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Role for Chinese Commercial Banks in the Belt and Road Initiative

By **HERBERT POENISCH***

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Abstract

China's meteoric rise to become second economy in the world is not only a tribute to the size of China but also to the hard work of the Chinese population and the wise policy by the Chinese leadership.

In addition to a big manufacturing base, a major link in the international value added chain, China is now the major commercial power in the world, acting as major trading partner for more than 50 countries world wide. The partnership is not only on the export side but also on the import side. In addition, Chinese know-how and prowess is visible in more than 70 countries after President Xi Jinping launched the Belt and Road Initiative (BRI) in 2013.

While commerce has become mainly a private affair, with trading partners concluding agreements and exchanging goods, the BRI so far has been a government to government affair. The work is done by Chinese government linked enterprises financed by the policy development banks, first and foremost the China Development Bank (CDB) and the China Import and Export Bank (CMXB). It seems to be accepted that after the initial push, there is ample room now for other enterprises to join and financing being provided by the major Chinese as well as foreign commercial banks.

The article will first present historical examples of banks following trade and investment by previous global powers, the United Kingdom (UK) and the Unites States of America (US). In their cases the banks followed the flag, providing finance for trade and investment of their private companies. Thanks to this strategy, British banks still play a global role long after the demise of the British empire and US banks still enjoy a global role thanks to the US economic global predominance in the 20th century.

In the second part, the presence of Chinese banks in the current global environment will be scrutinised. How is their global presence organised, such as financing from the head office and their branches and subsidiaries abroad and how important are their cross border activities? Are they following the international banking model or have already turned into global banks? How do they rank among the other global banks in the Bank Internationalisation Index?

In the third part the Belt and Road strategy, in particular the financing side will be

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analysed. While the Chinese policy banks have shouldered the main burden of the BRI, the Chinese leaders have opened the door to a different business model, with financing provided by the commercial banks and private investors. This is not only confined to Chinese banks but could also involve foreign banks.

Finally, if Chinese commercial banks were to play a bigger role in the BRI, what would that mean for the form of their participation. While there is no doubt about the top down leadership defining the BRI, the implementation could be an excellent business case for Chinese banks to show their prowess. They could seize the financial and reputational incentive when the policy banks reach their limitations. Would they simply act as agents of the Chinese government or would they participate in their own right? The latter would require the necessary safeguards, such as compliance with international standards such as due diligence and feasibility assessment.

The article will conclude, that Chinese commercial banks can and should pick up the challenge, showing the world, both the investment partners and critiques that they are not in game for political ends but for purely commercial reasons, providing finance for sound infrastructure projects.

1. Historical expansion of national banking systems

The recent history, ie over the past 300 years has seen the industrial revolution, rise in international trade followed by the emergence of international finance. The result was a cumulative process, that countries became first manufacturing powers, then trading powers and finally financial powers.

The dominant ones with a global outreach were the UK since 1800 and the US since 1900. They will provide the historical examples here. Other global powers before were the Dutch and the Spanish. Reaching further back, the Italian bankers in Florence and Genoa were the centres of the financial world, financing the Spanish expeditions to discover the New World.

There seems to be a pattern in development, the so called hegemonic cycle. Countries became vibrant manufacturers first following the industrial revolution. At this stage financing from banks was secondary to financing from equities. This development coincided with the age of imperialism, when countries reached out to far away territories as suppliers of raw materials and markets for finished products. The next stage was commerce, when the dominant powers became major traders of goods and raw materials. The expeditions were financed by private sources and enacted by private companies such as the East India Company. Colonial banks were established to finance trade, import of commodities and export of manufactures. The UK government was deeply divided over joining such endeavours.

During these two stages banks' growth was domestically determined. They provided financial services for the government and domestic merchants. Banking business was based on trust, which only existed among nationals, national legal norms and national courts. Once these conditions were established in the overseas territories, overseas banks, such as the Oriental Bank provided finance for those which were under their jurisdiction. The mother country provided political, economic and legal stability. Outside the British empire, they faced alien political, legal and cultural systems.

