



# China checklist



WITH CHINA HAVING INTRODUCED REGULATIONS TO LIBERALISE THE RENMINBI, **HENDRA LEMBONG** OFFERS 10 GUIDING PRINCIPLES FOR CORPORATES THAT DEAL IN THE CHINESE CURRENCY.

It was in 2009 that the People's Bank of China (PBOC) launched a pilot programme to take the renminbi international, allowing approved mainland designated enterprises (MDEs) and their international trading counterparties to use renminbi to settle trade payments outside of China.

The scheme (and its subsequent extension in 2010) comes at a time when the world is seeing a decided change in cash management. The job of a corporate treasurer has become far more complex as local currencies are increasingly used to make and receive trade payments – the greenback is no longer the sole currency of choice. Today, the ability of China-domiciled corporations to make direct investments overseas using renminbi to establish new businesses, pay trading partners and make equity investments for mergers and acquisitions purposes also opens the doors for non-Chinese entities to reap the rewards of the early stages of liberalisation of one of the world's most hotly debated currencies.

There are many opinions about the pace at which the PBOC will make the renminbi freely available and fully fungible. At the moment, the focus appears to be on ensuring that China minimises the risk of excessive capital entering the mainland market and manages the inflation risks. For corporates engaged in business in China, considering making investments there, or looking for ways to integrate renminbi strategies into a more cohesive, streamlined and efficient working capital cycle, there is an urgent need to understand what the new regulations mean and how to make them work for them.

Here we offer corporates 10 principles to consider in evaluating renminbi holdings and in weighing the pros and cons of dealing with them onshore in China rather than offshore.

- **1. Greater use of renminbi as a global trade settlement currency offers the potential for increased working capital efficiency** In 2010, the

PBOC and mainland regulators extended the pilot programme, allowing cross-border trade to be settled in renminbi. What's more, the geographic scope is also set to expand, with eligibility likely to extend beyond the current 20 provinces/municipalities on the mainland to the entire

country within 2011. This means that corporates anywhere in the world can use renminbi when doing business with approved companies on the mainland. The increased usage of renminbi in international trade means that corporates around the globe have the opportunity to manage their renminbi payments and receipts better, thus increasing the potential for working capital efficiency, mitigating risks and costs associated with foreign exchange and interest rates.

- **2. Demand for settlement of transactions in renminbi is primed for growth** Chinese importers and exporters are facing significant exposure to foreign exchange volatility. Increasingly, they are looking to work with trading partners that can settle payments and receivables in renminbi. In this vein, the PBOC is looking to make it easier for them to make trade payments to partners outside of China. All importers in the eligible locations can make outbound renminbi payments without regulator pre-approval. Exporters must gain approvals from six central agencies to be eligible to receive renminbi, but there is no restriction on companies outside China. With the list of approved exporters growing from 365 in 2009 to more than 67,000, according to a PBOC announcement, in late 2010, all factors point to increased demand for trade in renminbi. International corporations will want to be in a position to trade more efficiently in renminbi.

- **3. Hong Kong is tipped to be the offshore renminbi destination of choice and offers the widest array of renminbi products** Due to its proximity to the mainland and its status as a special administrative region of China, Hong Kong has traded the vast majority of the





cross-border settlement renminbi since the launch of the pilot programme in 2009. Hong Kong is the only offshore market with a real-time gross settlement (RTGS) clearing system, and a deep enough pool of liquidity to handle significant renminbi transactions on a consistent and robust basis.

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can be slightly higher (and higher than both a standard US dollar or HK dollar savings account), which is advantageous for corporate savings. How much a company collects compared with how much it pays out in renminbi can be a decisive factor in the location of renminbi holdings.

- **4. Renminbi internationalisation offers greater investment opportunity** Beyond renminbi current and savings accounts, in Hong Kong, companies are able to put renminbi to work to get more out of their holdings, and to plan for future M&A and corporate movements in China. The market for renminbi funds is burgeoning. Renminbi bond issuances have picked up significantly, and renminbi-denominated securities issued by the Hong Kong Stock Exchange which launched in the second quarter of this year will help treasurers diversify their holdings and provide flexibility and liquidity within their portfolio.
- **5. Outbound and inbound capital flows are subject to different rules** One of the fundamental distinctions to make is that while the outward flow of funds (renminbi) from the mainland to other destinations around the world is being encouraged, the inflow of funds in any currency into China remains subject to stricter rules. Corporate treasurers should work with their cash management advisers to establish the correct and most prudent approach for their renminbi holdings.
- **6. Your business strategy and goals should guide your use of renminbi products and tools** Corporates are beginning to see how renminbi accounts, services and tools can help them to increase working capital efficiency, build closer relationships with Chinese counterparties, and help plan for a future where trade flows between China and the rest of the world will likely keep growing. For some, it is simply an easier way to settle trade payments and collections to and from counterparties in China. For others, companies have made it an important component of their hedging strategy, positioning themselves to benefit from enhanced yield in renminbi by putting money into renminbi-denominated bonds available in Hong Kong. Still others are looking to establish onshore renminbi accounts in advance of making investments in China. The benefits of renminbi exposure will vary for companies, and are wholly dependent on the individual corporate's needs.
- **7. The benefits of a Hong Kong account and a Non-Resident Account (NRA) on the mainland are different** The pros and cons of an NRA in mainland China and a renminbi account in Hong Kong differ considerably; the day-to-day needs of a company will dictate which is the most useful and cost-effective. Hong Kong offers a greater choice of hedging options, including spot forwards and non-deliverable forwards, whereas FX hedging tools are extremely limited onshore. And while the onshore interest rate is regulated at 0.50% (as at 13 June 2011), Hong Kong

- **8. CNY and CNH have their own risks, rewards and benefits** CNY (Chinese yuan) is the official ISO currency format used by SWIFT when transferring renminbi, but there is a distinction between currency circulated inside and outside of China: CNY indicates onshore currency while CNH indicates offshore currency. This is more than a distinction of location. At press time, buying renminbi using an onshore rate was to a corporate's advantage, while selling at an offshore rate provided greater value when converting to another currency. The good news is that the two rates appear to be trending towards convergence and greater stability. There is even a CNH fixing rate now available on Reuters to bring more transparency to pricing. However, as the internationalisation of the currency is in its formative stages, it is important to keep in mind that the renminbi is still restricted and is not as liquid as other reserve currencies such as the US dollar or the euro.
- **9. Onshore entities must communicate with the PBOC about offshore activities** The PBOC allows MDEs to hold renminbi receipts offshore by opening an account directly with an offshore bank. However, there are regulations around the movement of money and how long funds can be held offshore. Corporates that fall into this category need to be mindful of these regulations and ensure that their compliance team is involved in every decision, and is in communication with the PBOC.
- **10. Renminbi is becoming a truly international currency** Offshore pools of renminbi have grown considerably over the past two years. In Hong Kong the growth is more pronounced, but it is a trend that will emerge in other financial centres as well, including London, New York, Singapore, Tokyo and other key treasury centres. The evolution of the renminbi has significant implications for corporates, and the starting point is exploring opportunities in an established hub like Hong Kong. Funds, hedging products, innovative services and ways to work renminbi strategies into a more efficient working capital structure are already here.

There is no slowing down the interest in holding renminbi. Smart and agile corporates need their treasurers to be looking at the solutions that make sense now – and for the future.

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