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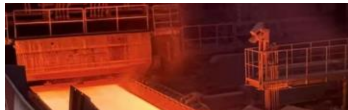
Trading Commodity Futures in China

A guide to China's futures and options markets for international investors



March 2025

Why China?

- **Liquidity** — China is the largest consumer and importer of commodities, with deep markets for everything from metals to petrochemicals
- **Pricing Power** — China is a key node in the global trading system yet follows its own dynamics - and the China price is increasingly becoming the benchmark
- **Investor Protection** — A strong regulatory structure and clear legal framework for both domestic and overseas participants ensures market stability and protects client assets

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China's Futures Market

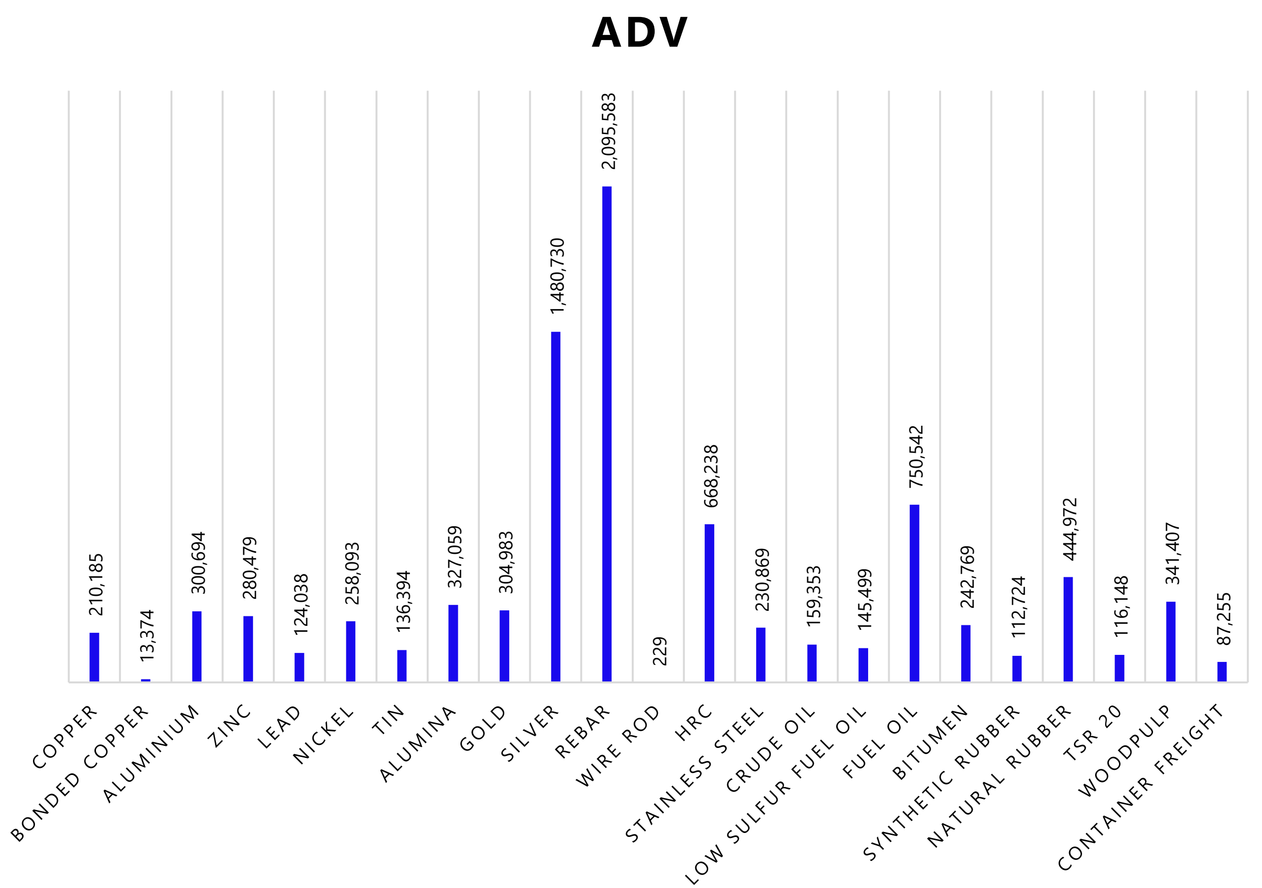
- China's futures market began to develop in the 1990s; the development continues with the newest exchange only being established in 2021 and new products being launched on a regular basis
- China's major state-owned exchanges (SHFE, DCE, ZCE) are **non-profit organisations**; as such, their raison d'être is to provide a venue for price discovery and risk management for industrial companies
- Their mission is to **serve the real economy**; a stable market closely reflecting the underlying fundamentals is the goal
- Contracts are designed to suit a wide range of users, incl. SMEs; as a result, contract sizes are typically smaller but liquidity benefits from a wider range of end users – from local scrap yards to multinationals
- While they are SOEs with a primarily domestic focus, their teams are experienced and have international experience, incl. at overseas exchanges; thus, while they follow their own path, they are actively engaged in the international market
- Historic & live market data is freely available, ensuring price transparency for all market participants

