CLIFFORD
CHANCE

New developments accelerate Renminbi internationalisation

July 2013

contents

New developments accelerate Renminbi internationalisation – Perspectives from Clifford Chance's global network

Recent developments in the People's Republic of China (China)[1] and around the globe indicate that the internationalisation of the Renminbi (RMB) is moving forward rapidly. As highlighted in previous client briefings[2], the rise of offshore RMB and its emergence as an increasingly global currency has benefitted companies and financial institutions in and out of China. The following statistics are good illustrations of the RMB's growth[3]:

- the value of payments using RMB grew by 171% in a year, from January 2012 to January 2013; and
- the ranking of RMB as a payment currency jumped from 20th place to 13th place from January 2012 to March 2013, pushing it past currencies like the New Zealand Dollar and the Russian Rouble.

China continues to accelerate regulatory reforms to liberalise the currency and nations throughout the world have been embracing this fast pace of reform by priming their financial markets to take advantage of the rapid RMB growth. With the ongoing plans of China to gradually develop the RMB into a global currency, major financial centres worldwide have recognised opportunities to participate in, and enjoy, the financial benefits of the internationalisation of the RMB. This client briefing highlights important recent developments in China, Asia Pacific, Europe and the United States.

"Although internationalising RMB may seem desirable, the process is laden with risk. Therefore, ever since 1996 when RMB became convertible under current accounts, the government leadership has been very cautious and prudent in the process of currency reform. It is very likely that the government will adopt certain phase-in procedures in the contemplated plan and may adjust its policies where appropriate going forward."

Tiecheng Yang, Partner, Regulatory, Beijing

China – steps towards greater RMB convertibility for capital accounts

China government's approach towards RMB internationalisation

Our focus begins in China, as regulators there naturally have the most direct influence over the development of RMB as a global currency.

At an executive meeting chaired by Premier Li Keqiang on 6 May 2013, the State Council stated that its objectives for 2013 include:

- putting forward more reform initiatives to liberalise interest rates and exchange rates;
- working out an operational plan to make RMB fully convertible under capital accounts; and
- establishing a system that allows for outbound investment by individuals.

Although the meeting shed little light on the details of how these reforms would be implemented, these proposals indicate that the central government is reform-minded in further internationalising the RMB and has set out specific steps to realise this goal.

These initiatives would require China to fundamentally restructure its system of capital controls and further open up its domestic financial markets. To this end, various regulators such as the People's Bank of China (PBOC) (which regulates interest rates and RMB accounts), the State Administration of Foreign Exchange (SAFE) (which regulates foreign exchange controls), and the Ministry of Commerce and the National Development and Reform Commission (both of which regulate overseas direct investment),

[1] For the purpose of this client briefing when we refer to China we mean People's Republic of China not including Hong Kong, Macau and Taiwan

[2] See for example Clifford Chance client briefings entitled "Renminbi Internationalisation – The London Perspective" (May 2012) and "Renminbi Internationalisation – Market and regulatory developments over the past three years" (May 2012)

[3] SWIFT Monthly RMB Tracker – February 2013

among others, will need to coordinate among themselves to develop concrete implementation plans. The new measures are also intended to curb speculation on the currency.

These initiatives are in line with the previous "step-by-step" approach outlined in the Twelfth Five-Year Plan for Financial Development and Reform (unveiled by China's financial regulators in September 2012) and the report for the 18th National Congress of the Communist Party of China (November 2012), which stressed that free convertibility of RMB capital accounts should proceed on a step-by-step basis.

The pace of reform towards full RMB convertibility may still be gradual in the near term, and Zhou Xiaochuan, the governor of PBOC, has confirmed that RMB convertibility under capital accounts will not necessarily implicate 100% convertibility or a free-flowing currency.

However, Premier Li's words have shown the State Council's willingness to push forward with its reforms at a pace it is comfortable with, and reflects the potential for further liberalisation of the current regulations in a bid to promote even greater use of RMB globally.

