LEGAL REGULATION OF EXCHANGE TRADE IN OIL AND PETROLEUM PRODUCTS IN THE PEOPLE'S REPUBLIC OF CHINA

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Shakerov Rustam R.
Degree-Seeking Student of the Department of Energy Law
of the Kutafin Moscow State Law University (MSAL)
energylawdep@msal.ru

For a long period of time, the Chinese Government has adopted the issue of arrangements for trade in oil futures. On March 26, 2018, trade in oil futures was organized at the Shanghai Energy Exchange for the first time. The experience of legal regulation of trade in oil futures in China is of particular interest to our country. In the first place this is due to the fact that Russia and China are important strategic partners. In 2017, China overtook the USA and became a major importer of oil in the world: the volume of purchases amounted to about 8.43 million barrels per day. The article investigates the peculiarities of legal regulation of exchange trade in oil and petroleum products in China. It considers the requirements for the bidders and discloses the rights and obligations of the bidders, the conditions of work of their personnel in the exchange trading. The list of documents that must be submitted by the bidder to participate in the exchange trade in oil and petroleum products is given. Basic requirements to a standard futures contract for supply of crude oil are reviewed.

Keywords: *energy law, legal regulation of exchange trade in oil and petroleum products, requirements to the bidders, oil futures.*

One of the most interesting experiences in exchange trade in oil and petroleum products is trade organized in the People's Republic of China (PRC), where this practice, just like in Russia, has only just begun to develop. However, as compared to Russia, the Chinese exchange actively becomes one of the world leading exchanges in terms of exchange trade in oil and petroleum products. Its main difference from other exchanges is implementation of exchange trade in national currency, which contributes to its strengthening in the international market as well as the detailed legal regulation of the process of exchange trade in oil and petroleum products.

The launch of the first Chinese oil futures contract in Shanghai promoted creation of a benchmark for the global oil sector. [1] In just six months, the trading volume of Shanghai oil futures in Yuan has already exceeded the volume of the oil contract at the Dubai Mercantile Exchange, which was previously the third most popular oil benchmark in the world. At the end of September 2018, the contracts traded at the Shanghai International Energy Exchange accounted for 16% of the global market of short-term oil futures, herewith, trading volumes 49 times exceeded sales in Dubai, according to data compiled by Gavekal Research. As of April 1, 2019, the total trading volume of crude oil futures contracts at the Exchange amounted to 36.7 million lots with a turnover of 17.12 trillion Yuan (2.55 trillion dollars).

Urals medium sour crude oil was chosen as the major product. The Chinese Government explains this by the fact that the resources of medium sour crude oil are quite abundant. Its production amounts to about 44% of the total world volume. [2]

However, the ratio of supply and demand for medium sour crude oil is not quite the same as the ratio for WTI oil. Moreover, it is a major product imported by China and many other neighboring countries. According to statistics of the General Administration of Customs, in 2016, China imported 381 million tons of crude oil, of which 183 million tons were attributable to the Middle East (49% of the total volume). Therefore, it was decided to trade in crude oil in order to form a reference price for medium sour crude oil.

For many years, the PRC has been developing laws on exchange trade in oil and petroleum products prior to introduction of this practice. Thus, the experience of the PRC is interesting for study, which also indicates the relevance of the chosen topic.

The sale and purchase of oil and petroleum products (petrol and Euro-5 diesel account for a dominant share of petroleum products) in the PRC commenced on March 26, 2018, at the Shanghai International Energy Exchange through trade in oil futures. Preparation and adoption of a decision by the Government of the PRC on the arrangements for trade in oil futures took more than 20 years. It should be emphasized once again that this period is the time, during which not only a decision on trade was made, but also the legal regulation of exchange trade in oil and petroleum products and the choice of the trading instrument itself were thoroughly considered.

Prior to this, futures contracts were mainly traded at the London, New York and Dubai exchanges. Despite the well-developed oil futures markets in Europe and the USA, their prices do not reflect the ratio of supply and demand in the Asia-Pacific Region in an objective and comprehensive way. This gave rise to the need to arrange for exchange trade in oil and petroleum products in the Asia-Pacific Region.

The Shanghai International Energy Exchange is a legal entity in the futures market, that is, an organization that develops Trading Rules for the Exchange, the requirements of which apply to all parties to exchange trading. The Rules developed by the Exchange comply with regulatory requirements of the China Securities Regulation Commission (the CSRC). The Shanghai International Energy Exchange was established by a number of public institutions, including the Shanghai Futures Exchange, and it is open for the members of the world's futures.

According to the Articles of Association, the Exchange performs its activities in accordance with the following regulatory legal acts of the PRC: [3]

— the Law of the PRC on Companies;

— the Law of the PRC on Securities;

— the Provisions on Arrangements for Trade in Futures.

As the organization, the Exchange fulfills its duties in accordance with the above laws. Based on the principles of openness, fairness and impartiality, the Exchange aims to create a global trading platform for derivative energy carriers, which "=is internationalized, focused on the market, governed by legislation and professionalism to objectively reflect the conditions of demand and offers at the stock market.

