



Our Ref.: B1/15C

23 December 2010

The Chief Executive
All Authorized Institutions

Dear Sir/Madam,

Renminbi (RMB) cross-border trade settlement and net open position

The business of cross-border trade settlement in RMB has undergone significant development since its commencement in July 2009. Recently, the Mainland authorities also announced a substantial expansion of the list of Mainland enterprises that are eligible to participate in the RMB trade settlement scheme. The Hong Kong Monetary Authority (HKMA) has reviewed the situation with a view to enhancing the operations of RMB cross-border trade settlement and establishing a market-based approach. This letter serves to provide further guidance on the handling of RMB cross-border trade settlement by authorized institutions participating in RMB business (Participating AIs)¹, as well as the keeping of RMB net open position (which is applicable to all AIs). Unless stated otherwise, the arrangements set out below should take effect from 1 January 2011.

RMB exchange under cross-border trade settlement eligible for position squaring with the RMB Clearing Bank

General operation

As a general reminder, Participating AIs should put in place stringent Know-Your-Customer procedures as well as exercise due diligence to ascertain that customers' purchase of RMB for trade settlement purpose are supported by genuine cross-border trades². Particular attention should be paid to transactions in large amounts requested by new customers, or transactions between entities that are related to each other. Appropriate third party documents (e.g. shipping

¹ The HKMA also issued circulars regarding RMB cross-border trade settlement on 6 July 2009, 11 February 2010, 19 July 2010 and 28 October 2010.

² These requirements have been stated in the HKMA circular of 6 July 2009 and Question 4 in the list of frequently asked questions attached to the circular of 19 July 2010.

documents) in support of the trade should normally be requested, particularly for trades between related parties.

Exchange transactions

Participating AIs should only provide trade-related RMB conversion service for their own customers in relation to transactions due for settlement not more than 3 months from the date of conversion, if the resulting position is to be squared with the RMB Clearing Bank. Appropriate systems and procedures should be established to monitor and follow through the subsequent settlement of the underlying trade. In this regard, the RMB exchange transaction in relation to a particular trade and the subsequent outward remittance to settle that trade are expected to be conducted by the same Participating AI.

For RMB cross-border trade proceeds received and credited to a customer account, if the customer sells such RMB proceeds to the Participating AI concerned after 3 months such exchange transaction is not considered to be arising from RMB trade settlement (and hence not eligible for position squaring with the RMB Clearing Bank). If the customer transfers such trade proceeds to its RMB account with another Participating AI, these are not considered to be trade proceeds for the latter AI. Exchange of such RMB funds to other currencies by the customer with the latter AI is therefore not treated as RMB exchange under the trade settlement regime (therefore also not eligible for position squaring with the RMB Clearing Bank).

Separately, it should be noted that the regime is aimed to facilitate the use of RMB in cross-border trades between the Mainland³ and its trading partners. In line with this objective, Participating AIs should provide RMB conversion service to customers for trade settlement purpose (and with a view to squaring the resulting position with the RMB Clearing Bank) only when one leg of the trade transaction in question touches the Mainland.

Position squaring with the RMB Clearing Bank

When meeting customer demand for RMB for the purpose of cross-border trade settlement, Participating AIs should first utilise their RMB positions derived under the trade settlement regime. RMB positions derived under the trade settlement regime (i.e. RMB trade positions) refer to RMB positions derived from RMB exchange transactions with customers that meet the requirements set out above. If such RMB trade positions are exhausted, the Participating AI concerned can approach the RMB Clearing Bank. This effectively means Participating AIs can only square with the RMB Clearing Bank their RMB net

³ Currently 20 Mainland provinces and cities are designated for this purpose. See HKMA circular of 19 July 2010 for details.

open position arising from exchange transactions with customers for cross-border trade settlement under the regime as set out above⁴.

In order to achieve a smooth transition to this new arrangement for squaring position with the RMB Clearing Bank, for January 2011 Participating AIs are required to utilize their available RMB positions (i.e. regardless of whether previously derived from trade or non-trade exchange transactions) to meet customer demand for cross-border trade settlement RMB conversions before approaching the RMB Clearing Bank. During this month, Participating AIs should start to keep track of their RMB trade positions as derived from RMB exchange transactions with customers for cross-border trade settlement purpose which meet the requirements set out above. The position squaring arrangement set out in the preceding paragraph will commence from February 2011 onwards⁵.

Supply of RMB funding by HKMA

Participating AIs that do not have long RMB trade positions and cannot obtain RMB from the RMB Clearing Bank to meet customers' demand can approach the HKMA for RMB funding. The HKMA's source of RMB funds is through the activation of the RMB Currency Swap Arrangement with the People's Bank of China. Again, the cross-border trades concerned should be due for settlement not more than 3 months from the date of approaching the HKMA and the Participating AI should approach its usual supervisory contacts at the HKMA as early as possible⁶. In considering the request, the HKMA will assess, among other things, whether the Participating AI has first utilised its long RMB trade positions in satisfying the conversion needs of customers for cross-border trade settlement.

RMB net open position

The net RMB positions maintained by Participating AIs are expected to be commensurate with the scale of their RMB business. In addition, given that RMB is presently not a freely convertible currency, AIs are required to properly manage the foreign exchange risk associated with their RMB open positions. In this regard, all AIs (i.e. not only Participating AIs) should restrict their RMB net open positions (whether net long or net short) to 10% of their RMB assets or liabilities, whichever is larger. For the avoidance of doubt,

⁴ RMB conversions not falling within the requirements of the cross-border trade settlement regime set out in this letter (e.g. for trades not crossing the Mainland border, trades due for settlement beyond three months, etc) can still be conducted, but the open position arising from such conversions cannot be squared with the RMB Clearing Bank.

⁵ In the situation where the original RMB positions have been fully utilized before February 2011, Participating AIs can approach the RMB Clearing Bank for position squaring.

⁶ Participating AIs should note that in general the processing of the request would take about two weeks.

RMB net open position is the difference between on-balance sheet RMB assets and liabilities, but excluding any RMB structural position (e.g. investment in Mainland subsidiary banks). AIs should approach the HKMA to agree a plan to gradually reduce their RMB net open positions if these are already larger than the required limit.

If you have any questions on this letter, please feel free to contact Ms Denise Tai at 2878 1589 or your usual supervisory contacts at the HKMA.

Yours faithfully,

Arthur Yuen
Deputy Chief Executive