Expansion of QFII, RQFII and QDII Programmes in China

In an important move to hasten RMB convertibility under capital accounts, China's regulators have actively worked on expanding certain existing programmes, including the Qualified Foreign Institutional Investors (QFII) programme, the RMB Qualified Institutional Investors (RQFII) programme and the Qualified Domestic Institutional Investors (QDII) programme, to encourage inbound and outbound capital flows between securities markets. Since late 2012, several new rules and amendments have been introduced to the QFII and RQFII programmes to lower the threshold requirements for licence holder qualification, expand the investment scope and streamline the fund transfer process under such programmes.

In particular, the China Securities Regulatory Commission (CSRC) published a consultation draft on 14 March 2013 to amend the current QDII regulations with the aim of attracting more domestic participants by removing the relevant financial requirements to this programme. Aside from the build-up of a more investor-friendly legal framework, China's regulators have also been steadily boosting quotas for the QFII, RQFII and QDII programmes. In just a year[4], the aggregate QFII quotas increased to US$41.882 billion compared to US$26.13 billion; the aggregate RQFII quotas more than doubled to RMB76.3 billion from RMB20 billion; and the aggregate QDII quotas increased from US$76.447 billion to US$85.027 billion.

China's regulators have also started to focus their attention on developing inbound and outbound securities investment by individual investors. In early April 2013, Hong Kong, Macau and Taiwan residents and foreign individuals working and living in the mainland became the first group of individual investors (without Chinese citizenship) permitted to directly open accounts to trade A shares and purchase mutual funds. Further, officials at CSRC and SAFE have indicated that there have been internal discussions on plans to launch "QFII2" and "RQFII2" programmes, although there is no definitive timeline for these plans. If both programmes get the go-ahead, offshore individual investors would be able to directly access China's securities market in the same manner as existing QFIIs and RQFIIs. In January 2013, PBOC announced plans to launch the QDII2 programme this year. When this programme comes into effect, certain qualified domestic individuals will be permitted to invest in offshore securities markets (likely through Chinese securities companies).

Parallel to the Chinese central government's initiatives mentioned above, regional authorities, such as the local Shanghai government, have been working on pilot schemes, including the QDLP (Qualified Domestic Limited Partner) pilot programme permitting foreign hedge funds to establish a presence in Shanghai to raise RMB and subsequently convert the RMB into USD

[4] These figures are from 30 April 2012 to 30 April 2013.

to invest offshore. Local authorities in Qianhai (a special zone in Shenzhen, which is geographically close to Hong Kong) are similarly experimenting with a local QDLP pilot programme. These local initiatives will further boost the pace of internationalisation of RMB from within China.

Hong Kong – looks to cement its top spot

On 25 April 2013, the Hong Kong Monetary Authority (HKMA) announced measures that will significantly liberalise the market for RMB in Hong Kong. The announcements aim to confirm Hong Kong's market leading position as an offshore RMB hub. We set out the key elements of these measures below:

Flexible Net Open Positions in Hong Kong

The HKMA announced that it would allow banks to determine their own limits on RMB Net Open Positions (NOP)[5], removing the current mandatory limit of 20%. Any bank wishing to maintain a RMB NOP limit above the 20% threshold must first inform and demonstrate to the HKMA that the move is prudent and appropriate for the scale and nature of its business.

Historically, the HKMA has regulated this area carefully, relaxing RMB NOP limits at a gradual pace. For instance, in December 2011, the HKMA imposed a 10% limit on Hong Kong banks' NOP. This limit was increased to 20% in January 2013.

The HKMA's justification for removing the current limit is to allow Hong Kong banks to manage their own risk and exposure in the offshore RMB market. In addition, the removal of this limit should allow banks to take larger positions and enhance market liquidity in offshore RMB.