The authorized capital of the Exchange amounts to 5 billion Yuan. The legal representative of the Exchange is the Chairman of the Board of Directors.

In accordance with the current laws, the Exchange shall: 1) provide space, facilities and services for trade in futures; 2) conclude contracts with the parties to exchange trading and draw their lists; 3) arrange for and control trade, clearing and delivery; 4) ensure and guarantee arrangements for trade in futures; 5) formulate and improve the rules and provisions, strengthen control over risks in trade in futures and supervision of the member states, overseas special participants (the OSPs) and personnel of the Exchange, and it strongly urges the member states to strengthen control of their trade activity; 6) formulate and ensure compliance with the General Rules of Trading at the Exchange; 7) publish market information; 8) perform marketing activities and ensure staff training; 9) regulate the futures business of the member states, foreign intermediaries, clients, designated storages, designated depository banks, and other players of the futures market; 10) investigate violations of the rules, and other functions.

The Government of the PRC developed a significant number of regulatory legal documents regulating the activities of the exchange and exchange trading, for example, the Exchange Marketing Management Rules, the Rules for Management of Trading Behavior of the Parties to Exchange Trading, the Provisions on Administration of Accounts Using the Actual Rules for Control of Relations between the Parties, etc., which contributes to organization of efficient trade in oil futures.

The exchange is directly controlled by the China Securities Regulation Commission (CSRC). The licenses for performance of activities at the Exchange are also provided by the Commission, quotas are approved by the State Administration of Foreign Exchange (SAFE), and special accounts in Yuan are finally approved by the People's Bank of China (PBC). The China Securities Regulation Commission (CSRC), the state agency at the level of ministers directly subordinate to the State Council, performs a single regulatory function in accordance with the relevant laws and regulations, and has powers of the State Council in respect of the market of securities and futures.

The exchange exercises direct control of the listed companies, in accordance with which monitoring and supervision over disclosure of information on listed companies, so that the investors could timely obtain reliable information and make rational decisions on investment.

All parties to exchange trading (registered company and its directors, managers, senior officials, shareholders, actual controllers, buyers, and agencies for maintenance of securities, related parties, etc.) shall comply with the laws, administrative provisions, rules of the competent authorities, other regulatory documents of the PRC as well as these Rules and other provisions of the Exchange.

In accordance with the laws of the PRC, the rules of the Exchange as well as by virtue of powers granted to the Exchange by the China Securities Regulation Commission (CSRC), the exchange performs supervision over the listed companies and their directors, supervisors, senior officials, shareholders, actual controllers, buyers as well as agencies for maintenance of securities and relevant parties.

All parties to exchange trading, on which the obligation to disclose information on the ongoing trade is imposed, shall timely and fairly disclose information in accordance with the laws and rules of the Exchange and ensure its reliability, accuracy and completeness of the disclosed information.

To take part in exchange trading, it is necessary to comply with the requirements established in the PRC Membership Management Rules. According to these Rules, the parties to exchange trading may be: [4]

— legal entities (business or non-profit organizations) registered in the country and approved by the Exchange;

— foreign parties that are divided into special brokers engaged in overseas operations and foreign parties not engaged in brokerage activities.

A party to exchange trading may be a member of a futures company (Futures Firm Member, FF Member) or a member of a non-futures company (Non-Futures Firm Member, Non-FF Member). The applicant for membership from a futures company shall have the authorized capital of at least 30 million Yuan, and the applicant for membership from a non-futures company shall have the capital of at least 10 million Yuan.

The main condition for all parties to exchange trading is availability of personnel licensed to perform futures activities issued by the China Futures Association (CFA). Moreover, in the application for membership, all parties to exchange trading shall provide the Exchange with a futures broker business license issued by the China Securities Regulation Commission (CSRC). In addition, the applicants shall provide the Exchange with the following documents: a written application signed by the legal representative and certified with a seal; the license issued by the Administration for Industry and Commerce of China; annual financial statements for the past few years audited by an audit company. This list is not exhaustive.

Within 30 trading days after receipt of the notice of admission to the exchange, the applicant shall perform the following procedures: conclude an agreement with the Exchange, pay a commission for trading at the established rate, transfer the amount established by the Exchange to the settlement account designated for the company as a clearing deposit, open a special margin account with any of the banks determined by the Exchange, provide the Exchange with a list of employees that will be engaged in trading.

If the above procedures are not completed within the established period, it shall be deemed that the applicant voluntarily renounced membership.

