

Yuan-denominated Bonds as an Alternative Source of Borrowing*

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Abstract. The article covers the actual theme of issuing bonds in Chinese national currency Yuan Renminbi by foreign entities with the focus on the latest developments in the plans of Russian financial authorities, banks and companies to issue such bonds in Russia and China as the alternative source of borrowings.

Keywords: federal loan bonds; dim-sum bonds; panda bonds; Moscow Exchange; China; Russia; yuan; internationalization; world reserve currency; CNY; RMB; CNH; financial market; investments.

Облигации в юанях как альтернативный источник заемных ресурсов

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Аннотация. Статья посвящена актуальной теме выпуска облигаций в китайской национальной валюте юанях жэньминьби иностранными эмитентами. Основной акцент сделан на актуальных планах российских финансовых властей, банков и компаний по выпуску таких облигаций в России и Китае как альтернативного источника заимствований.

Ключевые слова: облигации федерального займа; облигации дим-сам; панда-облигации; Московская биржа; Китай; Россия; юань; интернационализация; мировая резервная валюта; CNY; RMB; CNH; финансовый рынок; инвестиции.

With the decreasing of opportunities for Russia to borrow on the global financial market in connection with unilateral US and EU sanctions, the issue of finding the alternative sources of borrowed resources has acquired particular significance.

In November 2015, the Ministry of Finance of Russia first announced its intention to issue treasury bonds in Chinese yuan, and in October 2016, the director of the Department of the State Debt and State Financial Assets

of the RF Ministry of Finance K. Vyshkovskiy said that the first federal loan bonds (OFZ), denominated in RMB, for a total of 6 billion yuan (about 1 billion US dollars) is planned to be placed before the end of 2016.¹ However, less than a week passed, as Finance Minister A. Siluanov said that such a placement in 2016 will not take place, since all necessary borrowing will be made on the domestic market.² Most likely, at the end of 2016, restrictions imposed by Chinese regulators on investment activities

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abroad and difficulties in obtaining new quotas for Chinese qualified institutional investors working in the framework of QDII and RQDII programs, did not allow Russia to place sovereign bonds in yuan that could be purchased by the investors from the mainland China.

So what are the bonds in Chinese yuan and what are their specific features and the particularities of their issuance by non-residents of the PRC?

Currently, the Chinese legislation in principle allows the issuance of two types of bonds in yuan by China non-residents:

Panda bonds, i.e. bonds in yuan placed by foreign borrowers in the interbank market of the mainland China⁵ (the Chinese bond market is the 3rd largest bond market in the world after the USA and Japan.⁴ As of the end of 2016, the amount of outstanding bonds in the Chinese bond market was approximately 9.3 trillion US dollars);⁵

Dim sum bonds, i.e. bonds in yuan, issued outside of mainland China.

The issuance of **Panda bonds** is limited by regulatory measures. Issuers of such bonds may be international financial development institutions, involved in transactions on debt and investment financing of projects of a multilateral, bilateral and local nature; subsidiaries of foreign banks and foreign non-financial companies registered in the PRC. The funds in RMB obtained as a result of the issuance of such bonds can be converted into other currencies and transferred out of Chinese jurisdiction under the permission of the foreign exchange control authorities of the People's Republic of China, and can also be used to invest in projects inside the PRC.

To date, Panda bonds have been issued by IFC, ADB, Daimler AG, UFJ (China) — a subsidiary of the Bank of Tokyo-Mitsubishi, HSBC, Bank of China (Hong Kong), Standard Chartered, the administration of the Canadian province of British Columbia and the National Bank of Canada, Republic of Korea, Hungary and Poland.⁶ The government of Indonesia and the Export-Import Bank of Korea also announced their interest in placing bonds in RMB in 2016. In 2016, the amount of issued Panda bonds reached 19 billion US dollars and according to JPMorgan estimates in 2017 it could grow by 50%.⁷

In the current situation of the limited access of Russian borrowers to funding sources in the Western capital markets, the attraction of financial resources through bonded loans in the PRC has become the issue of the considerable interest. The Government of Russia, Vnesheconombank and Gazprom, which received from the Chinese agency Dagong the highest credit rating AAA with a stable outlook (Gazprombank's Dagong rating is A-), expressed their interest in the issue of Panda bonds.

At the same time, according to available data, the Panda bonds issue program has a number of key restrictions that create obstacles for the participation of Russian issuers from among the financial and credit institutions:

A small potential amount of attraction (on average, the volume of one issue is equivalent to 150–200 million US dollars.).

A local credit rating of AA or higher must be assigned by at least two rating agencies, one of which must be registered in China.

