Bills Committee on Mass Transit Railway Bill
Thursday, 16 December 1999

Speech by Mr Leonard Wei, Managing Director,
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Ladies and Gentlemen,

Introduction

I am pleased to have the opportunity this morning to address the members of the Bills Committee in relation to on-going deliberations concerning the privatization of the Mass Transit Railway Corporation. I have been asked to share with you my views as regards the banker's perspective on the IPO initiative and, more particularly, the matter of MTRC's fare-setting process currently under review by this committee.

As a practitioner in the financial services industry for nearly twenty years, fourteen of which have focused on debt fundraising for corporations and government owned entities, I am well aware of the issues and concerns with which the members present today will wish to address. I should also mention that I have a good knowledge of MTRC from a lender's perspective as Chase Manhattan Bank has supported, and in many instances arranged, a number of major international financing transactions for MTRC.

Market Perception of the Privatization

In general terms, the government's proposal to effect a partial privatization of MTRC will be well received by the banking community at large. As one of the most efficiently run and financially independent public transport providers in the world, but one with substantial continuing capital investment requirements, the privatization initiative will be regarded as a sound decision enabling the corporation to broaden its access to financing beyond the traditional debt markets. Armed with an equity funding capability, the corporation will have the added financial flexibility to undertake major capital expenditure programs in the future on a timely and cost effective basis while preserving its strong financial standing and investment grade credit rating. Moreover, the status of the corporation as a publicly listed entity will perpetuate its international standing and reputation as a public utility committed to upholding a high degree of financial integrity, transparency, accountability and operating efficiency.

The Lender's Perception of Changes to the Fare Setting Mechanism

As part of the privatization debate, there have been suggestions put forward to change the railway corporation's present fare-setting process and, if appropriate, to subject that process to approval by Legco or to introduce an inflation-based fare setting formula.

In order to gain a fuller appreciation of the position of lenders with respect to such change, it is perhaps useful to understand the key drivers in the lenders' credit decision making process in relation to the extension of funding. The critical determinant in quantifying MTRC's repayment ability focuses on the economic viability of the corporation's business on a standalone basis. The pre-requisites for a lending decision must therefore include a favorable assessment of the corporation's financial standing, its operational efficiency, management competence and ability to generate sufficient revenue. It is important to recognize the fact that throughout the term of a lender's relationship with any client, it will continuously assess the impact of internal and external events on the borrower's business to ascertain that these key principles underlying business survival remain intact and if not to take appropriate action.

For public service providers with capital intensive needs, support from government and a stable operating and regulatory environment are also regarded as important factors in forming a credit position For the purposes of MTRC one can argue that these criteria are satisfied by virtue of full government ownership and a long and stable history of operational independence. In the context of the current privatization debate two critical questions must be asked: (1) Will MTRC's lenders continue to support the Corporation under less than full ownership by Government? (2) Will a change in the fare-setting mechanism be positively received? To the first question, the answer is a "yes" provided government continues, as is contemplated, to retain majority ownership. To the second question, the answer is arguably far less certain since a change in MTRC's present fare-setting mechanism will adversely affect a lender's assessment and comfort level as to the sufficiency and predictability of future revenue flows for debt repayment and, ultimately, cast uncertainty over the availability of funding on acceptable terms for MTRC's continued maintenance, working capital and capital investment needs.

Far more important, but perhaps less obvious, is the lender's overall interpretation and rationalization of such an act by Legco. There has to date been no question in regard to the corporation's track record of operating under prudent commercial principles or in pursuing a consistent fare policy. Moreover, there is every expectation that MTRC will continue to operate under these principles after privatization. Why then, the lender must ask, should a change to MTRC's modus operandi be considered- a change which runs contrary to the very principle of operating under prudent commercial principles?

An educated guess might lead the lender to conclude that the proposed change is intended to ensure the continued availability to the public of an efficient urban transport system at less than commercial fares. Were this to be true, the lender would deem its loans to the corporation as being no longer extended on a commercial basis. In this situation, the lender would look for explicit government financial or guarantee support. The fundamental inconsistency in the present deliberations, therefore, appears to revolve around the inherent contradiction associated with the government's privatization and rail development initiatives within a less certain fare-setting environment, since this leads in turn to a less stable operating environment for MTRC with potentially adverse financial consequences. Experience suggests that this inconsistency will not be lost in the eyes of the lender.

Conclusion

In deliberating the merits or otherwise of changing the current fare-setting mechanism which MTRC has exercised judiciously and sensibly, therefore, one must carefully weigh the expected or probable gains against the potential or likely consequences. More critically, and perhaps a point for further consideration by the members of the Bills Committee, we must be clear and convinced about whether compelling grounds exist for advocating change where, insofar as the lender is concerned, the status quo has proven to have served so well the interests of the corporation, the lenders and the travelling public over a period of twenty years. As the saying goes, "If it isn't broken, don't fix it."

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