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Growing Asia's Markets

RMB ROADMAP

May 2014

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ASIFMA's 4th Offshore RMB Markets Conference, March 13, 2014: Quotes from Key Speakers

Mr Mark BOLEAT

Chairman of the Policy and Resources Committee, City of London

" It's very clear that the Chinese authorities are progressively opening up the financial markets. They want to see greater use of RMB in international transactions. They want to make it easier for businesses to trade between China and the rest of the world. "

Mr Thierry DE LONGUEMAR

VP, Finance and Risk Management, Asian Development Bank

" Swap lines between central banks are key in providing market liquidity particularly in times of financial distress; facilitating trade and investment; and developing financial markets including local currency bond markets. "

Mrs Alexa LAM

Deputy Chief Executive Officer & Executive Director, Securities and Futures Commission, Hong Kong

" The RMB story is not just a Hong Kong story. In fact, it is not even just a China story. It is a global story. Competition has always been the key driver for innovation and growth. It is during times of intense competition where Hong Kong shines brightest. "

Mr Esmond LEE

Executive Director, Financial Infrastructure Department, Hong Kong Monetary Authority

" This is not the end. This is not even the beginning of the end. But it is, perhaps, the end of the beginning. (quoting Winston Churchill in reference to the growth of the RMB Market) "

Mr LEONG Sing Chiong

Assistant Managing Director (Development and International), Monetary Authority of Singapore

" With continued strong commitment towards promoting RMB internationalization and achieving capital account convertibility, coupled with a strong push towards further deepening of its capital market, we are likely to see a greater degree of economic and financial integration between China and the rest of the world. Within Asia, we believe that the growing role of the RMB is likely to transform the Asian financial landscape in the next 5-10 years. "

Mr Antony PHILLIPSON

British High Commissioner to Singapore

" It is only right that the RMB plays a more significant role in global trade and financial relations, commensurate with China's increased economic weight in the world economy. "

Mr Alain RAES

Chief Executive, Asia Pacific & EMEA, SWIFT

" For the RMB to internationalize, the best practices in RMB processing need to be in place. By "best practice," I mean a combination of all elements needed for an offshore RMB center to compete with others. This is a combination of a robust local RMB payment infrastructure, use of international standards, and community-agreed best practices to cater to local markets. "

ASIFMA is an independent, regional trade association with over 80 member firms comprising a diverse range of leading financial institutions from both the buy and sell side including banks, asset managers, law firms and market infrastructure service providers. Together, **we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia.** ASIFMA advocates stable, innovative and competitive Asian capital markets that are necessary to support the region's economic growth. We drive **consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice.** Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the US and AFME in Europe, ASIFMA also provides insights on **global best practices and standards to benefit the region.**

ASIFMA would like to extend its gratitude to all of the member firms and associations who contributed to the development of this roadmap

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Introduction

A combination of factors has driven the emergence of China as a global player on the world economic stage and the time is finally ripe for the Chinese currency, the *renminbi* 人民币 (RMB), to take its place among the leading currencies of the world.

While the global financial crisis of 2008 served as a clear tipping point for China's rise to prominence, stresses arising from continued fiscal, current account and debt woes in the US, the economic crisis at the Eurozone periphery and the long-term stagnation of Japan (coupled with its massive public sector debt build-up) have all served to highlight the woes of the world's traditional reserve currencies: the USD, EUR, JPY and GBP.

At the same time, China's rising global power in the early years of the 21st century has become increasingly evident, much as the US displaced the UK as the world's leading economic power in the early 20th century. The growth of a multipolar world has led to an international re-evaluation of the USD's role as the world's dominant reserve currency – paving the way for the possible adoption of the RMB as a global alternative.

The seeds of China's dramatic rise were sown in 1978 when the late Deng Xiaoping put the country on a path of economic reform and modernization. This followed nearly three decades of a closed and domestically focused economy after the founding of the People's Republic of China (PRC) in 1949. Since the introduction of Deng's reforms, China's rapid growth and its rise as a manufacturing powerhouse have seen the nation make spectacular strides in the following respects:

a) China is now the world's second largest economy, accounting for 12% of global GDP in 2013. Trailing just behind the US, China is on track to become the world's largest economy by 2020. In fact, by other measures[1], it is believed that China is likely to overtake the US this year.

b) China is also the world's largest exporter and second largest importer, accounting for about 12% of world trade in 2013 (up from just 4% at the turn of this century). Joining the World Trade Organization (WTO) in 2001 gave a major impetus to trade volume growth.

c) With over USD 110bn in foreign direct investment (FDI) in 2013, China is the world's largest developing country recipient of FDI inflows.

d) China is the world's largest consumer of iron ore, copper and tin; and the world's largest producer of steel and gold. China is also the world's second largest oil consumer and is set to become the world's largest oil importer in 2014[2]. In addition, China is one of the largest consumers of liquefied natural gas (LNG). The global commodity cycle is now inextricably tied to China's economic growth.

e) China is the world's largest holder of FX reserves, with a total of USD 3.8tn in reserves at the end of 2013 - well ahead of the next largest holder of FX reserves, Japan.

China is by any measure a global economic power. However, the country's economic might is not matched, as yet, by the RMB's role in global trade and investment. A relatively closed capital account and under-developed domestic capital market (accompanied, however, by gradual current account liberalization), coupled with growth in the use of

[1] According to data compiled by the International Comparison Programme hosted by the World Bank, as reported by the Financial Times

[2] Source: US Energy Information Administration

RMB in trade settlements (which has been rapid, at 18% of total China trade volume, but still below its developed country peers), has meant that RMB recognition and usage internationally is only now gaining traction.

Gradual onshore and offshore participation in the RMB markets by global central banks and investors through the use of swap lines, the Qualified Foreign Institutional Investor (QFII) and RMB Qualified Foreign Institutional Investor (RQFII) programs, the rapidly growing offshore RMB bond[3] markets and the rise of offshore RMB centers – Hong Kong being the largest – have contributed to the first phase of the RMB's internationalization, but there is a long way to go.

Opening of the country's capital account, the increased use of the RMB as an investment currency by international investors and International Monetary Fund (IMF) recognition of the RMB as a potential reserve currency through Special Drawing Rights (SDR) are all critical future steps towards the greater internationalization of the RMB and the liberalization of China's financial markets.

BREAK-OUT BOX 1

Is it the *Yuan (元)* or is it the *Renminbi (人民币)*?

Reading any articles or watching news on the Chinese currency, one would notice the seemingly interchangeable use of the *yuan* and *renminbi*. So is there a difference?

Renminbi (人民币), which means the "people's currency" in Chinese, is the official name of the currency of the People's Republic of China. The main unit of the Chinese currency is the *yuan (元)* – please see chart below. So what's causing the confusion?

Country	China	USA	UK
Name of currency	*Renminbi*	*United States Dollar*	*Pound Sterling*
Unit of currency	Yuan	Dollar	Pound
Generic short form	Yuan, RMB	USD, US$	GBP, Stg
ISO code	CNY, CNH (1)	USD	GBP
Common sign	¥	$	£

(1) The term CNH was introduced to differentiate between the RMB traded offshore from that traded onshore, CNY. The industry has labelled the offshore pool with a pseudo currency code – CNH – to distinguish it from the onshore pool – CNY. Although not an official ISO currency code, CNH was created by the front office for dealers to indicate FX trades for offshore RMB because it has a different spot rate and yield curves than for onshore CNY. CNH is not an ISO 4217 currency code (SWIFT messages use only the ISO 4217 currency codes). Firms use the code CNH for offshore CNY that is being passed from the front office. Once the code CNH is passed to the middle or at times the back office, this non-ISO currency code must be translated to CNY for settlement. Market practice uses CNY as the ISO currency code with the addition of structured code words to indicate offshore CNY. CNH is widely used as the name for the global offshore RMB market, which originated in Hong Kong.

In the Chinese language, "*yuan*" is a commonly used term for a unit of currency for many currencies – just as "*dollar*" in the English language is a commonly used term for a unit of currency for many currencies. Thus, in circumstances where it is understood which currency one is referring to, ¥1mn (be it CNY or JPY)

[3] Bonds issued outside China but denominated in RMB.

or $1mn (be it USD, AUD, SGD, etc) is enunciated simply as "*one million yuan (一百万元)*". Officially, the USD in the Chinese language is "*mei yuan (美元)*" and JPY is "*ri yuan (日元)*". In circumstances where it is necessary to distinguish which "*yuan*" is being referred to, one would quote, for example:
"*one million yuan renminbi (一百万元人民币)*" to mean CNY 1mn,
"*one million mei yuan (一百万美元)*" to mean USD 1mn, or
"*one million ri yuan (一百万日元)*" to mean JPY 1mn.
Since both "*one million yuan*" and "*one million yuan renminbi*" invariably mean the same to non-Chinese speakers, it is not surprising that "*yuan*" and "*renminbi*" could be confused as interchangeable terms.

As the offshore RMB Market outside Hong Kong continues to grow, some feel the "H" in CNH perhaps better stand for "*haiwai (海外)*" - which means "offshore" in Chinese.

The Emergence of the RMB

While capital controls have been in place since the founding of the PRC in 1949, this issue has only gained prominence since liberalization and financial market reforms were initiated in the 1980s.

During the Asian financial crisis, China fixed its currency to the USD. However in July 2005, there was a switch to a managed float against the USD, under which the value of the RMB gradually increased over time and strengthened by as much as 21% versus the USD. A change in China's exchange rate policy came about in August 2008 as China's export sector came under enormous pressure after the US subprime crisis led to a wide decline in world trade. To protect Chinese exporters from further competitive pressures, China again decided to peg its currency to the USD. But in June 2010, the People's Bank of China (PBOC) announced that the exchange rate would be made more flexible again, after which the exchange rate gradually appreciated at an average of 5% per annum. This year, most experts have modestly scaled back their appreciation forecasts, but increasing global volatility has ended the 'one-way' expectation of constant growth.

Until recently, Chinese authorities have viewed capital controls and a managed exchange rate as key tools in the promotion of economic stability and steady GDP growth, free from the volatility that accompanies freely floating exchange rates and the "destabilizing" effects of unmanaged capital inflows and outflows. In March 2014, the PBOC doubled the width of the daily trading band for onshore trading from +/-1% to +/-2%, with further band widening expected during the year. The PBOC stated that it will keep the RMB at a "reasonable balanced level", and that there are no grounds for a significant appreciation or depreciation in the currency. This suggests that the authorities are confident they can manage any new FX-market volatility, however 1-year implied volatilities are expected to reach new highs in 2014.

Moving forward, less active management of the exchange rate is expected. However the lessons of the Asian financial crisis in the late 1990s (which saw China remain relatively unaffected) reinforced the Chinese government's view that a hasty opening up of a country's FX regime and capital markets could prove counter-productive. With the IMF recently conceding its long-held views that open capital markets need not always be an unmitigated positive, especially in the case of developing markets, there has been some medium term acceptance of China's approach towards opening up to the rest of the world.

In recent years, there has been a fresh impetus for the gradual liberalization of capital controls and the path to full convertibility, including the opening of the offshore RMB market, allowing foreign investors access to the domestic capital markets through the QFII and RQFII programs, and the opening of Free Trade Zones (FTZs) – Shanghai for example. These factors, coupled with Chinese authorities' determination at the recently concluded Third Plenum to promote economic growth and market liberalization, have all set the stage for the gradual lifting of capital controls.

The continued growth of the RMB under the Chinese government's internationalization plans will influence the way in which governments, companies and investors engage with both China and each other.

China's international trade has grown at a compound annual growth rate (CAGR) of 19.1% between 2001 and 2013, with RMB-denominated trade now indicatively worth USD 700bn. China's total trade is expected to double in size between now and 2020, with the share of RMB settlement also doubling.

Gradual FX liberalization means the RMB remains relatively modest in the context of FX markets, with daily turnover of USD 120bn – equivalent to 1.3% of annual Chinese GDP (compared with 23.9% for Japan).

The offshore RMB debt market has grown more than 200% over the past three years. Offshore RMB debt sold in the quarter ending March 2014 amounted to RMB 193bn (USD 31bn), the highest quarterly level on record[4], rising from RMB 116bn in the last quarter of 2013. The drive for issuers in this market is still related to less expensive funding offshore vs onshore, and the fact that investors can still earn attractive yields by swapping these bonds back into USD or holding them to maturity. Offshore RMB bonds have developed from a niche market primarily used by Chinese corporates into international securities issued by a wide range of multinational companies.

Growth in offshore RMB centers – Hong Kong, Singapore, Taiwan, the United Kingdom, and Luxembourg, among others – has contributed to the spreading influence of the RMB, along with concerted efforts by Chinese policymakers to internationalize the currency.

The establishment of swap arrangements between the PBOC and other central banks has been a critical step towards internationalization. To date, the PBOC has signed RMB-denominated bilateral swap agreements (BSAs) with 24 foreign central banks, totalling RMB 2.6tn (USD 424bn)[5].

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[4] Source: Thomson Reuters

[5] Source: Standard Chartered

Why is the RMB Internationalizing?

The RMB Internationalization process is part of a broader desire to reform the International Monetary System (IMS) to reflect a more diverse and inter-connected global economy. IMS reform measures undertaken since the Global Financial Crisis in 2008 include the G20 agreement to reduce persistently large current account imbalances, new perspectives on the role of capital controls against speculators, and expansion of the IMF toolkit for assisting distressed countries. However, none of these initiatives has been a panacea in addressing concerns regarding the fragility of the IMS. As a result China is pressing ahead with reforms to integrate its currency into the global economy.

The internationalization of the RMB can stimulate and contribute to true IMS reforms. For instance, to the extent that the pace of USD accumulation by countries running current account surpluses is reduced in the years ahead, this would go a long way towards IMS rebalancing. For the RMB, the crucial question is how to model the careful sequencing of these reforms, such as increasing flexibility of exchange rates and opening up financial markets, as part of this process of IMS reform.

However, besides meeting the lofty goals of IMS reform, there are several other reasons why the process of RMB internationalization needs to occur and indeed accelerate, more so because of the fact that the RMB's status does not match that of China's economy, which is now the world's second largest. Some of these reasons are set out below:

a) Currency risks for both importers and exporters are reduced if the RMB is internationally accepted as a trade settlement currency. China has the world's second-largest economy, and by some measures, China is the world's largest trading nation – thus, this is a major benefit.
b) Given China's position as the world's largest holder of FX reserves, the bulk of which are in USD (which is the dominant international reserve currency), China's exposure to USD exchange rate volatility will be considerably reduced if the RMB has a greater international role. China's pace of USD accumulation will likely slow (or even reverse) once the RMB gains prominence as an internationally traded currency.
c) Finally, on the key issue of the RMB becoming a reserve currency as the end objective of IMS rebalancing, there is now evidence that up to 40 of the world's central banks in recent years have chosen to at least hold some of their reserves in RMB[6]. This level of acceptance of the RMB on the part of the world's central banks suggests that the Chinese currency is effectively a "de facto" reserve currency, even before it has become fully convertible – as the IMF has recently pointed out. We believe that this trend is set to continue, as progressively more central banks consider holding RMB as part of their reserves diversification process.

Chinese authorities fully recognize the need for RMB internationalization and have clearly embarked on a roadmap that achieves this goal (albeit in a controlled fashion). The enshrining of "full convertibility" in the recently concluded Third Plenum, and the opening of the capital account in the controlled environment of the Shanghai FTZ are positive developments. Other steps include the rapid growth of the offshore RMB bond market accompanied by the commensurate growth in RMB held offshore, and the granting of increased QFII and RQFII quotas to foreign investors giving them access to the onshore markets.

[6] Source: Standard Chartered

What is the plan for RMB Internationalization?

RMB internationalization is the process by which the RMB will become widely circulated outside China and used by non-residents as a means of payment, investment and store of value. Both policy and market driven, this process is a unique case of a closed, regulated financial system promoting the active use of its currency outside its borders.

To date, RMB internationalization efforts have involved five main channels;

1) Development of RMB deposit accounts;
2) Use of the RMB as a settlement currency for cross-border trades;
3) Use of the RMB as an investment currency and the creation of an offshore RMB market;
4) The provision of RMB BSAs between the PBOC and other central banks; and
5) Use of the RMB as a reserve currency.

The initial kick-start took place in early 2004 when banks in Hong Kong were allowed to accept RMB retail deposits. The next step came with the introduction and subsequent expansion of the pilot scheme for RMB trade settlement for cross-border trades - first in Hong Kong, Macau and ASEAN followed by the rest of the world.

As non-residents and foreign firms become more familiar with using and accumulating RMB, offshore avenues for saving and investments must be made available if the RMB is to be attractive to non-residents – ultimately leading to the creation of investment options and an offshore RMB market to deepen the liquidity of the market.

To ensure liquidity support for increasing RMB-denominated trade and investments worldwide, the PBOC and other central banks must put BSAs into place. The final step in the RMB's internationalization journey will be realized when it becomes a global currency, fully convertible and coveted as a reserve currency.

China is taking steps to open up and seek new sources of growth to support, and ultimately replace, the old investment-led model. The recent decision to widen the trading band appears to be another step towards full RMB convertibility. According to the IMF, full convertibility is a defining characteristic of a reserve asset – so steps in this direction will make the RMB more attractive to central bank reserve managers globally.

1. Launch of RMB Deposit Accounts in Hong Kong

The first step in the internationalization process took place in January 2004 when local banks in Hong Kong were authorized to launch personal RMB businesses for Hong Kong residents, most notably RMB deposit-taking. Corporate customers were allowed to open RMB deposit accounts in 2010. Hong Kong now has the world's largest offshore pool of RMB. RMB customer deposits grew rapidly from RMB 54.4bn at end-January 2009 to RMB 730bn at end-September 2013. Growth was initially driven by retail deposits on expectations of RMB appreciation, and later fuelled by the increase in RMB receipts by corporate customers through cross-border trade settlement transactions[7].

However, Hong Kong residents are still subject to a daily conversion limit of RMB 20,000 while non-residents in Hong Kong have been allowed to purchase an unlimited amount of offshore RMB since August 2012. The daily conversion

[7] Source: Hong Kong Monetary Authority

limit is a hindrance as Hong Kong faces competition from other offshore RMB centers. The Hong Kong Association of Banks (HKAB) submitted a proposal in October 2013 for the removal of the limit, but this is still awaiting final endorsement by the Chinese authorities. In addition, Hong Kong residents are also subject to a daily remittance limit of RMB 80,000. Removing or relaxing the RMB remittance limit would help to expand the scope of RMB business in Hong Kong.

2. Use of the RMB as a Settlement Currency for Cross-border Trades

Making the RMB a viable currency for cross-border trade is a core focus of the RMB internationalization program. The RMB was previously restricted from use in settlement of cross-border trade, with payments mostly settled in USD or EUR. Lifting these restrictions has increased settlement of cross-border trade in RMB – expanding circulation outside of China and consequently driving global demand for RMB-denominated investments.

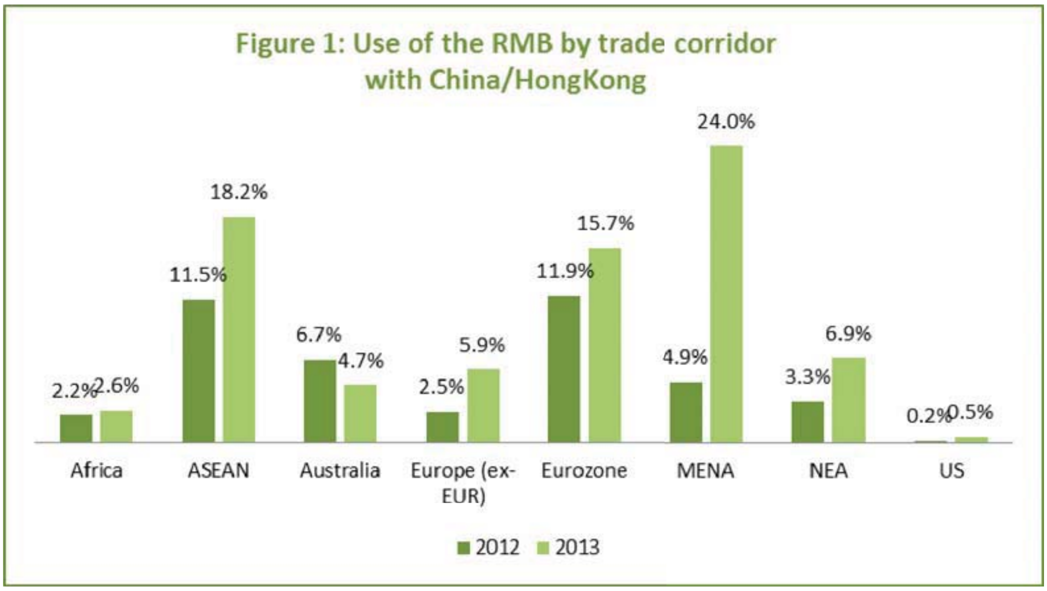
Chinese corporates are interested in RMB settlement as they are able to avoid some of the hedging and transaction costs associated with foreign currency transactions. Corporates outside of China also benefit from the ability to negotiate better pricing from their counterparties by offering settlement terms in RMB. According to PBOC surveys, Chinese exporters may be prepared to offer discounts of up to 3% if the buyer pays in RMB.

