立法會
Legislative Council

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Bills Committee on
Mass Transit Railway Bill

Minutes of meeting
held on Thursday, 16 December 1999, at 10:45 am
in Conference Room A of the Legislative Council Building

Members present : Hon Mrs Miriam LAU Kin-yee, JP (Chairman)
Hon HO Sai-chu, SBS, JP
Hon Edward HO Sing-tin, SBS, JP
Hon Ronald ARCULLI, JP
Hon Ambrose CHEUNG Wing-sum, JP
Hon CHAN Yuen-han
Hon Bernard CHAN
Hon CHAN Wing-chan
Hon CHAN Kam-lam
Hon SIN Chung-kai
Hon Howard YOUNG, JP
Hon LAU Kong-wah
Hon Andrew CHENG Kar-foo
Dr Hon TANG Siu-tong, JP

Members absent : Hon Kenneth TING Woo-shou, JP
Hon Cyd HO Sau-lan
Hon Albert HO Chun-yan
Ir Dr Hon Raymond HO Chung-tai, JP
Hon LEE Cheuk-yan
Hon Eric LI Ka-cheung, JP
Hon NG Leung-sing
Hon Mrs Selina CHOW LIANG Shuk-yee, JP
Hon Andrew WONG Wang-fat, JP
Hon LAU Chin-shek, JP
Hon FUNG Chi-kin

Public officers : **Transport Bureau**

attending

Mr Kevin HO
Deputy Secretary for Transport (1)

Mr Thomas CHOW
Deputy Secretary for Transport (4)

Mr Roy TANG
Principal Assistant Secretary for Transport (3)

Finance Bureau

Miss Jenny YIP
Principal Assistant Secretary for the Treasury (I)

Department of Justice

Mr Jonothan ABBOTT
Senior Assistant Law Draftsman

Ms Betty CHOI
Senior Government Counsel

Attendance by invitation : **MTR Corporation**

Mr Clement KWOK
Finance Director

Mrs Miranda LEUNG
Corporate Relations Manager

Goldman Sachs (Asia)

Mr JIANG Fan
Executive Director

Standard & Poor's International Ratings

Mr Paul COUGHLIN
Managing Director

Chase Manhattan Bank

Mr Leonard WEI
Managing Director

Clerk in attendance : Mr Andy LAU
Chief Assistant Secretary (1)2

Staff in attendance : Miss Connie FUNG
Assistant Legal Adviser 3

Miss Irene MAN
Senior Assistant Secretary (1)6

Action

The Chairman advised that the Second Reading debate of the Bill was expected to resume in February 2000 and the meeting schedule of the Committee in January 2000 would be as follows:-

Date	Time
4 January 2000	9:00am to 1:00pm
6 January 2000	morning session (tentative)
11 January 2000	4:30pm to 6:30pm
13 January 2000	4:30pm to 6:30pm
14 January 2000	10:45am to 12:45pm
20 January 2000	9:00am to 1:00pm
25 January 2000	10:45am to 12:45pm
27 January 2000	10:45am to 12:45pm

I Presentation on fare determination mechanism
(LC Paper No.CB(1)600/99-00(01))

2. At the invitation of the Chairman, Mr JIANG Fan, Executive Director of Goldman Sachs (Asia), presented to members his views on the importance of fare autonomy for the Mass Transit Railway Corporation (MTRC) and the perspectives of international bond investors on fare determination and credit evaluation of the Corporation. He said that MTRC could attract a stable and loyal investor base because it operated under commercial principles, one of which was fare autonomy. The mechanism for the Corporation to set its own fares which were regulated solely by competitive market forces offered MTRC the flexibility to control its cash flow and adjust its tariff rates to overcome adverse market conditions. Besides, the Corporation's high quality management and operational performance, as well as the timely completion of development projects within budget had also impressed investors.

3. If fare autonomy was eliminated or restricted, however, Mr JIANG believed that the certainty of the Corporation's future income would be weakened. The Corporation might cut back on its investment which would affect the quality of service. If the Corporation were unable to access capital markets for financing due to its weaker credit profile, it would have to seek subsidies from the Government eventually. The change in fare autonomy would also affect long-term investments. This was contrary to the nature of railway operation which required long-term investment with high upfront initial capital commitment. Besides, transferring the fare determination mechanism from a market determined one to a Legislative Council (LegCo) approved mechanism would mean moving away from the free market principles. This would diminish Hong Kong's credit image in the international investment community. While China was gradually transferring decision-making power from the state to the market, Hong Kong would ironically be seen as moving in the other direction.

