem credit management unit, e.g.

- when a credit has been classified as Substandard or worse;
- when the overdue period of a credit exceeds a certain threshold and after initial warnings² have been given but to no avail; and
- in the case of Special Mention accounts which are significant in balance and more complicated to handle.

3.3.3 Als should ensure that credits are regularly reviewed and promptly downgraded if appropriate so that there is no delay in the referral of problem credits to the problem credit management unit.

3.3.4 Once an account is referred to the problem credit management unit, there should be a structured process for reviewing it and assessing the best way to handle it. Depending on the severity of the case, there are likely to be three main options:

- the account is left with the account officer, but the unit liaises with that officer on necessary action, e.g. close monitoring or contact with the customer to restore the account to normal status;
- the unit takes over management of the account and explores whether it is viable to restructure the credit, including possibly by providing additional finance, to nurse the borrower's financial position back to health. Contact and negotiation with the customer may be handled by the unit itself or jointly with the account officer; or

² In the case of retail credits managed on a portfolio basis, prior to being transferred to the problem credit management unit, problem credits are normally managed according to the period for which payment has been overdue. Actions to be taken would include contacting the customer by telephone or in person, sending him a reminder that payment is overdue and, if the account is still not normalised within a certain pre-determined period, issuing a letter threatening legal action.



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- the account is referred to the staff within the unit responsible for collateral recovery, enforcement of guarantees and collection.

3.3.5 The whole process needs to be speedy. This applies to:

- the initial identification of problem accounts;
- the formulation of an appropriate strategy for the management of the account, i.e. choosing from the options listed above; and
- the action that is taken in respect of the account.

3.3.6 Strategies for the management of individual problem accounts should be constantly reviewed and adjusted where necessary to achieve better results.

3.3.7 There should be a process in place to provide feedback on an AI's experiences in problem credit management to other credit functions. In particular, where it is noted that certain aspects of the credit policy or strategy need to be re-appraised or adjusted (e.g. the credit granting criteria for certain facilities are not stringent enough), the problem credit management unit should report these observations to management so that appropriate remedial actions can be promptly taken. This may form part of the unit's regular monthly reporting to the Credit Committee or senior management.

3.4 Restructuring and work-outs

3.4.1 AIs should provide adequate guidance to the problem credit management unit on the approach to be adopted in respect of the restructuring, extension and work-out of problem credits.

3.4.2 Where the case can be justified, it is usually preferable for a customer in difficulty to be helped towards recovery rather than put immediately into liquidation or bankruptcy. There will, however, be instances where swift action to reduce the exposure or close down an account is necessary to protect the AI's interests.

3.4.3 In any case, AIs should not extend or restructure a problem credit without an adequate assessment of the extension or restructuring proposal and the longer-term viability of the borrower.



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3.4.4 Where additional collateral or guarantee is received as a condition for restructuring a credit, it should be thoroughly evaluated prior to acceptance (see [CR-G-7](#) “Collateral and Guarantees” for further details).

3.4.5 While the debt recovery unit may handle less complex restructurings independently, it may well work jointly with the AI’s corporate banking staff on more complex restructurings where other institutional lenders are involved. It is important in such cases to ensure that objectivity is maintained and that the AI’s position is safeguarded. Account should also be taken of the “Hong Kong Approach to Corporate Difficulties” jointly issued by the Hong Kong Association of Banks and the HKMA.

3.5 Management of repossessed collateral

3.5.1 Als should ensure that there is an effective process for controlling, managing and efficiently disposing of repossessed or foreclosed collateral. In this regard, there should be policies and procedures, approved by legal counsel, addressing the conditions under which repossessions will occur, the method of repossession and disposal, and other legal requirements.

3.5.2 Als should designate staff in the problem credit management unit responsible for managing this process. The staff should have detailed knowledge and experience in the practical aspects of foreclosure and liquidation covering all types of collateral, e.g. properties and shares.

3.5.3 Reference should be made where necessary to qualified legal advisors with experience in such matters.

3.6 External debt collection agencies

3.6.1 Where collection is outsourced to external debt collection agencies, Als should have appropriate procedures in place to review the performance of these agencies and to ensure that their conduct is acceptable and they respect customer confidentiality and all relevant laws.

3.6.2 In particular, Als should ensure compliance with the relevant guidelines stipulated in the “Code of Banking Practice” (see Chapter 5 on “Debt Collection by Third Party Agencies”) jointly issued by the Hong Kong



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Association of Banks and the Hong Kong Deposit-taking Companies Association and endorsed by the HKMA.

3.7 Professional advice

3.7.1 Als should lay down criteria and procedures for seeking professional advice from external lawyers and accountants as resolving problem credits is usually a complex matter, e.g. involving legal actions relating to debt collection, foreclosure, liquidation and insolvency proceedings.

3.8 Management information

3.8.1 There should be sufficient in-depth management information to enable the problem credit management unit to operate effectively. This falls into two types:

- sufficient account-specific information to enable the performance and viability of accounts to be assessed effectively; and
- comprehensive consolidated information, e.g. reliable and up-to-date lists of problem credits and aggregate information on the volume of problem credits.

3.8.2 A quality control procedure should be in place to ensure that the figures are accurately reported.

4. Management of accounts written off

4.1 Debt recovery efforts should not cease after an account has been written off. A process should be in place to continue collection efforts in order to seek recovery.

4.2 Management approval should be obtained for ceasing debt recovery action on individual accounts.

5. Re-classification of problem credits

5.1 The classification of problem credits should be regularly reviewed and updated. This task is often delegated to the problem credit management unit. On a regular basis, preferably weekly but at least monthly, the problem credit management unit should consider whether accounts referred to or managed by it need to be re-classified. This is important as a means of



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ensuring that senior management is kept as up-to-date as possible on the quality of the credit portfolio.

- 5.2 The unit should also ensure that the relevant collateral for problem credits is revalued regularly and determine the need for additional provisions (see section 6 of [CR-G-7](#) “Collateral and Guarantees” for further details).

6. Management review

- 6.1 The Credit Committee or senior management is responsible for overseeing the debt recovery process. They should review periodically the work of the problem credit management unit and information on problem credits at least on a monthly basis.
- 6.2 There should also be a system in place to regularly review and evaluate the activity and performance of individual debt collectors as well as the effectiveness of debt recovery actions taken.

7. Independent audits

- 7.1 Internal Audit should carry out regular independent reviews of the problem credit management process to evaluate its effectiveness for managing problem credits.
- 7.2 Such review should take place at least annually and should cover the entire process, including:
- identification and classification of problem credits;
 - effectiveness of debt recovery actions, restructurings and work-outs;
 - repossession and disposal of collateral;
 - monitoring of external debt collection agencies, if applicable;
 - handling of accounts written off; and
 - accuracy of management reports on problem credits.

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HONG KONG MONETARY AUTHORITY
香港金融管理局

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