FEATURE ARTICLE

Multi-currency cross-border payment arrangements between Hong Kong and Mainland China

by the Financial Infrastructure Department

The establishment of multi-currency cross-border payment arrangements between Hong Kong and the Mainland on 16 March 2009 marked an important step in strengthening co-operation on the development of the two economies' financial infrastructure. The arrangements enable banks in both economies to make cross-border payments more efficiently with reduced settlement risks and costs. This article describes how this new payment service works and its benefits to banks and their customers.

Background

In recent years, the number of cross-border foreign currency transactions between banks in Mainland China and across the region has increased markedly, reflecting the growth of financial markets on the Mainland. To cope with this increasing demand and to promote the safety and efficiency of foreign-currency payments and settlements, the People's Bank of China (PBoC) launched China Domestic Foreign Currency Payment System (CDFCPS) in 2008. The CDFCPS, a Real Time Gross Settlement (RTGS) system covering eight foreign currencies[1], facilitates real-time money transfers of the relevant currencies among domestic banks in Mainland China participating in the CDFCPS.

Against this backdrop, the HKMA and the PBoC have been working closely to examine ways to leverage the multi-currency settlement capability shared by both the newly established CDFCPS on the Mainland and Hong Kong's Clearing House Automated Transfer Systems (CHATS)[2] to further promote payment efficiency and safety between banks in the two economies. Both authorities saw merit in offering a new cross-border payment channel for multi-currency settlement supported by the two payment systems. In February 2009, the PBoC and the HKMA signed a Memorandum of Understanding on the establishment of multi-currency cross-border payment arrangements. The service was introduced on 16 March with the full support of the two authorities.

This article explains the mechanism of these cross-border payment arrangements, their usage so far and the key benefits to banks in Mainland China and Hong Kong.

Objectives of the payment arrangements

A key objective of setting up the payment arrangements is to meet the increasing demand for cross-border foreign-currency payment services within the region, particularly between Hong Kong and the Mainland, as a result of closer economic and financial ties. The authorities also want to encourage

[1] The eight foreign currencies are: the Hong Kong dollar, US dollar, euro, British pound, Japanese yen, Australian dollar, Canadian dollar and Swiss franc.

[2] CHATS covers the Hong Kong dollar, US dollar, euro and renminbi.

competition among banks to benefit users of the system. The payment arrangements provide banks and their customers with a new payment option in addition to the various existing payment channels. This more efficient system will help to stimulate an upgrading of service standards by existing providers of the more conventional payment channels. The enhanced competitive environment will eventually translate into more attractive pricing and business terms that will benefit the banks and their customers. It will also help increase the use of the various multi-currency payment systems operating in both Hong Kong and the Mainland, thus opening them up to a wider group of market players. The introduction of the new service is in line with the HKMA's efforts to develop Hong Kong into a payment and settlement hub in the Asian region.

Scope of service

The scope of the payment arrangements covers cross-border payment and settlement items of relevant foreign currencies in compliance with the Mainland's rules and regulations on foreign exchange control, to be observed by Mainland banks using the payment arrangements to settle cross-border payment instructions.

After considering the business demand and the infrastructure currently in place, the HKMA and the PBoC have decided that the payment arrangements would initially cover the Hong Kong dollar, US dollar, euro and British pound. The development of cross-border payment arrangements for other currencies will depend on market demand.

Establishing the payment arrangements

The PBoC has appointed four banks as the Settlement Institutions (CSIs) for various currencies covered by the CDFCPS. The cross-border payment arrangements are established through the Mainland SIs and their designated Agent Banks in Hong Kong for the four currencies covered. Table 1 provides a list of the Mainland SIs and the Agent Banks.

Each Mainland SI is required to open a settlement account with its respective Agent Bank in Hong Kong. For a payment from Hong Kong to the Mainland, the Agent Bank will credit the settlement account and send the payment details to its Mainland SI for payment execution through the CDFCPS. For a payment from the Mainland to Hong Kong, the Agent Bank will debit the settlement account and credit the funds into the beneficiary bank's account in Hong Kong through CHATS.

