



HONG KONG MONETARY AUTHORITY
香港金融管理局

Our Ref.: B1/15C

8 November 2011

The Chief Executive
All Authorized Institutions

Dear Sir/Madam,

Renminbi (RMB) business – Requirements on position squaring with the RMB Clearing Bank

The HKMA has received some enquiries from Participating authorized institutions (AIs) regarding the requirements on position squaring with the RMB Clearing Bank. To ensure the proper use of this supplementary RMB conversion channel, we would like to provide the following clarifications of the requirements that should be observed by all Participating AIs for position squaring in respect of RMB trade settlement transactions with the RMB Clearing Bank and to elaborate on the HKMA's supervisory expectations in this regard.

Position eligible for squaring with the RMB Clearing Bank

Cross-border trades

In determining whether trade transactions are eligible for position squaring with the RMB Clearing Bank, Participating AIs must be able to demonstrate that:

1. the trade transactions concerned are merchandise trade transactions (i.e. trade in services are not eligible);
2. such merchandise trade transactions must be cross-border with one leg of the trade touching the Mainland, as evidenced for instance by the delivery of goods to or from the Mainland, or having a trading partner located on the Mainland; and
3. the timing and sequence of the RMB conversion conducted by customers and the delivery of goods should be consistent.

Participating AIs should especially stay vigilant to cross-border merchandise trade transactions that are artificially structured to “round-trip” through Hong Kong (or other locations outside the Mainland) into Mainland China. Generally speaking, the flow of funds should not be contrary to the flow of goods for a cross-border merchandise trade transaction (e.g. RMB purchased for payment into the Mainland while the goods are also delivered into the Mainland and vice versa).

Supporting documents

To substantiate the flow of goods, invoice and sales agreement provided by the customers are not considered sufficient. In the circular dated 23 December 2010, the HKMA expects Participating AIs to request third-party documents from their customers, especially for cross-border merchandise trade transactions between related parties for verifying the genuineness of the cross-border trade transactions. Such third-party documents may include bill of lading, warehouse receipt, goods delivery note, customs-verified declaration form or other documents that can indicate the identity of the buyer and the seller of a cross-border merchandise trade transaction and the movement of goods consistent with information provided in the invoice and sales agreement.

Where third-party documents are unavailable or unable to clearly indicate the identity of the buyer and the seller of the cross-border merchandise trade transactions and/or the movement of goods consistent with information provided by customers in the invoice and sales agreement, assessment of the genuineness of the cross-border merchandise trade transactions should be supplemented by sufficient know-your-customer (KYC) and due diligence procedures. In particular, Participating AIs should be able to substantiate that the cross-border trade transactions and delivery routes for the merchandise have sound business case and are consistent with customers’ established business pattern and practices. The onus is on the Participating AIs to demonstrate to the HKMA that there are sufficient grounds to believe that the transactions are genuine cross-border trade transactions eligible for RMB position clearing with the RMB Clearing bank. Participating AIs should document their assessment including the reasons why third party documents are unavailable and why they consider these transactions are genuine cross-border trade transactions eligible for position squaring with the RMB Clearing Bank. On request, these documents should be readily made available for review by the HKMA.

Inward and outward remittances

Consistent with the above requirements, for an inward payment from the Mainland via a Mainland Correspondent Bank that is subsequently sold to the Participating AI and squared with the RMB Clearing Bank, the Participating AI receiving the inward remittance should not solely rely on the information given in the remittance instructions for determining eligibility for position squaring. It should liaise with the customer as recipient of the inward remittance, or the Mainland Corresponding Bank as appropriate, for additional trade-related information including third-party documents so as to substantiate that it is genuine cross border trade transaction. Similar due diligence and documentation are also required for outgoing payments into the Mainland for customers. If there are occasions where the conversion and payment of RMB takes place before shipment/delivery of goods, Participating AIs should have procedures to follow-up with customers for third-party documents to verify that the cross-border movements of goods are genuine and consistent with the direction of the payment made.

Positions not eligible for squaring with the RMB Clearing Bank

Participating AIs are expected to adhere strictly to the above requirements. They will be asked to unwind the RMB position squared with the RMB Clearing Bank if it is found that the underlying transaction is non-eligible trade transaction. If there are repeated instances of non-compliance, position squaring with the RMB Clearing Bank by a Participating AI may be suspended until inadequacies of its internal control in this respect are rectified. If AIs have questions on the eligibility of transactions to be squared with the RMB Clearing Bank, they should proactively approach the RMB Clearing Bank or their usual supervisory contacts at the HKMA for advice.

Compliance checking

To provide assurance that there is adequate ongoing monitoring of compliance in this regard, Internal Audit or Compliance Department of a Participating AI should conduct reviews of its top ten RMB cross-border merchandise trade transactions or the relevant remittances to verify the compliance with the relevant requirements should a net total of RMB200 million or above is squared with the RMB Clearing bank within a month. Such confirmation should be provided to the HKMA within seven days after each month-end. For the position of October 2011, Participating AIs may submit the confirmation on or before 14 November 2011. The HKMA will further verify as necessary the adequacy of compliance checking conducted by the Internal Audit or Compliance Department of the Participating AIs going forward.

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

Yours faithfully,

Nelson Man
Executive Director
(Banking Supervision)