Early July 2009, the Administrative Rules on Pilot Program of Renminbi Settlement of Cross-border of Trade Transactions ("Rules") was jointly promulgated by the People’s Bank of China (PBC), the Ministry of Finance (MOF), the Ministry of Commerce (MOC), the General Administration of Customs (GAC), the State Administration of Tax (SAT), and the China Bank Regulatory Commission (CBRC), which marked the formal implementation of the pilot scheme of RMB settlement of cross-border trade transactions.

The Rules listed Shanghai, Guangzhou, Shenzhen, Zhuhai, and Dongguan as the first pilot cities, and Hong Kong, Macao and ASEAN countries for the first batch of overseas pilot regions. According to the Rules, HK and Macao enterprises may choose RMB clearing in trading with enterprises of Shanghai, Guangzhou, Shenzhen, Dongguan and Zhuhai, and qualified domestic commercial banks can provide the pilot enterprises with RMB clearing of cross-border trading, while providing RMB trade financing for overseas enterprises when conditions allow. In the meantime of carrying out pilot practice of RMB settlement of trade in said regions, relevant authorities are contemplating on the pilot program on RMB clearing in the trades between Yunnan and Guangxi regions with Southeastern countries.

Concept

RMB settlement of cross-border trade transactions refers to the practice of clearing in renminbi currency the transactions carried out between domestic and overseas enterprises. The practice was not allowed before the Rules. On April 8 2009, the State Council decided on the pilot scheme of RMB clearing of cross-border transactions in five cities, however, the administrative rules was not issued until July, which marked the formal launch of the pilot program. The expansion of RMB use shall further facilitate the global role of the RMB currency.

However, not all enterprises in the five pilot cities can benefit from the program. According to the Rules, pilot enterprises shall be recommended by the local government and then be subject to the verification and authorization of the Central Bank in joint work with relevant authorities, which will aim for inclusion of enterprises enjoying profound experiences in international trade settlement, good performance in compliance with relevant financial & tax, commercial and foreign exchange administration rules and regulations, and boasting reliable corporate credit. Pilot enterprises shall be required on authenticity of the trades settled with RMB, accuracy of records on customs declaration of exports & imports and information of RMB income and payment.

Meantime, in a bid to satisfy their demands, pilot enterprises may deposit their RMB income from exports at overseas banks while, however, filing with local branches of the PBC through their domestic clearing banks. In case the pilot enterprise fails to transfer its RMB income to domestic banks within 210 days after exporting, it shall within 5 work days report to the RMB cross-border income & payment information administration system information of the amount of the income remaining overseas, and the code corresponding to the customs declaration for the exporting through, and meantime provide related data and information to, its domestic clearing bank. Pilot enterprises each shall assign one domestic clearing bank for the main reporting banks for their RMB settlement of cross-border transactions.
whereby the main reporting banks shall bear the duty of bringing to their attention of obligations on reporting and filing of related data and information.

Export trades cleared in RMB currency shall apply the exported goods tax rebate (exemption) policies. Pilot enterprises are not required to provide the foreign exchange control declaration on making customs declaration and applying for exported goods tax rebate (exemption) on RMB cleared cross-border trades. Tax administrative authorities under the State Council shall work out administrative rules on export rebate (exemption). Pilot enterprises breaching any state rules related shall be punished by law, and may have their qualification of pilot enterprises revoked for any material fault. Information of pilot enterprises in breach of laws and rules concerning RMB settlement of cross-border transactions shall be recorded in the cross-border RMB income and payment information administration system established and shared by relevant departments and basic enterprise credit information database of the PBC.

RMB clearing of cross-border trades is provided with two approaches. One is the approach for the trans-border RMB fund clearing and settlement through RMB business settling banks in Hong Kong and Macao, and the other is one which means domestic commercial banks may act as agents for overseas commercial banks in the cross-border clearing and settlement of RMB accounts.

As for the RMB currency cross-border clearing and settlement in Hong Kong and Macao, commercial banks having joined in the large sum payment system established by the PBC and having handled the business of RMB settlement in Hong Kong and Macao shall serve as RMB settling banks at Hong Kong and Macao without authorization of the PBC, the Hong Kong Monetary Authority and Monetary Authority of Macao. Currently, the RMB clearing bank at Hong Kong is Bank of China (HK) Ltd., and that in Macao is Bank of China (Macao) Ltd.

**Impact**

Pilot implementation of the RMB clearing of cross-border transactions indicates the further opening of China's financial markets. However, without full opening of capital items, it's still a long way to the globalization of the RMB currency. The pilot work shall first aim for the objective of making RMB a major clearing currency in the trades with counterparts in regional neighbors and bordering countries.