TABLE 1
CSIs and their Agent Banks in Hong Kong

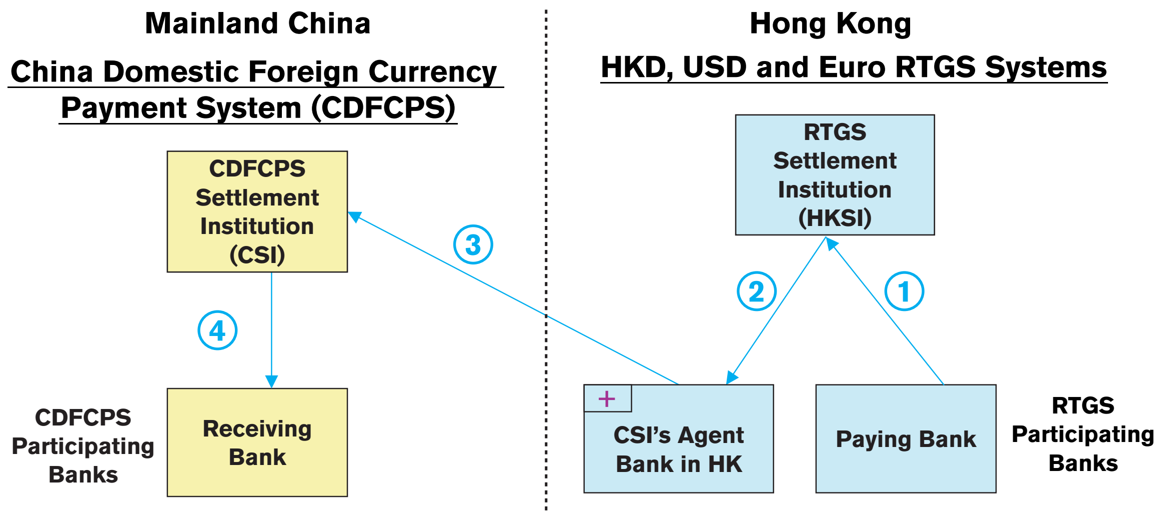
Currency	CSIs	Agent Banks in Hong Kong
HKD	China Construction Bank	China Construction Bank, Hong Kong Branch
USD	Bank of China	Bank of China (Hong Kong)
Euro	Industrial and Commercial Bank of China	Industrial and Commercial Bank of China (Asia)
GBP	Shanghai Pudong Development Bank	Citibank (Hong Kong)

Under these payment arrangements, participating banks on the Mainland and in Hong Kong are able to issue and receive cross-border payment instructions in Hong Kong dollars, US dollars and euros through the RTGS systems of these three currencies, which are already established in both the Mainland and Hong Kong. Diagrams 1 and 2 illustrate the flow of fund transfers for these three currencies. However, there is a slightly different arrangement for the British pound as an RTGS system for the pound is not yet available in Hong Kong. Mainland participating banks can issue and receive their cross-border payment instructions through the Mainland's RTGS system for the British pound, while participating banks in Hong Kong will need to issue and receive their cross-border payment instructions for the pound through the conventional correspondent banking network of the appointed Agent Bank for the pound in Hong Kong.

To help banks signify payments made through the payment arrangements, three new payment codes, "63", "64" and "65" have been introduced to CHATS. Payment instructions bearing payment codes "63" and "64" are used for Mainland-related Commercial Transfers and Mainland-related Liquidity Transfers respectively, and classified as "customer payments". Those bearing payment code "65" are used for Mainland-related Return Payments and classified as "member payments".

DIAGRAM 1

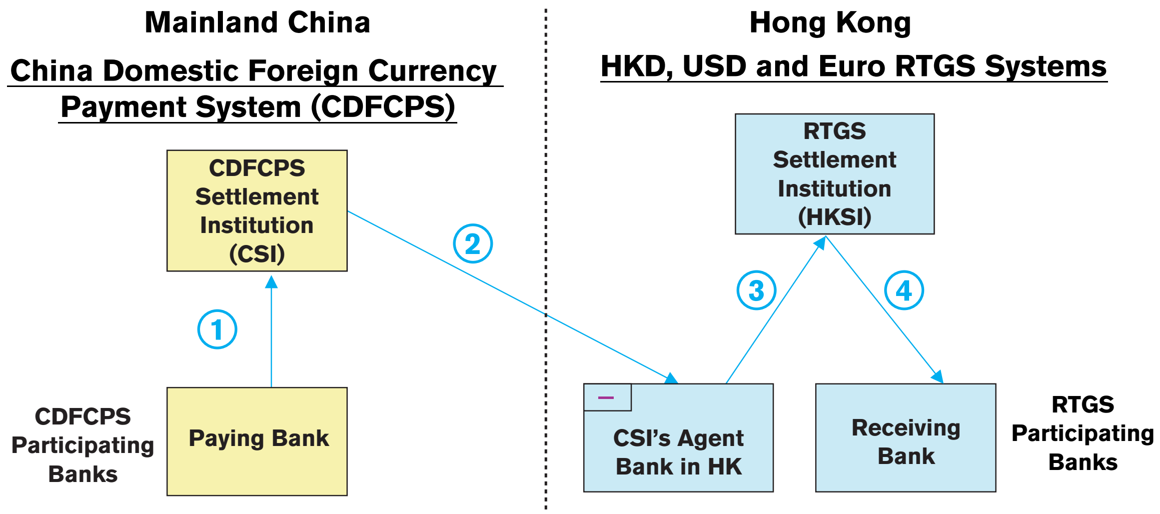
The operating model of cross-border fund transfers from Hong Kong to the Mainland



