



Hong Kong

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CHARLTONS EMPHASISES HONG KONG'S "SUPER CONNECTOR" ROLE AT THE BELT AND ROAD FORUM IN CHENGDU

Introduction

On 29 July 2017, the 'Belt and Road Forum' took place in Chengdu, China. The forum was jointly organised by Charltons and Grandall Law Firm from the PRC. In her speech to the forum, Charltons' managing partner, Julia Charlton, emphasised how Hong Kong is expected to play a "super-connector" role in many of cross-border projects developed under the Belt and Road initiative.

Ms. Charlton said she believes that Hong Kong is the ideal location to raise funds for Belt and Road investment projects, and facilitate connections between project developers, investors and service providers. In addition to being a major capital raising and financing centre, Hong Kong is home to professionals with expertise in infrastructure development and cross-border transactions, and has an internationally recognised independent legal system, meaning it is well-equipped to act as the bridge between Chinese enterprises and companies and projects in Belt and Road participant countries.

Speech

China's Belt and Road initiative aims to promote infrastructure development in 69 countries, which taken together account for approximately 4.4 billion people or 65% of the world's population. The Belt and Road initiative is likely to have a

profound influence on the economic activity and capital flows in participant countries and could lead to a reconfiguration of political and economic power throughout Asia.

So what is Hong Kong's role in the initiative?

Hong Kong's position is unique: it is an inalienable part of China, but under the "One Country Two Systems" framework it retains its own legal system with control over its economic and financial affairs. Hong Kong's lack of restrictions on capital flow and currency convertibility and simple low tax regime allow it to play a key role in facilitating investment under the Belt and Road initiative.

Hong Kong has a number of other advantages as a centre for raising capital for Belt and Road initiative-related projects. Geographically, Hong Kong is located at the mouth of the Pearl River Delta Region in the southern part of China, standing on the major trade routes that run through Asia. In terms of its cultural advantage, Hong Kong is a cultural centre populated by many different nationalities and persons speaking a number of different languages. To succeed, the Belt and Road initiative will ultimately require will require a degree of cultural as well as economic connectivity.

The key areas in which Hong Kong can facilitate Belt and Road projects are:

- The provision of professional financial services;
- Hong Kong's common law system;

- Capital raising for companies involved in Belt and Road projects; and
- Chinese Government's policy in supporting Hong Kong's participation in the Belt and Road development.

Leading Financial Centre

Hong Kong has become China's most international city and one of the world's leading international financial centres along with London and New York. In 2016, more funds in initial public offerings were raised on the Hong Kong Stock Exchange (**the Stock Exchange**) than on any other exchange worldwide¹.

Hong Kong is the world's largest centre outside Mainland China for issuing debt denominated in renminbi (**RMB**). It is also well positioned as the primary offshore RMB debt centre for infrastructure investments, which include structured debt and infrastructure bonds. Hong Kong is therefore in a position to serve as a "super-connector" between Mainland China and the rest of the world, and to help to bring together the strengths of Belt and Road economies. Hong Kong is therefore in a position to serve as a "super-connector" between Mainland China and the rest of the world, and to help to bring together the strengths of Belt and Road economies.

Hong Kong Law and Legal System

Hong Kong's internationally recognised legal system based on English common law has made it a very attractive jurisdiction for Mainland companies to raise funds and a location for international companies to structure investments in China.

A large number of infrastructure and financing contracts between parties from different parts of the world are being entered into under the Belt and Road initiative. With its trusted legal system, Hong Kong law is an obvious choice for the governing law for the projects being developed under Belt and Road initiatives. Hong Kong also has a key role to play from a dispute resolution and arbitration perspective.

The Belt and Road Initiative involves multilateral negotiations between Mainland Chinese and foreign enterprises. Hong Kong lawyers, many of whom are fluent in Chinese as well as English and other foreign languages, are experienced in serving multi-jurisdictional clients in complex cross-border

matters. The Hong Kong legal profession is therefore well placed to assist in the structuring of investment projects under the Belt and Road initiative.

Hong Kong as a Capital Raising Centre

A huge amount of capital will be needed for the Belt and Road initiative.

In addition to the Chinese government's promise that its public banks will take the lead in underwriting projects, the scale of the Belt and Road initiative offers plenty of opportunities for private financing. The Asian Development Bank has estimated an annual funding shortfall for Asian infrastructure projects of US\$750 billion through 2020.

As one of the world's leading financial centres, Hong Kong can play a leading role in fundraising that will be required for the Belt and Road initiative. A key Hong Kong initiative aimed at this was the establishment of the Infrastructure Financing Facilitation Office (**IFFO**).

Established in July 2016 by the Hong Kong Monetary Authority (**HKMA**), the IFFO is not an investor per se, but instead provides a platform that enables interested partners to collaborate in identifying infrastructure investment and their financing opportunities. The IFFO will identify any impediments to attracting infrastructure investments and their financing. Where appropriate, it will recommend ways to address these issues to help make relevant projects more feasible.

