

The Clearing and Settlement of Renminbi in Hong Kong

A talk to a delegation from
Singapore Polytechnic

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Outline

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- (3) The system of clearing settlements in Hong Kong
- (4) RMB offshore liquidity and further liberalisation
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(1) Background of Renminbi business in Hong Kong

- Renminbi business in Hong Kong started only in 2004. Initially, the arrangement covered mainly personal banking business, including deposit-taking, currency exchange, remittance, debit and credit cards, and cheque payments, i.e. largely cash-based transactions.
- From 2007 onwards, Mainland financial institutions have been issuing renminbi bonds in Hong Kong, and the range of issuers has spread to the Ministry of Finance, the Mainland subsidiaries of Hong Kong banks, local and multinational corporations, and international financial institutions.
- The term “dim sum bonds” has become popular.

(1) Background of Renminbi business in Hong Kong

- Meanwhile, the introduction of the pilot scheme for renminbi trade settlement in 2009 and its extension in 2010 represented another breakthrough for the development of offshore renminbi business in Hong Kong.
- With the broadening of the enabling policy framework, banks and other financial institutions in Hong Kong now offer a full range of renminbi services, including deposit-taking, currency exchange, remittance, trade finance and wealth management.

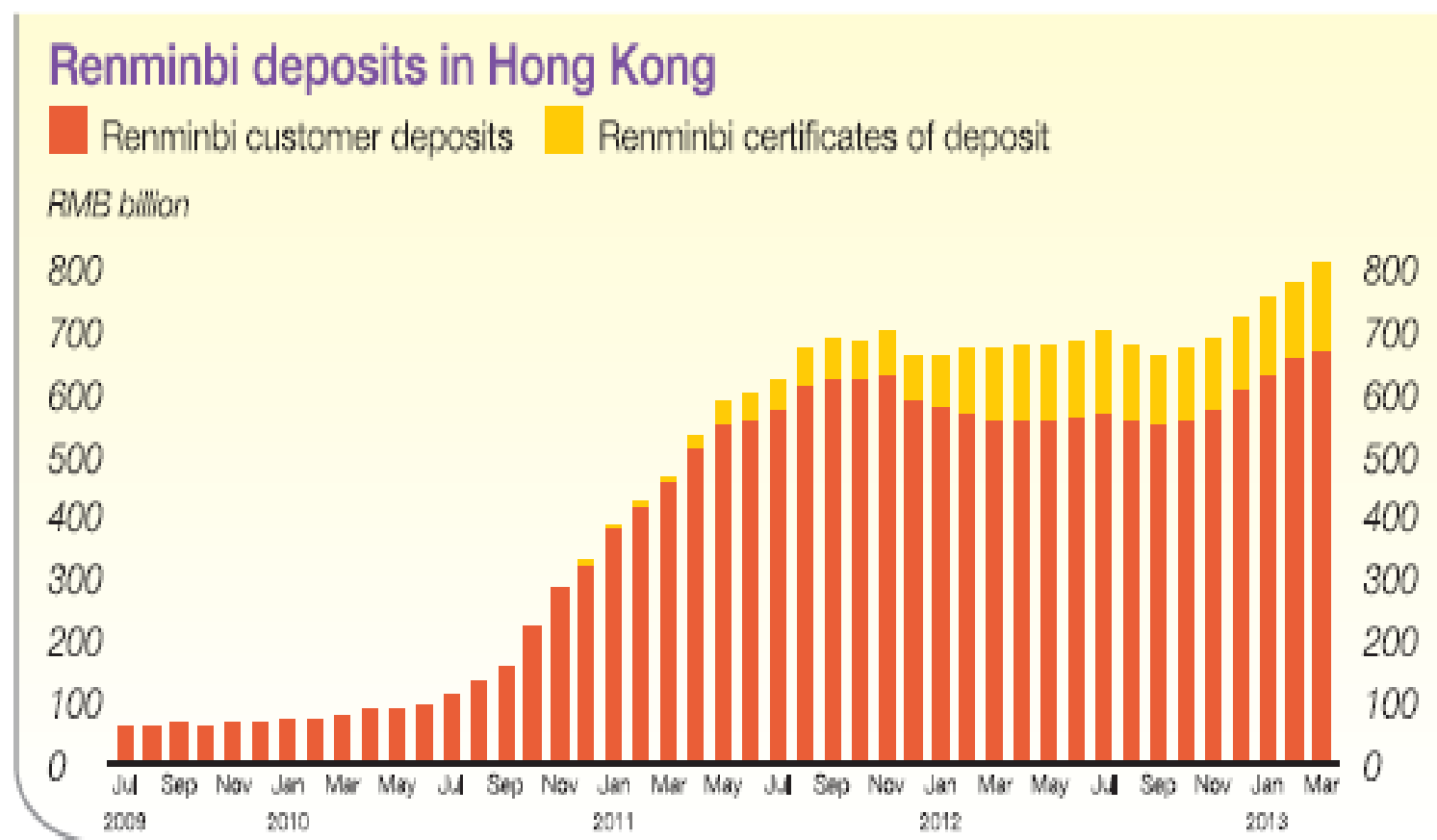
(1) Background of Renminbi business in Hong Kong