RMB cross-border trade settlement was launched with a pilot program in July 2009, when importers from Shanghai, Guangzhou, Shenzhen, Zhuhai and Dongguan were allowed to settle cross-border trades with Hong Kong, Macau and ASEAN countries in RMB. Following a review of the pilot program in June 2010, it was expanded to twenty Chinese provinces (and included designated exporters) and the rest of the world, and was then extended throughout China in August 2011.

China's position as the world's largest exporter and second largest importer has undoubtedly facilitated the growth of RMB trade settlement. Between 2001 and 2013, China's international trade grew at a 19.1% CAGR – reaching USD 4.2tn as of the end of 2013. In parallel, the proportion of China's trade settled in RMB has grown from 7% in 2011 to 10% in 2012, and to 14% as of Q3 2013[8].

Use of the RMB in global trade varies by geographic region. Although it is primarily used for trade with China (including Hong Kong), the popularity of RMB cross-border settlement varies by trade corridor as outlined in the chart below.

[8] Source: Standard Chartered



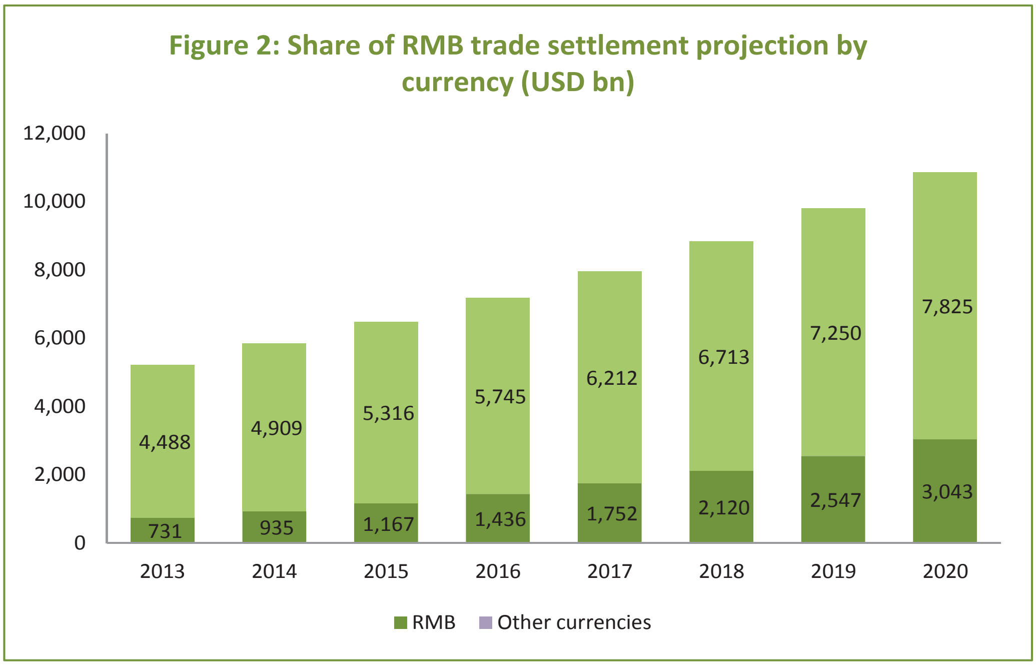
Source: SWIFT

Data is compiled using MT103 transactions, by comparing RMB-denominated total sent/total received versus total sent/total received in any currency between China/Hong Kong and the specific region

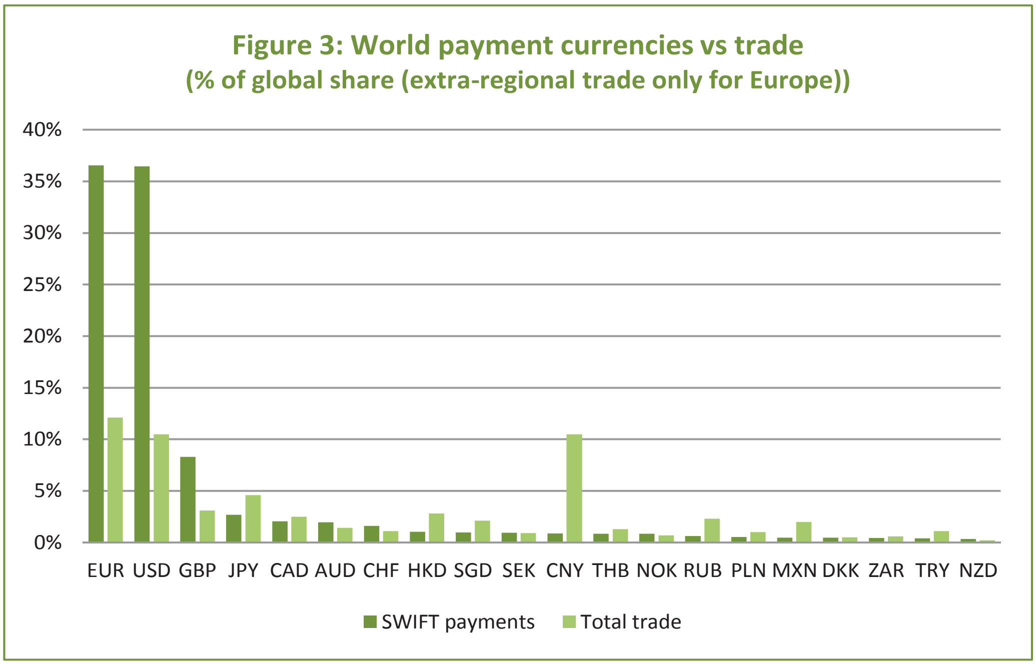
China's total trade is expected to double in size between now and 2020. The share of trade invoiced in RMB will double to 28%, and trade settled in RMB is expected to quadruple up to USD 3tn by 2020 (Figure 2). Forecasts predict the RMB is likely to become the fourth largest global payment currency by 2020 (behind the USD, EUR and GBP), with a global share of around 3%. The RMB ranked 12th in terms of global payment flows as of October 2013, with only a 0.84% share of the total. A 3% share of global payments by 2020 means the total share of trade denominated in RMB would surpass the JPY (2.6%), the CAD or the AUD (both 1.9%) as of October 2013[9].

The top seven currencies used for global payments are also the seven major official reserve currencies identified in the IMF Composition of Foreign Exchange Reserves (COFER) report. The need for a central bank to hold the most "relevant" foreign currencies to pay off international debt obligations, or to influence their domestic exchange rate, justifies the mirroring statuses between top currencies and the choice of reserve currencies. The continued rise of RMB use in trade will prepare the groundwork for the currency to become a major reserve currency.

[9] Source: Standard Chartered



Source: Standard Chartered Research



Source: WTO, SWIFT, Standard Chartered Research

Growth in RMB trade settlement will boost offshore RMB liquidity. Assuming that the ratio of China's exports to imports denominated in RMB remains at the current 1:1.2, USD 3tn of RMB-denominated trade by 2020 will entail a net annual outflow of RMB 1.7tn (USD 273bn) from China to the offshore market. As of February 2014, RMB deposits in Hong Kong totalled RMB 920bn[10]. In reality, other factors will affect the size of offshore deposits, particularly two-way capital account flows. All these tools for increasing liquidity will support more offshore RMB bond issuances and increase inward RMB flows back into China (e.g., via the RQFII scheme).

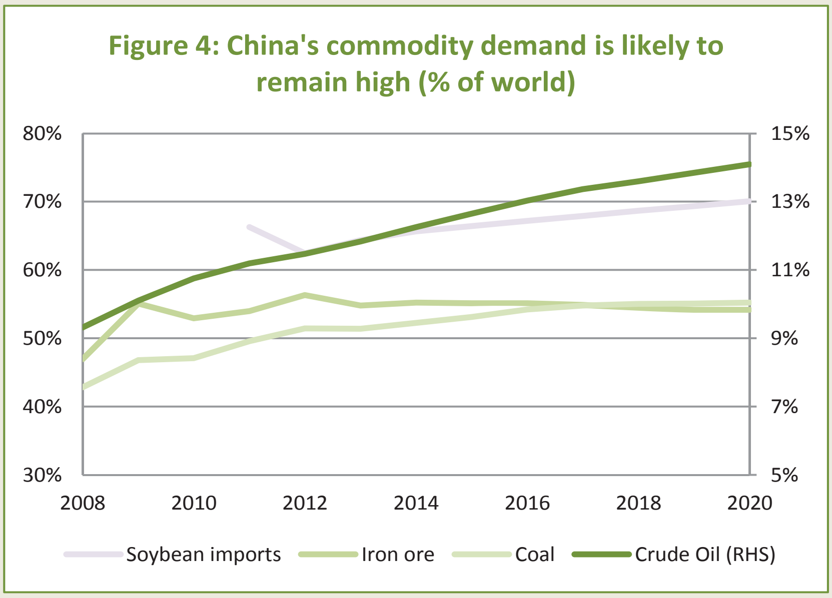
[10] Source: Thomson Reuters

BREAK-OUT BOX 2

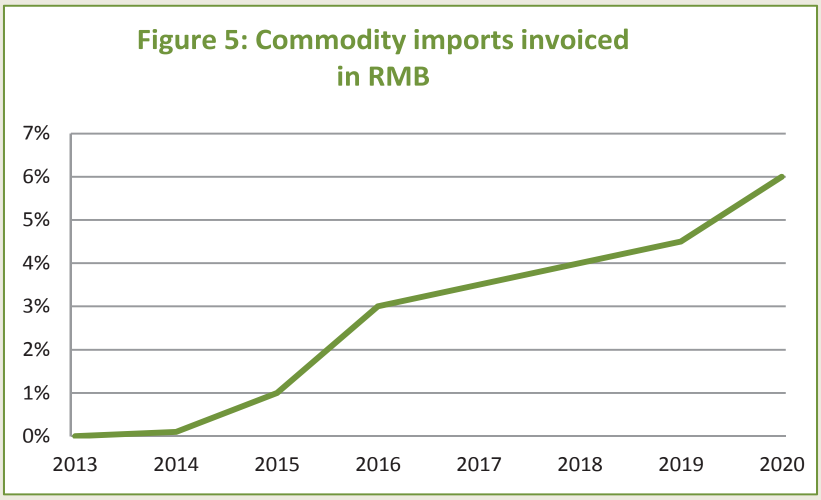
The China Commodity Connection

One big area of China's trade story is commodities, and the question of whether commodities can be priced and traded in RMB in anytime soon.

Close to one-third of China's imports are commodities. Four commodities – iron ore, coal, crude oil and soy – together make up almost 20% of the country's imports. China's position as a top commodity importer is set to consolidate further as demand continues to grow through to 2020 (as shown in Figure 4). Most global commodity trade is currently USD-denominated, and even a partial re-denomination of China's commodity trade into RMB would significantly boost RMB trade flows. RMB-denominated commodity trade flows are expected to account for close to 6% of China's commodity trade by 2020 (see Figure 5).



Source: US EIA IEO, USDA, Standard Chartered Research



Source: Standard Source: Standard Chartered Research

While RMB-invoiced commodity trade will likely grow at a slow pace to start with, the oligopolistic structure of China's biggest commodity suppliers should cause the growth rate to increase exponentially once RMB-denominated flows reach a critical size, starting in 2019[11].

Commodity derivatives priced in RMB should also be introduced to enable efficient hedging against both commodity price moves and FX fluctuations. A re-denomination of commodity indices is still some way in the future, but markets are expected to move in this direction.

In the case of coal, shipments are priced off USD-denominated commodity indices (e.g. the Newcastle coal price index). The biggest impediment to shifting to RMB invoicing of coal (and the price indices) is that miners' costs are predominantly in USD. With most of the world's coal mines nearing the production phase after a sustained period of investment, this is an ideal time to move to RMB invoicing. China holds considerable bargaining power as the world's largest importer of coal.

China is currently the world's second-largest importer of crude oil, and the US Energy Information Administration projects that it will overtake the US in Q4 2013. China's imports are set to increase as its energy requirements rise, even as shale gas reduces the dependence of the US on imported energy. Some Gulf Cooperation Council (GCC) countries already hold Chinese government bonds as part of their reserves; indicating their willingness to have exposure to the RMB. The oligopolistic structure of the oil producers, the RMB's increasing international stature and growing use as a reserve currency, and China's importance as the world's largest importer are ideal conditions for a shift towards payment in RMB.

3. Use of the RMB as an Investment Currency and the Creation of an Offshore RMB Market

Although use of RMB in international trade has been growing, non-Chinese entities outside China tend to convert their RMB – utilized purely for trade with their Chinese counterparts – back into USD or their home currency. In order to induce non-resident entities and individuals outside China to hold funds denominated in RMB, these parties need access to a wide range of RMB-denominated investment options. The impetus to create and further develop a wider variety of RMB financial products is greater than ever.

Global usage of the RMB has shown exponential growth. Offshore, total RMB assets across four major centers (Hong Kong, Singapore, Taiwan, London) – including deposits, certificates of deposits (CDs), bonds, and loans – reached RMB 1.88tn by end-2013, from virtually zero four years ago (see Figure 6). Outstanding offshore RMB bonds and CDs reached RMB 634bn by February 2014, and are likely to reach RMB 750-800bn by the end of the year (see Figure 6). Just three years after its launch, the size of the RMB market is reaching parity with certain regional markets, including the Philippines peso bond market and the Japanese Samurai bond market.

Onshore, China's domestic markets have become more accessible to foreign investors – by the end of 2013, a total of RMB 1tn in investment quotas had been approved for foreign investors' onshore investments. Foreign ownership of China's domestic market is expected to reach 3-5% by the end of 2014, from less than 1% a year ago[12]. On the back of accelerating financial reforms, China's capital account is expected to become open by 2020[13].

[11] Source: Standard Chartered

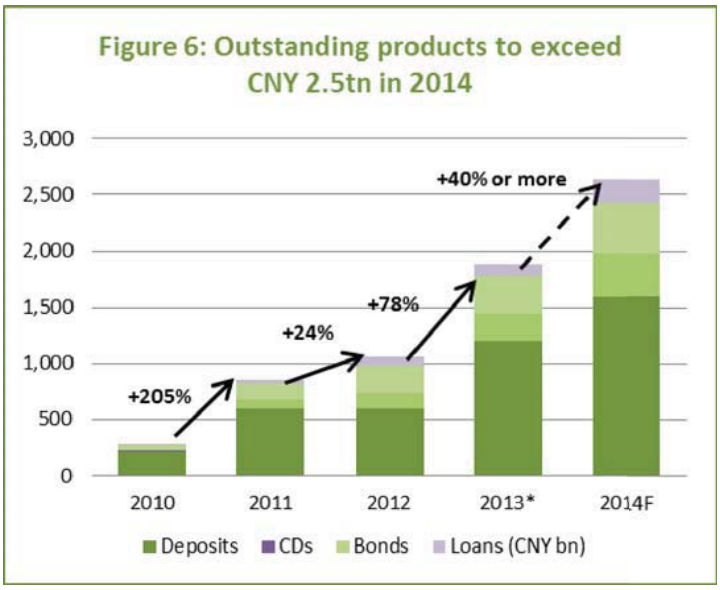
[12] Source: Standard Chartered

[13] Source: Standard Chartered

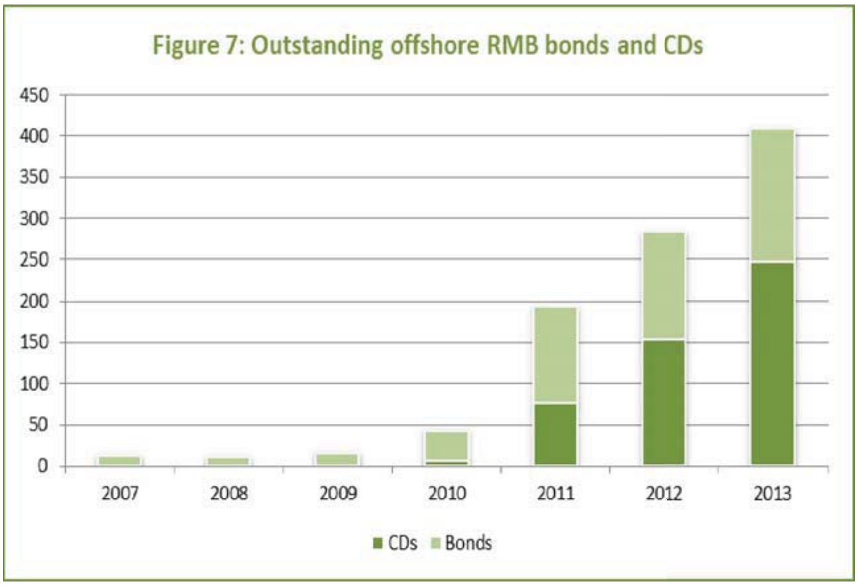
Strong growth momentum should continue, underpinned by the rapid development of new offshore centers, the broadening and improvement of cross-border remittance channels, and a likely sharp increase in capital raising by Chinese entities amid tighter onshore credit conditions[14].

- Total outstanding amount of key offshore products is expected to increase by at least 40% to over RMB 2.5tn this year.
- Offshore RMB deposits are anticipated to reach RMB 1.8tn this year.
- Total outstanding amount of offshore RMB bonds and CDs may exceed RMB 750bn, likely reaching RMB 800bn[15] in 2014;

The onshore market is also opening up quickly. China's domestic markets have become more accessible than many had expected.



Source: Thomson Reuters



Source: Thomson Reuters

[14] Source: Standard Chartered

[15] Source: Standard Chartered

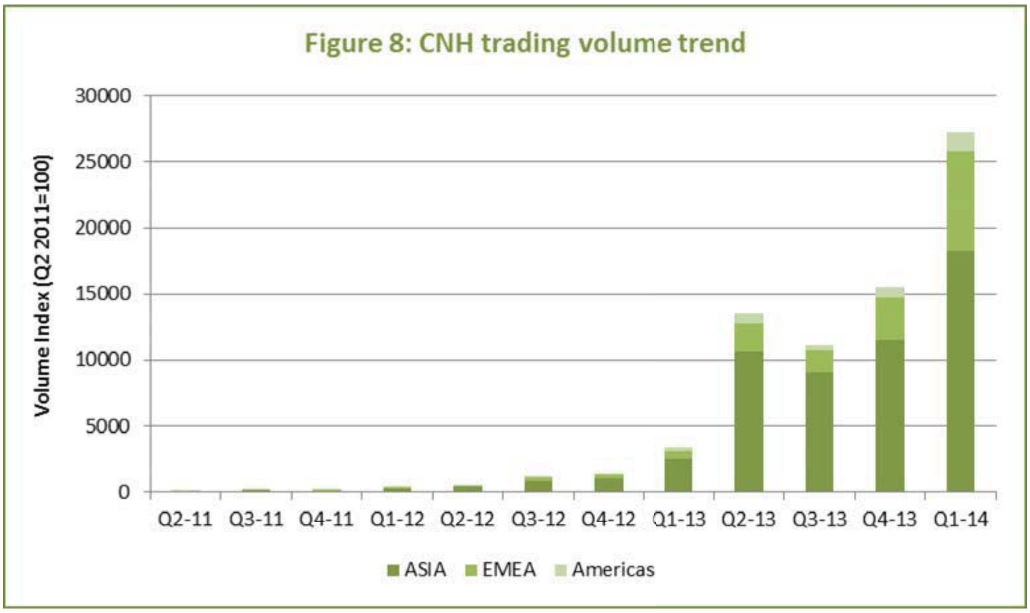
Total approved onshore investment quota for offshore investors under the three existing programs comfortably exceeds the total outstanding amount of offshore RMB bonds. Total onshore quota surpassed RMB 1tn by the end of 2013 – well in excess of outstanding offshore RMB bonds and CDs, which stood at RMB 572bn.

The rest of this section discusses several important aspects of the offshore and onshore RMB markets.

CNH FX Markets Overview

According to the latest Bank of International Settlements (BIS) data, the RMB is now the ninth most traded currency against the USD in the USD 5tn daily turnover global FX market – behind the Canadian Dollar and Mexico Peso. Much of this growth has come from the growth of the offshore RMB market in Hong Kong and other financial centers. BIS breaks down RMB trading into the following categories: USD 34bn spot, USD 28bn outright forwards, USD 40bn FX swaps and USD 17bn FX options. BIS puts onshore (PRC) FX trading volumes at USD 44bn (which could include small quantities of other currency pairs besides CNY), so global RMB trading is estimated to be roughly maximum ⅓ onshore and ⅔ offshore.

Trading volumes have grown sharply with a rise in daily trading volatility and two-way movement of the Chinese currency over the last two years. Turnover has nearly quadrupled during the last four years, and 15-20% year-on-year growth can be reasonably expected in the near future. While there continues to be some minor bursts of intervention from state-run banks in the offshore market to smooth out liquidity mismatches or wide price differentials, the pricing is largely market-driven[16].