China’s Futures Exchanges

- China currently has 6 futures exchanges: SHFE, INE, DCE, ZCE, GFEX & CFFEX
- The exchanges are distinct in terms of their product offering and focus
- Futures and options are traded electronically & on-screen
- Historic & live market data is freely available, ensuring price transparency for all market participants

Shanghai Futures Exchange - SHFE

- Metals, Energy & Industrial
- 23 Futures, 13 Options (incl. INE contracts)
- Owner of the INE
- About to open up its first internationalised contract (Nickel)



International Energy Exchange - INE

2024 ADV: 521,628 lots

2024 Average Turnover: USD 17.9bn

- Fully Internationalised
- SHFE Subsidiary
- 5 Futures (Copper, Crude Oil, LSFO, TSR 20, Container Freight), 1 Option (Crude Oil)
- First exchange to allow overseas exchange membership

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Dalian Commodity Exchange - DCE

- Agricultural & Industrial
- 22 Futures, 17 Options (incl. 6 internationalised futures & 5 options)
- Internationalised contracts: Iron Ore, Palm Oil, Soybean, Soybean Meal, Soybean Oil
- 2.1mn investor accounts, 530 designated delivery warehouses, record annual volume: 2.3bn lots

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Zhengzhou Commodity Exchange - ZCE

- Agricultural & Industrial
- 26 Futures, 19 Options (incl. 4 internationalised futures & 3 options)
- 2.6bn lots traded in 2024 with turnover of RMB 85.1tn (USD 11.8tn)
- First approved in 1990, it was among the first exchanges in the country, covering wheat, maize, soybean, green bean and sesame
- Internationalised contracts: PTA, Peanut Kernel, Rapeseed Oil, Rapeseed Meal

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Guangzhou Futures Exchange - GFEX

- New Energy & Technology
- 3 Futures, 3 Options: Polysilicon, Industrial Silicon, Lithium Carbonate
- China’s newest exchange: established in 2021, first contract launched in 2023
- Global benchmark for lithium & silicon pricing

China Financial Futures Exchange - CFFEX

- Bonds & Stock Indices
- 11 Futures, 3 Options
- Based in Shanghai
- China’s only dedicated financial derivatives exchange with 253,403,809 lots traded in 2024

Why China is Opening Up its Market

- Build a strong influence in the commodity futures market and a mature commodity pricing center: the **China price**
- Enhance China's "voice" in the global economy
- Ensure the rational allocation of resources by bringing Chinese domestic supply and demand in line with the international market

The Opening Up of China’s Futures Market

- China saw itself as “**big but not strong**” in the global commodity market: commodities are “traded in the East, priced in the West, denominated in US dollars, and based on futures benchmarks”
- The process of opening up and build a “world-class” futures market only began in 2018 with crude oil and iron ore
- The **iron ore** contract was an existing **domestic** and VAT included Chinese contract that was simply **opened up** to international participants; international participants could tap into Chinese liquidity
- **Crude oil** futures were a completely **new contract** on a new exchange: the INE, which was specifically set up as a bonded and open subsidiary of the SHFE; the contract is **VAT exclusive**, but as a new contract, it first had to establish itself
- Given the existence of international oil benchmarks like WTI and Brent, initial take-up by overseas traders was slow: **why would they need another oil contract?**