- The main source of information for this presentation is: “Hong Kong: The Premier Offshore Renminbi Business Centre” published by the Hong Kong Monetary Authority in May 2013:
- <http://www.hkma.gov.hk/media/eng/doc/key-functions/monetary-stability/rmb-business-in-hong-kong/hkma-rmb-booklet.pdf>
- Many of the diagrams and charts are taken from that publication, except noted otherwise.
- As can be observed, offshore RMB business has been a **recent** phenomenon, growing almost exponentially.

Offshore renminbi business in Hong Kong at a glance

Renminbi retail and corporate banking	<ul style="list-style-type: none">◆ Deposits — conventional and structured deposits, certificates of deposit◆ Currency exchange◆ Cheques◆ Bank cards◆ Remittance◆ Financing — trade financing, other kinds of loans and advances◆ Wealth management products
Renminbi capital market	<ul style="list-style-type: none">◆ Debt origination◆ Investment funds (with access to both onshore and offshore markets)◆ Commodity-linked products◆ Real estate investment trusts (REITs)◆ Exchange-traded funds◆ Equity financing
Renminbi money and forex market	<ul style="list-style-type: none">◆ Spot FX◆ Deliverable forwards and futures◆ Non-deliverable forwards◆ FX options◆ FX swaps
Renminbi insurance	<ul style="list-style-type: none">◆ Insurance plans and products

Hong Kong hosts the largest pool of renminbi liquidity outside Mainland China. At the end of March 2013, renminbi customer deposits and certificates of deposit issued by banks in Hong Kong together amounted to over RMB810 billion yuan. About 70% of the renminbi customer deposits were held by corporates, and over 15% of which were from overseas. This sizeable liquidity pool is helping to meet increasing global demand for renminbi financing and investment.



(1) Background of Renminbi business in Hong Kong

- Anyhow, we should note that the full convertibility and internationalisation of a currency are two different issues, and China is taking a somewhat novel path.
- “While a currency cannot be significantly internationalised without being freely convertible, the reverse is not true.”
- Tsang Shu-ki, “Internationalisation and the full convertibility of the Renminbi”,
(http://www.sktsang.com/ArchiveIII/Tsang_RMB_20100717.pdf)
- How to reduce transaction cost, clearing risk and improve settlement smoothness? These are big questions and challenges. The rationale for using RMB is just next, followed by clearing and settlement technicalities.

(2) The rationale for settling trade and investment in RMB

- Over the past twenty-two years, China has achieved a phenomenal twenty-fold increase in its GDP, as it expanded from less than US\$400 billion in 1990 to over US\$8 trillion in 2012. China's trade and foreign direct investment have also grown significantly from around US\$100 billion to nearly US\$4 trillion in the same period.
- China is now the second largest economy and has become the largest trading country in the world. The International Monetary Fund has projected that China will contribute to about one-third of global growth by 2017.



(2) The rationale for settling trade and investment in RMB

Key benefits of using renminbi to conduct trade and investment activities with China

- Enlarged supplier and customer base and better access to business partners to cover those who prefer to settle transactions in renminbi;
- Improved pricing competitiveness through the elimination of currency exchange costs and risks involving a third currency;
- Shortened settlement cycle which allows business to be done more efficiently;
- Enhanced access to new financing and investment opportunities in renminbi.

