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**Subcommittee on proposed resolution
under section 3(1) of the Loans Ordinance**

Background brief

Purpose

This paper sets out the background of the proposed resolution to authorize the Government to borrow by way of securitizing Government revenue receivable from tolls on bridges and tunnels, and summarizes the major concerns raised by Members at the meeting of the Panel on Financial Affairs (FA Panel) held on 5 January 2004.

Background

2. The Government announced in the 2003-04 Budget its intention to dispose of or securitize \$112 billion of assets in the next five financial years and set a target to raise an estimate of \$21 billion in 2003-04. On 17 December 2003, the Secretary for Financial Services and the Treasury (SFST) gave notice that he would, at the Council meeting on 14 January 2004, move a resolution under section 3(1) of the Loans Ordinance (Cap. 61) to authorize the Government to securitize its revenue from tolls on bridges and tunnels. A LegCo Brief on the proposed securitization exercise and the proposed resolution was issued to all Members on the same day. The FA Panel was briefed on the proposal on 5 January 2004.

3. In response to some drafting issues raised by the Legal Service Division (LSD) of the Legislative Council (LegCo) Secretariat, SFST obtained the President's permission on 7 January 2004 to replace the original resolution with a modified one. LSD was satisfied that the legal effect of the modified version was substantially the same as that of the original one and that it had addressed the relevant drafting issues. The modified version was attached to the LSD Report (LC Paper No. LS 28/03-04) issued on 8 January 2004.

4. At the House Committee meeting on 9 January 2004, Members agreed that a subcommittee should be formed to study the proposed resolution. The Administration then withdrew the notice given for moving the proposed resolution at the Council meeting on 14 January 2004.

Proposed securitization exercise

5. The proposed securitization structure and indicative terms are illustrated in *Annex B to the LegCo Brief*. They are subject to refinement after the Administration have engaged the arrangers for the execution of the transaction and after its discussion with regulatory authorities and credit rating agencies during the next few months. In brief, the Government would issue, through a wholly-owned special purpose issuer (the Issuer), notes or other financial instruments (the Notes) backed exclusively by future revenue, over a limited period, from Aberdeen Tunnel, Cross-Harbour Tunnel, Lantau Link (comprising Tsing Ma Bridge, Ma Wan Viaduct and Kap Shui Mun Bridge), Lion Rock Tunnel, Shing Mun Tunnels, and Tseung Kwan O Tunnel. The indicative average maturity for different tranches of the Notes will be eight to nine years. Such Notes will entitle the investors to be paid annual or other periodic sums serviced from net revenue derived from the operation of the above toll bridges and tunnels. The Government will retain ownership of the above bridges and tunnels, and all of the Government's right to the revenue from the bridges and tunnels will fully revert to the Government at the end of the securitization period.

6. As the Government will not guarantee the return to investors and the traffic volume of the toll bridges and tunnels, the Administration anticipates that arrangers and ultimately investors of the Notes may require the Government to disclose relevant information and provide certain undertakings in areas such as operations and transport policy. Key areas in respect of which the Administration might consider giving commitments to investors are set out in *paragraph 7(a) to (f) and Annex C to the LegCo Brief*. These include transport policy, toll adjustment risk, possible payment items by the Government, and insurance arrangements. These issues will be finalized by the Administration after the details of the offer structure have been confirmed and discussion with regulatory authorities and credit rating agencies has been completed.

7. Subject to market conditions and the final structure and tenor to be agreed with the arrangers, the Administration expects that the proposed securitization will bring in one-off capital revenue of up to \$6 billion.

Major concerns raised by Members

8. At the FA Panel meeting on 5 January 2004, Members have generally indicated their support for the policy objectives of the proposed resolution. They have however expressed concern over the following issues:

- (a) lack of details of the proposed securitization exercise provided by the Administration, such as estimated costs, structure and target investors of the exercise, interest rates of the Notes, recourse obligations of the Government;

- (b) whether it is appropriate to include Lantau Link in the proposed securitization exercise given that it is still at the early stage of its economic life and is not generating much revenue;
- (c) whether the proposal to provide the Government with an option to exclude Cross-Harbour Tunnel from the securitization structure after the first five years of issuance of the Notes through early redemption would undermine the attractiveness of the Notes to investors;
- (d) whether it is necessary for the Government to provide direct payments to the Issuer in respect of business interruption events due to force majeure, given that events like terrorist attacks are beyond the Government's control;
- (e) whether it is appropriate for the Government to compensate investors of the Notes for a reduction in toll revenues arising from adjustment in toll rates in future;
- (f) whether the possible need for the Government to provide undertakings to investors in respect of transport policy insofar as it may affect the traffic flow of the bridges and tunnels concerned would restrain the Government's power in formulating transport policy;
- (g) whether the proceeds raised from the proposed securitization exercise would also be used to meet Government's recurrent expenditure;
- (h) whether similar securitization exercises in other jurisdictions have been successful; and
- (i) whether the issuance of bonds is a viable alternative to the proposed securitization exercise.

9. After the FA Panel meeting, Mr Henry WU wrote to SFST on 6 January 2004 (LC Paper No. CB(1)727/03-04(01)), requesting the Administration to provide more detailed information about the proposed securitization exercise.

10. The Administration's responses to the major concerns expressed by Members at the FA Panel meeting and to Mr Henry WU's letter were circulated to all Members vide LC Paper No. CB(1)717/03-04(01) on 6 January 2004 and LC Paper No. CB(1)735/03-04(01) on 8 January 2004.