HONG KONG MONETARY AUTHORITY
香港金融管理局

Circulars

06 Jul 2009

Renminbi Business in Hong Kong

Our Ref.: B1/15C

6 July 2009

The Chief Executive
All Authorized Institutions

Dear Sir/Madam,

Renminbi Business in Hong Kong

The People's Bank of China (PBoC) together with other Mainland authorities promulgated on 1 July 2009 the administrative rules on settlement of cross-border trades in renminbi (the Rules [1]). As a result, the scope of renminbi business in Hong Kong is expanded. This circular sets out the HKMA's supervisory guidance to authorized institutions (AIs) participating in such cross-border trade settlement (Participating AIs) in the light of this development. For AIs already engaging in renminbi business in Hong Kong, this circular should be read in conjunction with the previous circulars on the subject [2].

Restricted licence banks and deposit-taking companies are also eligible to engage in the new scope of renminbi business set out in this circular, i.e. to become Participating AIs. To do so they need to either execute a settlement agreement with the Clearing Bank for renminbi business in Hong Kong (Clearing Bank) or to engage one or more correspondent banks on the Mainland (Mainland Correspondent Banks [3]) for this purpose, or to adopt both approaches at the same time (see below for further details). Under both arrangements, they will have to apply for renminbi open position limit(s) from the PBoC.

Two arrangements for renminbi trade settlement

According to the Rules, there are two arrangements for cross-border trade settlement in renminbi, i.e. through the Clearing Bank and through Mainland Correspondent Banks. In Hong Kong, Participating AIs may execute the Agreement for Clearing and Settlement of Renminbi Trade Settlement Business with Bank of China (Hong Kong) Limited, the Clearing Bank for renminbi business. Separately, Participating AIs can also execute correspondent bank agreements with Mainland banks to conduct such renminbi trade settlement. Under both arrangements, the respective agreements must comply with the applicable legal and regulatory requirements in Hong Kong and the Mainland.

To facilitate the processing of renminbi transactions associated with trade settlement, the Renminbi Real Time Gross Settlement System (RMB RTGS) has been enhanced and the

entry requirements will be revised shortly so that all types of AIs may apply to become a direct participant. Participating AIs should approach the Clearing Bank if they wish to gain this status. It should be noted that Participating AIs must join the RMB RTGS if they intend to conduct renminbi trade settlement via the Clearing Bank. They will also need to join the RMB RTGS if they intend to conduct renminbi interbank fund transfers or money market deals in Hong Kong (see below).

Scope of services and renminbi funding

Participating AIs may provide renminbi services including deposit, cheque [4], currency exchange, remittance and trade finance to Renminbi Trade Settlement Enterprises [5](TSE) for settling cross-border trade transactions. The details of the services available will be set out in the agreement with the Clearing Bank and/or Mainland Correspondent Banks. Specifically, Participating AIs may accept deposits from TSE, conduct renminbi exchange with TSE for the purpose of or arising from cross-border trades, conduct renminbi remittance for TSE to settle cross-border trades, and provide trade finance facilities in renminbi to TSE for the purpose of cross-border trades. Participating AIs and TSE may also invest in renminbi bonds issued in Hong Kong using their own renminbi funds [6].

Participating AIs have to open designated renminbi accounts for TSE for the relevant services. In other words a company currently being a Designated Business Customer (DBC) for the purpose of renminbi business and already maintaining a renminbi account in a Participating AI will need to open a separate renminbi account in the capacity of TSE for the trade settlement services.

For the avoidance of doubt it is emphasized that while the services targeting TSE can be conducted by all Participating AIs, the existing renminbi business targeting personal customers and DBCs can only be conducted by licensed banks which have executed the Agreement for Settlement of Renminbi Banking Business in Hong Kong with the Clearing Bank.

In respect of funding, Participating AIs may utilise the renminbi they obtain from customers (e.g. through deposit-taking) to fund the new scope of business. They can also conduct currency exchange with or obtain renminbi credit facilities from the Clearing Bank and Mainland Correspondent Banks. Further, inter-bank money market transactions in renminbi can be conducted between Participating AIs.

While Participating AIs can maintain renminbi accounts with the Clearing Bank and Mainland Correspondent Banks at the same time, it should be noted that the two arrangements represent distinct routes of fund movements. In other words, there will be no transfer of funds between the account maintained with a Mainland Correspondent Bank and the account held with the Clearing Bank by a Participating AI.

Internal controls

The HKMA expects Participating AIs to conduct their RMB business carefully. It is imperative that they have a clear understanding of the contractual terms in their agreements with the Clearing Bank and the Mainland Correspondent Banks. They should put in place proper internal control systems, effective policy and procedures as well as adequate resources to ensure compliance with these contractual terms.

The new scope of business may result in more corporate customers opening renminbi accounts with Participating AIs. As always, they should carry out adequate Know-Your-Customer procedures and endeavour to guard against potential money laundering activities as well as counterfeit renminbi banknotes in processing the relevant transactions. This is particularly important for renminbi trade settlement, which may involve frequent and substantial amount of renminbi funds flowing through the renminbi accounts of TSE. Participating AIs should satisfy themselves that the fund flows are in line with their understanding of the TSE trade operations.