How the renminbi trade settlement scheme works

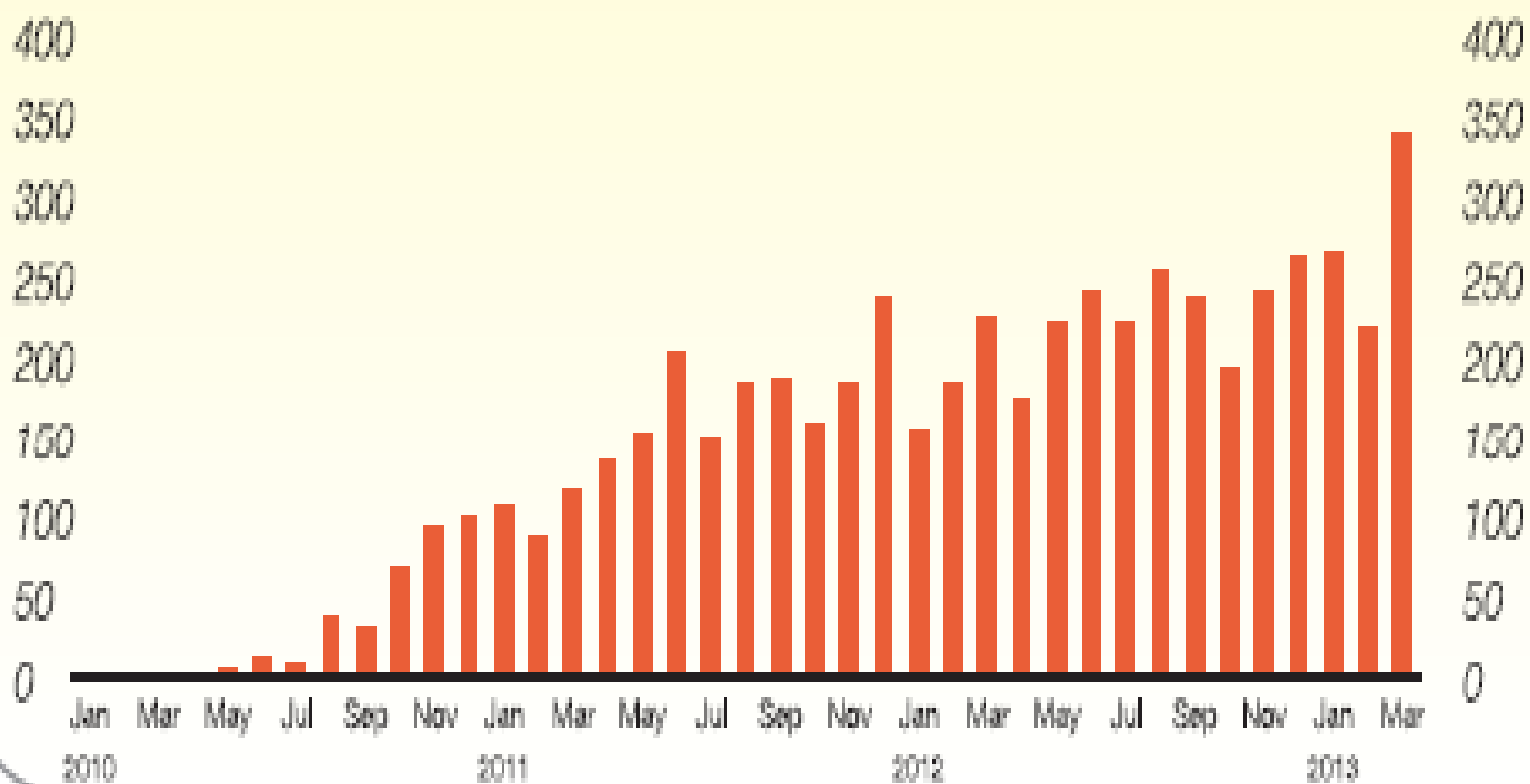
- All trade and other current account transactions between Mainland China and other parts of the world can be settled in renminbi.
- For purchases of goods from Mainland China:
 - An offshore company can make renminbi payments through a bank in Hong Kong to its trade counterpart in Mainland China.
 - Renminbi can be purchased or renminbi credit can be obtained from any bank in Hong Kong if necessary.
- For sales of goods to Mainland China:
 - An offshore company can receive renminbi payments through a bank in Hong Kong from its trade counterpart in Mainland China.
 - The renminbi proceeds can be deposited with a bank in Hong Kong, invested in a wide range of renminbi financial products or converted into other currencies.
- At the wholesale level, an offshore bank can convert renminbi with or borrow renminbi from another bank in Hong Kong, the clearing bank in Hong Kong, or a correspondent bank in Mainland China.

How foreign direct investments in Mainland China can be conducted in renminbi

- An offshore company, having obtained the necessary approval from Mainland Chinese authorities for its direct investment projects, can conduct capital injection and related transactions in renminbi instead of other currencies.
- Banks in Hong Kong can provide a full range of related services, from the remittance of funds to Mainland China, to arranging financing in renminbi, for instance through bank loans or arranging for the issuance of dim-sum bonds.

