The Nation

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Headline: Foreign banks will need niche to prosper in free trade zone LIBERALIZATION...

The Yangshan port area in Shanghai free trade zone on Nov 2, 2013. PEI XIN / XINHUA

Foreign banks will need niche to prosper in free trade zone

LIBERALIZATION CREATES OPPORTUNITIES FOR OVERSEAS FINANCIAL INSTITUTIONS

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Since the China (Shanghai) Pilot Free Trade Zone was launched in September, there's been an increasing number of bank opening ceremonies, and executives of foreign banks say that as more detailed guidelines are released, business has been picking up.

Since March 1, there's been no interest rate ceiling on foreign currency deposits of up to $500,000, whether held by companies or individuals.

And according to the People's Bank of China, companies based in the zone may borrow offshore yuan.

There's certainly plenty of competition, bankers say, but with the vast demand in the zone, lenders should be able to find a market niche.

"I think there's ample market demand in the zone, and each player may have its own strengths. Competition is good for clients, and we are looking for a win-win-win situation for lenders, clients and the market," says Andrew Au, chief executive officer of Citi China and chairman of Citibank (China) Co Ltd.

Unlike branches of Chinese lenders in the FTZ, foreign banks' facilities are less crowded. Indeed, some are essentially deserted.

"It's not that we have less business than Chinese lenders; it's simply because foreign banks may attach more importance to corporate finance, a business that clients can do over the Internet. There is less on-site, face-to-face contact," says an employee at a foreign bank outlet in the FTZ.

Foreign banks are probably eyeing the expanding trade that will be conducted through the FTZ. Those transactions will increase demand for cross-border financing, says Jimmy Leung, a banking specialist at PricewaterhouseCoopers.

Access to global networks will help foreign banks leverage their FTZ presence to forge links between the zone and foreign markets, helping clients capture new growth opportunities, bankers say.

The FTZ is a milestone in China's efforts to build an international financial center in Shanghai and reform the economy for longer-term viability, says Neil Ge, DBS Bank (China) Ltd's chief executive officer.

"As a leading bank in Asia, DBS is committed to leveraging our strong Asian connectivity and insights from Singapore and Hong Kong to fully support the development of the zone," says Ge.

Innovative cross-border yuan busi-

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nesses have been created, including cross-border yuan cash pooling and centralized cross-border transactions in the yuan.

These solutions mark another milestone in the development of the zone's financial services industry. Banks including Citibank and HSBC Holdings Plc are offering such services.

Enterprises within the zone have benefited from these financial innovations. Saint-Gobain SA is among the first group of multinational corporations to implement some of these solutions in the FTZ, according to HSBC.

Saint-Gobain makes and distributes building materials. It also has operations in energy conservation and environmental protection.

Since entering China in 1985, Saint-Gobain has invested more than 2 billion euros ($2.79 billion) in the market.

Using a subsidiary in the FTZ, the company can centralize payments and collections for merchandise and services trade settlement, along with other current account items, thus improving the use of renminbi settlements within the group.

It's also been able to make its cash management more efficient within Asia.

Centralized payments and collections are efficient cash management solutions for multinational companies, which need to manage accounts payable and receivable among many subsidiaries, bankers note.

Regulations in the FTZ enable such companies to consolidate and offset accounts payable and receivable in a single transaction.

Centralized cross-border yuan payments and collections will bring significant benefits to clients by simplifying their payment processes, reducing the number of transactions they must conduct and unlocking liquidity.

The process helps improve the efficiency of funding management and settlement, thereby reducing funding costs and foreign exchange risks, says Kee Joo Wong, who heads the global payments and cash management operations of HSBC China.

Lenders have reacted positively to regulatory moves to further relax cross-border payments, including the announcement on Feb 18 that five Chinese payment firms may process cross-border yuan payments for trade transactions in the FTZ.

"These are all important steps to facilitate offshore treasury funding in renminbi," says one banker.

While liberalized policies for the FTZ may bring more cash flows to the zone and opportunities for foreign lenders, regulators have been keeping a close eye on the risk management part of the equation.

The new measures in the FTZ reflect the philosophies and practices of market liberalization, and administrators will strengthen cooperation with their counterparts elsewhere to achieve effective controls against systemic and regional financial risks, says Zhang Xin, head of the PBOC's Shanghai branch.

One concern is that once policies are relaxed in the FTZ, significant amounts of depositors' money may shift toward the FTZ, and with the relaxation of foreign currency administration, exchange rates may become more volatile, says Zhang.

"I would like to re-address the role of financial reforms in the FTZ as a support to the development of the real economy.

We do not wish to see wild volatility of cash flows in the FTZ ... We will pay close attention," says Zhang.

"We reckon trade freedoms will probably come first, followed by financial reforms involving interest rate liberalization and currency convertibility."

The authorities have emphasized that trials of financial reforms must be conducted under the condition of controllable risks, says Tommy Ong, executive director of treasury and markets at DBS Bank (Hong Kong) Ltd.

"This is the ultimate challenge because the government needs to effectively ring-fence capital flows within the FTZ under full currency convertibility under the capital account," says Ong.

TRADE, FINANCE BENEFIT MOST FROM PILOT ZONE

Trade and financial services are among the sectors that have been benefiting the most so far in the China (Shanghai) Pilot Free Trade Zone, analysts say in a half-year review of measures and policies for development in the zone.

Free trade accounts and a capital market for foreign investors are among the items most expected to attract businesses.

Pilot financial liberalization schemes will soon include a free trade account and a capital market for foreign investors, said Dai Haibo, deputy director of the FTZ administration committee, setting a timetable for the launch of both the free trade account and crude oil futures. He was speaking at a news conference on Tuesday.

The expected move will affirm the renminbi as one of the leading currencies in today's rapidly evolving financial arena. It will secure cheaper funding for local companies from offshore sources, according to Zhang Xiaomeng, branch manager of Citi's Shanghai FTZ sub-branch.

Specific rules on the free trade account that allows full convertibility of the yuan and facilitates offshore financing will be rolled out in the second quarter and tested so they can be applied elsewhere in China by September, which will mark the FTZ's anniversary, according to Dai.

Procedural moves by the People's Bank of China, the central bank, have allowed employees working in the FTZ to set up accounts for offshore investments, which ease restrictions on money flow, paving the way for substantial reforms.

According to Qu Hongbin, HSBC Holding Plc's chief economist for Greater China, the nation has a three-pronged approach to renminbi internationalization:

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Expand the currency's role in foreign trade settlement (it has already overtaken the euro to become second to the dollar), encourage its use in cross-border investment and develop offshore renminbi centers.