



Insights | Corporate Clients

Navigating the New Renminbi Landscape: A Risk Management Perspective

With the People's Bank of China (PBOC) changing the reference rate for the Renminbi (RMB) on August 11, a move which has devalued the currency, the RMB has moved back to center stage. Many treasurers are now reviewing how best to manage the ever evolving dynamics with China and the RMB by ensuring that they have the right practices and processes in place to manage the changes.

From a risk management perspective, the unexpected change further illustrates why companies should embark on the RMB internationalization journey now and integrate China into their regional and global practices.

In this article, we take a look at the key considerations that treasurers should critically review to ensure sustainable structures and processes are in place to strategically manage dynamic changes in the regulatory landscape.

RMB as Treasury Settlement Currency

Over the years, China has continued to ease cross-border currency controls such as allowing cross-border intercompany loans out of China in 2012 and, into China in 2015. Pilot free trade zones in Shanghai, Guangzhou, Tianjin have also continued to fuel usage of the RMB for treasury settlement.

A year-on-year comparison of RMB flows from Citi's clients shows a 150% increase in usage of RMB as a treasury settlement currency. Having these pipes in place is imperative as a risk management tool, whether to manage down the continued build-up of cash in China or to ensure that there are efficient means to fund working capital as and when the need arises. In addition, as intercompany loans conducted via this channel is outside of the foreign debt quota, companies are presented with an additional means of funding into China.

Considerations that companies should take into account when implementing these intercompany structures include:

- **Efficiently managing intercompany loan limits in line with regulatory controls**

While cross-border controls have been relaxed, they are not completely removed and thus

limits will apply. For example, the movement of cash back to China will be capped to the loan amount out of China. As automated structures are in place, an efficient control function is required to avoid regulatory breaches.

- **Deciding on a suitable arms-length transfer price**

There are several benchmarks to choose from, particularly with the existence of the onshore CNY interest benchmarks and the offshore CNY (CNH) interest rate curves. Citi has observed that more companies have selected the offshore CNY benchmark due to the transparency and rates driven by market forces. Before implementation, we recommend seeking tax advice in selecting a suitable benchmark, as this view may now be different in consideration of the volatility seen in the past few weeks.

- **Flexibility of funding versus full efficiency**

A bank like Citi can assist a company to structure a fully automated liquidity and treasury structure integrating both the regional/global pool with China domestic entrustment structures, whilst applying systemic controls to manage regulatory controls. This takes over the complexities of managing ongoing regulatory risks. However, aside from regulatory risks, a company needs to consider various factors to determine if a fully efficient structure should be applied. This includes:

- **Type of operating business in China:** Excess cash in China creates currency exposure, and presents incremental risks as the currency devaluation in August 2015 has shown. As an example, an export company may choose to leave minimal cash positions in China opting for a fully efficient model.
- **Funding sources:** With differing yield curves between the onshore and offshore CNY markets as well as USD funding sources, many treasurers have opted to maintain flexibility by delinking their domestic and cross-border pools, enabling treasury decisions to be made on the most optimal funding source.
- **Regulatory framework:** Where companies have implemented a RMB cross-border pooling structure (i.e. where intercompany lending and borrowing may take place with a Chinese incorporated entity), the free trade zone (FTZ) guidelines stipulate that only self-owned funds may be used for funding into China. Therefore, it is imperative to maintain the integrity of the structure accordingly, which may not be conducive for a fully efficient structure.

RMB as Trade Settlement Currency

The monthly average flow of RMB denominated trade settlement rose from nearly zero in 2009 to close to RMB600 billion by June 2015¹. In addition, Citi has observed that since the broader relaxation of cross-border controls on capital and treasury settlement in 2014, over 25% of Citi's trade settlement with China can be attributed to capital flows, which is double the growth on a year-on-year basis. Citi sees the growth in capital flows as a catalyst for large multinational companies in using the RMB as a trade and treasury settlement currency as this creates a natural hedge, effectively reducing foreign exchange exposures.