Source: Thomson Reuters

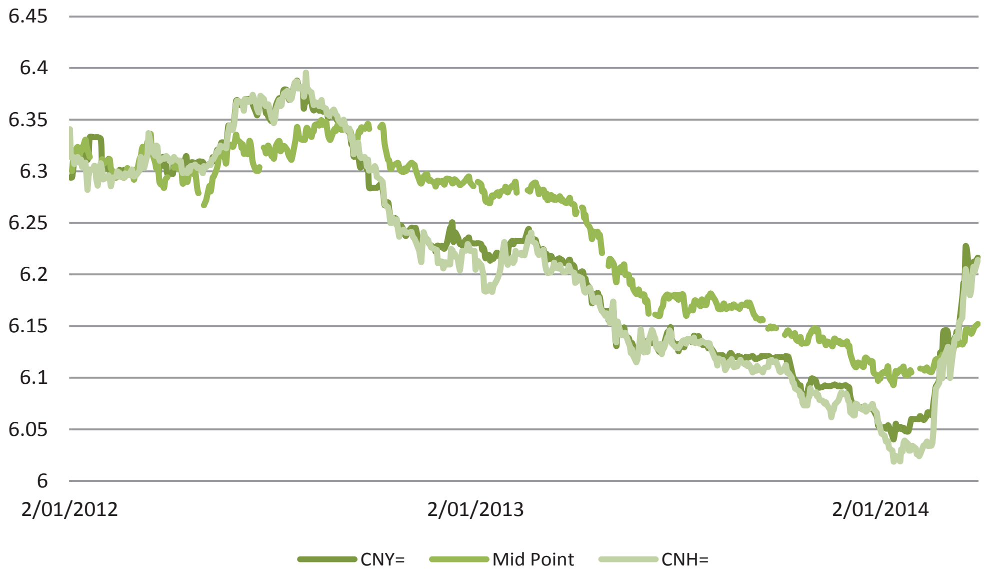
In line with the establishment of more offshore RMB hubs in Singapore, Taiwan and London last year, foreign exchange volumes have grown quickly outside Hong Kong. Transactions have grown particularly rapidly with daily average spot trading in London in the first half of 2013 at nearly USD 5bn, representing a nearly seven-fold increase from less than a billion dollars in 2011[17]. In Singapore, the RMB FX average daily turnover has almost doubled within

[16] Thomson Reuters

[17] Source: City of London

a span of one year to USD 31bn[18]. The growth in RMB turnover has also come at a time when the Chinese authorities have taken big steps to reform their currency markets, including widening the currency's trading band by 2% on either side of the daily mid-point fixing in March 2014.

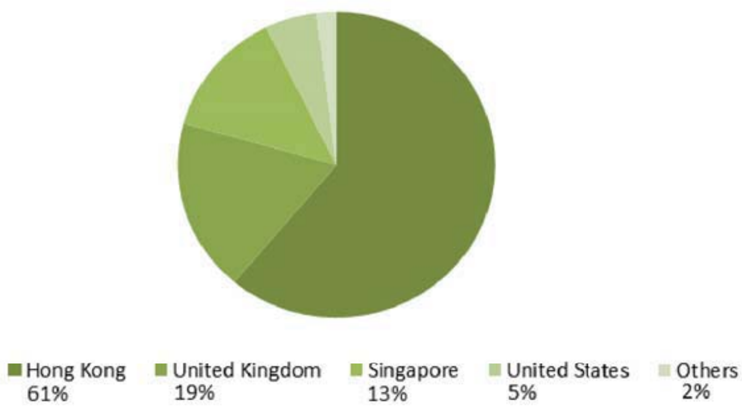
Figure 9: RMB enters volatile era
Offshore vs onshore Yuan vs midpoint



Source: Thomson Reuters

More than 30% of CNH trading volume is centered in the United Kingdom and Singapore, in line with the two cities' pre-eminent status as FX trading hubs, though Hong Kong retains its dominance among offshore RMB hubs with a 61% market share[19].

Figure 10: CNH trading share by countries in 2013



Source: Thomson Reuters

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[18] The RMB FX average daily turnover has increased from USD 16bn in March 2013 to USD 31bn in December 2013.

[19] Source: Thomson Reuters

A further analysis of CNH trading volumes by major centers reveals some interesting trends. While Hong Kong remains at the forefront, other centers (notably London and Singapore) have grown in recent months. An indication that the RMB market is becoming increasingly mainstream is evident through reports of greater use of electronic trading platforms for RMB spot. Market participants' reports of derivatives, including currency options and swaps trading, and a strong rise in the range of products, is a sign that investors are gaining confidence in the offshore markets. Participants in the offshore RMB centers are roughly divided among corporates, hedge funds, banks and proprietary trading firms.

Source: Thomson Reuters

Offshore RMB Bonds

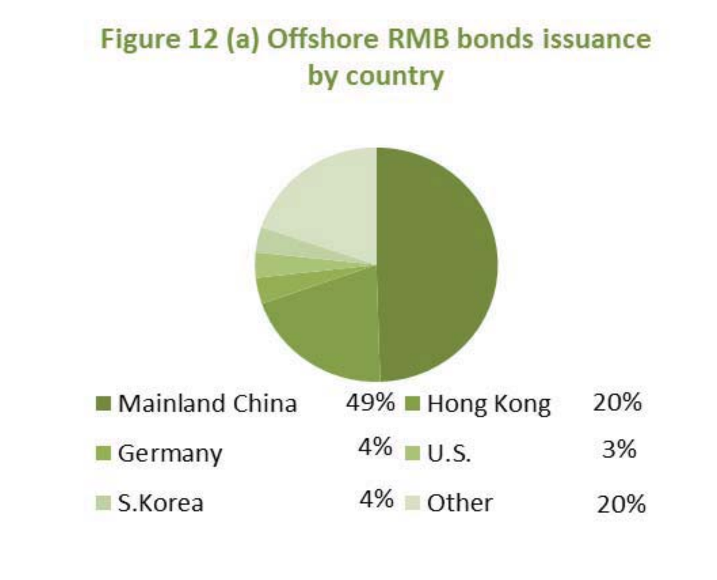
Bonds denominated in the Chinese currency sold in Hong Kong are popularly known as "dim sum" bonds, in a nod to the tasty dumplings found in Hong Kong where the offshore RMB bond market traces its roots. Other offshore markets for RMB bonds have since emerged – "Lion City bonds" in Singapore and "Formosa bonds" in Taiwan. Offshore RMB bonds are attractive to foreign investors who desire exposure to RMB-denominated assets, but are restricted from investing in domestic Chinese debt by China's capital controls. Issuers of offshore RMB bonds are largely entities based in China or Hong Kong, and occasionally foreign companies.

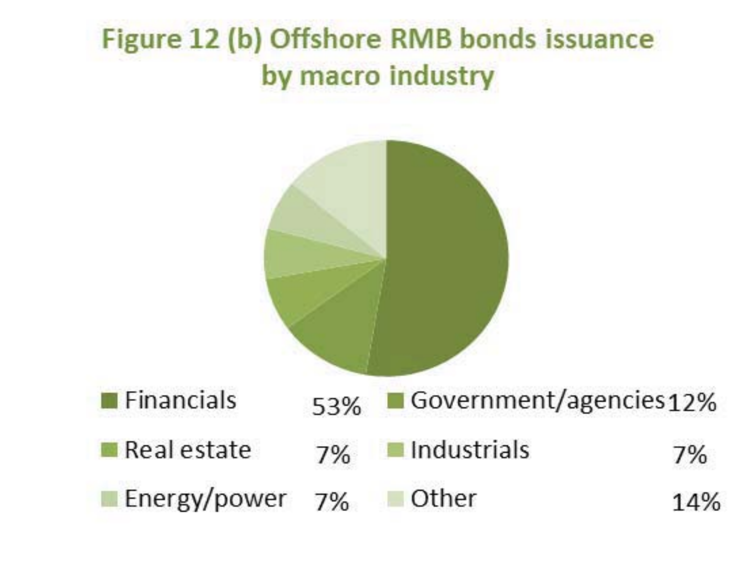
While China Development Bank and Bank of China were the early pioneers as far back in 2007, issuances were few and far between, and largely gobbled up by retail accounts eager for any RMB investments that offer more than near zero return on their Hong Kong dollar or RMB deposits. The dim sum market took off from mid-2010 after Hong Kong signed a revised clearing agreement with the PBOC paving way for the establishment of an offshore RMB hub in the city.

Since then, a variety of issuers have tapped the market including banks, state-owned enterprises (SOEs), private companies from the Mainland and Hong Kong. The first foreign multinational company to enter the dim sum bond markets was McDonalds with a RMB 200mn issuance in August 2010. Since then issuance volumes have been robust with total outstanding dim sum bond issuance, including certificates of deposit (CDs), at more than half a trillion RMB including certificates of deposits. The robust growth rate of the market has even dwarfed some of the more established local currency bond markets in Asia such as the Philippine peso and the Hong Kong dollar market.

While Chinese companies followed by Hong Kong names have led the issuance of dim sum bonds in the offshore RMB market, foreign companies with Mainland operations have found the offshore RMB market to be a competitive financing alternative compared to traditional USD-denominated markets. The reasons for the dominance by Chinese issuers are twofold: offshore interest rates are cheaper than Mainland's by as much as a few percentage points and the lack of RMB-denominated investment options means that investors are always hungry for RMB-denominated avenue. That trend has changed in recent months as issuers from 30 foreign countries have tapped the market – with German, US and South Korean issuers accounting for over 10% of the market. Most of the issuances are also dominated by financial institutions, particularly banks that have more than half the market followed by government and agencies. That is because banks often use the offshore RMB market to raise cheap funds. Compared with the stricter covenants in dollar-denominated high-yield debt, offshore RMB bonds usually do not have stringent controls such as fixed-charge coverage.

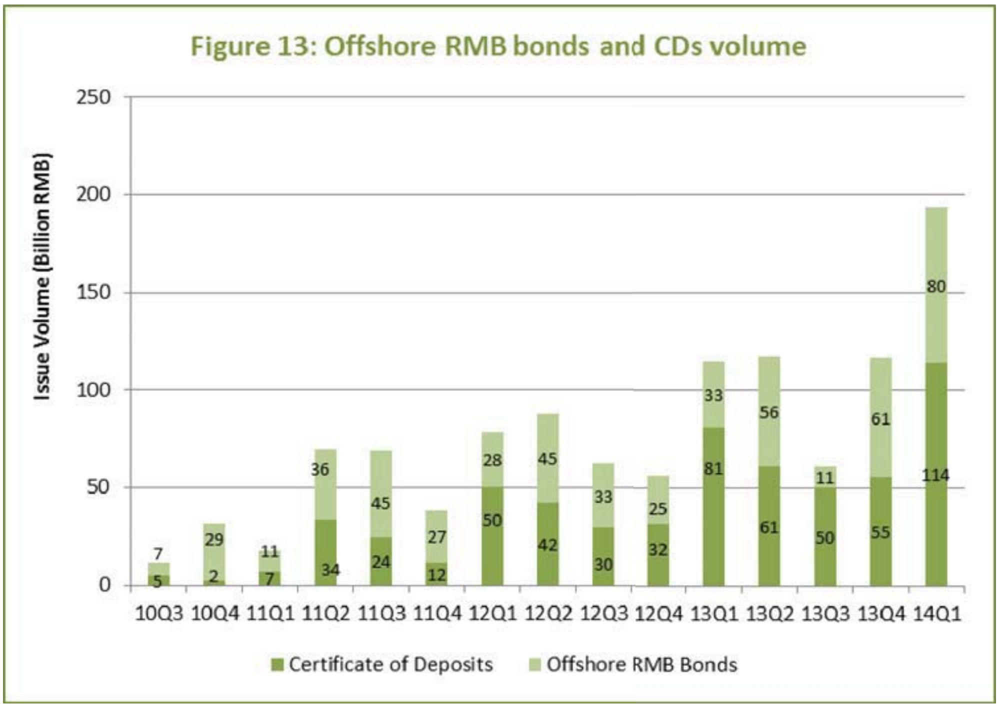
Figure 12: Offshore RMB bonds issuance by country, macro industry
(Total issuance (2010-2014) =$56.6 billion)



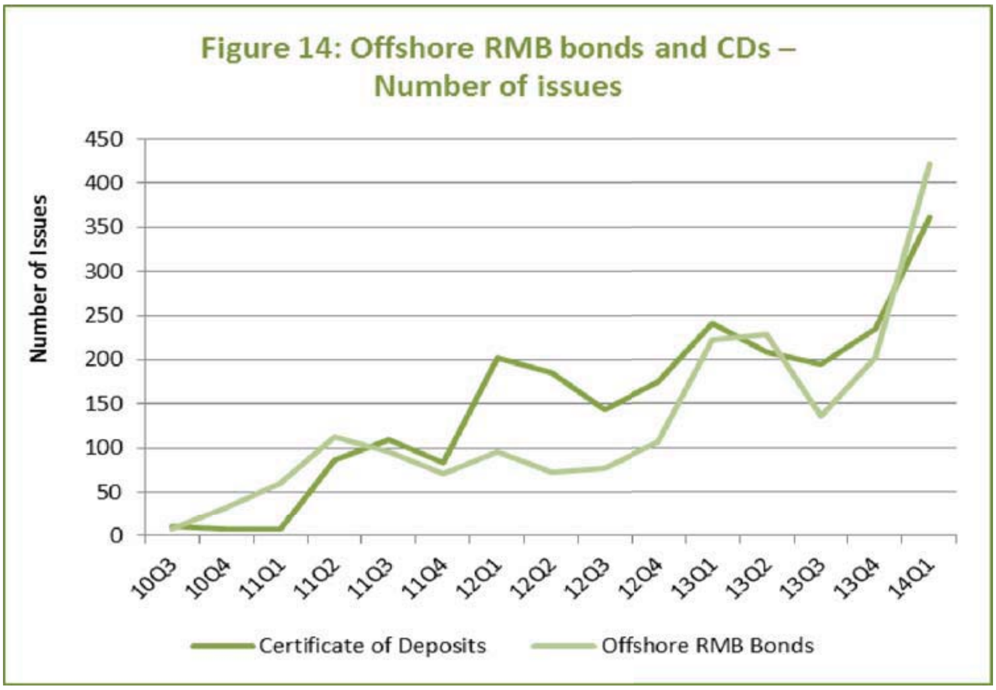


Note: Other issuers are from 27 countries including UK, France, Taiwan, Russia, Singapore, Japan and India at the top of the list.
Source: Thomson Reuters

As raising debt is more expensive in the Mainland market compared with the offshore market, companies borrow offshore to finance trade and operations in the Mainland, leading to increased cross-border trade movement. Improvement and growth in cross-border RMB trade channels and tighter credit conditions onshore are also likely to fuel more offshore issuances this year. While yields have generally increased following their Mainland counterparts, a closer look reveals the rise in yields has been led by high-yield names compared to the high-quality names. Despite market concerns surrounding a spreading slowdown in the Chinese economy, a weakness in the Chinese currency and a historic debt default, issuances in the offshore market have been robust. Offshore RMB bonds and CDs sold in the quarter ended March 2014 amounted to RMB 193bn (USD 31bn), the highest quarterly level on record, compared with RMB 116bn for the last quarter of 2013. Cheaper financing costs via the derivative markets and a heavy borrowing calendar skewed to the first half because of refinancing pressure were the key factors.



Source: Thomson Reuters



Source: Thomson Reuters

Despite attempts by the authorities to lengthen the yield curve in terms of issuance, the lack of supply in longer maturity paper and the overwhelming supply of certificates of deposits by banks, a short-term money market instrument, means the average maturity of the offshore RMB bond market has remained on a downward sloping path.

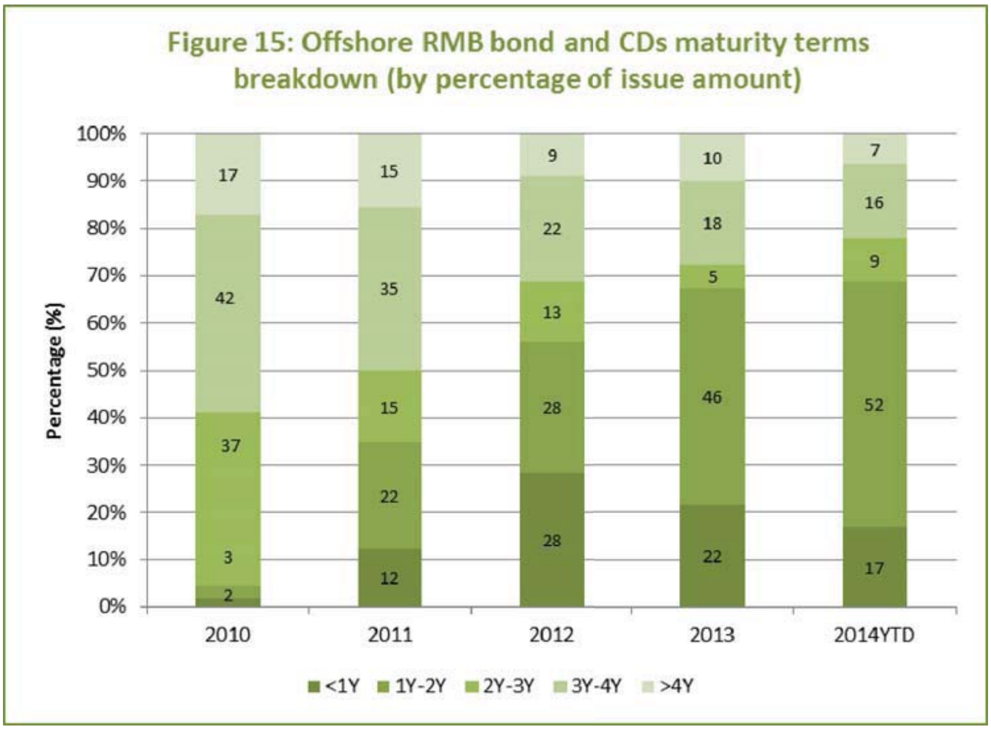


Figure 15: Offshore RMB bond and CDs maturity terms breakdown (by percentage of issue amount)

Source: Thomson Reuters

In terms of yield, offshore RMB bond issued by the Chinese government show a declining yield trend, with 2-year bond yield dropping by 12% for the first quarter of 2014.

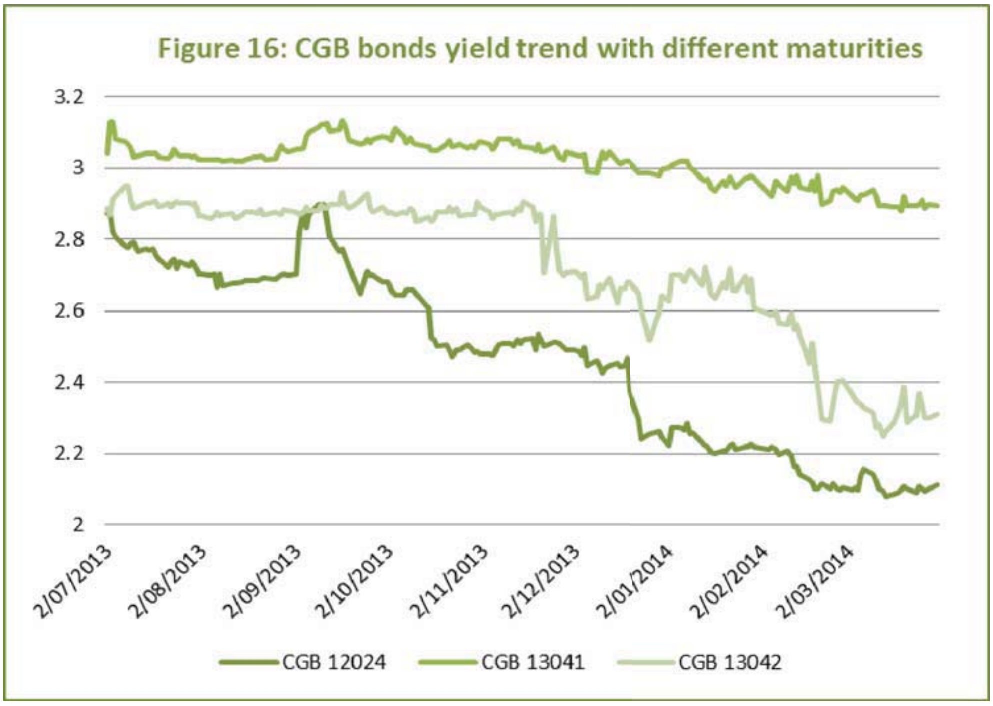


Figure 16: CGB bonds yield trend with different maturities

Source: Thomson Reuters

Moving away from Hong Kong, other centers have also seen strong bond issuances. The International Finance Corporation (IFC) issued a RMB 1bn bond on March 20, 2014 on the heels of ICBC's successful issuance of a RMB 2bn (USD 328mn) bond in November 2013. The bond, issued in London, was oversubscribed and followed the successful 2012 issue by China Construction Bank into the London market. Since the launch of RMB clearing services in Singapore in May 2013, Singapore has also seen several successful issuances of RMB bonds worth a total of RMB

7.5bn. Issuance in the CD market has been robust so far this year keeping in line with the short term nature of these instruments and a convenient tool for banks to refinance their maturing CDs. Average monthly issuance in the first quarter of 2014 was nearly RMB 38bn, growing by nearly 40% over the same period last year.

Offshore Centers and Development of the Offshore RMB Market

An offshore center is a financial hub outside China that conducts a wide variety of financial services denominated in RMB. These centers can concentrate offshore RMB funds in a country and its neighbouring region(s). Hong Kong was chosen as the first offshore RMB center given its special relationship with China and its long-standing role as an international financial center.

