The Belt and Road: A new landscape for China’s financial industry
Beijing Business Forum

Navigating the Belt and Road

China’s Belt and Road initiative is expected to change the way the world trades, with massive investments in infrastructures and the development of trade routes covering over 60 countries. Together these countries represent about 65% of the world population, contribute to one-third of the world’s GDP and of the world’s trades. The plan is ambitious and the Chinese financial industry needs to be properly equipped to help realise the full potential of the Belt and Road initiative.

On July 28, 2017, the Chinese financial industry gathered at the Beijing Business Forum to take collective action and discuss the many areas that need focus as the Belt and Road initiative unfolds. That includes the internationalisation of the RMB, cross-border payments along the Belt and Road, capital market liberalisation in China, the use of Big Data, but also areas such as standards, compliance and cybersecurity.

The Belt and Road initiative is about creating a positive environment for economic activities and development. This comes with a number of challenges as effective infrastructures and processes need to be built by the financial industry to serve the initiative and allow it to realise its full potential. Financial institutions are always critical to economic success.

RMB internationalisation: will the Belt and Road revitalise the RMB?

Despite the opening of more RMB clearing centres in markets around the world and inclusion in the IMF’s Special Drawing Rights (SDR) currency basket in October 2016, the utilisation of Chinese renminbi globally as a payment currency has lost momentum over the last two years. Policies to contain capital outflows and ongoing concerns over currency depreciation are likely to hold back internationalisation in the short-term, according to Fitch Ratings.

SWIFT data indicates a slowdown in internationalisation, with the proportion of international currency payments (Credit Transfer Payments and Institutional Transfers) denominated in RMB falling from 2.09% in June 2015 to 1.98% in June 2017. In June 2017, the RMB was ranked #6 as a world payment currency, following the CAD representing 2.04%.

The Special Edition of the RMB Tracker, released at the Beijing Business Forum, highlights five key enablers for RMB internationalisation: the Belt and Road initiative, CIPS, the unique place of Hong Kong, capital markets liberalization, and finally the growing role of FinTechs.

For the first time in this tracker, the RMB is looked at along the Belt and Road countries. The initiative is reflecting uneven impact on RMB usage for Credit Transfer Payments.

Managing Cross-Border Payments along the Belt and Road

Michael Moon
Head of Payments, APAC, SWIFT

“Despite the initiatives to develop the RMB at an international level, China remains a very dollarised market. As of June 2017, 98% of the payments between the United States and China are performed in US Dollars, and the RMB is used for more than 2% of payments to China in most markets, Taiwan being the only notable exception.”

Although the absolute value remains low in comparison to their Western European counterparts, those countries have shown a growth over 150% over the past three years.

The Sea route shows the most growth, with volumes of transactions remaining extremely high in ASEAN, and in Singapore and Malaysia in particular, despite the slight decline of Singapore.

Africa on the other side did not show much growth as very few transactions have been happening, despite major investments already realised by China on the continent.

Last but not least, the European clearing centres are still performing quite a large number of transactions, but the region is home to very disparate situations with an increase over 400% in Germany compared to substantial decreases in Italy, France and the Netherlands.
Today, RMB utilisation across Belt and Road is concentrated in major RMB centres

Some markets emerging as new pockets of growth

Note to the reader
List of countries used for the analysis below: Austria, Belgium, Bangladesh, Bulgaria, Czechia (formerly Czech Republic), Egypt, France, Germany, Greece, India, Indonesia, Iran, Italy, Israel, Kazakhstan, Kenya, Kyrgyzstan, Lithuania, Malaysia, Nepal, the Netherlands, Pakistan, Poland, Portugal, Russia, Saudi Arabia, Singapore, Tajikistan, Thailand, Turkmenistan, Turkey, Ukraine, UAE, Vietnam.

Please note that the list of countries used for the analysis listed is not exhaustive.

Disclaimer
The percentages of growth presented are only for the countries with significant RMB Credit Transfer Payments values. The rationale is to avoid a misrepresentation of countries with very low volume.
Managing cross-border payments along the Belt and Road

Cross-border payments can be daunting at times as local regulations and the friction that exists in the correspondent banking process can impact corporations. With over 60 countries on the Belt and Road, the success of the initiative requires financial infrastructures that can match the quality and efficiency of the trade infrastructures China is investing in.

We don’t know where the money is, when it can be paid to our counterparty. Sometimes it makes us not confident to tell our counterparties when they are going to be paid. Also, we receive so many cross-border payments but we don’t necessarily know which payment goes for which of our businesses as the information is not enough. This does impact our efficiency.

