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Another offshore renminbi centre? Taiwan's Opportunities and challenges

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The Central Bank of the Republic of China (Taiwan) (CBC) announced on February 6, 2013 to permit local banks' renminbi (Rmb) business in Taiwan, about a week ahead of 2013's Lunar New Year holiday break, which is the most important traditional holiday in both China and Taiwan. The Bank of Taiwan Shanghai-branch, also launched its New Taiwan Dollar (NT\$) - Rmb currency exchange business on April 2, 2013. The lawful currencies of Taiwan and China (NT\$ and Rmb), have been officially circulating in the banking systems and the daily lives of people on both sides. This is a remarkable breakthrough in the cross-strait financial market.

LAUNCH RMB BUSINESS IN TAIWAN

This remarkable breakthrough started on August 31, 2012, the date when the CBC and People's Bank of China (PBOC) signed a memorandum of understanding on the cross-strait currency clearing system (Currency Clearing MOU), establishing a basis for Rmb clearing services on both sides. This is the first time the central banks on both sides have signed an official agreement to facilitate their cooperation in the central banking system and foreign exchange regulations across the Taiwan Strait.

Following the execution of Currency Clearing MOU, the CBC and the PBOC announced on September 17, 2012 and December 11, 2012 to appoint the Bank of Taiwan - Shanghai branch and the Bank of China-Taipei branch as an NT\$ clearing bank in China and an Rmb clearing bank in Taiwan respectively. The appointments formed a stepping-stone for officially launching the Rmb and NT\$ business in Taiwan and China.

To serve as the basic rules for local banks (DBUs) to operate their new Rmb business, the CBC promulgated its amendments to the Regulations Governing Foreign Exchange Business of Banks on January 25, 2013. The summary of such amendments are as follows:

1. DBUs may launch their Rmb business after opening an Rmb clearing account respectively with the Bank of China, Taipei branch.
2. The daily conversion limit for Taiwanese individuals is Rmb20,000 per person per transaction or Rmb20,000 per day for transactions through his/her account.
3. The daily limit for each Taiwanese individual's Rmb remittance to China is Rmb 80,000, for current account transactions. The remitter and recipient of each Rmb remittance may be in different names.

The DBUs, after signing settlement agreements and opening their Rmb settlement accounts with the Bank of China, Taipei branch, launched their Rmb business in Taiwan starting from February 6, 2013 in accordance with the above rules.

According to the CBC's statistics, as of July 31, 2013, there were 61 DBUs and 55 offshore banking units (OBUs) engaging in Rmb business in Taiwan. The total deposit balance of these DBUs and OBUs hit a

historical high of Rmb76.86bn in just five and a half months from February 2013. The total remittance amount of Rmb through DBUs and OBUs in July 2013 was Rmb67.32bn, up by about 80% from Rmb 37.52bn in June 2013. It is believed that China's unexpected Rmb shortage in June 2013 because PBOC withheld its funding to the banking system in China would be the reason for this remittance surge. The total settlement amount of Rmb by all Taiwanese banks through the Bank of China, Taipei branch in July 2013 reached Rmb118.8bn, another historical record since February 2013. This is also the first time that this settlement amount has exceeded the Rmb 100bn threshold.

RMB DERIVATIVES BUSINESS AND STRUCTURED PRODUCTS

The CBC on January 29, 2013 also announced its permission to DBUs to conduct two types of Rmb-related derivative transactions:

- (i) principal-settled and non-principal settled Rmb derivatives involving the Rmb exchange rate or interest rate and structured products with a combination of the above; and
- (ii) derivatives and structured products with a link to the PRC stock index or specific shares issued by a PRC listed company.

Since the CBC offered a simplified process for DBUs to expand their derivatives business to Rmb-related ones, DBUs are in a better position to offer their Rmb derivatives business to investors in Taiwan. In addition, some Rmb structured products are offered to local investors through retail banking channels after February 2013, further expanding the diversified investment spectrum for Taiwanese investors.