By February 2014, offshore RMB deposits in Hong Kong amounted to RMB 920bn. According to the HKMA, May 2013 marked the first time the daily value of RMB cleared under HKMA's Real-Time Gross Settlement (RTGS) system exceeded that of HKD[20]. Hong Kong is also the hub for issuance of dim sum bonds which has created new opportunities for the financial services industry.

The stellar rise of Hong Kong's offshore RMB businesses has lured other financial centers – including Singapore, Taiwan and the United Kingdom – to follow suit. Most important, however, is for offshore RMB centers to define their targeted focus and specializations to make sure they are not missing opportunities or overinvesting in the hope "they will come".

Offshore RMB centers may have a clearing bank although this is not a necessity. RMB service offerings in offshore RMB centers can include FX trading, primary and secondary securities markets, derivative products, retail and commercial banking services, trade facilitation services, clearing services, etc.

Figure 17: Comparison of different offshore RMB centers

	Hong Kong	Singapore	Taiwan	London	Luxembourg
RMB Deposits	RMB 827bn	RMB 172bn	RMB 123bn	RMB 15bn	RMB 56bn
Clearing Bank	BOC HK	ICBC SG	BOC TW	SCB & ABC[21]	N/A
RQFII Quota	RMB 270bn	RMB 50bn	RMB 100bn	RMB 80bn	N/A
RMB Services Offered	Retail and commercial banking FX Primary and secondary RMB securities market RMB trade facilitation	Retail and commercial banking FX A wide range of financial market products RMB trade facilitation	Retail and commercial banking Limited financial market products RMB trade facilitation	FX Limited financial market products Limited retail and commercial banking	Fund Domicile Limited retail and commercial banking RMB trade facilitation

[20] For RMB, the daily turnover was RMB 390bn (HKD 494bn) and for the Hong Kong dollar it was HKD 487bn

[21] Offshore RMB clearing services in offshore centers are normally driven by the PBOC which has yet to appoint a clearing bank in the UK. In March 2014, the PBOC and the Bank of England signed a memorandum of understanding paving the way for a clearing bank to be officially designated in due course. However, as an example of a private sector and market-led initiative, Standard Chartered and the Agricultural Bank of China (ABC) partnered up in December 2013 to launch RMB clearing services in London via a book-transfer model.

PBOC Swap	Yes	Yes	No (in discussions)	Yes	Yes (ECB)
Key Advantages	Traditional gateway to Chinese markets Strong commercial and financial linkages Robust existing financial infrastructure	ASEAN financial hub Robust existing financial infrastructure Hub for regional treasury centers and commodity traders Third largest FX center globally Strong asset management capabilities with wide investor pool	Strong trade links Large deposit base with need for cross-border remittances	European time zone World's leading FX center Robust existing financial infrastructure	Global marketing center and access platform for funds Single platform access for investors globally to China exposure
Focus Markets	Greater China RTC Pilot Schemes / New Products Dim sum bond market	South East Asia RTC Commodities Hub Private Banking	Domestic/ Cross-Strait RMB Usage	Global Treasury Center Global FX Trading Asset Management	Europe's biggest fund management center

Note: Paris has a RQFII quota of RMB 80bn since Q1 2014.
Source: Standard Chartered

Further details regarding the development of selected offshore RMB centers (such as Singapore, Hong Kong, London and Luxemburg) are available in Appendix A.

The QFII and RQFII Programs

Several programs exist that allow foreign investors to access domestic securities markets in China. The Qualified Foreign Institutional Investor (QFII) program allows foreign investors to bring US dollars into China, convert them into RMB onshore, and deploy the RMB for investment. The RMB Qualified Foreign Institutional Investor (RQFII) program allows for RMB accumulated offshore to be invested back into China. Both programs require an application to the China Securities Regulatory Commission (CSRC) for an access license, and also a quota from the State Administration of Foreign Exchange (SAFE) specifying the total investible amount.

Both the QFII and the RQFII programs allow foreign investors to invest in shares, bonds and warrants listed on stock exchanges (currently the Shanghai Stock Exchange and the Shenzhen Stock Exchange); fixed-income products traded in the inter-bank bond market; securities investment funds; stock index futures; and other financial instruments approved by CSRC. RQFII investors can also subscribe for equities in an IPO and convertible bonds, as well as rights on issuance and allotment of shares.

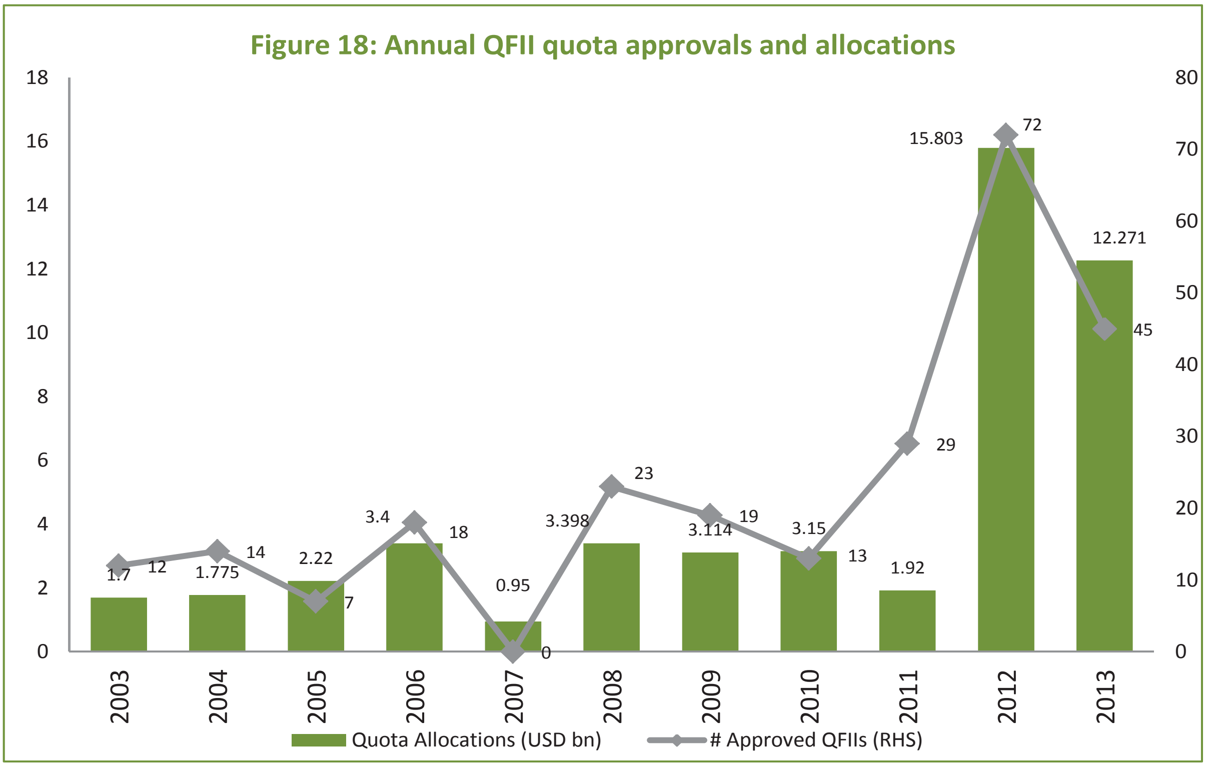
In early 2013, China allowed investors under these schemes to separately apply for access to the Chinese interbank bond market, which accounts for 95% of fixed income trading volume in China. Access to the interbank bond market is granted through a separate application to the PBOC upon receiving a QFII or RQFII license and quota. Key features of the QFII and RQFII programs include:

QFII (Qualified Foreign Institutional Investor) Program

- The oldest program for onshore access, initially announced in 2002
- USD 12.3bn (c. RMB 75bn) was approved in 2013, bringing total quota granted under the program to USD 49.7bn (c. RMB 300bn)
- Eligible to access the interbank bond market upon PBOC approval (expanded in March 2013)
- Application requirements were sharply loosened in 2012

RQFII (RMB Qualified Foreign Institutional Investor) Program

- Announced in late 2011
- RMB 91bn was approved in 2013, bringing total approved quota to RMB 200.5bn by end of March 2014
- Can access both interbank bond and stock exchange markets
- Investors qualifying for local regulatory approval to conduct asset management activities are eligible to apply
- Eligible centers: Hong Kong (RMB 270bn), Singapore (RMB 50bn), London (RMB 80bn), Paris (RMB 80bn), Taiwan (RMB100bn)[22]

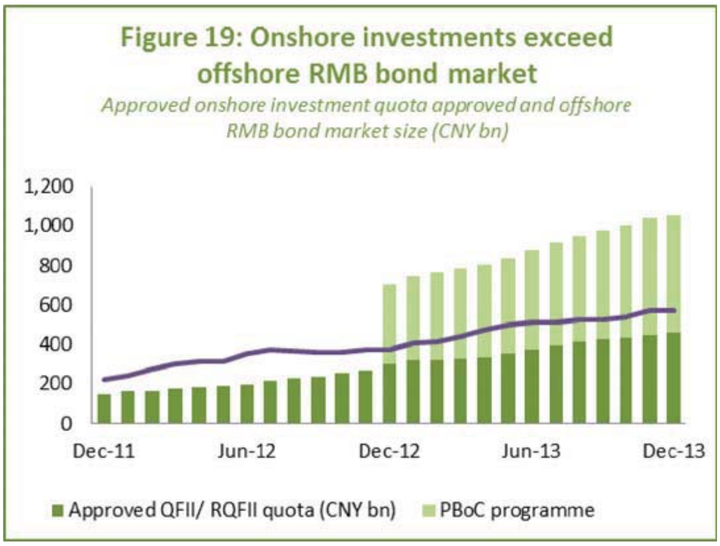


Source: CSRC & SAFE Standard Chartered

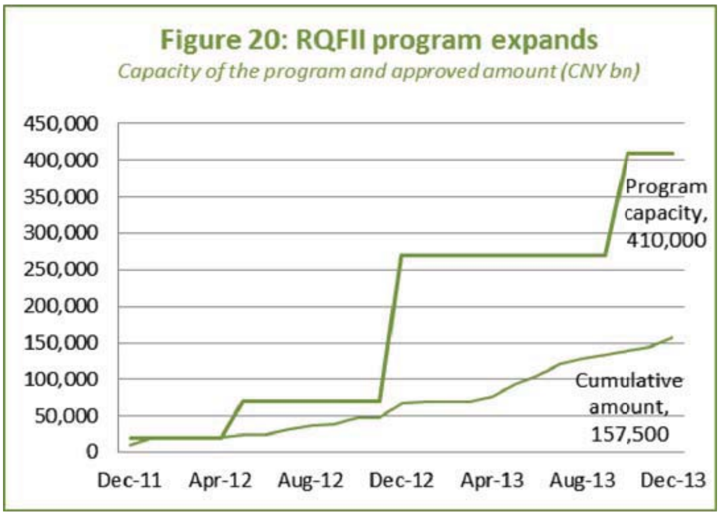
The capacity of the RQFII program (i.e. total cumulative quota that can be approved) has increased to RMB 580bn from RMB 270bn (see Figure 19) with the addition of new eligible centers outside Hong Kong from October 2013. New quotas of RMB 200-250bn are expected to be approved under the QFII and RQFII program in 2014, up from RMB 157bn in 2013. Foreign ownership of Chinese bonds is also expected to reach 3-5% by the end of 2014, up from 1.5-3% as of the end of 2013[23].

[22] The market is waiting for local fund eligibility guidelines from the TW regulator.

[23] Source: Standard Chartered



Source: Standard Chartered



Source: Standard Chartered

London: The first UK-based investor received approval in January 2014. The total quota available for London investors is RMB 80bn.

Taiwan: Total quota of RMB 100bn. No local investors have been approved as the industry is waiting for the eligibility of funds to be defined.

Singapore: Total quota of RMB 50bn. The Monetary Authority of Singapore (MAS) issued guidance on RQFII application process in January 2014. All Singapore-incorporated financial institutions that are approved by the MAS to conduct fund management activities may apply for a RQFII licence and quota. No local investor has been approved to date.

China has continued to support offshore business in Paris via similar arrangements, according to a joint statement issued by the two countries during the first China-France high-level economic and financial dialogue in November 2013. Paris in Q1 2014 received RMB 80bn in RQFII quota. Luxembourg has also been open about their talks with the Chinese regulators to gain quotas of their own. This may just be the beginning with other centers looking to be awarded quotas in 2014 and beyond.

BREAK-OUT BOX 3

The China-Hong Kong Mutual Fund Recognition

Widely reported in the press earlier this year is the agreement reached in substance between the China Securities Regulatory Commission (CSRC) and Hong Kong's Securities and Futures Commission (SFC) on the mutual recognition of funds authorized for sale to the retail public in mainland China and Hong Kong. While the final details and this agreement have yet to be announced, the mutual recognition scheme is expected to become another avenue through which offshore RMB may be used to purchase onshore funds in the Mainland, and onshore RMB may be used to purchase offshore funds (initially funds domiciled and authorized in Hong Kong).

While mutual recognition generally means that funds authorized in one jurisdiction may be recognized for sale in the other jurisdiction, in practice, it usually means that the funds will be subject to a streamlined process for authorization and distribution in the other jurisdiction. The details of the Hong Kong-China mutual recognition scheme may still take time to finalize as it involves cross-border RMB flows between Hong Kong and the Mainland and a quota is likely to be imposed to control such flows. Whether the quota will be imposed on a per fund or aggregate fund basis or on each fund manager or on some other basis remains to be seen. Tax treatment on the income or gains derived from a Mainland fund purchased by a Hong Kong investor or vice versa is another important question. What is certain is that the mutual recognition scheme, once launched, will likely increase the flow of RMB outside the Mainland and open up the door to more RMB-denominated funds for Hong Kong investors.

Shanghai-Hong Kong Stock Connect Pilot Program

In April 2014, the China Securities Regulatory Commission (CSRC) and Hong Kong's Securities and Futures Commission (SFC) jointly announced their approval, in principle, for the development of a pilot program that will enable eligible investors in Hong Kong and the Mainland respectively to trade eligible shares listed on the other market through local securities firms and brokers. The Shanghai-Hong Kong Stock Connect operates through the Shanghai Stock Exchange (SSE), the Stock Exchange of Hong Kong (SEHK), the China Securities Depositary and Clearing Corporation (CSDCC) and the Hong Kong Securities Clearing Company Limited (HKSCC). Its main features include:

- Northbound Trading Link: Hong Kong investors, through their Hong Kong brokers and a securities trading service company to be established by SEHK, will be able to place orders to trade eligible shares listed on SSE by routing orders to SSE.
- Southbound Trading Link: Eligible investors in the Mainland, through domestic securities firms and a securities trading service company to be established by SSE, will be able to place orders to trade eligible shares listed on SEHK by routing orders to SEHK.
- Trading time: The Shanghai-Hong Kong Stock Connect will be open on any day that both SSE and SEHK are open for trading.
- Clearing: CSDCC and HKSCC will become each other's clearing participant.
- Eligible shares: Shares eligible to be traded through the Northbound Trading Link include all the constituents of SSE 180 Index and SSE 380 Index, and shares of all SSE-listed companies which have issued both A shares and H shares, whereas eligible shares under the Southbound Trading Link comprise all the constituents of the Hang Seng Composite LargeCap Index and Hang Seng Composite MidCap Index, and shares of all companies listed on both SSE and SEHK;

- Quotas: Subject to further adjustment by regulators, trading through the Northbound Trading Link will be limited to an aggregate quota of RMB 300bn and a daily quota of RMB 13bn, and trading through the Southbound Trading Link will be limited to an aggregate quota of RMB 250bn and a daily quota of RMB 10.5bn;
- Eligible investors: The SFC requires Mainland investors participating in the Southbound Trading Link to be limited to institutional investors and individual investors with an aggregate balance of not less than RMB 500,000 in their securities and cash accounts.
- Cross-border regulatory and enforcement cooperation: Cross-border cooperation between CSRC and SFC includes enhancement of referral and information exchange mechanisms concerning improper activities, investigatory cooperation in relation to cross-border illegal activities, bilateral enforcement exchange and training, and enhancement of general standards of enforcement cooperation.
- Timeframe: Subject to finalization of all necessary regulatory approvals, market readiness and relevant operational arrangements. It is expected to take approximately six months from the date of the announcement to complete the preparation for the formal launch. Further announcements will be made as development work progresses.

The Shanghai-Hong Kong Stock Connect is intended to further open China's capital market, enhance capital market connectivity between the Mainland and Hong Kong, and does not displace any other program currently providing cross-border access.

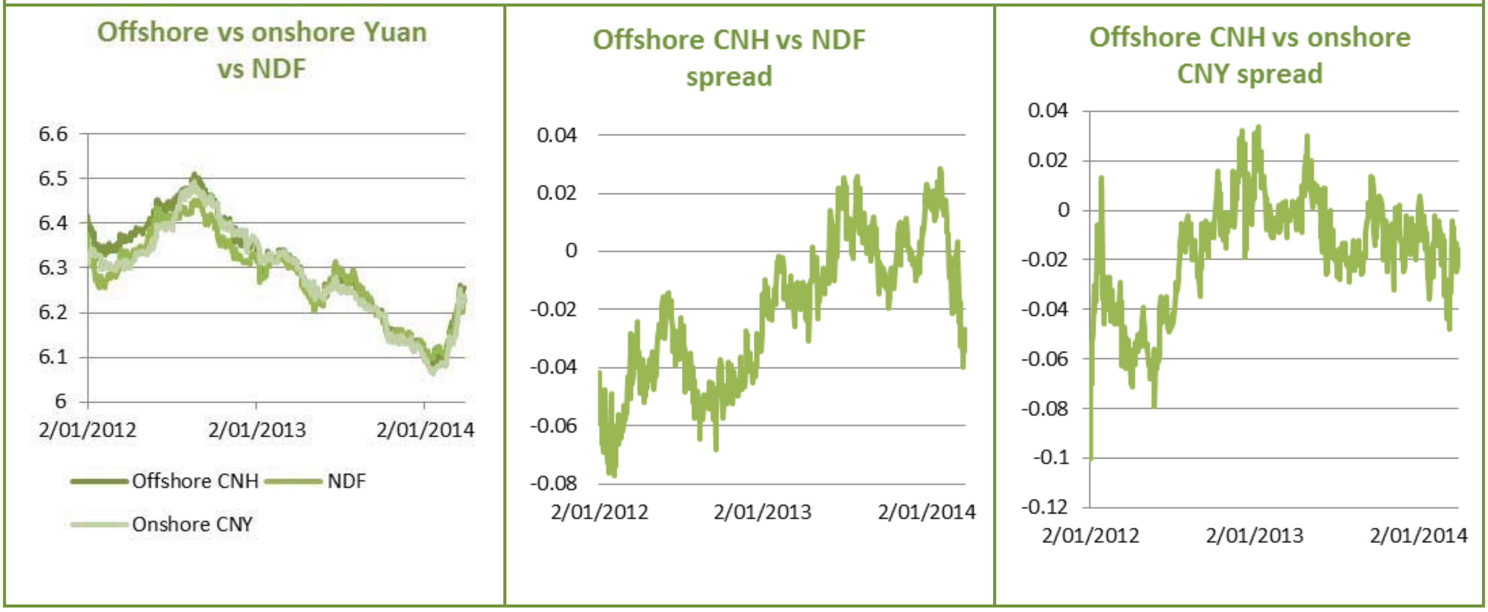
Offshore Onshore Convergence

The offshore RMB market was explicitly created to allow the RMB to internationalize while the onshore market remains separate from the global market. This has resulted in three different main markets for the RMB: the onshore RMB (CNY) market in the Mainland, the dollar settled non-deliverable forward (NDF) market, and the offshore RMB (CNH) market. Each of these markets has its own demand and supply dynamics because of capital controls and the partial convertibility of the RMB as between the onshore and offshore markets. These conditions have resulted in the three separate, but related, markets with differentiated FX and interest rates and securities pricing. As capital controls ease and linkages grow, the level of difficulty in making cross-border transfers will drop – resulting in offshore onshore convergence.

Convergence in the FX Market

Before the offshore RMB market developed in mid-2010, foreign investors wishing to take a position on the Chinese currency could only do so via the NDF market. As a result, the NDF market in the RMB usually traded at a premium to its Mainland counterparts. This was also evident when the offshore RMB or CNH came into being in 2010 mainly due to two factors: 1) Expectations of more currency gains has fuelled the appetite of global investors hungry for RMB assets in Hong Kong, and 2) the relative lack of RMB deposits outside China’s borders – for example, even Hong Kong’s current liquidity pool of nearly a trillion RMB is roughly equivalent to few percentage points in the amount of deposits on the Mainland. That said, the offshore market has started to move in tandem with the onshore market as more channels of cross-border RMB trade open and the offshore RMB deposit pool deepens. In the recent episode of RMB weakness in February followed by a subsequent widening of the currency’s trading band to 2% on either side of its daily mid-point fixing, the movement of offshore RMB has closely tracked the onshore RMB. The average spread between the offshore and the onshore RMB for the first quarter of 2014 was 172 pips compared to 535 pips in Q4 2010.