> "We can expect the relaxation of these rules to increase the use of RMB by Hong Kong banks by increasing liquidity and reducing balance sheet constraints. These restrictions were initially imposed by HKMA to make sure that banks didn't rush into RMB business without appropriately managing their balance sheet and their RMB liabilities. This development indicates a maturing of the Renminbi as a currency in Hong Kong as Renminbi becomes more widely used."
>
> **Francis Edwards**, Partner, Derivatives, Hong Kong

HKMA removes Minimum Liquidity Ratio Limit for RMB

The HKMA has removed the minimum liquidity ratio of 25% for offshore RMB. This minimum liquidity requirement was designed to prevent a surge in RMB business by banks following their entry into the RMB market and meant that banks had to hold a certain amount of assets, such as cash against their exposures to the RMB. This development means that banks can now treat RMB currency deposits in the same way they treat other currencies, and do not need to maintain additional reserves in cash. The move is aimed at releasing more offshore RMB into the interbank system which will improve the liquidity of the currency. This is expected to lead to lower borrowing costs and to facilitate the growth of the use of the currency for various financial products.

Hong Kong creates an RMB interbank rate

The Treasury Markets Association of Hong Kong (TMA) has, since 24 June 2013, been providing daily benchmark RMB interest rates covering eight tenors, from overnight to up to one year[6]. These rates have been termed the CNH Hong Kong Interbank Offered Rate, or CNH HIBOR.

The TMA has appointed 16 banks to contribute their interest rate quotes based on their activity levels in the Hong Kong offshore RMB market. The CNH HIBOR rates will then be calculated by averaging the middle quotes, with the three highest and three lowest quotes excluded from this calculation.

The move is expected to boost the development of offshore RMB products that rely on interest rates, for example syndicated loans. Additionally, it should have a positive impact on the use of derivatives to improve the risk management of businesses that have exposure to RMB by allowing the development of more sophisticated hedging products, especially on interest rates.

The move should also promote the growth of the offshore RMB loan market as the interbank rates are be designed to provide a reliable benchmark for pricing loan facilities and to boost transparency among financial institutions.

Investors still hungry for Dim Sum bonds in Hong Kong

The appetite for Dim Sum bonds continues, with both China-centred

[5] A bank's NOP is the difference between the assets and liabilities on its balance sheet.

[6] The planned CNH HIBOR fixing will include tenors of overnight, 1 week, 2 weeks, 1 month, 2 months, 3 months, 6 months and 12 months.

"The appetite for Dim Sum bonds continues, with both China-centred corporates and banks, as well as companies and financial institutions based across (and outside) the Asia Pacific region looking to tap RMB liquidity to achieve attractive funding costs. As the initial wave of Dim Sum bonds mature, many issuers are considering re-financing these bonds."

Matthew Fairclough, Partner, Capital Markets, Hong Kong

corporates and banks, as well as companies and financial institutions based across (and outside) the Asia Pacific region looking to tap RMB liquidity to achieve attractive funding costs. As the initial wave of Dim Sum bonds mature, many issuers are considering re-financing these bonds.

China-based issuers continue to explore a number of structures, including letters of support, keep-well arrangements, letters of credit and equity purchase undertakings, to provide credit enhancement to offshore bond issuances, for which credit support from onshore operations is difficult to obtain due to the regulatory constraints. However, approvals from China's National Development and Reform Commission have been issued to a select few large state-owned companies, enabling them to issue offshore bonds directly without the need to have offshore SPV/issuers and other credit enhancements. Clifford Chance recently acted for China Minmetals on its issuance of a combined RMB18.5 billion worth of offshore RMB-denominated Dim Sum bonds in Hong Kong, one of four large state-owned companies that recently obtained approval for direct issuance from China's National Development and Reform Commission.

Taiwan – strong appetite for RMB

Taiwan develops RMB* clearing capability

On 25 January 2013, Taiwan and the Mainland governments signed the Currency Clearing Agreement, with The Bank of China, Taipei Branch, being

"Aside from adding a fresh source of RMB liquidity, the move to make Taiwan the second offshore RMB financial centre is part of a much broader effort by the Taiwan and Mainland governments to stabilise relations and deepen economic ties following decades of political dispute. Therefore, how to maintain stable and sustainable cross-strait relations – both political and economic – will become a vital challenge for Taiwan."

Tiecheng Yang, Partner, Regulatory, Beijing

Views from Hong Kong

Anthony Wang, a partner in the finance team of the Clifford Chance Hong Kong office, comments that: "For a long time the market has been lacking a reliable benchmark interest rate for offshore Renminbi. This may prove to be a significant step in the development of Renminbi as a currency for offshore financing and other financial products".

