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Merrill Lynch**



International RMB Cross Border Settlement

Optimizing Trade and Treasury Management

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Agenda

- Evolution of RMB Cross-Border Settlement
- Benefits of RMB Cross Border Settlement
- Overview of RMB Cross Border Settlement
- Trade Settlement: Current Common Structures
- Conclusion

Evolution of RMB Cross-Border Settlement

JUL '09	<ul style="list-style-type: none"> ■ Pilot Scheme launched in five cities in Mainland China. Mainland Designated Enterprises (MDEs) in the 5 cities are eligible to participate. ■ Corporations in HK, Macau and ASEAN countries are eligible to participate.
JUN '10	<ul style="list-style-type: none"> ■ The RMB Trade Settlement Scheme expanded to cover 20 provinces and cities in Mainland China. Trade transactions between eligible enterprises in Mainland China and corporations in any other part of the world are allowed to be settled in RMB. ■ Any enterprise in the 20 provinces and cities in Mainland China can settle their merchandise imports, service trades and other current account transactions in RMB, while an expanded list of eligible MDEs in 16 provinces and cities in Mainland China are able to settle their merchandise exports in RMB.
JUL '10	<ul style="list-style-type: none"> ■ People's Bank of China (PBOC) and the Hong Kong Monetary Authority (HKMA) signed a Supplementary Memorandum of Co-operation on the expansion of the RMB trade settlement scheme, agreeing to further cooperate in the development of the offshore RMB trade settlement business.
OCT '10	<ul style="list-style-type: none"> ■ ADB and IFC of the World Bank Group announced issuance of RMB bonds in Hong Kong. The ADB 10-year issue is the longest tenor RMB bond issued in Hong Kong.
NOV '10	<ul style="list-style-type: none"> ■ Ministry of Finance (MoF) and HKMA sign a memorandum on using the Central Moneymarkets Unit (CMU) for issuance of the RMB sovereign bonds. <ul style="list-style-type: none"> ■ Enhance the methodology and environment for the issuance of RMB sovereign bonds.
DEC '10	<ul style="list-style-type: none"> ■ Expanded list of eligible MDE's under the Cross-border RMB Trade Settlement Scheme. (67,359 MDEs as of 12/3/2010) - Source: BoA Merrill Lynch Global Research, HKMA ■ HKMA issued a circular for AI to comply with the RMB Net Open Position Limit
JAN '11	<ul style="list-style-type: none"> ■ Pilot Scheme for settlement of overseas direct investments (ODI). ■ Under the scheme and following approval, Mainland enterprises can conduct direct investments overseas in RMB. Hong Kong Banks can obtain RMB funds from the Mainland and lend RMB to business conducting ODI. ■ 63% or USD36 billion of ODI went through Hong Kong in 2009. - Source: BoA Merrill Lynch Global Research, HKMA
MAR '11	<ul style="list-style-type: none"> ■ 3/31/2011 HKMA issued a circular: The RMB Fiduciary account <ul style="list-style-type: none"> ■ authorized institutions participating in RMB business (Participating AIs) can place RMB funds in excess of their day-to-day business and settlement needs in a segregated Fiduciary Account with the People's Bank of China through the RMB Clearing Bank.

¹RMB – refers to both CNY and CNH
 CNH - refers to offshore RMB market
 CNY – refers to onshore RMB market

Note: All the information set out above is provided to the best of the bank's knowledge and understanding of the relevant laws, rules, regulations, directions and guidelines governing or otherwise applicable to the Pilot Scheme. Such laws, rules, regulations, directions and guidelines may change from time to time.

Benefits of RMB Cross Border Settlement

For Global companies conducting cross border trade with Mainland China enterprises

EXPORTERS

SELLING TO
MAINLAND CHINA

- Competitive differentiation: ability to sell in RMB and expanding customer base
- Choice and ability to hold RMB as a store of value
- Free movement of offshore RMB

IMPORTERS

BUYING FROM
MAINLAND CHINA

- Reasons for Mainland supplier's lower pricing
 - No Foreign Exchange risk
 - Lower administrative cost

OTHER TREASURY OPPORTUNITIES

- Availability of non-Trade Settlement RMB (CNH)
- Maintain one single RMB account for Trade and non-Trade activities
- Potential RMB investments and funding
- Ability to participate in liquidity structures