British colonies became bases for banking and finance, notably Australia, India, South Africa, but also Hong Kong and Singapore. Under Colonial Banking Regulations of the 1830s Royal Charters were given to newly established banks to operate in a limited geographical area. London was then and still is the paramount financial centre of the world. In a first phase, the overseas banks raised capital on the London Stock Exchange and financed their local lending by local deposits. They performed payment functions through issue of bills of exchange. Their reserves were Sterling balances in London. Keeping and moving balances in Sterling in London was the only accepted global means of payment.

From mid 19th century until WW1 London accumulated huge reserves which had to be recycled through capital exports. Its financial network acquired unique financial expertise and housed the major financial institutions, banks, insurances and brokers and determined standards and rules for the financial industry, providing a fair and transparent environment for the legal and accounting profession until today. During the apex of London's power, foreign funds flowed into London and foreigners were allowed to issue securities, with banks acting as brokers.

Once Britain's manufacturing and commercial power was eclipsed by the US in the first half of the 20th century, funding for global financial operations in London became inadequate. Attempts were made to restore the UK Sterling to its previous glory, such as the return to the gold standard, which failed. Thus foreigners did not put trust into Sterling but the newly rising USD which was more useful in acquiring real resources. The final blow was dealt to Sterling by the financial realities of the WW2.

After WW2 the world financial locations remained the same, London and the offshore centres, but soon the world currency changed.

By the mid 20th century the US had become the major world manufacturing power, but not yet the commercial power nor financial power. US banks were domestic institutions based on domestic funding and lending. World shipping, commerce and finance was still based in London.

The rise of US commerce began after WW2 when the surplus production of US goods, together with provision of finance to major trading partners under the Marshall plan necessitated some financial underpinning. The Marshal plan itself was operated by trading partner governments without US banks playing any major role. US banks started playing a global role when the recycling of trade surpluses from the US became a major task.

US banks followed the UK model, concentrating their lending on US corporations who were eager to go out into the world purchasing raw materials and setting up and/or acquiring operations abroad. Another major engine for US internationalisation were the overseas wars the US got involved in. First the Korean war and then the Vietnam war. As a result, the US became not only a major commercial power but also a financial power as USD flooded the world. US banks imported funds and channelled them back into domestic operations. From 1950 to 1990 the number of overseas branches increased from 95 to 1000.

From the 1960s onwards USD surpluses did not return to the US but stayed outside as Eurodollars due to US regulations. London snatched the moment and attracted these funds thanks to its superior financial infrastructure mentioned before. This offshore activity was not perceived as danger for the highly regulated world financial system. Before long, US banks set up in London, working next to the established UK banks to put this liquidity to good use. US banks set up in other countries served only US manufacturing and trading interests. However, the network covering the globe became available to foreigners to use advanced US banking services as well as new financial techniques. US banks were there to do business and compete with local banks.

After the Great Depression, for most of the 20th century US banking was separated into commercial and investment banking as a result of the Glass-Steagall Act in 1933. As from 1971 floating exchange rates expanded new financial techniques through financial speculation and hedging activities, as well as new techniques for liquidity and risk management, such as derivatives. All this financial expansion occurred on the basis of the global role of the USD. At this stage banks were riding the wave of financial expansion, but they were soon eclipsed by the financial markets.

Similar to developments in the UK, manufacturing and commerce declined, opportunities for productive investment declined, while financial instruments offered high rates and capital gains, corporations channelled large amounts into the financial markets. Commercial banks sought to keep their share by financial engineering which failed after the repeal of the separation of the Glass-Steagall Act in 1999, ending in the financial crisis of 2008.

What are the main lessons from UK and US banks' globalisation. Firstly banks follow manufacturing but mostly commercial interests for their own nationals. Secondly, as countries' manufacturing and commerce sectors decline, banks play a major role in propagating finance for its own sake, money to make money. Finally, banks stay within a well defined regulatory, legal and accounting environment. Having global standards and obeying them, such as the Basel capital standards helps their standing with shareholders. The stock markets are the masters of global banks who punish excessive risk taking.