Figure 21: Offshore and onshore China currency converge



Source: Thomson Reuters

The offshore RMB market got off to a choppy start in 2010. The limits on central clearing imposed by the PBOC via Bank of China (Hong Kong) Limited capped the liquidity of the market. At the same time, the use of CNH in trade settlement got off to a slower start relative to the demand for offshore RMB bonds, leading to imbalances in the young market. USD/CNH market squeezes in 2011, tied to the quota for central clearing being hit, also caused large divergences between the CNH and CNY markets. This prompted the HKMA to reassure on its ability to provide liquidity via its swap line with the PBOC.

Things began to change once Hong Kong's Treasury Markets Association launched a daily USD/CNH spot fixing in June 2011. That needed source of transparency quickly gave rise to FX derivatives and options. In July 2012, Singapore became the second clearing center offshore, opening up new channels of liquidity.

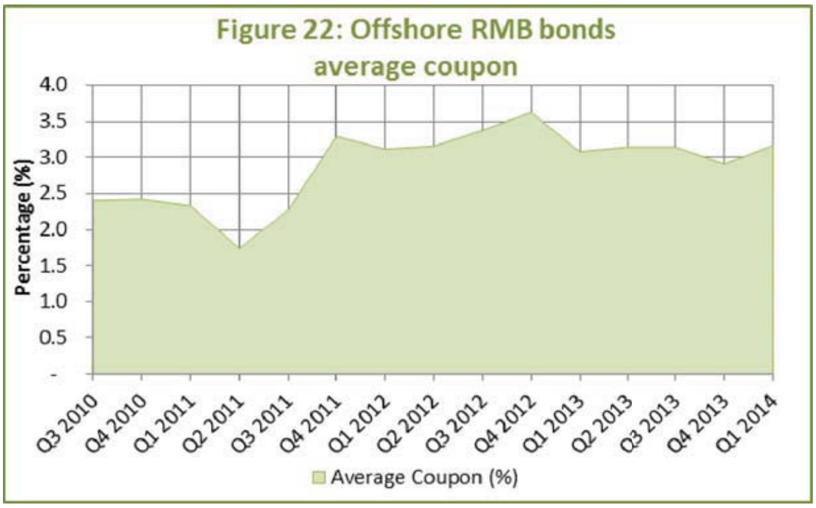
The success of USD/CNH has led to flourishing markets in cross-currency swaps and even structured products. In late February 2014, approximately USD 350bn notional of CNH-related structured products, such as target redemption forwards, had been sold for a market betting on further RMB appreciation. For multiple reasons, the PBOC pushed back against the one-way bets of RMB appreciation in February 2014. The central bank likely wanted to create more two-way traffic and set the stage for another widening of the onshore daily trading band, which it did in March, taking the band to 2%.

A string of higher USD/CNY fixes starting on 19 February 2014 prompted a violent move in USD/CNH as speculators began to cover positions. The violence of the move spilled into the onshore USD/CNY market as well, causing the sharpest one-week fall in CNY in the currency's modern history since the landmark 2005 revaluation. But while the market violence was severe, partly tied to the PBOC nudging its fix higher, partly tied to flows related to structured products, USD/CNH and USD/CNY forwards have converged more closely together. The heavy USD/CNH volumes seen during late February and March this year – some days, as much as 3 to 5 times the average daily volume before the PBOC intervention[24] – was a testament as to how big the market had become and how, in many ways, it had taken over from the NDF market as the main RMB hedging and trading tool.

Convergence in the offshore RMB bond Market

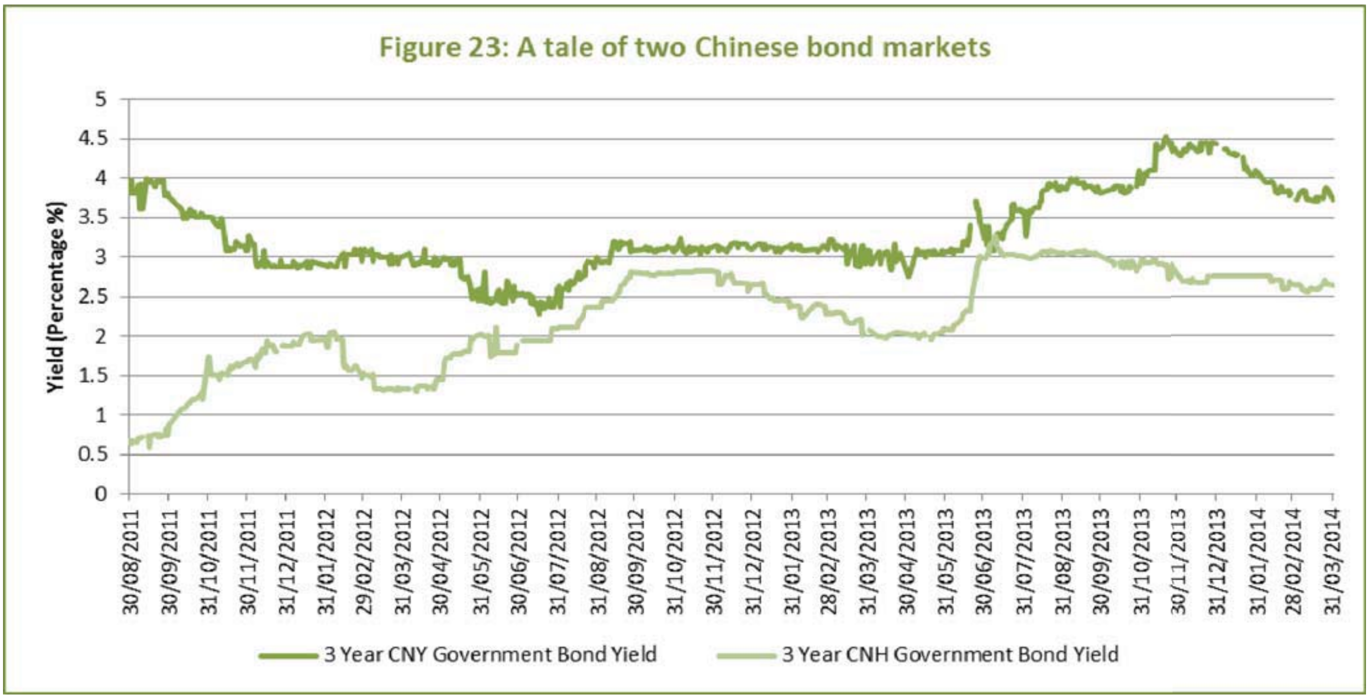
[24] Thomson Reuters

Spreads between offshore bond yields and that of onshore bonds have gradually narrowed since the offshore RMB bond market opened in July 2010, as market participants started looking at this market as more of a credit market than just an access vehicle for RMB-denominated assets. With more linkages between the onshore and the offshore bond markets, yields are likely to converge in the long term. While average coupons on offshore RMB bonds have moved to 3.2% in 2014 from 2.4% in 2010, they are still lower than their onshore market counterparts. The average coupon on onshore bonds is 3.8% in 2014, up from 4.7% in 2010. This trend is expected to continue. A volatile currency market and the opening up of more investment channels between the offshore and the onshore markets mean that yields will converge gradually in the long term.



Source: Thomson Reuters

For example, the yield gap between the three year government bonds traded on the Mainland and the offshore Chinese three year government bond has narrowed since the start of the market in 2010. Recent weakness of the RMB has prompted market participants to reprice risk in the offshore RMB market in terms of credit and not just as an investment vehicle to bet on currency gains. While that is a positive trend, structural factors still means that any convergence in yields may not be an immediate process. One of these challenges is a shortage of attractive CNH products which discourage turnover to leave the secondary market illiquid and keeps the offshore yield curve below the Mainland market.



Source: Thomson Reuters

4. The Provision of RMB Swap Lines between the PBOC and Other Central Banks

Until the RMB becomes a fully convertible currency with no restrictions, the offshore RMB market will grapple with an overall liquidity issue. To avoid a dearth of liquidity in the offshore market and for RMB-denominated instruments not to be considered excessively risky (conditions that could potentially drive away investors), the PBOC may benefit from establishing resilient and steady conduits. Hence, the Bilateral Swap Agreement (BSA), which offshore markets can draw upon at any time when a downward inflection of liquidity occurs. As offshore markets are deemed less risky, more investors will find it convenient and worthwhile to invest in RMB-denominated instruments.

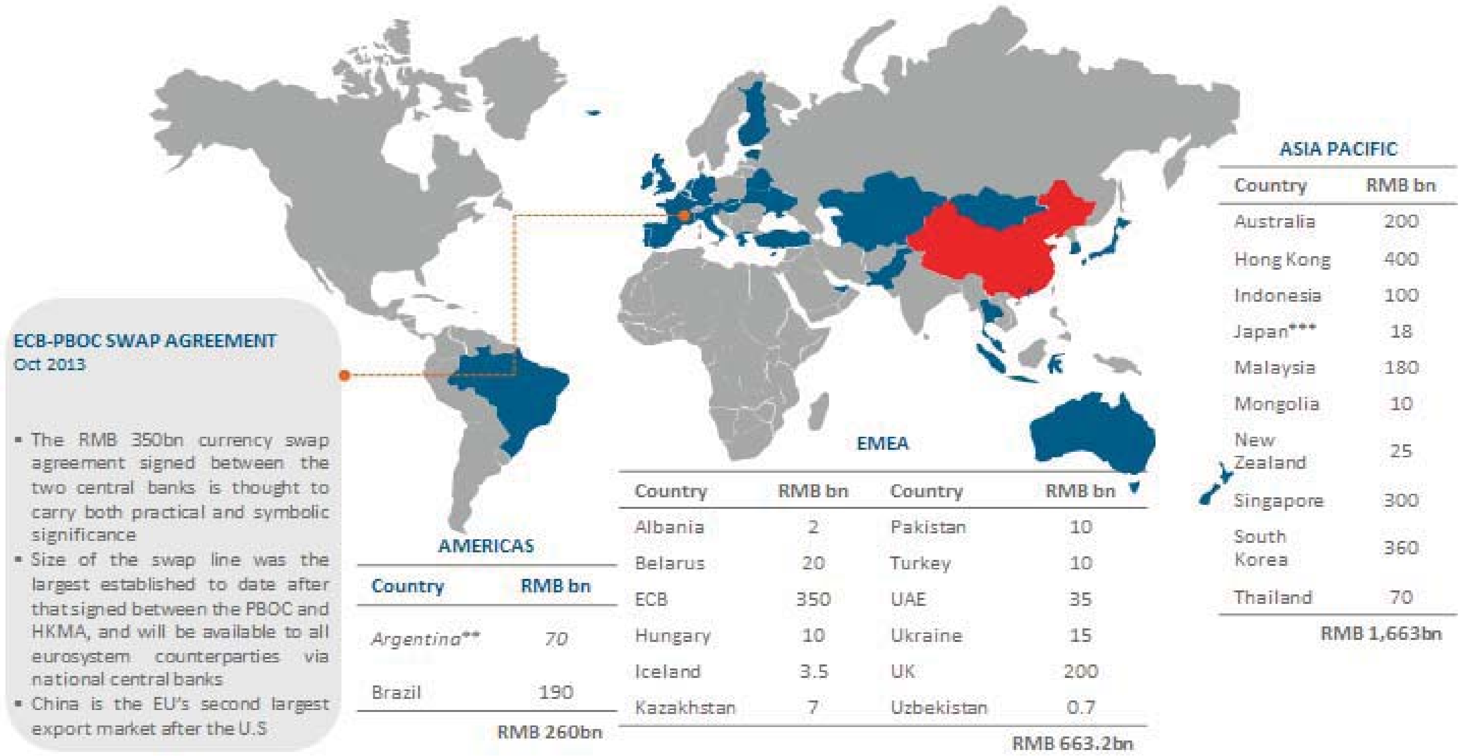
Currently, the PBOC has signed 24 RMB-denominated BSAs with foreign central banks, worth an aggregate notional amount of RMB 2.55tn (see Figure 24 for a list of outstanding agreements). These BSAs are designed to support increasing trade and investment in RMB beyond China. The BSAs with the PBOC are signed for a three-year period and have in all cases been extended before expiration.

Illustrating the usage of BSAs, in July 2013 the Hong Kong Monetary Authority (HKMA) and the Monetary Authority of Singapore (MAS) utilized their respective BSAs to establish liquidity facilities.

- The HKMA facility focuses on maintaining market stability and support for emergency liquidity demand by offering overnight funding settled on the same day. For same day settlement provided to banks, the HKMA bears the funding cost of maintaining its own RMB liquidity pool of RMB 10bn. The HKMA accepts this as part of the cost of developing its RMB business.
- The MAS facility boosts trade financing by offering 3-month RMB liquidity at the SHIBOR rate to banks engaging in RMB trade settlement. The scope of the facility has been expanded to allow both MAS and PBOC to provide foreign currency liquidity to stabilize financial markets. This offers a precedent model to support offshore funding demand in other RMB centers where local RMB liquidity is still thin.

Unlike the BSAs in place between the Federal Reserve and other central banks, which are designed to provide emergency liquidity during times of crisis, the PBOC's BSAs are used to promote the global use of the RMB for trade and investment. Central banks should be aware that there is no stigma in deploying the BSA to support RMB trade in their home market.

Figure 24: The PBOC's RMB bilateral swap lines with central banks



AMERICAS

Country	RMB bn
*Argentina***	*70*
Brazil	190
	RMB 260bn

EMEA

Country	RMB bn	Country	RMB bn
Albania	2	Pakistan	10
Belarus	20	Turkey	10
ECB	350	UAE	35
Hungary	10	Ukraine	15
Iceland	3.5	UK	200
Kazakhstan	7	Uzbekistan	0.7
			RMB 663.2bn

ASIA PACIFIC

Country	RMB bn
Australia	200
Hong Kong	400
Indonesia	100
Japan***	18
Malaysia	180
Mongolia	10
New Zealand	25
Singapore	300
South Korea	360
Thailand	70
	RMB 1,663bn

**Argentina is reportedly in negotiations to renew the currency swap arrangement first signed in 2009
*** Swap agreement established as part of the Chiang Mai Initiative, with a maximum value of USD 3bn equivalent
Note: China's bilateral currency swap agreements are typically 3 years in duration and are extendable
Source: Standard Chartered

5. Use of the RMB as a Reserve Currency

As the RMB continues down the path of internationalization, more and more central banks have re-denominated a portion of their reserves into the currency. Although China's capital account still remains largely closed, the Chinese authorities have instituted preferential programs and policies to encourage official sector investment and redenomination into RMB. Global reserves managers' desire to diversify reserves investments is expected to continue to drive an increase in RMB asset allocation over the years and decades ahead[25].

Among the RMB 600bn quota approved for foreign investors' investment in China's interbank bond market, about half was allocated to foreign central banks and sovereign wealth funds (SWFs), according to the PBOC. More than 30 foreign central banks are believed to have started investing in Chinese onshore bonds, with more (likely around 10 if not more) currently involved in offshore RMB bond investments[26].

Despite growing quickly, global reserve managers' allocations in RMB are still very limited. The estimated amount of RMB 300bn is still far less than 1% of global FX reserves, at USD 11.4tn by end Q3-2013. Foreign central banks'

[25] Source: Standard Chartered

[26] Source: Standard Chartered

allocations in RMB assets may exceed those of GPB and JPY in the coming years[27]. IMF data shows that current allocations in GBP and JPY assets were USD 243bn and USD 239bn, respectively, each accounting for approximately 4% of world reserves as of end Q3 2013.

Although the RMB is not yet recognized as a reserve currency by the IMF, a growing number of central banks have publicly committed to holding the RMB in their portfolio, ranging from developing nations like Nigeria to industrialized nations like Australia. Indeed, central banks often act as pioneers for RMB use in their home markets, and in many cases have taken the lead in helping their domestic stakeholders understand, utilize, and access the RMB.

Holding the RMB as a reserve asset provides the following primary benefits:

- Matching trade flows: Overseas corporates are increasingly using the RMB for trade settlement with their Chinese counterparts. Foreign central banks should therefore hold RMB reserves to match rising RMB usage in their country's current account.
- Increasing investment returns: Despite appreciation against the USD since 2008, RMB denominated assets like Chinese sovereign bonds provide higher yields than their US equivalents. With China's AA- credit rating, holding Chinese sovereign bonds in RMB provides higher yield with the possibility of currency appreciation – without taking on substantially more risk than holding US Treasuries in USD.
- Strategic signalling: Central bank investment into RMB assets can help strengthen a country's engagement with China. With China's global economic influence growing, holding RMB as a central bank asset would align with trade flows in Asia and globally. Furthermore, extraordinary monetary policy conditions in Western countries have depressed returns from traditional forms of central bank reserve management.

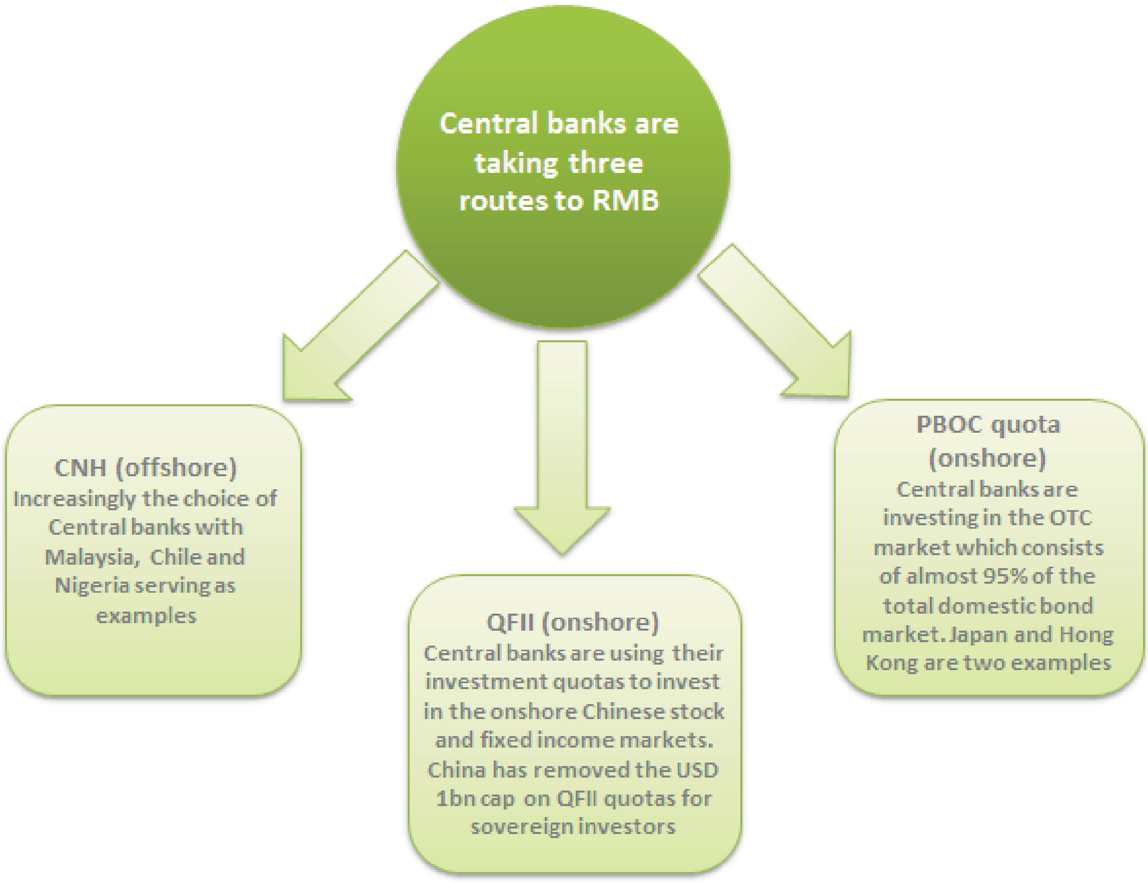
Foreign central banks are now accessing the RMB through three primary routes (see figure 26). In many cases, Chinese authorities have given preferential treatment to foreign central banks and official institutional investors, including minimal repatriation and taxation limitations that effectively allow free convertibility of RMB investments for certain privileged investors.

- Offshore markets: Perhaps the easiest route for central banks to access RMB investments is to go to the CNH, or offshore RMB, market. This market has grown tremendously in recent years to encompass a wide range of investment options, including supranational and sovereign debt that is favoured by central bank investors. The offshore market does not have any capital account restrictions and functions like any other open financial market. Central banks can open RMB current and term deposits in any major offshore center, conduct FX transactions, and invest in RMB fixed income assets. The annual offshore Chinese sovereign bond issuance has included a tranche specifically reserved for foreign central bank investment as well.
- QFII (onshore market): Some central banks have taken advantage of the QFII program to invest in China onshore equities and fixed income. In 2013, QFII investors were allowed to invest in the separate interbank bond market (which accounts for 95% of the bonds traded onshore) through a separate application to the PBOC. The central banks of Malaysia, Hong Kong, Singapore, Thailand, Korea, Lithuania and Macau have chosen this route.
- PBOC quota (onshore market): The PBOC administers a special quota program for foreign central banks that provides access to the interbank bond market, the most liquid market for Chinese sovereign bonds and policy bank bonds. Quota sizes granted under this program are generally larger than those seen under the QFII program. Access through the PBOC quota requires direct negotiation with the PBOC. Current publicly-known

[27] Source: Standard Chartered

quota-holders include the central banks of Australia, Austria, Hong Kong, Indonesia, Japan, Korea, Malaysia, Nepal, Pakistan and South Africa as well as the World Bank.