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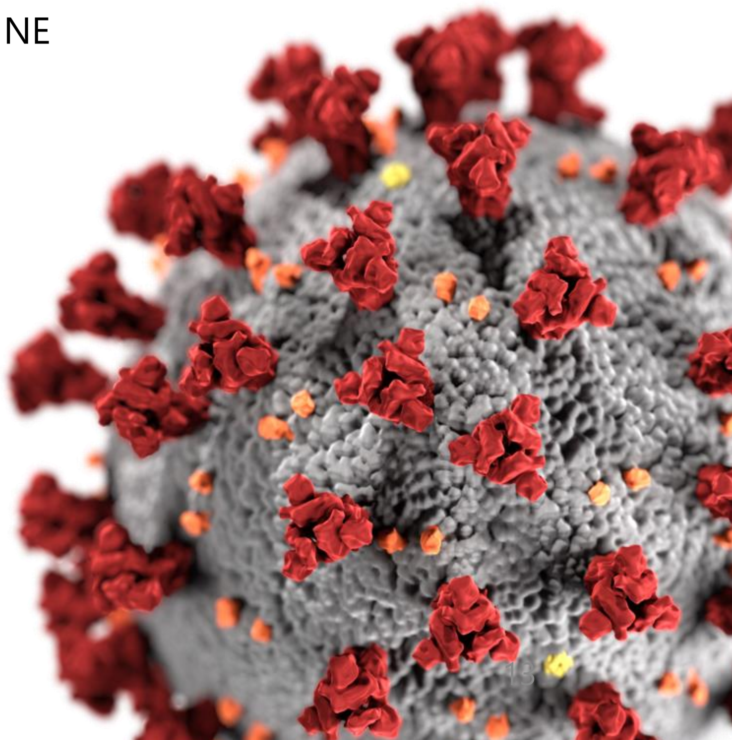
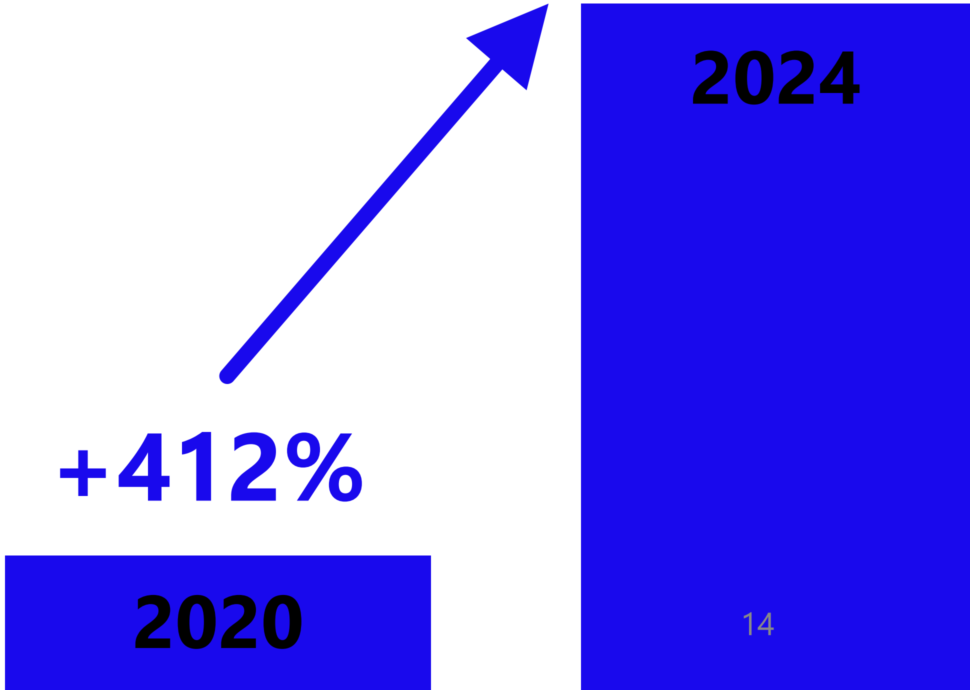
COVID as a Catalyst

