Guidelines for the Measurement of Regulatory Capital for Credit Risk Mitigation in Commercial Banks

(September 18, 2008)

Chapter I General Provisions

Article 1 To accurately measure the effects of credit risk mitigation instruments in offsetting risks and regulate the management of credit risk mitigation instruments of commercial banks, these Guidelines are formulated in accordance with the Banking Supervision Law of the People’s Republic of China, the Law of the People’s Republic of China on Commercial Banks, the Real Right Law of the People’s Republic of China and the Guarantee Law of the People’s Republic of China.

Article 2 These Guidelines apply to banks implementing the New Capital Accord as determined in the Guiding Opinions Concerning the Implementation of the New Capital Accord by China’s Banking Industry and other commercial banks implementing the New Capital Accord of their own free will.

Article 3 For the purpose of these Guidelines, the term “credit risk mitigation” refers to a process in which commercial banks use qualified collateral, netting, guarantees and credit derivatives to transfer or reduce credit risks. Commercial banks shall measure their credit risk regulatory capital by the internal ratings approach. Credit risk mitigation functions for the purpose of reducing default probability (DP), loss given default (LGD) or exposure at default (EAD).

Article 4 Credit risk mitigation shall follow:

1. the principle of legality: credit risk mitigation instruments shall meet the requirements of the laws of the state so as to ensure their enforceability;

2. the principle of effectiveness: the required formalities shall have been handled for credit risk mitigation instruments so as to ensure their compensatory capacity and accessibility;

3. the principle of prudence: commercial banks shall take into account the risk factors the credit risk mitigation instruments may bring about and their effects should be estimated in a conservative way;

4. the principle of consistency: if a commercial bank uses a credit risk mitigation haircut estimated by itself, it shall apply this coefficient to all credit risk mitigation instruments

qualified for the use of the coefficient; and

5. the principle of independence: there shall not be any substantially positive correlation between the credit risk mitigation instruments and obligor risks.

Article 5 The management of credit risk mitigation generally requires commercial banks to:

1. make an effective legal review to ensure that the acknowledgement and use of a credit risk mitigation instrument are based on explicit and enforceable legal papers which are binding to all parties to a transaction;

2. specify the coverage of credit risk mitigation in the relevant agreements;

3. not repeatedly consider the effects of credit risk mitigation, which can only be reflected once in obligor rating, debt rating or EAD;

4. conservatively estimate the correlation between credit risk mitigation instruments and obligor risks, and comprehensively consider such risk factors as money mismatch and maturity mismatch;

5. ensure that the capital requirements after credit risk mitigation are not higher than those on the same risk exposure before credit risk mitigation;

6. formulate explicit internal management rules, examination procedures and operating flowcharts and set up a corresponding information system to ensure the effective display of the role of the credit risk mitigation instruments; and

7. disclose the policies, procedures and effects of credit risk mitigation, the main types of the collaterals and the approaches for estimating their values, the types of guarantors and their counterparties in the trading of credit derivatives as well as their credit standing, the risk concentration level of the credit risk mitigation instruments, and the risk exposure covered by credit risk mitigation instruments.

Chapter II Qualified Collateral

Article 6 Qualified collaterals include financial collaterals, receivables, commercial properties, and residential properties, etc.

For commercial banks which adopt the basic internal ratings approach, the qualified collaterals are those listed in Annex 1 of these Guidelines which simultaneously meet the relevant requirements of Article 7 and Article 8. Commercial banks which adopt the advanced internal ratings approach may determine qualified collaterals out of those which satisfy the requirements of Article 7 and Article 8 at their discretion, but they shall have historical data to show that the determined collateral has the risk mitigating effect.

Article 7 Requirements of a qualified collateral:

1. the collateral shall be an acceptable property or entitlement as prescribed in the Real Right Law of the People’s Republic of China or the Guarantee Law of the People’s Republic of China;

2. the ownership of the collateral is undisputable and the pledge is based on valid legal papers;

3. the collateral shall meet the necessary conditions for enforceability, and, if it requires the approval of or registration with the competent department of the state, the corresponding formalities shall have been handled;

4. there is a market of high fluidity for effectively disposing of the collateral at a reasonable market price; and

5. when the obligor is at default, insolvent, bankrupt or any credit incident as stipulated in the loan contract occurs, the commercial bank concerned can settle with or dispose of the collateral betimes.

