

2011

lakkyara

Kyara, which means "precious" in ancient Japanese, is an aromatic resin regarded as the highest quality of all agarwood. "lakkyara [la-ká-la]" aims to deliver the same quality as Kyara together with NRI's endeavour for continuous excellence and innovation to provide the most advanced and up-to-date information to our readers worldwide.

vol.104 (10.March.2011)

**Hong Kong is ramping up
renminbi financial services**

China is steadily internationalizing the renminbi. In January 2011, it legalized renminbi-funded foreign direct investment. Against such a backdrop, Hong Kong is focused on providing renminbi financial services in the aim of becoming a key renminbi offshore center.

Hong Kong is positioning itself as an RMB offshore hub

With China steadily taking steps to internationalize the renminbi (RMB), Hong Kong is positioning itself as a key RMB offshore center.

If the RMB becomes an international currency, how to (1) supply RMB to China's trading partners and (2) provide investment vehicles for RMB funds held offshore will obviously be important issues¹⁾.

To address the first issue, China launched an RMB trade settlement pilot project in July 2009 and the People's Bank China (PBoC) entered into currency swap agreements with seven other central banks between December 2008 and year-end 2010. In terms of investment vehicles, RMB bond

issuance has been taking place in Hong Kong since 2007.

Against such a backdrop, Hong Kong laid a foundation for dynamic growth in local RMB financial services businesses in 2010.

First, in February 2010, the Hong Kong Monetary Authority (HKMA) issued a document entitled "Elucidation of Supervisory Principles and Operational Arrangements Regarding Renminbi Businesses in Hong Kong" in the aim of facilitating the development of various RMB financial service businesses in Hong Kong in the wake of the RMB trade settlement pilot program's advent in July 2009.

The document set forth the following two principles for RMB trade settlement and RMB businesses.

Exhibit. RMB financial services in Hong Kong

Service	Until July 2010	Changes since July 2010
Deposits	<ul style="list-style-type: none"> Hong Kong residents, businesses in 7 designated sectors (see note), and importers/exporters eligible to participate in RMB trade settlement pilot program could open deposit accounts at Participating Als. 	<ul style="list-style-type: none"> Any company may open a business account for general purposes at a Participating Al. No restrictions on business customers' cash deposits and withdrawals. Participating Als may offer customers RMB investment products and issue CDs also.
Currency exchange	<ul style="list-style-type: none"> RMB HKD conversions by individuals were subject to daily limit of RMB20,000 (or equivalent). Remittances to Mainland accounts held in customer's own name were subject to daily limit of RMB80,000. Companies in 7 designated sectors could convert RMB funds obtained in ordinary course of business to HKD. Importer/exporters' currency conversions to RMB were limited to trade transactions' actual value. 	<ul style="list-style-type: none"> No change in restrictions on individuals and companies in 7 designated sectors. Participating Als may square open currency positions with an RMB clearing bank if the purpose of doing so is (a) related to RMB trade settlement (up to a maximum of the transaction value), (b) repayment of RMB trade finance (only if the customer lacks sufficient RMB funds for repayment), or (c) currency conversion between RMB and foreign currency to enable business customers to pay expenses related to bond issuance in Hong Kong. For conversion services for business customers for purposes not mentioned above, Participating Als are not subject to any restrictions if they do not square the corresponding open position with a clearing bank or if they square it with another Participating Al.
Remittances/checking	<ul style="list-style-type: none"> RMB checks drawn on RMB demand accounts at Participating Als could be used only to pay (1) expenses related to acquiring RMB bonds in Hong Kong or (2) consumption expenditures in Guangdong Province (subject to a daily limit of RMB80,000 per account). Permissible RMB remittances (including checks) within Hong Kong were limited to transfers between accounts for businesses held in the same name at different banks for the purpose of pooling RMB funds for trade settlement. 	<ul style="list-style-type: none"> Restrictions on remittances (including check payments within Hong Kong) by individuals and companies in 7 designated sectors were abolished (customers in Hong Kong may remit RMB funds at their discretion (e.g., to purchase wealth management products)). Businesses may remit RMB funds between different accounts (including check payments within Hong Kong) at their discretion.
Lending	<ul style="list-style-type: none"> RMB trade finance was limited to the value of trade transactions with Mainland companies and had to be paid directly to the Mainland company. 	<ul style="list-style-type: none"> No restrictions on RMB loans to business customers but loans to individuals and companies in 7 designated sectors are currently prohibited.

Note: The above table includes only a partial list of RMB financial services available in Hong Kong.

The seven designated sectors are retailing, restaurants/bars, lodging, transportation, telecom, healthcare, and education.

Source: NRI, based largely on HKMA, "Renminbi Business in Hong Kong" (Arthur K.H. Yuen, 19 July 2010)

(1) Cross-border flows of RMB funds into and out of Mainland China should comply with Mainland rules and requirements.

(2) For RMB funds that have flowed into Hong Kong, participating Authorized Institutions²⁾ (Participating AIs) can develop RMB businesses based on Hong Kong's regulatory requirements and market conditions, provided that such businesses do not involve the flow of RMB funds back to the Mainland.

In other words, the HKMA authorized financial institutions to provide RMB financial services in Hong Kong like they already do for other foreign currencies, subject to the condition that RMB funds that have entered Hong Kong may not be repatriated to Mainland China.