① The paying bank in Hong Kong sends a payment instruction through the RTGS system and remits the funds to the receiving bank on the Mainland through the respective currency's Agent Bank in Hong Kong.
② The Agent Bank in Hong Kong receives the funds through the RTGS system.
③ The Agent Bank in Hong Kong will credit the funds into the CSI's account maintained at its bank and notify the CSI of the payment details.
④ The CSI credits the funds into the receiving bank through the CDFCPS.

\+ CSI's account with their respective Agent Bank in Hong Kong (balance increased).

DIAGRAM 2
The operating model of cross-border fund transfers from the Mainland to Hong Kong



① The paying bank on the Mainland sends a payment instruction through the CDFCPS and remits the funds to the receiving bank in Hong Kong through the CSI.
② The CSI receives the funds through CDFCPS.
③ The CSI notifies its Agent Bank in Hong Kong of the payment details; its Agent Bank in Hong Kong will deduct the remittance amount from the CSI account.
④ The Agent Bank in Hong Kong will credit the fund to the receiving bank through Hong Kong's RTGS systems.

– CSI's account with their respective Agent Bank in Hong Kong (balance decreased).

Key benefits

The payment arrangements provide banks in Asia with a multi-currency cross-border mechanism operating in the same time zone, which allows them to provide real-time foreign-currency money-transfer and settlement services to their customers with no time difference. This increases the efficiency of cross-border multi-currency payments and reduces settlement risks and costs. It also satisfies the need for same-day payments arising from financial and business activities in Hong Kong and on the Mainland. In addition, as the time required for liquidity transfers, cross-border payments and remittances is reduced under the payment arrangements, participating banks can benefit from enhanced liquidity efficiency and management, and provide better and more efficient cross-border payment services to their customers at competitive prices. More generally, the introduction of this wide-ranging cross-border payment and settlement mechanism covering multiple currencies marks an important step in further deepening the financial co-operation between the Mainland and Hong Kong.

A notable feature of the payment arrangements is their pricing structure. Instead of entering into a bilateral agreement with each of the Agent Banks on the price to be charged, participating banks enjoy a competitive, unified rate published by each Agent Bank when using the payment arrangements for the transfer of funds. The pricing structure conforms to industry trends and is straightforward and transparent with the removal of the lengthy and complex pricing negotiation process, thereby making this new payment channel more attractive.

Usage

In the first two months of operation, the payment arrangements handled 130 transactions with a total value of approximately HK$50 million equivalent. User feedback has so far been positive and the market-driven usage of the payment arrangements is expected to pick up gradually. The encouraging growth trend of CDFCPS's usage may provide some useful references in this regard. Since the full launch of CDFCPS in August 2008, the number of participating banks has doubled and is expected to grow further. The number and value of transactions processed through the CDFCPS has also experienced significant growth. These developments point to the potential for usage increase in the cross-border payment arrangements. To help capture this potential business growth, the PBoC and the HKMA will jointly promote the new system to banks on the Mainland and in Hong Kong in the coming months. The authorities will also regularly update each other on usage data and user comments. This will provide the basis for a review of the arrangements later in the year aimed at further improving and promoting the service.

Looking forward

Co-operation between Hong Kong and Mainland China on cross-border financial infrastructure has been evolving since 1998 — from joint cheque-clearing arrangements to RTGS linkages, involving the Hong Kong dollar and US dollar, and benefiting banks in both Hong Kong and Guangdong Province. The launch of the multi-currency cross-border payment arrangements, with a wider choice of currency type and geographical coverage, is another step in this evolution. All these initiatives have played an important role in promoting the safety and efficiency of cross-border payment and settlement system, as well as strengthening the economic and financial ties between the two economies.

The HKMA will continue to hold regular discussions with its Mainland counterparts to exchange views and explore ways to further improve the financial infrastructure development of the two economies in light of the latest market needs and developments. These efforts will complement the HKMA's work in strengthening Hong Kong's multi-currency, multi-dimensional financial infrastructure with a view to promoting payment efficiency and harmonisation within the region.