Fully aware of the challenge, China has been investing in financial infrastructure to support capital flows. The Belt and Road initiative highlights 5 areas that require higher level of connectivity: policies, infrastructures, trade, capital, and culture. With high demand in capital flows to support China’s international development, the country put together the Cross-Border Interbank Payment System (CIPS) to allow for faster clearing and settlement, using the ISO 20022 international messaging standards. Zhang Xin, General Manager, China International Payment Service Corp, explained: “CIPS was established in 2016 to become the bridge that would connect countries along the Belt & Road, similar to a highway. Since its establishment, it grew steadily and now has 31 direct participants and 600 indirect participants, covering over 85 countries on all six continents”.

Banks also are getting ready to support the initiative and to facilitate cross-border payments along the Belt and Road. Peng Hua, Deputy General Manager,Operations, Industrial and Commercial Bank of China said: “ICBC has signed a lot of documents with many countries along the Belt and Road and we have reviewed our offering to provide different services and products, such as bonds and connectivity. Together all these milestones have contributed to RMB internationalisation and to position the RMB as an international currency”. Banks play a critical role in offering connectivity to their clients.

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“We need to be a bridge, not an obstacle. Countries along the Belt and Road are at different levels of prosperity and risks differ, but for commercial bank that’s a good opportunity to improve our regulation & risk control, to the point it becomes our unique competitive edge”, said Sun Shangbin, Deputy General Manager, Clearing Department, Bank of China.

Cross-border payments also require a frictionless network to be carried more effectively. As a cooperative network connecting 11,000 financial institutions in over 200 countries, SWIFT is uniquely placed to help improve standardisation in processes and removes the existing friction that exists on the payments rails. The SWIFT global payments innovation (gpi) service was launched with that idea in mind to allow for faster, more transparent, fully traceable payments, along with richer payment information to facilitate reconciliation. Talking about SWIFT gpi, Sun Shangbin explained: “we are already solving problems for corporates and we are definitely on the right track. Our customers are very satisfied; they can track the progress of their transactions and get an estimated time of arrival. Additionally a lot of overseas students can now pay their tuition fees more timely and accurately.”

Live since January 2017, SWIFT gpi is already the biggest change to have happened to correspondent banking in over three decades, but some challenges still remain. Sun Shangbin added: “Since its launch, SWIFT gpi got high recognition from the industry, and is consistent with the Belt and Road initiative. It is not a revolution but it brings the industry in the right direction. In the future, we will also need to have a higher focus on compliance, for regulators and other participants alike”.

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Supporting capital markets liberalisation in China

The China's capital markets have come a long way since 2002 and the start of the Qualified Foreign Investor (QFII) programme. Since then the legal framework has evolved steadily to enable the internationalisation of the currency, leading to the first RMB denominated dim sum bonds issuance in 2007. The ability to invest offshore and onshore has been steadily relaxed and recent events such as the launch of the “Connects” (Hong Kong-Shanghai and Hong Kong-China Bond Connect), the inclusion of the RMB in the IMF’s SDR basket, or more recently China’s inclusion in the MSCI all point in the way of further normalisation and liberalisation. In parallel, China’s regulatory framework evolved, to the point this year’s financial work report states that the “financing in China’s financial system”, he adds. "The move toward a stable tax base for major economies in the world will be an important development over the next few years”, professor Gao, Associate Professor, School of Public Policy and Management, Tsinghua University explained.

Shadow banking is another critical issue in China as volumes represent a large part of the regular banking system. However, a recent analysis showed that about 99% of shadow lenders in China are SOEs. “I would like to emphasise that China’s shadow banking is somewhat different from what we are familiar with, especially the UK and US ones. A big part of China’s shadow banking system is the shadow of banking such as wealth management products, not really shadow banking” observed professor Gao. “If we look at the historical data, we’ll see that indirect finance, say through financial institutions such as banks, remains the dominant source of financing in China's financial system”, he adds.

The Belt and Road initiative strongly encourages China’s Foreign Direct Investments (FDI), although China has recently tightened rules on outbound investments, in particular towards non-state firms, due to concern that they would buy more real estate or make wasteful direct investments. "Regulators are now worried about the flow of vast sums of private capital into the US for deals making, or even what media reports said was the exodus of capital. China’s investment along the Belt and Road is still dominated by SOEs though, and if we look at US data, we find that SOEs still account for 70% of China’s FDI in Belt and Road countries”, commented professor Gao. “China’s tightening of outbound investment is to be taken in the wider context of the country’s falling foreign exchange reserves between 2014 and 2016, as regulators gradually tightened restrictions on outbound direct investment on the grounds that many investments were not making effective use of the country’s forex reserves. However, such a tightening is not to be expected in Belt and Road investments, which remain dominated by SOEs. The Belt and Road initiative encompasses not only business activities, but also China’s diplomatic strategy, aid strategy and business strategy”.

