

**Frequently asked questions in relation to the
responsibilities of Hong Kong Settlement Banks under Bond Connect**

(I) General

Q1.	What is the supervisory approach to Settlement Banks providing relevant currency conversion and hedging services under Bond Connect?
A1.	<p>In order to maintain your bank's access to the onshore interbank foreign exchange market to conduct the permitted position squaring transactions, you should ensure your bank's compliance with the relevant requirements, including the rules, guidelines and FAQ issued by the People's Bank of China (PBoC).¹</p> <p>Settlement Banks have the obligation to ensure that foreign currency converted into CNY is only used for Bond Connect investments and that a similar proportion of CNY, after investment, is converted back into foreign currency if not being re-invested. When providing hedging services, Settlement Banks should ensure that the hedging arises from genuine and reasonable needs from Bond Connect investments.</p> <p>In practice, Settlement Banks are expected to oversee the overall activities at a CMU member's account, which may reflect the aggregated transactions from different end investors. At the moment, it is not our requirement for Settlement Banks to monitor transactions undertaken by end investors on a deal-by-deal basis. The same is true for Settlement Banks which are concurrently acting as the CMU members/local sub-custodians for the end investors, i.e. it is not a requirement at the moment for the Settlement Banks to monitor individual transactions by end investors even though the investors have appointed the same bank as the CMU member/local sub-custodian.</p> <p>Settlement Banks should, based on individual CMU member's account activities, maintain ongoing, holistic and dynamic oversight of the account in light of the "genuine and reasonable" requirement. Relevant indicators include, but are not limited to, inward/outward remittance from the account</p>

¹ Relevant documents can be accessed at the PBoC's website, including -

- Interim Measures on Bond Connect:
<http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3330621/index.html>
- FAQ:
<http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3331208/index.html>

	and the CNH/CNY position of the CMU member. As market situation and client circumstances vary, it is not possible to set out definitively the possible irregularities but Settlement Banks should put in place mechanism(s) and exercise judgment to flag up suspicious cases, such as frequent and sizeable conversions and withdrawals from the account without corresponding remittance payments under Bond Connect, disproportionate amount of RMB funds being withdrawn without being converted back into foreign currency having regard to the CMU member's CNY/CNH positions. In such cases, Settlement Banks should request ex post clarification or information from CMU members, and if found warranted, report the cases to HKMA and PBoC.
Q2.	What is the CMU member's responsibility in ensuring investors' currency conversion and hedging activities are genuine and reasonable?
A2.	CMU members have the responsibility to ensure that their client investors' currency conversion and hedging transactions are genuine and reasonable in light of the settlement and holding information of a particular client investor. If Settlement Banks consider that there is cause for suspicion, and that it is necessary, they may request reasonable ex post clarification or information from CMU members.

(II) Client/ account management

Q3.	Is there a requirement that each CMU member must open a designated account for Bond Connect transactions? Is there a need to open separate accounts for CNH and CNY?
A3.	<p>At the initial phase, it is not a must to open new and separate accounts for each CMU member for Bond Connect currency conversion purposes. However, the Settlement Bank must put in place proper bookkeeping arrangements to monitor and track fund flows by each individual CMU member in connection with Bond Connect investment activities.</p> <p>Subject to the above, it is at the discretion of Settlement Banks at the moment to determine whether they will require a CMU member to open new and separate designated accounts for Bond Connect, and whether to further break these down into separate CNH and CNY accounts.</p>

