



Level 21 | Centennial Tower
3 Temasek Avenue Singapore 039190
T +65 6549 7337 | F +65 6549 7011
www.fiaasia.org

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Shanghai International Energy Exchange
500 Pudian Road, Pudong New District
Shanghai 200122
People's Republic of China

Email: ine.advice@ine.cn

Dear Sirs and Madams

Re: Public Comment on the Futures Trading Participant Management Rules of the Shanghai International Energy Exchange and other Implementing Rules (together, the “Exchange Rules”)

On behalf of the membership of Futures Industry Association Asia (“**FIA Asia**”) we welcome the opportunity to respond to the public consultation on the second batch of Exchange Rules published by the Shanghai International Energy Exchange (“**INE**”).

We note that FIA Global has previously commented on the public consultation conducted by the China Securities Regulatory Commission¹ and that FIA Asia has previously commented on the INE’s first rules consultation².

We wish to reiterate many of the comments set out in our previous letters as they remain key areas of focus for our members. In addition, we would like to emphasize the following:

1. Adoption of international standards and industry best practice

As highlighted in our previous letters, we recommend the INE adopt common international standards and industry best practice. The relevant international standards include those set out in the CPSS-IOSCO Principles for Financial Market Infrastructures (“**PFMIs**”)³. We urge the INE to consider the PFMIs, assess and work towards compliance and provide transparent and consistent disclosures which are publicly available.

Adoption of the PFMIs, common international standards and industry best practice will assist in fostering international participation and trading by minimizing potential conflicts of rules for participants and assist the INE when seeking recognition, authorization or exemption under the European, US or other third country rules.

We would like to share some work that we have been involved with recently that we hope will provide useful guidance for the INE when considering industry best practice and standards.

¹ <https://asia.fia.org/articles/fia-global-responds-consultation-liberalisation-chinese-domestic-futures-market>

² <https://asia.fia.org/articles/fia-asia-comments-shanghai-international-energy-exchange-draft-rules>

³ <http://www.bis.org/cpmi/publ/d101a.pdf>

From a trading perspective, this includes FIA's "*Guide to the Development and Operation of Automated Trading Systems*"⁴. This Guide was developed by a committee of the FIA Market Technology Division. The Committee represents a broad range of industry participants including exchanges, brokers, and principal traders. Regulators, standards bodies and exchanges were also consulted to determine the scope of the Guide and to develop a consensus description of current practices.

The Guide addresses a broad range of categories relevant to automated trading systems including pre-trade risk controls, post-trade analysis, co-location, disaster recovery/business continuity, system development and support, security, operations and documentation of policies, procedures and systems. We believe consideration of the issues set out in the Guide will assist the INE in enhancing the safety and integrity of its marketplace.

In relation to clearing, FIA Global has published the FIA Global CCP Risk Position Paper⁵ which may assist the INE when assessing and managing risks associated with central clearing and identifies some key concern areas. The paper is written from the perspective of clearing members and makes a number of recommendations including consistent and transparent CCP disclosures, ensuring CCP continuity through clearly defined loss allocation tools and effective resolution plans and enhancing CCP governance.

We would be happy to provide further information on these matters if required.

2. QCCP Status

We also urge the INE to seek and obtain Qualifying Central Counterparty ("**QCCP**") status as that will greatly assist the INE in attracting international participation.

As you may be aware, in July 2012, the Basel Committee on Banking Supervision published the "*Capital requirements for bank exposures to central counterparties*"⁶ which prescribes a capital charge on banks' exposures to CCPs arising from certain transactions. There are lower capital charges for banks' trade and default fund exposures to QCCPs. Various countries are implementing these Basel capital requirements in their own laws and regulations, for example, under the Capital Requirements Regulation IV in Europe.

Essentially if a clearinghouse does not obtain QCCP status in the relevant jurisdiction, it will significantly increase the capital costs for bank clearing members who will be subject to higher and more restrictive capital adequacy requirements. Significantly increased capital costs will likely result in market exit by some clearing members as well as clearing members being very selective of which CCPs they become members of due to economic viability.

