White paper

RMB internationalisation:

Implications for the global financial industry

Key contributors

Understand what RMB internationalisation means for you

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More than 900 financial institutions in over 70 countries are already doing business in the Chinese Renminbi (RMB)[1]. Is yours one of them – or are you still trying to figure out what the internationalisation of the RMB means for your bank?

We're all familiar with China's economic success story. But its currency is used far less internationally than one would expect. This is because until 2002, China's domestic market was pretty much closed to foreign investors. That's all changed now. Since June 2010, corporations anywhere in the world can settle in RMB.

You might be surprised by the spectacular growth we've seen during recent months: more than 10% of China's cross-border trade is now settled in RMB. In Hong Kong, 'Dim Sum' bonds and RMB IPOs are really taking off. The RMB is used for retail business in Singapore, and there's active FX trading around the RMB in London.

Both Chinese and non-Chinese banks involved in global trade with China will feel the impact of the RMB internationalisation on their business:

— Chinese banks see this as a strategic opportunity to follow their clients abroad and develop their international payments clearing business;

— Non-Chinese banks see this as a growth opportunity, as foreign corporates now need to buy, pay and invest the RMB they receive;

— Banks globally may over time see payments to China, of which over 90% are currently in USD, migrate directly to China in RMB, affecting the clearing business in New York.

SWIFT RMB Business Insights report
Some statistics in this White Paper are taken from the SWIFT RMB Business Insights report. That 40-page report provides more detailed business insights into recent RMB transaction flows, business development opportunities and market share – based on financial transactions going over SWIFT as extracted from SWIFT Value Analyser. The report can be purchased from SWIFT. Please contact swiftforbanks@swift.com.

The full implications of the internationalisation of the RMB are still not clear. This white paper does not just illustrate how the RMB is developing but also identifies specific scenarios as to how this will impact banks' revenues and the financial industry as a whole.

If your institution is active in the international markets, you have little choice but to formulate an RMB strategy. It's time to seize this opportunity to develop new business. This paper shares insights and guidance on how to prepare for this important change that is already under way.

Banks see a positive role for SWIFT here, to create collaborative solutions that improve the automation of RMB transactions, further broaden the understanding in the financial industry of the impact of RMB internationalisation, and provide insights that help our customers spot new revenue opportunities.

As next steps, four strategic actions should be pursued:

1. Additional policy liberalisation;
2. Closer integration of China with the international financial community and automation of RMB transactions flows;
3. Continue to promote customer take-up. This will lead to more volumes;
4. Further improve the banks' RMB business case.

This paper identifies countries with a positive outlook to develop your RMB payments business. Because for banks, building a sizeable revenue stream is what the RMB internationalisation is all about.

We look forward to your thoughts and opinions.

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Source: SWIFT

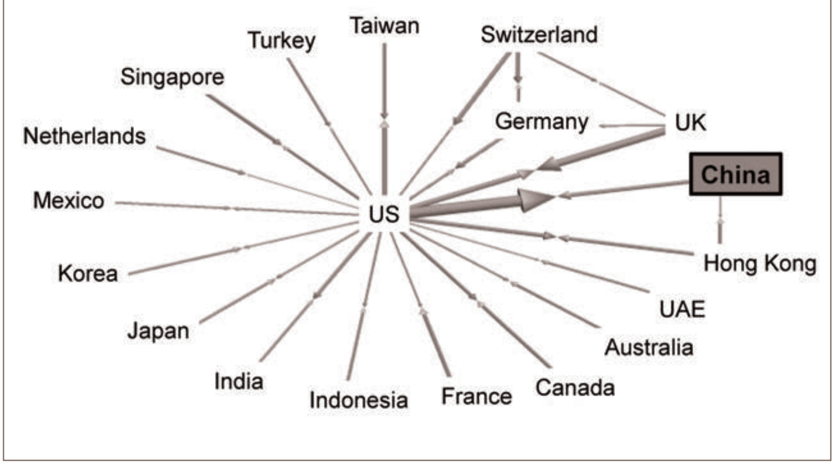

Figure 1: China is biggest payments corridor. June 2011 year-to-date customer initiated and institutional payments. Size of arrow represents number of payments.

China is big, but the RMB is underutilised internationally

China has developed into a world economic giant.

In 2010, China overtook Japan to become the world's second largest economy with a GDP of USD 5.8 trillion, or 9.5% of the world's total GDP. China is now the world's largest exporter.

Some analysts predict China will overtake the US as the world's largest economy by the mid-2020s. China's GDP growth in 2010 was 10.3%. This rate is expected to slow in the coming decade to 8-9% (due to factors including the slowing of export growth because of weaker demand from large developed economies, RMB appreciation and rising labour costs); the Chinese 12th Five-Year Plan predicts a GDP growth target of 7%.

China – the biggest international payments corridor

On SWIFT, payments with China – in particular from the US – represent the biggest international corridor (see Figure 1).

However, the currencies of other countries are used for the vast majority of those payments with China, while its own currency – the Renminbi (RMB) – is underutilised at the international level.

China's payments are mainly in USD

In June 2011, 98% of payments in and out of China were not in RMB but mainly in USD (nearly 80%). There are actually more cross-border trade settlements in RMB with Chinese corporates, but most happen via Hong Kong.

This is in sharp contrast to the US, where more than 90% of payments in and out are in USD and Japan, where more than 70% are in JPY. These are developed economies however, whose currencies are freely convertible and have been internationalised for many years. That said, it is worth noting that the RUB is used in 46% of payments with Russia.

