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China's Belt & Road Initiative:

Opportunities and Risks for Singapore and ASEAN

MARSH & McLENNAN COMPANIES

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The Belt & Road (B&R) Initiative, a development strategy proposed by Chinese President Xi Jinping that focuses on connectivity and cooperation – with an investment of many billions in railway lines, pipelines, and ports, could provide a boost for international trade – and also for insurance.

WHAT IS THE BELT & ROAD INITIATIVE?

The land-based "Silk Road Economic Belt" and the oceangoing "Maritime Silk Road" will directly affect 4.4 billion people with a collective GDP of US$2 trillion.

The strategy underlines China's push to take a larger role in global affairs, and the desire to coordinate manufacturing capacity with other countries.

At the Belt and Road Forum (BRF) in Beijing on May 14- 15, 2017, President Xi pledged to funnel an additional RMB 100 billion (US$14.5 billion) into the Silk Road Fund, while the China Development Bank and the Export-Import Bank will set up new lending schemes of RMB250 billion (US$36.2 billion) and RMB 130 billion (US$18.8 billion) respectively.

The most obvious winners from China's new strategic move are bankers, construction companies, infrastructure investors, consultants, professional services firms, equity fund managers, and exporters.

Businesses need to understand the financial and economic implications of a coordinated infrastructure spending program that spans up to 65 countries.

"The manufacturing companies, the equipment companies, the finance companies, the banks – they are all working to support B&R – they all have a plan," one senior executive for a multinational firm said during his recent visit to China. "B&R is more than an initiative, it is a way of life."

Asian companies will get more opportunities as the Chinese government, banks, and enterprises invest in B&R countries, especially for infrastructure projects. Based on the Center for China and Globalization (CCG) survey, most Chinese companies venturing into overseas markets prefer to partner with local enterprises in the host countries. Lack of talent, cultural differences, and a lack of familiarity with local regulations and policies are the key limitations for Chinese firms operating on the global stage.

AIIB

The Asian Infrastructure Investment Bank (AIIB) is a new intergovernmental development organization founded to bring countries together to address the massive infrastructure needs across Asia. Being the first multilateral financial institution initiated by China and headquartered in Beijing, the objective of the AIIB is to promote interconnectivity and economic integration in Asia, and also to strengthen cooperation between China and other Asian territories. As of May 31, 2017, the AIIB has 77 member states.

"AIIB will only fund projects that are economically beneficial, environmentally sustainable, and socially acceptable."

The bank possesses a capital of US$100 billion, equivalent to 2/3 of the capital of the Asian Development Bank, and about half that of the World Bank.

The Asian Development Bank Institute published a report in 2010 which said that the region requires US$8 trillion to be invested in infrastructure between 2010 to 2020, for the region to sustain economic development.

ASEAN's 10 countries are all members of AIIB. Major economies that are not members include Japan and the United States.

Mr. Jin Liqun, the President of AIIB, said during the World Economic Forum in 2016, that "AIIB will only fund projects that are economically beneficial, environmentally sustainable, and socially acceptable."

During 2016, AIIB committed a total of US$1.73 billion to nine projects, among which six projects were joint initiatives with other international lenders such as the World Bank and the Asian Development Bank, achieving its loan disbursement target of US$1.2 billion for the first year.

FIGURE 1 2016 AIIB LENDING

APPROVAL DATE	COUNTRY	PURPOSE	AMOUNT (US$ M)	CO-LENDERS
Jun 24, 2016	Tajikistan	Road Improvement	27.5	European bank for reconstruction and development
Jun 24, 2016	Bangladesh	Power Distribution Lines	165.0	None
Jun 24, 2016	Pakistan	Motorway Construction	100.0	Asian development bank and united kingdom's department for international development
Jun 24, 2016	Indonesia	Redevelopment Of Poor Districts	216.5	World Bank
Sep 27, 2016	Pakistan	Hydropower Plant	300.0	World Bank
Sep 27, 2016	Myanmar	Combined Cycle Gas Turbine Power Plant	20.0	International finance corporation, the asian development bank and certain commercial lenders
Dec 8, 2016	Oman	Railways	36.0	None
Dec 8, 2016	Oman	Port Facilities	265.0	None
Dec 21, 2016	Azerbaijan	Gas Pipeline	600.0	A number of other multilateral development banks including the world bank and other commercial entities

It is quite obvious that the following industry sectors will benefit directly from B&R and AIIB:

- Railways and highways.
- Sea ports.
- Aviation.
- Energy – Oil and gas pipelines, power supply.
- Communications – Optical networks.

