Research on RMB Settlement Mode of Cross-border Trade in the Guangdong-Hong Kong-Macao Greater Bay Area

He-Xiang PENG
Guangdong University of Finance and Economics, Guangdong, China
461114163@qq.com

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Abstract. On the background of the gradual maturity of the Guangdong-Hong Kong-Macao Greater Bay Area and the continuous development of cross-border trade RMB settlement, China has gradually developed into four types of cross-border trade RMB settlement methods mainly with clearing Banks. This paper compares the cross-border trade settlement modes in the Guangdong-Hong Kong-Macao Greater Bay Area, and puts forward three Suggestions on the actual operation, foreign exchange risk and supervision of the current cross-border RMB settlements. And then the paper proposes three suggestions, firstly some suggestions of settlement within a multinational corporation, secondly improvement of RMB settlement of cross-border trade, and finally improvement of strengthening authenticity audit of trade.

Introduction

In July 2017, the promulgation of the Deepening Guangdong-Hong Kong-Macao Cooperation and Promoting the Construction of the Greater Bay Area Framework Agreement marked the gradual maturity of the Guangdong-Hong Kong-Macao Greater Bay Area. Dong and Zhang (2013) focus on the Hong Kong market. From the perspective of the offshore RMB bond market, the cross-border trade RMB settlement business has a positive correlation with the offshore RMB financial market in Hong Kong, namely the development of cross-border trade RMB settlement business affects the Hong Kong's offshore RMB financial market, and Hong Kong's offshore RMB financial market will in turn promote cross-border trade RMB settlement [1]. In 2016, the import and export trade volume among Guangdong Province and Hong Kong and Macao reached US$185.682 billion and US$2.059 billion respectively. There is a huge demand for RMB cross-border trade settlement. In April 2009, the State Council decided to establish a pilot program for cross-border trade settlement in Guangzhou, Shanghai, Shenzhen and Zhuhai. With the continuous development of RMB cross-border trade settlement, China's cross-border trade RMB settlement method has gradually developed into four categories. On October 8, 2015, the RMB cross-border payment system CIPS (Phase I) was successfully launched. On May 2, 2018, the RMB cross-border payment system CIPS (Phase II) was put into operation. The continuous improvement of RMB cross-border payment system shows that RMB is moving forward on the road of internationalization. The successful launch of the RMB cross-border payment system CIPS has also broadened the way for RMB settlement of cross-border trade in Guangdong, Hong Kong and Macao. The use of RMB as a trade settlement currency in the Guangdong-Hong Kong-Macao greater bay area will increase transaction efficiency and reduce transaction costs. In this context, this paper compares the cross-border trade settlement models of RMB in Guangdong, Hong Kong and Macau, and analyzes the problems and provides some reasonable suggestions.

Four Settlement Modes of Cross-Border Trade RMB in the Guangdong-Hong Kong-Macao Greater Bay Area

Nowadays, banks mainly carry out the settlement of RMB funds in cross-border trade through four modes: agency bank, clearing bank, non-resident account (NRA) and cross-border Inter bank
Payment System (CIPS). The financial sector of Hong Kong and Macao, due to the national policy of "One Country, Two Systems", are still belong to the outside areas. The Guangdong-Hong Kong-Macao greater bay area spans the mainland and Hong Kong-Macao regions, and the settlement of RMB in cross-border trade also follows the above four modes.

**Agency Mode**

The agent bank model selects qualified domestic clearing banks and agent banks for overseas participating banks. The overseas commercial bank can open a clearing account, which is RMB inter-bank current account, in a domestic bank which has international settlement ability and can conduct international settlement independently. When cross-border capital of overseas banks uses clearing agent mode, overseas participating banks system transfer funds receipt and payment information via SWIFT system to the agent bank in China. And then the agent bank in China transfer funds by the CNAPS system or the internal clearing system. At the same time, the accountant of the domestic bank registers RMB inter-bank current account, and completes the capital settlement with overseas participating banks. In addition, for RMB inter-bank current account opened by overseas participating Banks in domestic correspondent Banks, domestic correspondent Banks will require them to set the foundation capital. At the same time, within the limit prescribed by the people's bank of China, domestic correspondent Banks shall provide overseas Banks with capital exchange service of laying the foundation. Domestic correspondent Banks are also able to provide short-term RMB account financing to participating foreign banks that have RMB inter-bank current accounts, to meet the temporary demand for their account positions.

**Clearing Bank Mode**

On the clearing bank mode the capital settlement of participating banks in China and overseas go through the bank of China Hong Kong and Macau. When domestic and foreign commercial Banks do not have international settlement capacity but want to complete RMB settlement, they have to get approval by the people's bank of China and the Hong Kong and Macao monetary authorities. And the participating Banks of Hong Kong and Macao shall open RMB clearing accounts at the Shenzhen central sub-branch and Zhuhai central sub-branch of the People's Bank of China. Clearing bank, that is the bank of China Hong Kong and bank of China Macau, transmits clearing information through the people's bank of China's inter-bank payment system to domestic Banks. Finally, the capital settlement of foreign banks goes through the Hong Kong real time full payment system (RTGS) and other systems to domestic banks. Among them, the bank of China Hong Kong and Macau can not only enter the inter-bank foreign exchange market to conduct RMB flat trading, but also can open and unpack funds through the national interbank lending market. So more and more clearing banks of Guangdong province chooses the clearing bank mode.

