# TREASURY MANAGEMENT IN CHINA

v1501

A Treasurer's Guide

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China is the undisputed home of both enormous business opportunities and incredibly complex business challenges. These opportunities are generated as hundreds of millions of consumers enter the middle class and have disposable income, as well as an abundance of low cost labor and an educated tech savvy work force.

The challenges of doing business in China start with its pure geographic and economic size and its rapid growth over the last decade. In addition, the evolution in industrialization, corporate structure, business governance, physical infrastructure, financial regulation, and rule of law are all progressing at a pace few of us have ever experienced. A typical business executive with China responsibilities will carry a management agenda exponentially larger and more complex than his peers in other markets.

DBS has helped produce and sponsor this guide to treasury management in China. We hope you will find it useful as you grow your business in one of the most exciting and vibrant markets in the world.

**Tom McCabe**
Managing Director and Country Head, USA
DBS Bank

# Contents

# 1. Introduction

Managing the treasury for a company with operations in China is challenging for many reasons. These include the size, unfamiliarity, diversity and heterogeneity of the country. Along with the rapid changes that are associated with its growth and dynamism there are also an evolving regulatory environment and developing financial infrastructure. Add to this more general concerns with social stability, economic stability and political control and the treasurer's job becomes challenging indeed.

China's scale and potential impact on virtually any company operating globally demand senior management attention. Unfortunately there are no simple templates for treasury management in China and it is not a wise idea to outsource this task. What is required is basic homework in three areas. The first is building a picture of how, where and why the company operates in China. This includes information about strategies, business models and legal structure. The second is an understanding of the financial environment in the country. Treasury goals and objectives are common across the globe. Techniques for achieving these goals and objectives vary considerably and China is no exception.

The third is timeless and particularly important to the complex environment that is China, where guidelines and suggestions sometimes lack explicit rules and can therefore be subject to interpretation. The answer here is to have a clear understanding of your company's business, objectives and financial requirements.

This guide can provide some help in the first two areas, the third is up to you.

**China at a Glance: The Peoples Republic of China (PRC) is a huge country consisting of 23 provinces, 5 autonomous regions, four municipalities and more than 1.4 billion people living in an area of over 3.7 million square miles. China is a significant exporter of manufactured products, importer of many raw materials and significant internal market for consumer goods.**

**The Renminbi (RMB) is the currency of China which is denominated as the Yuan. The Yuan is further subdivided into 10 Jiao or 100 Fen. It is issued and managed by the People's Bank of China (PBOC), which is the monetary authority of China. While RMB is often used to denote the Chinese currency, the ISO code for the currency is CNY. RMB policies are set by the PBOC while the State Administration of Foreign Exchange (SAFE) is in charge of exchange control.**

**The financial environment in China is constantly changing to reflect political and economic needs. This guide is updated periodically to reflect these changes and readers should ensure they are working with the most current edition. This can be done at treasuryalliance.com/publications.**

# 2. Company Formation

One of the first issues a company must address is the legal structure they will use to operate in China. There are a number of different forms that a company may assume, each with varying benefits, costs and restrictions. Recommendations on the most appropriate type for company operations are outside the scope of this guide, but the basic options and descriptions are contained in the following table:

| Type of Establishment | Description |
|---|---|
| Representative Office | A Representative Office (RO) is the quickest and simplest way to establish a presence in China. ROs are usually created to serve as the local liaison office for a foreign company and handle imports, exports and communications. ROs are not permitted to engage in profit-making activities such as the issuance of sales invoices or the collection of receipts. Some companies have stretched the functionality of their ROs to include generating sales and this has met with additional regulation including limits on staff size and the requirement to pay taxes at the standard corporate tax rate. Many companies use the RO to establish their presence in China setting up additional companies as the nature of their operations take greater shape. |
| Foreign Investment Enterprise | The Foreign Investment Enterprise (FIE) can assume several forms, the two main forms being the equity Joint Venture (JV) and Wholly Owned Foreign Enterprise (WOFE). JVs allow the company to take advantage of a local partner's market knowledge their and relationships to conduct business. Companies that prefer to operate alone will typically opt for the WOFE. In both cases capital can be injected as cash, land, buildings, equipment, or intellectual property subject to approval by the State Administration of Foreign Exchange (SAFE).<br><br>A number of authorities must approve the establishment of an FIE including:<br>● The National Development and Reform Commission (NDRC)<br>● The Ministry of Commerce (MOFCOM)<br>● The State-Owned Assets Supervision and Administration Commission of the State Council (SASAC) if the JV partner involves a State Owned Enterprise (SOE)<br>● Some industries may require additional approvals<br><br>Before starting operations there is the need to secure a business license from State Administration for Industry and Commerce (SAIC) and approval for foreign capital injection from SAFE. |

| Type of Establishment | Description |
|---|---|
| China Holding Company | The China Holding Company (CHC) is a form used by established companies that allows the CHC to directly hold shares of local subsidiaries. There are additional benefits such as the ability to serve as a political liaison or provide shared services. The current minimum registered capital is USD30million in addition to other requirements.<br><br>The CHC may apply to acquire Regional Headquarters (RHQ) status that permits additional activities such as the ability to provide logistics services or establish a finance company. Additional approvals are required and the paid up capital should be at least USD 100 million. |

Companies with mature or maturing operations in the People's Republic of China (PRC) frequently operate with a mix of all three forms. They may also be in a position to take advantage of the limited number of established double tax treaties in place, facilitating the establishment of a WOFE through those countries. Multinational companies with significant Chinese and regional operations find the CHC with RHQ status to be particularly useful in conducting their business.

There is an additional possibility and that is to set up the company's presence in a free trade zone (FTZ) in Shanghai, QianHai or Tianjin Eco City. While the Shanghai Free Trade Zone is perhaps the most widely known, with expansion plans expected to be announced soon, the Chinese government is also considering other cities and locations for additional FTZs.

**The China (Shanghai) Pilot Free Trade Zone (SFTZ) is one of the most recent liberalizations of the financial sector and builds on other trade zone pilots stretching back several decades. The zone itself is a bit over 10 square miles and is located on the outskirts of Shanghai. Business located within the zone receive preferential terms on the import and export of a defined group of products and services—of which financial services is the most recently favored area of commerce. The objectives behind liberalizing the financial sector are to help make Shanghai and China a financial center within this decade and to further internationalize the RMB. The means are in a rapid state of development but include flexibility in intercompany lending, favorable borrowing/deposit rates and reduced rules surrounding foreign exchange. The actual impact of the SFTZ has received mixed reviews, but the experiment seems to be succeeding as the Chinese government has recently approved the establishment of three other free trade zones in the country. Given the rapid changes taking place in this area readers are advised to seek local expertise to ensure that they are dealing with the most current rules and regulations.**

Once the company is established the next step is the injection of capital. Capital injections have traditionally been made in US dollars, although CNY injections are now being used, with the initial registered capital dependent on the total planned investment. The total planned investment amount, as well as capital injections, must be approved by the MOFCOM and PBOC (for CNY)/SAFE (for FCY) and approval will depend on the type of industry. As general guidance, the minimum registered capital is a function of the total anticipated investment according to the following guidelines.

