

# **Appendix R**

## **Credit Reporting System**

# **The Pragma Corporation's Recommendation**

**For**

## **Development Of Credit Reporting System for China**

### **A. PHASE I of PROJECT**

#### **Key Issue # 1**

Is the lack of personal and SME credit histories limiting the extension of credit within China and will it stall future economic growth within these sectors?

#### **Pragma's Recommended Approach to Address this Issue**

Pragma recommends a review of the methods used within the country in extending credit to individuals and Enterprises by the banking institutions and merchants. It is important to determine:

- a. How do merchants extend credit now and what credit checks are performed;
- b. How are credit checks done on Enterprises and
- c. Is there a difference in the manner that credit checks are made on SMEs and large enterprise?

#### **Key Issue # 2**

Will the lending and merchant community support the concept of a credit reporting system and have a role in any future development of such a system? What are the opinions that they now hold regarding the trading of credit information? Would they voluntarily participate in a system? Is the lack of credit histories a factor in extending loans to individuals and SMEs? Would they support a government policy regarding the reporting of credit extensions?

#### **Pragma's Recommended Approach to Address this Issue**

Pragma recommends an extensive survey and meetings with lender groups and merchants be undertaken to determine their views and attitudes towards the establishment of such a system. Pragma also recommends that, with the cooperation of the Government of China, an advisory panel be formed that would assist in the communication of views and recommendations.

#### **Key Issue # 3**

Will the various levels of government within China support a credit reporting system?

#### **Pragma's Recommended Approach to Address this Issue**

Interviews should be conducted to ascertain the views at all levels of government as to the need for a credit reporting system and what governmental involvement,

in their opinion, is needed for such a system to be successful in China.

#### **Key Issue # 4**

What is the current legal environment and what is needed in the way of laws, regulations and policies that will allow for the flow of information to and from credit grantors and at the same time protect the individual or enterprise information from unauthorized use.

#### **Pragma's Recommended Approach to Address this Issue**

Pragma recommends a complete research of existing laws and regulations that affect such information be undertaken to determine what changes would be needed or what new laws are needed so that such a system could operate within the enterprise environment of China.

#### **Key Issue # 5**

What is the best approach in structuring such a system in China and the related costs to establish and operate such a system including:

- The feasibility and costs of establishing a government operated system.
- The feasibility and costs of a privately operated system.

#### **Pragma's Recommended Approach to Address this Issue**

Pragma recommends a detailed assessment of the potential of establishing a credit reporting system in China and the issues that must be addressed in the structuring of any such entity.

Feasibility reports should be done on the various issues relating to a publicly owned system versus a privately owned system, along with cost analyses. Costs and benefits of a technical cooperation agreement or joint venture with foreign partners that have experience in the development and the operations of such systems should also be undertaken.

#### **DECISION POINT**

At this point in the project, a decision should be made on whether the information compiled in Phase I warrants the project to enter Phase II. Phase II is the development stage of the project where the findings of Phase I are expanded by the drafting, as needed, legislation, rules and regulations, joint venture agreements, computer programs, operating Manuals, training and perform related activity to bring the project to an operating level.

#### **B. PHASE II OF PROJECT**

The exact process that would be undertaken in Phase II will depend on the information gathered in Phase I and the decisions made from such information and recommendations. However, the following is the general approach that would be undertaken. Phase II brings the project from a feasibility stage through the development and testing stages.

### **Key Issue # 6**

Developing a legislative package that will address the needs of a universal credit reporting system is needed to assure participation and cooperation of the private as well as the public sector. It is also needed to assure the proper use of credit information being gathered on individuals and companies.

### **Pragma's Recommended Approach to Address this Issue**

Based on the needs defined in Phase I for laws, regulations and policies, drafts of the necessary documents should be completed to ensure proper written authorities and responsibilities regarding a credit reporting system.

