Introduction

Mainland China has made great strides in opening up its futures markets to international investors in recent years. Apart from the conventional way of setting up a wholly foreign-owned enterprise (“WFOE”) onshore, an international investor could now access onshore futures markets in Mainland China by trading through an onshore futures broker (either directly or indirectly via an offshore intermediary), becoming a direct trading member of a futures exchange or trading onshore financial futures and (after the rules set out in the consultation paper on QFII/RQFII issued on 31 January 2019 by the CSRC (the “New QFII/RQFII Rules”) becoming effective) commodity futures through a QFII or RQFII.

International investors have also been considering using derivatives in the form of swaps, participatory notes and zero-strike warrants (“market access products”) to access Mainland China’s futures markets in the same way as they have accessed A-shares and CIBM markets. This bulletin examines some of the key considerations and issues when accessing Mainland China’s onshore futures market by market access products.

Table 1 - Different ways to access Mainland Chinese futures market:

- Setting up a WFOE
- QFII/RQFII (not effective for commodity futures yet)
- Trading via an onshore futures broker (directly or indirectly) – for certain specified futures contracts
- Direct trading member – only available at INE
- Acquiring synthetic exposures through market access products

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1 Please also refer to Linklaters bulletin Shanghai International Energy Exchange: Direct Trading Access for Overseas Participants issued in September 2017 for greater details about trading, clearing, margining, default management mechanisms of, and our other key reservations in relation to, onshore futures exchanges.

2 Currently, this approach is available to foreign investors to trade certain commodity futures but not financial futures at China Financial Futures Exchange.

3 Currently, Shanghai International Energy Exchange is the only futures exchange which has made trading memberships available to international investors.

4 China Interbank Bond Market.
Can international firms provide market access products referencing onshore futures?

A key question an international firm (which has been permitted to access onshore markets through an approved scheme such as QFII/RQFII) would have to address upfront is whether it could provide market access products so as to provide its clients with synthetic exposures to the onshore futures markets. In particular, would the provision of such market access products be construed as violating Mainland Chinese regulations (such as “quota renting”) since the investors of such market access products are investors which may not be able to access Mainland Chinese markets directly?

Although not expressly authorised by Mainland Chinese regulations, it would appear that an international firm may provide market access products to offshore clients thereby giving them synthetic exposures to the onshore futures markets for the following reasons:

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<th>No prohibitions over market access products</th>
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<td>It is worth noting at the outset that there is no explicit prohibition under Mainland Chinese regulations or exchange rules against entering into market access products which reference prices of futures contracts quoted on an onshore futures exchange.</td>
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<th>Recognition of practice</th>
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<td>Although market access products are not expressly authorised by Mainland Chinese regulations, international firms have been offering market access products over A-shares and CIBM markets for many years. Despite that concerns have been expressed from time to time, Chinese regulators (including CSRC and SAFE) have by and large accepted that qualified investors such as QFIIs and RQFIIs have offered market access products and as a matter of practice have required them to provide business plans as well as periodic updates about such products. To this end, it is interesting to note that the draft New QFII/RQFII Rules seems to formalise this requirement and expressly provide for such plans and reports to be submitted to CSRC. The same approach is likely be taken for market access products over onshore futures contacts given that CSRC is also the regulator for the futures markets.</td>
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<th>Developing market trends</th>
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<td>It is interesting to note that although offshore market access products referencing onshore futures contracts are new, these products have been allowed (and could become more common) in the onshore markets. A case in point - Dalian Commodity Exchange set up a platform in November 2018 to provide services to facilitate bilateral swaps transactions referencing commodity futures and index prices between “recognised traders” and their clients.</td>
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However, given that the market is still in its infancy and sound market practice is still evolving, market participants are reminded to remain cautious and keep in view applicable regulatory requirements and market developments (including matters set out in the checklist below).

### Checklist of issues

A checklist of issues and risk mitigations which an international firm providing market access products is well advised to address:

- **How would market misconduct rules under the futures regulations in Mainland China affect its provision of market access products?**
- **Although the requirements for on-exchange trading of a Mainland China’s Exchange might not directly apply to the market access products, how would these requirements affect its ability to acquire and liquidate hedging positions?**
- **Would any filing or reporting requirements apply as a result?**
- **Whether it and its offshore clients be considered as “persons having actual controlling relationship” as a result of the market access products triggering certain disclosure obligations?**
- **Does it have any obligation to ensure its counterparty do not fall within the list of persons that are barred from trading in the onshore futures markets?**
- **Is it necessary to obtain standard representations for market access products over onshore futures as published by ISDA from its counterparty?**
- **Given possible regulatory interventions in the futures markets (when under distress), what are the disruption events and fall-backs that could be adopted in the documentation for market access products?**

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