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Belt and Road: Capturing the opportunities, managing the risks

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Good morning ladies and gentlemen.

I am delighted to be here today to talk about a subject that is directly relevant to the core purpose of banks and insurance companies. That is adding value to society by effectively managing risk and helping clients to capture new and exciting opportunities.

The extensive and significant scale and ambition of Belt and Road is now widely recognised.

Launched in 2013, Belt and Road aims to promote trade and economic integration between China and the rest of Asia, Europe, the Middle East and Africa.

The initiative spans more than 65 countries, which together account for 29 per cent of global GDP and 63 per cent of the world's population.

Our discussions suggest that at least 100 countries are involved and Belt and Road reaches as far south as New Zealand, as far west as the UK, and as far north as the Polar Silk Road in the Arctic.

We are already seeing very significant ecosystems being created, and these are facilitating cross-border co-operation on many different levels.

For example, the Digital Silk Road involves co-operation across many different sectors – from the construction of telecommunications networks to scientific collaboration and smart agriculture systems.

And the collaboration that has developed between the members of ASEAN over the past decades will be a valuable foundation for further mutual benefit – particularly as the member countries recently agreed here in Singapore to work together to accelerate infrastructure development by mobilising private capital.

It is important to be aware that this is all happening at a time of growing economic nationalism.

While many countries are turning inwards towards protectionism, Belt and Road is arguably one of the key driving forces for cross border cooperation.

China's established foreign policy is to engage with its external environment in a way that supports its economic and social development and international cooperation, achieves stability at home and aids its growth towards becoming a high-income country.

Belt and Road is an expression of this.

President Xi Jinping underlined this at the Boao Forum in April, saying that: "… we can make Belt and Road the broadest platform for international cooperation in keeping with the trend of economic globalisation and to the greater benefit of all our peoples".

Critics of Belt and Road are sceptical as to whether China's desire to spread prosperity is part of a wider plan to assert its influence.

An opposing view was recently put forward by notable academics – including Francis Fukuyama – saying that the demand for ever-higher Western standards has meant that projects in developing markets are in economic, political, regulatory and operational terms very challenging – and that because of this, leadership of infrastructure financing in emerging markets was long ago ceded to China.

China has thus filled a gap, and Belt and Road is fundamental in this regard.

I would like to do three things in my speech today.

First I would like to discuss the enormous opportunities that Belt and Road offers.

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Second I would like to set out the risks that need to be managed.

And finally I would like to provide some thoughts on how Belt and Road will be financed, and the specific role that insurance companies can play in this process.

Let me begin with the opportunities.

Belt and Road is based on two centuries-old trade routes – the land-based "Silk Road Economic Belt" connecting Europe and the Middle East to China and the "Maritime Silk Road" that connects China, South East Asia, India and Africa.

Historically each of these routes created a web of trading points around them.

Today Belt and Road is creating a network of ecosystems that that can provide for cross-border co-operation on many different levels

China anticipates its annual trade with countries along the Belt and Road will pass 2.5 trillion US dollars in the next decade.

Earlier this year, the scope of Belt and Road was extended to the Polar Silk Road.

Global warming is melting Arctic sea ice which is enabling goods to be shipped from Asia to Northern Europe across the top of Russia in under half the time of traditional shipping routes.

Moreover – and as we saw last week with the meeting between President Xi and President Putin – it is ushering in a new era of China-Russia relations as part of Belt and Road and the rediscovery of Eurasia as "the centre of the world".

Meanwhile the Digital Silk Road includes co-operation in a wide range of sectors – including the construction of cross-border fibre-optic and mobile networks, the establishment of regional e-commerce markets and the securing of food and energy supplies.

And international electricity networks are being built that enable developing markets to export power surpluses.

Many of these new economic ecosystems depend on building the physical infrastructure that will improve access and create new demand.

The Asian Development Bank estimates that the region needs 1.7 trillion US dollars of infrastructure investment annually to 2030 to keep pace with climate change and economic growth.

This compares to a current annual spend of around 900 billion US dollars.

So there is a substantial long-term funding gap still to be bridged, which the public sector cannot meet alone.

This is why Belt and Road has the potential to be truly transformative.

It is an unprecedented opportunity to overcome the bottlenecks and blockages that have prevented private sector investors from taking a greater interest in infrastructure in the developing world.

And at the same time, it can create excellent long-term opportunities for investors with reserves of capital searching for yields.