| Amount of Total Investment | Minimum Registered Capital |
|---|---|
| Less than USD 3 million | 70% of total investment |
| USD 3-10 million | Greater of USD 2.1 million or 50% of total investment |
| More than USD 30 million | Greater of USD 12 million or 33.3% of total investment |

These general guidelines present the typical company with the need for decisions on a number of matters that will have a major impact on its future within the PRC. Three decisions that are important and relevant for treasury are the:

1. Bank to receive the capital injection
2. Location and account type of bank accounts to be opened
3. Initial and ongoing funding of company operations

# 3. Banking Environment

The People's Bank of China (PBOC) is the central bank and has responsibility for monetary policy, maintenance of the payment and clearing systems and, through SAFE, for setting foreign exchange policies. The Central Bank law of 1995 gave the PBOC autonomy and authority to manage monetary policy. Matters dealing with banking regulation are under the control of the China Banking Regulatory Commission (CBRC), which handles bank supervision. The goal of these laws and institutions is to make the Chinese banking system more modern and efficient as Chinese institutions evolve. The 1995 law, for example, required banks to conduct their lending operations on the basis of profitability, liquidity and risk minimization.

The indigenous Chinese banks are giants by virtually any measure with the dominant players in the banking sector being the former state-owned commercial banks. These include the Agricultural Bank of China (ABC), Bank of China (BOC), Bank of Communications (BoCom), China Construction Bank (CCB) and the Industrial and Commercial Bank of China (ICBC). The "big five" provide a full range of commercial and investment banking services with varying degrees of quality and consistency across the country. Many companies have some form of relationship with some or all of these banks which, because of their substantial branch operations can make them the only choice for certain types of business. This can involve a great deal of work if it is necessary to work out arrangements with each branch and in any case is becoming less important as electronic versions of paper instruments are more widely adopted. The chart on the following page provides a larger, but by no means comprehensive, listing of Chinese banks.

This alphabet soup of banking reflects the fact that the system has evolved from a highly centralized, 100% government operated system of strict regulation to a still somewhat centralized, somewhat government operated and still strictly regulated system where an understanding of roles and responsibilities is critical.

According to CBRC statistics, at year-end of 2012, there were 42 locally incorporated foreign bank branches, 95 foreign bank branches and 197 foreign bank rep offices in China representing 49 foreign countries. These include the usual large, global banks such as JP Morgan Chase, Citibank, Deutsche Bank, Bank of America, HSBC and BNP Paribas along with strong regional and niche players such as DBS, Standard Chartered Bank and ANZ. Non-Chinese banks compete with the indigenous banks through customer service and the ability to supply more sophisticated banking products and treasury management services. They are limited by the amount of capital required to sustain a large branch presence and other factors.

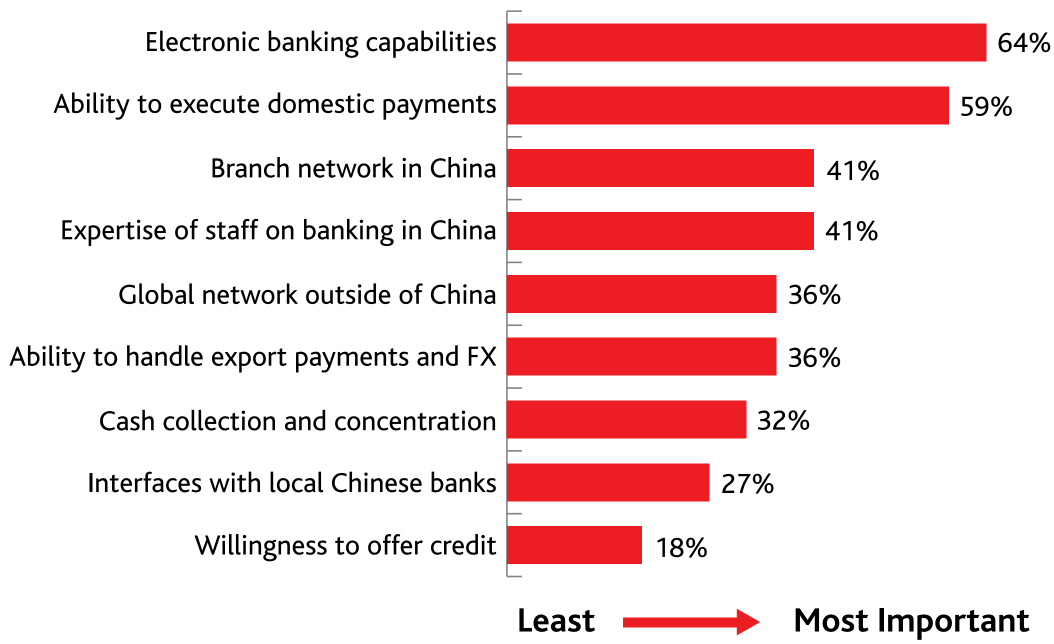
**A larger listing of Chinese banks is contained in the following table, this listing based on selected measures of financial stability.**

| Bank | Tier 1 Capital Ratio % | Nonperforming Assets to Total Assets Ratio % | Cost to Revenue Ratio % |
|---|---|---|---|
| Bank of Beijing | 10.9 | 0.3 | 32.8 |
| Hang Seng Bank | 12.2 | 0.1 | 56.3 |
| BOC Hong Kong Holdings | 12.3 | 0.2 | 45 |
| China Construction Bank | 11.3 | 0.6 | 37.1 |
| Industrial & Commercial Bank of China | 10.6 | 0.5 | 36 |
| Industrial Bank | 9.3 | 0.2 | 34 |
| Shanghai Pudong Development Bank | 9.0 | 0.3 | 36.7 |
| Bank of Communications | 11.2 | 0.6 | 39.5 |
| Agricultural Bank of China | 9.7 | 0.7 | 43.1 |
| Bank of China | 10.5 | 0.5 | 43.9 |
| China Merchants Bank | 8.5 | 0.4 | 42.8 |
| China CITIC Bank | 9.9 | 0.6 | 39.1 |
| China Everbright Bank | 8.0 | 0.3 | 37.9 |
| Huaxia Bank | 8.2 | 0.4 | 47.2 |
| Ping An Bank | 8.6 | 0.4 | 48 |
| China Minsheng Banking | 8.1 | 0.4 | 41.7 |

Source: Bloomberg (Included were banks domiciled in China and Hong Kong with total assets of $100 billion or more as of August 31, 2013. Sixteen banks qualified; data were for their 2012 fiscal year.)

