

**For discussion
on 4 February 2005**

**Legislative Council Panel on
Information Technology and Broadcasting**

Review of the Film Guarantee Fund

Purpose

This paper seeks Members' endorsement of the proposal for continuing the operation of the Film Guarantee Fund (FGF), which will expire on 31 March 2005, and the revival of a funding scheme to finance projects conducive to the long-term development of the film industry.

Proposal

2. We recommend that:
 - (a) the FGF scheme, with a reduced commitment from \$50 million to \$30 million, be continued with a minor modification to the eligibility criteria as explained in paragraph 9 below; and
 - (b) the \$20 million arising from the reduced commitment in (a) be used to create a commitment to finance projects conducive to the long-term development of the film industry such as technical training and investment in post-production infrastructure.

Justifications

Review of the FGF

3. The Government established the Film Development Fund

(FDF) in April 1999 with a commitment of \$100 million to finance projects which would benefit the long-term development of the Hong Kong film industry. Recognizing that the film industry had difficulties in obtaining loans from lending institutions to finance film productions and there was then an uncommitted balance of \$59.3 million in the FDF, the Finance Committee approved in January 2003 the redeployment of \$50 million from the FDF to launch the FGF on a pilot basis for two years, from 1 April 2003 to 31 March 2005. The Administration undertook to review the operation of the FGF eighteen months after it has come into operation.

4. The FGF, administered by the Film Services Office of the Television and Entertainment Licensing Authority, facilitates access to film financing provided by Participating Lending Institutions (PLIs) through the provision of a loan guarantee of a maximum of \$2.625 million per film from the Fund. The FGF operates on a revolving basis, i.e., once discharged by the PLI, the guarantee will be ploughed back to the FGF for guaranteeing other successful applications. Details of the FGF are at **Annex A**.

A

5. Up to 31 December 2004, the FGF has received and approved a total of seven applications. Of these seven approved projects, one eventually secured alternative source of funding and did not take out the loan from the PLI. For the other six films, a total commitment of \$14.165 million, as loan guarantees, were provided by the FGF. Details of the six guaranteed films are at **Annex B**.

B

6. We have reviewed the operation of the FGF in consultation with the PLIs, the film industry and the Film Services Advisory Committee (FSAC)¹. The PLIs agree that the FGF scheme has encouraged them to explore business in film financing. They would however remain cautious in approving loans for filmmaking due to the relatively high risk involved. The film industry and the FSAC generally support the continuation of the Fund because it has proved to be effective in facilitating access to film financing. Their feedback is summarized below:

¹ The FSAC comprises representatives from different sectors of the film industry and advises the Secretary for Commerce, Industry and Technology on measures to support the development of the film industry.

- (a) securing a reduced commitment of \$30 million for the continuation of FGF will suffice while the remaining \$20 million could be redeployed for the revival of a funding scheme similar to FDF to finance projects conducive to the long-term development of the film industry;
- (b) raising the guarantee ceiling of \$2.625 million per film to \$3 million to over \$5 million;
- (c) relaxing the track record requirement that the applicant has produced at least three films from 1992 to 2001 for commercial theatrical release in Hong Kong; and
- (d) relaxing the requirement for the submission of a completion bond to secure completion of the guaranteed film because it is a financial barrier to access to the FGF.

Assessment

Continuation of FGF

7. Film financing is relatively weak in Hong Kong. Local lending institutions have been hesitant to provide finance for filmmaking due to the lack of exposure to this field. The FGF has proved to be a successful breakthrough for encouraging lending institutions to engage in film financing. We therefore consider that the FGF should continue to keep the momentum of developing film financing infrastructure.

8. We do not propose to increase the guarantee ceiling of \$2.625 million per film. The ceiling amount is set according to the principles that the film production company shall bear at least 30% of the budget and the Fund will provide a guarantee of 50% of a maximum loan amount of \$5.25 million. We consider that the existing risk-sharing ratio and the Fund's maximum exposure to an individual film are appropriate. With a reduced commitment of \$30 million, maintaining the ceiling means the Fund can guarantee at least 11 films at any one time. Raising the ceiling

would reduce the maximum number of films that may benefit from the FGF at any one time.