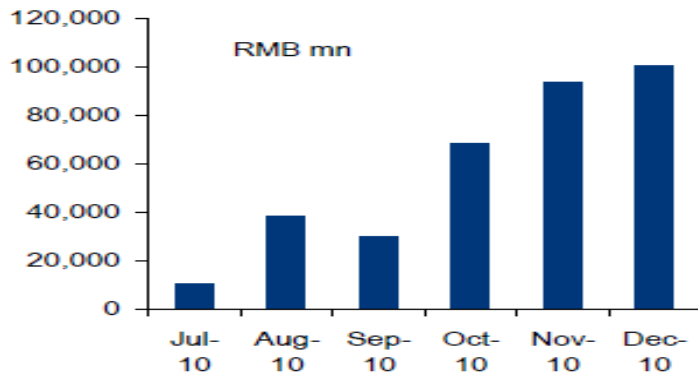
Overview of RMB Cross Border Settlement



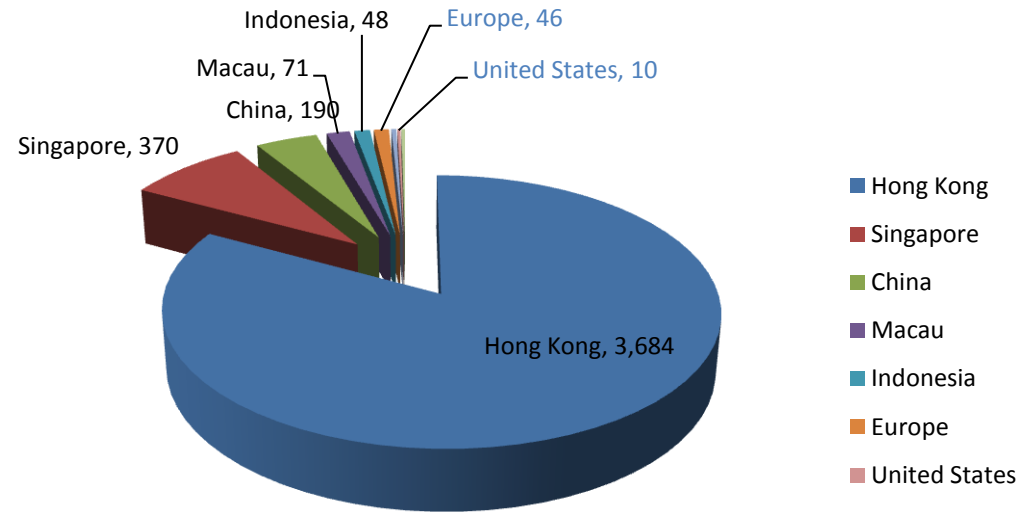
Players / Participants

- Investors
- Retail
- Financial Institutions
- Corporations

RMB Cross Border Settlement Value in 2010 (Mainland China)
Source: PBOC



RMB Remittances – Value for Q3 & Q4 '10
Source: BoA Merrill Lynch Global Research, HKMA



No. of RMB L/Cs received in Q4 '10
Source: Swift

Total Count: 4445



Overview of RMB Cross Border Settlement

Corporate

- Accumulate RMB Deposits
- Add CNH to Multi-currency Notional Pooling
- Shanghai entities can borrow RMB from overseas via intercompany loan
 - Subject to SAFE approval
- Service/Current Account Items, (includes but not limited to):
 - Dividend Payments
 - Royalties
 - Management Fees

Non Bank Financial Institutions

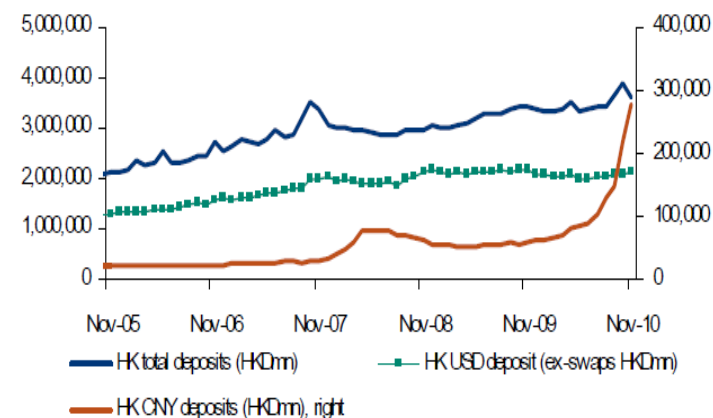
- Permits collection of Insurance Premium
- Facilitates participation in Investment Funds

