

Mr. Paul Chan Mo Po, GBM, GBS, MH, JP  
Financial Secretary  
25/F, Central Government Offices  
2 Tim Mei Avenue, Tamar

11 February 2021

Dear Financial Secretary,

### Solvency Capitalisation Scheme ("SCS")

At the Budget Consultation Session for international chambers held before Christmas, I mentioned that BritCham would write to you concerning a proposal for a Solvency Capitalisation Scheme.

The Hong Kong Government has been generous in its economic support throughout the Covid-19 Coronavirus pandemic. The Loan Guarantee Scheme ("LGS") has helped to ensure a flow of cash for SME's which would otherwise have struggled to obtain liquidity from conventional bank lending in this unprecedented economic downturn. The Employment Support Scheme ("ESS") has allowed companies to maintain employment through a period where business levels have in many cases dried up completely and would otherwise have required significant employee lay-offs. As employee payroll is frequently the largest cost item for SMEs, the ESS has also acted as a form of solvency support. In many cases, businesses would have been forced to close completely without this financial support and the rate of insolvencies in Hong Kong in 2020 would have been potentially much higher.

We understand why the Government has been required to tailor the latest version of its financial support scheme to target those business that have been hardest hit by the pandemic. These are expensive schemes. However, we are concerned that insolvencies may now start to rise significantly, particularly in the SME sector, without some additional level of solvency support for those businesses that are not included in the target list.

We would propose, therefore, that the Government consider a scheme which would help with the recapitalization of businesses badly hit by the pandemic in what we are calling a Solvency Capitalisation Scheme ("SCS"). The source of this additional pandemic support funding might be from the Hong Kong Future Fund. The SCS is also designed to function so that the Government maintains an investment interest in participating companies and so reaps the rewards of recovery once COVID is conquered.

In essence, we would propose that the Government consider making a convertible loan investment in “qualifying companies” through a 3 year convertible loan note. The purpose would be to capitalise Hong Kong companies that have fundamentally sound business models but which have been financially stretched as a result of the pandemic. Access to this Government funding would depend on existing shareholders or new private shareholders also subscribing on a “matched basis”.

Under the SCS, all investment terms of the convertible loan note would be the same irrespective of the nature or financial state of the qualifying investee company. Loans would be made using pre drafted documents with terms which cannot be negotiated.

Terms of the note might look something like the following:

- Subscription amount: Between HKD 1.0 mio to HKD 50.0 mio which must be matched by private investors, either existing or new investors;
- Term of the note: 36 months;
- Interest rate: 6-8% on a non-compounding basis, payable annually in arrears;
- Conversion terms: The conversion rate into equity capital would be determined at a discount to the valuation (say 20%) placed on the most recent equity capital fund raising in the ten years to 31 December 2019;
- Security: Unsecured and ranking pari passu with all other unsecured indebtedness of the applicant company;
- Early repayment of the note for cash would be possible with the agreement of all private shareholders but otherwise there is an expectation that the loan note will convert on expiry into equity.

Qualifying companies under the SCS would need to prove that they satisfy the following criteria:

- They are based/registered in Hong Kong;
- They generate at least 50% of their revenues in, or base at least 50% of their employees in Hong Kong;
- They must be unlisted limited liability companies;
- They must have been incorporated before the start of the pandemic (say, before 31 December 2019);
- They must have raised equity funding in the last ten years prior to the start of the pandemic (say, before 31 December 2019);
- They must prove a track record of audited profitability in at least three out of the previous five years (prior to the year ending on 31 December 2019).

In circumstances where an applicant company is part of a group, only the parent company can apply for the SCS. The funds should be deployed strictly as working capital and cannot be used, for example, to repay existing debt or pay shareholder dividends or employee or management bonuses.

In designing the scheme, we have been conscious that the Government would prefer to take as few discretionary decisions as possible and apply the SCS in accordance with clear formulations which are the same for all applicant companies. The terms of the investment cannot be negotiated and are standardized for all applicants. The amount is determined by the extent to which matched funding can also be obtained (up to a cap of HKD 50 mio). Qualifying companies must meet certain pre-agreed criteria, including having a substantial part of their business in Hong Kong.

The question of how the Government might deal with a portfolio of equity investments in SME's as a result of the SCS remains open. Our assumption is that the Future Fund will have the resources and governance mechanisms to handle these investments.

The proposal we have laid out above is loosely based on a similar scheme offered in the United Kingdom by the British Business Bank.

We believe that the Government should grasp the moment now to consider the SCS proposal. If current economic conditions continue for much longer into 2021, there is a high risk of substantially increased insolvencies with a concomitant impact to employment levels and social cohesion.

We would be delighted to discuss our thinking with you some more.

Yours sincerely,



**Peter Burnett**

Chairman

The British Chamber of Commerce in Hong Kong

Cc: Mr Edward Yau Tang Wah, GBS, JP, Secretary for Commerce and Economic Development  
Mr Brett Free, Deputy Director at HKSARG Information Services  
Miss Carrie Chang Kar Wai, Administrative Assistant to Chief Secretary for Administration