Article 8 A commercial bank shall set up a collateral management system composed of sound rules, valuation methods, management flowcharts and a corresponding information system:

1. a commercial bank shall set up collateral management rules to specify the categories of the qualified collaterals, the collateral ratio, the methods of and frequency for estimating the value of collaterals and the relevant requirements on monitoring, settling with and disposing of collaterals;

2. a commercial bank shall estimate the value of collaterals under the principles of objectiveness, independence and prudence and ensure that the estimated value do not exceed the current reasonable market value thereof. A commercial bank shall set up the procedures for reviewing the estimated value of collaterals and determine the methods of and frequency for re-estimating the value of collaterals according to the fluctuation features of the value of the collaterals. A commercial bank shall re-estimate the value of the collaterals when the market fluctuates sharply and re-estimate the value of the commercial properties and residential properties at least once every year;

3. a commercial banks shall set up the procedures and a flowchart for the investigation and examination of collaterals so as to ensure that all collateral are authentic, legal and valid, and shall set up the procedures for the timely and effective collection of collaterals;

4. a commercial bank shall monitor and check collaterals on a regular basis and urge pledgers to fulfill their obligations according to the collateral contracts. The evaluation of the returns

from a collateral shall reflect the scope and effect of the liens which takes precedence over the bank’s claims, and conduct incessant monitoring. A commercial bank shall ensure that all collaterals are fully covered by insurance and prevent pledgers from taking unreasonable means to use the collaterals in a way that may reduce the their value;

5. a commercial bank shall, in case the collateral is held by a custodian, ensure that the custodian has separated the collateral from the custodian’s self-owned assets and exercised dynamic management over the real objects and accounts of the assets under its custody;

6. a commercial bank shall set up a collateral management information system to record the basic information of the collaterals, e.g., the name, quantity, quality, location, ownership, the methods, frequency and time for estimating the value of collaterals, the relationship between the collateral and the corresponding debts, and the disposal and recovery of the collaterals, etc.;

7. where a commercial bank believes that inventory is a qualified credit risk mitigation instrument, it shall meet the requirements listed in Items 1 through 6 and the following risk management requirements:

(1) ensuring that the storage company that keeps the inventory or the spot transaction market has legal capacity, a good business standing, good management rules, professional management facilities and technologies, qualified managers and a highly efficient warehouse information transmission system;

(2) sufficiently analyzing the supply-demand relations and trend of development of the market and estimating the market value of the inventory. The inventory value shall be estimated according to the cost value or the market value, whichever is smaller. The value of unsalable and overstocked goods or goods whose price has been reduced shall be determined according to their recoverable net income; and

(3) checking the physical objects of the inventory on a regular basis.

8. where a commercial bank believes that receivables are a qualified credit risk mitigation instrument, it shall meet the requirements as listed in Items 1 through 6 and the following risk management requirements:

(1) subtracting the bad debt reserve when estimating the value of receivables;

(2) setting up the process for determining the credit risks of receivables, including analyzing the business operations, financial standing, industrial situation and the category of the obligors of the receivables, etc. Where a commercial bank determines the risk of a receivable through the borrower, it shall examine the borrower’s credit policies with respect to the reasonability and credibility;

(3) setting up a monitoring system over receivables, including report of the age of the account receivables, control over the trade documentations, control and concentration level of the income from the accounts of payment, etc. A commercial bank shall also examine the performance

of loan contracts and whether there are any environmental restrictions or legal requirements on a regular basis; and

(4) establishing process for collecting receivables in written form. If any borrower has any financial difficulty or breaches the loan contract, the commercial bank shall have the power to sell or transfer the receivable without being subject to the consent of the obligor. The bank shall nonetheless make sound measures for collection where it collects receivables through obligors under usual circumstances.

9. where a commercial bank determines the lease of assets as a credit risk mitigation instrument, it shall fully consider the residue risks of the leased assets.

Article 9 For a commercial bank which adopts the basic internal ratings approach, the credit risk mitigating effect of a financial collateral is reflected in the adjustment of the standard LGD. The post-adjustment LGD is calculated as follows:

$$LGD^* = LGD \times (E^*/E).$$

where:

LGD = The standard LGD of the underlying unsecured loans before the involvement of the collateral

E = The current value of risk exposure

E* = The risk exposure after credit risk mitigation.

$$E^* = \max\{0, [E \times (1+He-C \times (1-Hc-Hfx]$$

where:

He = The adjustment coefficient of risk exposure

C = The current value of the financial collateral

H_c = The haircut of the financial collateral

H_{fx} = The haircut for the disposal of the money mismatch between the financial collateral and risk exposure

If the financial collateral is a basket of assets, the haircut of the basket of assets shall be as follows:

$$H=\sum_i a_i H_i$$

where:

a_i = The portion of the financial collateral in the basket of assets

H_i = The haircut applicable to the financial collateral

A commercial bank can estimate the haircuts of He, Hc and Hfx by its own or use the standard figures given by these Guidelines. See Annex 2 for the standard haircuts of He and Hc. The standard haircut of Hfx is 8% for marking to market and adjusting the guarantee money on a daily basis with the shortest holding period of 10 trading days, and for transactions subject to different shortest holding period requirements or reevaluation frequencies, Hfx shall be adjusted according to Annex 2.