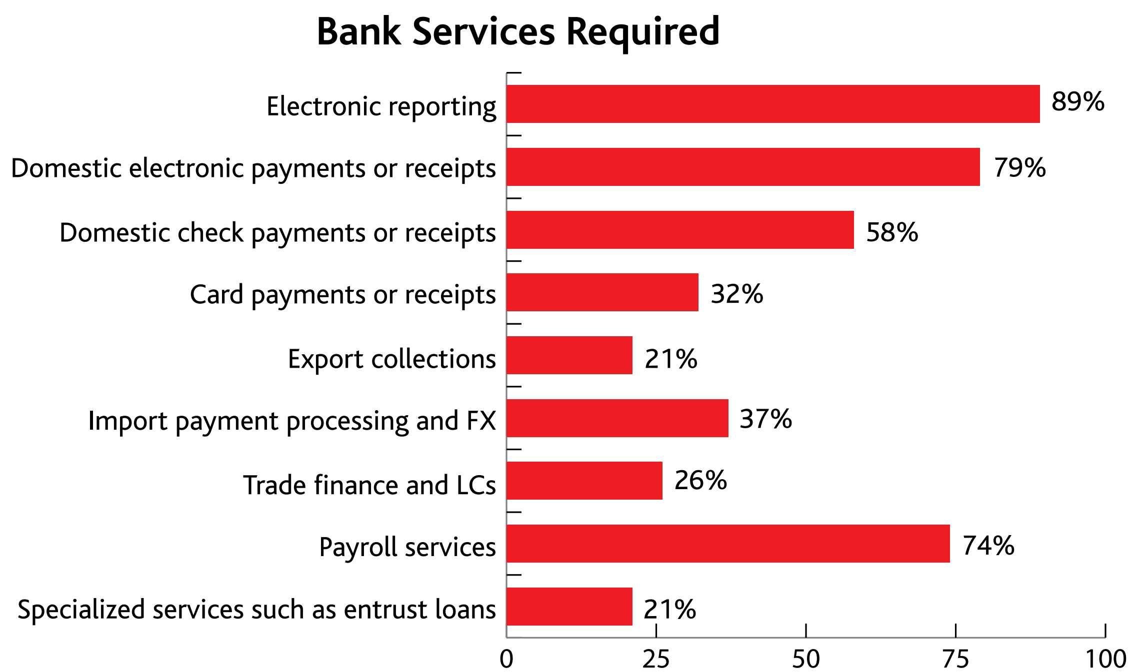
Multinationals require a combination of global and indigenous banks for their cash management needs in China. The global banks and regional banks offer well-developed electronic banking platforms and cash management services that are essential to the operation of a global treasury. Indigenous Chinese banks are required to meet unique regulatory requirements and sometimes for their extensive branch network. It's important to note that these large domestic branch networks in China struggle with non-electronic connectivity, but with the greater use of electronic channels comes the opportunity to implement more cost effective and process efficient processes. In fact, companies have been able to centralize payments and collections processes via domestic shared service centers.

In a survey of multinational companies, Treasury Alliance Group identified the following as key criteria in bank selection.




Source: Proprietary Treasury Alliance Group study, September 2012

The companies in the survey group used the following services from their banks in China.




Source: Proprietary Treasury Alliance Group study, September 2012

In summary, indigenous banks are frequently used for local deposits, nationwide collections, check payments, selected electronic payments, payroll/employee accounts and tax payments. Global and regional banks leverage their capabilities in the areas of cash concentration, batch payments, electronic banking and liquidity solutions. Both types of bank are used for handling import payments through SAFE.

# 4. Bank Accounts

Bank accounts are available to residents and foreign entities although the account options for foreign entities are very limited. The following table provides general guidance and does not include free trade zone accounts:

| Entity Status | Onshore CNY | Onshore Foreign Currency | Offshore CNY | Offshore Foreign Currency |
|---|---|---|---|---|
| Resident | Yes | Yes | No (Note 1) | No (Note 2) |
| Foreign entity, no permanent establishment | No | No | No (Note 3) | Yes (Note 4) |

1. Only Shanghai registered companies can apply for foreign entity RMB accounts for their overseas investments subject to Ministry of Commerce and PBOC approval.
2. Chinese resident companies may open a foreign currency account offshore for specific trading or project investment purposes subject to SAFE approval.
3. Foreign entities can open NRA CNY accounts with Chinese banks or open NRA CNH accounts with overseas banks, with no PBOC approval required.
4. Foreign entities can open RMB denominated accounts outside China, such as CNH accounts in Hong Kong. RMB can also be held in other locations such as Singapore or London.

Renminbi accounts fall into four categories: Basic, General, Temporary and Special. The general account corresponds most closely to what most treasurers would think of as a current account used for general collections and disbursements. While the general account has less functionality than the basic account, the latter has special stature as a primary account and it can also be used as a concentration account or header account. Also of note are tax accounts, which, strictly speaking, are general accounts that allow the tax bureau to directly debit the various taxes that are levied. The accounts and their purposes are summarized in the following table:

| RENMINBI ACCOUNTS | | |
|---|---|---|
| Account Type | Purpose | Comments |
| Basic | The primary account maintained by a company used for funds transfer, settlement, payroll, and cash deposits/withdrawals. The opening of a basic account is subject to PBOC approval where the company is registered. | A company is allowed to maintain only one basic account and it should be opened with a bank located in the same city where the entity is registered. This is an important account and care should be taken in selecting a quality bank near the company's offices. |
| General | The company can maintain any number of general accounts with multiple banks to meet additional business needs or for special purposes set out in the rules and regulations in China. May not be used for cash withdrawals or payroll. Tax accounts are a type of a general account used to pay local and provincial taxes. | Can be used for the same types of payments and receipts as basic accounts, but not for payroll or cash withdrawals. There is no restriction in the location and number of general accounts. Tax accounts can only be opened with those banks that have an established link with the local tax bureau, and may not require the opening of an additional account. |
| Temporary and Special | Temporary accounts are only in use for a certain period of time for purposes of capital validation or bankruptcy liquidation. Special accounts may be necessary to meet legal or regulatory requirements, such as government financial, security trading and capital construction funds, or RMB capital and foreign debt accounts. | The most commonly used accounts by corporates are basic and general accounts. |

Foreign currency accounts are available in most of the major currencies including USD, EUR, HKD, JPY, SGD, AUD, GBP, NZD and CHF. They also fall into three broad categories; capital, settlement and loan accounts. Companies are required to obtain local SAFE approval prior to any foreign currency capital account opening or closing. Other types of foreign currency accounts do not require SAFE approval after the initial capital account approval has been received. The accounts and their purposes are summarized in the following table:

| FOREIGN CURRENCY | | |
|---|---|---|
| **Account Type** | **Purpose** | **Comments** |
| Capital | This account is established by the company to receive and disburse the foreign currency that is injected into China as capital for the enterprise. Chinese entities are permitted to have this account in RMB. | Registration with SAFE is required before a first time capital injection. Additional accounts may be opened thereafter without SAFE pre-approval. Holding multiple accounts is possible.<br><br>This is an important account and care should be taken in selecting a quality bank. Proximity to the company's offices is not required.<br><br>Companies can choose to establish an RMB capital account instead of a USD capital account if they want to manage their FX exposure directly. |
| Settlement | This account is used for day-to-day operational needs that are transacted in foreign currencies, such as import and export transactions. It can also be used to pay and receive funds for services rendered under a service contract agreement. | There is no restriction in terms of the number of settlement accounts, aggregate balances, and the location where the settlement account is maintained. Supporting documentation is required for third party payments. |
| Loan | This account is used for any foreign currency borrowing from both banks and overseas shareholders. | Pre-registration with SAFE is required for each foreign debt contract. After registration, accounts may be opened without pre-approval. |

# 5. Funding Operations

Funding the company is a critical function both when it is established and then once it is operational. In the case of funding, operations are divided into one of two categories; onshore and offshore, with funding options for both types are contained in the following table.

