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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 General Exchange 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 are grateful for and welcome the opportunity to respond to the public consultation on the Exchange Rules published by the Shanghai International Energy Exchange (“**INE**”).

FIA Asia represents a diverse group of participants in the exchange traded and centrally cleared derivatives industry. Our members include banking organizations, futures exchanges, clearinghouses, brokers, vendors and trading participants. FIA Asia is affiliated with FIA and FIA Europe. The alliance of our three associations, known as FIA Global, is the primary global industry association for centrally cleared futures, options and swaps.

We are supportive of the opening of domestic futures markets to overseas participation and believe it will assist in the development and strengthening of global capital markets. We also note that FIA Global has previously commented on the public consultation conducted by the China Securities Regulatory Commission (“**CSRC**”) on the “*Interim Measures on the Administration of Overseas Trading Participants’ and Overseas Brokerage Institutions’ Engagement in Trading of Domestic Specified Futures Products*” (“**Interim Measures**”)¹.

We have set out our specific comments on the Exchange Rules at Appendix 1 and wish to highlight certain key areas for consideration by the INE.

1. Adoption of international standards and industry best practice

We recommend that PRC Futures Exchanges including the INE who are involved in the trading and clearing of the domestic specified futures products under the Interim Measures adopt common international standards and industry best practice.

This will help to ensure consistent global market standards and transparency and will assist in fostering international participation by:

- a) minimizing potential conflicts of laws and rules for participants; and
- b) assisting PRC futures exchanges, such as the INE, when seeking recognition, authorization or exemption under the European, US or other third country rules (further described in paragraph 3 below).

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

The relevant international standards include those set out in the CPSS-IOSCO Principles for Financial Market Infrastructures (“**PFMIs**”)².

We also wish to highlight that FIA has recently issued a comprehensive “*Guide to the Development and Operation of Automated Trading Systems*”³. 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. We would be happy to provide further information on these matters if required.

2. Authorisation of PRC Futures Exchanges and PRC Brokers

Under the various participant routes set out in the Interim Measures, overseas brokers and overseas trading participants may trade and clear domestic futures products directly on the PRC Futures Exchanges or engage a PRC broker. We wish to highlight that for the PRC Futures Exchanges (such as the INE) and PRC brokers to validly offer these services to overseas participants, the PRC Futures Exchange and the PRC Brokers will need to be licensed, authorized or exempted in that overseas country for trading and clearing. The type of authorization or exemption required for each country will depend on the nature of the services provided, the products offered and the types and location of customers.

By way of example, in the US, the PRC Futures Exchange would be required to seek authorization as a “Foreign Board of Trade” with the U.S. Commodity Futures Trading Commission (“**CFTC**”) if it sought to provide direct access to electronic trading systems to US participants. Similarly, if a PRC Broker wanted to provide trading and clearing services to a US customer, that broker would require registration as a futures commission merchant or an exemption under CFTC Part 30 Rules from the CFTC.

In Singapore, the PRC Futures Exchange would be required to seek authorization as a “Recognised Market Operator” or exemption as an “Exempt Market Operator” with the Monetary Authority of Singapore (“**MAS**”) to provide direct access to electronic trading systems for futures products to Singapore based participants. A PRC Broker would also require exemption or authorization from the MAS depending on the type of activity and customer it is targeting.

There would be further licenses, authorizations or exemptions required in Europe and other countries in the Asia-Pacific region depending on the location of the overseas broker or overseas trading participant. We would be happy to provide further information on these matters if required.

3. Clearing and Central Counterparties

We strongly support the central clearing of domestic futures products set out in the Interim Measures and the Exchange Rules. However in order for the INE to be able to operate effectively as a central counterparty, we wish to highlight certain areas regarding the current PRC legal and regulatory framework for central clearing. We understand some of these issues may be outside of the control of the INE (as it may require further legislation and regulations) but we hope this will assist in identifying areas that require further consideration.

(a) Close-out Netting Rights

We encourage the introduction of close-out netting legislation that protects close-out netting rights in the event of an insolvency of the central counterparty or a clearing member. These rights assist

² <http://www.bis.org/cpmi/publ/d101a.pdf>

³ <https://americas.fia.org/articles/fia-issues-guide-development-and-operation-automated-trading-systems>

in facilitating effective risk management including mitigating credit risks and are consistent with international standards and global best practice.

We would also be grateful for further guidance on how the member bankruptcy and close-out netting provisions in the Exchange Rules are intended to apply in practice in light of the current regulatory and legal framework.

(b) *Capacity and Contractual Novation to a central counterparty*

We encourage, to the maximum extent possible under PRC law, that the clearing structure for domestic futures products allow for legal title to be transferred or novated to the central counterparty. This will help to align the clearing structure with international standards and global best practice.

We would be grateful if the Exchange Rules can clearly state the contractual relationship between INE, its Members and Overseas Special Participants and the legal capacity in which transactions are entered into by all stakeholders (including members, Overseas Special Participants and clients).

