

For information

Finance Committee

Asian Infrastructure Investment Bank

The paper provides supplementary information in the light of the enquiries made by Hon Nathan Law (Annex) on the funding approval vide FCR(2017-18)2.

I. Costs and benefits of Hong Kong's participation in the Asian Infrastructure Investment Bank ("AIIB")

Questions (1) and (2) – Contracts awarded to Hong Kong companies

2. Since its commencement of operation in 2016, the AIIB has approved 12 projects with a total commitment of US\$2 billion. The Government does not have any data on contracts awarded to Hong Kong companies as these projects were not undertaken directly by the AIIB but implementation agencies of partner organisations. After we have become a member, we may request the AIIB to collate the relevant data.

3. The AIIB's contracts are awarded through an open process. Given the standard of Hong Kong's professionals, they are well positioned to compete for those contracts. Indeed, many Hong Kong companies have taken part in overseas infrastructure projects. The Government is prepared to disseminate information on the latest projects and policies of the AIIB timely to facilitate the business community.

Question (3) – Benefits of joining the AIIB

4. The benefits of joining the AIIB do not derive from winning project-related contracts only. Given the depth and breadth of Hong Kong's financial markets and availability of financial sector professionals, the professional services and financial services sectors of Hong Kong (e.g. project financing, bond issuance, investment management, financial management and foreign exchange management)

will stand to benefit from the AIIB's operations. As we have experts in project negotiation, preparation of works and management contracts and international law as well as professional arbitration services, Hong Kong can also take part in the planning, implementation and operation of infrastructure projects.

5. However, the exact benefits will be subject to a number of variables, e.g. the investment amount of the AIIB, the capital raised by the AIIB in Hong Kong, the role played by Hong Kong companies in different projects, etc. and hence are difficult to be quantified.

Question (4) – Risks

6. The AIIB is not operated as a fund. The AIIB's capital is provided through members' subscription of its shares. For approving a project, the AIIB will undertake a due diligence process considering in detail factors such as returns and feasibility before making a decision. The AIIB operates in accordance with prudent principles. According to the Articles of Agreement for establishing the AIIB ("AoA"), the total amount of outstanding loans, equity investments, guarantees and other types of financing provided by the AIIB in its ordinary operations shall not be increased, if by such increase the total amount of its unimpaired subscribed capital, reserves and retained earnings included in its ordinary resources would be exceeded (Article 12(1)). According to Article 12(2) of the AoA, the amount of the AIIB's disbursed equity investments shall not at any time exceed an amount corresponding to its total unimpaired paid-in subscribed capital and general reserves.

7. The Ministry of Finance has pointed out that it is not China's objective and priority to support domestic projects through advocating the establishment of the AIIB. Therefore, China will not apply for any loan from the AIIB during its early operation¹. Of the 12 approved projects and other proposed projects, none involves any investment in China.

¹ <http://news.wenweipo.com/2016/01/15/IN1601150040.htm> and <http://finance.sina.com.cn/roll/2016-01-16/doc-ifxnqriz9724906.shtm>.

8. Besides, as shown by empirical data over the years, China's economy has enjoyed robust growth as compared with other major economies.

Question (5) – Research on Hong Kong's participation in the AIIB

9. Regarding Hong Kong's participation in the AIIB, the Government has studied different reports between end-2014 and mid-2015, covering such topics as the demand for infrastructure in Asia, returns to infrastructure investment, financing options for infrastructure, roles and functions of multilateral financial institutions, Hong Kong's functions and advantages, etc.. One of the conclusions from these reports is that there is a huge demand for infrastructure investment in Asia, and setting up a new institution dedicated to promoting infrastructure investment, e.g. an Asian infrastructure fund or a dedicated infrastructure investment bank, should facilitate such development².

10. Our research then also looked into the feasibility of Hong Kong's participation in the AIIB. As relevant parties were discussing the details and agreement for establishing the AIIB around March and April 2015, and given that Hong Kong is not a sovereign state, it is of utmost importance to ensure that the AIIB provides appropriately for the participation of non-sovereign economies.

11. The Financial Services and the Treasury Bureau has not commissioned any outside party to conduct the above research, so there is no topical report for release to the public.

II. Hong Kong's role in the AIIB

Question 6 – AIIB's sub-office in Hong Kong

12. If the AIIB decides to set up a sub-office in Hong Kong, our professional and financial services sectors will benefit from this decision. It will further consolidate our position as an international financial centre.

² The idea of setting up an infrastructure investment bank has been raised by, among others, the Economic and Social Commission for Asia and the Pacific of the United Nations and the Asian Development Bank.

Hong Kong's membership and contribution to the AIIB's capital as well as secondment of civil servants to the AIIB underline our commitment to the bank, which will strengthen Hong Kong's standing and credibility in our bid for the AIIB to set up a sub-office in Hong Kong. Hong Kong possesses the attributes for hosting the sub-office, and one of its functions can be treasury management.

13. We have not reached any agreement with the AIIB yet, but are continuing our discussion with the bank. It is not appropriate to publicize the details of our discussion, lest it would undermine our cooperation and mutual trust with the AIIB, and give away our plan to other competitors.

Question (7) – Hong Kong's representatives and secondment of civil servants

14. The Under Secretary for Financial Services and the Treasury, Mr James Lau, and Principal Assistant Secretary for Financial Services and the Treasury (Financial Services), Mr Paul Wong, have been representing the Government and have joined the Chinese delegation in the Chief Negotiators' Meetings.

15. At the request of the AIIB's management, we have seconded civil servants from the Executive Officer and Treasury Accountant Grades to support the AIIB's operation, especially in the establishment of its administrative and financial systems during the initial operation period. From end-2015 till to date, three civil servants have been seconded to the AIIB, with a total expenditure (covering, among other things, salaries and allowances) of about \$6 million (as of end-March 2017). The expenditure is absorbed by the Financial Services and the Treasury Bureau.

Questions (8) to (10) – Hong Kong's voting power and influence

16. We estimate that Hong Kong's voting power is about 0.7%. The Under Secretary for Financial Services and the Treasury has been participating in the AIIB's Board of Directors ("BoD") meetings as an

Advisor of the China constituency³. We have reflected our views and comments on various AIIB's matters through the constituency's Director to the AIIB's BoD. The constituency's Director has also consulted Hong Kong on matters affecting our interests, e.g. the admission process of new members. After joining the AIIB, we plan to join the China constituency. We are confident that Hong Kong's representative can continue to be an Advisor of that constituency, and sit in the BoD meetings as necessary. We envisage that Hong Kong's views and interests will be adequately represented at the BoD under this constructive working relationship.

17. Hong Kong will have to pay our own subscribed shares in accordance with the AoA when joining the AIIB. We have provided the details in FCR(2017-18)2. Hong Kong is not required to shoulder capital subscription made by the Central People's Government.

Financial Services and the Treasury Bureau
31 March 2017

³ The Board of Directors is responsible for the direction of the general operations of the AIIB. The Board shall be composed of 12 members returned from 12 constituencies, nine of whom representing regional members of the AIIB and three representing non-regional members. Each Director is entitled to appoint three Advisors as observers who can also sit in a BoD meeting.