HONG KONG MONETARY AUTHORITY
香港金融管理局

Circulars

20 Jun 2007

Renminbi Business in Hong Kong

Our Ref. : B1/15C

20 June 2007

The Chief Executive
All Licensed Banks

Dear Sir/Madam,

Renminbi Business in Hong Kong

The State Council announced on 10 January 2007 the further expansion of the scope of renminbi (RMB) business of Participating Banks in Hong Kong. This circular sets out the HKMA's guidance to Participating Banks on the major supervisory issues arising from this development, and shall be read in conjunction with the previous circulars of 5 February 2004 and 13 December 2005 on the subject.

Issuance and dealing of RMB financial bonds in Hong Kong

According to the announcement made by the People's Bank of China (PBoC) subsequent to that of the State Council, Mainland financial institutions may issue RMB financial bonds in Hong Kong (RMB bonds) upon the relevant Mainland authorities' approval. Through the RMB Clearing Bank, RMB bond issuers may remit RMB funds thus raised in Hong Kong to the Mainland, and vice versa for the payment of interest and principal relating to such bonds. The PBoC promulgated the Provisional Procedures for the Issuance of Remninbi Bonds by Domestic Financial Institutions in the Hong Kong Special Administrative Region (Provisional Procedures) on 8 June 2007, which sets out the relevant requirements. Among other things, the Provisional Procedures provide that the issuance and selling arrangements, dealing, registration, custody, settlement as well as information disclosure of RMB bonds issued in Hong Kong will follow the local requirements.

In summary, Participating Banks may conduct the following additional RMB business in Hong Kong as a result of the changes:

1. To open RMB deposit accounts for RMB bond issuers and underwriters in Hong Kong. The scope of eligible retail RMB depositors is still confined to individuals holding Hong Kong Identity Cards and Designated Business Customers (DBC).

2. To process the remittance of RMB funds associated with RMB bond issuance and interest/principal payments via the Clearing Bank.

3. To provide one-way exchange service for RMB bond issuers to convert RMB to Hong Kong dollar for the payment of bond issuance and related expenses. The scope of exchange services available to individuals and DBC remains the same.

4. To conduct certain types of Regulated Activities, such as Dealing in Securities, Advising on Securities and Advising on Corporate Finance, under the Securities and Futures Ordinance (SFO) to facilitate the issuance of RMB bonds and dealing in such bonds by customers. RMB deposit account holders as well as Participating Banks may invest in such bonds using their own RMB funds.

For the purpose of clearing and settling the above RMB-denominated transactions, the HKMA has collaborated with the Hong Kong Interbank Clearing Limited (HKICL) and the Clearing Bank to transform the Renminbi Settlement System into a full-fledged Renminbi Real Time Gross Settlement System (RMB RTGS) with a linkage to the Central Moneymarkets Unit. The RMB RTGS has commenced operation on 18 June 2007. Participating Banks may conduct the enhanced RMB business after becoming a direct participant of the RMB RTGS and executing a new Agreement for Settlement of Renminbi Banking Business in Hong Kong (Settlement Agreement) and the relevant supplementary documents with the Clearing Bank.

Internal controls

The HKMA has always required Participating Banks to conduct their RMB business carefully. It is imperative that Participating Banks have a clear understanding of the contractual terms under the Settlement Agreement. They should put in place proper internal control systems, effective policy and procedures as well as adequate resources to ensure compliance with those contracted terms. In the context of RMB bond issuance and dealing, Participating Banks should where applicable be mindful of the statutory and regulatory requirements, such as the registration requirements, relating to the relevant Regulated Activities under the SFO.

The Settlement Agreement provides that only Participating Banks and RMB deposit account holders may deal in RMB bonds. To facilitate RMB bond transactions and interest/principal payments, inter-bank transfer of RMB funds and the use of RMB cheques in Hong Kong for such purposes are allowed[1]. This may attract more individuals and DBCs to open RMB deposit accounts with Participating Banks, and there may be deposit by various means (i.e. cash, currency exchange, incoming cheques and inter-bank fund transfer). Participating Banks should carry out adequate Know-Your-Customer procedures to ascertain customers' eligibility for opening RMB deposit accounts and guard against potential money laundering activities as well as counterfeit RMB banknotes.