We will design a set of governmental laws, rules and policies governing the collection, distribution and use of credit data should be designed. This will include a set of very specific principles and standards that all credit grantors and collection facilities will follow in granting credit and reporting of experiences with individuals and enterprises.

### **Key Issue # 7**

The development and implementation of a credit reporting system that addresses the need of Kazakhstan is critical for the success of the project.

### **Pragma's Recommended Approach to Address this Issue**

Based on the information gathered in Phase I, a review of the various systems currently in use in other countries and their appropriateness for implementation in China verses designing a specific system that will better serve the needs of the country should be undertaken. Any system should provide for a core of information to be exchanged, have easy access by credit grantors and debtors and be designed for easy expansion of areas and elements.

A committee or council of merchants, lenders and government officials should be formed to assist in the development of such a system.

If the findings and decisions in Phase I establishes a need for a joint venture, great care should be exercised in the designing of the venture and assist in its implementation to assure that the project will have continuous management and oversight.

The system should be tested in a small geographic area with limited merchant and

other credit grantors participating to assure that the system is ready for countrywide implementation.

Training must be provided for all users of the pilot system and a public awareness program should be developed that will keep the public informed on the progress of the system and the importance being placed on personal and enterprise credit.

### **C. PHASE III OF PROJECT**

Phase III will bring the project to full implementation on a countrywide basis. Taking the results of the testing period and making systems and implementation adjustments as necessary the project will enter its final phase of expanding in preplanned steps to a nationwide system.

#### **Key Issue # 8**

The development of a public awareness program is very important to the success of a credit reporting system.

#### **Pragma's Recommended Approach to Address this Issue**

A public awareness program should be designed that will include information pamphlets designed to inform the public the importance of good credit habits, spot radio and TV public service announcements as well as Web based information programs.

#### **Key Issue # 9**

There will be a need for an ongoing informational and training program to assist credit grantors, debtors and government officials in understanding credit reporting and the accompanying systems.

#### **Pragma's Recommended Approach to Address this Issue**

An ongoing training package must be designed that will augment the systems and the overall project being delivered.

It should also include web based training courses in handling credit information that can be used by credit grantors in the training of their staffs.

#### **Key Issue # 10**

There needs to be a specific implementation plan to bring the system nationally.

#### **Pragma's Proposed Approach to Address this Issue**

A stepped implementation plan should be used with constant monitoring in the implementation phase of the project, providing technical support to the system as well as program management expertise.

## LENDER REVIEW ELEMENTS

Processing/Forms/Eligibility/ Credit Analysis	
1	<b>Is the SETC application form complete, signed and dated by the borrower?</b>
2	Is SETC guaranty request form complete, signed, and dated by the Lender?
3	Are personal financial statements present, complete signed and dated for all owners of 20% or more of the borrower, personal guarantors and others required?
4	<b>Are the required business financial statements present, complete, signed and dated?</b>
5	<b>Were size determinations correct and analyzed according to SETC policy (including affiliation determinations)?</b>
6	Did the loan file document that credit was not available elsewhere on reasonable terms?
7	Was the personal resources test, applied and enforced according SETC policy?
8	Was the nature of business of the small business concern eligible for SETC financing?
9	Was this loan to a PRC citizen or eligible non-citizen?
10	<b>Was the purpose of the use of proceeds eligible?</b>
11	If the project involved the refinancing of existing debt, was SETC policy correctly applied regarding the eligibility of the debt refinanced?
12	If the loan involves a change of ownership was it eligible?
13	If the loan involved a franchise, does the borrower have the power to control the franchise?
14	Were you unable to detect any apparent conflict of interest related to the borrower on this loan?
15	Were you unable to detect any apparent conflict of interest related to the lender on this loan?
16	Did the new loan, coupled with any other outstanding SETC loans, meet the allowable loan program limits?
17	Were the loan amount, guaranty percentage, maturity and interest rate of the loan consistent with SETC policy?
18	<b>Was repayment ability reasonably assured by historical cash flow, credible projections, or loan scoring?</b>
19	Was adequacy of working capital correctly determined?
20	Was the adequacy of capitalization correctly determined?
21	Was the management ability of the borrower analyzed consistent with SETC policy (or for <i>Express</i> , consistent with lender's non-government guaranteed loan policy)?
22	Was the basis for collateral adequacy properly supported and calculated consistent with SETC policy?
23	<b>If the loan was undercollateralized, was SETC policy followed for obtaining additional collateral, including personal guarantees as required?</b>
24	Was a credit investigation performed and documented in the loan officer's report?