In evaluating the switch to use RMB for trade settlement, companies should be aware of the nuances with the current clearing and settlement model which includes:

- **Multiple clearing centers**

We have seen the evolution of a fragmented clearing model in the offshore markets with the presence of multiple clearing banks and centers. For a company, this may involve a single transaction crossing multiple time zones and cut off times and therefore having to account for a transaction not being cleared on the expected value date. The introduction of the Cross-Border Interbank Payment System (CIPS), which is expected to be implemented shortly will act to streamline the multiple clearing centers and present less settlement risks.

- **Payment information required, higher rate of reject**

To allow for streamlined processing in Mainland China, companies are encouraged to provide further payment details (including CNAPS Bank Code, purpose of payment, specific formatting of a payment

message) for a RMB versus USD payment to China. This creates a necessity for corporates to review how the additional requirements can be factored into global streamlined account payable processes. In addition, with the higher risk of payments being rejected (due to insufficient information presented), companies will have to ensure sufficient implementation resources are assigned upfront.

- **Earlier access to funding**

Citi offers an electronic paperless solution in China which streamlines the documentation process and therefore, unlike USD incoming receipts in Mainland China, RMB funds can be accessed upfront, thus enabling improved cash forecasting. Taking into account the difference in timing, companies are recommended to ensure they have structures in place to manage the cash positions on a timely basis.

Location. Location. Location.

With the creation of multiple RMB clearing centers, many companies often struggle with the decision on where best to open their RMB or offshore CNY account. We suggest that treasurers base their decision making on the same criteria as any other currency - i.e. looking at the most suitable payment cut off time; ability to allow for integration with existing regional and/or global notional pooling structures for optimal cash efficiency; and corporate policies for currency accounts.

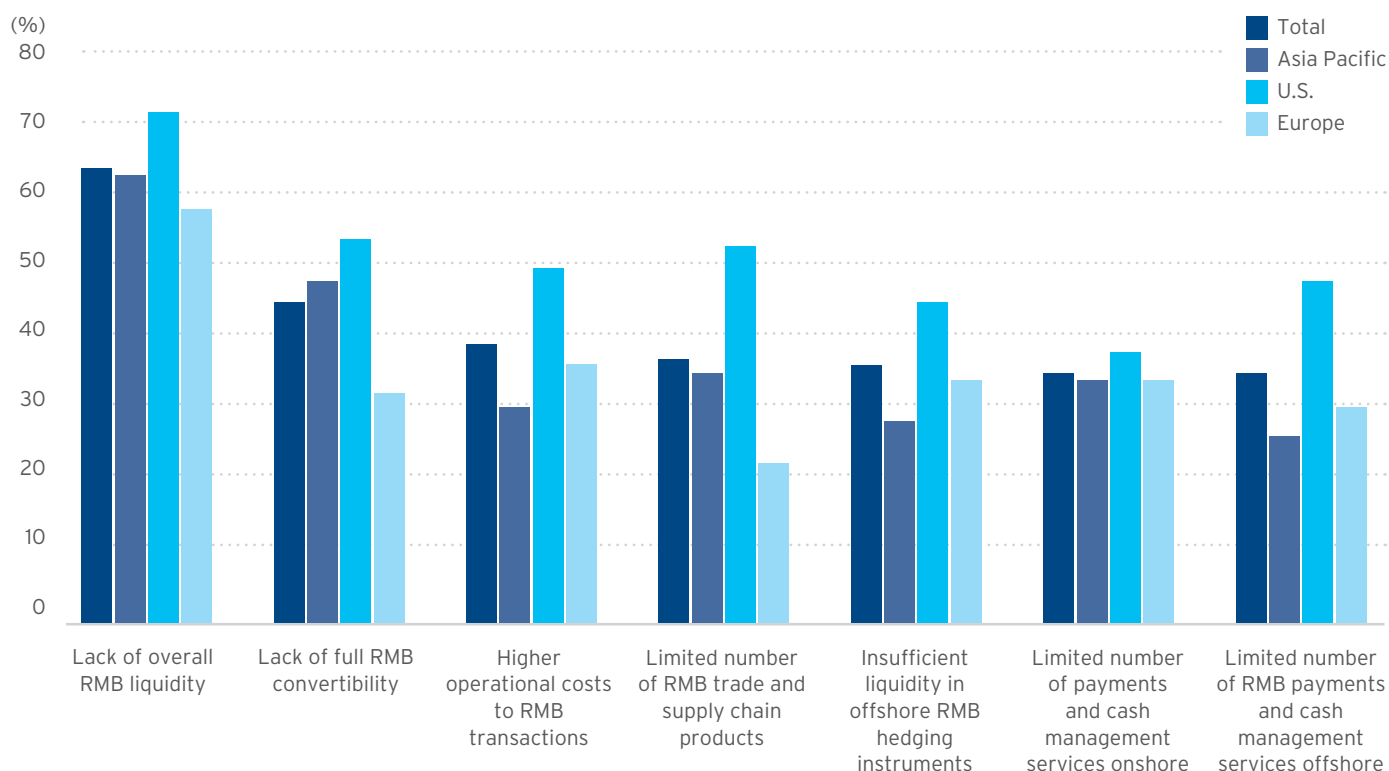
As the onshore and offshore CNY markets are still relatively distinct, in a survey commissioned by Allen & Overy, and carried out by the Economist Intelligence Unit², the overall lack of RMB liquidity is revealed as the greatest obstacle to further growth of RMB in cross-border transactions.

