

Accessing PRC futures exchanges – key legal, regulatory and risk issues

FIA Asia seminar
October 2016

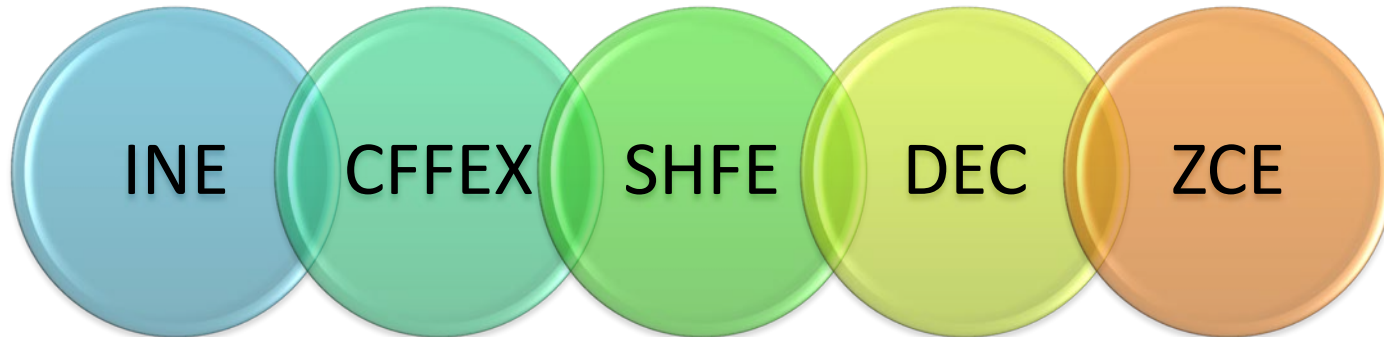


Ashurst

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PRC futures exchanges



Introducing China's five futures exchanges

Futures Exchange	Location	Products	
Shanghai International Energy Exchange (INE)	Shanghai, established in 2013	Energy:	crude oil, natural gas
China Financial Futures Exchange (CFFEX)	Shanghai, established in 2006	Stock indices:	CSI 300 Index, CSI 500 Index, SSE 50 Index
		Bonds:	5-year Treasury bonds, 10-year Treasury bonds
Shanghai Futures Exchange (SHFE)	Shanghai, established in 1999	Base metals:	copper, aluminium, zinc, lead, nickel, tin
		Precious metals:	gold, silver
		Other industrial products:	steel rebar, steel wire rod, hot rolled coil, fuel oil, bitumen and natural rubber

Introducing China's five futures exchanges

Futures Exchange	Location	Products	
Dalian Commodity Exchange (DCE)	Dalian (Shandong province), established in 1993	Softs:	corn, corn starch, soybean, soybean meal, soybean oil, palm olein, egg
		Energy:	coke, coking coal
		Other industrial products:	iron ore, fiberboard, blockboard, plywood, propene polymer
Zhengzhou Commodity Exchange (ZCE)	Zhengzhou (Henan province), established in 1993	Softs:	cotton, rice, rapeseed oil, rapeseed mill, rapeseed, wheat, sugar
		Energy:	thermal coal
		Other industrial products:	methanol, ferrosilicon, silicon manganese, pure terephthalic acid, flat glass, ferroalloy

Three issues to consider:

Market access

- Four possibilities

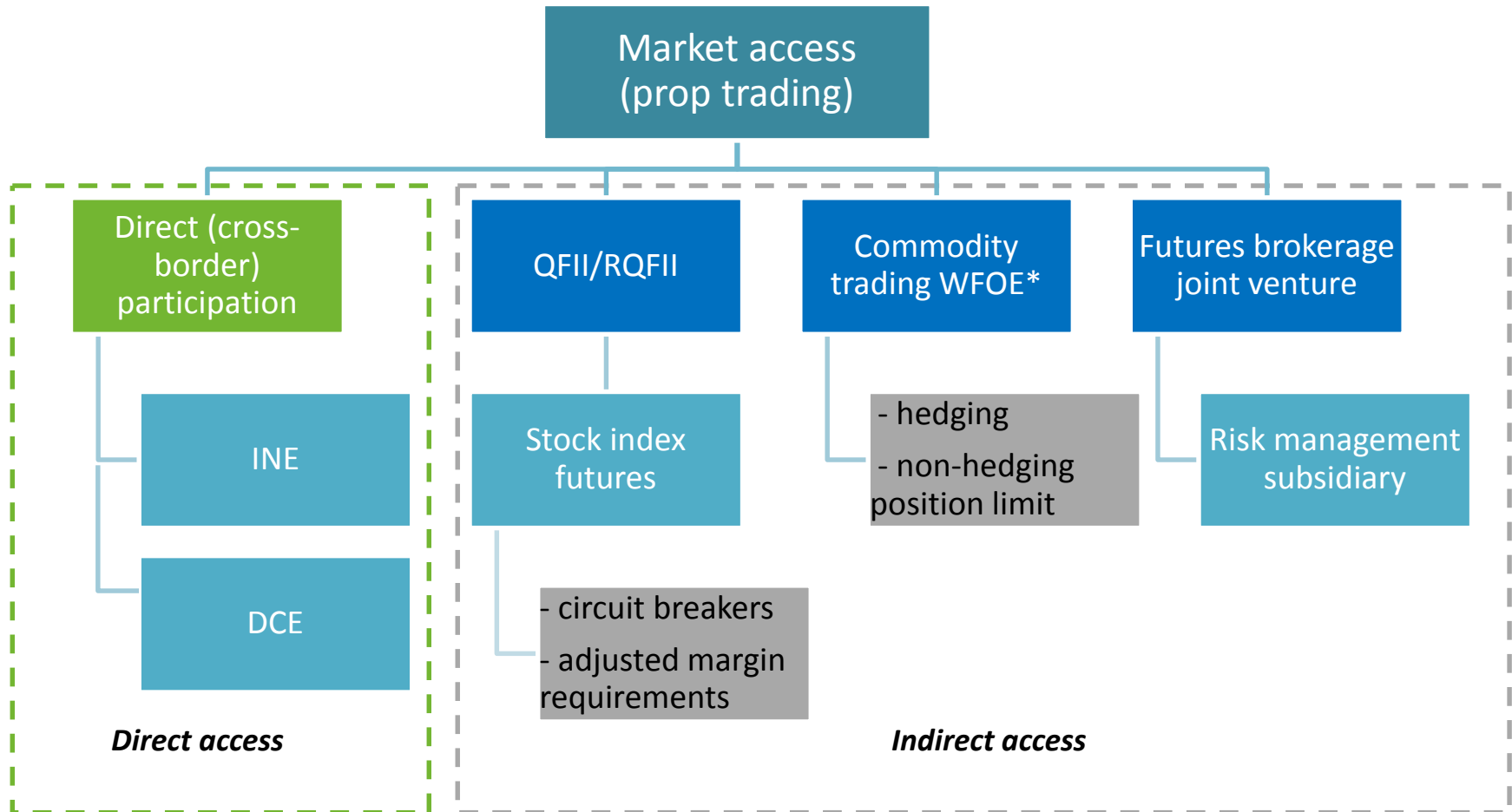
Regulatory compliance

- Navigating divergences in AML and trade sanction requirements between China and other jurisdictions