- China was hit by COVID early but locked down fast and held a big pool party in Wuhan by the time COVID was just beginning to spread in the US
- Factories in China were up and running again as the US and Europe were shutting down
- Oil prices were hit hard by the **demand shock**: WTI went negative and Brent was trading at $19 while INE Crude Oil remained at $31
- The resulting **arbitrage opportunity** saw vast amounts of oil shipped to China while anyone with access to both markets could pocket the difference
- The COVID shock exaggerated the fact that regional dynamics still matter, even in a globalised world, and an open futures market helped **balance regional supply and demand differences**



Growing Participation

- Since COVID, we have seen China-bound volumes surge, going from an almost negligible fraction of our client volume to one of our largest markets, making up almost 50% of our client volume at times
- Client margin was traditionally almost exclusively held in USD, but in line with the rise of the Chinese market, we now have more and more clients keeping RMB in their accounts
- The biggest beneficiary turned out to be the SGX UC FX contract, where our volume increased over 400% from 2020 to 2024



6 Years of Opening Up: The Status Quo

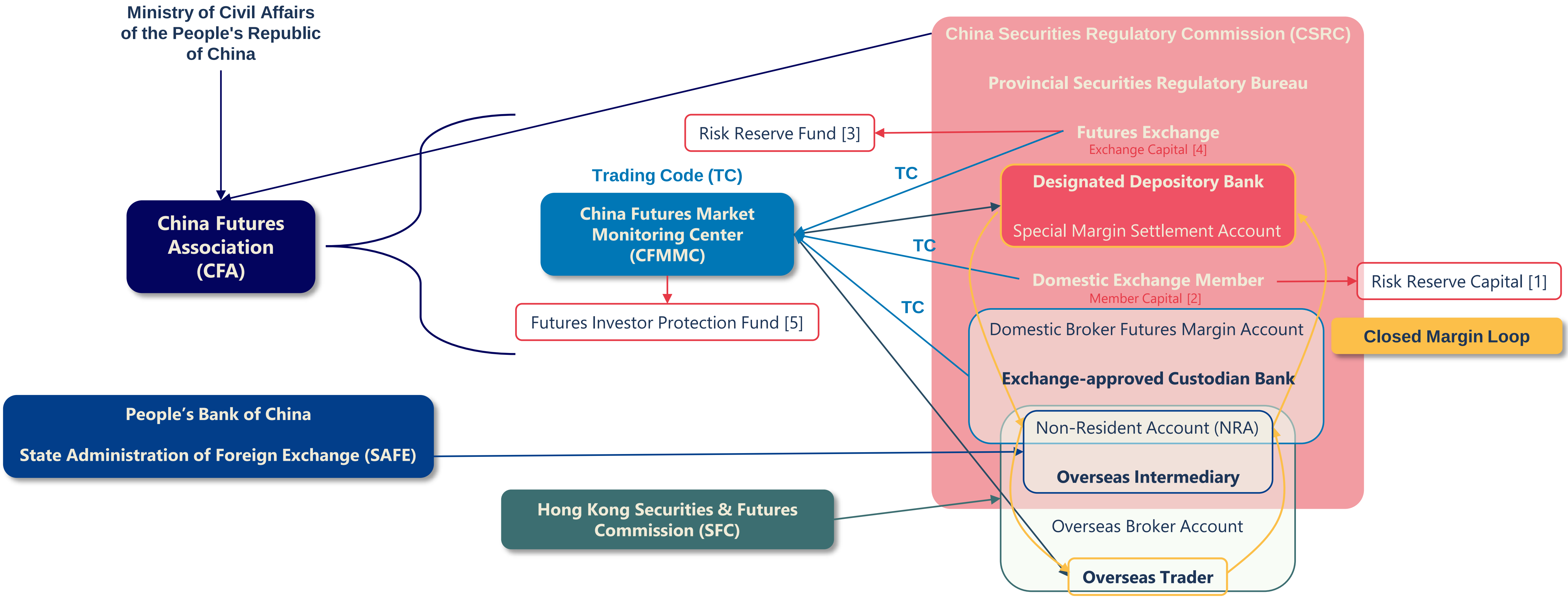
- China’s international crude oil futures were launched by the Shanghai International Energy Exchange (INE) on March 26, 2018
- Since then, in addition to the **INE**, the **DCE** and **ZCE** partially opened up, while the **SHFE** is preparing to follow suit
- **24 futures and options** are now available to foreign market participants via overseas brokers
- They include **crude oil & iron ore** as well as lesser-known contracts like **PTA, TSR 20, Container Freight & Peanuts** – all of which are highly liquid and serve as **benchmark contracts** for their respective industries