Renminbi trade settlement in Hong Kong

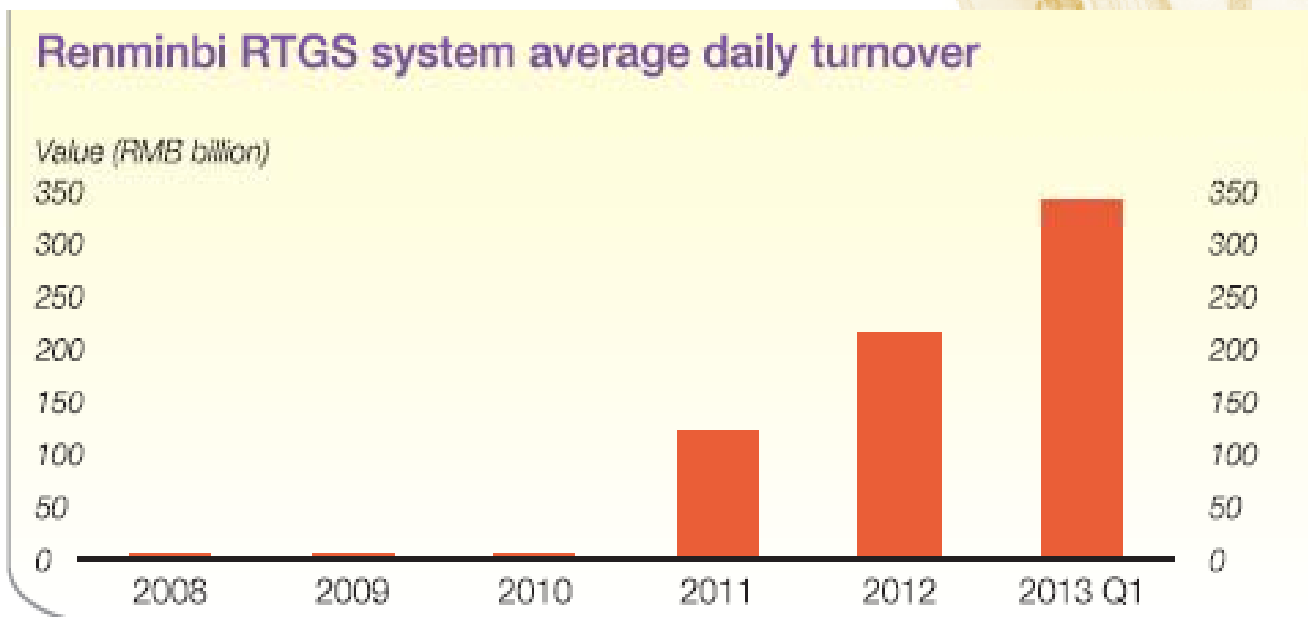
RMB billion



(3) The system of clearing settlements in Hong Kong

- To support the operation of renminbi business, the renminbi Real Time Gross Settlement (RTGS) system in Hong Kong was upgraded from the renminbi Settlement System in June 2007.
- It has then been used not just by Hong Kong corporations, but also international traders and investors.
- Hong Kong has one set of the most efficient RTGS systems in the world, hosting four currencies: HKD, USD, euro and RMB in CHATS (Clearing House Automated Transfer System).

- At the end of March 2013, there were a total of 208 banks participating in the renminbi clearing platform in Hong Kong, of which 184 were branches and subsidiaries of foreign banks and overseas presence of Chinese banks. This has formed a global payment network covering more than 30 countries in six continents, capable of handling renminbi transactions between Mainland China and overseas as well as among the different offshore markets.
- Overseas banks have already maintained over 1,500 renminbi correspondent banking accounts with banks in Hong Kong to meet the increasing demand of offshore renminbi business from their local customers.



Features of the renminbi RTGS system in Hong Kong

System Support	<ul style="list-style-type: none">◆ SWIFT-based RTGS platform◆ Seamless interface with CNAPS (i.e. RTGS system in Mainland China)◆ Linkages among renminbi, Hong Kong dollar, US dollar and Euro RTGS systems◆ Interface with securities clearing and settlement systems (Central Moneymarkets Unit and Central Clearing and Settlement System)
Liquidity	<ul style="list-style-type: none">◆ Deposit base◆ Interbank money market◆ Securities issuance◆ Financing provided by the clearing bank◆ Liquidity facility provided by the Hong Kong Monetary Authority (making use of the currency swap arrangement between the Hong Kong Monetary Authority and the People's Bank of China)
Legal protection	<ul style="list-style-type: none">◆ Settlement finality according to the Clearing and Settlement Systems Ordinance in Hong Kong

How banks can trade and settle foreign exchange transactions involving renminbi

- Trading: Electronic trading platforms, such as Reuters, are available for banks to trade major currency pairs such as USD/CNY in the offshore renminbi market.
- Settlement: the US dollar and renminbi RTGS systems in Hong Kong
 - Allow PvP settlement of USD/CNY foreign exchange transactions
 - Support transactions effected in the Asian time zone, with the renminbi RTGS system also operating in the European and part of the American time zones.
 - Help eliminate settlement risks for the banks and address counterparty risks/limit issues
 - Introduce a cost effective means to meet international best practices
 - Offer better liquidity management

How banks and companies capture benefits of the renminbi RTGS system in Hong Kong

- Banks in Hong Kong or any part of the world can join the renminbi RTGS system directly by opening renminbi accounts with the clearing bank. Overseas banks and financial institutions can also choose to join the system indirectly via a correspondent bank in Hong Kong.
- Companies can enjoy the benefits of the renminbi RTGS system for efficient and reliable cross-border payment services by opening renminbi accounts with any participating bank of the renminbi RTGS system.

(4) RMB offshore liquidity and further liberalisation

- An important element for clearing of RMB settlements is liquidity provision, given transfer smoothness and time difference. For the other CHATS, the managing banks are responsible to provide liquidity.
- RMB is not yet fully convertible, hence a currency swap arrangement between HKMA and PBOC was signed to facilitate. For individual banks, repos should be an important instrument.
- HKMA started to provide repos for RMB in mid-2012.

