ISDA®

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BY FAX AND BY POST

1 August 2008

Mr Yi Gang
Vice Governor
People's Bank of China
32 Chengfang Street
Xicheng District, Beijing 100800
The People's Republic of China

Dear Mr Yi,

China Inter-bank Market Financial Derivatives Master Agreement (2007 Version) ("NAFMII Agreement") and the Master Agreement for Renminbi Foreign Exchange Derivative Products on the National Inter-bank Foreign Exchange Market (2007 Version)("CFETS Agreement")

On behalf of its members, the International Swaps and Derivatives Association, Inc. ("**ISDA**") presents to the People's Bank of China ("PBOC") this letter in relation to the NAFMII Agreement and the CFETS Agreement.

By way of brief introduction, ISDA is the leading global trade association in the privately negotiated derivatives industry with over 830 members from more than 56 countries worldwide. Many major Chinese banks (including Agricultural Bank of China, Bank of Beijing, Bank of China, China CITIC Bank, China Construction Bank, China Development Bank, Industrial and Commercial Bank of China, Shanghai Pudong Development Bank and The Export-Import Bank of China) and most foreign banks operating in China are all members of ISDA. ISDA's primary purpose is to encourage and assist in the establishment of sound financial risk management systems and to ensure the prudent and efficient development of the derivative markets.

The purpose of this letter is to bring to your attention an issue existing in China's OTC derivatives market, the conflict of the NAFMII Agreement and the CFETS Agreement.

Pursuant to the relevant PBOC regulations, the participants of the National Inter-bank Bond Market must sign the NAFMII Agreement before they may enter into Renminbi interest rate swaps or forward rate agreement transactions. Under Section 3(II) of the NAFMII Agreement, any "Financial Derivative Transaction" to be entered into between the parties is required to be governed by the NAFMII Agreement. The term “**Financial Derivative Transaction**” (the scope of which cannot be amended by the parties) is defined broadly and includes interest rate derivative transactions, bond derivative transactions, currency derivative transactions and credit derivative transactions. However, this creates a conflict with the CFETS Agreement currently in use in the foreign exchange market.

Renminbi-foreign exchange forwards, swaps and cross currency swaps between financial institutions in the PRC (“**CFETS Transactions**”) and conducted on the China Foreign Exchange Trading System (“**CFETS**”) are required under the SAFE regulations and CFETS’ trading rules to be governed by the CFETS Agreement. If two parties who have signed the CFETS Agreement also enter into the NAFMII Agreement, any currency derivative transactions (such as Renminbi-foreign exchange forwards, swaps or cross currency swaps) between them will be governed by both the CFETS Agreement and the NAFMII Agreement. This could bring about legal and documentation risks to these market participants as follows: if an event occurs in relation to a party that may give rise to an action under one master agreement but not under the other, there is likely to be confusion as to what rights the parties have under the agreements and what action they may take. Even if a similar action happens to be triggered under both agreements, the rights and remedies available to a party may still be different with the result that the consequence of a particular event may become uncertain and open to dispute**.**

Further, the co-existence of the two master agreements has also weakened the single agreement concept and thus increased credit risk and systemic risk for all market participants. Outside China, market participants use the ISDA Master Agreement to govern OTC derivative transactions regardless of whether the transaction is a foreign exchange, rate, credit, commodity or equity trade. Similar to the ISDA Master Agreement, the NAFMII Agreement and the CFETS Agreement have also incorporated the "single agreement" and "close-out netting" provisions. The single agreement concept is a critical element of the netting mechanism in that it inextricably connects all transactions which means that if a default under one transaction occurs, all transactions should terminate simultaneously and be netted. As a matter of prudent credit risk management, having different agreements for different products defeats the purpose and benefit of having one single master agreement for all OTC derivative transactions and is not in line with the prevailing market practice in other jurisdictions.

The conflict of the NAFMII Agreement and the CFETS Agreement is unavoidable for the market participants of the onshore derivatives market given that PBOC and SAFE have made the execution of the two agreements a pre-condition of doing onshore Renminbi derivative transactions. The conflict has posed a major challenge for the market participants and cannot be satisfactorily resolved by a contractual arrangement between parties.

ISDA believes that it is critical to merge the two existing master agreements into one single agreement that governs all OTC financial derivative transactions in China. ISDA has held talks with NAFMII, SAFE, Mr Li Bo at PBOC's Legal Division, as well as a broad range of market participants on several occasions and believe all of these parties share our belief that a single, merged agreement is crucial to the development of a healthy and robust OTC derivatives market in China. ISDA understands that it may take time for the two agreements to be merged, and if so, ISDA would suggest that until then, some interim measures be adopted to minimize the legal and documentation risks caused by the conflict of the two agreements. Possible solutions include allowing parties to carve out the CFETS transactions from the NAFMII Agreement or the use of a bridging provision.

ISDA is grateful for the opportunity to have a dialogue with PBOC on the development of the derivatives market in China. ISDA would be pleased to discuss further the issue highlighted above and assist PBOC and NAFMII in any way that you deem appropriate. If you or your colleagues have any questions, please do not hesitate to contact Keith Noyes in Hong Kong on (852) 2200 5909, Bay Way Yee in Singapore on (65) 6532 3870 or Jing Gu in Hong Kong on (852) 2200 5908 or to send a fax to us at the above number.

Yours faithfully,
For the International Swaps and Derivatives Association, Inc.

Keith Noyes 駱嵐
Regional Director
Asia Pacific