The Way Forward

- China's State Council & CSRC outlined their plans for the further development of the futures market in their "Opinions on Strengthening Supervision and Preventing Risks to Promote the High-quality Development of the Futures Market".
- The goal is to build "**world-class exchanges**" to serve as **regional pricing centres**, advance **RMB internationalisation**, expand the range of products and **further internationalise** and open up
- **SHFE Nickel** is likely the next contract to become available, while **LNG** and more **green futures** are also high on the agenda
- The Chinese exchanges are looking to **bring more industrial clients into the market** through discounted fees and margins

Fee / Exchange	Delivery	EFPs	Warrant Transfer	Warrant as IM	Hedge POS	Brand Registration	Options Assignment	HFT
INE	Waived	Waived	Waived	Waived	Halved	Waived	n/a	n/a
SHFE	Waived	Waived	Waived	0.10%	Halved	Waived	n/a	n/a
DCE	Waived	Waived	Waived	Waived	Halved	n/a	n/a	n/a
ZCE	Waived	Waived	Waived	Waived	Waived	n/a	n/a	n/a
GZEX	Waived	Waived	Waived	Waived	Halved	n/a	n/a	n/a
CFFEX	Halved	n/a	n/a	n/a	n/a	n/a	Halved	n/a

Market Supervision



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The Role of the Trading Code

- The Trading Code (TC) is a **unique end client identifier** that is attached to all client funds, margins, positions & trades, providing the regulator with full see-through ability for risk control
- It enables the CFMMC to conduct its own settlement for every single client in the Chinese market; clients can even get an official daily statement directly from the CFMMC

Risk Control

- The Trading Code is the first line of defense as the exchanges & regulator can see large client positions even when spread across multiple brokers
- Percentage-based initial margins in combination with price limits essentially eliminate intra-day cascading failures as the initial margin in the system will be sufficient to cover losses within the price limit range
- The CFMMC is developing a real-time market supervision system
- With risks inside the Chinese market under control, the next question for clients is typically: **can I get my money back out of China?**

Accessing China's Futures Exchanges

There are 4 ways to access the Chinese market: setting up a **Wholly Foreign-Owned Enterprise (WFOE)** in China, applying for **Qualified Foreign Institutional Investor (QFII)** status, opening a **Non-Resident Account (NRA)** at a bank in China and using an onshore broker, and the **Overseas Intermediary (OI) route**. They are not mutually exclusive, their **flexibility and complexity varies** and they come with different advantages and limitations, making them suitable for **different uses cases, asset classes and exchange products**.

