



New Opportunities for Onshore and Offshore RMB Liquidity Management

For Corporate Clients



INDUSTRY INSIGHT

“The new regulation now allows any company incorporated in China to manage their foreign currency balances centrally by making use of multilateral entrustment loans and overnight overdraft facilities.”

While the global economic crisis had repercussions in every country, China was one of the few countries that did not experience recession; indeed, although economic growth slowed between 2007-2009 from 13% in 2007 to 8.7% in 2009, this compares with 2007 growth in the United States of 2.1% and a decline of 2.4% in 2009 (CIA World Factbook). Following the recession in western economies and the prospect of a slow recovery, the trading and investment communities recognize that China will be pivotal to future growth, resulting in increasing international investment and trade flows into China.

Larger numbers of multinational corporations (MNCs) are setting up treasury centers on the Chinese mainland and more Chinese companies are leveraging their lower cost base and strong liquidity to expand overseas. The challenges for Chinese and foreign MNCs have included restrictions on cross-border RMB trading and foreign currency liquidity management, particularly the issue of ‘trapped’ cash; however, as the regulatory environment in China is liberalized, there is greater flexibility for managing domestic and foreign currency financial activities in China, a trend that we expect to continue as RMB takes its place as a global currency.

Opportunities for onshore liquidity management

In 2009, a new regulation was enacted that increases the availability of multilateral foreign currency entrustment loan cash pooling structures. Previously, under 2004 legislation, although one-off, bilateral foreign currency entrustment loans were feasible for both Chinese and subsidiaries of foreign companies, multilateral cash pooling structures could only be established by MNCs with a holding company or qualified regional/global headquarters in China.

Under the traditional bilateral RMB or foreign currency entrustment loan structure, a bank acts as an intermediary between the lending/borrowing parties in order to meet regulatory restrictions on intercompany lending. Entities with surplus funds place cash on deposit with the bank, and request that the bank lends the funds to a designated company and specifies the terms of the loan. Under a multilateral arrangement, this structure can be expanded to multiple entities, with multiple entrusted loans covered under a single legal agreement and reducing the administrative overheads. Using this structure, foreign currency cash concentration or pooling can be achieved by sweeping

“Since implementing the new structure, Honeywell China has experienced considerable benefits such as higher investment returns, lower local borrowings and better control and visibility of cash.”

positive and negative balances to a header account by concentrating balances at the end of each business day to determine the group cash position, and then sweeping back to the respective accounts at the start of the following day.

Under the latest legislation, the approval for multilateral entrustment loan cash pooling structures has been delegated to local SAFE offices. Until recently, regulatory approval for cash management structures was centralized through the Beijing head office of the State Administration for Foreign Exchange (SAFE). This will significantly reduce the approval time from 4-5 months to 1-2 months. The agent bank will continue to be responsible for the structural design, approval and reporting for multilateral entrustment loan cash pooling structures.

Case study: Honeywell China

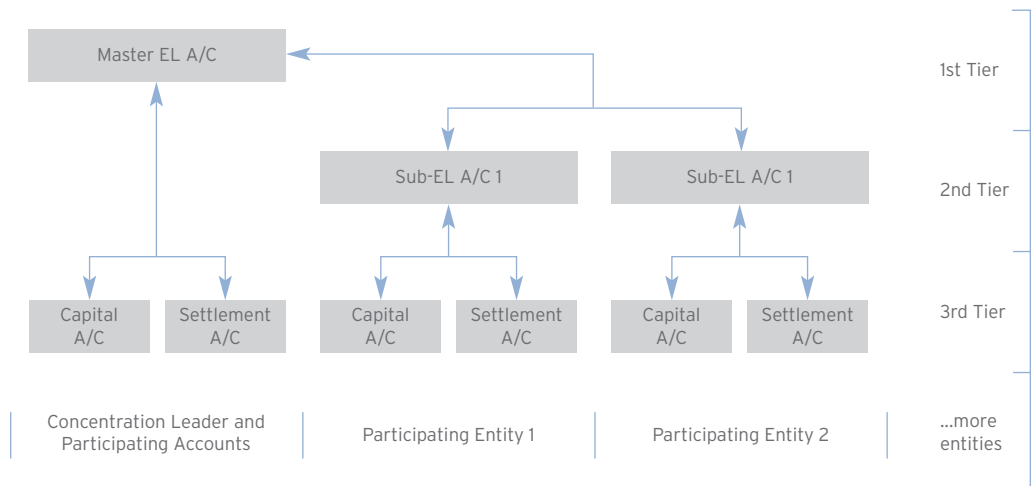
An example of a company that has successfully implemented the new structure is Honeywell China. Headquartered in New Jersey, United States, Honeywell International is a Fortune-100 diversified technology and manufacturing leader. Honeywell’s activities in China date back to 1935 and Honeywell (China) Co., Ltd (Honeywell China) now has more than 30 legal entities across China.

