

# **Circular of the People's Bank of China on the Establishment of the Centralized Clearing Mechanism for Over-the-Counter Financial Derivatives and the Launch of the Central Clearing of RMB Interest Rate Swaps**

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The Shanghai Head Office of the People's Bank of China ("PBC"); all branches and operations offices of PBC; all central sub-branches of PBC in capital cities of provinces (or autonomous regions) and sub-provincial cities; China Development Bank; all policy banks, state-owned commercial banks, and joint-stock banks; Postal Savings Bank of China; National Association of Financial Market Institutional Investors; China Foreign Exchange Trade System and National Inter-Bank Funding Center; and Shanghai Clearing House,

In order to promote the sound and well-regulated development of over-the-counter ("OTC") financial derivatives market and to establish a central clearing mechanism for OTC financial derivatives, the OTC financial derivative transactions including RMB interest rate swaps concluded by the participants in the national inter-bank bond market (hereinafter referred to as the "market participants") shall conduct central clearing in accordance with the relevant requirements, and Shanghai Clearing House (hereinafter referred to as the "SHCH") shall provide central clearing services. Relevant issues are hereby notified as follows:

I .As is referred to in *the Circular*, "central clearing of RMB interest rate swaps" means the process in which market participants submit the RMB interest rate swap transactions concluded by them to Shanghai Clearing House for central clearing, and the latter as the central counterparty (CCP) inherits the rights and obligations of the parties to a transaction, calculates the net interest of market participants in the manner of multilateral netting on the same settlement date, and establishes corresponding risk control mechanisms to ensure the fulfilment of contracts and completion of interest netting.

The RMB interest rate swap transactions shall be confirmed by the trading system of China Foreign Exchange Trade System and National Inter-Bank Funding Center (hereinafter referred to as the “CFETS”).

II. For the purpose of participating in the central clearing of RMB interest rate swaps, a market participant shall enter into an *Agreement on the Central Clearing of RMB Interest Rate Swaps* with SHCH.

The *Agreement on the Central Clearing of RMB Interest Rate Swaps* concluded by market participants and SHCH shall apply to the central clearing of RMB interest rate swap transactions conducted by SHCH.

III. SHCH shall start to provide the central clearing services for RMB interest rate swap transactions to market participants from the date of issuance of *this Circular*.

From July 1, 2014, the RMB interest rate swap transactions newly concluded among financial institutions with FR007, Shibor\_ON and Shibor\_3M as the reference rates and with a term of no more than five years shall be submitted to SHCH for central clearing, provided that participants and contractual elements conform to the relevant provisions of SHCH. Explanations shall be made to the PBC if transactions cannot be submitted for central clearing.

IV. SHCH shall establish a rigid risk management mechanism for the central clearing of RMB interest rate swaps from the perspectives of rules, personnel and systems, including but not limited to:

Developing the standards for central clearing participants and establishing a participant credit risk monitoring and assessment system;

Establishing risk management rules for margin, default fund and risk reserve, reasonably measuring the mark-to-market value and risk exposures of the positions of central clearing participants, and conducting regression testing and stress testing on a regular basis; and

Establishing a mechanism for handling defaults of central clearing participants, implementing bank credit and other liquidity support measures, to ensure the safe and stable operation of clearing business.

V.The margin and default fund submitted to SHCH by market participants for participation in central clearing are owned by submitters, and shall be exclusively used for the performance of claims and debts arising from central clearing and for the handling of defaults.

SHCH shall separate the margin and default fund submitted by the participants in the central clearing of RMB interest rate swaps from their own assets, and shall not use them for other purposes.

VI.The participants in the central clearing of RMB interest rate swaps shall ensure that there is a sufficient balance in the corresponding fund accounts for settlement of funds and margin.

The funds or margin in the settlement process may only be used for the current settlement, and the settlement is irrevocable once completed.

VII.The PBC shall, in accordance with the standards for qualified CCP as prescribed in the *Principles for Financial Market Infrastructure*, apply effective supervision and administration to SHCH on an on-going basis.

For the RMB interest rate swap transactions subject to the central clearing by SHCH, market members shall, according to the relevant regulatory requirements, calculate corresponding risk-weighted assets in accordance with the standards for qualified CCP.

VIII.CFETS and SHCH shall strengthen coordination and cooperation, effectively conduct daily monitoring over RMB interest rate swap transactions and the clearing respectively, and report in a writing form the required information on central clearing of RMB interest rate swaps in the previous month to the PBC within the first 10 workdays of each month, with a copy sent to National Association of Financial Market Institutional Investors. Any unusual situation discovered shall be dealt with and reported in a timely manner.

IX.SHCH shall, on a regular basis, provide the PBC's Shanghai Head Office, all branches, operations offices and all central sub-branches in capital cities of provinces (or autonomous regions) and sub-provincial cities with the required information on central clearing of RMB interest rate swaps in which institutions within their respective jurisdictions have participated.

All branch offices of PBC shall strengthen the daily administration of institutions participating in the central clearing of RMB interest rate swaps within their respective jurisdictions.

X.CFETS and SHCH shall develop specific trading and clearing rules in accordance with the requirements of this Circular and report them to the PBC for approval before implementation.

XI.The PBC shall, on the basis of the risk exposures, turnover, improvement of pricing mechanism and degree of standardization of OTC financial derivatives as well as the adequacy of preparations by the designated institution for central clearing, decide on the categories and specific varieties of other OTC financial derivatives subject to central clearing.

XII.The Circular will be affective from the date of issuance.

The People's Bank of China  
January 28, 2014