RMB – not a world currency yet

At the international level, the RMB is currently underutilised.

A currency is typically considered "international" when it is used as a unit of account (for example corporate invoices), a medium of exchange (to settle cross-border trade) and a store of value (deposits, reserve currency).

Analysis of two very practical measures – market shares in international payments and in foreign exchange markets - is informative.

Import/export is typically a driver for the international use of a currency. In June

2011, the RMB was world payments currency number 21, with 0.24% share in payments value, while China's share in world trade was 11.4% in 2010. These figures show a clear underutilisation of the RMB in relation to China's economy.

Internationalised currencies like the EUR, USD and GBP are used way beyond their country's share in trade. New Zealand is one example of a small economy with an extremely international NZD currency (see Figure 2).

In the FX business, the RMB is currently underrepresented when compared to the size of China's economy. With a world market share of 0.9% in FX value in June 2011 and a world GDP share of 9.5% in 2010, we get an FX/GDP co-efficient of 9%. This is very low, even when compared to the Thai Baht, for example (see Figure 3).

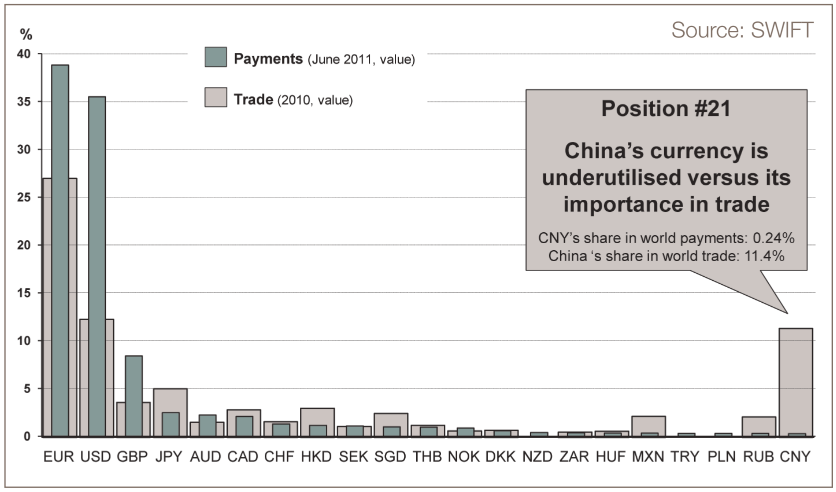

Figure 2: World payments currencies vs trade

Source: SWIFT

Rank	Currency	Share FX June 2011	Share GDP 2010	Share FX / Share GDP
1	USD	45.9%	23.3%	197%
2	EUR	16.9%	19.4%	87%
3	JPY	6.8%	8.7%	79%
4	GBP	5.8%	3.6%	162%
5	AUD	3.7%	2.0%	189%
6	CHF	2.9%	0.8%	348%
7	CAD	2.4%	2.5%	94%
8	SGD	1.6%	0.4%	446%
9	HKD	1.2%	0.4%	334%
10	KRW	1.0%	1.6%	62%
14	**CNY**	**0.9%**	**9.5%**	**9%**
27	THB	0.2%	0.5%	46%

Figure 3: Underrepresentation of RMB in FX

RMB internationalisation is at an early stage – but the benefits are clear

International usage of the RMB is in its early days. However there are many benefits to be achieved through the liberalisation and promotion of the use of RMB beyond China's borders.

Chinese corporates, in particular SMEs, can use RMB for cross-border trade instead of a foreign currency avoid FX costs and exchange risk. Foreign corporates paying in RMB can do business with more corporates in China, thus increasing the overall size of trade. Large corporates can manage their RMB more globally and over time diversify their assets and protect against depreciation of one currency.

From a macro-economic point of view a third world currency could be beneficial – particularly one from Asia, in which countries could hold their reserves, especially as trade between Asian countries increases. During the recent financial crisis, banks in some Asian economies that use USD experienced liquidity issues because of the increased cost of funding.

First regional, then international

Mindful of the benefits to be achieved, China embarked on a gradual approach to RMB internationalisation, sometimes described as a strategy of 'crossing the river by feeling the stones'.

While there is no roadmap with predefined timeframes for the full convertibility of the RMB, we can identify certain phases (see Figure 4. A list of key milestones is included in Annex 1).

As far back as 1993, the People's Bank of China signed cross-border trade currency settlement agreements with the central banks of countries like Vietnam, Mongolia and Russia. By June 2011, China had signed currency swap agreements with 12 countries for a total of RMB 834 billion.

A number of actions were taken to further promote the use of the RMB internationally. Policy liberalisation started in 2002, when for the first time qualified foreign institutional investors (QFII) were allowed to invest in China's domestic stock market. Liberalisation expanded regionally beginning in 2004 for retail, bonds, currency swaps and trade settlement with Hong Kong and ASEAN countries. It went international from June 2010, allowing trade settlement with any corporate in the world (except in the case of local restrictions), and more recently further lifting restrictions and creating more investment options in RMB.

Hong Kong has become the main offshore RMB clearing centre. The concept of CNH (CNY delivered in Hong Kong) was created to indicate FX trades in offshore CNY as those have different exchange rate and yield curves from onshore CNY (in China).

More investment and protection options

There are a number of ways in which a financial institution can obtain RMB:

1) Received from a corporate receiving payment in RMB
2) Converted from other currencies through FX
3) Received as part of offshore interbank financing
4) Received as return from investments such as in Dim Sum bonds
5) In offshore centres like Hong Kong, received from retail or corporate deposits
6) Received through a currency swap facility with its central bank (last resort, if swap agreement with People's Bank of China).