In December 2016, the HKMA also signed a Memorandum of Understanding with the Export-Import Bank of China and the China Development Bank Corporation establishing a strategic framework for co-operation on facilitating the financing of infrastructure projects via the IFFO platform. As of July 2017, the IFFO has more than 60 partners, including development banks, public sector investors and private sector investors including, banks, insurers, asset managers, project developers and professional service providers.

Apart from the IFFO, Hong Kong also offers world-class fund-raising opportunities for infrastructure companies. Infrastructure companies can raise capital by listing on the Hong Kong Stock Exchange

In 2016, amount of US\$24.8 billion was raised through initial public offerings on the Hong Kong Stock Exchange more than

¹ <https://www.charltonslaw.com/hong-kong-is-worlds-top-ipo-fundraising-market-in-2016-while-listed-debt-turnover-rises-126-percent-on-2015/>

any other stock exchange worldwide.² The depth of liquidity in the Hong Kong market as well as analyst expertise in the China market is one of the principle attractions of Hong Kong for Mainland Chinese companies looking to list offshore. Hong Kong has been home to some of the world's largest IPOs by Mainland companies – the Postal Savings Bank of China, for example, raised approximately US\$7.4 billion in its September 2016, and was the world's largest IPO since Alibaba Group Holding's listed on the New York Stock Exchange in 2014.

Mainland-Hong Kong Stock and Bond Connect Schemes

A major initiative of the Mainland and Hong Kong market regulators over the last two years has been the setting-up of channels for Mainland Chinese investors to invest in the Hong Kong market and for Hong Kong and international investors to invest in the Mainland market through Hong Kong.

In November 2014, the *Shanghai-Hong Kong Stock Connect* was launched³. For the very first time Hong Kong and international investors gained direct trading access to Shanghai-listed shares, while Mainland Chinese investors gained direct access to Hong Kong-listed shares.

This was followed by the launch of *Shenzhen-Hong Kong Stock Connect*⁴ on 5th December 2016. *Shenzhen-Hong Kong Stock Connect* provides mutual market access allowing Hong Kong and international investors to make northbound investments in certain stocks listed on the Shenzhen Stock Exchange and mainland investors to invest southbound in stocks listed in Hong Kong through the Shenzhen Stock Exchange.

More recently, in July 2017, *Bond Connect*⁵ was launched, enabling Hong Kong and international investors to invest in the China Interbank Bond Market (**CIBM**) and Mainland investors to invest in the Hong Kong bond market. Currently, only northbound trading is allowed. According to the HKMA and People's Bank of China, southbound trading will be explored in due course.

The Hong Kong and Mainland regulators propose to extend

mutual market access arrangements between Hong Kong and the Mainland markets to cover other products, such as Exchange Traded Funds (**ETFs**). There are also plans to launch "Primary Equity Connect", a scheme which would allow investors to subscribe for IPO shares through the Stock Connect schemes.

Listing on the Stock Exchange

The Stock Exchange currently operates two markets, namely the Main Board and the Growth Enterprise Market (**GEM**). The Main Board caters for companies with a profitable operating track record or that are able to meet alternative financial standards. GEM, on the other hand, caters for smaller growth companies and has lower admission criteria. Currently, GEM acts as a stepping stone to Main Board listing and provides a streamlined procedure for transfer to the Main Board once a company meets the Main Board admission criteria. At the moment, the Stock Exchange is conducting a public consultation⁶ on fine tuning the Main Board and GEM listing rules to better meet current market conditions.

Post-Listing Fundraising

A major advantage of a Hong Kong listing is the ease with which further funds can be raised after a successful listing. In 2016, companies listed on the Stock Exchange's Main Board raised HK\$145.9 billion through share placings and HK\$45.8 billion via rights issues. Top-up-placings provides a very convenient method of fundraising for listed companies. There is no requirement for an offering document. If the number of shares involved is within the company's existing mandate to issue new shares, there is no need for shareholders' approval. The fundraising can therefore be completed quickly and conveniently.

A New Third Board

There have been calls for the establishment of a new third board in Hong Kong to attract more tech-company listings in Hong Kong. In 2014, Hong Kong missed out on the listing of Chinese tech giant Alibaba Group because its management structure was considered to be in breach of Hong Kong's "one share one vote" principle.

2 Source: HKEx Market Statistics 2016 <https://www.hkex.com.hk/eng/newsconsul/hkexnews/2016/Documents/1612202news.pdf>

3 <https://www.charltonslaw.com/hong-kong-law/shanghai-hong-kong-stock-connect/>

4 <https://www.charltonslaw.com/shenzhen-hong-kong-stock-connect-to-launch-on-5-december-2016/>

5 <https://www.charltonslaw.com/mainland-hong-kong-bond-market-connect-to-be-established/>

6 <https://www.charltonslaw.com/changes-to-the-gem-rules-and-main-board-rules-proposed-by-the-hkex/>

This June 2017, the Stock Exchange published its New Board Consultation Paper⁷ setting out its proposals for the establishment of a New Board for New Economy Companies, separate from the Main Board and the GEM, which would permit companies with weighted voting rights to list in Hong Kong. Pre-profit companies would be allowed to list. Mainland Chinese companies that wish to list on the Stock Exchange as a secondary listing venue would also be allowed to list.