OPPORTUNITIES FOR SINGAPORE

Since establishing diplomatic relations in 1990, Singapore and China have developed strong trade, finance, and investments links. Trade and investment ties between the two countries grew steadily over the years, and China became Singapore's largest trading partner in 2014, with bilateral trade in goods reaching US$86 billion. In 2013, Singapore's investment in China reached US$7.23 billion, making it China's largest investor. Singapore is China's top investment destination in Asia as well, attracting over 6,500 Chinese firms operating in Singapore.

Singapore will benefit from the B&R initiative by allowing businesses to operate out of this trading and investment hub, to tap on growth opportunities in the Asian region. Singapore has also established itself as the second-leading offshore hub for RMB trading. We expect to see Singapore's status become more prominent as the shipping and aviation hub of Southeast Asia, in addition to witnessing an increase in trade and personnel exchange across the region as a result of the construction and development of infrastructure, such as ports, airports, and other facilities.

Earlier this year, Singapore and China launched two new projects to expand Chongqing's transport links to Southeast Asia and Central Asia.

Known as the Chongqing Logistics Development Platform (CLDP) and the Multi-Modal Distribution and Connectivity Centre (DC), the two projects are borne out of the Transport and Logistics Masterplan for the Chongqing Connectivity Initiative (CCI).

The CLDP, a company set up for logistics planning, will develop standards and best practices for the transport and logistics industries. The DC is a logistics hub that caters to different transport modes such as river, rail, air, and road, said IE Singapore, a statutory board under the Ministry of Trade and Industry of the Singapore Government.

The CCI, which commenced in November 2015, is Singapore's and China's third joint project, after Suzhou Industrial Park and Tianjin Eco-City. It aims to help drive growth in China's developing western region by improving Chongqing's transport and services links to the region and beyond.

"The two projects raise Chongqing's status as a key inland logistics hub for western China, and also contribute to China's Belt and Road initiative," an IE Singapore executive commented.

OPPORTUNITIES FOR ASEAN

The Chinese government places a strong emphasis on directing the Maritime Silk Road towards the Association of South East Asian Nations (ASEAN). Even though Southeast Asia is rich in resources, it lacks construction funds to develop its infrastructure and suffers from low levels of industrial development. Hence, strengthening infrastructure in ASEAN countries would allow these resources to be tapped into. This initiative strives to promote Chinese capital and technological investment into these ports, transport routes, and other infrastructure in order to improve the resource distribution, market integration, and allow for better facilitation of trade and investment within Southeast Asia.

In high-speed rail, China has now taken its expertise global. B&R will see it take that expertise into the rail connection between China and Southeast Asia.

On November 1, 2016, China Communication Construction Company (CCCC) signed the business contract with Malaysia Rail Link (MRL) for a railway project on the east coast of Peninsula Malaysia, with a contract value of some 46 billion Malaysian ringgit. This is the largest overseas project signed by CCCC, as well as the largest economic and trade cooperation project between China and Malaysia so far.

China is ASEAN's largest trading partner, with a trading volume double the size of Japan-ASEAN trade. However, Japan's total investment amount in ASEAN is three times larger than China's. It is expected that China will increase its investment in the region in the next five years, to catch up with Japan's.

CHALLENGES AND RISKS

However, the opportunities that the B&R initiative brings also result in some risks and challenges. B&R will pass through diverse countries spanning Africa, Asia, and Europe, exposing participating companies to political, credit, and security risks. Numerous countries receiving Chinese financing already bear elevated debt levels and B&R will weaken their sovereign credit position further. The Fitch ratings agency warns that the creditworthiness of many countries along the B&R are rated as extremely low. This significantly raises the risks for Chinese banks that are financing parts of the project. Moreover, China's growing regional influence will elevate geopolitical risks, as it encroaches into India's traditional sphere of influence. We have already seen the recent confrontation between the two countries on their disputed border.