The question to ask, particularly if you are a corporate customer of a bank, is, once I have RMB, what can I do with it?

The expected appreciation of the RMB (by 3-4%, which has a degree of risk itself) is not enough to justify substantial holdings. So, more investment options are needed. In 2011, there was a first equity IPO in RMB, and further liberalisations in bond and equity markets are expected in the near future.

As the exchange risk is now transferred from Chinese to overseas corporates, more RMB risk and hedging products must be developed in order for those corporates to be willing to be paid in RMB.

Further developments are expected during the next three years, including the signing of currency exchange agreements with more countries, the further establishment of Hong Kong as an RMB offshore market and Shanghai as an international financial centre, and the further expansion of RMB "outflow" channels, as a result of for example lifting controls over RMB foreign loans.

A fully convertible RMB in five years?

While there is no official timetable, some market analysts expect the RMB to become fully convertible within the next five years (although other say it will not happen until 2020). Moving too quickly is not without risks: a currency whose value is determined by global markets is vulnerable to exchange rate shocks, and if movement of money in and out of a country is fully open, it is prone to large and sometimes violent capital flows ('hot money').

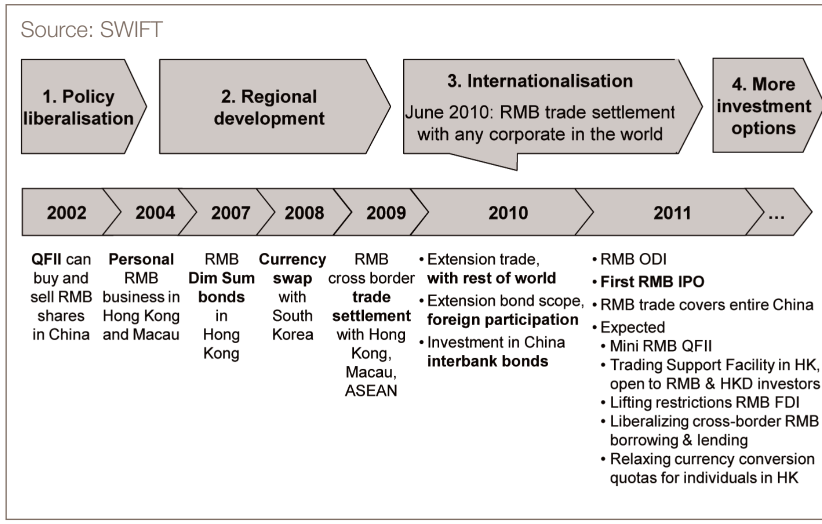

Figure 4: RMB internationalisation process

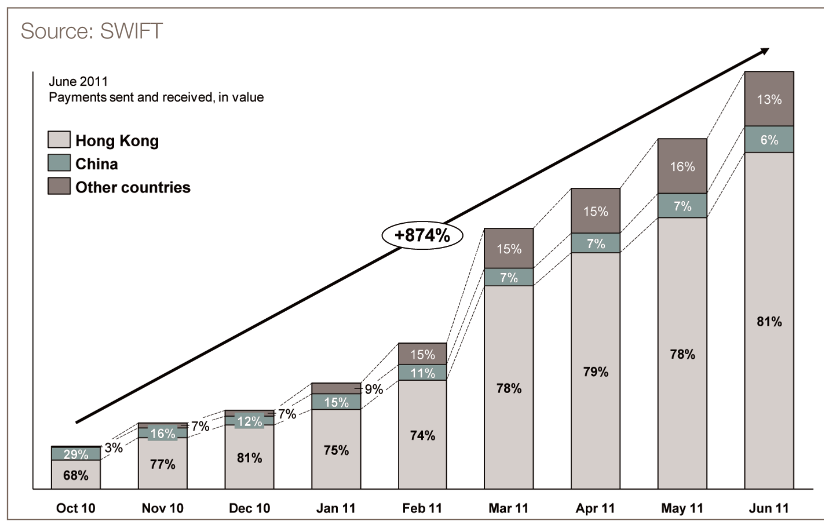

Figure 5: RMB payments growth

Full convertibility does not make a currency international. The yen became fully convertible in 1980, but is still not a dominant international currency, despite efforts by the Japanese government in the 1990s.

RMB growth is now spectacular

As a result of these policy liberalisations, RMB internationalisation is moving ahead quickly.

Whether we look at redenomination of cross-border trade settlement, Dim Sum bonds in Hong Kong or offshore FX in London, the RMB market is ramping up quickly. There is now concrete evidence of RMB usage on a truly international level.

10% of China's trade

In May 2011, less than two years after the cross border trade settlement pilot was introduced, 10.2% of China's foreign trade was done in transactions denominated in RMB[2], up from 7% (USD 360 billion) in Q1 2011 and a mere 0.5% in Q1 2010. The majority are RMB payments going out, for imports by China.

On SWIFT, we can see that RMB payments have really started to take off in value since early 2011. We can report a growth of 874% between October 2010 and June 2011 (see Figure 5)[3].

Hong Kong as main offshore RMB centre

More than 80% of all RMB payments pass via Hong Kong. This is no surprise, as the first RMB liberalisations took place there, and Hong Kong has a long history of interconnection with the world's financial markets and a very developed RMB financial infrastructure. Its Real Time Gross Settlement (RTGS) System supports the RMB, provides a linkage with its HKD, USD and Euro RTGS (to facilitate settlement of FX transactions on a payment-versus-payment basis), with the Central Clearing and Settlement System (CCASS) , to facilitate settlement of equities on a delivery-versus-payment basis), and with its Central Moneymarkets Unit (CMU), for clearing of bonds and investment funds).