Specifically, Participating AIs should endeavour to prevent abuse of the renminbi trade settlement services by customers using trades that are not genuine. Adequate measures should be taken to detect fraudulent trades or trades that do not have commercial substance. In this regard, Participating AIs should review the relevant trade documents diligently and monitor whether the relevant renminbi fund movements are used for settling cross-border trades. While similar controls are in any case expected of AIs in their trade finance business, these are particularly important in the current context as cross-border trade settlement in renminbi is being allowed on a trial basis. Any abuse of the arrangement may cast doubt on the compliance capability of the relevant Participating AIs in this regard, and in turn bring detrimental effect to the ongoing development of renminbi banking business in Hong Kong.

In addition, Participating AIs should note that the new scope of renminbi business aims to facilitate the settlement of cross-border trades. In this regard, renminbi funds provided to TSE through currency exchange or trade financing should be utilized forthwith in paying the enterprises on the Mainland rather than credited to the TSE renminbi account as deposit. Further, Participating AIs should guard against undue accumulation of renminbi by TSE. For instance, repayment of trade finance in renminbi should where practicable be processed by utilizing available renminbi funds of the TSE first.

As a result of the new business scope, TSE may execute inter-bank transfer and/or use renminbi cheques in Hong Kong to pool their renminbi funds in one account for cross-border trade settlement. Participating AIs should establish reasonable procedures to guard against inappropriate use of the relevant services. In particular, Participating AIs should have procedures to check whether such transfers or cheques are in favour of the fund transferors or cheque issuers themselves. Participating AIs should raise enquiries with customers if they identify any irregularities and take appropriate actions where necessary.

Risk management limits

Participating AIs should be particularly cautious of the exchange rate and liquidity risks involved in renminbi business, as the sources of renminbi funds in Hong Kong are still limited and the currency's exchange rate may fluctuate. Procedures should be established by each Participating AI to ensure compliance with the renminbi open position limits obtained from the PBoC.

To ensure that it will be able to service renminbi liabilities as they fall due, each Participating AI should observe two limits. First, it should always maintain a total amount of renminbi cash plus settlement account balance with the Clearing Bank no less than 25% of its renminbi customer deposits (which is a limit already applicable to existing Participating AIs). Second, the aggregate of its renminbi cash, settlement account balance maintained with the Clearing Bank and with all Mainland Correspondent Banks should always be no less

than 25% of its renminbi liabilities, i.e. renminbi customer deposits plus all inter-bank money market and trade finance liabilities in renminbi.

As a further measure to contain the renminbi liabilities of Participating AIs, they should at all times ensure that their outstanding inter-bank funding in renminbi (whether from the Clearing Bank, Mainland Correspondent Banks and other Participating AIs) does not exceed their outstanding renminbi customer deposits.

Other issues

As mentioned above, Participating AIs have to execute agreements with the Clearing Bank and/or Mainland Correspondent Banks and apply for open position limits, which will be determined by the PBoC. For existing Participating AIs that intend to provide cross-border trade settlement services, this may be an application to increase the current open position limit via the Clearing Bank if necessary. Each Participating AI should copy its agreements with the Clearing Bank and Mainland Correspondent Banks to the HKMA as soon as this is available, and also inform the HKMA of any revised or new open position limit. Participating AIs should establish internal guidelines on the new scope of renminbi business to elaborate on the relevant operating systems and procedures. These should be submitted to the HKMA within one month after executing any agreement with the Clearing Bank or Mainland Correspondent Banks.

As a result of the current changes to the scope of renminbi business, the "Return of Renminbi Business Activities" (MA(BS)16) is under revision. The relevant details as well as any interim reporting requirements will be discussed under separate cover.

Should you have any question on this letter, please feel free to contact Mr Thomas Wong (tel. no. 2878-1553), Ms Denise Tai (tel. no. 2878-1589) or your usual supervisory contacts at the HKMA.

Yours faithfully,

Nelson Man

Executive Director

(Banking Supervision)

[1]《跨境貿易人民幣結算試點管理辦法》(Also see《跨境貿易人民幣結算試點管理辦法實施細則》promulgated by the PBoC on 3 July 2009.）

[2] The HKMA's circulars of 5 February 2004, 13 December 2005 and 20 June 2007.

[3] In this circular, the term Mainland Correspondent Bank(s) refers to the "domestic agent bank(s)" mentioned in the Rules.

[4] Under the Banking Ordinance, only licensed banks can provide cheque services to customers.

[5] The term is defined in the Agreement for Clearing and Settlement of Renminbi Trade Settlement Business or the relevant agreement with Mainland Correspondent Banks.

[6] For the requirements of dealing in renminbi bonds issued in Hong Kong, refer to the HKMA's circular of 20 June 2007.

Last revision date : 01 August 2011