2. Chinese banks' cross-border operations

While traditionally Chinese banks confined themselves to major financial centres, such as London, New York, Hong Kong, Singapore and Tokyo, since the 'going out' by enterprises and banks has been declared a strategy by the Chinese leaders in 2008, a rush by Chinese enterprises and commercial banks has swept the world. They participate in mergers with and acquisitions of established institutions, setting up branches (preferred) or subsidiaries and representative offices, subsequently called affiliates. In the case of China, lending is done through all four categories of affiliates.

A case in point for mergers and acquisition is the purchase of Standard Chartered Bank operations by Industrial and Commercial Bank of China (ICBC) in Argentina with branches in Latin America. A case for a branch is Bank of China (BOC) in Singapore. A case of wholly owned subsidiary is the Bank of China (UK) in London, incorporated in the UK and supervised by the BoE. Lending through representative offices are initiated there and booked through other affiliates.

While the number of affiliates has been disclosed with pride by Chinese banks, the volume of their overseas business has been shrouded in mystery, even more so their cross-border RMB business. Therefore their actual claims and liabilities will be taken from the balance of payments published by SAFE and the BIS locational banking statistics (LBS), also published on the SAFE website. China does not report data for the consolidated statistics (CBS). The LBS shows both series, lending from banks resident in China (including policy banks) and from China registered banks worldwide in close to 50 jurisdictions reporting to the BIS. It can be assumed that lending from China on the claims side is performed by Chinese owned banks which conduct cross-border business. Foreign owned banks in China receive cross-border funds from their head offices which count as liability for China.

As a recent BIS study shows, Chinese banks lend globally through their affiliates rather than through the head office. While advanced country banks lend 60% of their cross border lending from their head offices, the EME owned banks lend mainly from their affiliates. This is not reflected in the balance of payments, as this is compiled on a residency base. The statistics therefore show the following picture.

Table 1 shows the balance of payments of China, the financial account item 'other investments' in particular. This includes finance other than direct investment (which creates ownership), portfolio investment and derivatives. Over the past 5 years, since the inception of the BRI, banks resident in China increased their cross border net assets, except in 2017 when Chinese entities were encouraged to repatriate funds from abroad.

Table 1. China Balance of Payments, other investment flows, in bn USD

	2014	2015	2016	2017	2018
Total	-2788	-4340	-3167	+519	-770
Assets	-3289	-825	-3499	-1008	-1984
Liabilities	+502	-3515	+332	+1527	+1214

Source: SAFE data, in total +equals inflows and -equals outflows, assets -equals increase in assets, capital outflows, liabilities +equals increase in liabilities, capital inflow www.safe.org.cn

The BIS locational banking statistics which are based on a territorial principle and thus comparable to the BOP show the following picture of stocks in Table 2 (China has been a reporter only since 2016).

Table 2. BIS locational banking statistics, outstanding at year end, in bn USD

	2016	2017	2018
Total	-86	-281	-182
Assets	894	998	1116
Liabilities	980	1279	1298

Source: BIS banking statistics table CN5 www.bis.org/statistics

Even before China became a reporter to the BIS, China always received more funds from abroad than it sent abroad. This was due to borrowing by Chinese banks in the international interbank market and borrowing from their head office by foreign owned banks resident in China. Interbank funds make up about half of claims and liabilities of cross border business. There is no breakdown into intra-bank financing which would show the importance of funding from head office.

The picture changes again when looking at the cross-border business by Chinese owned banks worldwide (in 50 countries and regions reporting to the LBS). As shown in Table 3, Chinese banks are net lenders to the world reflecting their business model mentioned earlier, mainly lending from branches.