Trading in Dim Sum bonds rose from RMB 200 million in January 2011 to RMB 3 billion in July 2011; the total outstanding value may reach 250 billion by the end of 2011. During the first six months of 2011, 38 entities issued RMB 43 billion bonds, exceeding RMB 36 billion by 16 issuers in the whole of 2010. There are also synthetic bonds – RMB denominated but settled in USD - for investors with an appetite to bet on the RMB's appreciation, with an outstanding amount of nearly 20 billion. Recently, several banks have issued offshore RMB bond index products to help local retail investors gauge the performance of their RMB bonds or bond funds.

In April 2011, a first RMB denominated IPO by Hui Xian (part of Cheung Kong Group) was listed on the Hong Kong Exchange.

As of the end of June, RMB deposits (71% by corporates) climbed to RMB 550 billion (compared to RMB 310 billion at the end of 2010), representing around 9% of total deposits in Hong Kong.

To provide more investment options, a Trading Support Facility is set to launch to enable offshore RMB as well as HKD investors to buy RMB stock.

A hurdle to further internationalisation is the limited number of avenues for offshore RMB to be repatriated to China (without case by case regulatory approval). By June 2011, there were 113 Qualified Foreign Institutional Investors with a total of more than USD 20 billion quota approved (up from 12 investors and nearly USD 5 billion in 2003). A "mini" RMB-QFII is expected, for Hong Kong subsidiaries of Chinese fund managers and securities brokers to utilise offshore RMB funds to invest directly in onshore listed securities.

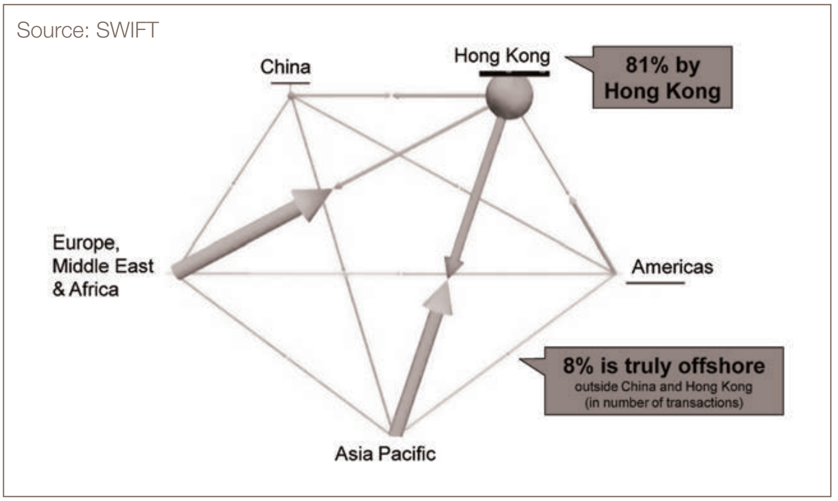

Figure 6: Top RMB payments corridors

Regional, now going international

Further liberalisation opened up RMB trade with ASEAN countries. Singapore, trying to become a further RMB offshore location, has seen strong growth, with several banks offering RMB deposit products and access to offshore RMB bonds.

And the RMB has spread further internationally. Banks from more than 130 countries are said to have opened RMB correspondent banking accounts in China.

In June 2011, more than 900 financial institutions in over 70 countries had RMB transactions across financial markets[4]. The following is a quick country perspective (for more details, see the SWIFT RMB Business Insights report):

— RMB payments are mainly cleared in Hong Kong, concentrated with a few banks in China and with Singapore and the UK; 8% is truly offshore (outside China and Hong Kong). The top RMB payments corridors are illustrated in Figure 6;

— RMB FX involves many banks in China, Hong Kong and South East Asia, but is mainly handled by the UK (nearly 30% of all RMB FX), with the US and Hong Kong. More than 40% is offshore;

— RMB trade finance is mainly done from China with Hong Kong and with Singapore;

— RMB securities settlement confirmations are mainly sent by China to Singapore, France and the UK, and with active participation by most financial institutions in Hong Kong.

RMB opportunities and threats

While we are seeing a big take-up of RMB outside China, it will take years to develop substantial volumes.

Meanwhile, everybody is positioning for growth – banks and their clients. Even if the business case is not there yet, many banks see it as a question of 'when', not 'if', and have made a strategic decision to actively pursue this opportunity. This means they must have an RMB strategy. Then it is just a question of scale.

But is all this not just substitution? A redenomination of the same trade, now in RMB? If so, will mainly Chinese banks benefit, as payments in RMB are cleared, say, in Hong Kong instead of New York?

Each bank will make its own business case, but we can nonetheless examine the implications of the RMB for the financial industry as a whole – on payments, FX, trade finance, and securities as well as retail flows and transactions.