<b>Due Diligence/Authorization/Closing</b>	
25	Was the borrower's identification and legal name consistent between the authorization and the lender's documents?
26	If the authorization required guarantees, were they acquired according to SETC policy and the authorization?
<b>27</b>	<b>If required, was the borrower's injection capital verified?</b>
28	Was the loan authorization constructed in accordance with the loan approval?
29	Was the signature of the lender on the authorization?
<b>30</b>	<b>Do the terms of the Note match the authorization?</b>
31	Does the Note have the proper signatures?
32	Do the lien instruments, including but not limited to Deed(s) of Trust or Mortgage(s), have the proper signatures?
33	For real estate collateral, is SETC in the appropriate, perfected lien position?
<b>34</b>	<b>If personal property was taken as collateral, is SETC in the proper, perfected lien position?</b>
<b>35</b>	<b>If the authorization required an appraisal was it obtained and did it meet the conditions of the authorization?</b>
36	Were insurance requirements specified in and met according to the authorization?
37	Was the Settlement Sheet completed correctly and in accordance with the authorization?
38	Was the guaranty fee paid, in the correct amount and submitted within the proper time-frame?
39	If required, were any standby agreements signed properly and in order?
<b>Servicing and Liquidation</b>	
40	Were the insurance requirements up to date?
41	Were the financial statements current or can the lender document efforts to secure timely financial statements?
<b>42</b>	<b>Were servicing and liquidation actions for this loan properly documented, supported and within the scope of the lender's unilateral authority? (If unilateral authority taken).</b>
<b>43</b>	<b>Did the lender have prior written SETC approval for servicing actions outside the scope of the lender's unilateral authority?</b>
<b>44</b>	<b>Did SETC receive proper notification of all servicing/liquidation actions taken as required?</b>
45	If a liquidation case, was the liquidation plan developed and submitted in a timely basis?
<b>46</b>	<b>If the loan was purchased, were the fees charged by the lender for servicing and liquidation customary and reasonable?</b>
47	If a liquidation case, were status reports submitted on a timely basis as required?
48	If a liquidation case, were alternatives explored to avoid the acquisition of collateral?
49	If a liquidation case, were current appraisals used by the lender to evaluate collateral?
50	If a liquidation case where title of property was taken, was an environmental review done prior to the acquisition of title?
51	If a liquidation case, did the file reflect that workout attempts were explored where possible prior to commencement of liquidation?