9. We agree that the existing track record requirement is too demanding. Having regard to the decreasing number of Hong Kong films produced in the past three years, with only 297 films released from 2001 to 2003 (compared with a total of 234 films released in 1993), we propose a relaxation of the requirement, so that any applicant who has produced at least two films in the past ten years for commercial theatrical release in Hong Kong before applying for guarantee under the FGF will be eligible.

10. The submission of a completion bond² is not a mandatory means to fulfill the requirement for making arrangements to ensure completion of the guaranteed film. Engaging an independent agent to monitor the film production and, in case of default, to either take over and complete the film project or repay the outstanding loan to the PLI would also be acceptable to the PLIs. We will publicize this alternative for the reference of the film industry.

Revival of a Funding Scheme

11. We agree that the revival of a direct funding scheme, with a commitment of \$20 million, similar to the FDF will be beneficial to the long-term development of the film industry at a time when it is facing new challenges such as competition from films produced in the Mainland and other Asian countries, increasing availability of new home entertainment options, and the trend of sophisticated application of computerized audio-visual special effects in post production to enhance the appeal of films to moviegoers. To compete with other rising film production centres in the region and capture new market opportunities arising from the implementation of the Closer Economic Partnership Arrangement, there is a need to assist the industry in investing in state-of-the-art post-production facilities to maintain its competitiveness. We also need to raise the production personnel's technical skills through training to ensure their mastery of advanced computerized audio-visual technology.

2 When a completion bond is secured, the PLI will require the involvement of the completion bond company to assess the loan application, oversee the progress of film production and ensure that the project will not deviate from its pre-set budget. Hence, the PLI can insure against any loss caused by delay, non-completion or other contingencies.

12. A Project Vetting Committee, comprising members of the film industry, chaired by the Permanent Secretary for Commerce, Industry and Technology will be formed to vet and approve applications. Successful applicants are required to submit reports and audited accounts upon completion of their projects for the Committee's consideration. Eligible projects are those that meet any of the following objectives, same as those for the FDF :

- (a) to enhance the professional and technological capabilities of the local film industry;
- (b) to improve the professional skills of the industry's workforce;
- (c) to encourage the production of more creative and diversified films;
- (d) to facilitate the industry in the mastering and application of advanced technology so as to enhance the audio and visual effects of films;
- (e) to stimulate further improvement in the quality of local film production and services; and
- (f) to improve the production and operating environment of the industry.

13. A brief description of the FDF and projects approved under the scheme are at **Annex C**.

C

Way Forward

14. Subject to the views of the Members, we will seek Finance Committee's approval at its meeting on 4 March 2005 to implement the proposal in paragraph 2 above.

**Communications and Technology Branch
Commerce, Industry and Technology Bureau
February 2005**

Mode of Operation of the FGF

(A) Eligibility

Only film production companies which are registered in Hong Kong and credit-worthy (i.e. with no bad loan within the past 12 months) are eligible for applying for a loan guarantee under the FGF. Moreover, at least 50% of the major cast and film crew¹ of the film production must be Hong Kong permanent residents and the film has to be a feature film for commercial theatrical release in Hong Kong.

2. In order to ensure that the film under guarantee will be up to a standard for commercial theatrical release -
 - (a) the eligible film production companies must have produced at least three films from 1992 to 2001 for commercial theatrical release in Hong Kong; or
 - (b) in case of a newly formed company with no track record, it will be eligible if the producer or the director of the film in question has produced or directed at least three films from 1992 to 2001 for commercial theatrical release in Hong Kong.

Such requirement in track record gives confidence to local banks for providing loan to support film productions under this loan guarantee scheme. With the flexibility allowed, new talent in the film industry can link up with more experienced partners to benefit under the scheme.