Growth of RMB financial services in Hong Kong

In July 2010, the PBoC entered into a Supplementary Memorandum of Cooperation with the HKMA and a revised agreement with the Bank of China (Hong Kong) regarding RMB trade settlement. By virtue of these agreements, Participating AIs in Hong Kong can now (1) open RMB deposit accounts for businesses, (2) provide RMB currency exchange services to business customers, (3) transfer funds between different customers' RMB deposit accounts held at Participating AIs, (4) extend RMB loans to businesses, (5) offer RMB investment products to customers, and (6) issue CDs (see table).

In August, the PBoC issued a notice³⁾ opening the Mainland interbank bond market to investment of RMB funds by (1) RMB clearing banks and Participating AIs in Hong Kong and Macau, (2) overseas Participating AIs, and (3) overseas central banks and monetary authorities.

Of course, not everything has proceeded according to plan. Last autumn, RMB purchases from the Shanghai Foreign Exchange Center via Participating AIs were halted in response to widespread arbitraging of RMB interest rate and exchange rate differentials between Hong Kong and the Mainland. Regulations were subsequently revised to prevent such speculation⁴⁾.

Hong Kong's importance will grow in tandem with RMB internationalization

In June 2010, China expanded the scope of its RMB trade settlement pilot program to 20 Mainland provinces and cities (it was initially limited to Shanghai and one other city in Guangdong Province). The included provinces and cities account for some 97% of China's outward trade (as of 2009). At the same time, China eliminated restrictions on overseas trading partners eligible to participate in the program (eligibility was initially limited to Hong Kong, Macau, and ASEAN countries). Additionally, the pilot program's scope was expanded to include trade in services and other current account transactions also.

In 2011, the PBoC issued Provisional Rules for the RMB Settlement Program for Foreign Direct Investment (FDI) on 6 January, legalizing RMB-funded FDI.

According to these Provisional Rules, nonfinancial companies registered within the RMB trade settlement pilot program's geographic boundaries may use RMB funds for FDI. These companies may also use RMB funds for domestic remittance of profits derived from FDI. Additionally, banks may extend RMB loans to domestic companies' FDI-investee companies and projects via overseas branches or overseas correspondent banks.

The Provisional Rules are intended to promote both further development of RMB trade settlement services and China's "Go Global" FDI strategy in anticipation of sustained RMB appreciation. Additionally, RMB will likely flow into foreign countries through RMB-funded FDI and RMB loans to Chinese-owned overseas companies acquired through FDI.

In the wake of the above developments, RMB financial services are gaining recognition in Hong Kong as bona fide businesses, not pilot programs. In addition to RMB bonds, equity offerings denominated in RMB are expected in the future. China is also considering allowing investment in domestic A shares through the mini-QFII (Qualified Foreign Institutional Investor) program⁵⁾. Meanwhile, financial regulatory authorities and financial institutions are proceeding with infrastructural preparations such as modification of trading systems.

As RMB trade settlement and fund-raising continues to increase, Hong Kong's importance as an RMB financial hub is expected to likewise grow.

Author's Profile

Takeshi Jingu

Chief Researcher
Nomura Research Institute (Beijing), Ltd.

E-mail : kyara@nri.co.jp

Note

1) Full internationalization of the RMB will require capital account liberalization, transition to a floating exchange rate regime, and strengthening of domestic financial institutions' management capabilities. Such reforms will likely take a long time to be realized. For the time being, Chinese authorities are apparently pursuing currency regionalization (i.e., promoting the RMB's widespread use for trade settlement in neighboring countries/regions, including Southeast Asia).

2) For more details on Participating Als and RMB clearing banks, see "Outlook for Chinese Renminbi as It Sets on Path toward Internationalization" (in Japanese) (Nomura Financial & Economic Research Center, *Zaikai Kansoku*, Spring 2010). Overseas Participating Als settle and clear RMB trade transactions through RMB clearing banks in Hong Kong and Macau, between themselves, or through Mainland correspondent banks. The RMB clearing bank in Hong Kong is Bank of China (Hong Kong).

3) "Notice Concerning Pilot RMB Investment in Interbank Bond Market by Three Types of Institutions, Including Overseas Participating Als."

4) RMB funds were apparently being obtained under the guise of trade settlement. In response, in December 2010, the authorities imposed two additional restrictions on Participating Als' RMB purchases from the Shanghai Foreign Exchange Center through an RMB clearing bank. First, if after purchasing RMB funds from customers in connection with trade settlement, Participating Als lack sufficient RMB funds to meet customers' trade-settlement funding requirements, they may purchase only enough RMB to offset the deficit. Second, Participating Als may purchase RMB only for trade transactions that require payment to the Mainland within three months.

5) The mini-QFII (RMB QFII) program allows Mainland-owned financial institutions to create RMB funds in Hong Kong to invest in domestic A shares, among other assets.

The entire content of this report is subject to copyright with all rights reserved. The report is provided solely for informational purposes for our UK and USA readers and is not to be construed as providing advice, recommendations, endorsements, representations or warranties of any kind whatsoever. Whilst every effort has been taken to ensure the accuracy of the information, NRI shall have no liability for any loss or damage arising directly or indirectly from the use of the information contained in this report. Reproduction in whole or in part use for any public purpose is permitted only with the prior written approval of Nomura Research Institute, Ltd.

Inquiries to : Financial Technology and Market Research Department
Nomura Research Institute, Ltd.
Marunouchi Kitaguchi Bldg.
1-6-5 Marunouchi, Chiyoda-ku, Tokyo 100-0005, Japan
E-mail : kyara@nri.co.jp

<http://www.nri.co.jp/english/opinion/lakyara>