RMB heat map

The effect of the RMB (beyond economic growth) on the global financial industry is illustrated in Figure 7 and can be summarised as follows:

1. Everybody is building up an RMB settlement and payments capability, on their own or by opening RMB accounts with banks in Hong Kong or China, creating new business for banks offering accounts, liquidity reporting and clearing services.
2. RMB trade settlements are mainly substitution - the same payment in another currency. For banks individually this means new – or loss of – business as Chinese and global banks are likely to increase their market share, and we may over time see a loss in intermediary banks revenue if payments shift from USD to more direct RMB clearing in Hong Kong and China. On the positive side, paying in RMB could reach more corporates in China, thus increasing overall trade.
3. On the FX side, banks are already seeing a reduction in revenue on trade related FX from Chinese corporates, but now foreign corporates need to buy RMB, as well as do currency risk hedging. The biggest RMB opportunity lies in FX trading, developing a global market share from currently less than 1% to say 5% by 2020.
4. Currently RMB is not having a big impact on trade finance. We are mainly seeing redenomination of the same underlying trade, and RMB volumes will remain relatively small unless commodities are priced in RMB.
5. The other big opportunity is from RMB investments and securities services, following gradual policy liberalisation like in bonds and equities, as more investors outside China holding RMB will seek returns beyond currency appreciation, driving product innovation in this space.
6. Retail RMB is new business, but mainly for banks in large offshore centres like Hong Kong.

A more detailed look at these scenarios is provided in Annex 2.

Source: SWIFT

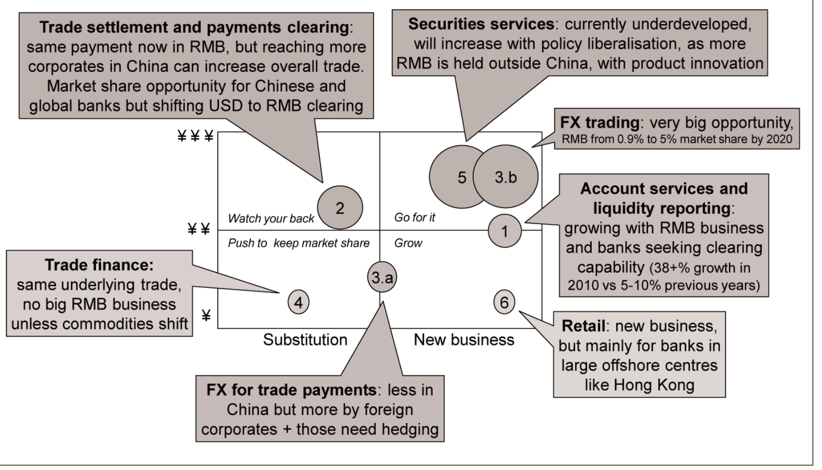

Figure 7: RMB heat map

How to get ready for RMB

The best strategy for capitalising on opportunities (and fending off threats) presented by RMB internationalisation is to be well-prepared. Here are a few tips from banks that have already built up some RMB experience:

1) Decide on your RMB strategy:
defensive/offensive business development, direct/indirect clearing, product innovation… you first need to decide how your bank wants to play this.

2) Enhance your RMB processing, accounting, clearing and reporting capabilities.
For most banks, support of the RMB is about adding 'just another currency' from a systems and application point of view. But there needs to be a clear management of RMB treasury, funding position and liquidity process across the bank, to ensure RMB can be made available in those countries and cities where it is needed.

The processing of payments and receivables in RMB is not yet at the same level of efficiency as for example a cross-border payment in USD. Manual and specific processes are required for RMB transactions (see box).

This makes the processing of onshore payments into the China National Advanced Payment System (CNAPS) – a labour-intensive process – often with high manual repair rates, increasing the unit cost per RMB transaction.

The Chinese regulator will continue to ask for supporting documentation et cetera, but the processing cost of RMB payments must come down, so that when corporates do start to put significant RMB volumes through, banks can handle them smoothly and efficiently.

RMB processing issues / improvement map: examples

1. All RMB transactions come in as CNY but each must be booked to its yield curve (CNY, CNH, non-deliverable forward CNY).
2. Banks must investigate the background of each transaction to ensure compliance with current policy (for example RMB trade only with Mainland Designated Enterprises) to avoid the risk of having to reverse transactions.
3. The CNAPS clearing code has a more complex structure than the BIC code, so is currently not easily referenced to identify the beneficiary bank.
4. Beneficiary names in Chinese must be converted to 4 digit codes supported by FIN messages, and back to Chinese for processing.
5. Restrictive name checking (e.g. if abbreviation used by originator) may lead to rejections by beneficiary bank.
6. Payments into China must be serial MT103 as CNAPS does not support MT202/202COV formats.
7. For payments from China, beneficiary institution details are in field 70 if an intermediate bank is used, leading to manual intervention.
8. Regulatory reporting must make distinction between trade and non-trade related operations.

3) Pay great attention to your corporate customers' demands, in particular for RMB payments and FX operations to support trade settlement, and further develop your product offering to be prepared for, for example, bonds products in the capital market, and investor products like funds and equities, as requirements evolve and new product opportunities emerge from further policy liberalisation. In particular in Hong Kong, the market for RMB products is very developed, including RMB IPOs, equity and debt markets and retail offerings.

Since your bank's capabilities – as well as the regulator's policies – are evolving, you need to develop a clear communication strategy towards customers, about what can be marketed by when, and publish an "RMB brochure" for the corporate treasurer with business benefits and practical advice on how to switch to RMB payments. And don't forget to equip your front line sales team with a clear and consistent message about what they can say about China's RMB policy and your bank's position vis-à-vis its development.

4) Keep a close eye on new policies by China's central bank and other regulatory institutions – as those policies are still evolving and fast, and further opening in particular of the capital account is expected. You must develop a clear understanding about what this means precisely – and what is allowed and what is not.