¹ Reuters CNH Tracker, August 13, 2015

² Economist Intelligence Unit, Generation ¥ - RMB: The New Global Currency, April 22, 2015

Liquidity Preference

Greatest liquidity/operational obstacles to usage of RMB in cross-border transactions (% respondents rating issue as "very important" or "important")



Source: Economist Intelligence Unit, Generation ¥ - RMB: The New Global Currency, April 22, 2015

Therefore, as treasurers consider the use of RMB as a treasury and/or trade settlement currency, there should also be a further review of how transactions may be settled due to the limited availability of short term, urgent liquidity in the offshore CNY market. This means that large valued transactions generally have to be pre-funded or pre-advice requested, adding to operational inefficiencies.

China is one of the top 3 markets globally for Citi's clients - and continued liberalization of the RMB creates strategic opportunities for multinational companies to adopt the currency for trade, treasury and investment on a global basis. While the dynamic changes are creating new risk management challenges for treasurers, our experience working with clients show that current and emerging risks can be effectively managed by having integrated regional/global processes and structures in place.

China is one of the top 3 markets globally for Citi's clients - and continued liberalization of the RMB creates strategic opportunities for multinational companies to adopt the currency for trade, treasury and investment on a global basis.



Ann Lin Khoo
 Head, Global RMB Solutions
 Treasury and Trade Solutions, Citi

Disclaimer

Statements and opinions expressed are those of the author. This communication is intended for reference only and is neither an offer to sell nor the solicitation of an offer to enter into a transaction with Citi. Nothing contained herein constitutes Citi's opinion. Although the information contained herein is believed to be reliable, Citi makes no representation as to the accuracy or completeness of any information contained herein or provided otherwise. The ultimate decision to proceed with any related transaction rests solely with you. Citi is not acting as your advisor or agent.

This Industry Insight and its contents are proprietary information and assets of Citi and may not be reproduced or otherwise disseminated in whole or in part without our written consent.

Treasury and Trade Solutions
citi.com/tts

© 2015 Citibank, N.A. All rights reserved. Citi and Arc Design is a registered service mark of Citigroup Inc.
CTA4505 September 2015