Table 3: BIS locational banking statistics, outstanding at year end, in bn USD

	2016	2017	2018
Total	+163	+94	+192
Assets	1732	1981	2177
Liabilities	1569	1884	1985

Source: BIS banking statistics table CN7 www.bis.org/statistics

One can combine tables 2 and 3 to obtain the cross border lending and deposits from branches of Chinese banks in the 50 countries and regions reporting to the LBS. They include the main finance hubs and offshore locations, such as Hong Kong, Singapore, London, Tokyo, New York.

Table 4. Offshore lending of Chinese owned banks, year end in bn USD

	2016	2017	2018
Assets	838	983	1061
Liabilities	589	605	687

Source: BIS statistics, tables CN5 and CN7 combined www.bis.org/statistics

China operates the largest bank operations of their overseas affiliates, making up 64% of all business of all EME owned banks. Others are banks from BRICS countries and Singapore.

Turning finally to the Bank Internationalisation Index 2018 compiled by AIF of Zhejiang University, the big five Chinese commercial banks top the list of largest overseas asset and list of biggest overseas profits. In the list of globally active banks BOC is in place 6, ICBC in place 11, CCB in place 21, COCOM in place 24 and ABC in place 25.

To sum up, the global spread of Chinese banks and their total international lending are a solid bases for increased support for the BRI during its second phase.

3. The opportunities from the Belt and Road Initiative

The Belt and Road Initiative (BRI) was initiated by President Xi Jinping in 2013. The first BRI Forum took place in 2017 and the second one in 2019. While the thrust of this initiative was welcome by most recipient EME, on the donor side there was hesitation to join. The main reason was that the details such as terms and conditions of finance, return on investment, viability were not disclosed.

3.1 BRI first phase

In the first phase it was a government to government agreement where commercial criteria did not matter much. The call during the first Forum for foreigners to join was left unheeded. The Chinese government used their policy banks, first and foremost the CDB and CMXB to finance the projects. The ownership of the projects was also opaque and left the impression that China was in charge and might take over the whole project at some stage.

This impression was reinforced by the design of the project management. The CDB and CMXB set up various funds to initiate, plan, procure, finance, build, and possible run the projects. One example is the China Eurasia Economic Cooperation Fund under the leadership of the CMXB also with the participation of the BOC. Other funds are for China-ASEAN regional cooperation, China-LatAm cooperation, China-Arab cooperation, China-African cooperation. Other donors are the Silk Road Fund, State Administration for Foreign Exchange and Buttonwood as sovereign wealth funds. The way of handling projects, whether confined to one country or to a number of countries such as economic corridors was like a multinational development bank. The members of the funds are in charge of all aspects of projects until the handover to recipient governments.

These funds resemble established financing vehicles. The are like closed end funds with members owning a certain share in the fund. The total value of the fund can increase or decrease depending on the return on investment. However, they are not quoted on exchanges. Funds based on lending resemble a syndicated loan vehicle. There are also mixed funds with an equity component as well as a lending component. The bottom line is that Chinese public funds are at risk.

Although the figures available so far for 2017 are USD 110bn by the CDB and USD 80bn by the CMXB, the total amount disbursed by these banks cannot be measured precisely. Do these figures include funding for Chinese government linked enterprises domestically, such as the China Communication and Construction Company? Do they include trade finance extended to the funds by the CMXB to purchase Chinese machinery and equipment? The Chinese commercial banks also got involved, the ICBC with some USD 160bn in non-concessionary loans, the BOC with USD 100bn also non-concessionary loans, and also CCB and ABC with smaller amounts. It was a rather safe bet for them as implicit government guarantees did not call for risk assessment of the funds' projects. However, market sources of finance were not tapped and foreigners were reluctant to join these opaque project management structures.

Over the years, the assessment of the financial viability of the projects, the risk-return profile on investment, other commercial considerations and debt limitations of the borrowers have raised criticism abroad and rethinking by Chinese authorities. Any government spending came under scrutiny in the drive to reduce the debt financing in the Chinese economy. The BRI projects boosted economic growth by exporting Chinese know-how, machinery and equipment and prevented the downsizing of certain industries. Unfortunately it was part of the debt-financed economy, where the credit risk as well as other risks were borne by Chinese policy and commercial banks. The latter are already burdened by risky domestic lending to SOE and sub-national governments.