A commercial bank which meets the requirements for the estimation of haircuts by itself shall guarantee the reasonability of the estimation process and submit the coefficients to the supervisory authorities for approval. A commercial bank shall estimate the haircuts for financial collaterals and foreign exchange money mismatches one by one, and, when doing so, it shall not take into account the correlation between unprotected risk exposures, collaterals and foreign exchange rates.

Article 10 Where the period of a credit risk mitigation instrument is shorter than that of the current risk exposure, the commercial bank shall take the effect of maturity mismatch into consideration. Where there is a maturity mismatch, if the original period of the credit risk mitigation instrument is less than one year or the remaining time period is less than three months, the instrument has no effect of mitigating credit risks.

1. a maturity mismatch of a qualified credit risk mitigation instrument shall be adjusted according to the following formula:

$$Pa = P \times (t-0.25) / (T-0.25)$$

where:

Pa = The credit mitigation value after adjusting the factors causing the maturity mismatch

P = The credit mitigation value after adjustment by haircuts but before adjusting the factors causing the maturity mismatch

T = The remaining period of risk exposure or 5 years, whichever is smaller, with the year as the unit; and

t = The remaining period of credit protection or T years, whichever is smaller, with the year as the unit.

2. The provisions on maturity mismatch are also applicable to netting, guarantees and credit derivatives.

Article 11 For a commercial bank which adopts the basic internal ratings approach, the credit risk mitigating effects of receivables, commercial properties, residential properties or any other collateral are reflected in the decrease of LGD, while the degree of decrease depends on the proportion between the current value of the collateral and the current value of risk exposure as well as the collateral level. Where a single type of collateral is used for credit risk mitigation, LGD shall be determined as follows:

1. a loan whose proportion between the current value of the collateral and the current value of risk exposure is below the minimum collateral level shall be deemed as a loan without collateral, and the standard LGD shall be adopted;

2. for a loan whose proportion between the current value of the collateral and the current value of risk exposure is above the overage collateral level, the corresponding smallest LGD shall be adopted;

3. for a loan whose proportion between the current value of the collateral and the current value of risk exposure is between the minimum collateral level and the overage collateral level, the risk exposure shall be divided into two parts, one with full collateral and one without collateral. The one with full collateral is the result of dividing the overage collateral level by the current value of the collateral, for which the smallest LGD set for this category of collaterals shall be adopted, while the rest part of risk exposure shall be the part without collateral, for which the standard LGD shall be adopted.

See Annex 3 for the minimum collateral level, overage collateral level and smallest LGD of the collaterals of different categories.

Article 12 Where a commercial bank which adopts the basic internal ratings approach uses two or more types of collateral for joint guarantee, it needs to split the risk exposure into parts covered by different collaterals and calculate their respective risk weight assets. The split should be done in the order of financial collaterals, receivables, commercial properties, residential properties, and other collaterals. The risk exposure value E* of a financial collateral after credit risk mitigation is divided into four parts: the part entirely covered by receivables, the part entirely covered by commercial or residential properties, the part entirely covered by other collaterals, and the part without any collateral.

If, upon the credit risk mitigating effects of qualified financial collaterals and receivables, the proportion between the total value of the other collaterals and the abated risk exposure value is less than 30%, that part of the loan shall be deemed as without any collateral, for which the standard LGD shall be adopted; if the proportion is more than 30%, the corresponding smallest LGD shall be adopted for the part entirely covered by each type of collateral, including qualified receivables.

Article 13 For a commercial bank which adopts the advanced internal ratings approach, the credit risk mitigating effects of a collateral is reflected in the valuation of LGD. The bank shall estimate the LGD for the risk exposure covered by each category of collateral according to its own estimated collateral recovery rate.