(c) *Settlement finality*

We would welcome the introduction of rules ensuring finality of settlement and payments to a central counterparty to mitigate risks including liquidity, credit and settlement risks. The introduction of such rules would also be aligned with international standards and global best practice.

4. Further Exchange Rules and Guidance

We note the Exchange Rules refers to further rules and guidance being issued by the INE, for example the Clearing Rules, the Delivery Rules and the Risk Control and Management Rules. At this stage, the draft Exchange Rules do not address significant issues such as governance and administration of the Exchange Rules, member liability and default fund structures including fund contributions and waterfall. We look forward to further guidance and clarity on these areas and welcome further industry discussions and consultation with the INE as we move forward.

Thank you for considering the issues raised in this letter. We would be happy to share with you our experience from other jurisdictions in these areas if required. Please contact Phuong Trinh at ptrinh@fiaasia.org or telephone: +65 6549 7335.

Yours faithfully,



Bill Herder
President, FIA Asia

Appendix One: FIA Asia Comments on Exchange Rules

No	Rule	Detail	Comment
General Exchange Rules – Chapter 4 Trading			
1.		Legal Capacity and Contractual Relationship	We would be grateful if the Exchange Rules can state clearly the contractual relationship between INE, its Members and Overseas Special Participants and the legal capacity in which transactions are entered into by all stakeholders (including members, Overseas Special Participants and clients).
2.	Article 7 – A contract is denominated in RMB or other currencies as prescribed by the Exchange		Are there any restrictions on the flow of RMB for remittance of funds relating to the trading, clearing and settlement of domestic futures products? We look forward to more detailed guidance.
3.	Article 15 – Risk management, IT Systems	The Exchange shall formulate rules for management and supervision of members and overseas special participants. The Exchange may impose requirements on the trading operation, risk management and IT systems where necessary.	<p>Is there any further guidance on these requirements?</p> <p>Will notice be given to members and overseas special participants prior to implementing any changes or new requirements?</p> <p>Recommendation: We recommend that the Exchange consider the guidelines set out in the <i>FIA Guide to the Development and Operation of Automated Trading Systems</i> which we believe will be helpful in assessing these requirements.</p>
4.	Article 17 – Account Opening	<p>Risk disclosure is needed before opening accounts for clients.</p> <p>Data retention: Members and overseas participants must retain account opening materials for at least 20 years</p>	<p>Is there a standard specified form of risk disclosure?</p> <p>The data retention period of 20 years appears excessive and conflicts with requirements in other jurisdictions and may prove impractical and difficult with changes and advancements in technology. The data retention period in many jurisdictions is 7 years.</p> <p>Recommendation: We recommend that the data retention period be reduced to 7 years.</p>

No	Rule	Detail	Comment
5.			<p>It is not clear whether different client account structures will be available to members and overseas special participants eg omnibus accounts. It is only mentioned in the Membership Management Rules for being available to FF Members.</p> <p>Will these account structures be available to all members and overseas special participants and intermediaries?</p>
6.	Article 35 – Mark-to-Market	The Exchange implements daily mark-to-market. After each trading day, the Exchange shall settle the profit and loss, the trading margin, taxes, transaction fees, delivery payments and other payments for each Member.	Recommendation: We recommend that the Exchange provide for daily close-out netting in the Exchange Rules with respect to mark-to-market payments.
7.	Trading Conduct		Recommendation: We recommend that the Exchange Rules contain trading conduct rules in line with international best practice.
8.	Block Trading		Recommendation: We recommend that the Exchange consider the provision of a block trading facility in the Exchange Rules consistent with the majority of international exchange traded derivatives markets.
General Exchange Rules – Chapter 5 Clearing			
9.	Articles 31 to 34 - Margin requirements	Funds in foreign currency, standard warrants, treasury bonds and other assets with stable value and high liquidity may be used as margin collateral.	<p>Are there any restrictions on the type of assets that can be used to meet margin requirements?</p> <p>Is there further guidance on how the Exchange will determine the value of the margin collateral and the margin safekeeping and segregation requirements?</p> <p>Recommendation: We recommend that the Rules clearly specify the legal basis on which the Exchange receives margin collateral from its members and how it will exercise its rights.</p>

No	Rule	Detail	Comment
10.	Article 38 – Data retention and record keeping	<p>The Exchange will retain data of futures trading, clearing, settlement and delivery for at least 20 years.</p> <p>Data retention: Members, overseas special participants, intermediaries and designated settlement banks shall keep the materials, account books and supporting documents of account opening, trading, clearing, settlement and delivery, client complaint files and other business records for at least 20 years.</p>	<p>The data retention period of 20 years appears excessive and conflicts with requirements in other jurisdictions and may prove impractical and difficult with changes and advancements in technology. The data retention period in many jurisdictions is 7 years.</p> <p>Recommendation: We recommend that the data retention period be reduced to 7 years.</p>
General Exchange Rules – Chapter 6 Delivery			
11.	Delivery Mechanisms		<p>How does the delivery mechanisms interact with the Exchange as CCP?</p> <p>For example if a clearing member fails to perform its delivery obligations, is the Exchange (as a central counterparty) responsible for the financial performance (replacement cost) with respect to the delivery?</p>
12.	Articles 45 to 47 - Default		Force Majeure events (events outside the control of parties) does not appear to be addressed in the articles dealing with default in delivery.
General Exchange Rules – Chapter 7 Risk Management			
13.	Position Limits		Recommendation: We recommend that the Exchange consider the guidelines set out in the FIA <i>Guide to the Development and Operation of Automated Trading Systems</i> which we believe will be helpful when considering position and price limit requirements.
General Exchange Rules – Chapter 8 Handling Abnormal Circumstances			
14.	Articles 58 to 60 - Handling of Abnormal Circumstances	The Exchange has certain rights and powers upon the occurrence of an ‘abnormal circumstance’ such as natural disaster.	It is not currently addressed how liability will be allocated if there is an ‘abnormal or emergency event’ as described in Article 58.