A direct impact of the RMB clearing of cross-border trading shall be the substantial alleviation of the risks of exchange rate on the enterprises. RMB given an equal position to foreign currencies, pilot enterprises shall benefit a lot, the biggest benefit being the avoidance of risk imposed by exchange rate fluctuation. When priced with the currencies of United States (USD), Europe (Euro), or others, exporter and importer enterprises faced considerable risk from fluctuating exchange rates, and were exposed to tremendous losses. With implementation of the new program, exchange rate fluctuation of USD and Euro currencies can be effectively avoided, and more conveniences shall be enjoyed in the exports and imports. Before the pilot practice, domestic enterprises for foreign currency clearing have to purchase foreign exchange on import while settling such on exporting, and bear full exchange rate risks on themselves. In the shadow of the financial crisis, major international settlement currencies such as USD and Euro were prone to significant exchange rate fluctuations, and enterprises of China as well as the neighboring countries and regions are exposed to considerable risks of exchange rate fluctuation when settling trade transactions with a third-country currency. With enhanced and accelerated growth of the trade, investment and civil exchange of China with the ASEAN countries, and those between China Mainland and Hong Kong and Macao countries, the RMB settlement practice is earnestly cried for in the civil business society.

Settlement in RMB can reduce the risks imposed to the exporters by exchange rate fluctuation, and meantime cuts down their costs spent on foreign exchange sale and purchase. At present, banks grant large business considerable discounts in their exchange sale and purchase, however, small-size firms have to bear fundamentally equal costs with the individuals on such, namely, 3%. If calculated on the preferential rate of 2‰, for exchange cost, the costs saved could amount to USD1.6 billion only taking account of the settlement scale of over USD800 billion carried out by Bank of China Shanghai Branch in year 2008.

Furthermore, with such practice, Hong Kong enterprises can have legitimate channels of RMB exchange, and no longer rely on illegal private banks, thus protected in safeguarded allocation of funds and benefited in the smooth development of domestic markets. In this pilot campaign, Hong Kong, for its gigantic volume of trading with Mainland counterparts surpassing HKD 1,300 billion annual, shall be the most benefited region. With Hong Kong banks following suits in opening the services for RMB settlement in cross-border trades, their clients shall extend to business enterprises, when the RMB based business of Hong Kong banks shall rise to a new stage.

As trade transactions normally settled
in foreign currencies, RMB clearing at five pilot cities shall increase RMB currency demands. In a long run, it will impose some pressure in the appreciation of RMB, however, the initial phase is believed to be on a considerably small scale since it’s only in practice in five pilot regions. On the beginning stage of implementation, there might be the situation that, due to varied levels of preparation work, there might be some banks which in the pilot cities are unable to open RMB settlement services immediately after the Rules. That may affect the scale of RMB settlement. Meantime, however, along with the increase flows of RMB overseas, it shall raise a new challenge to the regulatory authorities how to safeguard the stable and orderly cross-border flows of RMB currency, when coordination of related departments including the customs, tax authorities, foreign exchange administration and other authorities shall prove to be vital in the success of the pilot scheme. Furthermore, unless the Chinese trader enterprises acquired strong price negotiating abilities, the willfulness of foreign counterparts in RMB settlement and the market demands for such settlement shall have direct impacts over the effects of RMB clearing.

**Progress**

Validity of the Rules promised the prompt outcome of the first transaction which is settlement in RMB currency. Guangdong has finalized a list of 300 business enterprises for the pilot scheme, which cover trade, manufacturing and sales fields, and among which 100 have their business established in Guangzhou while about 100 from Shenzhen. Majority of the 100 pilot enterprises chosen in Shanghai have made due reserves for RMB settlement and related arrangements for the implementation of scheme and capital allocation. The first transaction thus settled shall be made by a Shanghai, and a Hong Kong enterprise, which, basing on the demands of the enterprises, might be a remittance transaction and concern the cross-border flows of funds.

The largest market sharer in foreign exchange and trading finance business, Bank of China (BOC) is expected to be awarded the first RMB settlement of cross-border trade transaction. BOC has taken lead signing with its overseas agent banks agent agreement on RMB clearing, among which are Agreement on RMB Clearing and Settlement of Trade Transactions signed with Bank of China HK Ltd. and the Hongkong & Shanghai Banking Corporation (HSBC). BOC thus becomes the first bank signing agreements with overseas agent banks on RMB clearing and settlement of cross-border trade transactions, and has already opened agent services for the said two banks in the cross-border trading RMB clearing and settlement.

In this background, the Central Bank of China and Hong Kong Monetary Authority have concluded their agreement on regulatory work and mutual supports in respective scopes of power over Hong Kong banks in handling RMB trading settlement services, which means Hong Kong is expected to be a first station on the way of RMB settlement of cross-border trades. Hong Kong enterprises shall be the most active group of participants in the cross-border RMB settlement practice, and that would bring new incentives and dynamics to the growth of Hong Kong’s financial industry. Currently, Hong Kong is already the region besides Mainland boasting most extensive RMB circulation and business undertaking and, basing on solid foundation of RMB business, Hong Kong is promised to be one of the major international financial centers to be listed for further pilot practice of RMB settlement of cross-border trade transactions.

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Odin Professional Services Company Ltd. (OPS) are specialists in educational and consulting services related to import/export and Customs clearance practice, for China operations of HK-based multinational companies. Odin has had collaborations since 2001 with trade organisations like the HKSC, CMA, HKPC, and also the City University of Hong Kong. OPS trains staff and assists major enterprises in improving or revamping their import/export logistics.