Credit risk

- Working through consequences of default by client, broker and exchange

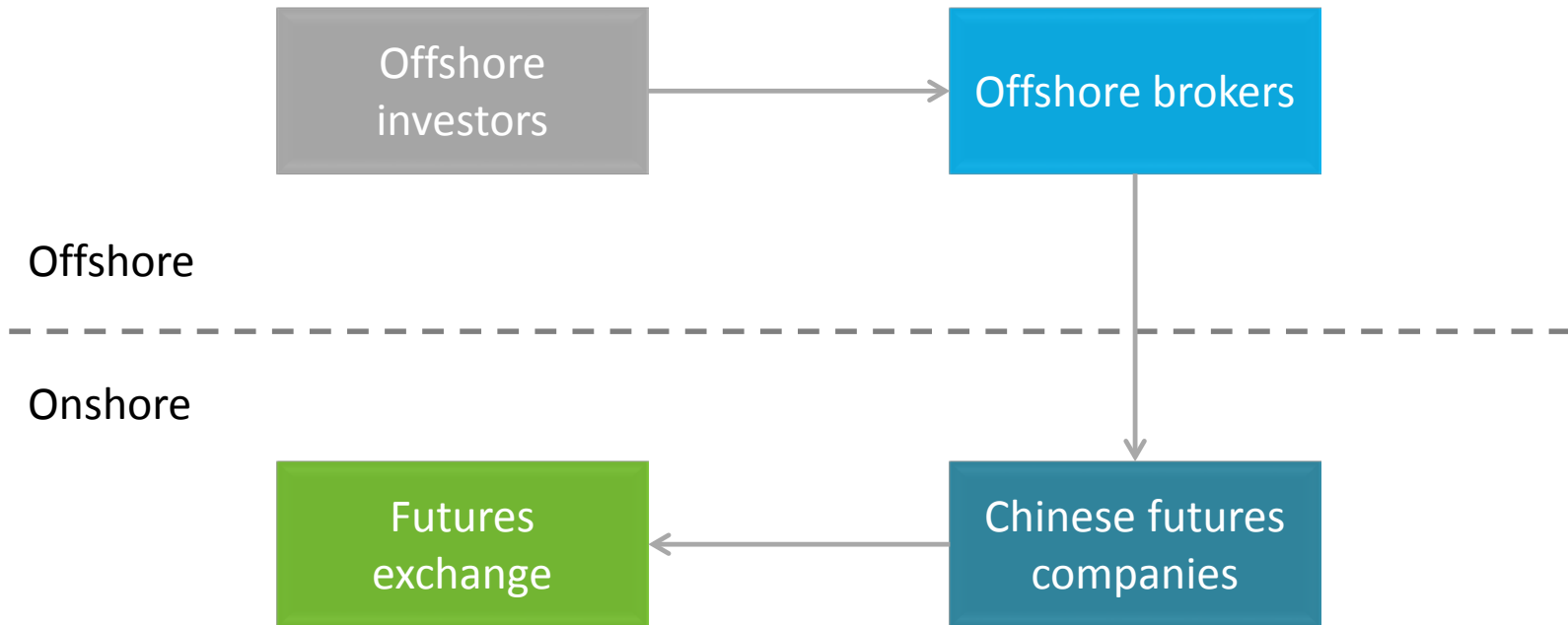
Issue 1: Market access



* Wholly foreign owned enterprise

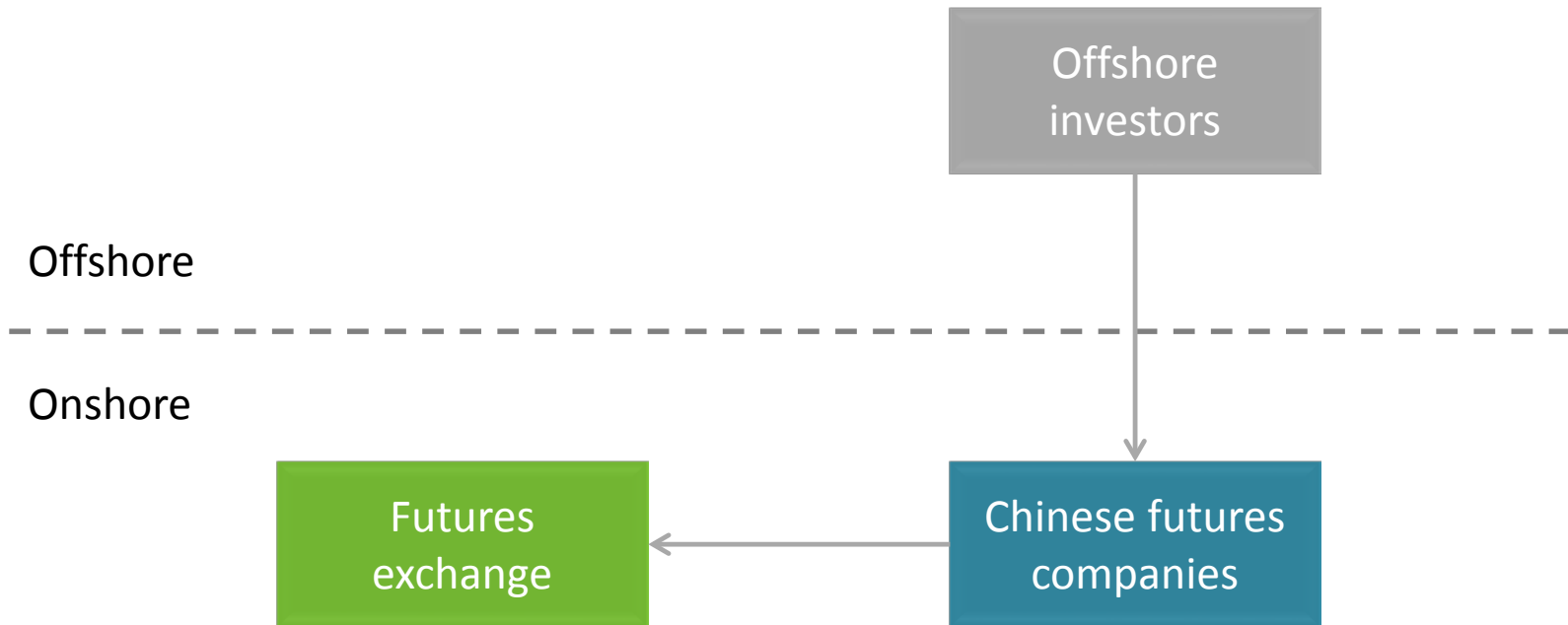
Issue 1: Market access (direct participation)