Connie Heng, a partner in the capital markets team in the Clifford Chance Hong Kong office comments: "We expect this new benchmark rate to spur the development of a market in dim sum bonds with floating rate coupons. Up to now the vast majority of dim sum bonds have been fixed rate issuances and we expect that some issuers, for example financial institutions, may prefer to issue floating rate bonds referencing this benchmark."

Francis Edwards, a partner in the derivatives practice of the Clifford Chance Hong Kong office observes that: "Along with the establishment of a reliable benchmark interest rate for offshore Renminbi financings, we can expect this to allow for the development of the interest rate swap market for offshore Renminbi which in turn will allow for efficient hedging of interest rate risk in Renminbi financings. Without such a benchmark, there has been a lack of liquidity in interest rate and cross currency swaps for Renminbi which has made interest rate hedging unattractive. The offshore Renminbi FX derivatives market is now firmly established since it began life in 2010 and the development of interest rate derivatives is the next stage in the Renminbi's evolution as a global currency for financings."

* Clifford Chance recently co-hosted a roundtable discussion on Chatham House's latest research paper on the development of the RMB market in Taiwan. This discussion paper is available online at – http://www.chathamhouse.org/publications/papers/view/192599

appointed as the RMB clearing bank for Taiwan. Between 6 February and 6 March 2013, 46 banks in Taiwan have been able to open RMB accounts and accept RMB deposits. According to local reports, initial appetite for RMB was huge, with more than RMB1.3 billion deposited into retail accounts on the first day alone. The central bank of Taiwan has released data which indicates that RMB deposits in Taiwan now exceed RMB 60.26 billion.

Formosa bond issue

According to local reports, the Taiwan Financial Supervisory Commission has expressed willingness to promote its RMB bond market. Chinatrust Commercial Bank obtained approval to, and issued, Taiwan's first offshore RMB bond on 25 February 2013, with Deutsche Bank opening Taiwan's RMB market to international names with its issue of a RMB1 billion three year bond and a RMB100 million five year bond on 5 June 2013. These bonds are referred to as Formosa bonds, after Taiwan's former name. With China CITIC Bank and Far Eastern New Century Corporation having also submitted applications to issue Formosa bonds, an increasing volume of Formosa bond issues over the near future can be reasonably anticipated.

Taiwan contemplates RQFII scheme

To boost the two-way flow of RMB, the China Securities Regulatory Commission has responded favourably to launching the RMB Qualified Foreign Institutional Investors regime (with an estimated RMB100 billion quota) in Taiwan in the near future. This activity is expected to secure Taiwan's position as the second most important offshore RMB hub behind Hong Kong.

Singapore – a clear leader in Southeast Asia

RMB clearing capability arrives in Singapore

A major development in the offshore RMB market in Singapore took place on 8 February 2013 when the Industrial and Commercial Bank of China, Singapore branch (ICBC) was authorised to act as the clearing bank for the RMB in Singapore. ICBC may now provide RMB clearing services to participating banks and their customers for the next five years.

Following on from this, the Monetary Authority of Singapore (MAS) and PBOC signed a Memorandum of Understanding (MOU) on RMB Business Cooperation on 2 April 2013. Under the MOU, the MAS and PBOC will cooperate closely in reviewing the conduct of RMB businesses and clearing arrangements in Singapore. The two central banks also agreed to establish a regular dialogue to review RMB liquidity conditions and discuss issues concerning the stability of the RMB market. The MAS, in May 2013, circulated a consultation paper on the implementation of the RMB clearing arrangements, inviting comments on its proposed regulation of banks conducting foreign exchange conversions with RMB. The MAS has now released its response to feedback received on the consultation, which provides further details in relation to the framework for the RMB clearing arrangements in Singapore. As a sign of the deepening financial ties between Singapore and China, the MAS opened an office in Beijing in May 2013 to reinforce collaboration with key Chinese institutions such as the PBOC.

