A long-held goal of the Chinese government is for Chinese bonds to be eligible as collateral in transactions anywhere around the world. Although institutions are taking important steps forward on this project, and investor interest in Chinese bonds is at an all-time high, new hurdles seem to form almost at the exact same time.

The China Central Depository and Clearing Co (CCDC) has been saying that cross-border utilization of Chinese bonds has been a main priority for years. In October 2019, at the Asian Prime Collateral Forum, Fei Tao of the CCDC’s Collateral Management Center showcased use cases backed by the Chinese government as opposed to international demand for Chinese bonds in their own right. His presentation noted that “[Bank of China] used its green bonds as collateral to guarantee its issuance of overseas bonds. CCDC, as the collateral management provider, carried out the valuation, mark-to-market and assessment of the pledged assets pool. Meanwhile, CCDC acted as an executing agent to perform the default operation of the collateral in the event of default.” There are also cases of domestic commercial banks accepting RMB bonds from international central banks as margin collateral.

CCDC has been working with Euroclear, Clearstream, DTCC and others on cooperation; this can range from the discussion stage to actually getting somewhere. The last we heard, Euroclear and CCDC signed a memorandum of understanding in September 2019, including that “The two parties will also explore opportunities to provide cross-border collateral management services which will aim to promote the use of RMB-denominated securities as collateral in the international financial market.” CCDC and Clearstream signed an MOU in March 2017, and in February 2019 DTCC published ALERT settlement instructions for securities issued in China on the CCDC.
China has also seen its corporate bonds included in the Bloomberg Barclays Global Aggregate Index and JP Morgan’s Government Bond Index Emerging Markets, leading to increased international investor demand. In March 2020 alone, Chinese bonds saw some $11 billion in new inflows as US Treasury rates plummeted. Reuters said that “Offshore ownership of Chinese bonds breaks new high” as the CCDC reported foreign ownership of Chinese bonds at $281.39 billion.

China of course wants RMB-denominated bonds to gain acceptance in the collateral market as part of increasing the popularity of the RMB as a global currency. This requires not just accessible infrastructure but also trust in the bonds themselves. This latter point remains a difficult hurdle. Just last week, the Financial Times reported that administrators in the bankruptcy of Peking University Founder Group, a Chinese technology conglomerate, will not recognize the legal validity of “keepwell deeds” that back $1.7 billion of its bond issuance. According to the FT, “Keepwell deeds are letters of support that offer foreign investors some level of assurance that parent companies in China will make good on US dollar bonds sold by offshore subsidiaries. They were introduced in 2012 as a way of making foreign investors more comfortable with China’s dollar bond market.” Keepwell deeds are currently used in $100 billion of Chinese bond issuance. While a small part of China’s $13 trillion bond market, this sort of reputation and legal challenge is the sort of thing that will keep Chinese bonds off of any acceptance collateral acceptance list.

Last week there was more positive news but in the opposite currency direction: Euroclear and Clearstream said that the China Construction Bank would be a common custodian for distributing Eurobonds in China. According to the press release, “Alan Lai, head of Transaction Banking at CCB, said in a statement: “CCB (Asia)’s aim is to broaden the Eurobond market to reach more APAC market participants – especially new issuers and investors from the People’s Republic of China.” This should be helpful for Chinese firms to develop global funding sources but in Euros, not RMB.

Another challenge is coming from the US government, which appears to be a mix of legitimate concern about Chinese accounting practices and politics. On May 20, 2020, the US Senate passed a resolution that would kick Chinese companies off of US exchange listings if they did not meet US regulatory and audit requirements. Politico reported that “Lawmakers and investor advocates have raised alarm as hundreds of billions of dollars in Chinese
equities have poured into U.S. stock exchanges in recent years, even though the country continually refuses to give American regulators access to inspect their accounting audits.”

The same argument can be made about Chinese bonds.

The conversation about Chinese bonds as global collateral is far from over. This week though, it looks like the pace of movement is about neutral.