3. No single entity may at any time receive loan guarantee for more than one of its films. For this purpose two entities are treated as the same if they involve the same production company, or producer, or film director. In the case of a director of a film also acting as the producer of another film, the two combinations will be treated as the same entity. This seeks to enable the scheme to benefit as many film production companies, producers and directors as possible.

¹ Major cast and film crew refer to the following ten categories: (i) film director; (ii) screenwriter; (iii) leading actor; (iv) leading actress; (v) supporting actor; (vi) supporting actress; (vii) producer; (viii) cinematographer; (ix) film editor; and (x) art director.

4. Moreover, the film production company also has to declare on application as to whether it has any bad loan. To avoid possible conflict of interest, the film production company cannot be a related company of the PLI or of the company engaged to provide the film completion arrangement.

(B) Conditions of Loan Guarantee

5. As a large majority of local films produced in the past have a film production budget of not more than \$7.5 million, we use this amount as the reference for determining the maximum amount of loan guarantee to be provided by the FGF for each film project, i.e. for films with budget at or below \$7.5 million, we will use the budget to work out the loan guarantee; for films with budget above \$7.5 million, we will use \$7.5 million to work out the loan guarantee. This will on the one hand ensure that the FGF will not be over-exposed to large budget productions which may result in smaller productions having fewer opportunities to benefit from the scheme, while on the other hand large budget productions (which can encourage more completion bond companies to take part in the scheme) will not be excluded. There is thus flexibility to benefit film productions of different scale, but an absolute limit is maintained on the loan guarantee for each film. The budget submitted by the film production company in its application to the PLI should include all costs of production, promotion, distribution, printing of copies, and engagement of completion arrangement. However, the budget should not include any sponsorship secured.

6. Loan guarantee will be provided by the FGF on the following conditions -

- (a) the film production company must have secured an in-principle approval of loan from a PLI;
- (b) for film budget at \$7.5 million or below, the film production company has to bear at least 30% of the budget and the PLI provides a loan of not more than 70% of the budget. The FGF will provide a 50% (i.e. the risk-sharing ratio between the Fund and the PLI) guarantee to a maximum of \$5.25 million out of the loan provided by the PLI. In other words, the maximum loan guarantee for each film will be 35% of the budget, or \$2.625 million, whichever is the less;
- (c) for film budget exceeding \$7.5 million, the film production company has to bear at least 30% of \$7.5 million of the budget in the first instance (in addition to any amount on top of the \$7.5 million which the film production company has to prove that it has the means to provide it). The FGF will provide a 50% (i.e. the risk-sharing ratio between the Fund and the PLI) guarantee to a maximum of

\$5.25 million out of the loan provided by the PLI. In other words, the maximum loan guarantee for each film will be \$2.625 million; and

- (d) the film production company must have secured a film completion arrangement for the film prior to applying for the loan guarantee. The film production company bears the cost of the film completion arrangement and this cost may be included in the budget.

7. Applications for the loan guarantee will be submitted to the FGF through the PLIs and will be considered on a first-come-first-serve basis. The loan provided by PLI can only be used wholly and exclusively for the film project, through the operation of a separate account or sub-account in the PLI. Such requirements will be stipulated in the contractual documents to be signed between the film production companies and the PLIs.

(C) *Film Completion Arrangement*

8. As a means of risk management against non-completion, it is necessary for the film production company to satisfy the PLI concerned that sufficient arrangement has been made to ensure completion of the film project. It would be an acceptable arrangement for the film production company to engage an independent agent to monitor the progress of production of the proposed film on behalf of the PLI concerned. The agent should take over the production in case of cost overrun, non-completion, or if the production deviates from the implementation plan. The agent should also underwrite the risks of non-completion.

