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China's financial liberalization: Impact on U.S. companies

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Together we'll go far

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Presenters

Romano Kwok
MD, Head of FX Trading – Asia, Co-Head of FX Spot & Emerging Markets Trading

A 17-year veteran of Wells Fargo Foreign Exchange and its predecessor companies, Romano Kwok began his career with the bank as a Senior FX Trader in Hong Kong. In 2002 Romano relocated to Charlotte, to start the Asia Trading desk, where his desk managed the FX positions during Asian hours and managed the balance sheets for the Asian Branches. Later, Romano transitioned to lead FX Business Product Development, steering the team's development of customer pricing and booking systems as well as electronic pricing delivery. In 2007 Romano moved to distribution as Head of FX Institutional Sales – Americas, covering FX sales to Central Banks, Global Financial Institutions, Pension Funds, and Hedge Funds.

Romano repatriated to Hong Kong in the middle of 2008, and has since lead the FX Team in Asia. He currently co-manages the Global FX Spot and Emerging Markets Trading team, a role he commenced in 2014. Romano began his career with Smith Barney Hong Kong in 1993 where he was a FX Spot trader. Romano holds a Bachelor of Commerce (Finance) from University of New South Wales, Sydney, Australia.

Cheng Ye
Senior VP, China Country Head of Sales, International Trade Services

Cheng Ye is a senior vice president and China head of sales of Wells Fargo International Trade Services. Based in Shanghai, Cheng is focused on growing the international trade business throughout the country as Wells Fargo expands its international services for U.S.-based commercial and corporate customers doing trade business in China, and financial institutional clients around the world handling trade flows from and to China.

Before joining Wells Fargo 8 years ago, Cheng held a variety of positions in Bank of Nova Scotia Shanghai Branch, China Everbright Bank and China Construction Bank, mainly focusing on trade finance, financial institution and corporate lending.

Presenters

Moderator

Han Lin
Senior Vice President and Deputy General Manager, Shanghai Branch/Senior Relationship Manager, Global Banking
Vice-Chair Financial Services Committee of the American Chamber of Commerce in Shanghai

Han Lin is Deputy General Manager and a Global Banking Senior Relationship Manager of the Wells Fargo in China. In his role, Han advises Wells Fargo corporate customers on their U.S-China cross-border strategic, financing and trade needs. Prior to his current position, he was Asia Regional Sales Manager for Global Payments Product Sales, and Deputy Representative and Financial Institutions Relationship Manager of the Wells Fargo Beijing Representative Office.

Prior to banking, Han worked in GE with assignments in GE Capital, Transportation and Power. He served in the U.S. Marine Corps Reserves, and is a Returned Peace Corps Volunteer with service in Ukraine. Han earned his Bachelors in Business at the University of Michigan. He later pursued a Masters in International Studies from the Johns Hopkins School of Advanced International Studies (SAIS), and a Masters of Science in Global Finance from the New York University Stern Business School/HK University of Science and Technology.

Summary from China Webinar Session 1 (March 18, 2015)

Key Takeaways: China Business Climate Survey 2015 – AmCham Shanghai

Highlights

Performance and optimism still very strong

- Significant number of companies report profitability, growth and positive cash flows
- 85% have an optimistic five-year outlook
- 59% say that China is in the top three investment destinations; 29% put China #1

However, that optimism and growth is tempered

- Increase in operating costs and the concern over a risk of an economic slowdown
- Increased perceptions of regulatory bias against international companies
- Increasing strength of domestic competition

Lack of transparency is still hindering business

- The regulatory environment seen as increasingly opaque and deteriorating
- Significant concerns over fraud and corruption and a risk of being investigated

Source: American Chamber of Commerce in Shanghai http://www.amcham-shanghai.org/ftpuploadfiles/Website/CBR/2015/2015-China-Business-Report.pdf

Key Takeaways: Financial Liberalization

China Financial Liberalization	Impact over the Next 2-3 Years	Corporate Implication
Capital Control Liberalization	▪ Targeted free convertibility (2015) between USD and RMB, and easier movement of cash in and out of China ▪ Potentially more funding options for China on-shore operations (i.e. raising cheaper capital in Hong Kong to inject equity into the China subsidiary) ▪ Increased USD-RMB volatility	▪ Cash-Rich Subsidiaries: more ways to repatriate cash provided that tax obligations are fulfilled ▪ Cash-Poor: less restrictions on borrowing from the head office (i.e. borrowing gap) ▪ Greater need for FX hedging
RMB Internationalization	▪ Easier access to offshore RMB (aka CNH) ▪ Increased cross-border transaction volume in RMB ▪ Emergence of commodities redenominated into RMB (i.e. gold)	▪ Greater demand by Chinese exporters to transact in RMB (i.e. LCs) ▪ Asia to Asia trade corridor will see the largest RMB transaction increases
Interest Rate Liberalization	▪ Peoples Bank of China (PBOC) is allowing the market to dictate lending rates and eventually deposit rates, particularly after the introduction of deposit insurance	▪ Lending rates to go down (for quality corporates) ▪ Deposit rates to go up

Foreign Exchange

Foreign Exchange: RMB Overview

Understanding the RMB Framework: The Onshore and Offshore Market

Liberalizing China currency regulations, the RMB is traded both offshore and onshore in China

- Offshore RMB currency code: CNH | Onshore RMB currency code: CNY (ISO Code)
- Though a single currency, the offshore and onshore rates differ
- The Offshore CNH rate is freely convertible and driven by commercial and speculative flows
- The Onshore CNY rate against USD is influenced by the inter-bank trading band (2% above or below) set daily by the Peoples Bank of China (Central Bank)