(4) RMB offshore liquidity and further liberalisation

- “The cross-border funding issue is particularly important to Hong Kong given its role as an international banking centre. 139 of the 199 authorized institutions in Hong Kong are either branches or subsidiaries of banking groups incorporated outside of the territory. An important function of the new service is to enable financial institutions to make use of securities held in one of the partner systems as collateral to conduct secured borrowing in the Hong Kong dollar or renminbi in Hong Kong.”
- “Cross-border collateral management service Signing Ceremony and Press Conference”, Peter Pang, Deputy Chief Executive, Hong Kong Monetary Authority:
<http://www.hkma.gov.hk/eng/key-information/speech-speakers/pstpang/20120620-1.shtml>

(4) RMB offshore liquidity and further liberalisation

- As at the end of May 2012, there were 196 banks participating in Hong Kong's renminbi clearing platform. Of these, 170 are foreign-owned or located overseas. At the same time, over 1,100 renminbi correspondent accounts were maintained by overseas banks with banks in Hong Kong. The amount due to and due from such overseas banks amounted to RMB 128 billion and RMB 146 billion respectively. This is a clear indication that banks from around the world are using Hong Kong's robust platform and large liquidity pool to offer renminbi services to their customers at home.
- Source: same as the last slide.

(4) RMB offshore liquidity and further liberalisation

- The facility has been improved to offer better service and enhanced efficiency.
- In July 2013, HKMA made the following announcement: “The RMB liquidity facility was introduced to address potential short-term liquidity tightness in the offshore RMB market, which may be due to seasonable factors or capital market activities. The facility was first launched in June 2012. In the light of experience in operating the facility and developments in the offshore RMB market, the HKMA made enhancements to the facility in July 2012, January 2013 and again in July 2013.”

(4) RMB offshore liquidity and further liberalisation

- “Currently, overnight RMB funds available on the same day, and 1-day and 1-week RMB funds available on the next day are offered to Participating AIs in Hong Kong under the facility, under the [terms and conditions](#) as stipulated in the [circular](#) issued by the HKMA on 25 July 2013. The HKMA believes the facility can help reduce potential market disruptions and hence enhance market confidence, thereby supporting the long term development of the offshore RMB market. Participating AIs are welcome to use the facility to meet short-term funding needs.”
- [Source: http://www.hkma.gov.hk/eng/key-functions/monetary-stability/liquidity-support-to-banks.shtml](http://www.hkma.gov.hk/eng/key-functions/monetary-stability/liquidity-support-to-banks.shtml)

Terms and Conditions of the RMB Liquidity Facility

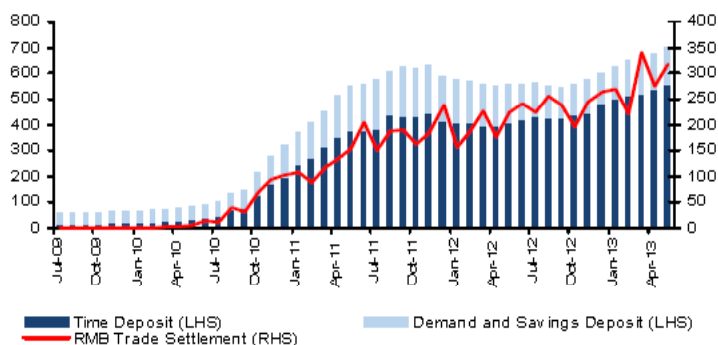
	Tomorrow/1-Week (1-week funds available next day)	Tomorrow/Next (1-day funds available next day)	Overnight (1-day funds available same day)
Tenor	One week	One day	One day
Interest rate	By reference to prevailing market interest rates		
Eligible collateral	<ul style="list-style-type: none"> ● Exchange Fund Bills and Notes ● HKSAR Government bonds ● RMB denominated bonds issued in Hong Kong by the Ministry of Finance of the People's Republic of China 		
Haircut on eligible collateral	<ul style="list-style-type: none"> ● 5% for securities with remaining maturity at 1 year or below ● 10% for securities with remaining maturity at 5 years or below but over 1 year ● 20% for securities with remaining maturity over 5 years 		
Banks eligible ⁽¹⁾	AIs participating in RMB business (Participating AIs)		

Circular related to “Liquidity Support to Banks”, HKMA: <http://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2013/20130725e1.pdf>