Figure 25: The three routes for central bank access to the RMB



BREAK-OUT BOX 4

Cash Pooling and RMB Sweeping

Cash pooling is the ability of a multinational group to control capital flows within the group and to move or sweep them according to specific needs, all operated from a central treasury. If a subsidiary based in a third country needs capital, the central treasury is then able to lend money to the subsidiary. The enormous advantage is that the local subsidiary can meet its needs without having to take out a loan from a third party banking institution. This is particularly important if the subsidiary is based in a country where the capital market is not soundly developed and the cost of borrowing may be high. Besides, if capital moves and remains within the same group, then no interest is paid out of the group and no capital leaves the group.

On the flip side, if a multinational corporation treasury is located outside a country, profits will then leave the country and converge to where the treasury center is. Therefore, the country will witness an outflow of capital and profit. However, allowing RMB sweeping would make the location of the group's RMB treasury as an offshore center, stimulating the usage of the RMB currency abroad.

In November 2012, a new pilot scheme gave the green light for corporations to move RMB out of the country via intercompany loans. Under this pilot program, a Chinese based subsidiary of an authorized multinational corporation is permitted to lend out RMB to its overseas parent or other related companies. The major advantage for the overseas parent / related company would be the possibility to settle invoices denominated in RMB.

The pilot scheme allows an approved company based in selected cities to set up a cross-border sweeping structure to perform automated foreign exchange sweeping in and out of China, so long as the amount of capital swept remains within the “Overseas Lending Quota” and “Foreign Debt Quota” approved ex ante by China’s State Administration of Foreign Exchange (SAFE).

Under the new regulation, cross border loans from overseas to China (i.e., when a Chinese subsidiary takes out a loan from the overseas treasury center) are allowed but regarded as foreign debt. However, the amount of such loans must not outstrip the borrower’s quota, and each transaction needs to be registered with SAFE. A drawback to this program is that a company must have a regional treasury center within China or Hong Kong to be permitted to sweep RMB denominated capital in and out of China. Clearly, this is a huge impediment for corporations that may need to reinvent their corporate structures in order to lend to overseas subsidiaries.

In February 2014, the Shanghai branch of the PBOC allowed true automated sweeping within the Shanghai FTZ. The principal advantage is the lifting of approval requirement and a substantial reduction of manual processes and paperwork for treasurers. Funds derived from financing (other than intra-group financing) may not be included in the sweeping and thus, the practical effect is to be tested.

Infrastructure

The further development of the RMB in the world's financial system will also require the continued development of market infrastructure and, ultimately, the integration of onshore and offshore activities, so as to enable cross-border RMB-denominated securities and payment transactions to be processed quickly, safely and economically. Today, the relatively high transaction cost (primarily driven by manual intervention) in RMB business operation suggests that the public and private sector have not yet invested enough in financial infrastructure to support RMB internationalization at the required level of scalability.

Onshore RMB payments are currently settled through the China National Advanced Payment System (CNAPS). In terms of offshore RMB payment infrastructure development, more and more RMB payment hubs are considering building multi-currency real-time gross settlement (RTGS) capability, which for offshore RMB can be considered as an extension of CNAPS for offshore/onshore payments. Hong Kong was the first mover and is an excellent example of the development of a market infrastructure supporting RMB with a highly efficient and reliable RMB clearing platform. This infrastructure facilitates banks from around the world to make RMB payments efficiently and with minimal risk. In 2013, the average daily turnover handled by the RMB RTGS system exceeded RMB 400bn. With more services introduced and more enhancement made on the system, eg extending the operating hours until 5.30pm Central European time to meet the needs of banks in Europe, Hong Kong has seen strong growth in RMB clearing value over the past two years. According to data published by Hong Kong Interbank Clearing Limited (HKICL), the year on year growth rate was 90% in 2012 and 86% in 2013. Taiwan was the second market to establish a local RMB RTGS, which has, together with the introduction of Bank of China Taipei as the RMB clearing bank, helped Taiwan become the fifth largest offshore RMB payment hub globally in terms of value[28]. Singapore is developing a RMB RTGS and the system is scheduled to be in place in 2015.

CIPS, an international RMB payment infrastructure announced by the PBOC, reflects China's intention to further facilitate global RMB adoption by providing a common clearing network. CIPS is seen as a "game changer" because it will re-define the ecosystem of RMB centers, clearing banks and international infrastructure. This new infrastructure is expected to cover multiple time zones and allow offshore banks to become direct participants, which could make offshore banks re-consider how they will expand their RMB clearing business. Furthermore, if CIPS adopts the advanced ISO20022 standards to be used by China's domestic payment infrastructure, the onshore and offshore RMB payments worlds will be significantly more interoperable – with each other and with the rest of the world. Although at this time the detailed functionality of this infrastructure as well as deployment timeline is not clear, it would appear that the cost savings and operational efficiency gains associated with CIPS could be a major incentive for potential offshore banks to use CIPS and consequently boost RMB transaction volumes. The market is expecting more dialogue between the PBOC and the onshore and offshore banks which may become CIPS participant in future. At the same time, the market is engaged in the emergence of the Shanghai FTZ and new rules around RMB transactions, which may shift focus from CIPS to Shanghai FTZ in this regard.

In terms of settlement of RMB FX transactions, most are settled on a non-PvP (payment versus payment) basis. The Basel Committee on Banking Supervision's February 2013 'Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions' advocates the use of PvP settlement to manage FX settlement risk. Settling on a non-PvP basis exposes participants to the risk of a loss of the full value of their transactions. In order to

[28] Source: SWIFT RMB tracker, February 2014

contain this settlement risk, at present banks set trading limits for their FX settlement exposure to each other. These counterparty limits are a potential constraint to the rate of growth of the offshore RMB FX market. ASIFMA regards settlement of the offshore RMB in CLS as desirable for the continued, stable expansion in the global use of the RMB for trade, investment and potentially as a reserve currency.

A milestone in the development of the offshore RMB market took place in June 2013 when the Treasury Markets Association (TMA) launched the CNH Hong Kong Interbank Offered Rate fixing (CNH HIBOR fixing). CNH HIBOR fixing now serves as an important piece of financial infrastructure for the offshore RMB market. It supports the growth of the RMB market by providing a benchmark for loan facilities and also facilitates the development of a variety of RMB interest rate products, increasing the ability with which market participants can manage the interest rate risk of their RMB businesses. The TMA's fixing of CNH HIBOR is subject to a governance and surveillance framework endorsed by Surveillance and Governance Committee (SGC), which is made up of members from professional, corporates and regulator. The robust framework helps ensure the benchmark fixing process is transparent and strengthens market participants' full confidence in the integrity of the rate fixing.

Under the arrangement, sixteen banks selected by the HKMA and appointed by the TMA as Contributing Banks for a term of one year to contribute interest rate quotes based on their activity levels in Hong Kong's offshore RMB market. Thomson Reuters is designated as the Calculating Agent for the computation and dissemination of the CNH HIBOR fixing. The CNH HIBOR fixing is published on the TMA's website at 11:15am every business day from Monday to Friday Hong Kong time. The fixing for each of the eight covered tenors, namely overnight, one week, two weeks, one month, two months, three months, six months and twelve months, is calculated by averaging the middle quotes after excluding the highest three quotes and lowest three quotes provided by Contributing Banks. TMA continues to review internally and exchange best practices with other administrators globally in order to fulfil international standard and guidelines, including the International Organisation of Securities Commissions' (IOSCO) Principles for Financial Benchmarks.

Greater collaboration on the development of RMB securities market infrastructure is high on the global agenda:

- The HKMA operated Central Moneymarkets Unit (CMU) is a bond clearing and settlement system which has established linkages with International Central Securities Depositories (ICSDs) like Euroclear and Clearstream to enable overseas investors to hold RMB bonds lodged with the CMU. This helps to contribute to the development of the offshore RMB bond market in Hong Kong in several respects: (i) in the secondary market, CMU provides a safe and efficient platform for clearing and settlement of offshore RMB bonds, (ii) in the primary market, CMU provides an efficient tendering platform for new issues. This tendering platform coexists with the conventional book building method, offering potential issuers of offshore RMB bonds more choices when they issue bonds in Hong Kong. The Chinese Ministry of Finance (MOF) and a number of policy banks from China have used this platform for primary issuances, and (iii) also in the primary market, there is a CMU Central Bank Placement Coordinating Window. This tendering platform enables an issuer to set aside a certain proportion of a new issue for placement to central banks and other sovereign entities outside China. The coupon rate of the placement will be the same as the accepted rate of the correspondent tenor at the tender.
- In December 2013, a memorandum of understanding was signed between Hong Kong Exchanges and Clearing (HKEx) and Singapore Exchange (SGX) with the aim to cooperate in promoting the internationalization of the RMB. Both exchanges are looking into joint product development; connectivity enhancement through a presence in each other's data centers and increased collaboration on technology development and regulatory issues. They may also work together in relation to extraterritorial market infrastructure regulation that impacts the Asia region.

- Another ICSD, Clearstream, announced in February 2014 its market approach to developing and delivering solutions to help support the internationalization of the RMB. The market approach involves bringing together market providers and participants from across the finance community to collectively enable foreign investors to further invest in the Chinese currency, help develop solutions to increase offshore RMB liquidity, enhance the depth and breadth of RMB products and services and facilitate both growth and maturity in the offshore RMB bond markets. To deliver this market approach, Clearstream is actively seeking partners to join in building and implementing the components that will help establish and facilitate an international offshore RMB market.
- On 3 April 2014, Euroclear announced its collaboration with the Taiwan Depository & Clearing Corporation (TDCC) to offer a new service allowing international investors to settle Taiwan-issued RMB bonds (Formosa bonds) in TDCC. The service, the first of its kind, allows settlement transactions to be routed from Euroclear to the local central securities depository, TDCC.
- On 10 April 2014, the Shanghai-Hong Kong Stock Connect pilot program was announced, which connects the Shanghai and Hong Kong stock markets. The program will promote the internationalization of the RMB and the development of Hong Kong as an offshore RMB business center since Mainland investors can participate in the Hong Kong stock market using RMB. It also expands investment channels for offshore RMB funds and helps the flow of RMB funds between the two markets.

In view of the world's increasing demand to invest in the Asian markets and RMB, more collaboration among the securities infrastructures are expected in the coming years.

What's Next?

The RMB internationalization project has achieved remarkable progress in a short period of time, taking the RMB from relative obscurity on the global stage to an increasingly commonly used currency for trade, investment, and official reserves. However, it remains to be seen whether the RMB will become a major fixture of the international economic system.

With China's capital account still largely closed, the RMB will likely not be incorporated into the IMF's special drawing rights (SDR) basket. While many central banks have already moved ahead with reserve diversification into RMB, the inclusion of the RMB in the SDR basket will leave no doubt that the currency is acceptable as an official reserve asset.

China recently established the pace at which it is planning to roll out financial reforms in its onshore FTZs. The Shanghai Pilot FTZ was officially launched in September 2013 as an experiment to observe how a free trade economy would survive on its own, as a possible prelude to full convertibility. Apart from certain black listed activities identified by the State Council, individuals and institutions are allowed to engage in any activities within the FTZ. In early January 2014, the government decided to establish twelve new FTZs over the subsequent three months.

The lending sector will be liberalized within the FTZs and remitting of RMB into China for foreign direct investment (FDI) purposes has been further simplified, making it easier for foreign investors to invest and develop their businesses within the FTZ zone. In addition, the government clarified operational details for conducting cross-border business in the Shanghai FTZ, after a broad framework was put in place in December 2013. Following those details, HSBC (China) said it had completed a first-of-its-kind cross-border RMB settlement for an individual customer. This followed the recent introduction of policies aimed at large multinational companies to integrate their onshore treasury operations with their global platforms offshore.

Provided risks can be controlled, the Chinese Government proposes full RMB convertibility for capital accounts within the FTZ, with entities established there permitted to conduct cross-border capital account transactions, such as share acquisitions, with fewer foreign exchange restrictions. The plan outlines future trial projects for liberalization of cross border RMB use and cross-border financing within the zone, giving companies full access to both domestic and foreign finance without restriction. Allowing free trade convertibility of the RMB within the FTZ would transform the zone into an offshore RMB center onshore, similar to Hong Kong.

To fully experiment and assess the effects of FTZs, regulators may wish to consider:

- Permitting qualified foreign investors to freely transfer investment gains out of China;
- Piloting convertibility of RMB capital items;
- Piloting cross-border RMB usage;
- Piloting market-determined financial interest rates;
- Supporting cross-border RMB re-insurance business;
- Encouraging multinational corporations (MNCs) to establish global/area fund management centers;
- Allowing qualifying private capital and foreign financial institutions to do business in the financial services sector; and
- Permitting overseas entities to participate in commodity futures trading in the FTZ.

Chinese regulators are also working to establish a FTZ to financially link up Hong Kong, Guangdong and Macau, which will help banks to open up the Chinese financial sector.

Despite these big steps taken in recent months and a drive to increase transparency of onshore FTZs, Hong Kong still remains the preferred destination for companies. More than 80% of RMB trade settlement transactions are handled in Hong Kong.

Another obstacle facing the RMB is the denomination of commodities into the currency. The commodity complex remains largely denominated in USD. However, as China is poised to become an ever more important hydrocarbon importer, and with the US increasing its energy independence, there is a growing case for commodity redenomination into RMB. 6% of all global commodities are expected to be priced in RMB by 2020[29].

Overall, the fate of the RMB's international use still lies in the outlook for the Chinese economy and the short-term developmental path for financial reforms. If China's economy falters or the authorities choose not to progress on key areas such as further interest rate liberalization and full convertibility of the RMB, the global use of its currency will come into question. However, if China can successfully execute the spate of reforms needed to transform and rebalance its economy, the RMB should move closer to the core of the international economic system.

Other 2020 Developments[30]

By 2020, the USD, EUR and CNY FX and rates markets will dominate global financial markets. Daily CNY FX turnover should grow from the current USD 120bn to exceed USD 500bn.

China's capital account should be 'basically open' by 2020, i.e., open but with some Chinese characteristics. Direct investment will flow much more easily than today, with only large deals subject to approval requirements. Portfolio flows will take place within significantly expanded QFII and QDII frameworks.

As the onshore capital markets become more accessible to offshore investors, the offshore market will also expand. The offshore RMB debt market will likely grow at a rate of 30% per year, and be worth RMB 3tn (USD 500bn) by 2020.

China's RMB cross-border payment clearing system, China International Payment System (CIPS), will likely be fully operational by 2015, ensuring global RMB liquidity.

The RMB is expected to be a basically freely floating currency, and SHIBOR will operate as China's equivalent of the federal funds target rate.

The realization of the above depends on Beijing's policy direction. The leadership team of President Xi Jinping and Premier Li Keqiang is serious about introducing more 'market' into China's economy, and further reducing the role of the state. This agenda involves reforms that will free up essential prices (eg interest rates and utility prices), introduce more competition into the services sector (through innovations such as private banks), and reduce the number of administrative approvals businesses need to obtain.

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[29] Source: Standard Chartered

[30] Source: Standard Chartered

The journey towards RMB internationalization will not be without challenges. China's capital account controls will not disappear quickly, but the trend has been set in motion. Figure 26 outlines how China's capital account may look by the year 2020.

Figure 26: How the capital account will open up between now and 2020

	Item	Current situation	Likely developments by 2020
Direct investment	FDI inflows	FX conversion may require approval by SAFE and/or reporting to PBOC, depending on size and use of funds. Strict controls on capital repatriation. Restrictions on which industries can be invested in.	Free FX conversion, apart from very large deals. Foreign investment banned only in a few strategic industries. Capital repatriation will be free, but monitored. More flexibility for timing of dividend remittance. Much more freedom of investment in currently restricted sectors.
	ODI outflows	SAFE approval needed.	Only very large deals will still need SAFE approval.
Portfolio investment: (a) equity	Equity inflows	Managed with QFII and RQFII quotas, which require approval for each institution, and FX inflow approvals. Complemented by Shanghai-Hong Kong Stock Connect program. Time limits apply on fund repatriation.	Significant increase in QFII and RQFII quotas, complementing by significantly expanded Shanghai/Shenzhen-HK Stock Connect program. Repatriation approval only needed for large amounts. Lock-up periods removed.
	Onshore equity issuance by offshore entities	Not possible.	To be permitted via the establishment of an International Stock Board.
	Offshore equity issuance	CSRC approval required.	Elimination of all approval requirements.
	Offshore equity purchases	Only through limited QDII scheme or by limited number of institutions trading on a proprietary basis. Complemented by Shanghai-Hong Kong Stock Connect program.	Large QDII expansion. Platform for individuals to purchase offshore equity securities, initially likely limited to Hong Kong and subject to quota. In either case, complemented by significantly expanded Shanghai/Shenzhen-Hong Kong Stock Connect program.
(b) bond	Bond investment inflows	Managed via QFII/RQFII and PBOC approval and quotas, and remittance subject to lock-up period.	Big expansion of QFII/RQFII quota; almost complete relaxation of repatriation rules.
	Onshore bond issuance by offshore entities	Not allowed, except in case of approved multilateral agencies. There is a recent pilot issuance by a non-PRC corporate issuer.	Extensive.
	Offshore bond issuance	NDRC/PBOC approval (and in some cases approval by State Council) required.	Led by MoF, to be allowed with approvals only required for large issues
	Offshore bond purchases	Only through QDII scheme, limited number of institutions trading on a proprietary basis.	Unlimited access for qualified institutional investors.
Other channels	Individual FX conversion	Limits on individual conversion, up to USD 50,000 equivalent each year unless documents could be provided to prove a true demand of foreign currencies for lawful purposes.	Allow individuals to convert up to USD 100-200k and then more. Likely need to report at USD 1mn.
	Cross-border lending	Extremely limited.	Likely to be completely liberalized.

Source: Standard Chartered research, IMF

This roadmap aims to illustrate the current state of China's currency and the major changes and challenges undertaken by the country while implementing new economic reforms, as well as the major instruments and programs implemented by the PBOC to promulgate RMB usage both regionally and globally.

BREAK-OUT BOX 5

Direct Crosses

While Chinese authorities have widened the number of currencies that the RMB can directly trade against, namely: USD, EUR, JPY, GBP, MYR, RUB, CAD, AUD and NZD, the USD still accounts for the lion's share of trading volumes. In recent months, while other currencies have risen in trading volumes, the USD's market share remains at more than 90% followed by the EUR, JPY and the AUD. Apart from the USD, the other currency volumes number a few hundred millions USD against the RMB, according to BIS data.

The direct crosses for RMB were first launched nationwide versus the Malaysian Ringgit in 2010 and then versus the Japanese Yen (JPY) in 2012. Australia and China reached a similar agreement in 2013. China has also designated a number of pilot regions in which the direct trading of RMB and the currencies of some neighboring countries are encouraged. In October 2013, the Central Banks of both the United Kingdom and Singapore and PBOC announced agreements for direct crossing of their respective currencies. The direct cross volume estimates are still marginal but it is an investment in future growth of bilateral trade and investment:

- MYR/CNY – unknown
- AUD/CNY - daily FX volume is about AUD 150mn
- JPY/CNY - daily FX volume is about USD 750mn
- GBP/CNY – unknown
- SGD/CNY – unknown

Without direct convertibility, trading of the RMB with another currency in the foreign exchange markets has always used the USD as the intermediary. The direct crosses are important to lower the cost of hedging for corporations as well as to rule out the risk of exchange volatility of the US dollar.

Conclusion and Summary

While the pace at which the RMB's global role has evolved has been quite rapid and in many instances exceeded all expectations, a great deal more needs to be done for the RMB to attain the same role as USD and EUR. A number of key measures, if undertaken by the Chinese authorities sequentially and at a pace commensurate with economic growth and stability, will enable the RMB to take on a dominant global role.

a) International Monetary System (IMS) reform requires a rebalancing of the global economy away from the USD, with a much greater role for the RMB. The first step of this process is the enabling of the RMB to circulate outside China – this can be achieved if individuals and institutions are increasingly willing to hold RMB in various deposit accounts. This process has already begun with the establishment of a number of offshore RMB centers, but has much further to go.
b) The next step is the increased global acceptance and usage of RMB as a settlement currency for trade purposes – the world should gradually transition away from the USD as the "de facto" trade settlement currency, given China's role as the leading global trading economy. Increased invoicing of both imports and exports in RMB, also a process that is well under way, will have the dual advantage of i) reducing the accumulation of USD reserves, a necessary step for global rebalancing and ii) commensurately increasing the role of the RMB in global trade. This also has the added benefit of reducing exchange rate risks for both importers and exporters.
c) Gradual opening of the onshore RMB market to international investment – the creation and rapid development of the offshore bond market was a key development in giving international investors access to the Chinese market. The next step will be the granting of on-shore access via the QFII and RQFII quotas to international investors and the increasing presence of global central banks in the domestic RMB markets. Further steps include the deregulation of interest rates, deepening the bond markets and increasing international investor access to domestic capital markets (the Shanghai-Hong Kong Stock Connect pilot program is an example of this and is a positive first step). The final logical development of this process would be the gradual convergence of onshore and offshore RMB (the opening of the Shanghai FTZ is an important step in this regard). Specific enhancements to the RMB settlements infrastructure are also essential for this convergence to gather pace.
d) The establishment of additional Bilateral Swap Agreements (BSAs) between the PBOC and foreign central banks, in addition to the 24 that are already in place, will help increase the usage and circulation of the RMB outside China, initially for trade and later for investment purposes. More BSAs will lower the level of concern around offshore RMB liquidity, a key factor in the path to RMB internationalization.
e) The final step in the evolution of the RMB's role as a global currency is its global acceptance as a reserve currency. While there are clear indications that the RMB is on the way to being a "de facto" reserve currency – with a number of Central Banks already holding at least some RMB as reserves – the fact remains that the RMB still accounts for less than 1% of global reserves and moreover is not formally recognized as a reserve currency by the IMF. Increased holdings of the RMB over time by global central banks through a) the offshore RMB markets, b) the use of QFIIs and RQFII programs, and c) direct access to the onshore RMB markets through privileges granted by the PBOC, will help cement the growing international role of the RMB and assist its final acceptance as a full-fledged reserve currency.