We therefore urge the INE to seek QCCP status to attract and sustain international and overseas participation in its markets. We would be happy to provide further information and detail on these matters and share our experiences if this would be helpful.

3. Detailed Comments on Draft Exchange Rules

We set out our detailed responses to the draft Exchange Rules in Appendix One of this response letter.

⁴ <https://americas.fia.org/articles/fia-issues-guide-development-and-operation-automated-trading-systems>

⁵ <https://fia.org/articles/fia-global-issues-recommendations-central-clearing-risks>

⁶ <http://www.bis.org/publ/bcbs227.pdf>

We understand further draft rules will be published in due course to address such areas as clearing, delivery, risk management and governance. We look forward to and welcome further industry discussions and consultation with the INE as you move forward towards launch.

Thank you for considering the issues raised in this letter.

Please contact Phuong Trinh at ptrinh@fiaasia.org or telephone: +65 6549 7335 if you have any questions or require further information.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Bill Herder', written in a cursive style.

Bill Herder
President, FIA Asia

Appendix One: FIA Asia Comments on Exchange Rules

No	Rule	Detail	Comment
Enforcement Rules			
1.	Supervision of overseas participants and intermediaries	The Exchange has audit, investigative and enforcement powers relating to futures trading activity conducted on or through the Exchange.	<p>We appreciate the need for the INE to have audit, investigative and enforcement powers over participants to ensure a fair and transparent marketplace. However, we note that for overseas special participants, overseas intermediaries and overseas clients there may be practical challenges in applying these powers due to potential conflicts with existing laws and obligations in home jurisdictions eg due to bank secrecy laws, data protection laws and confidentiality obligations.</p> <p>We therefore recommend that the INE include provision in the rules that the audit, investigative and enforcement powers are subject to any information sharing agreements or memorandums of understanding entered into by the CSRC and other third country regulators or agencies.</p>
2.	Article 6 – Routine Audit powers of the Exchange	The Exchange may conduct routine audit in accordance with Exchange rules over the business activities of Members, Overseas Special Participants, Overseas Intermediaries, Clients, Designated Delivery Warehouses, Designated Settlement Banks, Designated Inspection Agencies, information service vendors and other futures market participants.	We recommend that the INE set out in its rules that inspections must be held during ‘normal business hours’ and that prior written reasonable notice of any audit or inspection is provided.
3.	Article 7 – Requests for information	The Exchange may exercise a number of powers in performing its enforcement mandates including accessing and copying documentation, collecting evidence and requiring participants to provide reports and information.	We recommend that the INE amend the Rules to expressly introduce a concept of ‘reasonableness’ in relation to its requests for information.
4.	Article 9 – Complaints and Whistleblowers	The Exchange provides a channel for complainants and whistleblowers.	We would be grateful for clarity on the complaints and whistleblowing channel. Will the INE be releasing more detailed policies and procedures?