Direct access (INE) – Model 1



Issue 1: Market access (direct participation)

Direct participation (INE) – Model 2



Issue 2: Regulatory compliance

KYC, AML

- Financial institutions
- Non-financial institutions – Financial Task Force Act’s recommendations (reliance on third-parties?)

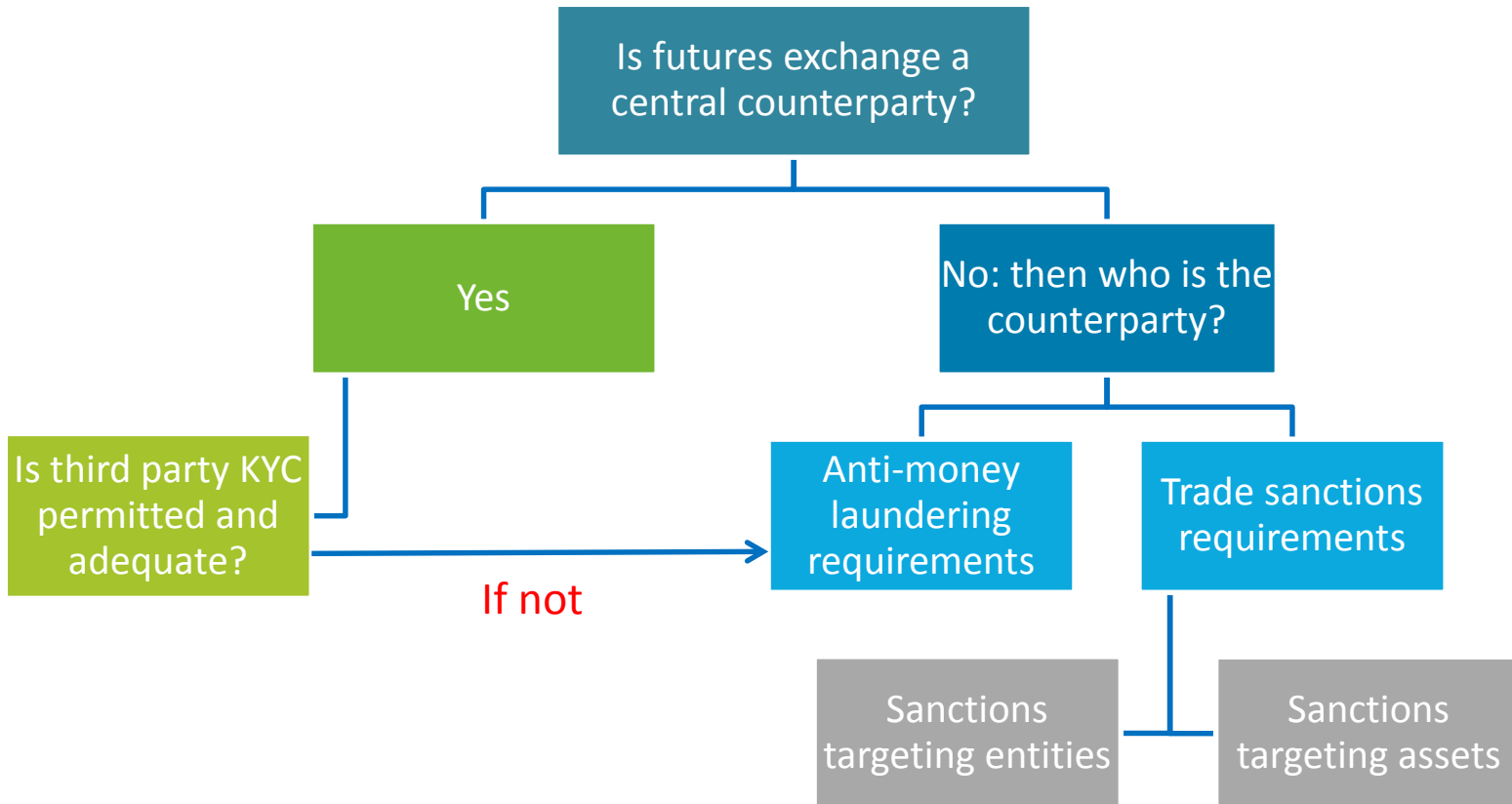
Trade sanctions

- Targeting particular persons, areas and assets (sanctioned persons list)
- Organization for Economic Co-operation and Development guidelines



Issue 2: Regulatory compliance

Road mapping:



Issue 2: Regulatory compliance



- Conflicting rules
 - information disclosure;
 - reporting; and
 - more
- Substituted compliance

Issue 3: Credit risks (client default waterfall)

1

- Margin posted by defaulting client applied

2

- Futures broker's risk reserve fund and its proprietary funds applied

3

- Restriction of defaulting client's trading

4

- Mandatory close-out of defaulting client's position by futures broker

5

- Futures broker is liable for unsatisfied obligations of defaulting client

Issue 3: Credit risks (futures broker default waterfall)

1

- Restriction of defaulting broker's trading

2

- Mandatory close-out of defaulting broker's positions and application of margin posted by defaulting broker

3

- Disposal of any non-cash collateral posted by the defaulting broker

4

- Application of other funds placed with futures exchange by the defaulting broker (e.g. guarantee fund contributions)

5

- Futures exchange acts as "central performance assurance provider"

* *Any porting mechanism available?*

Issue 3: Credit risks (futures exchange default)

FAQ: characterisation of the futures exchange

1. Is the relevant futures exchange a CCP?
2. Does the relevant futures exchange satisfy CPSS-IOSCO standards?
 - is there settlement finality?
 - will member/client's margin form part of futures exchange's bankruptcy estate?

Issue 3: Credit risks (futures exchange default)

FAQ: liability allocation