4. Mr JIANG also pointed out that many bond investors would review and revise their investment strategies if there was a change in the fundamental premise of their investment, including the existing fare determination mechanism which was well documented in the bond offering prospectus. Since investors would view the bonds of the MTR Corporation Limited (MTRCL) as Hong Kong's quasi-sovereign credit and as Hong Kong's benchmark in the absence of Government bonds, any negative perception towards MTRCL and its outstanding bonds would have a material and lasting impact on other credits in Hong Kong. Furthermore, bond investors had to consider an issuer's earning predictability and operating consistency before commitment of capital in order to reduce risk. The absence of fare autonomy would make MTRCL's recurrent cash flow less predictable and consistent. Concerning the checks and balances in the course of fare determination, he was of the view that the Corporation's Board of Directors and the consultation process with the Transport Advisory Committee (TAC) and the LegCo Panel on Transport would prevent abuse of the mechanism and safeguard public interest.

5. At the invitation of the Chairman, Mr Paul COUGHLIN, Managing Director of Standard and Poor's International Ratings Limited, briefed members on his views regarding the proposals to regulate the fares of MTRCL and the resulting impact on MTRCL's credit rating. In rating a capital-intensive utility company like MTRCL, the financial profiles of the company, the economic environment, the relationship with the Government and the regulatory environment would be considered. MTRC was well regarded in relation to all these matters and changing its existing fare determination mechanism after privatization would reduce its financial flexibility and reduce the certainty of its environment. Moreover, the introduction of political pressure into the fare determination mechanism could be regarded negatively from the credit perspective, and the unpredictable fare regulation could only increase the perception of risk. Since MTRCL would be operating in a competitive environment with considerable commercial risks involved in new rail projects, the imposition of a fare regulatory mechanism would have negative effect on the Corporation's credit standing.

6. Mr Leonard WEI, Managing Director of Chase Manhattan Bank, was then invited to present to members the bankers' perspectives on the Corporation's fare determination mechanism. He advised that for public service providers with intensive capital needs, support from the Government and a stable operating and regulatory environment were important in forming a credit position. After privatization, MTRCL's lenders were expected to continue supporting the Corporation provided that the Government would retain majority ownership. However, a change in MTRC's fare determination mechanism would adversely affect a lender's assessment as to the sufficiency and predictability of future revenue flows for debt repayment, and cast uncertainty over the availability of funding on acceptable terms for the Corporation's continued maintenance, working capital and capital investment needs.

7. Mr WEI advised that MTRC had a track record of operating under prudent commercial principles and the Corporation was expected to continue to operate in the same way after privatization. Any change in the fare determination mechanism which ran contrary to the prudent commercial principles would be viewed by lenders to operate the efficient railway system at less than commercial fares. As such, they would no longer extend their loans to the Corporation on a commercial basis but look for explicit financial or guarantee support from the Government. This would lead to a less stable operating environment for the Corporation with potentially adverse financial consequences. Since existing system had proved to have worked well in the past 20 years preserving the interests of both the Corporation, the lenders and the public, he asked members to weigh carefully the expected gains against the potential consequences in changing the current fare determination mechanism.

(*Post meeting note:* The speaking notes of Mr JIANG and Mr WEI were tabled at the meeting and were circulated to members vide LC Paper No.CB(1)636/99-00.)

8. Mr Howard YOUNG enquired about the downsides on credit ratings, availability of funds and interest rates caused by a change in the existing fare determination mechanism of MTRC. Mr JIANG said that it would be difficult to quantify the effects without a concrete macro-economical environment. However, he took the view that the credit rating company would probably downgrade the rating under the proposed mechanism. Regarding the financial impact, he explained by way of an illustration that a 10-year MTRC bond in US dollars in the international market was currently trading at about 135 to 140 basis points (equivalent to an interest rate of 1.35% to 1.4%) over the US Treasury. However, the proposed mechanism might add another 20 to 30 basis points, which was about 0.02% to 0.03% of interest rate, and would have significant effect on the interest payment in a period of 10 years. The Financial Director/MTRC (FD/MTRC) elaborated that although the exact basis points increase after a change of mechanism could not be predicted, the addition of 25 basis points for instance, would mean an additional annual interest of HK$50 million on outstanding loans amounting to HK$20 billion.; since borrowings usually involved a maturity period of up to 10 years, it could amount to an additional interest payment of

HK$500 million altogether. Therefore, a small increase in basis points could have a very significant impact on the ultimate cost.

9. Mr COUGHLIN pointed out that ratings and interests had a long-term relationship. It would be difficult to assess the impact because this would depend on the timing of borrowings and the number of basis points to be added up in the capital intensive business. Mr WEI remarked that it would be difficult to estimate the level of interest rates because different banks had different levels of scrutiny on the actual credit. If credit was regarded a key element, pricing would be viewed stringently when the credit profile was perceived to be deteriorating.