Bank Financial Institutions

- Enables eligible Cross Border Settlement transactions
- Enables settlement of RMB bonds/securities
- Enables settlement of RMB Foreign Exchange transactions

Advantages

- RMB as Store of Value
- Natural Hedging
- More attractive FX rate to convert CNH to USD



Market Value

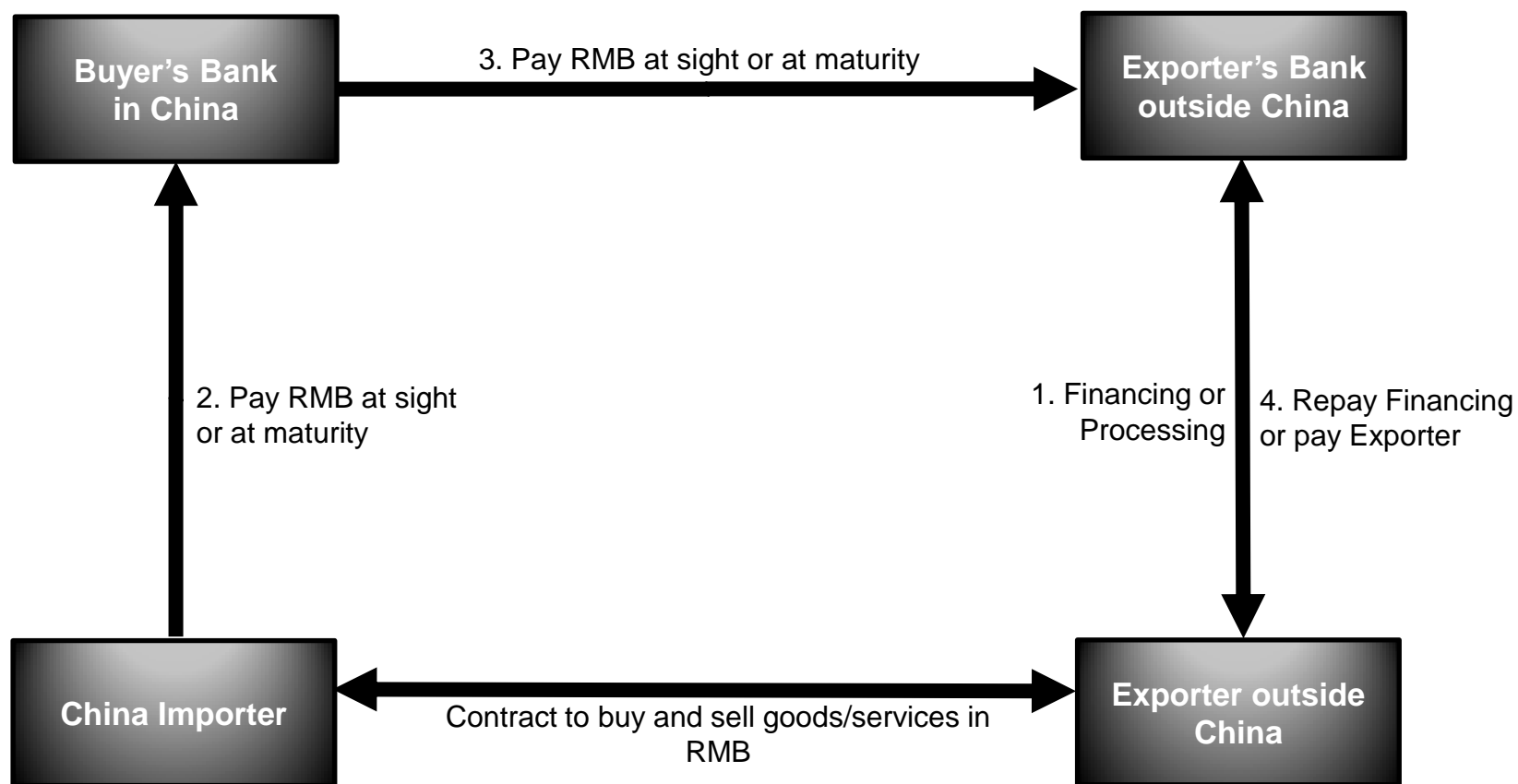
Source: BoA Merrill Lynch Global Research