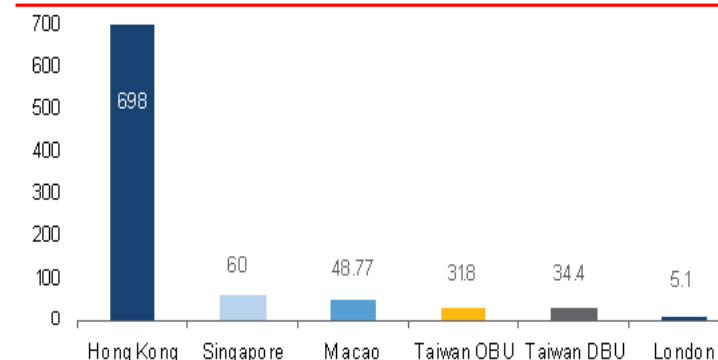
Offshore RMB Liquidity

- **RMB trade settlement** in Hong Kong – increased exponentially, major source of offshore RMB
- Hong Kong banks handled around 90% of Mainland's RMB trade transactions in 2012
- China's external trade settled in RMB increased by 5 times from RMB506.3bn in 2010 to RMB2.63trn for 2012, around 10% of China's total trade, expected to reach one-third by 2015
- **Currency swaps between PBoC and other central banks** is another source of offshore RMB – existing swap line formed between China and central banks in 18 countries and regions, total over RMB2,016.2bn
- Outstanding RMB loans in Hong Kong reached RMB88.7bn at end-Mar 2013, according to HKMA
- **HSBC** conducted the first ever **RMB repo** using HKMA and Euroclear bank as collateral management agent in Dec 2012. This helps to deal with the risk of fragmented liquidity and allows fund flow between different offshore centers

Offshore Liquidity in Hong Kong (RMBbn)



International RMB Liquidity (RMBbn)



Note: RMB deposits in Taiwan OBU and Taiwan DBU in May 2013, Hong Kong and Macao in Apr 2013 and London in Dec 2012. RMB deposits in Singapore was reported by Xinhua on 13 Jun 2012. There may be an overlap between offshore RMB deposits held by Taiwan overseas business units and the offshore RMB deposit pools in HK, Singapore or London.

Source: “RMB Internationalisation:RMB going global”

<http://www.law.harvard.edu/programs/about/pifs/symposia/china/2013-china/rmbchicagohsbc--apratim-chakravarty.pdf>

Recent events relating to RMB internationalisation

Liberalisation has accelerated...

2012

Jun	<ul style="list-style-type: none"> • Direct trading between RMB and Yen launched in Mainland China's inter-bank foreign exchange market • Relaxation of QFII Regulation: QFII investors will be allowed to invest in China's interbank bond market and the AUM requirement was lowered
Aug	<ul style="list-style-type: none"> • RMB services to non-Hong Kong residents began in Hong Kong. Non-residents are allowed to convert unlimited daily amounts of RMB • Mainland and Taiwan signed memorandum of understanding (MOU) on cross-strait currency clearing
Sep	<ul style="list-style-type: none"> • The world's first deliverable RMB currency futures started trading on the HKEx on 17 Sep
Oct	<ul style="list-style-type: none"> • The first RMB-traded equity security outside Mainland China and the first dual counter equity was listed in HKEx
Dec	<ul style="list-style-type: none"> • Bank of China Taipei branch was given official approval as the clearing bank for RMB in Taiwan • SAFE announced that it would remove the \$1bn individual QFII cap for sovereign funds, central banks and monetary authorities • PBoC released rules on the cross-border yuan lending business pilot between companies in the Qianhai business zone in Shenzhen and banks in Hong Kong

2013

Jan	<ul style="list-style-type: none"> • Cross-border RMB loan in Qianhai Shenzhen Zone kick started with 15 HK-based banks • Trial run cross-border RMB settlement under trade for individuals launched in Yiwu City in Zhejiang Province
Feb	<ul style="list-style-type: none"> • RMB business in Taiwan launched on 6 Feb, with 46 banks beginning to offer deposits, lending, remittance and wealth management services • PBOC named ICBC as the sole RMB clearing bank in Singapore
Mar	<ul style="list-style-type: none"> • CSRC expanded RQFII to HK subsidiaries of Chinese banks, insurers and HK financial institutions and removed restrictions on asset allocation • PBoC confirmed the eligibility for QFII and RQFII investors to enter China's interbank bond market
Apr	<ul style="list-style-type: none"> • Direct trading between the RMB and AUD launched in Mainland China's the inter-bank foreign exchange market on 10 Apr • The HKMA removed the RMB net open position (NOP) limit and the specific RMB liquidity ratio. They should help to improve offshore liquidity
May	<ul style="list-style-type: none"> • On 27 May, Singapore followed Taiwan and Hong Kong in beginning direct RMB clearing
Jun	<ul style="list-style-type: none"> • The Treasury Markets Association launched the CNH Hong Kong Interbank Offered Rates (CNH HIBOR) fixing on 24 June • China's Ministry of Finance announced the issue of RMB sovereign bonds totaling RMB 23billion in Hong Kong this year, of which RMB 13billion was issued on 26 Jun and RMB 10billion will be issued in the second half of the year