Due to the fact that the ratings of Russian issuers are generally significantly lower than required, in order to improve the placement rating, it is possible to carry out such operations under the guarantee of a local bank that is rated at least not lower than the specified level (China Development Bank, Bank of China, etc.).

The issuance of bonds in Chinese yuan should be approved by the Chinese regulators (People's Bank of China, Ministry of Finance, National Development and Reform Commission, China Securities Commission, the State Council and State Administration of Foreign Exchange). Approvals should be obtained individually for each program.

The total investment in the Chinese economy (in the form of loans granted or equity investments) made by the issuer prior to the release of Panda bonds, should exceed USD1 billion. Exemption from this requirement may be granted by the PRC State Council.

Issuers of bonds are required to prepare financial statements in accordance with Chinese accounting standards. Exemption from this requirement may be provided by the Ministry of Finance of the PRC in case that the accounting standards used by the issuer are approved by the Ministry of Finance as equivalent to Chinese standards.

Financial statements should be certified by auditors registered in China and possessing the necessary expertise in the securities market.

According to the available information, existing restrictions on the issue of bonds in the interbank market of China do not apply to bond issues of the sovereign and companies from the Russian real sector of economy. Possible requirements for Russian corporate borrowers include the presence of a subsidiary in China, an issuer or issuance rating from a Chinese rating agency, a report by a Chinese auditor, etc.

In early 2017, UC RUSAL registered a prospectus for the issuance of bonds denominated in yuan (Panda bonds), with a total value of up to 10 billion yuan (1.5 billion US dollars) for up to seven years and became the first foreign company with the main production assets outside the PRC whose bonds are offered to investors in the debt market of China by placing on the Shanghai Stock Exchange. On March 21, 2017, a placement of tranche of a total of 1 billion yuan was completed for a period of 2 + 1 years with a coupon rate of 5.5% per annum. Funds received from this placement will be used to replenish working capital, including purchases from suppliers in China. At the same time, the remaining part of the funds raised can be used to refinance the company's current debt.⁸ According to available information, the second tranche of UC RUSAL can be placed in May 2017.⁹

Although the first yuan bonds in Hong Kong were issued in 2007 by the state-owned China Development Bank, the emergence and development of the Dim sum bonds market, or the yuan bonds issued outside of mainland China, was the direct result of the implementation of the China's global project which started in 2008–2009—the project of internationalization of its national currency and turning it into one of the world's currencies. It is also associated with the emergence of the market of offshore yuan, which received the CNH code (Chinese Yuan delivered in Hong Kong) as opposed to the conventional Chinese currency code — CNY. The history of this project and the characteristics of the initial stages of the measures taken by China to “internationalize” the yuan, are now fairly well described and analyzed.¹⁰ Over the past years, the market of Dim sum bonds has been developing rapidly. If at the end of 2010 the

total amount of bonds in RMB, issued outside the PRC, reached 59 billion yuan, then in 2014 this amount increased to 337.7 billion yuan. In the next two years, in connection with the measures taken by the Chinese regulators to limit the outflow of capital abroad and increasing the attractiveness of the Panda bonds market, the amount of the issued Dim sum bonds fell to 163.3 billion yuan in 2015 and to 130 billion yuan in 2016,¹¹ i.e. below the 2011 level.

Hong Kong still retains its leading position in the Dim sum bonds market, although the geography of their placement over these years has expanded significantly, and bonds denominated in RMB were issued not only by foreign banks, but also by industrial companies and even by governments of some countries.¹²

Russian financial and credit institutions already have experience in issuing bonds denominated in RMB. Three state-owned banks (VTB, Gazprombank and Rosselkhozbank), as well as the Bank Russian Standard, placed six issues on the Irish Stock Exchange for a total of 6.75 billion yuan (more than USD1 billion). In January 2014, Gazprombank issued three-year bonds worth 1 billion yuan with a yield of 4.25% per annum.¹³

Taking into account the difficulties and limitations associated with issuing of yuan bonds by Russian issuers on the Chinese and international markets, the Bank of Russia and interested Russian banks are currently working with the relevant Chinese authorities to arrange the issuance of bonds in yuan on the Russian bond market.

