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China Moves to Open Commodity Futures Trading to Foreign Participants

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Recent reports indicate that, pending regulatory approval, the Dalian Commodity Exchange in China will open trading to foreign participants in futures contracts on soybeans, soymeal, soy oil and palm oil.[1] This is the latest in a series of actions by China, beginning in early 2018, to gradually open futures trading on its commodities exchanges to foreign participants. Previously, the Chinese government opened trading in crude oil, iron ore and purified terephthalic acid to foreign traders in Shanghai, Dalian and Zhengzhou, respectively, as of March, May and November 2018.

Currently, overseas entities and individual investors that meet criteria involving capital, expertise, operations, governance and experience may trade the aforementioned types of RMB-denominated futures products on the respective exchange through:

(i) a domestic Chinese futures firm which is a member of the specific exchange;

(ii) a qualified overseas brokerage firm approved by the exchange;[2] or

(iii) an overseas brokerage firm which in turn places the trade orders through

(a) a domestic futures member firm; or

(b) a qualified overseas brokerage firm approved by the exchange.

Alternatively, entities and individual investors that meet certain additional qualification requirements upon approval by the exchange may trade directly on the exchange.[3]

Foreign investors may also invest in domestic futures companies subject to an equity cap of 51% and approval by the China Securities Regulatory Commission (CSRC). The equity cap is expected to be eliminated in August 2021.[4]

To further open its securities and futures markets to foreign investment, CSRC in January 2019 issued the Draft Regulations regarding Investment in Domestic Securities and Futures by Qualified Foreign Institutional Investors (QFIIs) and RMB Qualified Foreign Institutional Investors (RQFIIs) (Draft QFII Regulations) for public comment through March 2, 2019.[5] A QFII can be an overseas asset management organization such as a fund management company, commercial bank, insurance company, securities company, futures company, trust company or sovereign fund management company, pension fund, or charity fund that is approved by CSRC and the State Administration of Foreign Exchange (SAFE) to use foreign exchange funds from overseas to invest in domestic securities and futures markets. When approved by the SAFE, such a QFII may also invest in domestic securities and futures markets using RMB funds from overseas, and such a QFII is called an RQFII. In order to use these funds, the QFIIs and RQFIIs must entrust a domestic commercial bank to act as custodian and entrust a domestic securities and/or futures company to conduct its trading activities in China. CSRC noted that it intends to announce the types of commodities eligible for trading by QFIIs and RQFIIs.

The Draft QFII Regulations are just the latest in a series of actions from Chinese senior officials that demonstrate their intention to further open and internationalize China's futures markets.[6] For instance, to attract more foreign investment, the Ministry of Finance has provided a tax exemption for foreign investors for profits derived from crude oil futures trading for three years beginning March 2018.[7] Despite concerns over RMB volatility, the sheer size of the commodity futures markets in China will likely continue to incentivize Chinese authorities to further open China's exchanges to foreign participants. Such market opening would increase China's prominence in commodities trading and enhance the role of mature institutional investors in these markets.

For additional information concerning trading on Chinese futures exchanges, please contact Paul Architzel or Petal Walker in WilmerHale's Washington DC office, or Lester Ross or Tingting Liu in WilmerHale's Beijing office.

1. See Reuters report of May 6 at: www.reuters.com/article/china-commodities-futures/update-1-chinas-dalian-exchange-to-open-soybean-soymeal-futures-to-foreign-investors-idUSL3N22I1AO.

2. E.g., net capital requirement for qualified overseas brokers eligible for trading is a minimum of RMB30 million or the equivalent in foreign exchange in the Shanghai International Energy Exchange.

3. E.g., net capital requirement for overseas participants eligible for direct trading is a minimum of RMB10 million or the equivalent in foreign exchange in the Shanghai International Energy Exchange.

4. www.ndrc.gov.cn/zcfb/zcfbl/201806/W020180628640822720353.pdf.

5. www.csrc.gov.cn/pub/zjhpublic/zjh/201901/t20190131_350601.htm.

6. Vice Chairman of CSRC Fang Xinghai in September and again in December 2018 pledged to open the rubber and soybean futures markets to foreign investors; see finance.eastmoney.com/a/20181201997203776.html and baijiahao.baidu.com/s?id=1611108177685093759&wfr=spider&for=pc.

7. szs.mof.gov.cn/zhengwuxinxi/zhengcefabu/201803/t20180320_2842286.html.

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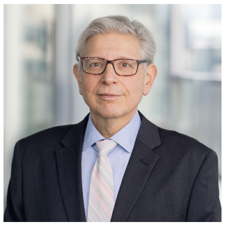

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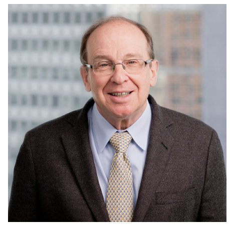

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