Chapter III Qualified Netting

Article 14 Requirements for determining a qualified netting:

1. there is a netting agreement which is legally enforceable disregard whether the other party to the transaction is insolvent or bankrupt;

2. it is possible to determine the assets and liabilities of a same party to a transaction under the netting agreement under any circumstances; and

3. it is possible to monitor and control the relevant risk exposures on the basis of net positions.

Article 15 Qualified nettings include on-balance sheet netting under valid netting agreements, repurchase netting under master netting agreements, and over-the-counter (OTC) derivatives netting and credit derivatives netting of the trading book under valid netting agreements.

Article 16 Where a commercial bank adopts qualified netting to mitigate credit risks, it shall continually monitor and control the follow-up risks, and shall monitor and control the relevant risk exposures on the basis of net positions. A commercial bank which adopts the advanced internal ratings approach shall set up the procedures for estimating the off-balance sheet EAD and set the estimated value of EAD adopted for each off-balance-sheet item.

Article 17 For a commercial bank which adopts the internal ratings approach, the credit risk mitigation effect of on-balance sheet netting is reflected in the decrease of EAD, and net risk exposure (E^*) shall be calculated as follows:

$$E^* = \max \{0, \text{on-balance sheet risk exposure} - \text{on-balance sheet liabilities} \times (1-H_{fx})$$

where:

On-balance sheet risk exposure and on-balance sheet liabilities are the on-balance sheet assets and liabilities of a same obligor under a valid netting agreement.

H_{fx} = the haircut in case of a money mismatch between on-balance sheet risk exposure and on-balance sheet liabilities.

Article 18 For a repurchase under a master netting agreement, the commercial bank may deem the repurchased financial assets as a financial collateral, and Article 9 of these Guidelines shall apply, or subject the repurchase to netting if the requirements provided in Article 14 are met.

1. The commercial bank shall separately subject the banking books and the trading books to netting and make sure that only when all transactions are marked to market and all collateral are qualified financial collaterals in the banking book may a netting be made to the offset balance position between the banking book and the trading book.

2. If the commercial bank subjects the repurchase to netting, the EAD shall be calculated as follows:

$$E^* = \max\{0, [(\Sigma(E) - \Sigma(C)) + \Sigma(E5 \times H5 + \Sigma(Efx \times Hfx]\}$$

where:

E^* = The risk exposure after credit risk mitigation

E = The current value of risk exposure

C = The current value of the accepted collateral

$E5$ = The absolute value of the given net position of securities

$H5$ = The haircut applicable to $E5$

Efx = The absolute value of net position of the money mismatched with the netting money;

Hfx = The haircut of money mismatch.

3. A commercial bank which meets the requirements of the market risk internal models may, by considering the correlation between securities positions, calculate the risk exposure and price fluctuations of the collateral in the repurchase by using the risk value model. The risk exposure under the risk value model shall be calculated as follows:

$$E^* = \max\{0, [(\Sigma E - \Sigma C) + VaR]\}$$

where:

VaR = The risk value on the previous trading day

If the commercial bank does not meet the requirements under the market risk internal models, it may apply to the supervisory department for using he internal risk value model to calculate the potential price fluctuations in the repurchase and back testing the results based on the data of a whole year to prove the quality of the model.

Article 19 Where a commercial bank which adopts the internal ratings approach uses OTC derivatives or the credit derivatives of the trading book for credit risk mitigation purposes, the net risk exposure of the other party to the a transaction shall be the sum of the current net exposure and the underlying net exposure:

1. the current net exposure is the sum of the positive market value and the negative market value of a single contract when the sum is a positive value;

2. the underlying net exposure shall be calculated as follows:

$$ANet = 0.4 \times AGross + 0.6 \times NGR \times AGross$$

where:

AGross = the sum of the underlying net exposure of all contracts concluded with a same person under the netting agreement, which equals the total of the contractual principal of each transaction multiplied by the appropriate credit conversion factor.

NGR = the ratio of net replacement cost to the gross replacement cost of the netting agreement. Upon the approval of the regulatory department, NGR can be calculated based on a single party to a transaction or all transactions covered by the netting agreement. A commercial bank shall stick to the approach for calculating NGR it is approved to use. See Annex 4 for the specific calculation of NGR by the said two approaches.

A commercial bank can also calculate the net exposure of the parties to the transactions by using the standard approach or the internal models approach upon the approval of the regulatory department.