In the end a modern world class infrastructure such as China has built over the past few years under the BRI is desirable but the ability to pay by recipients is as uncertain as ever. Very often officials in recipient countries signed on the dotted line without much scrutiny.

3.2 BRI second phase

During the second BRI Forum the tone changed radically, calling the initiative investable and bankable (para 18 of the communique). Details go even further (para 30 of the communique) when national and international financial institutions are invited to join, calls to mobilize private capital and local currency financing are added. During history major infrastructure projects abroad were mostly financed by private funding. The same is true for modern times.

Former PBoC Governor Zhou Xiaochuan in his speech at the BRI Forum 1 called for a market oriented approach, sustainable, a mutually beneficial investment and financial system. Solid finance should rest on two legs, public financing as well as private financing. Public financing consists of the budgetary financing, lending from the development banks, the sovereign wealth funds and bonds issued by banks (Silk Road Bonds) and the borrower governments. Private financing consists of loans from commercial banks, capital market financing through bonds and equity. Securitisation of loans would turn BRI loans into investable products.

Looking at the public financing, from the Chinese side, creativity has been used to avoid direct financing from the budget. There are still unexplored possibilities through special tax regimes for Chinese companies participating in the BRI as well as write off facilities for banks and companies.

The official bond issues for RBI in RMB have been modest, although the domestic RMB bond market is the second largest in the world. Domestic issues such as by participating banks and companies have be earmarked as Silk Road bonds which have already become an asset class. Foreigners should be able to issue Panda bonds in the domestic market. So far only the governments of Philippines and Malaysia have been allowed to issue such bonds. There are still 70 countries out there to tap this market. This would help the internationalisation of RMB as declared one of the BRI objectives.

It is thus surprising that financing in USD is predominant in bilateral (CDB, CMXB) as well as multilateral finance (such as AIIB). The existing swap agreements have hardly been utilised. BRI recipients could use these to obtain RMB while offering their currencies, their collateral or guarantees for a project during a specified period of time.

Turning to private financing, this potential has to be developed and will be subject to detailed discussion in part 4 below as far as commercial banks are concerned. Commercial loans, both domestic and cross border with adequate risk assessment are the mainstay financing vehicle. This can be complemented by private bond and equity issues. BRI project capital market instruments should become an asset class and receive investors' analysis and assessment. In order to receive the support of private investors the BRI related projects should be transparent, with as much information publically disclosed as needed. Under the present model it is not clear what counts as a BRI project and financial details are scarce.

3.3 New BRI project model

Moving from the government model to a market based model, the host countries need to play the key role, with financial feasibility being on par with technical and environmental feasibility.

The crucial part will be to identify investible projects following the criteria stipulated in the BRI communique and establish good governance for the project implementation. Projects need to be put forward by the host countries with estimates of their financial viability as well as the broader economic and social impact. The registry would be the Belt and Road Secretariat in China with posting chosen project details on the website yidaiyilu for transparency. The Secretariat would give brand recognition to projects.

A neutral institution needs to check the impact of the projects on all the UN Sustainable Development Goals (SDG). It has been suggested that the UN regional economic commissions might perform such a task. Once these projects are identified and prioritised, the beneficiaries call for tenders and explore financing methods, public or private or a mixture of them. The market should be clear about the BRI projects and various risks, such as credit risk, market risk, environmental risk and operational risk. Once the BRI brand is established they also carry reputational risk.

At the same time the host countries can nominate technical and financial partners from their countries or foreign institutions to participate in the tender process. This bottom up approach will ensure a transition to a market driven approach, away from top down guidance. This will certainly complicate the transition for Chinese companies as they have been used to do the whole project, from the design, the engineering, providing the machinery and equipment, the qualified cadres, to monitoring the implementation and the after sales service. In some cases they continued to run the project after completion, prompting the 'what is there for us' from the host countries.