**Non-Resident Account (NRA) Mode**

In the mode of non-resident account (NRA), overseas enterprises open current deposit settlement accounts of non-resident RMB in domestic banks and conduct cross-border clearing and settlement of RMB funds through CNAPS and other systems. After being approved by the local branch of the people's bank of China, an overseas enterprise may open a non-resident RMB settlement account in a domestic bank. However, the non-resident account is a domestic current account and non-resident enterprises conform to the domestic tax policy and shall pay tax according to the domestic tax policy. In addition, foreign enterprises are not allowed to convert the funds in their accounts into foreign currencies for use in addition to the relevant rules. These limitations make it not have obvious advantages than other modes. So less and less enterprises use this mode in actual operation.

**RMB Cross-Border Payment System**

RMB cross-border payment system (CIPS) is an important financial infrastructure in China, providing capital clearing and settlement services for RMB cross-border and offshore business of domestic and foreign financial institutions. CIPS system introduces direct participants of financial market infrastructure to clarify the access conditions of different types of participants. Direct
participants can conduct RMB cross-border payment business directly through CIPS system, while indirect participants need to conduct business through direct participants. In the early stage of CIPS, when there is no direct overseas participant, the fund custodian bank is required to conduct RMB settlement business for overseas institutions. In the integration of relevant systems of domestic cross-border payment business, CIPS can support RMB payment, payment settlement (DvP) settlement, simultaneous RMB to foreign currency settlement (PvP), central counterparty centralized clearing and other cross-border RMB transaction settlement businesses according to the capital settlement needs of different financial transactions. On the basis of the real-time full settlement mode, a fixed net settlement mechanism is introduced to realize the mixed settlement mechanism with more economical liquidity and meet the differentiated needs of participants. CIPS expands the definition of international text segment, and can optimize the transmission of messages through SWIFT system, which has a good expansibility.

Nowadays, Guangdong province, as a major economic province adjacent to Hong Kong and Macao, has huge trade and financial exchanges with Hong Kong and Macao. In terms of cross-border payment, the above four settlement modes can be used. However, there are still some problems in each of the four settlement modes.

Current RMB Cross-Border Capital Clearing and Settlement Problems Exist

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Practical Problems

The Hong Kong and Macao payment systems and the mainland payment and settlement systems sometimes still have the problem of message incompatibility. At the same time, the information disclosure requirements of the cross-border RMB payment system have brought great trouble to the offshore financial institutions. On the one hand, some offshore financial institutions do not want to disclose their commercial privacy in the payment process; On the other hand, such disclosure requirements also present some technical difficulties, as they may require the inclusion of Chinese characters in payment instructions, which sometimes leads to compatibility problems. For full settlement via an offshore clearing bank or RMB CHATS system, lack of net settlement leads to large liquidity needs, often requiring manual intervention to manage the release of funds for incoming and outgoing transactions and to search for funds for bilateral financial settlement transactions.

In the agency bank model, an enterprise can open an account in the agency bank to conduct cross-border RMB business directly, while the clearing bank model cannot achieve full automatic liquidation without delay. The clearing bank mode is widely used in Guangdong province. For some RMB businesses, the completion of cross-regional payment needs to go through between the headquarters and sub-branches of multiple agencies, which leads to a significant increase in time and cost. However, there is a cost problem for all international financial institutions to directly connect to the domestic payment and clearing system. For example, for Hong Kong financial institutions, the cost of directly connecting payment line is about 10,000 to 20,000 Yuan per month.

As a result, CIPS is the preferred operation order for cross-border RMB payment and clearing at the current stage. According to Operational Guidelines for RMB Cross-Border Payment System, the applicant shall complete the related technical and business training of CIPS system within 9 months after signing the agreement. As a result, the training time for practical operators is too short to complete the business well. Moreover, learning new systems will lead to confusion between different systems among practitioners and increase risks in operation. As a result, practitioners are usually very cautious in handling business, and they also strictly examined the files and it cost a long time. Each time the lower branch deals with cross-border RMB payment and clearing business,
it needs to submit a large number of materials to the higher branch and remit the capital after heavy
review, which is of poor effectiveness.

**Foreign Exchange Risk**

Since the year 2009, China's RMB cross-border trade settlement business has been developing
very rapidly, with its development speed far exceeding expectations. In 2010, China's total
settlement of cross-border trade reached 506.3 billion us dollars, which was 141 times of the year
2009, and reached 12.1 trillion Yuan in 2015, which was 23.9 times of the year 2010. The rapid
growth of RMB business is closely related to the current RMB settlement mode of cross-border
trade in China. RMB settlement of cross-border trade will bring about exchange rate risk, tax rebate
fraud risk, RMB policy regulation risk and other related risks for China's cross-border trade [2].