(D) *Roles of the PLIs*

9. All authorised institutions under the Banking Ordinance (Cap. 155) are eligible for participation as PLIs in the scheme. The participation is entirely on a voluntary basis. Eight financial institutions have participated as PLIs. The list of PLIs is in Appendix. The responsibilities of a PLI are -

- (a) to verify that an application made under the scheme satisfies all eligibility requirements as set out in paragraphs 1 to 4 above;
- (b) to exercise prudent professional judgment and due diligence in assessing an application based on the financial soundness and the commercial viability of the business proposal;
- (c) to seek the FGF's agreement of providing guarantee under the scheme to the loan it approved in principle;

- (d) to establish and maintain a separate account or sub-account for the exclusive purpose of handling all loan payment to and repayment from the film production company; and
- (e) to exercise due diligence in securing repayment of the loan from the film production company; and in case of default, to provide justification and documentary proof for demonstrating to the FGF that proper due diligence and prudent professional judgment have been exercised in approving the loan and in securing repayment before a call is to be made to the FGF on the loan guarantee.

(E) Interest

10. The interest rate of the loan is a commercial issue to be decided between the film production company and the PLI concerned. The FGF will not be involved in the process.

(F) Form of Loan Guarantee

11. After the loan guarantee is approved by the FGF, agreements amongst the film production company, the PLI offering the loan and the FGF will be signed, setting out the rights and obligations of each party as well as the relevant arrangements and requirements.

12. The loan guarantee may be offered for a term loan or a new credit line for a maximum period of two years, counting from the date when the facility is made available to the film production company. Under normal circumstances, a loan guarantee provided by the FGF will have to be activated within 90 days from the date of approval of the guarantee.

(G) Default

13. If a film production company fails to repay the principal of the loan 60 days after the payment due date, the PLI concerned may deem a default case constituted. In case of default, any amount eventually recovered from the film and the film production company, less the administrative cost² incurred, will be shared between the FGF and the PLI according to the risk-sharing ratio. The FGF will share the administrative costs incurred by the PLI in securing repayment of the loan according to the risk-sharing ratio, subject to the amount as guaranteed by the FGF.

² Administrative costs incurred by the PLI do not include any bank interest arising from the loan nor will bank interest be counted as part of the outstanding loan.

14. The PLI has to provide all evidence and justifications to the FGF in calling the guarantee. Upon completion of the verification process, the FGF will release the guarantee to the PLI. The amount of guarantee to be released will be determined by the amount of outstanding principal re-payment and the risk-sharing ratio between the FGF and the PLI.

(H) *Theme or Content*

15. Loan guarantee will be provided if all criteria set out in paragraphs 1 to 6 above are met. The FGF will not look into the theme or content of the film which will eventually have to be classified under the three-tier film classification system before exhibition in Hong Kong is approved.

(I) *Professional Advice*

16. To enhance the understanding of local banks about the film production process so as to increase their confidence in film financing and to provide professional advice to banks in the assessment of loan applications in areas such as film budget, production arrangements, overseas distribution agreements, etc., a list of advisors or organizations that can offer professional advice and consultancy in these areas has been drawn up by the film industry. The PLIs may on their own discretion approach the individuals or organizations on the list to seek their professional advice, with fees to be charged on mutual agreement basis. The Government would not be involved in the advisory process.

FGF - List of Participating Lending Institutions (PLIs)

Licensed Banks

Hong Kong and Shanghai Banking Corporation

Bank of East Asia

Dah Sing Bank

Liu Chong Hing Bank Limited

Citic Ka Wah Bank

Bank of China (Hong Kong)

DBS Bank

Restricted Licensed Banks and Deposits-taking Companies

HKCB Finance Limited*

* HKCB Finance Limited is a subsidiary of Citic Ka Wah Bank

Annex B

**Projects approved by
the Film Guarantee Fund
(From April 2003 to December 2004)**

<u>Name of Film and Production Company</u>	<u>Production Budget</u>	<u>Amount of Guarantee</u>	<u>Date of Approval</u>	<u>PLI involved</u>
Shaolin vs Evil Dead My Way Film Co Ltd	\$5.84M	\$1.250M	20.8.2003	HKCB Finance
Dating Death Mandarin Films Ltd	\$6.90M	\$2.415M	21.10.2003	HKCB Finance
A1 Panorama Distributions Co Ltd	\$9.96M	\$2.625M	29.12.2003	HKCB Finance
Love Battlefield Brilliant Idea Group Ltd	\$8.40M	\$2.625M	27.2.2004	HSBC
The Battlefield Jing's Production Ltd	\$13.03M	\$2.625M	23.8.2004	HKCB Finance
Himalaya Singh One Hundred Years of Film Co Ltd	\$34.48M	\$2.625M	28.10.2004	HKCB Finance