Following a period of substantial growth, Honeywell China has seen a significant increase in its group cash balances, with 65% denominated in RMB and 35% in USD. The USD cash balances were highly decentralized, with balances being held in various bank accounts with different banks. The situation made it difficult to obtain cash visibility as well as the control that the company needed from the treasury perspective.

This decentralization resulted largely from the regulatory constraints on foreign currency bank accounts in China. Using bilateral entrustment loans to manage company cash was ruled out as a viable option as it was considered too cumbersome. Consequently, Honeywell was seeking a suitable USD cash pooling arrangement to concentrate the company’s cash balances in China, reduce external funding costs and streamline bank relationships. However, as USD cash pools are a relatively new product in China, there were no suitable existing structures in place that Honeywell China could replicate.

Citi proposed a solution that represented the first cash pool structure of this kind to be seen in China, based on a three-tier automated zero-balancing account entrustment loan structure. Participants’ operating accounts form the lowest tier, loan accounts in the second tier and the pool header account in the highest tier. This structure ensures that there is no commingling of funds and simplifies interest allocation. SAFE approval was granted in August 2009, and implementation was completed two months later. The speed and success of the implementation was greatly assisted by Honeywell China treasury’s efforts to involve all stakeholders from the beginning.

Foreign Currency Entrustment Loan (EL) Cash Pool Structure



“Looking ahead, we are likely to see RMB being gradually and steadily aligned further with international currencies, leading to greater opportunities for liquidity optimization, tradability and the ability to integrate financial activities in China as part of broader, regional initiatives.”

Internationalization of the RMB

The continuing relaxation of liquidity rules in China is just one indication of the Chinese government's intention to promote the RMB as a global currency. The ability for all companies in China to operate onshore foreign currency cash pooling impacts considerably on both onshore and offshore liquidity management solutions, and reduces the trapped liquidity that has posed such a challenge in the past. However, this is just one of a series of changes that are also milestones in the gradual progress towards liberalization of the RMB. One example is the delegation of responsibility for regulation of the RMB. In the past, this was the sole responsibility of SAFE; however, this has now been decentralized to provincial People's Bank of China (PBOC) offices and tax bureaus in 20 approved cities, leading to reduced approval times, greater responsiveness and communication.

Subject to local laws and regulations, offshore RMB financing is now permitted and offshore RMB deposits can be used as collateral against any other credit facilities. This increases companies' financial flexibility and enhances liquidity management. Offshore foreign exchange conversion is also now freely permitted, subject to foreign exchange caps allocated to onshore clearing bank agents. These caps are aimed at limiting the size of the offshore market, so that growth can be controlled, but there are no limitations on offshore activity.

Offshore RMB transferability, which was strictly prohibited in the past, is now allowed for the settlement of all goods and services in any country that permits foreign currency transactions. This is only open to Mainland Designated Enterprises (MDEs) but there is no restriction on offshore companies holding RMB accounts. The definition of 'services' is very wide, and includes logistic fees, outsourcing fees, and/or consulting fees.

Leveraging the opportunity

With the relaxation of liquidity rules, together with RMB international trade initiatives, such as the cross-border RMB goods and services settlement scheme, major banks in China are rapidly expanding their suite of products and services to enable both Chinese and foreign MNCs to leverage these new opportunities. For example, banks such as Citi are supporting the liquidity management needs of their customers in ASEAN, Hong Kong and Macau by offering RMB-based account services including overdrafts, credit interest enhancement for offshore deposits, fixed deposits, domestic and cross border target balancing, and single and multi-currency notional pooling. In addition, clients are able to benefit from broader transaction banking services such as funds transfer, foreign exchange, trade finance and supply chain financing. Citi is continuing to work closely with the regulators to provide input, identify and leverage these opportunities as they arise.

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