To facilitate these projects, a multitude of financial services is required – from strategic advisory and transactional banking services to risk management and project and export finance.

Singapore is one of the few financial centres – along with London and Hong Kong – that can claim to have world-leading capabilities across these areas.

As more transactions are settled in renminbi – and more financing is conducted both onshore and offshore in the Chinese currency – we expect demand for cross-border renminbi services to increase.

Meanwhile Swiss Re estimates that Belt and Road projects could generate an additional 23 billion US dollars in commercial insurance premiums by 2030.

And the downstream opportunities that will come from the addition of 3 billion people to Asia's middle-class over the same period – in the largest growth of wealth in history – are potentially bigger still.

Arguably even more important is the wider impact that Belt and Road will have on the environment and the development of local capital markets.

President Xi's dictum that projects along the Belt and Road should be "green, low carbon, circular and sustainable" leaves no doubt that it is fundamental to China's efforts to improve the environment.

This also requires fundamental change.

Under a scenario where the share of global GDP accounted for by Belt and Road countries spikes to match their 63 per cent share of the global population – and where their economic activity is as carbon intensive as China's – global greenhouse gas emissions would increase by half again.

This would clearly make it impossible to deliver the two-degree commitment which global leaders made in Paris.

We simply can't afford to see large, sprawling cities, powered by coal and connected by roads full of cars driven by internal combustion engines.

What we need are well designed urban developments that use clean energy and with efficient mass transit systems.

And beyond physical infrastructure, consumption of natural resources needs to be limited, low-emission agriculture systems are required and smart data systems must be used to allow resources to be utilised efficiently and effectively.

So for Belt and Road to meet President Xi's commitment of being truly sustainable, countries need to follow a development path that is fundamentally different to that historically taken in the West – and also that taken more recently by China.

A successful transition will also certainly require the development of local capital markets.

While countries like China have the economic weight and markets to draw in private sector investors, others do not.

Developing local capital markets is essential to creating the capacity needed to support local economies.

I have long argued for better access to funding and financial instruments across the rest of Asia.

Singapore is leading Southeast Asia with the sophistication and depth of its capital markets, which benefit companies across the region and beyond. This is also supported by its asset management ecosystem and role as a regional treasury centre.

The trend towards productivity in place is also very relevant here.

For example 3D printing could make it viable to mass produce goods without the need to import intermediate and finished goods – affecting both local economies which rely on that trade, and the size and scale of the local communities that serve them.

Belt and Road investments will help to attract global investor attention and expand corporate access to long-term capital around the region – especially if greater policy co-ordination can be achieved in areas like taxation, foreign exchange regulation and credit ratings.

Here there is much that can be learned from the EU – in particular from its intention to enable common decision-making and what it has learned about the care and skill that requires.

Having set out the opportunities, let me now turn to the risks.

The four principal categories of risk are: political, economic and financial, regulatory and operational.

The management of political risk is fundamental to the creation of investable propositions.

Infrastructure typically requires significant capital commitment and needs to be built to last for many decades.

Having trust and faith in governments and their capacity to stand behind projects is therefore vital.

Achieving this is complicated by projects either physically spanning multiple territories or involving cross-border supply chains, and therefore requiring the co-operation of different authorities.

Rising international tensions pose a further dimension of risk.

In the context of Belt and Road, economic risk relates primarily to specific financial aspects of projects.

The long payback periods associated with infrastructure projects – particularly when it comes to investments in technologies which require higher upfront costs – can be very hard to justify in purely commercial terms. And that is why more than 90 per cent of infrastructure investment is financed by Governments.

The lack of deep and efficient capital markets in many developing countries can also limit financing options for those projects that can be made both viable and investable. This is why instruments like government bonds have been so widely used historically.

Regulatory risk encompasses the need to comply with different standards and laws, an increasing number of which have extra-territoriality.

Operational risk includes a lack of availability of people with the necessary skills, inadequate systems and the fragmented nature of processes between countries – or even the complete lack of them.

Together all of these risks have contributed to the bottlenecks and blockages that have prevented private investors, from taking a greater interest in infrastructure in the developing world.

Financial institutions, legal and accounting professionals, and specialist consultancies all have critical roles in helping to manage them well.

We are now seeing an increasing number of projects overcoming these risks and moving from planning to implementation.

These include: the Vakhdat-Yovon railway crossing in Central Asia; the Hungary-Serbia railway through the heart of Eastern Europe; Gwadar Port in Pakistan and; Piraeus Port in Greece.

