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Renminbi – An opportunity for the London market?

Much has been written recently in the European press regarding the internationalisation of the RMB and earlier this year, London announced that it was in talks with the Hong Kong Monetary Authority to explore London as a base for the offshore RMB trading platform in Europe. While the ongoing effort to expand further the scope for investments in offshore RMB products is undoubtedly exciting, much of the commentary has glossed over the key fact that the RMB is not a freely convertible currency.

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Brief history of the Offshore RMB market – a path to internationalisation?

Comparisons between the offshore RMB market and the early Eurobond market are misleading and ignore the fact that the RMB is not a freely convertible currency at present. The Chinese government has recently permitted the movement of renminbi ("RMB"), the legal currency of the People's Republic of China ("PRC"), outside of the PRC although the amount of RMB that can be moved "offshore" and the amount that can be moved back "onshore" is controlled through quotas and approval systems administered by PRC regulators. Taking advantage of this liberalisation of the RMB, China Development Bank issued the first offshore RMB bond in 2007.

In 2010, the rules and regulations governing offshore RMB denominated products were further relaxed and since then the offshore market has evolved at an extraordinary pace, a trend that is expected to continue. The relaxation of rules governing issuance of offshore RMB bonds has attracted a great deal of interest from non-PRC entities both in Asia and worldwide. Hopewell Highway Infrastructure, a company domiciled in the Cayman Islands and listed on the Hong Kong Stock Exchange, became the first foreign corporate entity to issue offshore RMB bonds in July 2010.

On 16 December 2011, the PRC launched a new pilot program, the RMB Qualified Foreign Institutional Investor ("RQFII"), which may reflect an increasing willingness to open channels for foreign investment in offshore RMB and provide the next step in the internationalisation of the RMB. The Chinese Securities Regulatory Commission has noted that the initial quota of the RQFII program is RMB 20 billion. In early January 2012, the first RQFII fund was launched in Hong Kong.

Some issues to consider

1. Approvals

Companies incorporated in the PRC need to obtain prior approval from the National Development and Reform Commission before issuing any offshore RMB bonds. Such initial approval will also allow for the remittance of issuance proceeds back into the PRC for the approved usage identified in the approval and for the repatriation of money offshore for the debt service and final repayment of offshore investors.

While no PRC government approval is required for offshore companies to issue offshore RMB bonds, there are restrictions on proceeds which are intended for use in the PRC as a result of regulations governing remittance of offshore RMB into the PRC. For example, no proceeds from an offshore issuance of RMB can be used for securities investment onshore. Similarly, any foreign direct investment into the PRC in the form of offshore RMB will be subject to the prior approval of the Ministry of Commerce. In contrast, the flow of offshore RMB once it is first available in the offshore market is not regulated, and structured products, investment funds and insurance products (amongst others), are constantly evolving in this rapidly growing and advancing market.

2. Evolution of deal terms

The standalone bond market developed in conjunction with EMTN issuances which added offshore RMB tranches to existing multi-currency EMTN programmes. The location of investors with available offshore RMB at that time tended to be in Asia, with a large concentration of available offshore RMB in Hong Kong. Issuers, ranging from multi-nationals such as the Asian Development Bank to Western corporates such as McDonald's, and regional corporates such as Hopewell Highway Infrastructure, took advantage of the early activity in the offshore RMB market to issue RMB denominated debt. These issuances provided relatively inexpensive funds with light covenants and few investor protections. Investors were attracted by the new asset class as well as expectations regarding RMB appreciation. As expectation regarding RMB appreciation and investor interest in RMB evolves, investors will likely push for a tightening of some if not all of the terms of the debt.

3. Refinancing opportunities

Offshore RMB bonds issued in the early days of the market tended to be short dated, less than 3 years, and therefore a number of issuers may be coming to the markets in 2012 and 2013 for refinancing. So far this year, the markets have seen a number of the more well known credits proceed with bond offerings and additional refinancings of the original issuances should be forthcoming.

Looking forward

Market observers have noted that the offshore market grew to RMB149.2 billion in outstanding value and RMB111 billion in total new issuances as at the end of 2011. Estimates for RMB issuance for 2012 vary widely with some commentators predicting that the amount of outstanding RMB could double over the course of the year. Given the impact of exchange controls on moving RMB offshore and repatriating it onshore, the growth rate in terms of the volume of offshore RMB bonds and other RMB denominated products is in the control of the PRC.

As previously noted, the RMB is not freely convertible and its future internationalisation lies firmly in the hands of the PRC. Internationalisation does continue to progress, however, both through an increased variety and complexity in RMB denominated products becoming available and an increased use of the RMB as a trade currency, particularly among the BRIC nations.

We anticipate that the offshore RMB market will evolve further, fueled by trade growth on the one hand and investor desire for additional RMB denominated products on the other, particularly in the form of bond and bank financing.

White & Case has a leading global capital markets practice, advising on the full range of securities transactions. We are distinguished through an outstanding reputation for our involvement in cutting edge and groundbreaking deals, including in the RMB market where our partners in London and Hong Kong have advised on a number of bond issues.