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MARKETS

Why China's Banks Won't Come to Russia's Rescue

The risk of additional sanctions deters Chinese lenders, while a fledgling payment network relies on the Swift global system



A liquefied-natural-gas cargo ship from Russia berthed in Tianjin, China.

PHOTO: VCG/GETTY IMAGES

By [Jing Yang](#) [Follow](#) and [Rebecca Feng](#) [Follow](#)

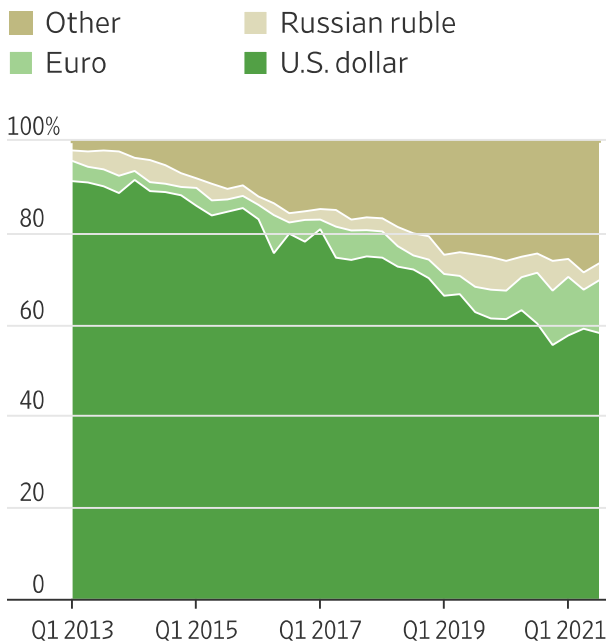
March 4, 2022 5:30 am ET

On paper, China's banks and its homegrown payments system could offer Russia respite from crippling Western sanctions. China has helped other nations evade sanctions, and both China and Russia share an interest in weakening the dollar's hold on the international financial system.

In practice, it isn't that simple.

Western countries have imposed an array of penalties on Russia in the past week, from freezing much of its central bank's foreign-currency reserves to booting some Russian banks off Swift, the payment network widely used in international banking transactions.

Russian imports from China by currency*



Note: *Shows settlement currency

Source: Bank of Russia

China has long been concerned about what it calls dollar hegemony, especially as the trade war with the U.S. worsened, and has found an ally in the Kremlin, which was previously sanctioned after its 2014 annexation of Crimea.

The two countries increasingly trade with each other without using dollars, giving Russia an important outlet for selling oil, gas and other products without touching the U.S. financial system. Just over a third of Russia's exports to China were settled in dollars as of last September, the most recent data available shows, down from 96% in 2013. A little more than half of China's

exports the other way were settled in dollars, down from 90% in 2013.

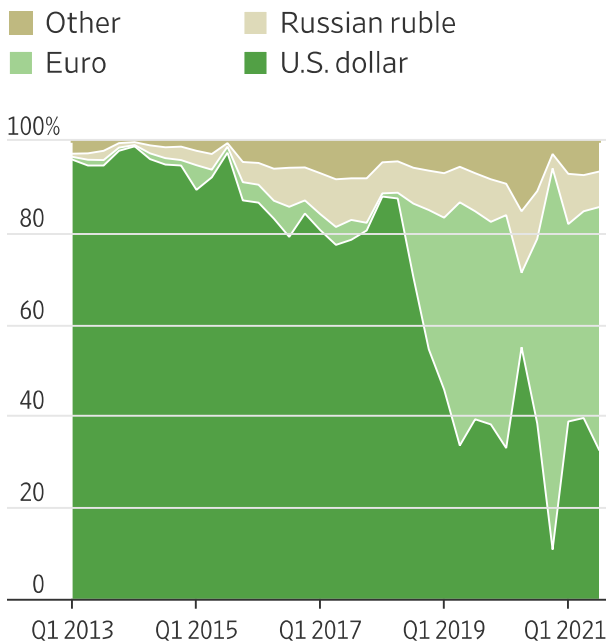
But this trade pales against the other markets now largely shut off to Russia, and while Beijing has also been vocal in its recent opposition to sanctions, big Chinese banks aren't likely to ride to Russia's rescue.

The first problem is that Chinese financial institutions have been less keen on the idea of banking Russian clients than their political leaders are.

Prof. Zhiwu Chen, chair of finance at the University of Hong Kong's business school, was involved in helping arrange early meetings between Chinese banks and Russian companies in 2014 and 2015. At that point, "Chinese banking executives really had no interest. They did not want to do anything with Russia," he said.

Eight years since the Crimea annexation, "the level of warmth has gone up," said Prof. Chen. "Once these 'forced marriages' were imposed and they started living together, some feelings started to develop and emerge." However, he added: "The push from the top leadership has had some effect but not as much as the leadership would like to see."

Russian exports to China by currency*



Note: *Shows settlement currency

Source: Bank of Russia

Another major headache is a 2017 law that allows the U.S. to penalize foreign entities that trade with sanctioned companies, countries and individuals. For any bank that wants to be able to transact in dollars, the consequences could be drastic.