ISSUANCE OF FORMOSA BONDS IN TAIWAN

The Rmb cash pool in Taiwan has grown so fast since February 2013 and therefore limited Rmb exit options have become an issue for local banks. The first Formosa Bonds issued by Chinatrust Commercial Bank, a leading bank in Taiwan, were listed on the GreTai Securities Market for trading on March 12, 2013. The size of this issuance was Rmb 1bn with a term of three years at an interest rate of 2.9% p.a., which was lower than the funding cost in Hong Kong through issuance of Dim-sum Bonds. Formosa Bonds (the same as Dim-sum Bonds),-are offshore Rmb denominated bonds issued in Taiwan, unlike Dim-sum Bonds which are issued in Hong Kong. It is a market view that Formosa Bonds are attractive to issuers located in China, Taiwan and Hong Kong because the costs borne by the issuers of Formosa Bonds are lower than those in Hong Kong. In addition, local investors are more interested in purchasing this product because Formosa Bonds offer a higher interest rate than NT\$ bonds.

Also, in order to expand the market share of Formosa Bonds, the FSC has officially announced its amendments to various regulations on August 27, 2013:

- (i) The FSC's prior registration requirement has been exempted for foreign currency denominated straight bonds (including Rmb bonds) issued by foreign issuers targeting the sale to local institutional investors only. Those bonds need to be registered with the GreTai Securities Market for trading on the over-the-counter market. Prior filing with the CBC is required instead of its prior approval.
- (ii) The existing mandatory rating requirement for foreign currency denominated corporate bonds has been removed. Issuers may decide by themselves whether they will obtain the credit ratings from Standard & Poor's, Moody's, Fitch and other rating agencies.
- (iii) The FSC also abolished its rating requirement for shelf registration of straight bond issuances if the governing law of such issuance will be foreign law. Instead, the FSC sets forth other requirements

for this foreign governing law privilege, such as the minimum listing history of the foreign issuers shall be at least three years or more and there should be no default or regulatory sanctions record of those foreign issuers in the most recent three-year period.

It is expected that the whole straight bonds issuance process will be simplified and shortened and the underwriting period and costs will be reduced after the above new rules have been adopted.

TAIWAN – ANOTHER RMB CENTRE?

Hong Kong is the most active offshore Rmb centre with high liquidity in the global financial market. Although Rmb's internationalisation still has a long way to go, Taiwan, Singapore and London are competing with each other to try and win this fierce war to become another Rmb centre regionally and even globally.

Taiwan has had a significant amount of trade surplus with China because of its close trading relationship with China for decades. Taiwan, as one of the most essential manufacturing and logistics centres of high technology products, also has its own advantages in this contest with other competitors. Sharing a similar cultural background and language, there is a seamless connection between China and Taiwan. Sizable investments by Taiwanese investors in China and their deep involvement in the supply chain management in the Great China area provide a sound and solid basis for pooling, trading and funding of Rmb. The growth in visitors from China and their spending in Taiwan after June 2011, when Taiwan first permitted independent visits of individual tourists from China to Taiwan, also increased the circulation of Rmb with cross-strait travels. The anticipated execution of a swap agreement between the CBC and POBC, hopefully by the end of 2013, will also be helpful to develop a stable, sound and liquid environment for the cross-strait financial industry. All of the above factors contribute to Taiwan being in a favourable position to become another offshore Rmb Centre.

However, the fragile relationship between Taiwan and China invites uncertainty for this goal. Also, opinions are divided inside Taiwan on a more open direction to the Taiwan-China relationship because of lack of trust and political competition. The financial deregulation in Taiwan on Rmb products is still at a slow pace, in some market players' view, and a detailed action plan for Taiwan to become another offshore Rmb centre is still in discussion. It is also unclear whether making Taiwan an offshore Rmb centre is the Taiwan government's top priority in its financial policy. Therefore, it would take time to reach the consensus and form the strategies for this aim.

Taiwan has a limited internal financial market due to its population size and its nature of being a small island inherently. The link to Rmb would provide some opportunities for Taiwan to play a more important role in the regional and global financial markets by leveraging the trend of Rmb internationalisation although it will take time and effort to reach this destination. However, challenges remain for Taiwan to build up its capacity to become an offshore Rmb centre next to Hong Kong and outperform its competitors, including Singapore and London. More confidence, ambition and internal consensus, together with financial deregulation and a well-designed action plan would be needed for Taiwan to ensure its presence and eventual success in this battle.

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