Film Development Fund

The Film Development Fund was established by the Government in April 1999 with an approved commitment of \$100 million. From 1999-2000 to 2003-2004, financial support from the Fund was provided for projects which would benefit the long-term and healthy development of the Hong Kong film industry. In January 2003, following the redeployment of \$50 million from the Fund to set up the “Film Guarantee Fund”, the approved commitment of the Fund was revised to \$50 million.

Administration of the Fund

2. The Fund was administered by the Film Services Office (FSO) of the Television and Entertainment Licensing Authority. A Projects Vetting Committee (PVC), chaired by the Permanent Secretary for Commerce, Industry and Technology (Communications and Technology), was set up under the Film Services Advisory Committee to assess applications and prescribe the terms and conditions of funding. Projects under application were primarily non-profit making by nature and had to benefit the entire film industry. The criteria for approving applications were as follows:

- (a) An applicant should normally be a locally registered institution/organisation engaged in film business or a related body. The FSO can also apply for funding.
- (b) Projects under application must be beneficial to the overall development of the local film industry, such as enhancing the competitiveness of the local film industry.
- (c) Benefits accrued from the projects must serve the interests of the entire film industry, and not just an individual private company or a consortium of private companies.

- (d) Projects should mainly be non-profit making by nature. Special consideration could be given for projects that can ultimately be self-financing.
- (e) In general, funds approved can only be used for non-recurrent expenditure.
- (f) Funds approved cannot be used to create any civil service posts.
- (g) In examining an application, the following must be taken into consideration:
 - (i) the benefits that a project may bring to the local film industry;
 - (ii) the need for such a project;
 - (iii) the technical and project management capabilities of the applicant institution/organisation;
 - (iv) whether the implementation schedule of the proposed project is well planned and whether the time required for implementation is reasonable;
 - (v) whether the proposed budget is reasonable and realistic;
 - (vi) whether there is/will be any duplication in terms of the work carried out by other institutions; and
 - (vii) for a project involving recurrent expenditures (such as salaries and other administrative expenses), the period required for such expenditures and whether the project can be self-financing after a certain period of time.

3. Based on the PVC's recommendations, the Commissioner for Television and Entertainment Licensing (CTEL) decided whether to approve the applications and disburse funds and monitored the progress and results of the funded projects. CTEL could not approve projects costing more than \$10 million each under the Fund. The \$10 million expenditure limit was the same as that delegated by the Finance Committee to the Financial Secretary or the Secretary for the Treasury for the creation of a new non-recurrent commitment. For projects worthy of support but costing more than \$10 million each, CTEL would refer the projects to the Finance Committee for individual approval.