Once the projects have been identified, the partners chosen by the beneficiaries in the tender process and the compliance with SDG been certified, a project management office (PMO), set up either in China or in the host country should issue a prospectus with the technical, financial, environmental and social aspects. This will serve as bases for issuing bonds or equities, either onshore in China or abroad. The beneficiary of the project itself will be the issuer. The PMO will be responsible for implementing the project, monitoring the work progress as well as settling of financial obligations. It is also the responsible to flag any irregularities to the owners.

Ownership of the project could be an individual existing company in the host country, such as a power company, a port or airport, a railway or a telecom company. Alternatively a new company, such as a joint venture between the Chinese and local firm can be established. If the project is of wider economic importance the host government can act as owner. The owner will supervise the work of the PMO, particularly any cost and time overruns. It should be clearly stated what happens in such cases, avoiding the impression that China might take over. In addition, the local owner is accountable to the local population for any grievances such as crowing out. At present they are easily directed at any Chinese partners, the companies or the banks.

Once the project has been finished, the PMO will prepare a comprehensive report on all technical and financial aspects, which will be approved by the owner at handover. This will also specify any follow up servicing, maintenance as well as further duties of the contractor to run the project. It should avoid the impression that China continues to run the projects.

4. Role of Chinese commercial banks in BRI projects

Remembering the history of banks going overseas, the UK and US banks in particular, there are parallels with the present situation for Chinese banks but also differences.

4.1 Legal, regulatory and business environment

The UK and US banks ventured abroad during the maturing manufacturing and commercial stages in the hegemonic cycle. They felt safe to venture abroad because the overseas jurisdictions, such as the British Empire and US hegemony defended their business interests. They found laws and regulations as in their home countries, they applied their risk management and accounting standards. In the subsequent years their home standards became the standards of the host countries and later global standards for businesses and banking. The Basel banking standards which were drafted under UK and US guidance and adopted globally are the pinnacle of global banking regulations.

Chinese banks still differ from global banks as they have not fully adopted international standards. When they venture out they will need to follow these standards. However, they bring their business practices with them in order to minimise their credit risk. In a sense they benefit from international banking standards while institutionalising their business practices. A case in point are the various China regional banking associations, such as the BRICS, the SCO (Shanghai Cooperation Organisation), the ASEAN, the Central and Eastern European (CEEC) , the African and Arab interbank associations. Chinese led agreement within these groups ensures that Chinese banks will not be surprised by any unexpected national regulations.

At this point it is unclear whether Chinese banks will comply fully with international standards or rather shape their business environment with the 'Chinese way of doing things'. This covers areas such as personnel management as well as business practices as well as profitability requirement. Regarding personnel, the cadres sent abroad from head office often do not all have necessary international experience. Regarding business practices, it is the mutual understanding between banks and clients which overrules hard fact analysis. Regarding profitability, the purpose of Chinese banks is not only profitability but also non-economic functions. In a domestic environment this would be social harmony and in an international environment spreading Chinese goodwill. Lack of transparency would also count as a Chinese characteristics.

Best banking practices are, on the other hand, as stipulated by the HKMA in a circular in 2017. They include corporate governance, proper incentives, disclosure, assessment and feedback, system monitoring such as AML/CFT, understanding local business practices, compliance and control. Chinese bank leaders have deplored on numerous occasions that Chinese banks going abroad do not fully meet these requirements.

The process of adopting these standards in China is well on the way, with both bank management and bank regulation and supervision pulling in the same direction. Banks going out to finance BRI projects have to beef up their management, risk assessment as well as corporate control.

Lending to BRI countries is particularly challenging as about half of them are below investment grade. It would be embarrassing if Chinese banks were to be seen to be cherry picking, ie lending only to the best risks. The common goal is to serve the globalisation of the Chinese economy by world class banks providing world class line of products. During this transition period Chinese banks have the following choices for providing finance.

4.2 Financing options for Chinese banks

Financing of BRI projects by Chinese commercial banks is well under way. BOC reported total lending of USD 130bn at the end of 2018. However, it is not clear what this includes?