Rates are converging as onshore capital controls are loosened due to:

- Continued RMB Internationalization efforts such as the creation of offshore RMB centers, Shanghai – Hong Kong Stock Connect, CIPS RMB Clearing System, etc. to elevate the RMB further as a trade, investment and reserve currency
- Creation of the Asian Infrastructure Investment Bank (AIIB) – likely to include RMB loans
- Expected eventual IMF acceptance of the RMB as a global reserve currency

Customers are increasingly:

- Redenominating USD invoices into RMB
- Increasing use of the CNH to diversify balances, invest, invoice, settle and hedge
- Shift currency hedging from CNY non-deliverable forwards (NDFs) to CNH deliverable forwards/swaps. The CNH forward market is very liquid, trades 24-hours, no fixing risk

Trade

Trade: RMB versus the USD

In which currency should I make my payments?

- Trade-related payments can be made in the currency (USD or CNY) designated on the invoice. This becomes important in the negotiation process

- To prevent payment rejection, the originating bank (WFB) will ask exporter to verify:
  - Transaction is trade-related
  - All enterprises with export rights are eligible to settle their cross-border trading transactions in RMB unless such enterprises are subject to key supervision

Currency	Key Considerations
CNY *(Onshore)*	▪ Eliminates supplier's currency risk as a factor during purchase negotiations *(may facilitate better pricing terms)* ▪ Currency risk exposure can be addressed via hedging strategies
CNH *(Offshore)*	▪ Eliminates supplier's currency risk as a factor during purchase negotiations ▪ Currency risk exposure can be addressed via hedging strategies ▪ Requires that counterparty accepts payment to CNH account
USD	▪ Completed via international wire transfer ▪ Currently most common method of payment into China ▪ Places currency risk on supplier and may result in higher pricing ▪ Difficult to forecast costs if price changes with each order

Trade / FX: Payment Execution

How can Wells Fargo help execute each payment option?

Onshore

Situation*: Supplier requires payment in RMB *(onshore)

Payment in CNH:

- Wells Fargo converts USD to CNH at spot rate
- Wells Fargo remits CNH payment cross-border to onshore beneficiary bank *(supplier's bank)*
- Beneficiary bank matches customs number and credits supplier's account

Offshore

Situation*: Supplier requires payment in RMB *(offshore)

Payment in CNH:

- Wells Fargo converts USD to CNH at spot rate
- Wells Fargo remits CNH payment to offshore beneficiary bank *(supplier's bank domiciled in Hong Kong)*
- Beneficiary bank immediately credits supplier's account

Onshore

Situation*: Supplier requires payment in USD *(onshore)

Payment in USD:

- Wells Fargo remits USD payment via international wire to onshore beneficiary bank

Wells Fargo is the world's largest provider of USD wires into China

Onshore payments must be trade-related

Borrowing

High Level Variance: China versus U.S.

1. In-country Loan Practice:

	China	U.S.
Committed/ Uncommitted	WC and Fixed Assets Loan typically uncommitted and on-demand due to funding environment where > 1yr money difficult to raise, practice of companies having multiple banks, and lack of strong secondary source of repayment	Committed facilities with standard covenants in documentation including min profitability, leverage, and liquidity
Regulatory Requirements	Restriction on amount of the loan (i.e. formula to calculate the WC need. For Fixed Assets Loan, government regulates LTV based on industry)	None
	Requirement to extend via entrusted payment for any new relationship, responsibility for banks to check supporting documents and disburse the funds to third party directly	None
	Limitation on number of extensions allowed	None
Ease in documentation	Documentation will consist of a loan agreement and pledge agreement in the event taking collateral; specific language around the borrowing gap must be included in both the U.S. guarantee and the loan agreement	Standard docs include promissory note and credit agreement at a min. Landlord waiver for personal property at leased space; Certificate of Title for Equipment Loan
Ability to enforce Parent Guaranty	Can enforce guaranty but to be able to convert USD proceeds into RMB to pay off loan requires SAFE approval – will look at how much borrowing gap available	Easily enforceable so long as beneficial consideration demonstrated; no fraudulent transfer allowed

High Level Variance: China versus U.S.

2. Collateral Considerations:

	China	U.S.
Security Perfection: Perfection process	Pledge requires physical possession; mortgage requires contract and subsequent registration with relevant authorities (assets and jurisdictional specific)	UCC filing done at State level; rapid process
Ability to liquidate collateral prior to bankruptcy	Actual enforcement of collateral extremely difficult due to heavily court-involved process that also requires borrower cooperation; cash is only realizable value	Post default written notice of acceleration and subsequent foreclosure required to liquidate outside of courts; company may file to protect itself via automatic stay
Central and searchable registry for other security interests	Registries are jurisdictional and asset-specific so need to conduct various individual searches, not all registries available to the public	UCC and mortgages deed searches can be performed, done at State level

High Level Variance: China versus U.S.

3. Bankruptcy Considerations:

	China	U.S.
Ability to liquidate/restructure out-of-court	No ability to liquidate/restructure out of court	Working capital loans typically secured with easy means of liquidating collateral outside of court; out-of court restructuring are also tested with precedent
Typical Bankruptcy Timeframe	Multi-year timeframe	Chapter 7: process begins immediately, c. 18-24 months Chapter 11: restructuring plan submitted w/in 18 months of filing, 6-9 months for pre-pack; 2-3 year for restructuring
Set-off Rights	If exercise contractual set-off rights over non-pledge cash, potential to be clawed back in an insolvency; will depend on timing of exercising rights with timing of company becoming insolvent	Allowed if also permitted under state law; stayed in Chapter 7

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