1. Is a member's potential liability limited or unlimited?
2. Is there an implicit government guarantee?

Issue 3: Credit risks (futures exchange default)

FAQ: margin collateral

1. What types of collateral are acceptable?
2. Can PRC brokers call for excess margin?
3. What level of account segregation is achievable?

Key contact



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Patrick is the managing partner of Ashurst's Beijing office, where he heads the firm's Finance practice in China. With 18 years of practice experience, ten of which have been in China, Patrick's clients span international and PRC banks, sovereign wealth funds, securities houses, commodities and high frequency traders, State-owned enterprises and other major corporates.

Patrick is recognised by Chambers Asia-Pacific and Asia Pacific Legal 500 as a leading practitioner in the PRC derivatives and regulatory market. He is actively involved in the development of many PRC market infrastructure projects. He is a member of drafting groups tasked by various industry associations to prepare industry standard documentation. Patrick speaks frequently at conferences and workshops, and to regulatory agencies, on the topics of derivatives market developments and regulatory issues.

Patrick also has extensive experience on a wide range of banking and finance matters, including advising both leading international financial institutions and Chinese policy banks on major outbound financing and cross-border financing transactions. He has native fluency in English, written Chinese and spoken Mandarin.



Q&A



FIA

The logo consists of three characters: 'F', 'I', and 'A'. The 'F' is a solid dark grey block. The 'I' is a solid dark grey vertical bar. The 'A' is composed of several overlapping geometric shapes: a light green triangle on the left, a blue triangle on the right, and a blue horizontal bar at the bottom. The background features a network of thin grey lines forming a grid of irregular polygons.