5) Keep track of new RMB product development, in particular in Hong Kong, as financial institutions continuously innovate around new RMB products;

6) Understand that RMB touches every aspect of your business and requires engagement from all teams, and therefore requires **the set-up of an RMB organisation** that fits your corporate culture. For some financial institutions, this is a loose, decentralised organisation in which RMB expertise resides within each business function and they coordinate with each other. For others this is – or is complemented by – a central RMB project team or taskforce acting as centre of competence, often at their branch in Hong Kong, because that is where most of the offshore market resides.

How SWIFT can help

Through our engagement with banks on the impact of the internationalisation of the RMB, it has become clear that they expect SWIFT to support them in three areas (see also Figure 8):

1) Facilitate the RMB in financial transactions and increase their automation
2) Help to broaden the industry's understanding of the benefits of the RMB, thus increasing transaction volumes
3) Provide detailed business insights on RMB volumes to track market share and identify new business opportunities.

Facilitating RMB transactions can be achieved by providing a global network, helping to expand and deepen the RMB business in particular in Hong Kong, publish best practice guidelines and further improve the interoperability between CNAPS and SWIFT message standards.

Another key role the members see for SWIFT is to help broaden industry understanding of RMB developments. This can be by for example facilitating debate at industry conferences and SWIFT events, or by educational webinars with a focus on operational aspects.

And as RMB transactions develop very rapidly and significantly, financial institutions are looking to SWIFT to provide business insights based on statistics from RMB transactions sent via SWIFT, to track performance and market share as well as assess new market development opportunities.

So, what's next? Strategic development perspectives

As next steps, four strategic actions should be pursued to further drive the internationalisation of the RMB:

1. Additional policy liberalisation is required to establish more transparent and standardized frameworks for RMB payments and investments. Three recent examples are illustrative. Hong Kong enterprises can now invest RMB in the form of Foreign Direct Investment in mainland China (with some controls). The mini QFII scheme has been given the official green light (likely by year end, with an initial small USD 3.1 billion quota – reflecting Beijing's ongoing concerns about capital inflows). And RMB trade settlement has now been rolled-out nationwide (previously it covered 20 provinces but they accounted for more than 90% of national exports). These changes will lead to extensions in product offerings and product innovation by financial institutions. Further policy announcements are expected in the coming months. Stay tuned.

2. Closer integration of China with the international financial community is to be pursued, via thought leadership exchanges at executive level and with improvements on the operational level to increase automation and make RMB transaction processing more competitive against the more straight-through-processing of other currencies. This can be achieved by providing on one hand an international gateway for banks around the world to connect into CNAPS, while at the same time improving interoperability with international standards and market practice. In addition, the establishment of

Source: SWIFT

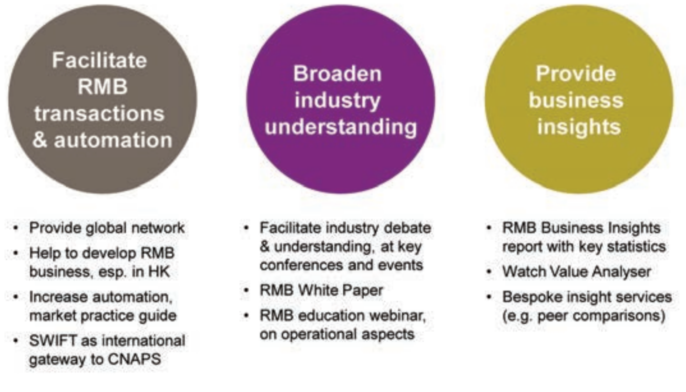

Figure 8: SWIFT's positive role to fully support the RMB internationalisation

more offshore markets, such as Singapore and London, may provide the impetus for banks to better trade in RMB and help speed up its internationalisation.

3. Stimulate further end-customer take up, by promoting the benefits of doing business in RMB (even though in certain countries and industries much still depends on the balance of power, ease of using the domestic currency and deeply engrained business practices). Regulations governing the RMB business are still quite complex and are not immediately obvious to corporates and banks the further you go away from China/Hong Kong. The SWIFT community of financial institutions can play a crucial role in 'bringing the message', and when take-up is there, in facilitating RMB transactions going truly international.

4. Improve the banks' business case. Regulation makes RMB transactions possible and automation will increase the per-unit profitability, but it's ultimately volume that banks need. Countries like Singapore, the UK and South Korea have those volumes, plus there is a positive outlook in an additional set of countries including Australia and Thailand and more recently the United Arab Emirates – as illustrated in Figure 9 (for more details, see the RMB Business Insights report).

We must continue to look carefully at triggers for RMB usage in major trade corridors with China and identify markets in which banks can concentrate their business development efforts.

Conclusion

The internationalisation of the RMB has begun and will gather pace in the years to come.

It is a major change in the global financial markets and also therefore a source of opportunities and threats for the transaction business of financial institutions.

A number of banks – both Chinese and non-Chinese – are proactively pitching for this RMB business, with the strategic goal of generating a sizeable revenue stream.

Banks see a very positive role for SWIFT, in providing a global network to carry these transactions and in helping the industry to further increase the automation of RMB transactions.