<table>
<tr><th colspan="3">FUNDING OPTIONS</th></tr>
<tr><th>Onshore Funding Option</th><th colspan="2">Description</th></tr>
<tr><td>Bank Loans</td><td colspan="2">Bank loans are the simplest and the most efficient manner to secure funding for on-shore operations. Repayment is based on a commercial arrangement with an approved financial institution, with pricing of RMB loans regulated as follows:</td></tr>
<tr><td></td><td>RMB Loan Tenor<br><= 1 year<br>1 year to 5 years<br>Over 5 years</td><td>RMB Base Rate (per annum)<br>5.60%<br>6.00%<br>6.15%<br>(Based upon PBOC announcement on Nov. 22, 2014)</td></tr>
<tr><td></td><td colspan="2">The pricing of USD loans is not regulated and continue to follow the international banking practices. However, short term and long term foreign debt quotas may restrict the approved financial institutions from leveraging offshore USD liquidity and, as a result, trigger inter-bank USD funding liquidity premiums.</td></tr>
<tr><td>Entrustment Loans</td><td colspan="2">Current regulations prohibit onshore intercompany lending and borrowing activities, but the PBOC has implemented an entrustment loan structure that allows intercompany lending and borrowing activities to take place through financial institutions that are approved Entrustment Loan Agents. The interest rates are determined by the lender and the borrower, while the fees are levied by the Entrustment Loan Agent. Other legal and tax considerations may also need to be addressed.</td></tr>
<tr><td>Trade Finance</td><td colspan="2">The Regulators encourage financial institutions to leverage a customer's trading activities to help fund their operations rather than relying on commercial bank loans. This would include traditional trade finance instruments (import LCs/TRs; export LC advising, negotiation and confirmation; AP/AR finance & guarantee/SBLC issuance), as well as structured trade finance and domestic draft issuance/discounting.</td></tr>
</table>

| FUNDING OPTIONS | |
|---|---|
| **Offshore Funding Option** | **Description** |
| Capital Injection | All capital injections must be approved by MOFCOM and SAFE. Consideration of the industry is a must, since the response to requests for capital injection by the Chinese Authorities will depend upon whether the investment is in an industry that is being encouraged, permitted, restricted or prohibited. Registered capital requirements exist and were referenced earlier in this document. |
| Shareholder Loan | Shareholder loans are a popular means for a local Chinese company to borrow from its overseas parent company, often due to the lower rates involved. Official approval must be received from SAFE based upon a business case with strong justifications, as well as the demonstration that sufficient foreign debt capacity is available. Further considerations include:<br>• Amount of foreign debt allowed for each entity is subject to a cap (being the difference between the entity's Total Investment and Registered Capital)<br>• After registration of the shareholder loan with the authorities, CNY receivables may be converted to FCY to repay foreign debt<br>• Approved repayment schedules must be strictly adhered to |
| Local Borrowing Secured by an Overseas Parent | Start-ups with weak credit often obtain onshore funding by securing guarantees from the overseas parent. Approved financial institutions often prefer that the local Chinese entity be wholly owned by the overseas parent as a means to avoid future commercial disputes. |
| Trade Finance | Structured trade finance structures are often used as part of a solution to help fund local operations, including RMB cross border trade settlement. As this option often involves tailored structuring due to the complexity, the parties involved need to have a comprehensive understanding of the circumstances before proposing possible solutions. |

# 6. Payment Systems

China is a huge country which less than 100 years ago was relatively poor and undeveloped. Recent developments in payment systems have been as rapid as they have been sophisticated but they have not been consistent through the country. This leaves some areas of the country badly out of date while others operate at the leading edge of sophistication. The challenge for companies operating thoughout China is that they need to accommodate this diversity along with a variety of payment methods ranging from cash to electronic systems. This makes it difficult to adopt a single approach to dealing with collections and disbursements nationwide and requires flexibility and local expertise.

**Chops, or seals are stamps that serve a similar function in China and other parts of Asia that facsimile signatures do in some Western countries, although the Chop may actually represent a family or company. Leaving aside the security issues and benefits of the Chop they are widely accepted and participants to a transaction will look to make sure that instruments that they send or receive are properly affixed with the company chop. For example, an electronic payment approval might well be expected to have a company chop prior to the payment being processed.**

Cash is widely used as a mode of payment in China, often in face-to-face retail payments, and even sometimes among corporate customers. Non-cash payment instruments in use include negotiable instruments (primarily checks), bank cards and remittances. The recent use of non-cash payment instruments in China is summarized in the following table:

| NON-CASH PAYMENT DATA | | | |
|---|---|---|---|
| Categories | Instruments | % Distribution (2010) | |
| | | By Volume | By Value |
| Negotiable | Checks (92% of category volume), bank drafts, commercial drafts, bank promissory notes | 3.24 | 31.43 |
| Bank cards | Debit (80% of cards) and credit cards | 92.97 | 27.26 |
| Remittances | Credit transfers (intercity payments) and interbank remittances | 3.69 | 40.07 |
| Other | Regular debits and credits, domestic letters of credit | 0.2 | 1.24 |

Source: BIS China Redbook 2012

Online payments have developed rapidly to match the growth in eCommerce and include internet, mobile, telephone and digital TV through public or dedicated networks, with internet payments playing a dominant role.

The national payment systems that most treasurers include when planning their payment strategies are operated by the PBOC and described in the following section.

## 6a) National Payment Systems (PBOC)

China's national payment system has played an important role in driving the country's recent economic and social development. Payment service providers have diversified, forming a framework of market players. As such, the services have become increasingly market oriented. The payment systems of the People's Bank of China (PBOC) serve as the backbone of the overall payment architecture, while the payment systems of banking institutions provide the primary infrastructure. Systems such as the interbank bankcard transaction clearing system, the foreign exchange settlement system and the local clearing systems are important components.

To support the application of negotiable instruments, bank cards and other payment instruments, the PBOC has developed and owns several interbank payment systems, including the China National Advanced Payment System (CNAPS), the Check Image System (CIS), the China Domestic Foreign Currency Payment System (CDFCPS) and the Electronic Commercial draft system (ECDS). The PBOC is also developing an offshore clearing platform for CNY called China International Payment System (CIPS) which is expected to be operational by the end of 2015.

### *6a1) China National Advanced Payment System (CNAPS)*

The High-Value Payment System (HVPS), the Bulk Electronic Payment System (BEPS) and the Internet Banking Payment System (IBPS) are the three primary application systems of the China National Advanced Payment System (CNAPS).