In foreign exchange market transactions, most banks set payment limits on counterparties to
control payment risks. Due to the inadequacy of these existing risk mitigation mechanisms related
to settlement, about 90% of RMB transactions are exposed to principal risks due to settlement
methods, thus limiting counterparty risk. Many overseas financial institutions have reported that
their counterparty limits have been exhausted, limiting their ability to trade with existing
counterparties and increasing the capacity of others. In the international foreign exchange market,
whether the RMB can be included in the CLS settlement system to achieve multilateral net
settlement is one of the considerations many financial institutions take when making decisions on
whether to intervene in the RMB business. The Bank for International Settlements also pointed out
that the internationalization of the RMB that cannot be included in the CLS settlement system may
encounter a barrier.

**Regulatory Issues**

The people's bank of China has no right to directly interfere with the Hong Kong and Macao,
which have independent monetary authorities to manage their local monetary policies and financial
order. Some Hong Kong and Macao Banks settle RMB cross-border trade through SWIFT system.
However, through the analysis of the supervision structure of SWIFT, it can be found that the
central bank of G10 countries is the institution that really controls the SWIFT system, and other
participants are only users of SWIFT system without any right of speech. China has no voice in
SWIFT system and no right to supervise and dispose of data [3]. This will lead to part of the
regulatory problems, not comprehensive regulation.

**Policy Suggestions**

**Intra-Group Settlement of Transnational Corporations**

In the pilot free trade zone of Shanghai, it was the first time that the centralized collection and
payment business of RMB cross-border settlement and two-way capital pool of RMB cross-border
trade under the current account have been implemented. After continuous development and
improvement, the business has been successfully promoted nationwide. Cross-border RMB funds
collection management can be imitated on the existing multinational enterprise funds centralized
management model for the construction and improvement. Therefore, to perfect the centralized
management of multinational companies, commercial banks have to ensure that take a good
communication with regulatory agencies. On the basis of establishing a perfect transnational
enterprise funds centralized management system, convenient RMB funds for centralized
management of enterprise. Secondly, it is very necessary to redact rules for the management of
RMB capital of transnational enterprises, their business processes should be described in detail, and
their risk prevention and control mechanism should be standardized, so as to provide a clear legal
basis for transnational enterprises to implement centralized management of RMB.

**Authenticity Audit of Trade Shall be Strengthened**

From the perspective of international practice, RMB settlement of cross-border trade does not
adopt the management of foreign exchange verification to check the authenticity of trade. The pilot
enterprises RMB customs clearance, settlement and export tax refund need not submit the verification. As well the export revenues have not to go to the advanced checking accounts, simplified the pilot enterprises business formalities, also shortened the time funds to the account. This means that the declaration of export tax refund procedures are relatively simplified, which makes the risk of the tax authorities increased. At the same time, it also gives pilot enterprises the convenience of tax violations and increases export tax fraud risk. So from this, we will strengthen the management of the whole process of trade and verify it authenticity.

The government agency should strictly supervise pilot enterprises to carry out the trade payment measures. Pilot enterprises shall establish cross-border RMB settlement ledger, accurately record import and export declaration information and RMB capital receipt and payment information, and reflect the real trade situation in detail. Strictly supervise the domestic settlement Banks, which must check the authenticity and consistency of trade documents one by one. We will strengthen whole-process management of trade. The government agency should strictly control the pre-selling and pre-payment funds in the trade process to ensure that the pre-selling and pre-payment funds have a real trade basis and compliance with the revenue and expenditure. For the advance receipt and advance payment of RMB funds by pilot enterprises, the domestic settlement bank shall examine and record the nature of advance receipt and advance payment of funds and the estimated customs clearance time, and timely update the changes of funds. If a pilot enterprise receives or prepays RMB funds in advance in excess of a certain proportion of the contract amount, it shall provide its domestic settlement bank with trade contracts, customs declarations and other trade documents sufficient to prove the authenticity of trade.

**Improve the Regulatory Framework of RMB Settlement Network for Cross-Border Trade**

In recent years, although the central bank has issued many regulatory policies on China's payment and settlement system, the supporting regulatory framework is still far from perfect due to the rapid development of China's cross-border payment and settlement system. Therefore, while strengthening the supervision of China's payment and settlement system, the central bank should further strengthen the supervision framework of cross-border payment.

**Conclusion**

In summary, in the future, with the further deepening of the financial connection between Guangdong, Hong Kong and Macao, the CIPS system may be optimized to achieve convenient settlement. Cross-border settlements in the Greater Bay Area of Guangdong, Hong Kong and Macao will be explored under the circumstance of innovation, and may also create more convenient settlement channels. Relevant research scholars propose that with the continuous opening up of logistics, information flow and financial flow in the Greater Bay Area of Guangdong, Hong Kong and Macao, it may be possible to consider the unification of currencies in some regions in foreign countries, and to further deepen the flow of financial flows in the official unified currency. To achieve coordinated development of financial support areas.

**References**