List of Sponsored projects under the Film Development Fund

(a) Sponsored projects (excluding those involving participation in overseas film festivals)	Approved Funding
1. The 18th Anniversary of the Hong Kong Film Awards - Forum on the Co-production of Motion Pictures and Exchanges of Creative Experience with Mainland Film Production Studios (The Hong Kong Film Awards Association Ltd.)	\$285,000
2. Training Programme for Film Art-work Professionals (The Hong Kong Film Arts Association)	\$1,046,000
3. Hong Kong Film 1997 - 1998 (Hong Kong & Kowloon & New Territories Motion Picture Industry Association Ltd.)	\$325,000
4. Hong Kong - Asia Film Financing Forum 2000 (The Hong Kong Directors' Guild)	\$3,541,400
5. Training Programme for Stuntmen (The Hong Kong Stuntman Association)	\$1,176,400
6. Consultancy Study on the Financing of the Hong Kong Film Industry (The Film Services Office)	\$938,260
7. Film Scriptwriters' Training Programme I - Theme Development and Adaptation (Film Scriptwriters' Training Programme)	\$691,000
8. Assistance Scheme for Script Writing (The Hong Kong Screen Writers' Guild)	\$4,888,000
9. The Hong Kong Millennium Film Awards Presentation Ceremony (The Hong Kong Film Awards Association Ltd.)	\$2,339,304
10. Hong Kong Film Industry Information and Copyright Database (The Hong Kong & Kowloon & New Territories Motion Picture Industry Association Ltd.)	\$1,220,000
11. Special Effects Operators Training Course (The Film Services Office)	\$2,000,000
12. Public Opinion Survey on Movie-goers (The Film Services Office)	\$700,000
13. Film Production Workshop (The Hong Kong Directors' Guild)	\$547,600
14. Seminar and Workshop for Professional Animators by Mr Richard Williams (The Hong Kong Productivity Council)	\$799,600
15. The 45th Asia Pacific Film Festival - The Hong Kong Film Delegation Participating in the Competition Section of the Festival (The Federation of Motion Film Producers of Hong Kong Ltd.)	\$301,000
16. Hong Kong Movies Promotion at Cannes Film Festival (The Film Services Office)	\$4,725,000

(a) Sponsored projects (excluding those involving participation in overseas film festivals)		Approved Funding
17.	The 20th Anniversary of the Hong Kong Film Awards Presentation Ceremony (The Hong Kong Film Awards Association Ltd.)	\$2,058,000
18.	Summer Overseas Study Programme on Computer Animation and Visual Effects (The Hong Kong Productivity Council)	\$560,630
19.	Hong Kong Film Forum (CIA) (The Hong Kong Arts Centre)	\$77,300
20.	Computer Animation and Special Effects Training Programme for Young Animators (The Hong Kong Productivity Council)	\$979,460
21.	The 21st Anniversary of the Hong Kong Film Awards Presentation Ceremony (The Hong Kong Film Awards Association Ltd.)	\$2,497,500
22.	Summer Overseas Training Programme on Digital Movie and Visual Effects Production (The Hong Kong Productivity Council)	\$738,860
23.	Revitalizing the Hong Kong Film Industry Forum (The Federation of Hong Kong Filmmakers)	\$316,530
24.	Step By Step Legal Documentation Guide on Film Financing and Production (Messrs Fong & Ng, Solicitors)	\$845,620
25.	Hong Kong Asia Film Financing Forum (The Hong Kong & Kowloon & New Territories Motion Picture Industry Association Ltd.)	\$3,066,900
26.	LAB24P: An exploration in Digital Making - Workshop on Digital Filmmaking (The Society of Cinematographers (HK) Ltd.)	\$72,048
27.	The 22nd Anniversary of the Hong Kong Film Awards Presentation Ceremony (The Hong Kong Film Awards Association Ltd.)	\$2,490,940
28.	New Development of Surround Sound in Cinema (The Hong Kong Society of Sound Designers and Engineers)	\$27,455
29.	Promotion of the Scripts Developed under the Assistance Scheme for Script Writing (The Hong Kong Screen Writers' Guild)	\$55,500
30.	High Definition Cinematography Workshop (The Society of Cinematographers (HK) Ltd.)	\$1,877,818
31.	Marital Art & Related Animation Knowledge for Animators (The Hong Kong Productivity Council)	\$282,274
32.	The 23rd Anniversary of the Hong Kong Film Awards Presentation Ceremony (The Hong Kong Film Awards Association Ltd.)	\$2,433,000

(a) Sponsored projects (excluding those involving participation in overseas film festivals)		Approved Funding
33.	Developing the Accounting Software for Film Production (The Hong Kong Movie Production Executives Association)	\$746,000
34.	Training Programme for Film Workers (Procurement of Training Equipment) (The Federation of Hong Kong Filmmakers)	\$1,207,200
Sub-total		\$45,856,599

(b) Participation in overseas film festivals		Approved Funding
	Sponsored 38 projects to participate in overseas film festivals	\$2,892,442

	Approved funding for the 72 projects (a) + (b)	\$48,749,041
--	---	---------------------