**6a1.1) HVPS**, a Real Time Gross Settlement (RTGS) system, performs real-time processing of large-value funds on a gross amount basis. Payment instructions are cleared transaction by transaction. This system mainly handles inter-city and local credit transfers above a given value, as well as urgent low-value electronic transfers.

**6a1.2) BEPS** targets low-value payments using an overnight batch process. The system sends payment instructions in bulk, nets in real time and settles at regular times. This system deals mainly with local and non-local paper-based debit payments as well as low-value credit transfers below the payment value threshold of RMB50,000 (current).

**6a1.3 IBPS** mainly handles interbank retail payment transactions via the internet, enabling customers to submit online payments and obtain results in real time. IBPS can support direct debit transaction and inter-bank account enquiry. This system allows public utility companies to initiate direct collection transactions to collect utility payments and social security funds. It also allows companies to disburse salary, allowances and social security insurance fund payments to beneficiaries nation-wide via their accounts maintained in different banks.

### *6a2) Check Image and Clearing System (CIS)*

CIS is a check truncation system supporting the use of checks nationwide. It converts physical checks into images, and then transmits the image and related information to the drawer's bank. Checks written by individuals and enterprises can be accepted nationwide, facilitating non-local settlement and enhancing the active role of check settlement in the economic and social development.

### *6a3) China Domestic Foreign Currency Payment System (CDFCPS)*

CDFCPS is an RTGS system developed by PBOC for the handling of foreign currency payments linked to domestic purchases of goods and services. CDFCPS can process payments in eight currencies, but does not involve foreign exchange transactions. The eight currencies and the primary participating Chinese local banks are as follows:

- USD: Bank of China
- EUR, JPY: Industrial and Commercial Bank of China
- HKD: China Construction Bank
- GBP, CHF, CAD, AUD: Shanghai Pudong Development Bank

### *6a4) Electronic Commercial Draft System (ECDS)*

The Electronic Commercial Draft System (ECDS) of the PBOC is designed as a comprehensive commercial drafts handling system and is also used to support dematerialization of paper-based commercial drafts with seals or signatures. ECDS minimizes fraud risk of commercial drafts and supports issuances, endorsements, discounts, interbank discounts, rediscounts, pledges and cancellation of pledges, guarantees, presentations and recourse of electronic commercial drafts.

## 6b) Local Clearing House Systems

In addition to the national systems a number of local clearing systems conduct centralized exchange and netting of local electronic and paper-based instruments. This improves efficiency and reduces cost. Many of these systems are still paper based clearing systems with specific clearing rules and turnaround times. These local clearing systems are mainly operated by PBOC branches. To appreciate the overall size of this system, PBOC branches owned and operated 1,017 local clearing houses in 2010, while an additional 144 local clearing houses were owned and operated by private entities in China.

**China Union Pay (CUP) Clearing System—China Union Pay (CUP) is approved and overseen by PBOC to provide clearing services for bankcard transactions between issuing institutions and acquiring institutions. As such, CUP facilitates the clearing of ATM, debit cards and credit card transactions through point of sale (POS), internet and telephone for all domestic card settlements. CUP has been working with more than 50 countries to allow the CUP-based ATM/debit cards/credit cards to be widely accepted globally. Many foreign banks have signed up with CUP to offer their clients direct debit and payment services to any bank account anywhere in China.**

**City Commercial Bank Draft Processing System—Clearing Center for City Commercial Banks (CCCB), a non-profit-oriented entity registered in Shanghai, mainly engages in clearing services and other business approved by PBOC. It clears transactions relating to bank drafts, online payments, and interbank deposits and withdrawals, largely serving city commercial banks, urban credit cooperatives and rural banks.**

**Rural Bank / Credit Cooperative Clearing System—Rural Credit Banks Funds Clearing Center (RCBFCC) is registered in Beijing and provides clearing services for real-time electronic fund transfers, bank drafts, and interbank deposits and withdrawals for China's rural credit cooperatives, rural commercial banks, rural cooperative banks and other local financial institutions. Their system assists the Rural Bank and Credit Cooperatives (RCCs) streamline the clearing procedures amongst the RCCs in rural locations.**

**Major Local Banks' Internal Payment Systems—Almost all major local Chinese banks have invested heavily in their technology infrastructure to setup clearing systems within the same bank on a nation-wide basis. Most of the clearing systems operate across various branches/cities almost instantaneously. These systems are an important part of the overall Chinese clearing system and allow the local Chinese banks to compete amongst themselves and the foreign banks.**

**Additional Foreign Currency (FCY) Clearing Systems—There are a number of FCY clearing systems in China for domestic FCY remittances. Besides the PBOC set up already documented, the most noticeable systems setup is the Shenzhen clearing system. It facilitates the real-time FCY settlement between Shenzhen and Hong Kong for USD and HKD.**

# 7. Trade Finance

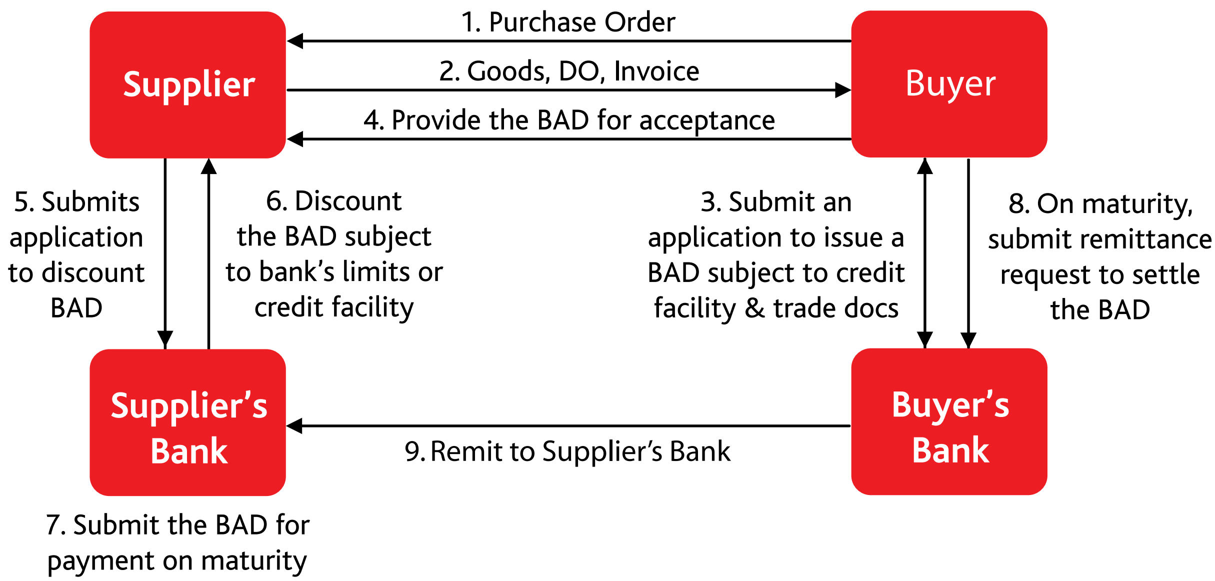
Trade finance is an integral tool in China commerce, both on the import and export side. Accordingly, most Chinese and major trade finance banks are able to offer a comprehensive suite of commodity, trade and supply chain finance solutions for risk mitigation, settlement, financing and information solutions. These solutions for companies operating in China cover the complete trade services spectrum from traditional paper-based documentary credits to sophisticated web-based services, including these traditional trade products:

