



Revision to the HKMA requirements on collateral and guarantees

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Background: SPM revision on collateral and guarantees management

The Supervisory Policy Manual Module (SPM) CR-G-7 “Collateral and Guarantees” has undergone a comprehensive update to address the evolving landscape of the banking industry. The latest enhancements seek to achieve alignment with international standards, reflect banking industry feedbacks and deliver strengthened guidance on collateral and guarantee management.

The changes reflect the latest “FSB principles for sound residential mortgage underwriting practices” and adopts consistent terminology with the Banking (Capital) Rules (BCR).

Alignment with international standards

The banking sector has experienced substantial changes, including increased complexity in collateral management and more volatile market conditions.

Response to evolving industry landscape

Response to industry feedbacks

Revisions incorporate valuable feedback and queries from industry stakeholders, ensuring the guidelines are both practical and applicable to real-world scenarios.

Provide enhanced guidance

The updated manual introduces tailored, scenario-specific guidance to address the diverse range of products and situations banks encounter in collateral management. Recognizing the growing sophistication of collateral structures, the revisions provide robust frameworks to help banks navigate these challenges effectively.

In a circular dated 11 April 2025, the Hong Kong Monetary Authority (HKMA) announced that the revised SPM CR-G-7 applies to all banks on a proportionate basis. This means that the expectations will be tailored according to the nature, scale, complexity and credit risk profile of each bank’s credit activities and risk mitigation practices.

All banks are required to assess their existing risk management framework to ensure alignment with the updated guidance relevant to their operations. Any necessary enhancements or adjustments must be completed within two years of the issuance of the revision, with a compliance deadline set for 10 April 2027.

Key updates

1 Policy and procedure enhancements under the revised SPM CR-G-7

The revised SPM CR-G-7 introduces several updates, identifying critical areas as below that banks may need to enhance their current policies and procedures, and consider implementing new frameworks to address the new requirements.

- 1

Defined roles and responsibilities for Credit Risk Mitigants (CRM) management

■ Acceptance

■ Release

■ Monitoring

■ Enforcement
- 2

Documented loan-to-value (LTV) ratio, margin level and haircut requirements

■ By collateral type

■ By exposure type
- 3

Concentration risk limit

■ Risk appetite

■ Concentration risk limits
- 4

CRM management

■ Eligibility of CRM

■ Validity of CRM

■ Valuation of collateral

■ Risks of failed or reduced credit protection

■ Release and realization of CRM

- 5

Acceptable CRM types and associated risks

■ Concentration

■ Wrong-way risk

■ Liquidity

■ Volatility

■ Currency mismatch

■ Currency volatility

■ Ease of monitoring

■ Valuation frequency

■ Valuation data used

■ First legal charge

■ Form of collateral documentation

■ Management of documentation

■ Jurisdiction and enforcement process

■ Insurance on physical collateral
- 6

Data collection and system controls

■ Data collection, data governance and data quality management processes for CRM

■ Systems and controls covering newly introduced and revised areas of CRM management
- 7

Independent review requirement

■ Subject to periodic independent review from internal audit function or other independent and qualified personnel

2 LTV ratios, margin levels, haircuts and concentration limit

Enhanced LTV ratio and haircut considerations

The revised SPM CR-G-7 introduces more rigorous requirements for setting LTV ratios and haircuts, requiring that banks explicitly factor in both **market volatility and stressed conditions**. The guidance emphasizes the necessity of **incorporating liquidity risks** associated with collateral, ensuring institutions adequately address the potential impact of sudden declines in collateral value.

Reflection of collateral-related factors in LTV ratios and haircuts

Banks are required to evaluate all costs associated with managing collateral, including assets such as trade receivables and real estate. The updated framework specifies that calculations for haircuts and margins **must incorporate the estimated costs of collection or repossession**.

Multi-dimensional concentration risk framework

The revised SPM CR-G-7 provides a multi-dimensional methodology for managing concentration risk limit, emphasizing comprehensive monitoring **across asset types, guarantee structures**, including indemnities, third-party guarantees, counterparty-guarantee, export credit insurance and mortgage insurance, standby letter of credit and **geographic regions for immovable property**. Banks are required to **assess exposures** not only by underlying asset types but also **by counterparty groups and interrelated industries**, thereby promoting more robust portfolio diversification and mitigating systemic risk concentrations.

3 Enhancements to credit approval and CRM management processes

The revised SPM introduces improvements beyond policy and procedure. These updates are designed to further strengthen the credit approval and CRM management processes for the banks.