The first one is supporting the BRI initiative mainly through domestic lending to the major Chinese corporations. They preserve the leverage between state owned banks and government linked enterprises. These are informal channels or through their common factual authority, the Communist Party of China (CPC). They have ways to serve the common goal and share the risks. The same logic applies to banks when joining the various existing BRI funds.

To tap local bond markets Bank of China has already issued Silk Road Bonds. Apart from issuing their own bonds, banks can also help BRI projects by acting as brokers for BRI borrowers, governments and companies in the RMB bond market and issuers on the Shanghai and Shenzhen stock exchanges. Investment grade borrowers such as the Governments of Philippines and Malaysia have already received authorisation to issue Panda bonds.

The second way is to go out and finance BRI projects through their affiliates. The BOC is leading with 545 affiliates abroad, followed by ICBC with 419, CCB with 30 and ABC with 17 (figures for 2017). While most of these are in advanced economies and their presence is limited to half the BRI countries, already nearly half of their foreign lending is through affiliates. They use a mixture of business models, international banking model where branch lending is funded from the head office as well as global banking model, where the funding comes from local deposits.

If their affiliates were to play a bigger role in financing BRI projects, the internal control mechanisms have to be improved. Similar to the domestic situation where lending by the branches is tightly controlled by the head office, affiliates abroad are constrained by head office control, both formal and informal through personal links. Risk management capacities of affiliates need to be improved. This includes knowledge of local legal situation and business practices.

As there is no separation of commercial banks and investment banks in China, the provision of long term loans by commercial banks is most likely to be in the form of syndicate loans with the CDB and the CMXB rather than from individual banks. Banks' contributions should be non-concessional. These loans can be off-loaded from the balance sheet through securitisation. Chinese banks have experience in setting up special vehicles, such as for wealth management. They should set up BRI securitisation vehicles off balance sheet. These SPV buy the BRI loans from commercial banks, securitise them in various tranches and sell to Chinese as well as international investors under the BRI brand. This process is similar to the CDO and requires new expertise.

Chinese banks can become partners in the swap agreements when BRI countries provide their currencies, or collateral and guarantees issued outside China in return for Chinese bank loans. Korea has already entered into such arrangements with Chinese banks.

Other ways commercial banks can help financing for the host countries is to arrange funds raising through issuing Panda bonds and equity in the Chinese capital markets. Issuers should be world class projects such as the Gwadar Port in Pakistan, the Bole airport in Ethiopia, the SGR in Kenya and the ECLR in Malaysia. They would qualify for issuing Silk Road Bonds and listing on stock exchanges, but will Chinese investors, apart from commercial banks and foreign investors be willing to invest in BRI financial instruments?

Investment grade borrowers among the BRI countries and low risk projects, such as mentioned above can obtain private finance. Other countries will require specially designed support to share the credit risk. More than half the BRI governments have not obtained investment grade status. They will have to resort to the current government financing model. Even there, the swap agreements of weak currencies have not been utilised and collateral and guarantees by these countries have not been accepted by Chinese banks.

Thus during transition to the new ways of financing, both models, public and private will be used as required by the host governments and the investors. There will be opportunities for Chinese banks to participate but many projects will be rejected for market financing on risk grounds.

5. Conclusion

Judging by the historical experience of banks' globalisation, they have ventured abroad only for their nationals in an environment of calculated risks. The adoption of global banking regulations has reduced the risks for modern banks to venture abroad. However, business environment and business practices as well as national legal norms do differ and pose challenges.

Chinese banks are already well represented abroad and active, offering nearly half of their cross border lending from their affiliates abroad. Their lending already goes beyond pure trade financing. They have thus acquired valuable experience which could be put to good use for financing projects in the BRI second phase.

The second phase of BRI is defined by investable and bankable projects. Different from the previous government to government finance in the first phase, projects should be proposed and operated by host countries, inviting finance from public as well from private sources. Chinese banks are able to provide various instruments of such private financing and should increasingly contribute.

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