The Stock Exchange provides companies involved in the Belt and Road initiative with a number of fund raising alternatives, including an IPO on the Main Board, GEM or proposed New Board as well as the prospect of future fund raisings via placings and/or rights issues.

Commodities

In 2012, the Stock Exchange has acquired the London Metal Exchange (LME) the world's largest market in metals futures contracts.

According to its 2016-18 Strategic Goals, the Stock Exchange plans to extend its existing global price benchmarks in commodities acquired through the LME, and attract international and Mainland investors to those products. Hong Kong also aims to become the Asian Gold Pricing Centre, and on 10 July 2017 Offshore RMB and US dollar Gold Futures were launched on the Stock Exchange to strong debuts.

Fixed Income and Currency

The Belt and Road Initiative will further drive the internationalisation of the RMB which will in turn encourage greater cross-border investment. The Stock Exchange's 2016-18 Strategic Goals include the establishment of a 'Bond Connect' scheme to facilitate cross-border capital flows in the underlying RMB cash bond market. Northbound trading under the Bond Connect scheme commenced in July 2017.

Hong Kong's Debt Market

Hong Kong has an active and liquid private sector bond market. In 2016, Hong Kong dollar-denominated bonds raised a total of US\$21.4 billion, an increase of some 74% on 2015 and the highest amount raised since 2007. The dim sum market (the issue of renminbi-denominated bonds in Hong Kong) dropped to 146.8 billion RMB in 2016, down 17.6% from 2015, due

largely to the devaluation of the RMB against the US dollar. Hong Kong nevertheless remains an important market for the issue of renminbi-denominated debt.

The recently launched Bond Connect scheme enables direct access to onshore renminbi-denominated bonds through Hong Kong. This scheme provides cross-border bond trading and settlement connectivity with Mainland China's major onshore bond market infrastructures. Notably, there are no investment quotas for northbound trading.

Hong Kong is the premier offshore RMB centre and has the largest pool of RMB outside Mainland China. It is therefore in a prime position for fund raising denominated in RMB.

Asset Management

Hong Kong is Asia's premier asset management centre and these funds also provide a source of finance for companies looking to raise capital. Particularly noteworthy is the Mutual Recognition of Funds Scheme⁸ established between Hong Kong and Mainland China which enables Hong Kong domiciled funds that have been authorised by the Hong Kong authorities for retail distribution to be sold in Mainland China under a lighter regulatory approval process (and vice versa for Mainland authorised funds).

Hong Kong's Involvement in the Belt and Road Initiative to Date

To date Hong Kong has proved to be the most popular offshore centre in respect to the provision of professional services to Belt and Road projects, accounting for approximately 50% of all professional services provided.⁹

Hong Kong businesses are heavily involved in the Belt and Road initiative: projects announced in the Mainland include partnerships with Hong Kong companies, such as Hutchison Ports¹⁰, and Hong Kong-listed subsidiaries of Mainland companies, such as COSCO Shipping Ports.¹¹

⁷ <https://www.charltonslaw.com/hkex-consults-on-proposed-new-board-for-new-economy-companies/>

⁸ <https://www.charltonslaw.com/hong-kong-law/mainland-hong-kong-mutual-recognition-of-funds-initiative-hong-kong-distribution-opportunities-for-china-funds/>

⁹ <http://economists-pick-research.hktdc.com/business-news/article/Research-Articles/Chinese-Enterprises-Capturing-Belt-and-Road-Opportunities-via-Hong-Kong-Findings-of-Surveys-in-South-China/rp/en/11X000000/1X0A87HY.htm>

¹⁰ <http://www.scmp.com/business/companies/article/2093995/hutchison-ports-sails-winds-belt-and-road-initiative>

¹¹ <http://www.reuters.com/article/us-china-silkroad-cosco-idUSKCN18A0KP>

In May 2017, Mass Transit Railway (**MTR**) Corporation announced that it will collaborate with partners in Mainland China to explore Belt and Road-related opportunities¹². MTR's shares immediately rose on the news.¹³

Super-Connector

As an international financial centre with strong support from Mainland China and from the international community, Hong Kong is ideally positioned to manage Belt and Road related investment projects and to act as a connector between investment projects, investors and service providers. Hong Kong's fund-raising and financing capabilities, expertise in infrastructure development and independent legal system mean that Hong Kong can help build a bridge between Mainland China and other countries participating in Belt and Road initiative.

¹² <http://www.scmp.com/news/hong-kong/economy/article/2094370/hong-kongs-mtr-corp-plans-joint-bid-mainland-rail-giant-build>

¹³ <http://quotes.wsj.com/HK/0066>

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