They demonstrate that the execution challenges can be overcome if the fundamental disciplines of sound project feasibility assessment and management, sensible financial structuring, effective working partnerships and robust risk mitigation are all in place.

This brings me on to how Belt and Road will be financed, and what part insurance companies can play.

There has been real progress in developing the financing platforms needed to implement the next stages of the initiative.

China's major state-owned commercial banks are engaged in lending. And institutions like the Asian Infrastructure Investment Bank, New Development Bank and Silk Road Fund are providing funding and bringing together the best expertise on all aspects of infrastructure design, financing and delivery.

Green financing – including bonds, loans, insurance and securities – is also being used to support Belt and Road projects.

HSBC was recently pleased to support Industrial and Commercial Bank of China in launching the first Belt and Road Green Climate Bond, which will channel more than 2 billion US dollars towards projects covering renewable energy, low carbon transport, energy efficiency, and water treatment and supply.

The main value that "global" banks like HSBC bring is our presence in and across a large number of Belt and Road countries, and in our case more than 150 years' experience of operating cross-border in developed and developing markets.

Those banks that are already active in infrastructure can – to an extent – use their balance sheets to provide short-term and bridge financing of infrastructure projects, as well as financial advice on structuring finance.

But risk appetite for financing in less developed Belt and Road countries varies, so political risk insurance and credit insurance have an important role to play independently and in conjunction with export credit agencies and development banks.

Infrastructure projects offer generally stable and predictable cash flows over long periods that are also more suited to investment by life insurance companies.

They allow for diversified exposure across a wide variety of geographies, sectors and risk types – and they often have risk and credit fundamentals that are superior to other investments.

Without proper risk-sharing and solid legal frameworks, private investors will not be willing to commit large-scale, long-term financing.

The World Bank reports that just 0.7 per cent of total global PPI investment, debt and equity is contributed by institutional investors.

The key to creating a significant enough asset class to attract institutional investment is a well-defined pipeline of projects that are investable, legal, feasible and sustainable.

At the same time as Western development institutions becoming more flexible in the ever-higher standards they are imposing, Chinese institutions will continue to aspire to the highest standards of sustainability and governance.

Belt and Road will only succeed environmentally, socially and economically if appropriate assessment and governance frameworks are developed that satisfy investors and regulators.

Singapore is again leading in this area. Last week Monetary Authority of Singapore Managing Director Ravi Menon announced that it is working to develop investment benchmarks to make infrastructure an investable asset class. This will allow investors to compare the returns of privately-held infrastructure debt and equity against other asset classes.

This underlines the value of extensive and lasting co-operation between governments, multilateral development banks, commercial banks and insurance companies.

But this is an attitude – and a skill – that is not widespread.

It requires clarity on the roles and responsibilities of each partner, and mutual understanding of how they need to support one another.

The private sector would expect governments to align investment rules and guidelines, improve legal frameworks and settle cross-border disagreements.

We would also ask for clear and well-defined infrastructure project pipelines, which raise awareness of upcoming investment opportunities and offer visibility and understanding about how projects will be used – not just how they're built and maintained.

And we might ask governments to channel funds towards potentially more risky 'greenfield' projects so as to enable better risk sharing mechanisms.

I was also pleased to see the announcement by the MAS last week that it would develop an infrastructure debt distribution facility to securitise brownfield project finance loans to help crowd in institutional investors.

Another thing that we would like to see – and which we've proposed to the Chinese government – is a Multilateral Belt and Road Investment Accord to enable greater co-ordination between China and Belt and Road countries.

Amongst its responsibilities could be the identification of best practice – which might include the ground-breaking work here in Singapore that I have mentioned – and consideration of how this could be replicated elsewhere.

And it could also be accompanied by regular ministerial summit meetings, with country delegations comprising financiers and service-providers to provide appropriate support.

In conclusion, President Xi has described Belt and Road as "the project of the century".

It is hard to disagree.

If delivered, the benefits will be immense.

There are risks that I am confident can be managed.

And while there is a financing gap, we are making good progress in bridging it.

As far as insurance companies are concerned, the biggest drawback is a lack of investable projects. Better co-ordination would help to overcome this problem.

This is an industry built on making good, long-term decisions. So my advice to you is to make sure you are part of the discussion right now.

Attending this Conference is a good first step – and I hope that what you hear today enables you to go on and take many more.