Singapore as the regional RMB FX hub

On 23 May 2013, Deutsche Bank took advantage of Singapore's newly minted status as an RMB clearing centre by becoming the first bank to complete and clear a SGD/RMB FX spot trade in Singapore. Deutsche Bank has also begun live pricing for RMB versus local currency

pairs across all of its onshore Asian locations, including the Hong Kong Dollar, Indian Rupee, Indonesian Rupiah, Korean Won, Malaysian Ringgit, Philippine Peso, Singapore Dollar, Taiwan Dollar and Thai Baht. This provides the Singapore financial markets with a comprehensive level of RMB liquidity, and will allow corporations in the Association of Southeast Asian Nations (ASEAN) to hedge their exposure to RMB. This in turn makes RMB more attractive as a currency for trade settlement in the region, which further promotes the globalisation of the currency.

This development is especially significant since China is the largest trading partner of ASEAN, with China's imports rising by almost 70% in the last five years, significantly outpacing imports-growth in any other region of the world.

Lion City bonds

HSBC and Standard Chartered, as of 27 May 2013, became the first banks to issue RMB-denominated bonds in Singapore and DBS has closely followed up on these issuances by successfully pricing and issuing its own RMB-

"Singapore's ability to clear offshore RMB will allow for a wider range of RMB-denominated products to be offered in Singapore, both in the debt and equity capital markets, and this has been shown in the recent Lion City bond issuances. Singapore is well-positioned to become a major hub for offshore RMB".

Lena Ng, Counsel, Derivatives, Singapore denominated bonds as well in Singapore. These bonds have been named *Lion City bonds*, arising from the common reference to Singapore as the Lion City. These banks issued bonds with a combined amount of RMB2 billion. The bonds are listed on the Singapore Exchange and are cleared through Central Depository (Pte) Limited, a unit of the Singapore Exchange.

The emergence of Lion City bonds is a significant step for Singapore's development as an offshore RMB hub as it allows banks and corporates to access the pool of offshore RMB in Singapore, instead of having to access the Hong Kong market.

These developments move Singapore forward in its aim to become a major RMB hub, as it is only the fourth centre to be authorised as an RMB clearing centre, after Hong Kong, Taiwan and Macau, and the first outside greater China. Furthermore, the recent Lion City bond issuances are a milestone in Singapore proving itself to be a credible offshore RMB hub with sufficiently deep RMB deposits to be able to support the offering of RMB products.

Australia – promoting its trading relationship with China

Direct convertibility between RMB and AUD

On 9 April 2013, Australia and China announced an agreement to launch direct trading between the Australian Dollar and the RMB on the China Foreign Exchange Trade System and in the Australian foreign exchange market.

The close trade and investment relationship between Australia and China and the support for RMB-denominated trade settlement and investment offered by the RMB200 billion (A$30 billion) bilateral currency swap entered into in March 2012 between the PBOC and the Reserve Bank of Australia (RBA) – the fourth-largest bilateral currency swap China has signed and one of the first to be agreed with a Western economy – has made the Australian Dollar a natural candidate to be paired with the RMB.

In an important symbolic step towards RMB internationalisation, the Australian dollar becomes just the third major currency to be directly traded with the RMB (the other two being the US Dollar and the Japanese Yen). ANZ and Westpac Banking Corporation designated by the PBOC as among the market-makers in the new currency pair support Australian dollar liquidity for trading in China through their China branches, while branches of Chinese banks in Australia provide RMB liquidity for trading in Australia. Since the commencement of direct trading, the volume of trade between the Australian Dollar and the RMB in the onshore spot market has increased substantially, with turnover rising from the equivalent of US$324 million in March 2013 to US$3.1 billion in May 2013**: this affirms the prospects for the development of a deep and liquid trading market between the Australian Dollar and the RMB.

Australia-Hong Kong RMB trade and investment dialogue

Direct convertibility was announced on the eve of the inaugural meeting of the Australia-Hong Kong RMB trade and investment dialogue held in Sydney in April 2013. The dialogue, announced in July 2012 and facilitated by the RBA, the Australian Treasury and the HKMA, is intended to:

- maximise the opportunities for, and promote the adoption of, RMB trade settlement;
- support the development and take-up of RMB-denominated financing and investment products; and
- foster closer RMB banking and financial links between Australia and Hong Kong.