52	If a liquidation case, did the lender pursue recovery from guarantors/obligors?
53	If a completed liquidation case, was the wrap-up submitted within the time frame to SETC?
54	If a liquidation case, did the lender receive prior written approval for actions outside the scope of unilateral authority?
55	If a liquidation case, were required site visits performed in a timely manner?
56	If a liquidation case where there has been a purchase, have any funds collected been remitted to SETC in a timely fashion?
	<b>Oversight/Policy/Controls</b>
<b>57</b>	<b>Does the lender have a written statement of policy?</b>
58	Does the lender have a normal geographic lending area and does the lender document under what circumstances they may provide lending outside this area?
59	Does the lender have a written policy of lending authority delegations?
60	Does the lender's written policy describe the fees that may be charged to the borrower?
61	Does the lender have a written policy for their portfolio review process?
<b>62</b>	<b>Does the lender's written policy outline what collection actions may be taken against borrowers who do not make timely payments.</b>
63	Did the lender document its procedure to ensure that loans are approved and authorizations signed by officers with the appropriate authority?
<b>64</b>	<b>Did the lender document its procedure to assure that required closing documents are obtained?</b>
65	Did the lender document its procedure for ensuring that items required after closing are collected?
66	Did the lender document its method of safeguarding collateral documents in the lender's care?
67	Does the lender maintain a schedule of any field visits required and document loan files when visits are completed?
68	Does the lender have a process for updating collateral filings, financial statements and insurance requirements? (Tickler system, etc.)
<b>69</b>	<b>Does the lender have access to counsel available for processing, closing and servicing advice?</b>
70	Did the lender document that it has the resources available for proper servicing and liquidation (if applicable) throughout the geographic area in which the lender makes loans?
<b>71</b>	<b>Does the lender document its process to setup regular reviews of seriously delinquent loans?</b>
72	Does the lender maintain its loan files in an orderly and accessible manner?
73	Is the lender's written policy consistent with SETC policy?
74	Does the lender have a marketing plan to utilize and promote SETC loans?
75	Does the lender have a marketing plan to reach SETC's public policy goals?
76	Did the lender document its procedures to ensure that required forms are with their SETC applications?
77	Did the lender document its procedure to ensure that SETC credit and eligibility requirements are complied with? (As evidenced by training manual(s), checklist(s), review procedures, etc.).
78	Did the lender document its procedure for ensuring that only allowable fees are charged to the borrower?

	charged to the borrower?
<b>79</b>	<b>Did the lender document its process for ensuring routine portfolio reviews and borrower contact on SETC loans?</b>
80	Did the lender document its process for ensuring timely filing of SETC required Lender Reports?
81	Does the lender have a process to ensure proper reporting to SETC of servicing/liquidation actions taken?
82	Did the lender document its training procedure for staff involved in SETC financing?

## **LOAN MONITORING DATABASE ELEMENTS**

Data collected at the time of origination should include:

- Name, address, and bank identification number of the lender,
- Name, address, and tax identification number of the SME,
- Amount of loan request,
- Total amount of Agency exposure in the loan,
- District, City, and Province where SME is headquartered,
- Industry code of SME's principal business activity,
- Amount of loan approved for guaranty
- Type of loan
- Interest rate
- Maturity
- Purpose of loan proceeds
- Loan Score (and selected Loan Score components)

Periodic reports (monthly, quarterly, etc.) submitted by the lender will include:

- Loan number identifier as State guaranteed loan
- Outstanding balance
- Last payment amount and date
- Next payment amount due and date
- Payment status for each loan guaranty outstanding (payment deferral, current, past due, in-liquidation, requested purchase, purchased)

## LOAN SCORING MODEL

<u>Risk Factor</u>	<u>Value</u>	<u>Score</u>	<u>Weight</u>	<u>Score</u>
Debt Coverage – past 2 year average	X	1-5	20%	Y
- projected year 1	X	1-5	5%	Y
Collateral				
Land and buildings	X			
Machinery and equipment	X			
Furniture and fixtures	X			
Vehicles	X			
Accounts receivable	X			
Inventory	X			
Cash and equivalents	X			
Total	T			
Loan to Value	%	1-5	20%	Y
Total Debt to Equity	%	1-5	10%	Y
Age of SME	X	1-5	10%	Y
SME Credit History	X	1-5	10%	Y
Largest Stockholder Credit History	X	1-5	10%	Y
Management Experience				
Overall years in Industry	X	1-5	5%	Y
Mgmt. years in Industry	X	1-5	5%	Y
Industry Risk Rating	X	1-5	<u>5%</u>	<u>Y</u>
<b>Total</b>			<b>100%</b>	<b>YT</b>

### Notes:

1 – Scoring value of 1 through five: 1 = worst, 5 = best

X – Value

Y – Score

T - Total

YT – Total Score (5.00 maximum)