Current Common Structures

- Service / Current Account Items (includes but not limited to):
 - Dividend Payments
 - Royalties
 - Management Fees

- Trade – Cross Border RMB Settlement
 - RMB Open Account
 - RMB L/C
 - RMB Prepaid L/C
 - RMB L/C CNH/CNY hedged with NDF
 - RMB L/C based cross-border financing

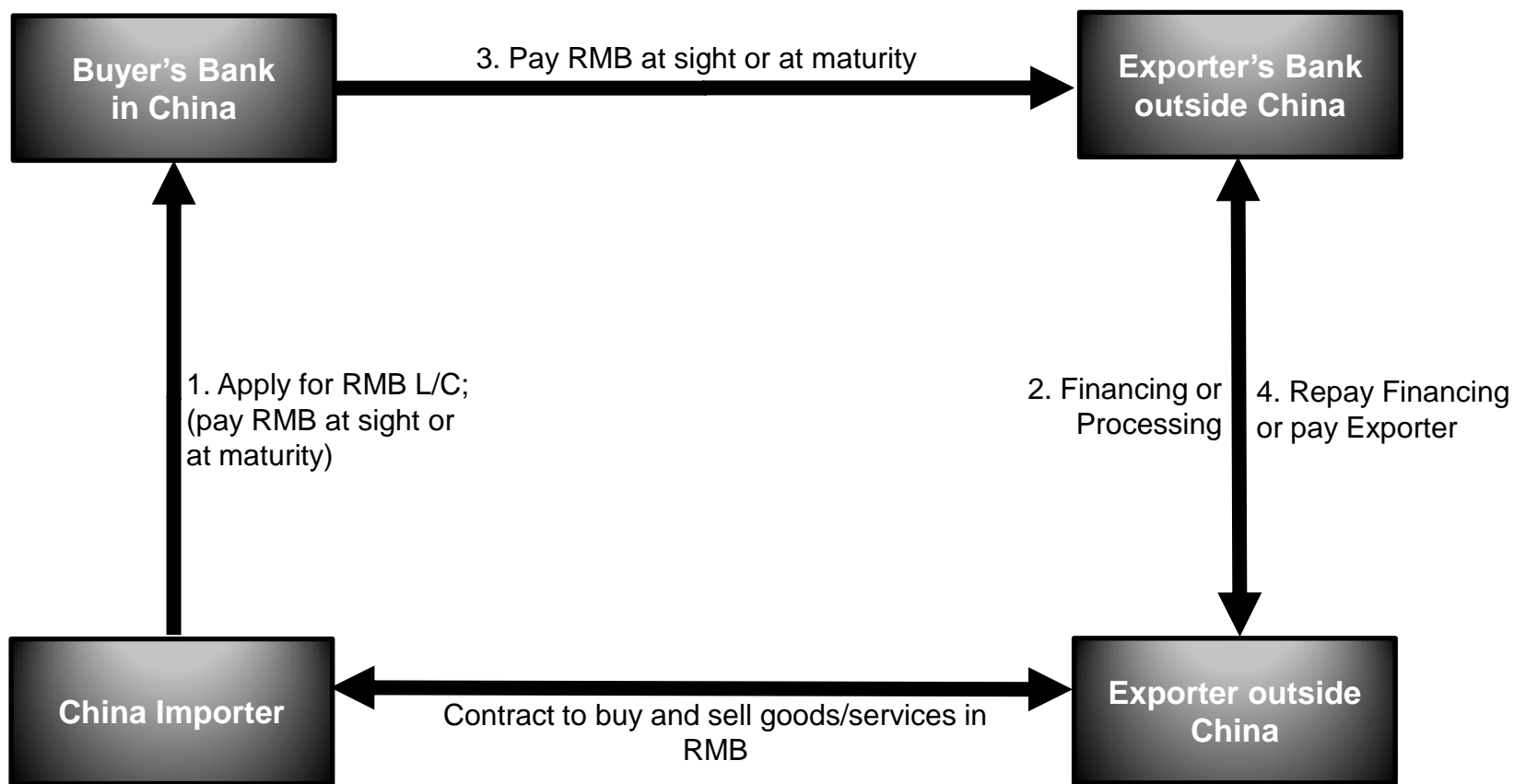
1. RMB Open Account



Exporter:

1. incur lower financing cost
2. hold RMB as a store of value
3. financing / processing

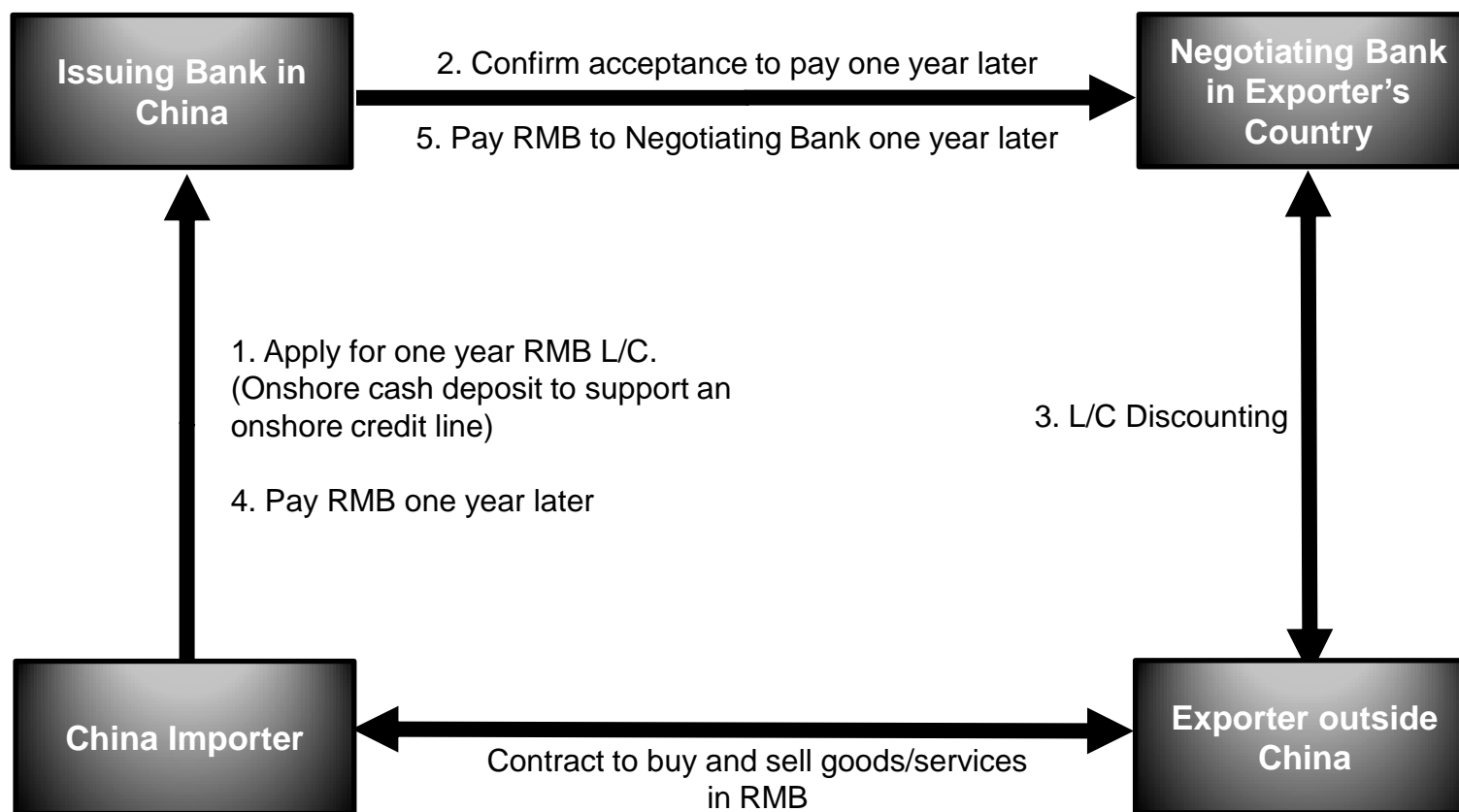
2. RMB Letter of Credit



Exporter:

1. incur lower financing cost
2. hold RMB as a store of value
3. financing / processing