China's endeavours to promote its currency on an international level go hand in hand with the gradual opening up of its financial system. This process, already underway and necessary for the health and viability of China's real economy, must be gradually absorbed by the country's corporate, banking and financial sectors, as the RMB makes the transition to become a truly global currency.

BREAK-OUT BOX 6

Industry Advocacy

- *Foreign Exchange* – it is important to ensure FX settlement risk is minimized so market participants feel secure that transactions will be settled as and when expected, protecting them from the potential loss of the full value of their transactions. CLS is the banking industry-owned organization that provides a multicurrency settlement system to mitigate settlement risk for FX transactions in 17 currencies. ASIFMA supports the ongoing consideration by authorities and market participants – including several of ASIFMA's members - of the eligibility of the offshore RMB for CLS settlement, which would significantly reduce FX settlement risk for RMB trades against USD, EUR, JPY, GBP and other currencies that account for the majority of the turnover in the global market.
- *Infrastructure* – A robust RMB infrastructure will be able to reduce transaction costs and generate new demand for RMB business. SWIFT's critical role of supporting market infrastructures has been well acknowledged around the world already with a massive and growing community connected. Any new RMB infrastructure launched in the future should consider SWIFT and ISO20022 standards for access and interoperability. This would save the industry's overall implementation and ongoing operational costs.
- *Liquidity* – it is important to improve the global liquidity of the RMB. Governments can support this through measures such as agreements on RMB central bank swap lines. Governments may also wish to consider whether they are able to issue government debt in RMB in order to provide additional liquidity. Further opening of China's markets in line with the process set out in the Third Plenum will provide additional liquidity.
- *Fungibility of the offshore markets* – while the onshore and offshore markets remain separate, it is important to ensure that all the offshore markets are connected so as to function as one global offshore market. This requires there to be no legal restrictions on the flow of RMB funds between these offshore jurisdictions, no operational issues amongst clearing centers, and ideally consistency in documentation conventions. However, while other currencies clear naturally in their respective home country jurisdictions, offshore RMB uniquely does not have a natural home clearing base and this gives rise to a number of peculiarities which the industry should remain alert to:
    1. Unlike other currencies, extra steps are currently required to clear RMB settlement between different offshore centers due to different clearing systems of different offshore RMB clearing banks. Ensuring transferability between any pair of offshore centers will get more complex as the number of offshore centers proliferate.

2. As the number of bigger offshore centers increases, market participants (for example, offshore RMB bond issuers) will have to consider the choice and number of clearing jurisdiction(s).
3. Where it is normal to relate country and legal risk (illiquidity, illegality and non-convertibility) for a currency to the sovereign issuer of the currency, risk analysis for offshore RMB would require additional considerations as to the offshore jurisdictions where a transfer is settled.

Thus, financial products of the same genre which clear through different offshore centers could potentially carry differing operational issues and risk profiles, resulting in a fragmented offshore market. This is exacerbated further as the number and variety of financial products increase. A common clearing network, such as CIPS, would be a big step in giving clarity to the situation and restoring PRC sovereign risk to the currency. In the meantime, standardization of legal interpretation and documentation as well as standardizing of clearing and settlement modes of different offshore RMB products would alleviate the issue.

- *Tax treatment* – the application of Chinese tax on QFIIs lack clarity and continues to be a concern. The industry believes that relevant authorities could take the introduction of the Shanghai-Hong Kong Stock Connect pilot program as an opportunity to provide transparency and clarity for all such related investments in China.
- *Market education* – educating businesses about the new RMB options is important. Governments should ensure that:

1. Government business and trade ministries, as well as business support/trade promotion agencies, should ensure trade in RMB is clearly included in educational material for businesses looking to export to China.
2. Regulators should ensure they understand how global markets are likely to develop as a result of the increased internationalization of the RMB.
3. The Chinese government should encourage greater use of RMB by Chinese companies in international transactions.
4. Governments and regulators should work with asset managers to understand the obstacles to further use of RMB. In particular, mutual recognition of funds will be key to ensuring the development of large pools of liquidity, making it easier for investors to access RMB investment opportunities.

Appendix A – Development of Selected Offshore RMB Centers

Hong Kong

The Hong Kong Monetary Authority (HKMA) views the RMB as a component or pillar of its multicurrency offering, which has successfully attracted flows in all currencies to settle within Hong Kong – further strengthening its position as a regional financial center (i.e. the RMB is part of a larger value chain).

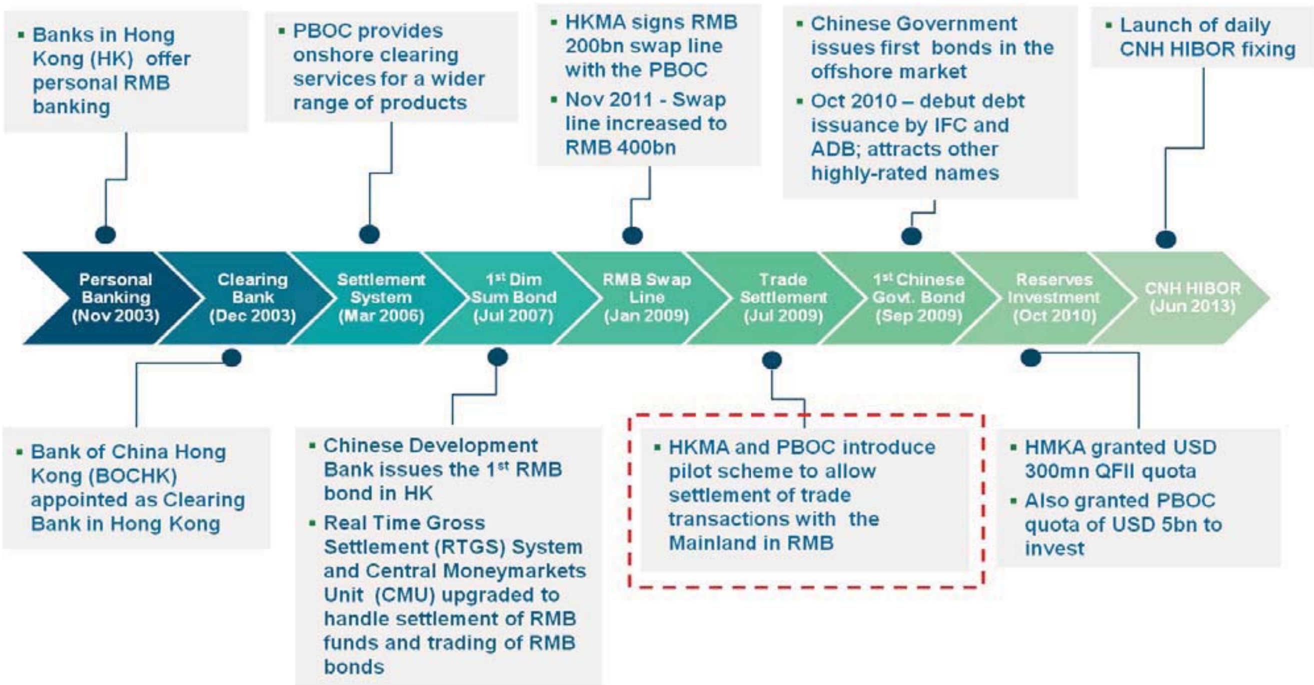
As a center for RMB trade and investment, many pilot tests have been held in Hong Kong. These include the first RMB cross border trade settlement, first primary market issuance of an offshore RMB debt (dim sum bond) and equity securities, the platform for cross border capital account investment schemes (QFII – Qualified Foreign Institutional Investor, QDII – Qualified Domestic Institutional Investor, RQFII – RMB Qualified Domestic Institutional Investor, etc.) and cross border lending, to name a few.

From a legal perspective, Hong Kong's financial markets are independent of the Mainland financial system in their autonomy to operate RMB businesses. This important point makes Hong Kong the financial gateway for cross border businesses with China. Countries rely on Hong Kong because of its political independence and stability, use of common law and a sound legal system, tax efficiencies and openness to the global economy.

Hong Kong’s finality of payment is one example of how the legal system supports global financial institutions’ transactions through Hong Kong. Finality is guaranteed in Hong Kong under the Hong Kong Clearing and Settlement Systems Ordinance (CSSO). The CSSO provides statutory backing for the finality through systems designated under the Ordinance by protecting the settlement finality from insolvency laws or other laws. Hong Kong Dollar Clearing House Automated Transfer System (CHATS), US Dollar CHATS, Euro CHATS and RMB CHATS systems were designated under the CSSO, to which certificates of finality have been issued by the HKMA.

Another advantage supporting Hong Kong’s position as an international financial center for RMB transactions is its robust and scalable financial infrastructure. The HKMA has spent over 7 years developing infrastructure to support this growing business, which includes a RMB RTGS with extended operating hours of 8:30am - 11:30pm Hong Kong time and a payment-vs-payment (PvP) platform to remove counterparty risk related to foreign exchange transactions.

Figure 27: Development of RMB Market in Hong Kong



Singapore

Singapore's RMB market has enjoyed a strong pace of growth since the launch RMB clearing services in May 2013. As at December 2013, total RMB deposits placed in Singapore have grown to RMB 195bn, up 70% from RMB 115bn in March 2013. RMB-denominated loans, mainly trade financing, grew by almost 40% in the same period to reach close to RMB 360bn. In October 2013, Singapore accounted for 60% of RMB trade finance volume outside China and Hong Kong. The RMB FX daily turnover almost doubled from USD 16bn in March 2013 to USD 31bn in December 2013. As at end-March 2014, six banks have issued RMB bonds in Singapore (or "Lion City" bonds) worth a total of RMB 7.5bn.

In one recent development, it is worth noting that Singapore has overtaken London as the number one offshore RMB payments center after Hong Kong. A spokesperson for SWIFT stated that ever since last year's nomination of ICBC as a clearing bank in Singapore, SWIFT has been expecting the Singapore RMB payments flows to accelerate, especially as Chinese companies use it as a hub to reach ASEAN countries, and is anticipating growth in capital markets/securities flows to follow as Singapore develops further as an offshore RMB center.

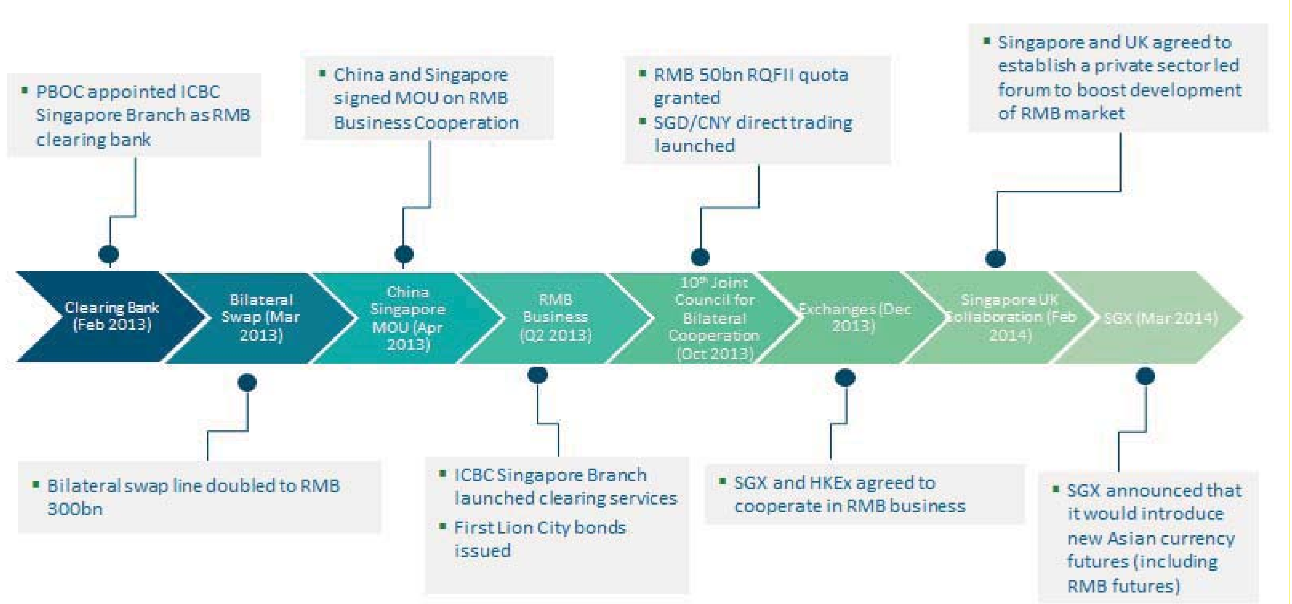
In October 2013, China announced a fresh round of measures which it would extend to Singapore to promote the international use of RMB through Singapore. These measures include granting Singapore a quota of RMB 50bn under the RQFII program, considering Singapore as an investment destination under the RMB Qualified Domestic Institutional Investor (RQDII) scheme, establishing cross-border RMB channels for registered entities in the Suzhou Industrial Park and Tianjin Ecocity, and launching SGD/CNY direct trading in both the China and Singapore markets.

The RQFII program was formally open to Singapore-based financial institutions in January 2014 and the other RMB measures are in the process of implementation. In particular, the measure to allow cross-border flows between Singapore and the two industrial parks in China is unique to Singapore, and complements the close economic linkages that Singapore has established with each of these zones. It also reflects PBOC's commitment to have appropriate financing arrangements that support real economic activities.

In December 2013, the Singapore Exchange (SGX) and the Hong Kong Exchanges and Clearing Limited (HKEx) agreed to cooperate in several areas of common interest, which include promoting the internationalization of the RMB by exploring joint product development; enhancing connectivity through points of presence in each other's data centers and collaborating on technology development and regulatory issues. The SGX also announced in March 2014 that it would introduce a new set of Asian currency futures (including RMB futures) to expand its current suite of foreign exchange futures in Q3 of 2014, subject to regulatory approval.

In February 2014, UK and Singapore agreed to establish a new, private sector led forum to boost the development of the offshore RMB market. This marks the first collaboration between Singapore and another offshore RMB financial center.

Figure 28: Development of RMB Market in Singapore



The MAS's Singapore RMB Gateway brochure (available at http://www.mas.gov.sg/Singapore-Financial-Centre/Overview/Regional-Gateway-for-RMB.aspx) provides the key milestones in Singapore's RMB journey, and Singapore's unique value propositions.

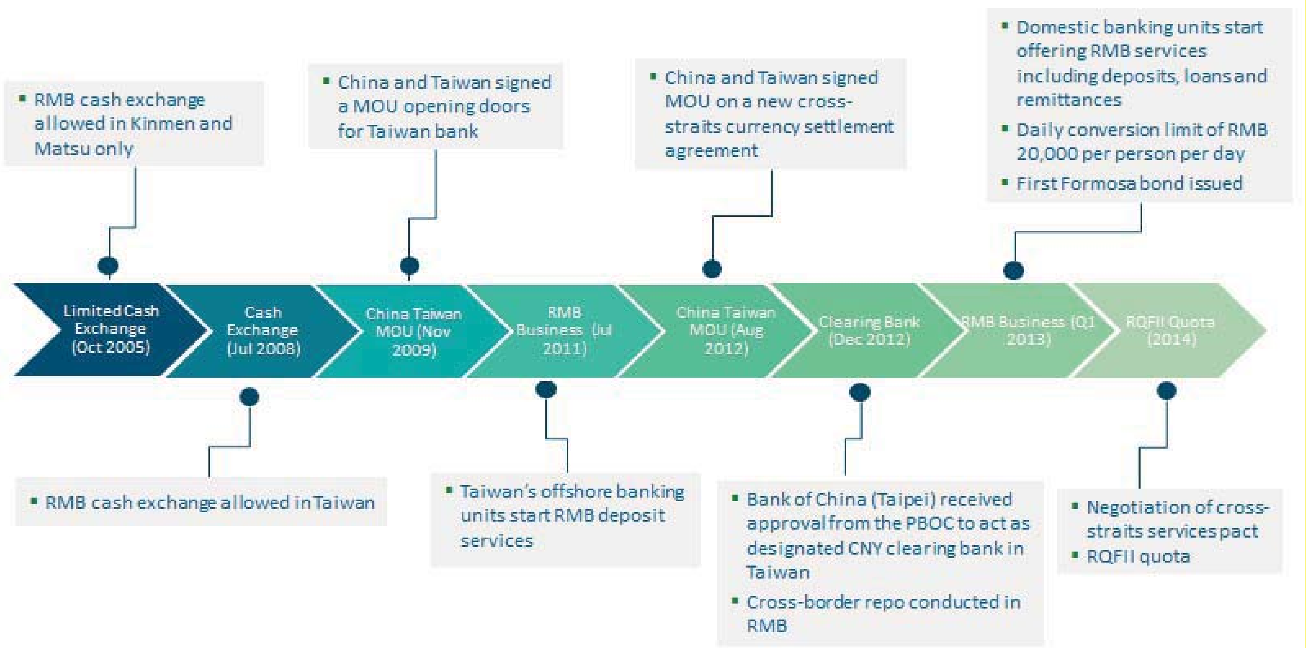
Taiwan

There is a great deal of potential for Taiwan to be a leading offshore RMB center on a number of factors:

- Largest overseas market: Trade volume between China and Taiwan exceeded USD 197bn in 2013, making China the biggest trade partner of Taiwan, as well as largest source of trade surplus.
- Most preferred overseas investment destination: Estimate of approximately 50,000-100,000 Taiwan enterprises currently operate on the Mainland.
- Largest group of overseas arrivals: Mainland Chinese visitors reached record 2.87 million in 2013, overtaking Japan as the biggest source of tourist arrivals since 2010.
- Increasing trade & investment opportunity: This is expected to receive a boost after the recent signing of bi-lateral free trade (ECFA) agreement, expanding tourism flow, as well as decisions to allow mainland Chinese to invest in public sector infrastructure projects.

As a consequence of the above factors, the growth of the offshore RMB market in Taiwan has been rapid, as the timeline below demonstrates:

Figure 29: Development of RMB Market in Taiwan



The Financial Supervisory Commission (FSC), Taiwan's regulatory authority, is also negotiating with Mainland officials to establish more channels for the recycling of RMB back to the onshore market. This includes expanding the Kunsan Experimental Zone Project to include China's Xiamen, Shanghai and Jiangsu province, where many Taiwanese enterprises are located. The project currently allows for two-way, cross-border, RMB-denominated intra-company lending for Taiwanese companies operating in Kunsan. Regulators are also negotiating the approval of RMB 100bn of RQFII quota for Taiwanese financial institutions and have introduced RMB-denominated insurance policies. This will make Taiwanese banks more willing to increase RMB liquidity on their balance sheets.

The FSC is also seeking to expand RMB usage in the domestic market. The regulator has considered allowing local insurance companies to invest in Formosa bonds by both foreign and Taiwanese enterprises. Additionally, the FSC may exempt local insurers' Formosa bond holdings from their overseas investment limits, besides allowing Mainland enterprises to issue Formosa bonds in Taiwan. These potential liberalization measures should increase demand for Formosa bonds. Total Formosa or "Bao Dao" bond issuance stands at RMB 12bn as at February 2014.

RMB derivatives business and structured products have also received a boost after the Central Bank of China (CBC), Taiwan's central bank, allowed Domestic Banking Units (DBUs) to conduct two types of RMB-related derivative transactions referencing a) the RMB exchange rate and/or interest rates and structured products with a combination of the above, and b) derivatives and structured products with a link to the PRC stock index or specific shares issued by a PRC listed company. Following these measures, some RMB structured products have been offered to local investors through retail banking channels, further expanding the diversified investment spectrum for Taiwanese investors.

Taiwan residents have shown a strong interest in holding RMB assets, attracted by higher interest rates and currency appreciation. RMB deposits have surged despite the conversion limit of RMB 20,000 per person per day. In fact, this desire on the part of Taiwan residents to hold RMB is reflected in the fact that deposits in the DBUs far exceed that in the Offshore Banking Units (OBUs). The pace of RMB deposit accumulation is expected to pick up further if the daily limit is removed. Total RMB deposits in Taiwan stand at RMB 268bn at end Q1 2014.