Exchange trading by overseas parties (Overseas Special Participants, OSPs) is regulated by the special provision Special Rules for Management of Overseas Participants of the Shanghai International Energy Exchange. [5]

Overseas organizations (OSP) shall meet the following requirements set by the China Securities Regulation Commission and the Exchange and approved by the Exchange for direct participation in trading with the Exchange, including foreign traders that are directly engaged in trading in the futures exchanges:

1. There is a reliable legal system in its country (region) of residence;

2. It has good financial position, good credit and sufficient working capital;

3. It has a reliable structure of corporate governance, a reliable system of internal control and properly controlled business;

4. It acknowledges and agrees to comply with the business rules and each of the provisions and decisions of the Exchange;

5. It has net capital or net assets in the amount of not less than ten million Yuan or its equivalent in a foreign currency;

6. Availability of personnel, a system of trade in futures, premises and facilities required for conduct of business;

7. It has a reliable financial management system, a reliable business management system for the future and good operational capabilities, creditworthiness and reputation, and it is in good working condition;

8. The overseas organization should create a business entity or a representative institution, which actually exists in China for not less than one year, as a designated contact office and appoint senior manager or personnel with good reputation of this business entity or the representative institution as the designated contact person;

9. Any other requirements set forth by the Exchange.

Overseas bidders may invest funds in foreign currency at the exchange rate set by the Chinese Currency Exchange on the date of trading. The US dollar is set as the foreign currency for trading.

All non-residents participants at the Shanghai International Energy Exchange are exempt from income tax for up to three years.

To provide bilateral quotes for futures or option contracts for certain products and other services, market makers operate at the Exchange. [6] A market maker assumes the obligation to submit a bid of the party to exchange trading on its behalf and at its own expense, and on its behalf and at the expense of the customers subject to certain terms and conditions specified in the Agreement for fulfillment of obligations of the market maker. The market maker implements orders of the customers in the market by means of communication via the Internet, telephone or SOES system, SelectNet, ECN. It maintains liquidity of the assets assigned to it by submitting bids for their purchase or sale, and records data on the bids in the specialist's book. The market maker fulfills the obligations specified in the agreement with the exchange.

In accordance with the Rules of the Exchange, the parties to exchange trading are entitled: to participate in trading, clearing, delivery or other business activities provided for by the Exchange; to receive information on trading services provided by the Exchange; to exercise their contractual rights in accordance with the agreement concluded with the Exchange. The obligations of the parties to exchange trading include: compliance with relevant laws, regulations, rules and policies of the PRC; compliance with the Articles of Association of the Exchange and the general rules for exchange trading, payment of relevant fees; adoption of the rules for control and management of the Exchange; fulfillment of all its contractual obligations in accordance with the agreement concluded with the Exchange.

Overseas participants have the same rights and obligations as the legal entities registered in the territory of the PRC. The only advantage over the resident participants is exemption from payment of any taxes.

In the exchange trading, the basic document is a futures contract, which is a standardized agreement in the form elaborated by the Exchange. [7]

In the conclusion of a futures contract for purchase of crude oil, the parties to exchange trade shall fulfill the following requirements: [8] oil should be purchased in Yuan, the Chinese national currency. The amount specified in the contract does not include any tax or duty; lot size is 1,000 barrels. This volume of transactions of 1,000 barrels per lot corresponds to the experience of international exchanges with regard to arrangements for trade in crude oil futures; the delivery time after the transaction is settled is 5 trading days; warehouse premises where crude oil shall be stored at the time of trading are determined by the Exchange; it is set that trading shall be performed from 9:00 am to 11:30 am and from 1:30 pm to 3:00 pm (Beijing time); the minimum trading margin (threshold, at which it is necessary for the broker to replenish its account) for a futures contract for crude oil is 5% of the notional value of the contract.

Despite the fact that the Exchange has just begun trading in oil futures, the number of its member countries increases on a daily basis. According to the Shanghai International Energy Exchange, the registered bidders currently include 52 foreign agencies, mainly, from Hong Kong, Singapore, the UK, the Republic of Korea and Japan that serve clients from the UK, Australia, Switzerland, Singapore, Cyprus, the Seychelles, Hong Kong, and Taiwan.

The Shanghai International Energy Exchange continuously makes efforts to investigate and punish violations of the relevant rules and regulations so that to improve risk management in the futures market, to regulate trade in futures and protect the legitimate rights and interests of the players in the futures market. Should it be suspected that the bidders violate the current rules, the Exchange shall be entitled to request explanations from the market players in respect of a particular situation, to hold interview including oral warnings, to deliver a letter containing the issued warning, and to take other measures, which the Exchange deems necessary to eliminate any risks. [9] To date, the Exchange has examined a total of 13 cases of violations of exchange trading rules, seven of which were situations with excess lot sizes and six cases were situations when the orders were cancelled.

These requirements are regulated by the Rules for Management of Trading Behavior of Parties to Exchange Trading, which are formulated to regulate the activities of trade in futures, to ensure order in the futures market and to promote its sustainable development. [10]

In accordance with Article 5 of the Rules, the Exchange may take any of the following actions in case of abnormal behavior in exchange trading: to request a written explanation from the bidder having violated the rules; to demand that the bidder should dismiss one of its representatives settling a transaction that violated the rules; to suspend opening of new positions; to issue a written warning; or to take any other measures in accordance with the rules of the Exchange.

It seems that the performed legal analysis may be useful not only for scientific purposes, but also has practical significance since the Russian Federation also recently began trading in oil futures at the St. Petersburg International Mercantile Exchange. Therefore, functioning of this area of exchange activity requires efficient legal support. ■

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