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REASONS CHINESE FIRMS ARE ATTRACTED TO INVEST IN B&R MARKETS

- 40% RICH NATURAL RESOURCES
- 13% LOW ASSET PRICE

PREFERRED MEANS OF CAPITALIZING ON THE B&R INITIATIVE

- 58% JOINT VENTURE WITH LOCAL PARTNER
- 50% MERGERS AND ACQUISITIONS
- 39% EXPORTING PRODUCTS TO B&R MARKETS

WAYS CHINESE FIRMS PROTECT THEMSELVES FROM RISKS IN B&R MARKETS

- 67% WORK WITH CHINESE EMBASSY, CHAMBERS, OR ASSOCIATIONS
- 51% JOINT VENTURES WITH LOCAL ENTERPRISES
- 51% HIRE LOCAL STAFF
- 42% PURCHASE OVERSEAS INVESTMENT INSURANCE

KEY CONCERNS FOR CHINESE ENTERPRISES INVESTING IN B&R MARKETS

- 36% HIGH POLITICAL RISK
- 33% LOW LEVEL OF DEVELOPMENT
- 31% UNDEVELOPED LEGAL SYSTEM
- 29% LACK OF FUNDING
- 29% UNDEVELOPED GOVERNANCE

KEY RISK CONCERNS FOR CHINESE COMPANIES INVESTING IN B&R MARKETS WITH WEAKER GOVERNANCE STRUCTURES

- 71% CONTRACT FRUSTRATION
- 71% CORRUPTION IN GOVERNMENT AGENCIES
- 65% POLICY CHANGES
- 59% POLITICAL VIOLENCE AND WAR
- 58% NATIONALIZATION

Source: Center for China and Globalization (CCG)

B&R could benefit many classes of insurance. The more than 60 countries that are to be connected by land and sea, together with their 4.4 billion inhabitants, are for the most part developing markets with great economic potential. This could throw a new focus on both Chinese and other insurance markets concerned – particularly in the area of marine insurance.

For the insurance industry, according to Swiss Re estimates, B&R could translate to an estimated commercial insurance premium of US$10.6 billion in the Southeast Asian region till 2030. In terms of lines of insurance, this is broken down to US$5.3 billion in Property, US$3.9 billion in Engineering, US$1.3 billion in Marine and US$0.2 billion in Liability.

Chinese firms are learning quickly and their risk awareness and insurance purchase behavior have been changing in the past few years. In the past, insurance purchase was a result of contract requirements from US or European importers, or overseas project owners. Chinese companies normally only paid attention to property loss, and they lacked proactivity towards insurance purchase. As they got exposed to regulatory and compliance requirements on insurance matters in the B&R markets, Chinese firms started to be more aware of the risk and insurance issues. For public-listed companies, a robust risk and insurance program is part of good corporate governance. Many stakeholders in large infrastructure projects (project owners, contractors, and lenders) also require a comprehensive insurance program covering a wide range of risks. The Chinese government, through the State-owned Assets Supervision and Administration Commission (SASAC), has also issued guidelines governing State-Owned Enterprises' (SOEs') overseas investments from an enterprise risk management perspective. Many failures in overseas investments and lessons learned in the past few years forced Chinese firms to elevate their risk awareness. International insurance brokers and insurers also play important roles in raising the risk awareness in China's business community. Today, Chinese firms and their Asian JV partners are more proactive and mature in risk management and risk transfer. They are not only protecting their assets, but also liabilities, people, and returns on investment.

FIGURE 2 RISK MANAGEMENT ADVICE TO CHINESE COMPANIES

In conclusion, China says it will invest US$4 trillion in B&R countries (although it has not given a timeframe for that investment), a significant proportion of which will be in infrastructure such as roads, railways, and airports. B&R will bring plenty of new opportunities to Asian companies, and also present great opportunities for the insurance sector. This is where international insurance brokers and risk advisors like Marsh are uniquely positioned to assist both Chinese and other firms in the B&R markets to assess risks and design effective and cost-efficient risk mitigation and transfer solutions.

MARSH IS ONE OF THE MARSH & McLENNAN COMPANIES, TOGETHER WITH GUY CARPENTER, MERCER, AND OLIVER WYMAN.

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