

## Investment Management Alert

January 23, 2015

### Consultation Draft Rules Issued by the China Securities Regulatory Commission Regarding Foreign Investment in Futures Contracts

#### Introduction

The China Securities Regulatory Commission (**CSRC**) has issued draft rules for consultation purposes relating to the proposed investment by foreign investors and dealing by foreign brokerages in futures contracts in the People's Republic of China (**PRC**) on 31 December 2014 (the **Draft Guidelines**). The deadline for the consultation contemplated by the Draft Guidelines is 31 January 2015. It is expected that the liberalisation of the PRC futures market will be implemented gradually and the liberalisation of the Renminbi (**RMB**), level of corporate involvement and risk management of the futures market will impact this liberalisation. The proposals set out in this client alert are matters which reflect proposed changes, and will not be set in stone or confirmed until the relevant implementing regulations are in place.

#### Types of Futures

The Draft Guidelines propose that foreign investors and foreign brokerages will be allowed to trade in crude oil futures.

#### Types of Investors

Foreign investors are defined as any companies/business organisations incorporated/organised outside of the PRC and any natural persons with non-PRC citizenship. Foreign brokerages are defined as companies incorporated outside of the PRC which are regulated in their relevant jurisdictions, and may accept capital and instructions to trade futures in their own name.

#### Methods of Participation

The Draft Guidelines specify two methods by which foreign investors and brokerages may invest in the crude oil futures:

1. subject to approval from the Shanghai Futures Exchange (SHFE) , qualified foreign investors will be able to directly invest in crude oil futures product listed on the SHFE.

The qualified foreign investor must:

- a. be based in a jurisdiction with a sophisticated legal system and monitoring systems;
- b. be financially stable, have a good credit rating and sufficient liquid capital;
- c. have a sound governance structure and sophisticated internal controls and operational specifications; and

- d. fulfil any other conditions specified by the SHFE.
2. Foreign investors may make indirect investments in the following manner:
    - a. instruct a domestic futures company to make investments in its own name; or,
    - b. instruct a qualified foreign brokerage, which may:
      - i. invest via a domestic futures company to make investments in its own name; or
      - ii. subject to approval from SHFE, directly invest in crude oil futures in its own name (please note that the foreign brokerage using this method must be based in a jurisdiction which has signed a memorandum of understanding (MOU) with the CSRC); or
      - iii. apply to the CSRC to set up a wholly owned or wholly controlled futures company in a Free Trade Zone ("FTZ") (including but not limited to the Shanghai, Guangdong and Fujian FTZs). This wholly owned/controlled futures company may then accept instructions from foreign investors or foreign brokerages to invest in the crude oil futures.

Foreign brokerages must not accept instructions from domestic investors and certain individuals/entities as specified under the current PRC futures regulations.

### **Regulatory Control**

The activities conducted by foreign investors and foreign brokerages activities in respect of futures products will be governed by the CSRC and other relevant authorities. In respect of foreign investors and foreign brokerages established in jurisdictions where the CSRC has an MOU in place, the CSRC intends to engage with overseas regulators to conduct cross-border regulatory control. The list of MOUs is here and for recent updates see here.

### **Other Issues Contemplated by the Draft Guidelines**

- Account opening procedures
- Operational matters
- Margin change procedures
- Clearing procedures
- Depository requirements

### **Conclusions**

The measures, if implemented, are likely to play a key part in the ongoing liberalisation of the Mainland Chinese financial markets and will complement existing initiatives such as the Stock Connect, the

Qualified Foreign Institutional Investors scheme and the RMB Qualified Foreign Institutional Investors scheme.

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