“Chinese financial institutions are taking these sanctions seriously and being very careful about understanding what the risks are,” said Chen Zhu, a Hong Kong-based partner at Morrison & Foerster LLP. Due to the broad Western actions, “there’s now less room for Chinese companies and financial institutions to be doing business with Russian

counterparts,” he said.

These secondary sanctions have hindered Chinese banks in the past. After the U.S. sanctioned Hong Kong Chief Executive Carrie Lam in 2020, she said she lost access to banking services and had to collect her salary in cash. Neither mainland Chinese nor Hong Kong banks could step in.

China’s Cross-Border Interbank Payment System, or CIPS, has been touted as a potential workaround as Russian banks get ejected from Swift. But analysts and lawyers say it isn’t fit for this purpose, at least yet.

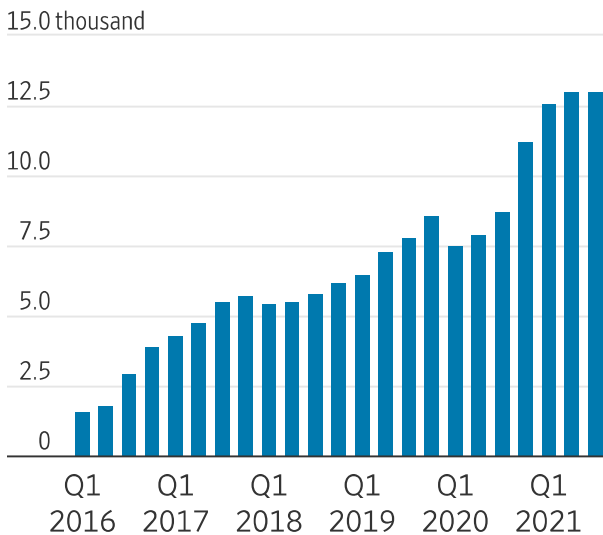
Launched in 2015, CIPS was developed by China’s central bank to promote the international use of the yuan, and largely handles yuan-denominated trades between China and abroad. But as of the third quarter of last year it handled an average of just 13,000 transactions a day, raising questions about how quickly it could scale up. Although the comparison isn’t exact, Swift processed more than 40 million messages a day over the same period.

“I don’t think it’s a viable alternative either as in sanction evasion or as a means of replacing the Swift system in international finance at the moment,” said Josh

Swift Uptake?

While CIPS has grown quickly since its launch in 2015, the Chinese payment network is still dwarfed by Swift, which handles more than 40 million messages on an average day.

Average daily CIPS transactions



Source: CIPS via Wind

Lipsky, director of the Atlantic Council's GeoEconomics Center. "CIPS is not ready," he said.

Any bank using CIPS to circumvent Swift would also face the risk of secondary sanctions, said Nicholas Turner, a lawyer at Steptoe & Johnson LLP. "A secondary sanction applies to pretty ordinary commercial activity," he said.

The two networks are also complementary as much as they are competing, since Swift is primarily a messaging system. More than 80% of CIPS transactions rely on Swift telegram, according to estimates by ANZ economist Raymond Yeung and his colleagues.

In a statement, Swift said: "Since 2016, Swift and CIPS have been working together to offer Swift as the secure, efficient and reliable channel to connect CIPS with Swift's global user community." CIPS didn't respond to requests for comment.

Swift messaging underpins transactions between the Moscow branch of Industrial and Commercial Bank of China Ltd. [IDCBY -0.51% ▼](#), the only yuan-clearing bank in Russia, and ICBC's Beijing headquarters, according to research by Prof. Wang Xiaoquan of the Chinese Academy of Social Sciences.

One longer-term option, if Western sanctions stay in place and cause long-term damage to the Russian economy and China's strategic interests, would be for Beijing to tap smaller lenders to deal with Russia.

"It's very easy to create a lot of single-purpose banks just to engage in sanction evading activities to help China's friends," said Prof. Chen. "If the conflict in Ukraine lasts for a few years, a number of such small single-purpose banks could

be created as vehicles.”

Some small Chinese banks have previously facilitated trade with sanctioned countries such as North Korea and Iran.

In 2009 the oil major China National Petroleum Corp. bought a Xinjiang-based commercial bank, which was later renamed Bank of Kunlun. After that, the bank relied on deposits and other businesses from the CNPC family of companies, according to its annual reports.

In 2012, the Treasury Department sanctioned Bank of Kunlun, together with an Iraqi bank, for helping Iranian banks move millions of dollars, and barred it from accessing the U.S. financial system. Bank of Kunlun has in recent years wound down its activities in Iran, as China diversifies its energy sources.

“Even if Kunlun Bank is sanctioned by the U.S. and other countries, what’s the damage? Nothing. You have no business in any of the developed countries to begin with,” said Prof. Chen, who was an independent director of PetroChina, the listed arm of CNPC, between 2011 and 2017.

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Appeared in the March 5, 2022, print edition as 'China's Banks Unlikely to Rescue Russia.'

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