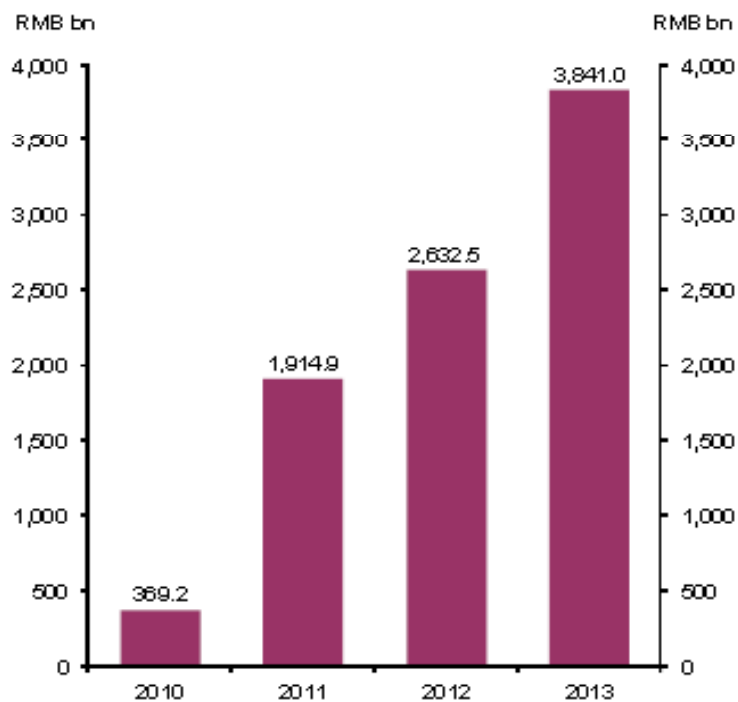
Source: HSBC

Source: same.

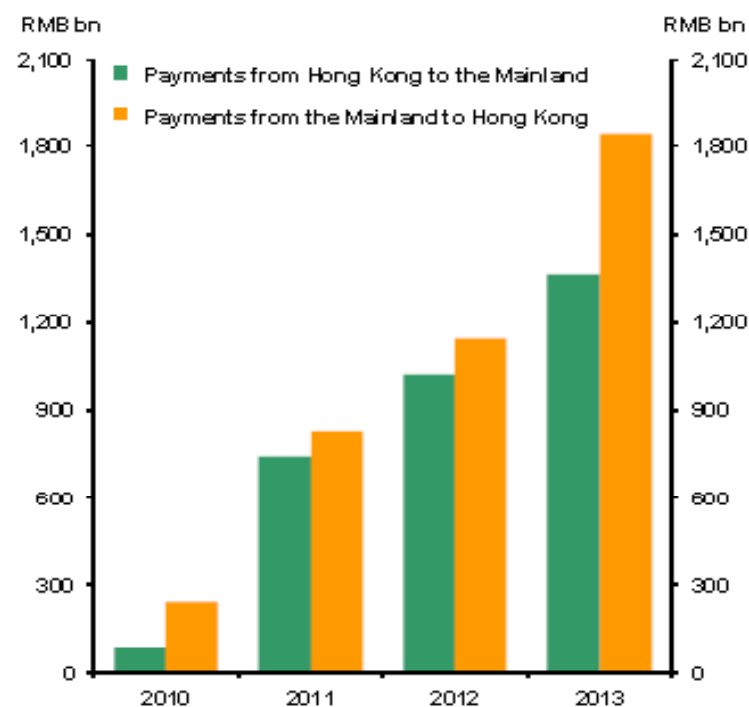


CONTINUED EXPANSION IN RMB TRADE SETTLEMENT

RMB trade settlement handled by banks in Hong Kong



Flows of RMB trade settlement between Hong Kong and the Mainland



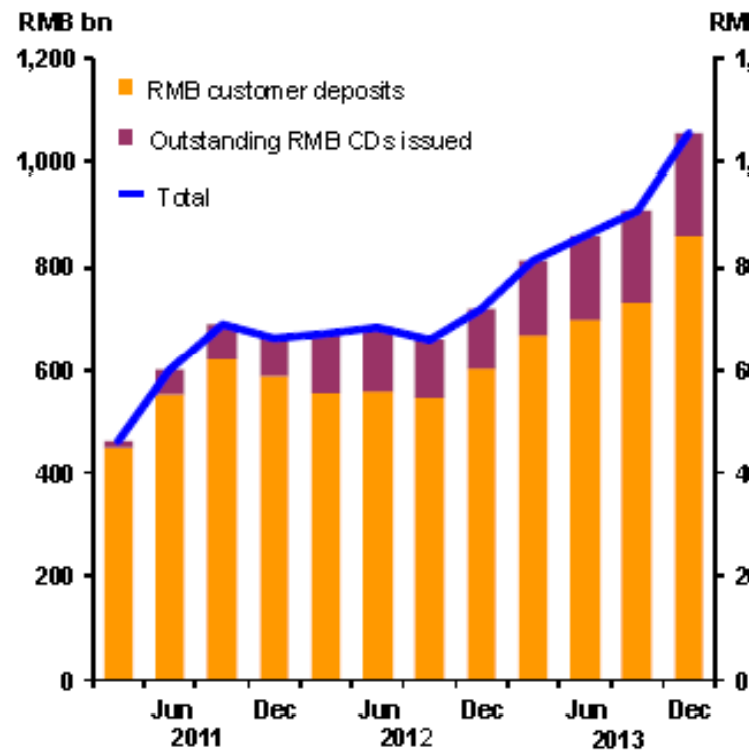
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“Briefing to Legislative Council Panel on Financial Affairs”, Hong Kong Monetary Authority, 7 February 2014 (<http://www.hkma.gov.hk/media/eng/doc/about-the-hkma/legislative-council-issues/20140207e2.pdf>).