Q4.	May Settlement Banks enter into currency conversion contracts with end investors directly?
A4.	A Settlement Bank may choose to execute currency conversion and enter into a contract directly with the end investor. However, irrespective of the contractual relationship, only the relevant CMU member's account may be used to settle the currency conversion transaction and process the relevant cash flows, i.e. that the Settlement Bank should only pay to (or process funds from) the account of the CMU member which is appointed by the relevant end investor. The Settlement Bank should keep the relevant CMU member apprised of such transactions, such that the CMU member can take the information into account when undertaking its own monitoring responsibilities.
Q5.	Should RMB funds received from onshore be booked as CNH or CNY? Can funds be moved freely between the account that a CMU member uses for Bond Connect investments and its other accounts?
A5.	Please refer to A1. Settlement Banks must keep records of the CNH and CNY movements in the CMU members' accounts and ensure that a similar proportion of CNY is converted back into foreign currency when funds are withdrawn from the accounts. Other than that, it is not a requirement for the Settlement Bank to segregate the CNH and CNY within individual CMU members' accounts.

(III) Currency conversion

Q6.	Do Settlement Banks need to obtain proof of bond investment before conducting requested currency conversion service?
A6.	Please refer to A1. It is not a requirement for Settlement Banks to scrutinise transactions by end investors on a deal-by-deal basis. And for that matter, it is not a requirement for Settlement Banks to match each currency conversion to a bond transaction or obtain proof to this effect. Settlement Banks are required to monitor transactions at the CMU members' accounts level. Specifically, Settlement Banks are required to make sure the CNY converted from foreign currency is used for Bond Connect investment purposes and that a similar proportion of CNY is converted back into foreign currency when withdrawn. In doing so, Settlement Banks need to look at individual CMU member's accounts in an ongoing, holistic and dynamic manner. Settlement Banks should request ex post clarification or information from

	CMU members if deemed necessary.
Q7.	Can Settlement Banks rely on a “signed declaration” from a CMU member to conclude the reasonableness of a transaction? For currency conversion transactions conducted under Standing Instruction, can Settlement Banks depend on a one-off “signed declaration”?
A7.	In conducting currency conversion under Bond Connect, Settlement Banks are required to put in place measures to ensure the CNY funds converted are for genuine Bond Connect investment purposes, including but not limited to asking the CMU members to declare the purpose and use of the CNY funds so converted. Subject to that, it is at the Settlement Banks’ discretion to decide the format and frequency of such declaration.
Q8.	Must the CNY funds received from onshore (e.g. redemption, sale or coupon payment) be immediately converted back into foreign currency?
A8.	At the moment, there is no rigid timeline for which a portion of CNY funds received from onshore must be re-invested or converted back into foreign currency. Current requirement is that the Settlement Bank should ensure a similar proportion of funds, which were originally converted from foreign currency for investment, must be converted back into foreign currency when withdrawn from the accounts of CMU members. Hence, we expect Settlement Banks should develop appropriate control and monitoring to identify possible illicit activities unconnected with Bond Connect investment purpose, including watching out for irregularities at each CMU member's account for unreasonable patterns of conversion and payment/receipt, which may differ according to situations of the market and/or the clients. Settlement Banks should request ex post clarification or information from CMU members if deemed necessary.

(IV) Hedging/ risk management

Q9.	Can Settlement Banks help investors hedge anticipated risks (such as those related to interest payments)?
A9.	We understand that Settlement Banks can only provide specified foreign exchange hedging products and square their associated positions in the onshore FX market. PBoC is planning to offer Bond Connect investors interest rate hedging tools.

Q10.	Can investors hedge Bond Connect investments made in CNH at the CNY rate or use CNH to settle CNY-denominated derivatives contracts? Does the tenor of hedging instruments need to match the tenor of the underlying bond directly?
A10.	<p>Please refer to A1. Settlement Banks should ensure that relevant hedging activities are genuine and reasonable based on their oversight of a CMU member's overall account activities. It is not a requirement for Settlement Banks to monitor end investors' Bond Connect transactions on a deal-by-deal basis. Settlement Banks may request ex post clarification or information from CMU members if deemed necessary.</p> <p>However, for avoidance of doubt, investors' CNY hedging activities should in principle arise from genuine and reasonable needs of Bond Connect investments. An investor without CNY exposure does not appear to have genuine and reasonable needs for CNY hedging.</p>