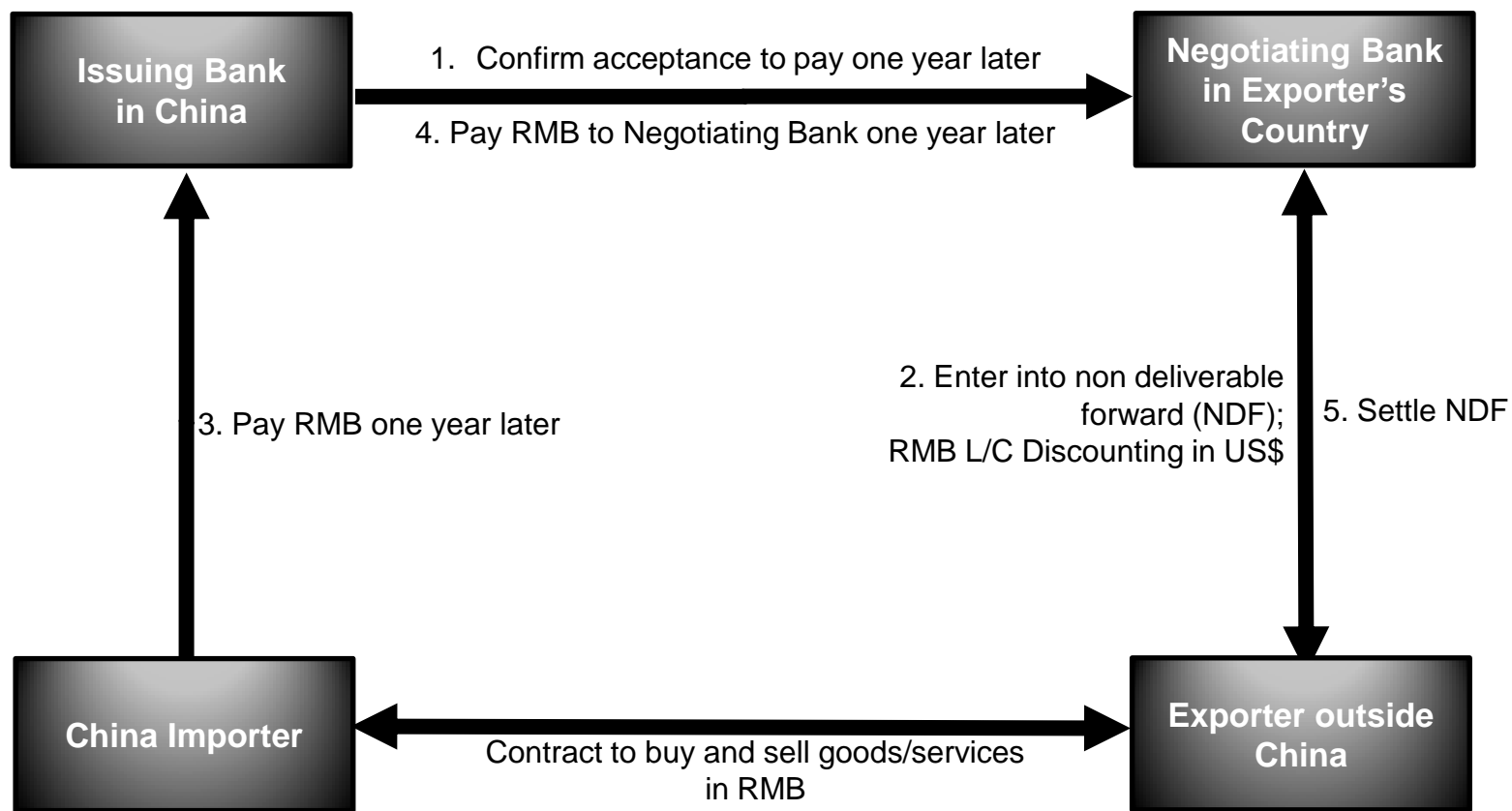
3. RMB Prepaid Letter of Credit



Exporter:

1. incur lower financing cost
2. enjoy flexibility of early payment through L/C discounting