10. Given that lenders had pledged their continuous support for the Corporation for so long as the Government remained to be the majority shareholder, and the Corporation would continue to offer quality service and acceptable fare levels after privatization, Mr CHENG Kar-foo enquired about the reasons for the certainty of future income of the Corporation being weakened upon alteration of the fare determination mechanism. Mr JIANG pointed out that the bond investors emphasized quality income in analyzing a credit. When bond investors analyzed a bond issuer such as MTRCL, they would evaluate its quality income which was the stability and predictability of its future income. However, MTRCL's future income was not as important as the predictability of the Corporation’s cash revenue during the repayment schedule over the next 10 to 20 years. Bond investors were not prepared to analyze another variable that added uncertainty to the cash flow, such as an external regulatory mechanism.

11. Mr WEI supplemented that fare levels acceptable to the public might not also be in the interest of commercial lenders. Banks were required to make credit decisions based on the commercial viability of a company. Since MTRCL would have continuing and substantial capital investments which required large sum of funding to be committed over a long pay-back period, lenders and bond investors would have to bear the uncertainty for a long period to lend money or buy bonds from the first day. The certainty of the fare levels would help ensure that the business would be commercially viable from the Corporation's perspective, and that the Corporation would have the ability to generate sufficient cash flow for repayment from the lenders' perspective. Mr COUGHLIN added that credit ratings depended largely on the degree of certainty of the business. This certainty was based on the profitability, stability and operating environment of the business. Credit rating companies would also compare various regulatory systems and their impact on railway business. He remarked that lenders were usually conservative in their decisions and would look for a high degree of certainty.

12. Furthermore, FD/MTRC advised that the Corporation would always strike a balance as regards the acceptability of fare levels between the public and commercial investors. He stressed the importance for flexibility for finding that balance in the interest of the Corporation's long-term financial planning. Although the Government could always make up for any shortfall in the fare setting process or the future cash

flows, that was not the basis on which the Corporation operated because the weaker the funding facilities offered by creditors, the more support would have to be granted by the Government.

13. As MTRCL had the obligation to provide transport service for the public, Mr CHAN Kam-lam enquired about the means to balance the interest between the public and the investors. Mr WEI advised from a banking institute's point of view that public interest would be best served under acceptable fare levels, and such levels could only be achieved when the Corporation was able to react and anticipate in response to changing economic and business conditions efficiently. This meant that the Corporation had to keep the cost of financing as low as the market would bear. He took the view that the present fare setting arrangement of MTRC had already achieved a balance of interest among the public, the Corporation and lenders.

14. Mr JIANG pointed out that the balance of interest was more relevant in a monopoly environment than in a competitive environment. As far as the local market was concerned, it was fairly competitive as there were many alternatives modes of transport. With the Board of Directors which represented a wide range of the community, and the strengthened consultation process with TAC and the LegCo Panel on Transport after privatization, he believed that the Corporation would work well and achieve a balance of interest of different parties under the existing fare determination mechanism. From the perspective of credit ratings, Mr COUGHLIN advised that the governing bodies should make the judgement of balancing the interests of the parties concerned, and the credit rating companies would determine credit ratings and credit risks according to the level of certainty.

15. Mr CHAN Kam-lam invited opinions on expanding TAC's authority in monitoring the fare and service standard as well as the development of railway projects so as to balance the interest of all parties. He suggested inviting more independent professionals from various sectors to join TAC and increasing its secretariat support. While TAC should continue its role in reporting its views to the Chief Executive (CE) in Council on railway issues, the fare determination power should rest with the CE in Council. In response, Mr WEI advised that since the nature of the Corporation's business was capital intensive which required long pay-back period, it would be best to bargain for a long funding period as far as possible. However, the above suggestion might introduce elements of uncertainty, and lender's level of confidence would be compromised by a longer lending period. Mr COUGHLIN advised that credit ratings might not be negatively affected if the suggestion was only to strengthen the consultation structure and TAC's role was to make recommendations to CE. However, uncertainty would arise if significant changes were introduced to the existing mechanism.

16. Mr SIN Chung-kai believed that any fare regulatory mechanism would affect the interest of investors and he sought suggestions on safeguarding the public's interest in this respect. Mr COUGHLIN said that various indicators in different regulatory systems adopted in other utility companies would serve the purpose of reference.

These indicators included customer service, credit ratings and cost of finance. The Government and LegCo should decide on the regulatory mechanism while credit rating companies would make observations on the impacts on risks. FD/MTRC stressed that the Corporation had been serving the public responsibly by minimizing its cost of operation. He considered the best way to serve the public was to keep the interest rate of loans at the lowest level which would, in turn, minimize the pressure on fare increase.

II Any Other Business

17. There being no other business, the meeting adjourned at 12:07 pm.

Legislative Council Secretariat
20 April 2000