Eligibility & validity of CRM

1

- **Collateral:** Require banks to conduct a detailed credit quality review of the issuers, such as for life insurance policies or trade receivables, to ensure ongoing reliability and soundness as collateral.
- **Guarantee:** Where guarantees are used, the banks should verify that the financial institution acting as credit protection provider is subject to robust prudential and regulatory oversight, ensuring the effectiveness and enforceability of the protection.
- **Legal enforceability of CRM:** Require banks to ensure fulfillment of legal requirements or contractual terms associated with the CRM that are necessary to perfect the security interest or credit protection, such as registering guarantees with relevant authorities, including the State Administration of Foreign Exchange in Mainland China for collateral taken.

Key risk reduction measures

2

- **Custody controls:** Regularly inspect and reconcile all physical collateral.
- **Insurance coverage:** Ensure all physical collateral held is insured against damage or loss until it is released.
- **Ongoing CRM quality assessment:** Periodically review and assess the quality of CRM measures.
- **Collateral maintenance requirement:** Maintain adequate monitoring of both borrower exposures and current collateral values, with prompt action on unmet collateral calls.
- **Stress testing:** Conduct stress tests in line with SPM IC-5 "Stress-testing".

Release and realization of CRM

3

- **CRM release controls:** Prior to release CRM, banks should have internal controls to ensure that the following three conditions are satisfied:
 - All contractual release conditions have been fully met.
 - The release has proper authorization.
 - The release is properly executed and documented.
- **CRM substitution:** Banks should ensure that any substitution of CRM instruments is subject to rigorous approval and review processes to prevent gaps in credit protection.
- **Maximum holding period in Banking (Exposure Limits) Rules (BELR):** Banks should ensure timely realization or substitution of CRM.

4 Valuation of collateral

The updated SPM sets out enhanced valuation standards, with a focus on three key areas highlighted below.

Basis of valuation

- Additional considerations for valuing collateral without observable market prices:
 - Climate risk, such as potential damage from weather-related hazards.
 - Liquidity considerations.
 - Risk of obsolescence and deterioration.
- The latest SPM CR-G-7 framework explicitly states that onsite or physical inspection by the appraiser may be required to produce a valuation report that is professionally adequate and suited to its intended purpose.

Selection of appraisers

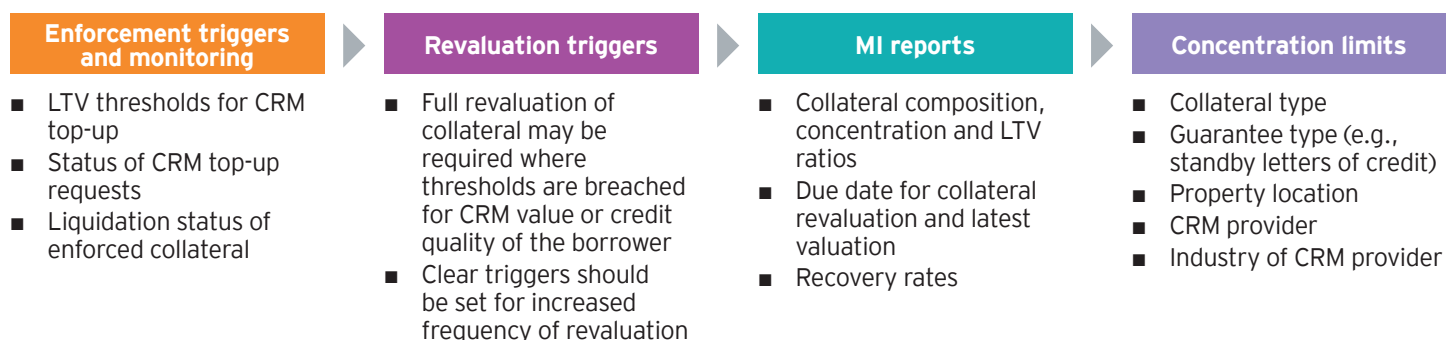
- Additional requirement for external appraisers: The revised SPM CR-G-7 explicitly states that the selection and evaluation of appraisers must be carried out by banks' risk management function, rather than by staff involved in credit or business origination.

Revaluation frequency

- The revised CRM framework requires minimum revaluation frequencies to be established based on the specific collateral type and credit exposure with proper documentation.
- Volatile or problematic exposures must undergo more frequent revaluation, with escalation protocols activated when adverse market conditions arise.