No	Rule	Detail	Comment
5.	Article 19 – Conduct of Overseas Special Brokerage Participant	Conduct of an Overseas Special Brokerage Participant constituting violation of rules include: <ul style="list-style-type: none"> (a) Failure to go through account opening procedure (b) Violating trading code system (c) Opening an account for ineligible Clients without verification (d) Failing to explain risk of futures trading or clients not signing the risk disclosure (e) Use a client’s account to trade on its own behalf (f) Failure to segregate funds (g) Disclosing confidential information (h) Violating trading rules of the Exchange 	We would be grateful if the INE can confirm if there is a standard specified form of risk disclosure. This article requires the OSB to indemnify for any losses arising from rule violation. We would be grateful if the Exchange can confirm who it intends for the OSB to indemnify as it is not clear from the current wording. This indemnity language also appears in other articles eg Articles 28 and 29 so we would be grateful for clarification.
6.	Article 21 – Revocation of membership	The Exchange may revoke membership for a number of reasons including if a member fails to conduct futures trading for 3 consecutive months without justified reasons.	We would be grateful if the INE could clarify what would constitute a ‘justified reasons’? Could the Exchange also clarify who and the process for determining whether a reason is ‘justified’?
7.	Articles 25, 28, 29 and 36 – Suspension		We would be grateful if the INE can clarify if “suspension of its partial futures business” provided in Articles 25, 28, 29 and 36 refer to “suspension of its partial futures business with INE”? If so, we recommend that this be made clear in the rules.
8.	Article 29 – Conduct constituting violation of trading management rules	Paragraph 9 refers to ‘no goodwill’.	We assume the reference to ‘no good will’ is intended to refer to an exchange for physical where there is no bona fide physical leg. If this is the case, we recommend that this definition of ‘no good will’ be made clear in the rules.
9.	Article 57 – Dispute Mediation	Article 57 Disputes among Members, Overseas Special Participants, Overseas Intermediaries, Clients, Designated Delivery Warehouses, Designated Settlement Banks, Designated Inspection Agencies, information service vendors, and any other participants in the futures market over the futures business activities may be settled among themselves or under the auspices of the	We would be grateful if the INE could clarify that mediation is not a mandatory prerequisite prior to raising any dispute at arbitration or court. We also note that Overseas Intermediaries and their clients will have customer agreements and terms in place between them governing their business relationship. Therefore these market participants should be able to

No	Rule	Detail	Comment
		Exchange. If the mediator is unable to resolve the dispute, the disputing parties concerned may raise them before other arbitral institutions or bring suit into court.	resolve disputes between them under their documented terms and the laws governing those terms. We would be grateful if the rules can be clear on these issues.
10.	Appeals		We recommend that an appeals procedure be clearly set out in relation to any enforcement decisions made by the INE.
Eligibility Management Rules			
11.	Eligible Traders	Only eligible traders who have the requisite knowledge of the market and product, risk control and tolerance and have an understanding of the Exchange Rules may trade.	Based on the current definition of “trader”, it could be interpreted that overseas intermediaries and their clients would be captured by the Exchange Rules. In practice this could lead to significant operational and implementation challenges as the business operations of overseas intermediaries would have to assess their client’s knowledge and risk tolerance against each of the INE rules and onboard each individual client to trade at the Exchange (in addition to home jurisdiction suitability rules). We would be grateful if the INE could clarify and narrow the scope of these requirements. We would also be grateful if the INE can confirm if it requires participants to keep an updated list of traders and if there are any notification requirements to changes to authorised traders?
12.	Trading conduct		We recommend that the Exchange Rules contain trading conduct rules for eligible traders in line with international best practice.
Designated Settlement Banks Management Rules			
13.	Financial requirements for designated settlement banks		We note there are different requirements stated for domestic and overseas designated settlement banks. We would be grateful for clarification on the reasons for the differences and recommend that the requirements are consistent across the different types of designated settlement banks.

No	Rule	Detail	Comment
14.	Clearing account structures	There are references to various accounts in the rules including 'dedicated margin account for members' and 'dedicated fund account of the member' in Articles 13 and 17.	We would be grateful if the INE can more clearly explain the various clearing account structures in the Exchange Rules and ensure consistency of terminology to minimise uncertainty. Is it intended that the reference to dedicated margin account and dedicated fund account are referring to the same account?
15.	Article 20 – payment of interest	Designated Settlement Banks shall pay interests to the Exchange at the interest rates negotiated with the Exchange.	We would be grateful if the INE can clarify what payments of interest this article refers to?
Other comments			
16.	Cross border fund flow		<p>The ability to facilitate cross border transfer and flow of funds is essential to attracting and supporting international participation and trading in the INE's markets.</p> <p>We request that the INE consider the impact of public holiday bank closures and time zone differences which may result in delay of fund transfers between domestic and international entities. The current processes and regulatory filings required for cross border transfers and remittance may also result in further delays.</p> <p>Where possible, we recommend the INE consider these issues and make necessary contingency arrangements and help to seek further clarity and guidance from the relevant regulatory bodies.</p>