"As the take-up of RMB trade settlement and investment in Australia increases – as we expect it to rapidly following the announcement of direct convertibility – so will RMB liquidity and the instruments available for managing currency risk. We foresee that capital raising by Australian corporates and financial institutions in RMB – including in Dim Sum bonds in the Hong Kong, London (and, ultimately, Sydney) financial markets – will follow consequentially from direct convertibility, providing access to alternative financing sources and funding diversification opportunities. National Australia Bank's recent issue of RMB400 million of two year bonds confirms the funding opportunities for Australian issuers presented by the Dim Sum bond market and underscores the strategic importance for Aussie corporates and financial institutions of the RMB as a business currency over the medium term."

Laura Sheridan Mouton, Counsel, Finance, Sydney

** Ballantyne, A., Garner, M. and Wright, M., *Developments in Renminbi Internationalisation*, Reserve Bank of Australia Bulletin (June 2013), 65-74.

This dialogue, which brings together Australian and Hong Kong senior banking and business leaders and officials from central banks and finance ministries, seeks to develop offshore RMB business opportunities while promoting Sydney as an offshore RMB hub within the regional 'hub and spoke' network of which Hong Kong is the centre.

The next Australia-Hong Kong RMB trade and investment dialogue will be held in Hong Kong in 2014.

Sydney as a regional offshore RMB hub?

While the extent to which Sydney develops as an offshore RMB hub will depend on China's policy, increasingly close economic and political ties between Australia and China – the bilateral currency swap, direct convertibility, the RBA's recent announcement of its intention to invest around 5% of its foreign reserves in Chinese government bonds, and the strategic partnership between China and Australia announced in April 2012 – credibly suggest that China may be willing to support Sydney's development as a financial market within the network of offshore RMB hubs.

Leaders of Australian corporates and financial institutions are actively promoting strategic adaptation and product innovation to allow Australian businesses to grasp the potentially enormous opportunities presented by Sydney serving as a regional financial centre building access to Asian financial capital markets as offshore RMB capital accumulation accelerates. The Australian Treasury and the RBA are also supporting a joint research project on the internationalisation of the RMB being undertaken by the Centre for International Finance and Regulation in collaboration with the Shanghai University of Finance and Economics. The joint research project will examine reforms to Australia's regulatory system that might facilitate the development of an Australian RMB hub.

Europe – a hub away from home

While Asia Pacific has been actively supporting the development of the RMB as a global currency, Europe also recognises the importance of this development. Major financial centres across Europe also see this as a good opportunity to ride the wave of the China growth story. London was the first in Europe to take tangible steps to establish itself as an offshore hub for RMB business with firm support from both the UK and Chinese governments[7]. Being the most international financial centre in Europe, it realises its potentially significant role as an active foreign-exchange and derivatives trading hub in supporting the transition of the RMB from an international trading currency to an international investment currency.

Paris has also been vying to become a major offshore RMB trading hub in the eurozone. According to data cited by a French newspaper, the current RMB deposits level in Paris is around RMB10 billion, closely following London at approximately RMB14.3 billion[8]. Almost 10 percent of Sino-French trade is now settled in RMB.

There is also Luxembourg, which has the ambition to become "a leading RMB offshore centre in the eurozone in the near future" as indicated by the Minister of Finance during a Luxembourg for Finance[9] mission to Beijing earlier this year. According to data cited by Luxembourg for Finance, Luxembourg has deposits of RMB20 billion as of January 2013, which is the largest pool of RMB deposits in the eurozone and the Luxembourg Stock Exchange has one of the largest RMB denominated bonds listed in Europe. In fact, ICBC has recently announced plans to create an RMB cross-border business centre in Luxembourg to cover cross-border transactions in Europe, reflecting the significance of Europe, and indeed Luxembourg, to China.