Source: SWIFT

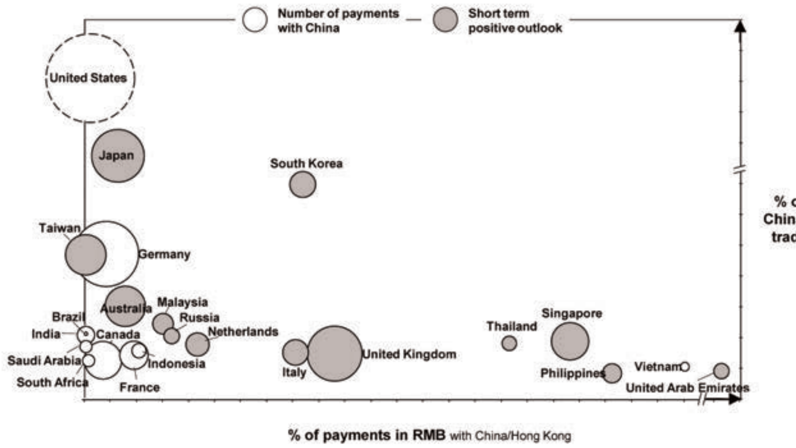

Figure 9: RMB payments opportunity

Going forward, further liberalisation and closer integration of China with the global financial community is required. And as more corporates use the RMB, the build-up in volumes will add to banks' business case for further facilitating the internationalisation of the RMB.

For more insights into recent RMB transaction flows and which countries to focus on for your RMB payments business development, please refer to the SWIFT RMB Business Insights report which can be purchased from SWIFT.

Please contact swiftforbanks@swift.com.

Annex 1: Key RMB internationalisation milestones

2002 November: Qualified Foreign Institutional Investors (QFII) can buy and sell RMB denominated shares in China's mainland stock exchanges, licensed by China Securities Regulatory Commission (CSRC). QFII investors need to obtain investment quotas from China's foreign currency regulator (SAFE) before they can start buying Chinese securities.

2004 February: Retail RMB business started in Hong Kong and Macau (following permission given in November 2003). The People's Bank of China provided clearing arrangement for relevant banks in Hong Kong and Macau via Bank of China Hong Kong and Macau.

2007 January: RMB bonds issued in Hong Kong, also known as Dim Sum bonds.

2008 December: currency swap with South Korea.

2009 July: RMB cross border trade settlement – between Mainland Designated Enterprises (MDEs) in 5 cities and corporates in Hong, Macau and ASEAN countries – following first cross border trade settlement between Shanghai Silk group (China exporter) and Zhong Ye Trading (Hong Kong importer) in April 2009.

2010

- June: Trade settlement expanded to 20 provinces and corporates in any part of the world
- June: RMB bonds extended to allow banks to develop all types of RMB products and open type of participation to all types of financial intermediaries
  - July: Hopewell Highway Infrastructure became the first non-financial Dim Sum issuer and the first issuing entity incorporated in Hong Kong
  - September: McDonald's was first foreign, non-financial corporate
  - October: Asian Development Bank issued first supranational Dim Sum bond
  - December: VTB was the first financial institution based in an emerging market outside China.
- August: Qualified financial institutions (overseas central banks, cross border settlement banks, RMB clearing banks) can invest in China's interbank bond market.
- December: Trade settlement expanded list of eligible MDEs to over 67,000.

2011

- January: RMB Overseas Direct Investment (ODI) – allows Chinese enterprises to conduct overseas direct investment in RMB.
- April: First RMB IPO by Hui Xian, listed on the Hong Kong Exchange.
- August: Cross-border trade now covers entire China.
- Expected for remainder of 2011 and beyond in short term:
  - Mini RMB QFII, for Hong Kong subsidiaries of large Chinese fund managers and securities brokers to utilise offshore RMB funds to invest directly in onshore listed securities;
  - Launch of an RMB equity Trading Support Facility in Hong Kong, open to offshore RMB as well as HKD investors to buy RMB stock (with Hong Kong Exchange as exchange broker and note issuing banks providing the FX);
  - Lifting restrictions on Foreign Direct Investment (currently requires a project like setting factory or supply chain and is approved on a case by case basis (with policy different per province);
  - Liberalising cross-border RMB borrowing and lending;
  - Relaxing restrictions on currency conversion quotas for individuals in Hong Kong.

Annex 2: Implications for the financial industry

Account servicing and liquidity reporting
Many financial institutions are building up an RMB trade settlement and payments clearing capability. In June 2011, nearly 750 foreign banks (more than double from 2006) from 100 countries had accounts in China (see Figure 10). Banks from more than 130 countries are said to have RMB accounts (although some are dormant for the time being).

This means new revenue for those banks that are providing these account and liquidity reporting services and there is fierce competition in this space among peer banks in China.

The new revenue has to be balanced however with the increase in cost of credit lines and risk management that now has to be performed with a larger number of (smaller) banks.

Trade settlement and payments clearing
The Chinese corporate market is largely dominated by Chinese banks. For them, cross-border settlement is very strategic as they follow their customers' expansion abroad.

In addition, Chinese banks with overseas branches see the internationalisation of the RMB as an opportunity to build up their payments clearing business and bring funds from foreign corporates into China. This may not be an easy path for them to follow, since those corporates already have relationships with local or global banks, may have sophisticated treasury needs currently not offered by Chinese banks, and find that their existing banks now offer RMB payment and clearing services as well, either directly (30% of Hong Kong RMB RTGS member banks are from outside Hong Kong and China, covering 30 countries) or via correspondent banking.

The increasing presence of Chinese banks in international RMB clearing should not be underestimated however, as they are very actively expanding and opening offices around the world.

Global banks with proactive RMB strategies will use their RMB capabilities to pitch for new business.