Chapter IV Qualified Guarantees and Credit Derivatives

Article 20 A commercial bank which adopts the basic internal ratings approach shall determine the range of qualified guarantees and credit derivatives in accordance with the requirements prescribed in Articles 21 and 22. For a commercial bank which adopts the advanced internal ratings approach, the range of qualified credit derivatives shall be the same as that when it adopted the basic internal ratings approach, and it may determine the range of qualified guarantees upon its own initiative in accordance with the requirements of Articles 21 and 22, provided that there are historical data backing the risk mitigation effects of such guarantees.

Article 21 A qualified guarantee shall satisfy the following minimum requirements:

1. the guarantor shall satisfy the requirements prescribed in the Guarantee Law of the People’s Republic of China and has the ability to pay off the principal of the loan guaranteed. For commercial banks which adopt the advanced internal ratings approach, there is no restriction on the category of qualified guarantors, but the commercial banks shall set forth in writing the standards and procedures for determining the category of guarantors;

2. the guarantee shall be in writing and the amount of guarantee shall be valid within the guarantee period;

3. for a commercial bank which adopts the basic internal ratings approach, the guarantee shall be unconditionally irrevocable; for a commercial bank which adopts the advanced internal ratings approach, the guarantee can be conditional but the factor that may potentially lessen the credit risk mitigation effects shall be taken into consideration;

4. a commercial bank shall examine and evaluate the credit standing and repaying capacity of the guarantor so as to ensure the reliability of the guarantee. There shall be no foreign exchange control in the host country or country of registration of the guarantor; if there is, the commercial bank shall ensure that the guarantor have the permit for inward or outward remittance of capital for purposes of fulfilling its obligations;

5. a commercial bank shall strengthen the management of the guarantors’ archival information and check their credit standing, repaying capacity and performance of guarantee contracts during the valid period of each guarantee contract, and such check shall be conducted at least once every year;

6. a commercial bank shall keep strict control over the mutual guarantee and cross guarantee among affiliated companies or companies of the same group, and guarantees with substantial risks shall not be taken as a qualified credit risk mitigation instrument; and

7. the risk weight after using a credit risk mitigation instrument shall not be less than that of the direct risk exposure of the guarantor.

Article 22 Credit default swap and total return swap can be used as qualified credit derivatives if they provide the same credit protection as guarantee. To adopt qualified credit derivatives to mitigate credit risks, the bank shall meet the requirements of Article 21 and the following as well:

1. the credit protection provided by credit derivatives must be a direct liability of the person that provides credit protection;

2. except for reasons attributable to the credit protection buyer, the contractual payment obligation shall be irrevocable;

3. the credit incidents stipulated in the credit derivatives contract shall at least include:

(1) the failure to pay in full amount on the final payment day of the basic debt according to the contract, and still failing to do so upon the expiration of the applicable grace period;

(2) the obligor becomes bankrupt or insolvent, admits its financial insolvency in writing or has any other similar incident; and

(3) the occurrence of a credit loss incurred by the reorganization of the basic debt resulting from the reduction or deferred payment of the principal, interest or charges. When the reorganization of liabilities is not treated as a credit incident, the effect of the credit risk mitigation shall be determined under Article 9 of the present Guidelines.

4. before the stipulated grace period for default expires, the failure to pay for the basic debt shall not lead to the termination of the credit derivatives;

5. there shall be rigid evaluation procedures for the credit derivatives which allow cash settlement so as to reliably estimate losses. The evaluation procedures shall expressly specify the time needed for obtaining the value of the basic debt after a credit incident has occurred.

6. if the settlement of credit derivatives requires the credit protection buyer to transfer the basic debt to the credit protection provider, it shall be expressly stipulated in the basic debt contract under which circumstances may such transfer be refused;

7. the identity of the person who determines whether a credit incident has happened shall be expressly defined. The buyer of credit protection shall have the power and capacity to notify the provider of credit protection of the occurrence of credit incidents;

8. the mismatch between the basic debt of credit derivatives and the reference debt which is used for determining the occurrence of a credit incident is acceptable when the grade of the reference debt is similar to or lower than that of the basic debt, the reference debt and the basic debt have the same obligor and they are legally enforceable in the case of cross default or accelerated maturity of debts; and

9. if credit derivatives do not cover the reorganization of debts but satisfy the requirements of Items 3 through 8 as described above, the risk mitigation effect of the credit derivatives may be partially recognized. If the value of credit derivatives does not exceed that of the basic debt, the part covered by credit derivatives shall be 60% of the amount of credit derivatives. If the value of credit derivatives exceeds that of the basic debt, the part covered by credit derivatives shall be at most 60% of the value of credit derivatives.