Participating banks should be mindful that the inter-bank transfer of RMB funds and use of RMB cheques in Hong Kong are made available to facilitate RMB bond transactions. They should therefore establish reasonable procedures to guard against inappropriate use of the relevant services. In particular, Participating Banks should have procedures to check whether such transfers/cheques are in favour of the fund transferors/cheque issuers themselves, or Participating Banks (or their nominees) involved in the issuance or dealing of RMB bonds. Participating Banks should raise enquiries with customers if they identify any irregularities and where necessary take appropriate actions to deter the inappropriate use of the relevant services.

Another issue relating to RMB cheques is the applicability of the daily limit of RMB80,000 in the light of the expanded scope of usage. This daily limit will continue to apply to RMB cheques presented by Mainland banks for settling the cheque issuers' consumer expenses incurred in Guangdong Province (including Shenzhen). In this regard, Participating Banks should continue to adopt the measures relating to RMB current accounts set out in the HKMA circular of 13 December 2005, although the handling fee mentioned therein will not be relevant to RMB cheques used in Hong Kong relating to RMB bond transactions. While the HKICL and the Clearing Bank will assist Participating Banks to distinguish the two categories of RMB cheques, Participating Banks should put in place effective systems and procedures to ensure that the two different types of RMB cheques will be handled properly.

In line with the existing practices of the local bond market, it is expected that market-making and sale and repurchase (repo) arrangements for RMB bonds will be developed in Hong Kong among Participating Banks. Participating Banks should follow the terms in the Settlement Agreement and the relevant supplementary documents for conducting such market-making and repo activities. In particular, apart from the repo of RMB bonds conducted between them, any other RMB credit facilities granted by Participating Banks are prohibited.

The Provisional Procedures require RMB bond issuers to complete the issuance of RMB Bonds and the subsequent remittance of the RMB funds back to the Mainland via the Clearing Bank within a set of specific timelines. There are also requirements on the maximum amount that can be remitted by RMB bond issuers to/from the Mainland. Participating Banks should ensure that these requirements are fulfilled when they conduct the relevant transactions.

Risk Management

Participating Banks should be cautious of the liquidity risk and market risk involved in the dealing of RMB bonds, especially when the amount of RMB deposits and hence funds available for investing in RMB bonds have yet to reach a considerable size. To avoid Participating Banks taking undue position in RMB bonds and to ensure their ability to service RMB deposit withdrawals, each Participating Bank should always maintain a total amount of RMB cash plus placement with the Clearing Bank no less than 25% of its total RMB deposits. They are expected to monitor their RMB deposit level and put in place appropriate mechanism to ensure this requirement is always observed.

Others

Similar to the previous arrangement, the new Settlement Agreement provides that each Participating Bank should file a copy of its internal guidelines for RMB business with the HKMA, which will then make a copy available to the PBoC for reference. In this connection, Participating Banks should revise their internal guidelines according to the latest changes and file the revised guidelines with us no later than one month after executing the new Settlement Agreement.

With the changes in the scope of RMB business, Participating Banks may wish to apply to the PBoC through the Clearing Bank for revising their respective Open Position Limit. As already required, each Participating Bank that applies for such a revision should copy a set of its application documents to the HKMA.

As a result of the changes introduced to RMB business, the "Return of Renminbi Business Activities" (MA(BS)16) currently filed by licensed banks to the HKMA is under revision. The HKMA is also considering the treatments of RMB-denominated claims and liabilities arising from RMB bond transactions in the calculation of the Liquidity Ratio. The relevant details will be discussed under separate covers.

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

Yours faithfully,

Arthur Yuen
Executive Director
(Banking Supervision)

[1] Interbank RMB fund transfers are allowed between bank-to-bank accounts, bank-to-customer accounts (and vice versa), and customers' same-name accounts opened in different Participating Banks to facilitate RMB bond transactions. On the use of RMB cheques for RMB bond transactions, an individual holding RMB current account may issue RMB cheques to oneself as beneficiary. He/she may also issue RMB cheques to Participating Banks or their nominees which are acting on behalf of RMB bond issuers as the receiving banks or the agent banks for conducting secondary market transactions for the individual current account holder.

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