Development of currency swaps in Europe

Exactly four months after the announcement on 22 February 2013, where the governor of PBOC, Zhou Xiaochuan, met with the governor of the Bank of England, Mervyn King, in Beijing and agreed to facilitate discussions on the establishment of a reciprocal three-year

"This time last year, we published a briefing and noted that London is in pole position to become the offshore RMB hub in the West. A year on, we see other cities in Europe pursuing the same goal, some with more determination and tangible steps. If London doesn't step forward, it will fall behind. That said; in three to five years time, the distinction between the offshore and onshore markets may well disappear, along with the need for "offshore centres", although competition for business opportunities is won during this part of the internationalisation journey."

Yinan Zhu, Senior Associate, Capital Markets, London

---

[7] See Clifford Chance client briefing entitled "Renminbi Internationalisation – The London Perspective" (May 2012)

[8] The size of the RMB deposits in London has fluctuated significantly during the last year mainly due to a fall in interbank RMB deposits according to a City of London Corporation report. The London RMB deposit size was up to RMB109 billion in early 2012.

[9] Luxembourg for Finance is the agency for the development of the financial sector, a public-private partnership between the Luxembourg Government and the Luxembourg Financial Industry Federation.

RMB-GBP currency swap arrangement that will allow the British central bank to supply RMB400 billion to the market, the PBOC and the Bank of England signed an agreement to establish the currency swap, albeit with a reduced maximum value of RMB200 billion.

Since the announcement in February, Paris and Luxembourg have accelerated the race with London by becoming increasingly vocal on the topic of the RMB. For instance, in early April, the Governor of the Bank of France commented: "The Bank of France, within the euro system, has been working on ways to develop a RMB liquidity safety net in the euro area with due consideration of a supporting currency swap agreement with the PBOC".

Market participants are very pleased to see that London has stepped up to remain in pole position in the race to become the offshore RMB business centre in Europe. This is of course good news for London and UK financial institutions and corporates, and will be particularly advantageous for European companies who will benefit from using London as a hub for RMB, as it has been for other currencies and financial products.

The currency swap will certainly encourage the use of RMB in Europe as a trade settlement currency as well as an investment currency. More importantly, it will raise awareness and boost market confidence in RMB by providing an "official endorsement" from central banks and reassure market participants that RMB liquidity will remain available.

It is yet to be seen how this swap will be put to use, with the Bank of England referring to it as having "the capability to facilitate RMB liquidity to eligible institutions in the UK". Effective and meaningful use of the swap will be key in promoting the continued growth of the use of offshore RMB as intended by PBOC. History has shown that the London financial market is a fitting arena with the financial innovation required to effectively utilise this swap.

Clearing banks for RMB in Europe

Earlier this year, the chief representative of PBOC in Europe indicated that the bank would be supportive of London having its own clearing bank if that is what London needs. As with the other developments in Asia Pacific, international and Chinese banks have been eyeing similar opportunities and movements across the continent, and working behind the scenes to win the support of Beijing in circumstances where a RMB clearing bank in London may be appointed. Paris and Frankfurt have also expressed interest in establishing an RMB clearing house there.

Development of RMB products in Europe

The development of RMB-denominated investment products is a key driver in the RMB internationalisation process. Offshore RMB-denominated bonds have gained significant traction, with French and German companies among the most active European issuers: with the total value of such bonds issued by French and German corporates reaching nearly RMB7 billion and RMB8 billion respectively, in 2011 and 2012.

According to Luxembourg's Minister of Finance, Luc Frieden, loans worth RMB30 billion are currently structured via Luxembourg, while the local fund industry manages RMB200 billion worth of RMB assets. Establishing Luxembourg as a hub for financial services and how Luxembourg can contribute to the international reach of Chinese asset managers have been the focus of Luxembourg's efforts in the offshore RMB business.

An MOU was entered into between Luxembourg's Commission for the Supervision of the Financial Sector (CSSF) and China Banking Regulatory Commission (CBRC) in as early as 2008. This MOU reportedly allows QDIIs to invest on behalf of their clients in financial products regulated by the CSSF. The MOU positions Luxembourg as a gateway to China and also makes it possible for Luxembourg fund management companies to reach investors in the booming Chinese fund industry through the QDII scheme.

