

Bond Connect

Institutional investors seeking to access the onshore Chinese bond market have specific needs when it comes to handling liquidity in Chinese Yuan Renminbi from onshore (CNY) and the offshore Chinese Yuan Renminbi (CNH). First, they may require liquidity in either CNY or CNH for bond settlement and hedging. Second, if investors are utilizing both onshore CNY and offshore CNH, they need a way to distinguish between the onshore and offshore versions of renminbi as funding currencies.

The introduction of the China-Hong Kong **Bond Connect** provided institutional investors with another way of accessing the China Interbank Bond Market (CIBM), this time through an offshore channel. With the increased weight of onshore CNY bonds in the Bloomberg Barclays Aggregate and other indices institutional investors demand better access to onshore CNY FX liquidity.

Our Bond Connect CNY direct FX and custody service provides a solution to two key challenges:

Distinguishing Between CNH and CNY

Different FX spot rates for CNY and CNH, as well as unique operational flows and regulatory monitoring requirements, make it necessary to distinguish between the two currency codes. Our automated solution solves this problem by using a segregated securities account for each funding code and then using the securities account number as a unique identifier for tracking each currency.

CNY For Both Bond Settlement and Hedging

Increased inclusions of Chinese bonds in market indices means institutional investors require solutions that allow them to closely follow the benchmarks. Providing the ability to settle bonds and hedge with CNY allows investment managers to strictly follow benchmarks as well as potentially achieve better economic value (when compared with CNH). Traditionally, CNY was outsourced to onshore sub-custodian banks or bond settlement agents (BSAs), which invited operational considerations and pricing opaqueness. As a global custodian, providing access to CNY, we provide clients with operational efficiencies and pricing transparency.



Providing FX liquidity in CNY and CNH



Dedicated expertise with significant market experience



Focus on innovation and continuous product development



Ability to participate in onshore interbank CNY market via the official CFETS channel



Market Trends and Product Overview

Through our Bond Connect solution, institutional investors gain access to hedging and bond settlement in CNY, along with CNY-funded fixed income custody services. As an FX Settlement Bank in the Bond Connect scheme, we can offer clients CNY as well as existing CNH FX liquidity in spot, forward and swap markets through our Direct FX and Indirect FX services.

We currently offer the following solutions to our custody clients:

CNH (Offshore Renminbi)

- FX liquidity in spot, forward and swap
- DirectFX/StreetFX for security settlement and hedging
- IndirectFX for security settlement

CNY (Onshore Renminbi)

- FX liquidity in spot, forward and swap
- DirectFX/StreetFX for security settlement and hedging
- IndirectFX for security settlement

A Principal CNY Liquidity Provider — we offer direct liquidity in CNY for spot, forward and swaps. Further, as a global custodian bank, we have access to clients' underlying security holdings enabling us to perform regulatory monitoring on CNY bond settlements and hedging.

Optimal Cost and Flexibility — our full-service solution provides flexibility (within the regulatory guidelines) between CNH and CNY funding and allows our clients to choose the more economical approach to settling bonds and hedging strategies.

Settle and Hedge China Bonds in Both CNY and CNH — our solution has been designed to track both CNY and CNH FX from beginning-to-end, allowing investors to fund and hedge currency exposure in either currency.

Case Study

The inclusion of Chinese bonds in the Bloomberg Barclays index created demand for a service that provides clients with liquidity in CNY. While both CNY and CNH are eligible funding currencies for securities settlement in Bond Connect, the FX rate difference between the two renminbi codes required clients to select one currency based upon economic value and/or operational convenience.

Challenge

When CNY was selected as the funding currency, it presented a challenge. CNY FX is a restricted market and it is easier for market participants to trade in CNH with their global custodians. With our membership in CFETS, we are able to participate in the onshore CNY FX interbank market, along with our ability to track both CNY and CNH, our clients are able to use dual-currency accounts and separately track CNY and CNH through the lifecycle of their investment.

Solution

Our role as a global custodian bank, and onshore CNY FX liquidity provider, means that we can efficiently manage the entire securities settlement and hedging process from beginning-to-end. When trading in overseas securities and tracking indices, FX rates matter, and having the capability to choose and distinguish between CNY and CNH allows our clients to select the most economical funding/hedging currency.

Strength and Stability — We are a Global Systematically Important Bank (G-SIB) with an AA- credit rating. We are not reliant on wholesale funding for our business activities, offering additional protection against major liquidity shocks.*

*S&P, December 2015

To learn more about Bond Connect

Please contact your Global Services client service representatives or Global Markets sales representatives

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