- Import LC Issuance
- Post-Import Financing; e.g. trust receipt loan
- LC confirmation (including silent confirmation or CtP)
- Export LC advising
- Export LC negotiation / discounting (with or without recourse basis)
- Export / Import Collection
- Transfer LC
- Standby LC / Guarantee / Bond Issuance
- Packing Loan / Pre-export Financing

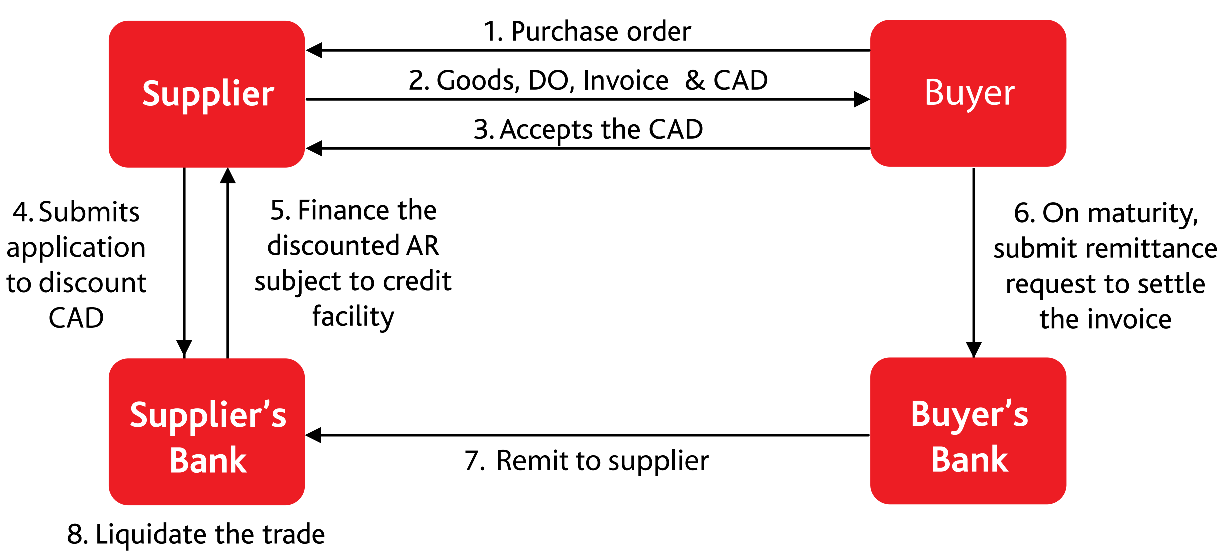
## 7a) Domestic Trade Finance

Domestic RMB LCs are not governed by the internationally recognized Uniform Customs and Practice (UCC), even though international RMB LCs are. As such there is low utilization of domestic RMB LC's as a form of domestic settlement. Instead, many corporates use RMB drafts as a form of settlement, an option that is cheaper and more efficient. For this form of settlement, China has established a set of regulations called the Negotiable Instrument Act to govern the use of drafts to support domestic trading activities, with Bank Acceptance Drafts (BAD) and Commercial Accepted Drafts (CAD) as the most frequently used settlement tools, especially since they can be managed electronically.

As shown in the process flow chart below, the BAD issuance and discounting process begins when a buyer has purchased goods from the supplier. The supplier issues the required invoices and requests payment. Subject to their mutual agreement, the buyer may choose to apply for a BAD to either extend the payment terms or act as an IOU instrument to the supplier. Before a bank can issue the BAD, the buyer must produce sufficient evidence (through the purchase/sales agreement, invoice & delivery order) that there is a genuine trade transaction. If the BAD is issued through ECDS in electronic form, the supplier is then able to present the BAD to the bank for financing with a maximum tenor of 1 year. The financing rate is subject to the financing bank agreement with the supplier and can be set at market rates.




The CAD issuance and discounting process between the buyer and supplier, as shown below, begins in a similar fashion when the buyer purchases goods from the supplier. The supplier will issue the CAD and request the buyer to accept the CAD. If the supplier requires financing, he can then present the CAD to the bank for financing with a maximum tenor of 1 year if issued through ECDS. Before the supplier's bank can discount the receivable, the supplier must produce sufficient evidence (through the purchase/sales agreement, invoice and delivery order) that there is a genuine trade transaction. The financing rate is subject to the financing bank agreement with the supplier and can be set at market rates. In addition, the discounting party is required to maintain a RMB account with the discounting bank.



As noted in the process flow charts, the BAD and CAD drafts can be structured to deliver an accounts payable, accounts receivable or supply chain solution.

## 7b) Structured Trade Finance

For more complex situations, there are a number of solution providers that offer structured trade finance solutions as follows:

1. **Supply Chain Finance Management**—Many companies work with their bankers to structure flexible solutions to provide financing to their distributors and suppliers where a credit insurance provider helps to mitigate the sovereign and credit risk.

2. **Inventory Financing**—There are a number of solution providers that offer innovative solutions to finance inventory in China. These providers are often able to structure inventory financing involving a collateral management agreement along with the appointment of a collateral manager for a bonded warehouse. Using back-to-back LC arrangements is also a common structured trade financing approach for inventory financing.

3. **Document Preparation**—Many banks are offering document preparation services to support L/C's, documentary collections or open account sales. These services help to optimize a company's days sales outstanding (DSO) and avoid potential errors in preparing documents.

# 8. Global Integration

One of the greatest challenges in managing treasury in China is integrating the liquidity position in China within a regional or global structure. Until the recent past it was necessary to move Chinese liquidity out of the country in the form of trade flows with the attendant, and time consuming paperwork, or dividends and their attendant paperwork and approval cycle. These constraints made conventional sweeping or pooling structures impractical and so China was generally excluded from larger treasury structures.

The first crack in the edifice came in 2009 when selected companies were permitted to trade the offshore RMB known unofficially as CNH (the CN designating China and the H designating Hong Kong). These RMB were in many respects similar to the Eurodollar of old typically trading at par with the official onshore RMB, CNY. In this scheme a company would move CNY to Hong Kong and then trade the CNH into the global position. As the CNH is not considered foreign exchange and therefore not subject to prior approval by SAFE the transactions, which are electronic, were fast and efficient. The scheme liberalized again in 2011 when it was extended to any Chinese company, locally or foreign owned.