5 Monitoring and management information (MI) impact

Additional monitoring and MI reporting requirements are part of the revision. Relevant, up-to-date and high-quality data is a pre-requisite to achieving the required types of monitoring.



New/Revised	Management report information	Proposed frequency	Purpose
Revised	Breakdown of credit exposures by type of CRM and collateral types and by issuer and credit protection provider	Monthly	<ul style="list-style-type: none"> ■ Identification of concentration risks ■ Stress-testing
New	Analysis of collateral composition, concentration and LTV ratios	Monthly	Formulation of corresponding risk management strategies or follow-up actions
New	Latest collateral valuation and due dates for revaluation	Monthly	Follow-up of collateral valuation
Revised	Credit exposures exceeding maximum LTV ratio	Margin lending: daily Others: monthly	Highlighting facilities requiring top-up of collateral for follow-up actions
Revised	Comparison of latest valuation with actual sale proceeds of collateral	Monthly	Evaluation of the accuracy and validity of the valuation methodology (including any haircut or discount applied to the valuation)
New	Recovery rates	Quarterly	Development of internal loss estimates

6 Internal control implication

Alongside with the implications across various areas, including policies and procedures, credit due diligence, valuation, LTV ratio, margin levels and haircut processes, internal systems and control processes must be up-to-date to align with the latest regulatory requirements.

Periodic review on CRM policies, procedures and limit

- The internal audit and compliance functions of banks should carry out periodic reviews to ensure that the CRM policies, procedures and limits.

Underwriting and credit approval control

- Check documentation completeness and whether approvals follow delegated authority limits.
- Verify whether an adequate legal review has been conducted in CRM arrangement.
- Validate whether regular evaluation are performed on the quality of the CRM obtained.

Credit protection assessment control

- Assess the adequacy of the evaluation process for determining the effectiveness of the provided credit protection.
- Check completeness of documentation and evidence.

Valuation control

- Verify that the valuation methodologies and models used by internal appraisers undergo regular review and validation, at least annually.
- Confirm that all types of collateral and credit exposures are revalued adhering to the minimum frequencies outlined in policies and procedures.
- Ensure that valuation reports are regularly submitted to management review.

Safe custody and access control

- Evaluate whether regular physical inspections of collateral are conducted and CRM-related legal documents are regularly reviewed.
- Ensure regular reconciliation of financial collateral balances maintained by custodians.

Management information system (MIS)

- Evaluate the timeliness, accuracy and completeness of the information produced by MIS for credit risk monitoring, ensuring it aligns with the specified frequency and content.

Potential challenges on banks' collateral and guarantee management

From our experience in credit risk and collateral management projects with various banks in Hong Kong, including D-SIBs, Hong Kong local banks and Chinese banks, we have identified the critical challenges that banks may typically encounter when implementing the revised collateral and guarantee management requirements.

Categories

Key potential challenges

Policy and procedure







- Existing policies and procedures may not incorporate all the new requirements outlined in the revised SPM CR-G-7, requiring comprehensive updates to meet the latest regulatory requirements.
- Implementation challenges due to limited industry benchmarks and standard practices for these new requirements.
- Existing policies and procedures may not incorporate requirements for periodic independent reviews with clearly definition of the roles and responsibilities of all participating departments.

Valuation and LTV ratios, margin levels and haircuts




- Current frameworks may lack consideration of market volatility and liquidity risk factors that are now required for calculating LTV ratios, margins and haircuts under the revised framework.
- Current calculation methodology may be missing considerations of key cost factors such as estimated cost of collection or repossession.
- Existing frameworks may lack defined LTV ratios calculation methods and revaluation methods and revaluation frequencies for different collateral types, which are now mandatory requirements under revised SPM CR-G-7.

Categories	Key potential challenges
Concentration risk limit 	<ul style="list-style-type: none"> ■ Currently may lack a concentration risk limit in its existing policies, or the granularity may not meet the requirements of the latest SPM. ■ Concentration risk limits may not be properly aligned with banks' overall risk appetite frameworks, requiring a comprehensive review and realignment of risk management strategies.
Stress testing 	<ul style="list-style-type: none"> ■ Current stress testing scenarios may fail to adequately capture stressed market conditions, resulting in an inaccurate assessment of the overall impact of adverse changes in CRM values or effectiveness. ■ Current stress testing scenarios may not align with other regulatory requirements, such as SPM IC-5 "Stress-testing".
Data collection and MIS reporting 	<ul style="list-style-type: none"> ■ Existing data may not adequately support the MIS reporting requirements, including issues with data compatibility, reporting scope coverage, data definition clarity, data quality and reporting efficiency. ■ Banks may lack sufficient system capabilities to automate processes, handle large volumes of data efficiently, perform complex CRM-related calculations and generate well-structured MIS reports within a short timeframe.
Internal control oversight 	<ul style="list-style-type: none"> ■ Current internal control frameworks may not adequately cover all the required controls and system controls specified in the revised SPM CR-G-7. ■ There may be unclear roles and responsibilities for internal control.