No	Rule	Detail	Comment
General Exchange Rules – Chapter 9 Information Management			
15.	Articles 63 to 69 - Dissemination	The Exchange has proprietary rights over market data information and transaction data and may manage and disseminate information including contract name, contract delivery month, price.	Recommendation: We recommend that any distribution and dissemination of market and trade data is anonymized.
16.	Article 68 – Remote Data Backup	The Exchange shall establish remote data back up facilities to ensure the safety of transaction data.	Recommendation: We recommend that the Exchange consider the guidelines set out in the FIA <i>Guide to the Development and Operation of Automated Trading Systems</i> which we believe will be helpful when disaster recovery and business continuity plans.
General Exchange Rules – Chapter 10 Supervision			
17.	Article 75 – Audit and Sampling	The Exchange shall, on an annual basis, audit a sampling of the members and overseas special participants on their compliance with the Exchange Rules and will forward the results of the inspection to the CSRC.	Will members and overseas special participants be notified by the Exchange if they are sampled?
Information Management Rules			
18.		The Information Management Rules govern the dissemination, management and use of market data, transaction data and various other announcement and notices made by the Exchange.	Recommendation: We recommend that any distribution and dissemination of market and trade data is anonymized.
Membership Management Rules			
19.	Chapter 3 – Acquisition, Changes and Termination of Membership	The criteria for a Futures Firm Member (“ FF Member ”) or a Non-Futures Firm Member (“ Non-FF Member ”) includes having registered capital of (i) no less than RMB thirty (30) million for an FF member or (ii) no less than RMB ten (10) million.	Recommendation: We recommend that the Exchange consider introducing additional financial safeguards with respect to membership criteria, for example, financial ratios.
20.	Article 20 – 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.	Could the Exchange clarify what would constitute a ‘justified reasons’? Could the Exchange also clarify who and the process for determining whether a reason is ‘justified’?

No	Rule	Detail	Comment
		The Exchange may revoke membership if a member is declared bankrupt.	We would be grateful for further guidance on how the member bankruptcy and close-out netting provisions (for example in Article 23) in the Exchange Rules are intended to apply in practice in light of the current regulatory and legal framework.
21.		Orderly withdrawal of membership	The draft Exchange Rules do not currently allow for a member or overseas special participant to withdraw or resign their membership from the Exchange. Recommendation: We recommend that the Exchange Rules include provisions which facilitate the orderly withdrawal of membership.
22.	Section 2 – Management of FF Member’s Carrying – Brokerage Service for Overseas Intermediaries	An FF Member may provide the carrying-brokerage service to qualified Overseas Intermediaries. Article 43 requires an FF Member shall open a separate trading account and acquire a trading code for each overseas client of its carried Overseas Intermediary counterparty pursuant to rules prescribed by the Exchange.	It is not clear how overseas clients who are carried in an offshore client omnibus account maintained by an Overseas Intermediary are treated under the requirement for every client to have a separate trading account and trading code. Could the Exchange provide further guidance and address this in the Exchange Rules?
Overseas Special Participants Management Rules			
23.	Chapter 3 – Acquisition, Change and Termination of Licences of Overseas Special Participants	The criteria for Overseas Special Participants include having net capital of no less than RMB thirty (30) million or its equivalent in foreign currency.	Recommendation: We recommend that the Exchange consider introducing additional financial safeguards with respect to membership criteria, for example, financial ratios.
24.	Article 20 - 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	Could the Exchange clarify what would constitute a ‘justified reasons’? Could the Exchange also clarify who and the process for determining whether a reason is ‘justified’?
		The Exchange may revoke membership if a member is declared bankrupt.	We would be grateful for further guidance on how the Overseas Special Participants bankruptcy and close-out netting provisions (for example, in Article 23) in the Exchange Rules are intended to apply in practice in light of the current regulatory and legal framework.

No	Rule	Detail	Comment
25.		Orderly withdrawal of membership	<p>The draft Exchange Rules do not currently allow for a member or overseas special participant to withdraw or resign their membership from the Exchange.</p> <p>Recommendation: We recommend that the Exchange Rules include provisions which facilitate the orderly withdrawal of membership.</p>