



HONG KONG MONETARY AUTHORITY  
香港金融管理局

*Banking Policy Department*

Our Ref: B1/15C  
B9/75C

8 May 2023

The Chief Executive  
All Locally Incorporated Authorized Institutions

Dear Sir/Madam,

**Regulatory Capital Treatments in relation to Swap Connect**

In light of the coming launch of Swap Connect, I am writing to set out the relevant capital and reporting treatments applicable to assets posted by authorized institutions (“AIs”) for participating in Swap Connect (“participating margin”).

With reference to the joint press release between the People’s Bank of China (“PBoC”), the Securities and Futures Commission of Hong Kong (“SFC”) and the Hong Kong Monetary Authority on 5 May 2023<sup>1</sup>, Swap Connect is an arrangement that enables overseas and Mainland investors to participate in the financial derivatives markets in the Mainland and Hong Kong through a connection between the infrastructure institutions in both places.

Hong Kong Exchanges and Clearing Limited, through its clearing subsidiary OTC Clearing Hong Kong Limited (“OTC Clear”), has partnered with Shanghai Clearing House (“SHCH”) to provide clearing services under Swap Connect. OTC Clear and SHCH, as the qualifying central counterparties (“qualifying CCPs”) recognised by the SFC and PBoC respectively, have established a clearing link, with OTC Clear providing central clearing services for Hong Kong and international investors, and SHCH providing central clearing services for investors in the Mainland. OTC Clear and SHCH will face each other as principal and will pay variation margin and settlement payments daily, and have established an inter-CCP margin to manage the default risk to the other.

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<sup>1</sup> <https://www.hkma.gov.hk/eng/news-and-media/press-releases/2023/05/20230505-4/>

In the initial stage, Northbound Trading will commence first, allowing overseas investors to participate in the Mainland interbank financial derivatives market through mutual access between Hong Kong and Mainland infrastructure institutions in respect of trading, clearing and settlement. Initially, interest rate swaps will be eligible with other products to be included in due course depending on market conditions.

***Regulatory capital and reporting treatments***

Having considered the nature of participating margins posted by AIs to OTC Clear in the latter's loss-bearing waterfall structure, we believe that AIs should treat such margins in the same manner as default fund contributions under the Banking (Capital) Rules ("BCR"). It follows that—

- a separate capital charge should be calculated for the participating margin by using Formula 23K in section 226X(4) of the BCR; and
- the amount of the participating margin posted and its capital charge should be reported in Item 1 in Division A of Part IIIe of the Capital Adequacy Ratio return in the same manner as default fund contributions made to qualifying CCPs.

Details of the above treatments are set out in the **Annex** to this letter.

Yours faithfully,

Daryl Ho  
Executive Director (Banking Policy)

Encl

cc: FSTB (Attn: Mr Justin To)