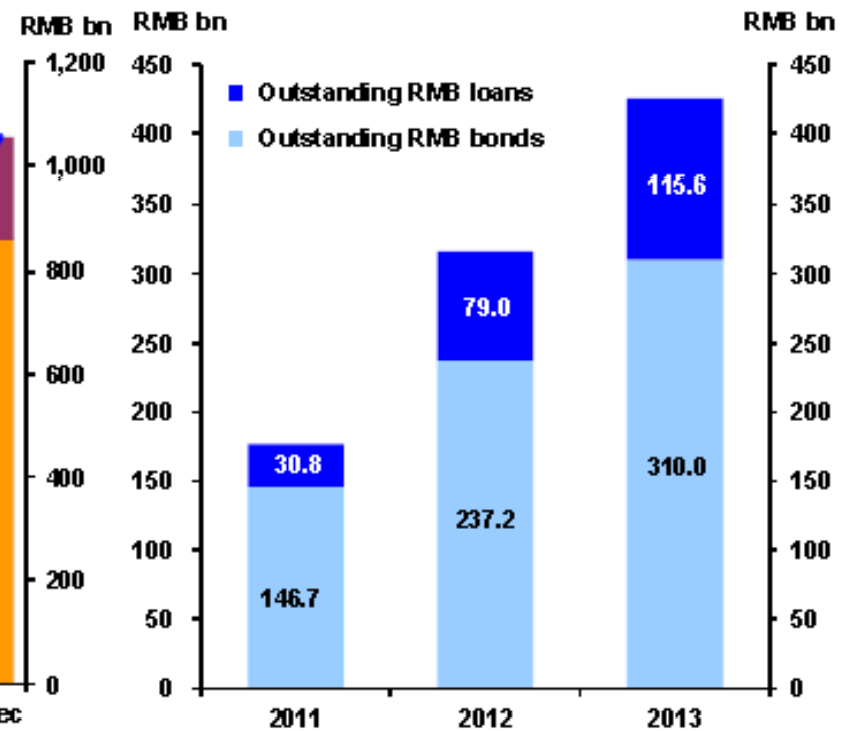


STEADY DEVELOPMENT OF RMB FINANCING MARKET

RMB customer deposits and certificates of deposit (CDs)



RMB financing activities



Source: same as last slide.



STRENGTHENING OF HONG KONG'S RMB BUSINESS LINKS WITH OTHER PARTS OF THE WORLD

	2013	2012	2011
1 No. of participating banks of Hong Kong's RMB clearing platform	216	204	187
Of which:			
Branches and subsidiaries of overseas banks and overseas presence of Mainland banks	191	181	165
2 Amount due to overseas banks (RMB billion)	166.0	99.1	116.4
3 Amount due from overseas banks (RMB billion)	164.5	117.1	121.7
4 Turnover in Hong Kong's RMB RTGS system (Daily average during the period; RMB billion)	395.4	213.7	121.4

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Source: same as last slide.

(4) RMB offshore liquidity and further liberalisation

- Full convertibility of RMB is officially implied at 2020, but commentators predict 2017.
- **A fully convertible RMB can only float. Pegging it to another currency would not be sensible as China aspires to be a world power.**
- As said, China has adopted the path of full convertibility and internationalisation as a **leapfrogging** strategy. So in the meantime, the floating range of RMB has been widening, one of the reason being to counter the expectations of “systematic appreciation”.
- It should not be surprising if the band is further expanded in the future.

(4) RMB offshore liquidity and further liberalisation

The floating range of RMB in the post-2005 period of managed flexibility

Time/floating range around the middle rate	Against USD
200507	0.3%
200705	0.5%
201204	1.0%
201403	2.0%

(5) References

- “Hong Kong: The Premier Offshore Renminbi Business Centre” published by Hong Kong Monetary Authority in May 2013: <http://www.hkma.gov.hk/media/eng/doc/key-functions/monetary-stability/rmb-business-in-hong-kong/hkma-rmb-booklet.pdf>
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- Circular related to “Liquidity Support to Banks”, HKMA: <http://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2013/20130725e1.pdf>
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