Going hand in hand with the gradual opening of China's capital markets is the internationalisation of the RMB. On that point, the inclusion of the currency in the IMF’s SDR basket in 2016 was of special significance. As of today, the RMB is still not a fully convertible currency, which gave the inclusion more of a symbolic impact. “With such an endorsement, the RMB is seen as a safer global reserve currency”, professor Gao commented. In the future, it seems reasonable to think the RMB will be used more widely in Belt and Road countries for clearing and settlement in their trade and investment with China. The unfurling of the initiative actually already generated improvements on that front as Hungary issued panda bonds for the first time in July, becoming the first country to issue dim sum bonds and panda bonds, demonstrating appetite to tap more into Chinese loans.

The most recent milestone achieved by China is certainly its inclusion into the MSCI indexes, marking a major move forward for China’s domestic markets and making funds from all over the world invest in mainland China. However, professor Gao argued. “It’s not a question of whether MSCI should add A-shares to its indexes. Instead, it’s a question of whether Chinese markets, Chinese A-shares or Chinese assets as a whole are investable.” The key significance of the inclusion is that it encourages China to make more investment assets available to foreign investors through new channels, leading to a further liberalisation of its capital markets.
Big Data: Identifying the right opportunities along the Belt and Road

The market potential along the Belt and Road is massive and identifying the right opportunities can be a daunting task. A big word on everyone’s lips for many years, big data and analytics could now be the key to identify opportunities and make the right business decisions in a timely manner.

Data from SWIFT show that the main opportunities along the Belt and Road still lie in the ASEAN region, with a particular focus on Singapore and Malaysia. As of today, Malaysia remains the main market trading with China, representing the largest share (42%) of the ASEAN-5. Joe Ng, Director, Head of Remittance Strategy, Group Global Banking, Maybank confirmed: “We see a huge increase in ASEAN and mainly in Singapore and Malaysia. We also see that implementation is much faster in Malaysia. This data is really useful for us and we would like to see more.”

Groups are very sized but if you have a big data platform it can create a lot of opportunities”, Geertjan van Bochove, Head of Analytics, APAC, SWIFT said: “Banks have a sizable pool of data they are sitting on and that could be used. These could also help tackle payments fraud, as it’s highly linked to analytics, via machine learning and anomaly detection”. Big data could help support fraud detection and make it more efficient.

New technologies are also seeing the light of day, such as Artificial Intelligence (AI) and predictive analytics. However, these technologies might still need some more time to bring benefits to the industry. “Machine learning and Al are still in their very early days. They have the potential to predict frauds in real-time and to help make decisions very quickly, but it might still take another ten year. There is a tendency in the industry to get overexcited, but there is no need to be the first in the financial industry when it comes to adopting new technologies. There are a lot of opportunities in innovation, breaking siloes, and working together with FinTechs in a collaborative fashion that the industry will make the best of this new era.

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Digitisation is a land of opportunities for financial institutions as FinTechs are now offering viable options, in particular in the retail space. “Innovation is still focusing on retail and microfinancing in China. However, we start seeing a strong need for FinTech solutions as financial institutions in Greater China are looking more and more at improving internal efficiency and rely on FinTechs to solve these challenges”, Zhang Xin pointed out. As the financial industry is entering a new era and opportunities in innovation emerge at a faster pace, it is critical for the industry to embrace innovation to remain relevant.

Zennon Kapron
Director, Kapronasia

Zennon Kapron concurred: “big data is now a viable option for banks but it’s also an internal opportunity. Analytics are very sized but if you have a big data platform it can create a lot of opportunities”, Geertjan van Bochove, Head of Analytics, APAC, SWIFT said: “Banks have a sizable pool of data they are sitting on and that could be used. These could also help tackle payments fraud, as it’s highly linked to analytics, via machine learning and anomaly detection”. Big data could help support fraud detection and make it more efficient.

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“I use Alipay and WeChat Pay more than I use my bank. I use my bank when I need cash but it became a utility”, Zennon Kapron added. As the financial industry is entering a new era and opportunities in innovation emerge at a faster pace, it is critical for the industry to embrace innovation to remain relevant.
Scaling your technology and operations to support the Belt and Road Initiative

The deployment of the Belt and Road initiative is expected to unfold fantastic opportunities for financial institutions and corporates alike, but discrepancy in standards and regulation will slow down the pace of development if not properly dealt with.

Standards are paving the way for the Belt and Road

Very much like the mythical Babel tower, over 60 official languages are spoken along the Belt and Road, making it a challenge for institutions to communicate in a unified and accurate manner, and creating additional manual work and potential processing errors. SWIFT was created forty years ago to bring together global financial institutions on a single, secure and reliable network whilst using common standards that would facilitate communication.