How can EY help?

Leveraging on our extensive experience working with banks in Hong Kong, we offer a broad comprehensive suite of services to support implementation of revised SPM CR-G-7 requirements. Our services are highly adaptable to align with each bank's specific requirements.

Services	Service description
<div>1</div> <p>Gap analysis</p> 	<p>Conduct a comprehensive gap analysis and provide a report on the identified gaps under the revised CRM framework, along with high-level gap closing recommendations.</p> <p>Policy and procedure:</p> <ul style="list-style-type: none"> ■ Conduct a line-by-line comparison between banks' existing Collateral Policy and relevant guidelines (e.g., LTV assignment guidelines for different business units, underwriting standards and credit approval forms for secured products) and the revised SPM CR-G-7. ■ Specify existing credit approval templates for secured lending that need to be upgraded for more detailed analysis on guarantors and collateral issuers. <p>Execution and documentation:</p> <ul style="list-style-type: none"> ■ Interview departments involved in the CRM management cycle and inspect the assessment documentation on a sample basis. ■ Develop detailed process maps of the current collateral management workflow to visually identify inefficiencies and discrepancies compared to the revised framework. <p>System and data structure:</p> <ul style="list-style-type: none"> ■ Evaluate the current systems used in collateral management to determine if they support the new framework effectively and identify any necessary upgrades or changes.

Services

Service description

2

Valuation and LTV ratios, margin levels and haircuts enrichment



- Assess valuation and credit risk management processes, incorporating methodologies that account for stressed market conditions and climate-related risks.
- Help ensure LTV calculation methodology aligns with updated Basel III requirements, including considerations for undrawn portions of credit facilities.
- Refine LTV assessments to factor in collection and repossession costs, ongoing carrying expenses and asset disposal costs for real estate holdings.
- Compare LTV ratio and haircut practices against industry benchmarks to evaluate competitiveness and regulatory alignment.
- Provide guidance on risk-adjusted approaches for identifying and reviewing these ratios.

3

CRM management process enhancement



Provide implementation facilitation to close the gaps identified in the gap analysis, including:

- Design detailed Standard Operating Procedures (SOPs) for collateral management processes that align with the revised guidelines, helping ensure consistency and clarity in execution.
- Revise the existing credit approval forms to help ensure that necessary information is collected at the time of CRM acceptance.
- Design necessary checklists, scorecards and questionnaires to supplement insufficient assessments.
- Assist in upgrading existing systems to streamline collateral management operations (e.g., prepare user requirements) and help ensure compliance with the revised framework.
- Provide customized training to staff involved in the CRM management cycle to help ensure they are equipped to implement the revised guidelines effectively.

4

Data collection and MIS reporting review



- Review the data quality to ensure that all essential CRM data is captured in MIS for the timely generation of management reports with accurate and comprehensive information, and to identify potential system improvements.
- Facilitate data cleansing to enhance the data quality, if necessary.
- Provide system enhancement suggestion to help ensure compliance with the latest revised SPM framework requirements for management reporting, including capabilities for analyzing collateral composition, concentration and LTV ratios, as well as evaluating recovery rate quality.
- Enhance the calculation methodologies and provide visualized solutions for the management reporting.

5

Internal process review



- Perform an internal control review for the various departments involved in the CRM management process, revaluation process and periodic review process to help ensure proper maintenance of documentation and to strengthen compliance with the revised SPM CR-G-7 framework.
- Support the update of stress testing scenarios in alignment with the revised SPM CR-G-7 framework.

6

Independent review



- Perform an independent review to assess the level of compliance with the revised SPM CR-G-7 after enhancement, by assessing whether policies and procedures have been updated with sufficient detail to reflect the latest requirements and whether the enhanced operational procedures are effective in fulfilling the latest requirements.

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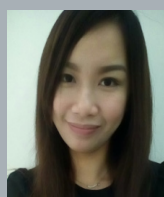
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