During the 17th meeting of the Russian-Chinese Subcommittee on Cooperation in the Financial Sphere in October 2016, the regulators of Russia and China paid much attention to the discussion of issues of cooperation in the securities markets. They highly appreciated the two-sided Memorandum of Understanding between the Bank of Russia and the PRC Securities Commission, which was signed in June 2016. This Memorandum, in particular, says that one of the areas of cooperation between China and Russia is cooperation in the securities market with focus on the stimulating the issuance and circulation of debt instruments on the stock exchanges of both countries, including the issue on the platform of Russian Stock Exchange of Russian sovereign bonds denominated in Chinese

yuan. The successful implementation of such an issuance meets the objectives of strengthening the cooperation between the two countries. The Chinese party informed that for Chinese investors operating under the QDII and RQDII programs (programs for Qualified Internal Institutional Investors), there are no regulatory restrictions on the possible purchase of yuan bonds issued in Moscow, but the quota for such investments provided by the QDII program for 2016 in the amount equivalent to 90 billion US dollars has already been exhausted.

In December 2016, the Government of the Russian Federation adopted the Regulation No. 1353, which allowed to issue federal loan bonds (OFZs) not only in rubles, but also in the national currencies of the BRICS and the Shanghai Cooperation Organization (SCO) member countries, which “will allow to issue new debt instruments, regulated by the Russian law, with the support of domestic financial institutions,”—the statement to the Regulation said.¹⁴

In February 2017 the Ministry of Finance of the Russian Federation informed that it does not rule out the possibility of the placement of federal loan bonds (OFZ bonds) denominated in yuan in 2017, but much depends on the willingness of the Chinese financial regulators. Director of the Department of the State Debt and State Financial Assets of the RF Ministry of Finance K. Vyshkovskiy said that the Ministry of Finance’s earlier statements that the placement of these securities in 2017 is unlikely, is not the final decision of the Ministry. “This is not a final decision, we said that the probability of placement this year is not very high or significantly lower than we planned earlier, and this is primarily due to the position of the Chinese authorities. We are ready to implement such a project. But as showed the studying and consideration of this issue in the past year, our idea to some extent runs counter to the general policy of the Chinese financial authorities to curb the outflow of capital from China,”¹⁵ clarified K. Vyshkovskiy. At the same time, he said, the Ministry of Finance did not consider any alternatives for OFZ in yuan, as this instrument was planned not as means of financing the budget deficit, but as an attempt to draw on the Russian market a new category of investors. “This is an attempt to probe the new market segment, attract a new category of

investors — domestic Chinese so-called mainland investors — to our market, to Russian infrastructure, and we should not consider this as an instrument that is intended to replace any existing ones, it is simply a desire to develop the market, an attempt to probe some alternative sources of resources We do not remove this project from the agenda completely, we will continue to work out this possibility with our Chinese counterparts,”—pointed K. Vyshkovskiy.¹⁶

In March 2017, after several years of negotiations and preparatory work, the settlement and clearing center for operations in yuan began to function in Moscow. By agreement between the Bank of Russia and the People’s Bank of China, the ICBC Bank Moscow, the “daughter” of the largest Chinese bank ICBC, has been assigned as the clearing bank for operations in RMB in Russia. This clearing and settlement center for RMB operations should become a key element of the market infrastructure that provides financial interaction between Russia and China, including settlements on trade operations, investments and securities issuance.¹⁷

According to available information, Gazprom, Gazprombank and Sberbank are going to issue bonds in yuan in Moscow. At the same time, Gazprombank even registered a package of issuance documents on the series of bond issues in RMB for a total of 2.85 billion yuan at the Moscow Stock Exchange, and in Sberbank’s plans for 2017 are not only its own borrowings in RMB, but also its participation as an organizer of such transactions for other companies.

Thus, by now, Russia has prepared all necessary technical and regulatory frameworks for issuing on the Moscow Stock Exchange bonds, nominated in yuan, as a new promising alternative source of borrowed resources. Interested market participants are now waiting for the RF Ministry of Finance to place the OFZ in yuan, since such a placement will not only “probe the new market segment, attract a new category of investors — domestic Chinese so-called mainland investors to our market, to Russian infrastructure,”¹⁸ but also will create a market benchmark for Russian companies and banks on borrowings in yuan, which will become the basis for further joint work of Russian borrowers and Chinese investors. However, in order to make such placement of Russian sovereign bonds in RMB possi-

ble, it is necessary for the Chinese regulators to resolve a number of unresolved issues related to the removal of certain restrictions stemming out of the current policy of combating capital outflow from the PRC. In particular, it is necessary to provide investors from the mainland China with special permissions for the purchase of such OFZs. It is possible that the remaining restrictions will be lifted in the near future, including

also, as one of the results of the working visit of President of the Russian Federation Vladimir Putin to the PRC in May 2017. In this case, the placement of OFZ in RMB on the Moscow Stock Exchange with the participation of Chinese investors from mainland China will make it possible to practically use the yuan clearing center in Russia and will enhance the status of Moscow as an international financial center.

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