Two SAFE-originated possibilities for cross border loans have improved things even further, one of which would enable conventional sweeping of funds as drawdowns and repayments of loans. The first is a program for intercompany loans in foreign currency, but because this approach requires pre-approval by SAFE, it is not a convenient treasury management tool. The second possibility is the introduction of FX Concentration Header Accounts which enable onshore companies to manage FX using bank accounts in Shanghai. Funds in these accounts can be swept cross border thereby integrating them into regional and global liquidity structures. Additional liberalizations also make it possible for the Chinese WOFE to participate in global cash pools.

SAFE's reason for permitting this and previous liberalization is both to internationalize the RMB and to make Shanghai an international financial center by the end of the decade. The benefit however, is entirely to companies with the scale of operations in China and general treasury sophistication to take advantage of the scheme.

It appears that in Shanghai special PBOC approval is not necessary to enter into this kind of structure as the PBOC has delegated the approval to banks operating in the area. Of course, nothing prevents a company from proposing a similar structure somewhere else in China and then seeking approval from the PBOC.

When cross-border loans are implemented under an intercompany lending facility, or as a bank-automated sweep they permit the integration of Chinese liquidity with the rest of the enterprise, with a major exception. Integrating Chinese liquidity requires that the balance of the loan must be a net loan from China to offshore. A full and true two-way sweep is obviously on the treasury wish list and is being tried in the Shanghai Free Trade Zone with potential national rollout within the next twelve months.

Another restriction, albeit a small one is that the maximum amount of the intercompany loans is capped at the total capital of the onshore entity. Between rapidly changing regulations designed to make China more of a global financial power and the creativity and needs of global treasurers, integration between Chinese and other treasury structures is certainly going to be an important area to watch and where no liquidity structure should be implemented without expert, current advice.

# 9. Treasury Technology

The many changes that have occurred recently in China have triggered actions to elevate treasury to its key role of supporting company growth, preserving capital and managing risk. At the heart of this is the need for both visibility and integration, elements that require standardized infrastructure with connectivity in today's business landscape. In this regard, treasury organizations of many companies have transformed or are in the process of transforming from a survival mode that relied on the deployment of spreadsheets and manual processes to handle complex treasury operations to an updated landscape that includes the use of ERP systems and treasury management systems (TMS) to capture the benefits of centralization, automation and auditability. This change is occurring in lockstep with the improvements in China's underlying payment infrastructure that facilitate access to real-time cash position data, as well as advancements in technology in the banking industry.

The adoption and implementation of new technology, whether it's hardware or software, is not without its challenges however, and these include:

- Chinese GAAP and accounting regulations require a Chinese version of accounting software, a separate chart of accounts to conform to relevant PRC accounting regulations, as well as standardized reporting formats stipulated by the authorities. This can be accomplished by the localization of an ERP system or the adoption of a financial general ledger interface solution.
- Optimizing payment processes and ensuring reliable payment processing are a top priority of treasurers. Many recommend the use of SWIFT Standards XML messages (MX), not SWIFT Standards FIN messages (MT), for all CNY payments since MX natively supports Chinese (based upon ISO 20022 XML). Interestingly enough, CNAPS Generation 2 is to be SWIFT based and multi-lingual, using ISO 20022 XML, which is inherently compatible with SWIFT MX messages.
- Driven by national security concerns, Chinese regulators have released policies about information security and have initiated widely publicized anti-trust probes. As a result, many in China are currently wary about entrusting sensitive financial data to the cloud, which limits technology adoption.
- China maintains tight control over the internet, using a censorship mechanism known as the "great firewall of China" to regulate and monitor internet use. Blocking methods have been used to control access to the internet, including actions such as preventing the downloading

of emails from Gmail accounts without VPN (virtual private network) software in place, making email communication difficult for companies operating in China that use Google Gmail.

- To ensure the use of safe technology, China plans to bolster its technology sector and step up efforts to encourage a shift to the use of Chinese suppliers at all layers of technology, from application and middleware down to infrastructure software and hardware. In fact, there are number of local Chinese technology providers that are able to offer multi-bank access. These developments may drive foreign companies to consider whether or not to share their core knowledge and key technologies in order for their products to be seen as safe and controllable. As a point of reference, solution providers in China include:
    - Global/regional technology solution providers in China include Misys and Murex for banks/financial institutions and Microsoft, SAP, Oracle, JDE, SunGard and Reval for corporates.
    - Up and coming Chinese companies in the technology arena include China Standard Software Company (NeoKylin operating system), Inspur Electronic Information Industry Company (servers) and Beijing Orient National Communication Science & Technology Company (software products).

With the many changes now in place in China comes a steep learning curve for all involved, including corporates, bankers, counterparties, regulators and taxing authorities, just to name just a few. Given its evolving nature, the overall communication challenge is huge, with misinformation a likely by-product. Advice here is pretty straightforward:

1. Partner with experienced technology solution providers you trust, many of whom can provide multi-bank access.
2. Look to leverage the enhancements in your bankers' infrastructure.
3. Build robust business cases for the results you seek. If it is real-time visibility into cash positions and fx exposures, with the cash positions fully automated and integrated into an ERP/TMS infrastructure, then work hard to quantify the benefits of eliminating manual efforts, saving costs and enhancing overall risk management.
4. Use a disciplined project management process to implement your solution.

# 10. Putting it Together

Much of this paper, and other writings on treasury management in China focus on how different and difficult it is compared with other parts of the world. While this is true, it is also true that treasurers and bankers working in China are resourceful in crafting solutions that work for their companies and industries. In this section, the focus is on how others have assembled the components described in previous sections into creative approaches to common problems.

**Domestic Payments**—Consider integrating the ERP system with the bank's web platform or in a host-to-host solution. This reduces errors generated from using multiple systems with manual interventions and can enable straight through processing rates well over 80%. By communicating directly with the bank it is also possible to push cutoff times to the maximum while handling large volumes of payments in virtually real time—with information reporting to match.

**Cross-Border Payments**—Here too there is the scope to integrate the ERP system with the bank's web platform or in a host-to-host solution. This has similar benefits to domestic payments but adds efficient regulatory reporting by seeking SAFE approval to simplify the reporting process.

**Direct Debits**—Directly debiting customer accounts is the most efficient way to collect funds, while reducing DSO and easing the challenges of cash application. This is possible when the ERP is integrated with the bank and leveraging information about the payer's account and payment amount to process payments through China Union Pay (CUP). It has the benefit of being bank-agnostic in that customers can have accounts with virtually any bank that offers CNY accounts and has a good working partnership with CUP. With real-time collection status possible through various formats this is an excellent way to gain control of the collection process.

**Virtual Accounts**—Banks with sophisticated back-office systems can offer virtual accounts which enable their customers to identify the paying party without opening a correspondingly large number of accounts. This type of approach leverages flexibility in parsing a larger account by contract number, business unit code or some other customer-meaningful nomenclature. It offers the standard benefits of real-time information within the capabilities of the bank and daily reporting of value added information.

**Cash Pooling**—Pooling is a well-recognized technique for optimizing internal company liquidity and is possible to implement within China. A single master agreement can define the sweeping arrangements of all the participating entities and, depending on the bank, customers can experience zero/target balance sweeping, tax-efficient sweeping, intra-day overdraft and reverse sweeping. Tax efficient sweeping is a new capability offered by the more innovative banks which allows companies to sweep the minimal amount required to optimize liquidity and keep tax payments, including the business tax as low as possible.

