

CIPS a ‘game changer’ but needs careful planning

Michael Vrontamitis, Head of product management, East, Standard Chartered

There is no question that the coming China International Payment Platform (CIPS), first announced by the People’s Bank of China (PBOC) in April, has the potential to be a game changer. Though the international renminbi clearing platform will take several years to develop, the basic functionality is expected to markedly improve access for foreign corporates as well as help accelerate the process of internationalising the renminbi. CIPS for the first time will put the renminbi on an even footing with other global currencies in areas such as operating hours, risk reduction and liquidity optimisation.

The introduction of the CIPS system is a huge positive for the development of the offshore renminbi market. CIPS is expected to take around two years to commence and will address a number of challenges to doing cross-border trades with Chinese onshore entities. For example, global transaction banks use international standard messaging for communication, reducing operational risk and lowering the cost of transactions. However, in China currently, players use the China National Payment System (CNAPS) which does not allow one-to-one comparisons. A future CNAPS release will be based on international standards and should allow a more direct comparison between what is used in the international interbank market and domestic China. CIPS will likely also be in line with international standards, which will keep transaction processing costs low for the industry.

Language issues are becoming increasingly problematic as renminbi transactions expand, but these issues are being dealt at the commercial bank level. There are, however, still some challenges associated with the processing of non-Latin characters in international financial transactions. The PBOC has stated that CIPS will support both Chinese and English characters, though the burden of translation and comprehension will still remain with the commercial banks.

Meanwhile, although the Hong Kong renminbi real-time-gross-settlement (RTGS) platform recently expanded opening hours, challenges still remain for the European market, with CNAPS and the China onshore FX market closing at 4pm. CIPS is expected to operate 23 hours a day which would solve this issue for non-Asian time zones.

While next generation CNAPS will remain for onshore use, CIPS will cater specifically to international transactions. There is great expectation that CIPS will make trading renminbi more efficient particularly for payments in and out of China.

It is expected that CIPS will have four key features:

- 1 Enables cross-border renminbi clearing among both onshore and offshore participants
- 2 Uses international reporting standards and be multilingual
- 3 Can handle payments in 17 time zones in Asia, Africa, Europe and Americas simultaneously
- 4 Run on SWIFT ISO20022 standards, thus optimizing mapping between SWIFT message formats and CNAPS message formats

The new system will hopefully overcome limitations in efficiency, security and stability in the current cross-border payment system, which are in part due to the conversion processing between standard international messaging and CNAPS, which is effectively done manually – and this will help to pave the way for a more automated process. Without a new system, the inherent weaknesses of the current system will limit growth as demand for cross-border renminbi settlement rises. Processing in renminbi currently means higher operational costs and is slower than in major currencies such as US dollar.

If the new system is well thought through from payment origination to completion – from one remote location to another and through multiple correspondent banks – it will reduce transaction costs and processing time, boosting confidence and encouraging the use of the Chinese currency.

Our excitement about this project is not without some caution. First, and most importantly, we believe that for the system to be maximally effective the Chinese regulators need to give careful consideration to how they develop the platform and actively engage in the standards conversation with the international community. Secondly, we believe that the new platform will impact other offshore markets with onshore renminbi clearing platforms, and this creates a challenge for those centres whereby they will have to consider what their value-add is to customers in the intervening years before the system launches.

For CIPS to reach its full potential it will need to include the four main aspects listed above, as well as being set up to be as robust as possible to encourage confidence. The devil will be in the detail. There are a range of other features that we expect will need to be considered to ensure success. For example, questions need to be asked of the clearing and settlement model; will it run on gross- or a net-settlement basis? If member banks directly open a clearing settlement account with PBOC, what will be the possible ways for

member banks to manage their liquidity position effectively? Within this, the ability to use reserves to cover payments or only funds in the current or settlement account, who the lender of last resort will be, and whether intraday credit is extended to the participants, will also need careful consideration. Clear system rules will need to be defined on finality and insolvency, helping create good governance of participant activities, and generating confidence in the system.

We can hope that CIPS will meet the efficiency of some of the most advanced clearing systems in the world such as Clearing House Interbank Payments System (CHIPS) in the US, referred to as hybrid systems in that they combine typical elements of both netting and RTGS. Essentially the participants on such platforms get rolling finality through the use of algorithms and netting. We also think that helping establish liquidity management tools such as repurchase agreements or delivery versus payment (DvP) agreements will help member banks arrange short term liquidity and mitigate counterparty risk on settlement. These are just some of the wide range of issues that need to be examined carefully.

This communication is issued by SC Group. While all reasonable care has been taken in preparing this communication, no responsibility or liability is accepted for any errors of fact, omission or for any opinion expressed herein. You are advised to exercise your own independent judgment (with the advice of your professional advisers as necessary) with respect to the risks and consequences of any matter contained herein. SC Group expressly disclaims any liability and responsibility for any losses arising from any uses to which this communication is put and for any errors or omissions in this communication. "SC Group" means Standard Chartered Bank and each of its holding companies, subsidiaries, related corporations, affiliates, representative and branch offices in any jurisdiction.