Article 23 A commercial bank which adopts the advanced internal ratings approach may find the credit risk mitigating effects of guarantees and credit derivatives by adjusting the estimated value of DP or LGD, while a commercial bank which fails to meet the requirements for the estimation of LGD upon its own initiative may get the effect of credit risk mitigation only by adjusting DP.

No matter whether DP or LGD is selected, a commercial bank shall guarantee that the same approach is applied to different guarantees or credit derivatives during a certain period of time.

Article 24 A commercial bank which adopts the basic internal ratings approach shall deal with the risk exposures covered by guarantees or credit derivatives by using the substitution method:

1. adopting the risk weight function applicable to the guarantor;

2. adopting the DP corresponding to the rating results of the guarantor. If the commercial bank holds that complete substitution is not suitable, it can adopt the DP of either the rating of the obligor or that of the guarantor;

3. deeming risk exposure as the exposure of the guarantor and adopting the standard LGD of the guarantee. If the guarantor has applied any other credit risk mitigation instrument to the guarantee, it is allowed to continue adjusting the standard LGD;

4. if the money used for credit protection is different from that for risk exposure, i.e., there is a money mismatch between credit protection and risk exposure, it shall be deemed that the risk exposure of the part under protection will be reduced by the haircut Hfx.

$$Ga = G \times (1-Hfx)$$

where:

Ga = The risk exposure under credit protection after the money mismatch is adjusted

G = The nominal value of the part under protection

Hfx = The haircut applicable to the money mismatch between credit protection and the corresponding liabilities

Article 25 A commercial bank which adopts the advanced internal ratings approach may apply the substitution approach to the part covered by guarantees or credit derivatives or use the DP and risk weight function of the obligor itself and have the bank estimate the loss ratio of the guarantee provided by the guarantor.

Of the two approaches neither DP nor LGD reflects the effects of double default. The risk weight resulting from the use of DP upon its own initiative shall not be lower than that of direct loans which are comparable to the guarantor’s.

Article 26 Where a same risk exposure is guaranteed by two or more guarantors and there is no division between their respective guarantee liabilities, a commercial bank shall not take into consideration the credit risk mitigation of two or more guarantors when using the basic internal ratings approach, but may select a guarantor with the best credit grade and best credit risk mitigation effects to deal with the credit risk mitigation.

For a commercial bank which adopts the advanced internal ratings approach, if historical data shows that the credit risk mitigation effect of a same risk exposure when there are two or more guarantors is better than that when there is only on guarantor, the commercial bank is allowed to consider the contribution of each guarantor to the reduction of risks, which is reflected in the reduction of the DP.

Chapter V Credit Risk Mitigation Instrument Pool

Article 27 Where there are more than one credit risk mitigation instrument available for a single risk exposure, the commercial bank which adopts the basic internal ratings approach shall dismember the risk exposure into parts covered by different credit risk mitigation instruments and then separately calculate the risk-weighted assets of each part. If the credit protection is provided by one credit protector but with different periods, the credit protection shall be dismembered into independent credit protections under the principle of maximizing the credit risk mitigation effects.

Article 28 A commercial bank which adopts the advanced internal ratings approach may apply two or more credit risk mitigation instruments to a same risk exposure. The commercial bank which adopts this method shall prove the efficacy of this method in offsetting risks and set up reasonable procedures and methods for applying multiple credit risk mitigation instruments.

Chapter VI Supplementary Provisions

Article 29 Annexes 1 through 4 are a component part of these Guidelines.

Article 30 These Guidelines adopt the credit rating tiers of Standard & Poor and Moody's Investors Service but do not provide for the commercial banks' hiring of external credit rating agencies. Commercial banks may select the credit rating results of rating agencies at their discretion, but shall maintain the continuity thereof.

Article 31 The power to interpret these Guidelines shall remain with the CBRC.

Article 32 Other commercial banks may use these Guidelines as a reference so as to strengthen the management of their credit risk mitigation instruments and improve their credit risk offsetting ability.

Article 33 These Guidelines shall come into force on October 1, 2008. The computational rules required by the relevant supervisory capital shall come into force on the day when the New Capital Accord is implemented upon the approval of the CBRC.

Annex 1: Cooperative Credit Risk Mitigation Instruments under the Basic Internal Ratings Approach

Annex 2: Standard Haircuts for Financial Collateral in the Basic Internal Ratings Approach

Annex 3: LGD of the Collateralized Part of Priority Debts in the Basic Internal Ratings Approach

Annex 4: Examples for the Calculation of the Net-to-Gross Ratio of Derivatives