Created in 2004, ISO 20022 is seen as the standard of the future when it comes to financial messaging. Flexible with its XML-based structure and accepting the use of Chinese characters, ISO 20022 is defining business meanings of financial concepts and incorporates global market practices, local market practices and bank practices. Today over 200 initiatives using the standard are unfolding across the globe and central banks are working together to develop and harmonise frameworks in order to develop a universal template to use the standard.

Standardisation is key to support the unfolding of the Belt and Road initiative. Mabel Lu, Director, Standards, APAC, SWIFT explained: "The use of ISO 20022 leads to greater automation and is key to improve interconnectivity and interoperability between financial institutions, which will help support the Belt and Road initiative".

As technologies evolve and the industry is looking at adopting new technologies such as Distributed Ledger Technology (DCT), adoption of international standards is a must to ensure interoperability of infrastructures.

Mitigating Financial Crime Compliance risks along the Belt and Road

Covers over 60 countries and a third of the world’s trades, the Belt and Road is of unprecedented scale and raises new challenges for compliance officers as each country has its own laws regarding Anti Money Laundering (AML) and financial crime. The initiative is expected to increase cross-border trade activities as well as the number of counterparties one will be dealing with, which will require scalable solutions to deal with sanctions screening and KYC/KVCC requirements.

Most countries along the Belt and Road are developing countries in economic transition, and are hence perceived as high-risk zones for compliance-related issues. Chinese corporations participating in the initiative will not only need to comply with Chinese regulations, but also with local regulations for their overseas branches. Following the US Foreign Corrupt Practices Act (FCPA), the UK Bribery Act and other laws in place, Chinese institutions will need to thoroughly assess the background of their local partners and clients.

Michelle Wong, Director, Compliance, APAC, SWIFT said: “the massive opening that represents the Belt and Road initiative puts lawyers and compliance officers on the front line as institutions will need to navigate through the various laws and regulations that their partners and branches are subject to. SWIFT will keep supporting China and its institutions with financial crime compliance solutions for screening, KYC, and transaction monitoring to ensure full compliance and scalability”.

The changing face of Cybersecurity Law in China

Chinese financial institutions are at the cusp of digitisation, but along with opportunities, new technologies bring their share of challenges and risks as greater complexity comes hand in hand with a greater need for cybersecurity frameworks.

Aware of these rising challenges, the National People’s Congress (NPC) adopted the Cybersecurity Law in November 2016 after a year of legislative proceedings. The law, effective since 1 June 2017, confirms China’s commitment to tackle cybercrime, especially in the financial space.

The new law covers various grounds such as personal information protection and transfer, security requirements for network operators, and critical information infrastructure. Penalties, ranging from fines to suspension of business activities, are also in place. Following the implementation of the law, financial institutions are expected to review the current status and capabilities of their security.

Talking about the law at the SWIFT Beijing Business Forum, Frank Xiao, Associate Director, Management Consulting, KPMG said: “it is very hard for me to say it’s an equal ground for all banks, it’s good for some and not for others but I believe the changes are equal. On the one hand, Chinese players are not familiar with overseas laws and regulations but are following the usual laws implemented by MPS and GBRC. On the other hand, foreign banks have inherited strengths in dealing with regulations and can share best practices with their Chinese counterparts”.

SWIFT’s Customer Security Programme is very impressive as in the past few years many regulations on cybersecurity have been released in China, but they were all lacking best practices. In comparison, CSP comprises many guidelines to help financial institutions and is also available to non-SWIFT members.

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SWIFT’s Customer Security Programme (CSP) is aligned with the requirements of China’s Cybersecurity Law and supports the financial community in its quest to improve the security of the financial ecosystem as a whole. Frank Xiao said: “SWIFT’s Customer Security Programme is very impressive as in the past few years many regulations on cybersecurity have been released in China, but they were all lacking best practices. In comparison, CSP comprises many guidelines to help financial institutions and is also available to non-SWIFT members”. 

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About SWIFT

SWIFT is a global member-owned cooperative and the world’s leading provider of secure financial messaging services. We provide our community with a platform for messaging and standards for communicating, and we offer products and services to facilitate access and integration, identification, analysis and financial crime compliance. Our messaging platform, products and services connect more than 11,000 banking and securities organisations, market infrastructures and corporate customers in more than 200 countries and territories, enabling them to communicate securely and exchange standardised financial messages in a reliable way. As their trusted provider, we facilitate global and local financial flows, support trade and commerce all around the world; we relentlessly pursue operational excellence and continually seek ways to lower costs, reduce risks and eliminate operational inefficiencies. Headquartered in Belgium, SWIFT’s international governance and oversight reinforces the neutral, global character of its cooperative structure. SWIFT's global office network ensures an active presence in all the major financial centres.

For more information about SWIFT, visit www.swift.com