Developments in the United States

While the United States is not obviously seen as a country that actively develops itself as an offshore RMB hub, there have been some recent developments which reflect the growing domestic demand for RMB products. In February this year, the Chicago Mercantile Exchange (CME), the largest futures exchange in the United States, launched a new offshore RMB futures contract deliverable in Hong Kong. This allows market participants to hedge exposure to the RMB as the currency further integrates into the global financial system. Furthermore, it is worth noting that the CME has been accepting offshore RMB as collateral for all its futures products since January 2012.

Internationalisation of RMB – looking forward

The recent developments in China, Asia Pacific and Europe demonstrate the strong willingness of many nations to support the continuous development of RMB as a truly global currency. China is the second largest economy in the world, so it comes as no surprise that there has been such a rapid growth of RMB as a payment currency and that it is increasingly accepted as a major currency in world trade. Major financial markets also seem united in their desire to promote and participate in this development.

A key factor in determining the pace of development of RMB as a global currency therefore lies with the RMB-liberalising reforms enacted by China's regulators themselves. While we do not expect China to abandon its step-by-step approach, it is obvious that these recent developments have increased the spotlight on RMB. At these relatively early stages of the RMB's growth, different countries have tailored their regulations and standards separately, with some concerns being voiced that, in the short term, there is a risk of multiple RMB liquidity "puddles" developing in each hub, causing a divergence of the treatment of RMB in different parts of the world. However, one might view this as a natural short-term circumstance in the relatively nascent stage of development of RMB as an offshore currency (since it is after all still a currency in respect of which domestic currency controls apply to the extent it crosses China's borders), and given the active and prudent role China's authorities are playing in the RMB 's continued liberalisation, it is reasonable to be confident that they will be able to effect a convergence of their regulations and standards to allow RMB to be treated and valued homogenously throughout the world.

It is clear that there are a number of hurdles China's regulators have to cross before achieving full convertibility of RMB. However, as can be seen from the recent international developments of RMB as a global currency, this RMB growth story is showing no signs of slowing, and it seems to be only a matter of time before the goal of RMB becoming a widely used global currency is achieved. A key question banks and corporates should ask themselves is whether they are positioning themselves effectively to benefit from the growth of RMB.

"The introduction of RMB futures contracts by the CME is a useful step in the wider acceptance of offshore RMB products in the United States, the world's biggest economy. We are closely watching how the United States market adapts to RMB's development into an international currency."

Gareth Old, Partner, Capital Markets, New York

Contacts

TieCheng Yang
Partner, Regulatory
Beijing
E: tiecheng.yang@
cliffordchance.com

Ying White
Partner, Funds
Beijing
E: ying.white@
cliffordchance.com

Mark Shipman
Partner, Funds
Hong Kong
E: mark.shipman@
cliffordchance.com

Matthias Feldmann
Partner, Funds
Hong Kong
E: matthias.feldmann@
cliffordchance.com

Francis Edwards
Partner, Derivatives
Hong Kong
E: francis.edwards@
cliffordchance.com

Connie Heng
Partner, Capital Markets
Hong Kong
E: connie.heng@
cliffordchance.com

Matthew Fairclough
Partner, Capital Markets
Hong Kong
E: matthew.fairclough@
cliffordchance.com

Anthony Wang
Partner, Finance
Hong Kong
E: anthony.wang@
cliffordchance.com

Habib Motani
Partner, Finance
London
E: habib.motani@
cliffordchance.com

Huw Jenkins
Partner, Finance
London
E: huw.jenkins@
cliffordchance.com

Yinan Zhu
Senior Associate, Capital Markets
London
E: yinan.zhu@
cliffordchance.com

Gareth Old
Partner, Capital Markets
New York
E: gareth.old@
cliffordchance.com

Paul Landless
Counsel, Derivatives
Singapore
E: paul.landless@
cliffordchance.com

Lena Ng
Counsel, Funds and Derivatives
Singapore
E: lena.ng@
cliffordchance.com

Laura Sheridan Mouton
Counsel, Finance
Sydney
E: laura.mouton@
cliffordchance.com

Michael Lishman
Partner, Corporate
Perth
E: michael.lishman@
cliffordchance.com

Notes

Notes


1
元
YI YUAN
2002

CLIFFORD

CHANCE