So, as all banks are fishing for the same corporate payments, the game plan here should be:

1) Deepen existing business with this additional capability
2) 'Watch your back' and protect market share
3) Pitch for new business from less responsive banks

Over time, if more payments with China are done globally in RMB, USD clearing may go down or not grow as quickly. A three-country flow, involving the US, may reduce to a two-country flow – with payments being cleared in Hong Kong or China, involving fewer intermediaries. The total wallet of revenue may shrink, especially creditor and beneficiary deducts along the way. Since volumes have been quite low to date, and the RMB has first been promoted and adopted on a regional level in Asia-Pacific, we have not seen such substitution of the USD however from (for example) emerging countries like Brazil.

FX
It is necessary to distinguish between FX to facilitate trade payments, following capital operations and FX trading – roughly split 10%, 20% and 70% of total FX volumes respectively.

FX to facilitate trade payments. Chinese banks have already seen a decline in FX revenue for trade, as the need for and conversion of foreign currency by Chinese corporates has reduced. Where importers previously bought USD, they now use RMB to pay directly; where exporters previously converted USD upon receipt of payment, they now receive RMB directly. Both trends lead to less currency exchange and loss of FX business for banks in China. There is a positive effect at the same time. As more RMB ends up overseas, those corporates will require RMB exchange risk management and hedging. This is a business opportunity for those (non-Chinese) banks servicing these corporates.

FX trading. In June 2011, RMB share in world FX trade was less than 1%. With the potential to develop to 5% or more by 2020, this represents a very big revenue opportunity for financial institutions. There is a growing business of one-leg-in transactions for Chinese banks, with stiff competition between peer banks. In addition, we are seeing both-legs-out FX RMB trades, for example, between London and New York.

Trade finance

The gradual economic expansion of China is leading to an increase in trade financing services to overseas enterprises, a new profit growth point for each bank involved in this business.

The RMB is already used extensively as a currency in trade finance and most major players are working on new product solutions to obtain a bigger share of this market. The effect of the RMB itself may not create more trade finance business however and shifts in structured trade services (collections, L/C) and financing (besides corporate initiated bonds in Hong Kong) due to the RMB is rather limited. A lot of commodities trade is guarantee driven, but the large majority of this (70+%) is denominated in USD. If this were to shift to RMB, that could make a big impact.

Securities services

Currently, investments and capital flows in and out of mainland China are still very controlled and options in RMB denominated products rather limited.

Overseas investors, however, are eager to invest in China's capital markets through, for example, the QFII scheme, hoping to benefit from China's appreciating currency and rapid economic growth.

As the Chinese investment market opens up further, more banks will provide investment services, and in particular offshore banks will benefit as the debt capital market will become more available to foreign banks. For the Hong Kong stock exchange, if over time there are no more capital account restrictions, its advantage over China's mainland stock exchanges will be language and legal environment.

Retail

The retail cross-border RMB business has developed slowly and there are a lot of restrictions.

Beginning in 2004, a couple of banks have made a prominent push into offering a full range of RMB retail services, mainly in Hong Kong (and now in Singapore as well). Retail investors are looking for new and more investment opportunities, given the low interest environment. In anticipation of RMB appreciation, clients can convert HKD to RMB (with a daily limit of RMB 20,000) and place in time deposit of three months, yielding 0.3-0.4% interest. In addition, Hong Kong and Macau residents can remit money to China (with a daily limit of RMB 80,000 and to a same name account) as onshore RMB savings accounts yield 2-3%. Since July 2010, retail person-to-person and person-to-corporate payments in RMB have been allowed in Hong Kong. Unionpay cards issued by domestic banks are used for purchase and ATM withdrawals in Hong Kong and Macau; cards issued by licensed Hong Kong and Macau banks can be used for purchase and ATM withdrawals in mainland China. If the RMB is further expected to appreciate in the future, more individuals will convert HKD into RMB, and will seek more investment options.

If the difference in interest rate with Hong Kong continues, more individuals will deposit RMB in China, increasing cross-border remittances.

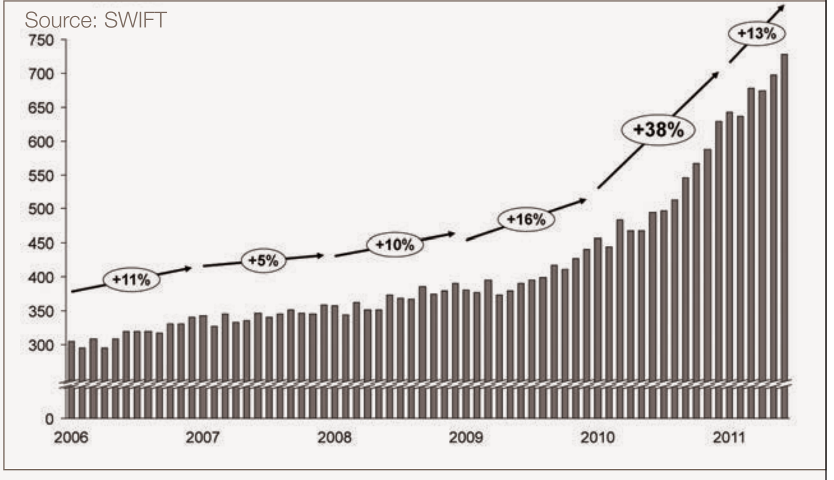

Figure 10: Foreign banks with accounts in China

Notes:

1 The source when indicated is the SWIFT RMB Internationalisation Business Insights report; other numbers quoted are from discussions with financial institutions and from resources and industry press available from the internet.

2 Peter Zhang, Deputy Director-General, China Banking Regulatory Commission, Shanghai Office.

3 SWIFT RMB Internationalisation Business Insights report.

4 SWIFT RMB Internationalisation Business Insights report.

Legal Notices

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