4. RMB Letter of Credit CNH/CNY hedged with NDF

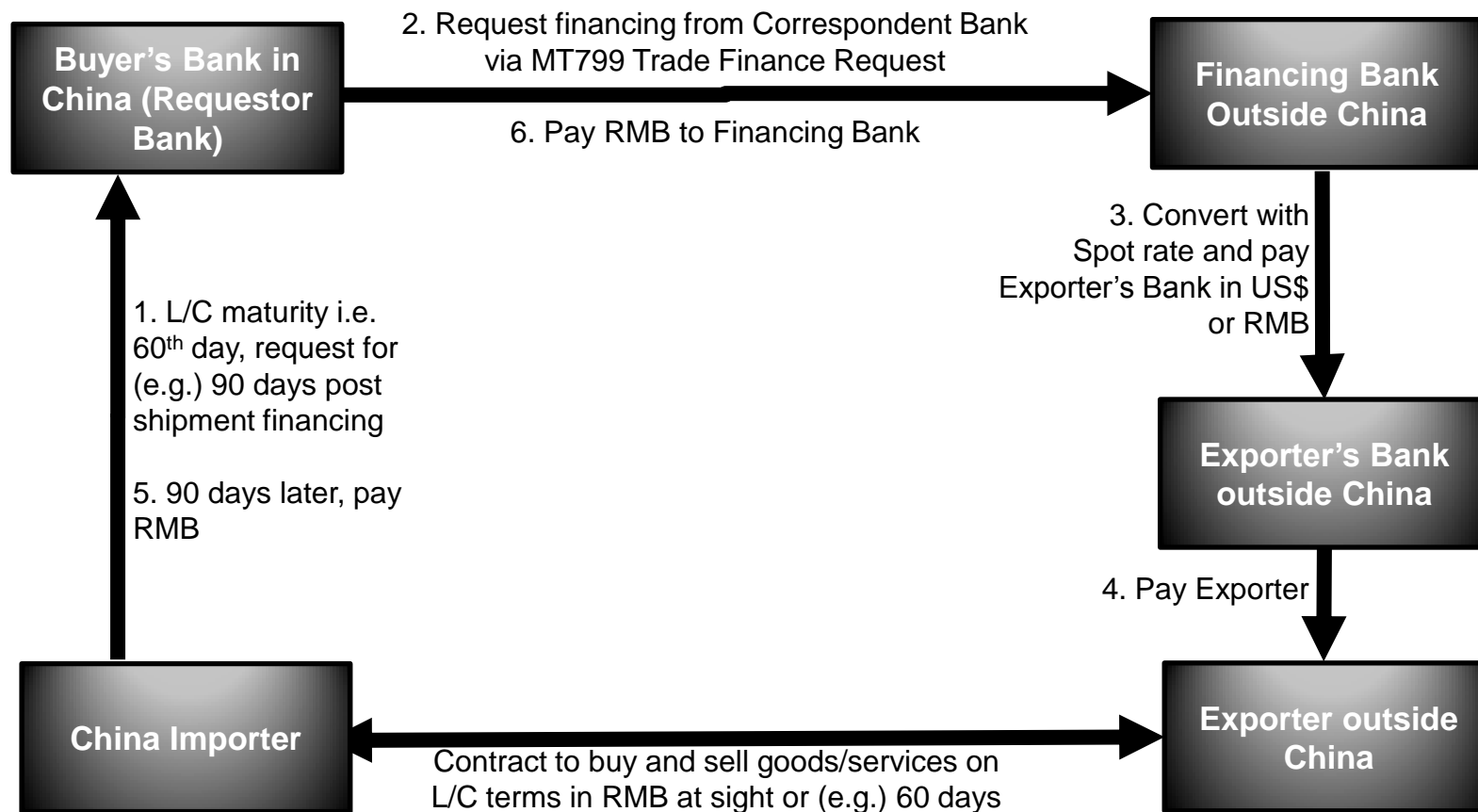


Exporter :

1. incur lower financing cost in US\$
2. limited-recourse financing
3. exchange rate &/or interest rate differential

NDF = Non deliverable forward

5. RMB Letter of Credit based cross-border financing



Importer:

1. extended Days payables outstanding (e.g. 60 + 90 = 150 days)

Exporter:

1. gets paid at sight or on 60th day as per L/C terms
2. interest rate differential

Conclusion

- RMB Cross-border Trade Settlement scheme
 - is a significant evolution
 - motivates trade settlement in RMB
 - will continue to evolve and gain momentum
- RMB liquidity in Hong Kong will continue to develop depth and volume
- New structures being introduced across Treasury and Trade daily

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