# 11. Summary

There are two facts that confront every treasury responsible for managing financial operations in China. First, the financial environment is complex and changing. Second, the business opportunity is so great that treasurers have no alternative but to find a way to manage their treasury operations. This guide has provided information on some of the key dimensions of treasury in China such as payments, technology and liquidity management. Interpreting the facts presented here suggest that experienced treasurers will begin to think of China in the same way they think of the US or other large countries. A country with the potential for large indigenous business operations that requires expert local staff and where the economics can justify the financial presence. Further, that while China is very large, it can still be integrated into regional and global treasury operations.

There are no shortcuts to developing an excellent treasury structure in China. As with other key parts of the world, the keys to success are information, hard work and persistence.

# 12. Appendices

## Glossary of Acronyms

| | |
|---|---|
| **ABS** | Central Bank Accounting Booking System |
| **BAD** | Bank Acceptance Drafts |
| **BEPS** | Bulk Electronic Payment System |
| **CAD** | Commercial Acceptance Drafts |
| **CBBS** | Bond Bookkeeping System |
| **CBGS** | Central Bond Generalized System |
| **CBRC** | China Banking Regulatory Commission |
| **CCCB** | Clearing Center for City Commercial Banks |
| **CCDC** | China Central Depository & Clearing Co., Ltd. |
| **CCP** | Central Counterparty |
| **CCPC** | City Clearing Processing Center |
| **CDFCPS** | China Domestic Foreign Currency Payment System |
| **CFETS** | China Foreign Exchange Trading System |
| **CFSTC** | China Finance Standardization Technical Committee |
| **CHC** | China Holding Company |
| **CIPS** | China International Payment System |
| **CIRC** | China Insurance Regulatory Commission |
| **CIS** | Check Image System |
| **CMU** | Central Moneymarkets Unit |
| **CNAPS** | China National Advanced Payment System |
| **CNCC** | China National Clearing Center |
| **CNH** | Unofficial ISO code for offshore Renminbi |
| **CNY** | Chinese Yuan |
| **CRMW** | Credit Risk Mitigation Warrants |
| **CSRC** | China Securities Regulatory Commission |
| **CUP** | China Union Pay |
| **ECDS** | Electronic Commercial Draft System |
| **FCY** | Foreign Currency |
| **FIE** | Foreign Investment Enterprise |
| **HKMA** | Hong Kong Monetary Authority |
| **HVPS** | High-Value Payment System |
| **IBPS** | Internet Banking Payment System |
| **MOF** | Ministry of Finance |
| **MOFCOM** | Ministry of Commerce |
| **NDRC** | National Development and Reform Commission |
| **NPC** | National Processing Center |
| **PBOC** | The People's Bank of China |
| **PBOC** | People's Bank of China |
| **PRC** | People's Republic of China |
| **RCBFCC** | Rural Credit Banks Funds Clearing Center |
| **RHQ** | Regional Headquarters |
| **RMB** | Renminbi |
| **SAFE** | State Administration of Foreign Exchange |
| **SAIC** | State Administration for Industry and Commerce |
| **SASAC** | State-Owned Assets Supervision and Administration Commission |
| **SD&C** | China Securities Depository and Clearing Corporation Ltd |
| **SFTZ** | Shanghai Free Trade Zone |
| **SHCH** | Shanghai Clearing House |
| **SOE** | State-Owned Enterprise |
| **WOFE** | Wholly Owned Foreign Enterprise |

# Key English Language Websites

| | |
|---|---|
| **CBRC** | China Banking Regulatory Commission<br>http://www.cbrc.gov.cn/english/index.html |
| **CFSTC** | China Finance Standardization Technical Committee<br>http://www.cfstc.org/publish/en/index.html |
| **CIRC** | China Insurance Regulatory Commission<br>http://www.circ.gov.cn/Default.aspx?alias=www.circ.gov.cn/english |
| **CSRC** | China Securities Regulatory Commission<br>http://www.csrc.gov.cn/pub/csrc_en/ |
| **CUP** | China Union Pay<br>http://en.unionpay.com/comInstr/aboutUs/list_aboutUs.html |
| **HKMA** | Hong Kong Monetary Authority<br>http://www.hkma.gov.hk/eng/index.shtml |
| **MOF** | Ministry of Finance<br>http://english.gov.cn/state_council/2014/09/09/content_281474986284115.htm |
| **MOFCOM** | Ministry of Commerce<br>http://english.mofcom.gov.cn/ |
| **NDRC** | National Development and Reform Commission<br>http://en.ndrc.gov.cn/ |
| **PBOC** | People's Bank of China<br>http://www.pbc.gov.cn/publish/english/963/index.html |
| **SAFE** | State Administration of Foreign Exchange<br>http://www.safe.gov.cn/wps/portal/english/ |
| **SAIC** | State Administration for Industry and Commerce<br>http://www.saic.gov.cn/english/aboutus/ |
| **SASAC** | State-Owned Assets Supervision and Administration Commission<br>http://www.sasac.gov.cn/n2963340/n2964712/3050194.html |
| **SD&C** | China Securities Depository and Clearing Corporation Ltd<br>http://www.chinaclear.cn/english/About/about_index.shtml |
| **SFTZ** | Shanghai Free Trade Zone<br>http://en.shftz.gov.cn/ |
| **SHCH** | Shanghai Clearing House<br>http://www.shclearing.com/DBS |

## About DBS

**DBS—Living, Breathing Asia**

DBS is a leading financial services group in Asia, with over 250 branches across 17 markets. Headquartered and listed in Singapore, DBS has a growing presence in the three key Asian axes of growth: Greater China, Southeast Asia and South Asia. The bank's capital position, as well as "AA-" and "Aa1" credit ratings, is among the highest in Asia-Pacific. DBS has been recognised for its leadership in the region, having been named "Asia's Best Bank" by The Banker, a member of the Financial Times group, and "Best Bank in Asia-Pacific" by Global Finance. The bank has also been named "Safest Bank in Asia" by Global Finance for six consecutive years from 2009 to 2014.

DBS provides a full range of services in consumer, commercial, middle market and corporate banking activities across Asia. As a bank born and bred in Asia, DBS understands the intricacies of doing business in the region's most dynamic markets. These market insights and regional connectivity have helped to drive the bank's growth as it sets out to be the Asian bank of choice.

For more information on our products and services contact Jenny Young (jenniferyoung @dbs.com) or Meetu Singh (meetusingh@dbs.com).

## About Treasury Alliance Group LLC

Treasury Alliance Group consults with clients globally in the areas of treasury operations, banking, payments, technology and risk. With decades of experience our consultants deliver practical, realistic solutions that meet each client's unique requirements. We welcome the opportunity to discuss how our experience can help meet your challenges.

Contact us by email at contact@treasuryalliance.com or call +1 630-717-9732.