

Preface

General

This preface is intended to give a general explanation of the purpose of the Clearing Rules of OTC Clearing Hong Kong Limited (“**OTC Clear**”) in respect of the clearing and settling of certain interest rate derivatives and FX derivatives in the over-the-counter derivatives market. This preface does not form part of the Clearing Rules and does not affect the construction of the Clearing Rules.

OTC Clear has been established to operate a clearing house for the purpose of clearing and settling over-the-counter derivatives transactions that OTC Clear has been approved by the SFC to clear (such transactions, the “**OTC Derivatives Contracts**”). OTC Clear has been recognized by the SFC as a recognized clearing house pursuant to the SFO.

OTC Clear may from time to time clear and settle OTC Derivatives Contracts other than interest rate derivatives or FX derivatives. In such case, OTC Clear may decide to amend or expand the Clearing Rules such that they may operate to govern the terms and conditions of clearing such other types of OTC Derivatives Contracts, or to introduce separate rules and documentation to govern the terms and conditions of clearing such other types of OTC Derivatives Contracts.

In its provision of the clearing services and implementation of the Clearing Rules, OTC Clear will comply with its statutory duties under the SFO and will seek to ensure general compliance with the relevant principles set out in the “Principles for financial market infrastructures” issued by the Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions dated April 2012.

Membership

Clearing Members of OTC Clear may be admitted to clear interest rate derivatives and/or FX derivatives. In addition, with the prior written approval of OTC Clear, designated branches of a Clearing Member and/or designated affiliates of such Clearing Member may submit interest rate derivatives and/or FX derivatives for registration in the name of such Clearing Member. OTC Clear may introduce new membership categories if it decides to clear other types of OTC Derivatives Contracts.

Relationship to the Hong Kong Exchanges and Clearing Limited

OTC Clear is a 76% directly-owned subsidiary of the Hong Kong Exchanges and Clearing Limited.

OTC Clear as Counterparty

In accordance with the Clearing Documentation, OTC Clear clears certain interest rate derivatives and FX derivatives in the over-the-counter derivatives market, calculates the risk associated with such cleared contracts, calls margin to cover this risk, ensures the proper settlement of the cleared contracts as a central counterparty, and performs all other functions specified in the Clearing Documentation.

Guarantee Resources

OTC Clear holds various resources to support the obligations of OTC Clear as counterparty under Contracts in respect of the Rates and FX Clearing Service. The management of OTC Clear monitors the level of the guarantee resources continuously, with particular reference to the risk level in OTC Clear’s system. The guarantee resources will be made up as follows:

- (1) Clearing Members' contributions funded upfront as a precondition to becoming a Clearing Member and recalculated by OTC Clear from time to time;
- (2) Clearing Members' contributions funded as and when required by OTC Clear, subject to a maximum amount calculated by OTC Clear from time to time. Each Clearing Member has an unconditional obligation to pay its proportionate share of such contribution calculated by OTC Clear at the relevant time; and
- (3) contribution from OTC Clear itself.

Risk Management

OTC Clear has a number of powers which it uses for its risk management process. These include, but are not limited to:

- (1) the power to demand margin from Clearing Members;
- (2) the power to require payment of additional margin from time to time, including intra-day, from Clearing Members;
- (3) the power to impose position limits;
- (4) the power to terminate one or more cleared contracts in limited circumstances such as the occurrence of a force majeure event with respect to either OTC Clear itself or one or more Clearing Members for purposes of reducing the risks associated with OTC Clear in such circumstances;
- (5) the management of the guarantee resources; and
- (6) the management of the default management process in case of a default by one or more Clearing Members.

Governance

OTC Clear has implemented a corporate governance structure to enhance its accountability with, and ensure that it deals fairly with, its shareholders, Clearing Members and other stakeholders, as well as to maintain high standards of business ethics and integrity. OTC Clear's corporate governance structure comprises the following:

- (1) the board of OTC Clear – responsible for establishing corporate policies, setting strategic direction, ensuring that an effective internal control environment is in place, and overseeing the functions of OTC Clear's committees;
- (2) various committees or groups are established by OTC Clear to assist OTC Clear and/or the board of OTC Clear in managing and operating the clearing services and these include:
 - (a) the risk management committee – primarily responsible for monitoring and minimising the risks associated with OTC Clear in its provision of clearing services;
 - (b) the default management group – primarily responsible for assisting OTC Clear in the default management process upon the occurrence of a default by one or more Clearing Members or in other limited circumstances; and
 - (c) the user committee – primarily responsible for reviewing and assessing operational matters relating to existing products and new products eligible for registration with OTC Clear, including the terms, operational policies, practices, and in relation to

new products, development plans, surrounding the provision of the clearing services to such products.

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