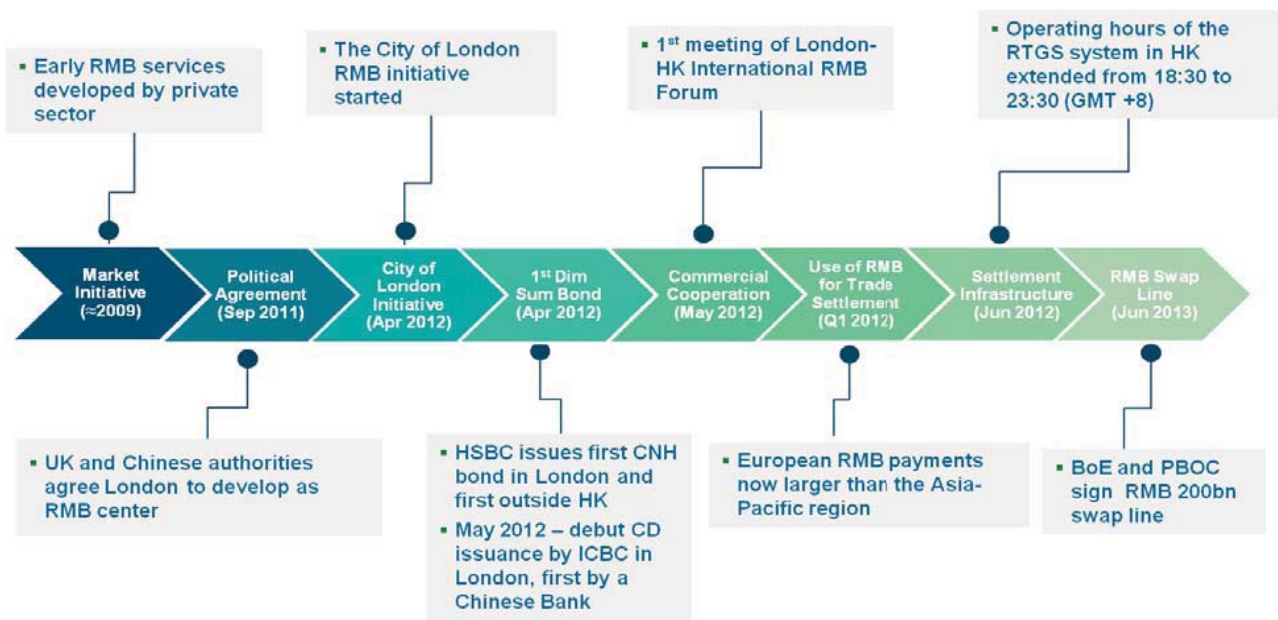
Taiwan also recently added the RMB to its FX settlement system (Real Time Gross Settlement, or RTGS). This is likely to reduce transaction costs and time and to lower FX risk, increasing local corporates' willingness to switch to RMB for cross-straits trade and investment flows.

Finally, the CBC has added RMB to its reserve portfolio. According to the CBC, this move reflects the growing status of China's economy, both globally and bilaterally. Taiwan joins the ranks of other Asian and global central banks that hold RMB reserves. A next key step would be to set up a swap line to provide liquidity support to Taiwan's growing RMB market in the event of shocks, a subject which is under discussion with the mainland authorities. The addition of RMB reserves underlines the growing importance of the RMB to Taiwan and should drive further market growth.

London

London has a native advantage as the largest foreign exchange (FX) market in the world. In September 2012, the UK surpassed Hong Kong to become the largest global treasury center for RMB transactions[31]. Shown below is London's journey to develop into an offshore RMB center.

Figure 30: Development of RMB Market in London



Since the creation of this diagram there have been some recent notable developments. For example, through the City of London (CoL) RMB initiative an active dialogue with the leaders of China and the UK and industry participants has led to several breakthroughs. For example, a direct exchange between GBP and RMB has been agreed. This will mean in the future that better prices for this currency pair and greater transparency will be possible without having to rely on the USD as an intermediary currency. UK has also successfully received regulatory approval for a RMB Qualified Foreign Institutional Investor (RQFII) RMB 80bn pilot scheme. On 7 January 2014 Ashmore received RMB Qualified Foreign Institutional Investor status from the China Securities Regulatory Commission (CSRC), allocating the first of the RMB 80bn issued to the United Kingdom. In Q4 2013 and in January 2014, a wave of institutions issued offshore RMB bonds from the London market. In London, Standard Chartered Bank is now offering RMB clearing services together with Agricultural Bank of China in response to industry-led demand.

[31] SWIFT, Treasury (USD bn), June 2013, MT300, excluding transactions by central banks

The City of London (CoL) represents the interests of UK's financial services community. It has been a staunch advocate for the development of RMB markets in London and has been at the forefront of researching, negotiating, and advocating for the development of this business in London because of the implied financial benefits.

The British and Chinese governments are in active discussions regarding the establishment of a RMB clearing bank in London, a milestone that would put the city in a leading position in Europe. All other offshore centers have Chinese banks as trade clearing institutions: Bank of China for Hong Kong and Taiwan, and Industrial and Commercial Bank of China for Singapore. A clearing bank is considered a politically sensitive subject and is usually a Chinese entity.

Luxembourg

The importance of the RMB for investors can be seen if the development of Luxembourg is examined as an offshore center. Luxembourg is the world's 8th largest financial investment center and Europe's biggest fund-management center. It had secured deposits of RMB 56bn as of June 2013, the highest in the euro area and even higher than London (RMB 5bn). Over RMB 67bn of loans were extended in Luxembourg in Q3 2013. Luxembourg is also responsible for the largest RMB trade finance volume in Europe: RMB 51.8bn in H1 2013.

Luxembourg's GDP is based on its fund industry. As of June 2013, 18 asset managers have established RMB funds in Luxembourg with a total of more than RMB 220bn of assets under management. As the home of many UCITS, Luxembourg serves as a central point for marketing funds across Europe, Asia, the Americas and the Middle East – efficiently using one fund structure.

In December 2013, the CSSF (Luxembourg Commission for the Supervision of the Financial Sector) granted its first RQFII UCITS approval to allow funds to invest up to 100% of their net assets directly into Chinese equity markets through the use of their quota. The CSSF approval has been granted under a number of conditions and subject to full compliance with the requirements of the UCITS directive. The allocation of the quota is still subject to Chinese regulatory approval. The CSSF had previously authorized Luxembourg UCITS to invest directly in Chinese equity markets through the use of a QFII quota. However, due to restrictions on repatriation of funds out of China under the QFII Regime (e.g. lock-up period, monthly repatriation cap), these investments were limited to 35% of the net assets of such UCITS. On 16 January 2014, the first Hong Kong RQFII UCITS ETF domiciled in Luxembourg was launched with the expectation that it will list on the London Stock Exchange. With these new regulations, Luxembourg is a choice domicile for global distribution of RQFII funds.

Appendix B – Timeline of Major Developments

APPENDIX B

TIMELINE OF MAJOR DEVELOPMENTS

Year	Month	Deposit	Offshore RMB Bonds	QFII/RQFII	Introduction of Swap Lines	Others
2002	Nov			The QFII program was introduced to allow foreign investors to trade A shares in the Shanghai and Shenzhen stock exchanges USD 10bn		
2003	Nov	Banks in HK offer personal RMB banking services				
	Dec					BOCHK was appointed as Clearing Bank in HK
2004	Jun	RMB deposits in HK RMB 6.8bn				
	Dec	RMB deposits in HK RMB 12.1bn				

APPENDIX B
TIMELINE OF MAJOR DEVELOPMENTS

Year	Month	Deposit	Offshore RMB Bonds	QFII/RQFII	Introduction of Swap Lines	Others
2005	Jun	RMB deposits in HK RMB 20.9bn				
	Dec	RMB deposits in HK RMB 22.6bn				
2006	Apr					The QDII program was introduced to allow domestic institutional investors to invest in offshore markets USD 14.2bn
	June	RMB deposits in HK RMB 22.7bn				
	Dec	RMB deposits in HK RMB 23.4bn				SFC authorized funds to be indirectly sold in mainland China through QDII program

APPENDIX B
TIMELINE OF MAJOR DEVELOPMENTS

Year	Month	Deposit	Offshore RMB Bonds	QFII/RQFII	Introduction of Swap Lines	Others
2007	Jun	RMB deposits in HK RMB 27.6bn				The renminbi RTGS system (also known as renminbi CHATS) in Hong Kong was established
	Jul		Eligible PRC financial institutions/PRC govt. allowed to issue RMB bonds in HK - the first dim-sum bond was issued by the China Development Bank			RTGS system and CMU upgraded to handle settlement of RMB funds and trading of RMB bonds
	Dec	RMB deposits in HK RMB 33.4bn				
2008	Jun	RMB deposits in HK RMB 77.6bn				
	Jul					RMB cash exchange allowed in Taiwan
	Dec	RMB deposits in HK RMB 56.1bn				

APPENDIX B
TIMELINE OF MAJOR DEVELOPMENTS

Year	Month	Deposit	Offshore RMB Bonds	QFII/RQFII	Introduction of Swap Lines	Others
2009	Jan	RMB deposits in HK RMB 54.4bn			Hong Kong RMB 200bn	HK was formally declared the first offshore RMB business centre
	Feb				Malaysia RMB 80bn	
	Mar				Indonesia RMB 100bn Belarus RMB 20bn	
	Apr				Korea RMB 180bn Argentina RMB 70bn	
	Jun	RMB deposits in HK RMB 54.4bn				
	Jul					RMB cross-border trade settlement was launched with a pilot program
	Sep		Chinese Government issues first bonds in the offshore market			
	Nov					China and Taiwan signed a MOU opening doors for Taiwan bank
	Dec	RMB deposits in HK RMB 62.7bn				

APPENDIX B
TIMELINE OF MAJOR DEVELOPMENTS

Year	Month	Deposit	Offshore RMB Bonds	QFII/RQFII	Introduction of Swap Lines	Others
2010	Jun	RMB deposits in HK RMB 89.7bn			Iceland RMB 3.5bn	
	Jul				Singapore RMB 150bn	
	Aug		McDonalds entered the dim-sum bond markets as the first foreign multinational company RMB 200mn			
	Oct			HKMA granted QFII quota USD 300mn		
	Dec	RMB deposits in HK RMB 314.9bn				

APPENDIX B
TIMELINE OF MAJOR DEVELOPMENTS

Year	Month	Deposit	Offshore RMB Bonds	QFII/RQFII	Introduction of Swap Lines	Others
2011	Apr				New Zealand RMB 25bn Uzbekistan RMB 0.7bn	
	May				Mongolia RMB 5bn	
	Jun	RMB deposits in HK RMB 553.6bn			Kazakhstan RMB 7bn	
	Jul	Taiwan's offshore banking units start RMB deposit services				
	Aug		China's corporates allowed to issue RMB bonds in HK			The use of RMB to settle cross-border trades was extended to the entire country

APPENDIX B
TIMELINE OF MAJOR DEVELOPMENTS

Year	Month	Deposit	Offshore RMB Bonds	QFII/RQFII	Introduction of Swap Lines	Others
2011	Oct				Renewal - Korea RMB 360bn	
	Nov				Renewal - Hong Kong RMB 400bn	
	Dec	RMB deposits in HK RMB 588.5bn		Introduction of RQFII program - which allows offshore RMB raised by Hong Kong subsidiaries of Chinese domestic fund managers and securities companies to invest directly in mainland China's RMB20bn	Thailand RMB 70bn Pakistan RMB 10bn	

APPENDIX B
TIMELINE OF MAJOR DEVELOPMENTS

Year	Month	Deposit	Offshore RMB Bonds	QFII/RQFII	Introduction of Swap Lines	Others
2012	Jan				United Arab Emirates RMB 35bn	
	Feb				Turkey RMB 10bn	
	Mar				Australia RMB 200bn	PBoC released the "Notice Concerning Issues on Administration of Enterprises Engaging in RMB Trade Settlements for Merchandise Exports", which stated that all enterprises with import-export rights are allowed to settle merchandise exports in RMB
	Apr		HSBC issues first CNH bond in London and first outside HK	RQFII quota had been increased by RMB50 billion for A share ETFs to be authorized by SFC and listed in Hong Kong. RMB 70bn Expansion of QFII program USD 80bn		

APPENDIX B
TIMELINE OF MAJOR DEVELOPMENTS

Year	Month	Deposit	Offshore RMB Bonds	QFII/RQFII	Introduction of Swap Lines	Others
2012	Jun	RMB deposits in HK RMB 557.7bn			Ukraine RMB 15bn	The Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone's ("Qianhai") was launched
	Aug					China and Taiwan signed MOU on a new cross-straits currency settlement agreement
	Nov			Expansion of RQFII program - an additional RMB 200bn RQFII investment quota RMB 270bn		Pilot scheme allowed for companies to move RMB out of China via intercompany loans. Banks were allowed to facilitate cross-border loans for corporates' activities outside China (RMB sweeping from China)
	Dec	RMB deposits in HK RMB 603bn	Total outstanding amount of offshore bonds reached landmark volume RMB 375bn			Bank of China (Taipei) received approval from the PBOC to act as designated CNY clearing bank in Taiwan

APPENDIX B
TIMELINE OF MAJOR DEVELOPMENTS

Year	Month	Deposit	Offshore RMB Bonds	QFII/RQFII	Introduction of Swap Lines	Others
2013	Jan					SFC announces that it is looking into Mainland-HK mutual recognition of funds CSRC announced that China is planning to launch a pilot scheme: QDII2, which would enable PRC individuals to invest directly in offshore markets
	Feb	Taiwan domestic banking units start offering RMB services including deposits, loans, and remittances; Daily conversion limit of RMB is RMB 20,000 per person per day	The first "renminbi Formosa bond" was issued by Chinatrust in Taiwan RMB 1bn			PBOC appointed ICBC Singapore Branch as RMB clearing bank
	Mar	RMB deposits in SG RMB 115bn		Hong Kong subsidiaries of international firms allowed to apply for RQFII quotas	Renewal - Singapore RMB 300bn Brazil RMB 190bn	

APPENDIX B
TIMELINE OF MAJOR DEVELOPMENTS

Year	Month	Deposit	Offshore RMB Bonds	QFII/RQFII	Introduction of Swap Lines	Others
2013	Apr					China and Singapore signed MOU on RMB Business Cooperation
	May		First Lion City bonds issued			ICBC Singapore Branch launched clearing services
	Jun	RMB deposits in HK RMB 698bn			Introduction of swap lines in UK RMB 200bn	Launch of the CNH Hong Kong Interbank Offered Rate fixing (CNH HIBOR fixing) by The Treasury Markets Association (TMA)
	Sep	RMB deposits in HK RMB 730bn				The China (Shanghai) Pilot Free Trade Zone (the "FTZ") was officially launched

APPENDIX B
TIMELINE OF MAJOR DEVELOPMENTS

Year	Month	Deposit	Offshore RMB Bonds	QFII/RQFII	Introduction of Swap Lines	Others
2013	Oct	HKAB submitted a proposal to Chinese authorities for the removal of daily RMB 20,000 conversion limit		RQFII quota granted to London and Singapore: RMB 80bn - London; RMB 50bn - Singapore	EU: RMB 370bn	SGD/CNY direct trading launched
	Nov		Taiwan's Financial Supervisory Commission published a set of rules governing the issuance of offshore renminbi bonds for PRC issuers			
	Dec	RMB deposits in SG and HK: RMB 195bn - SG; RMB 860bn - HK		Total quota granted under the QFII program reached landmark volume: USD 49.7bn		Total RMB assets in four major centres (HK, SG, TW, LDN) reached landmark volume: RMB 1.88tn SGX and HKEx agreed to cooperate in RMB business

APPENDIX B
TIMELINE OF MAJOR DEVELOPMENTS

Year	Month	Deposit		Offshore RMB Bonds		QFII/RQFII	Introduction of Swap Lines	Others
2014	Jan			Dim-sum bond issued by Bank of China in UK, which is the biggest dim-sum bond to date issued in London	RMB 2.5bn			
	Feb	RMB deposits in HK and TW	RMB 920bn - HK; RMB 247bn - TW	Total outstanding dim-sum bond and CDs have reached landmark volume	RMB 634bn	CSOP launches first RQFII Treasury Bond ETF in Hong Kong		Singapore and UK agreed to establish a private sector led forum to boost development of RMB market

APPENDIX B
TIMELINE OF MAJOR DEVELOPMENTS

Year	Month	Deposit	Offshore RMB Bonds	QFII/RQFII	Introduction of Swap Lines	Others
2014	Mar		Offshore RMB bonds and CDs sold in the quarter ended March reaches the highest quarterly level on record RMB 193bn	First balanced RQFII fund launched in Hong Kong RQFII quota granted to Paris RMB 80bn Total approved quota for RQFII program reached landmark volume RMB 200.5bn		The PBOC has doubled the width of the daily trading band for onshore trading of RMB from +/- 1% to +/- 2% SGX announced that it would introduce new Asian currency futures (including RMB futures)
	Apr					CSRC and SFC jointly introduce Shanghai-Hong Kong Sotck Connect pilot programme
Ongoing				RQFII quota for Taiwan is under ongoing discussion		Negotiation of cross-straits (China and TW) services pact

Appendix C – Table of Acronyms

A

ABC – Agricultural Bank of China
ADB - Asian Development Bank
ADTV - Average Daily Trading Volume
ASEAN - The Association of Southeast Asian Nations
AUD - Australian Dollar

B

BOC - Bank of China
BOE - Bank of England
BIS - Bank of International Settlements
BSA - Bilateral Swap Agreement

C

CAD - Canadian Dollar
CAGR - Compound Annual Growth Rate
CB - Convertible Bond
CBC - Central Bank of China
CCB - China Construction Bank
CD - Certificate of Deposit
CEIC - CEIC Data Company
CGB - Central Government Bond
CHATS - Clearing House Automated Transfer System
CIPS - China International Payment System
CMU - Central Moneymarkets Unit
CNAPS - China National Advanced Payment System
CNH - Offshore RMB
CNY - Onshore RMB
COFER - Composition of Foreign Exchange Reserves
CoL - City of London
CSDCC - China Securities Depositary and Clearing Corporation
CSRC - China Securities Regulatory Commission
CSSF - Commission de Surveillance du Secteur Financier (Luxembourg Commission for the Supervision of the Financial Sector)
CSSO - Clearing and Settlement Systems Ordinance

D

DBU – Domestic Banking Unit
DVP - Delivery Versus Payment

E

ECB - European Central Bank
EIA - U.S. Energy Information Administration
EMEA - Europe, the Middle East and Africa
ETF - Exchange Traded Fund
EUR – Euro

F
FDI - Foreign Direct Investment
FI - Foreign Institution
FR - Federal Reserve
FSC - Financial Supervisory Commission
FTZ - Free Trade Zone
FX - Foreign Exchange

G
GBP - British Pound
GCC - Gulf Cooperation Council
GDP - Gross Domestic Product

H
HIBOR - Hong Kong Inter-bank Offered Rate
HK - Hong Kong
HKEx - Hong Kong Exchange
HKICL - Hong Kong Interbank Clearing Limited
HKMA - Hong Kong Monetary Authority
HKSCC - Hong Kong Securities Clearing Company Limited
HM Treasury - Her Majesty's Treasury (UK government's finance ministry)

I
ICBC - Industrial and Commercial Bank of China
ICSD – International Central Securities Depositories
IFC - International Finance Corporation
IEO - International Energy Outlook
IMF - International Monetary Fund
IMS - International Monetary System
IOSCO - International Organisation of Securities Commissions
IPO - Initial Public Offering

J
JPY - Japanese Yen

L
LNG - Liquefied Natural Gas
LSE - London Stock Exchange

M
MAS - Monetary Authority of Singapore
MENA - Middle East and North Africa
MNC - Multinational Corporation
MOF - Ministry of Finance
MOU - Memorandum of Understanding
MYR - Malaysian Ringgit

N
NDF - Non-Deliverable Forward
NDRC - National Development and Reform Commission
NZD - New Zealand Dollar

O
OBU - Offshore Banking Units
ODI - Outward Direct Investment
OTC - Over-the-counter

P
PBOC - People's Bank of China
PRC - Peoples' Republic of China
PvP - Payment-vs-Payment

Q
QDII - Qualified Domestic Institutional Investor
QFII - Qualified Foreign Institutional Investor

R
RMB - Renminbi
RQFII - RMB Qualified Foreign Institutional Investor
RQDII - RMB Qualified Domestic Institutional Investor
RTC - Real Time Clock
RTGS - Real-Time Gross Settlement

S
SAFE - State Administration of Foreign Exchange
SCB - Standard Chartered Bank
SDR - Special Drawing Rights
SEHK - Hong Kong Stock Exchange
SG - Singapore
SGC – Surveillance and Governance Committee
SGD - Singapore Dollar
SGX – Singapore Exchange
SHIBOR - Shanghai Interbank Offered Rate
SME - Small and Medium Enterprise
SOE - State Owned Enterprise
SSE - Shanghai Stock Exchange
SWF - Sovereign Wealth Fund
SZSE - Shenzhen Stock Exchange

T
TDCC – Taiwan Depository & Clearing Corporation
TMA – Treasury Markets Association
TW – Taiwan

U
UCITS - Undertakings for Collective Investment in Transferable Securities
USD - US Dollar
USDA - United States Department of Agriculture

W
WTO - World Trade Organization

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