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How to Access the Chinese Market

Wholly Foreign-Owned Enterprise (WFOE)

Requires establishment of a new domestic Chinese company

Access to all exchanges and contracts

Challenges with cross border fund transfers and variation margin management

Subject to rules and limitations on repatriation of profits

Potential for double taxation

Qualified Foreign Institutional Investor (QFII)

Recently expanded to include a wide range of commodity contracts

Extensive application process and requirements for applicants

Unresolved questions regarding tax status and profit repatriation remain

Application process is faster than setting up a WFOE, but typically takes several months

Non-Resident Account (NRA)

Allows companies to open trading accounts at domestic Chinese brokers

Access to all internationalised contracts

Cross-border fund transfers are managed by the account owner

FX conversions executed in China rely on domestic bank rates with significantly wider spreads than on the international market

Overseas Intermediary (OI)

Allows companies to open an account with applicable overseas brokers

The fastest and most efficient way to access all internationalised contracts

Fast cross-border fund transfers managed by the broker

FX conversions at competitive rates in offshore banks

Engage in FX hedging and arbitrage trading

The Overseas Intermediary (OI) Mechanism

The Overseas Intermediary mechanism is the most established and straightforward way of accessing the Chinese futures market. It allows international investors to **face intermediary brokers outside of China**, such as BANDS Financial, **who handle fund transfers and trade execution** while relying on a domestic Chinese clearing broker.

This mechanism is currently **available on the INE, DCE and ZCE**. Advantages include:

- Trading on **international and Chinese markets in a single account** for **optimal capital usage**
- Use of **USD as initial margin** at the exchange level
- **Fund transfers** in and out of China **in less than 2h**
- **Simple and fast account opening** – there is no need to open a Chinese bank account or deal with any entities or regulators in China during the process, which is **handled in English and subject to Hong Kong law**.
- Competitive **FX conversions** and the ability to **hedge FX** exposure
- **No Chinese taxes** for inbound foreign clients
- **No NRA** or business entity in China required

Available OI Contracts

INE

Energy & Chemicals

- Medium Sour Crude Oil (F&O)
- Low Sulfur Fuel Oil (F)
- TSR 20 Rubber (F)

Non-Ferrous Metals

- Bonded Copper Cathode (F)

Indices

- Shanghai Containerized Freight Index (SCFIS) (Shanghai - Europe) (F)

大连商品交易所 DALIAN COMMODITY EXCHANGE

Agricultural

- Palm Oil (F&O)
- Soybean One (F&O)
- Soybean Two (F&O)
- Soybean Meal (F&O)
- Soybean Oil (F&O)

Industrial

- Iron Ore (F)

郑州商品交易所 Zhengzhou Commodity Exchange

Agricultural

- Peanut Kernel (F&O)
- Rapeseed Oil (F&O)
- Rapeseed Meal (F&O)

Non-Agricultural

- PTA (F)

In 2025, we expect to see the internationalisation or launch of LNG, nickel and further base and ferrous metals contracts.

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The OI Mechanism: Funding & Margins

Offshore

Onshore

Funds are tagged with the client's unique trading code

Regulated by the China Securities Regulatory Commission (CSRC)

1) Client funds are transferred from a **segregated bank account** to an **SFC-registered segregated Non-Resident Account** (NRA) in China. The NRA must be opened at an authorised bank approved by the Chinese Exchanges.

3) Any funds arriving in the broker's account are deposited into the **Special Margin Settlement Account** supervised by the **China Futures Market Monitoring Centre** (CFMMC). Even if the onshore broker goes bankrupt or is liquidated, the **client assets are protected** as they do not belong to the broker.

Funds are bound by the **Bank-Futures Transfer** process

Segregated & Hong Kong SFC-Licenced BANDS Client Account

Non-Resident Account (NRA)

Account opened with an exchange-approved custodian bank and registered with the SFC

CSRC Licenced Exchange Clearing Member

Special Margin Settlement Account

Account for settlement between the clearing member and the exchange

DCE

5) Cross-border transfers (in and out) between the segregated bank account in Hong Kong and the onshore Chinese NRA account can be completed **within 2 hours**.

2) Once the money arrives in the NRA account, the **domestic bank confirms the funds are for futures trading purposes only**. They can then be **transferred to the domestic broker account**. In effect, the **NRA account is bound to the domestic broker account**. A strict procedure and senior management approvals are required before this link can be set up.

4) All funds kept in the onshore **Settlement Accounts** can be used solely for the purpose of **settlement for futures trading** conducted in Chinese futures exchanges within a **closed system**.

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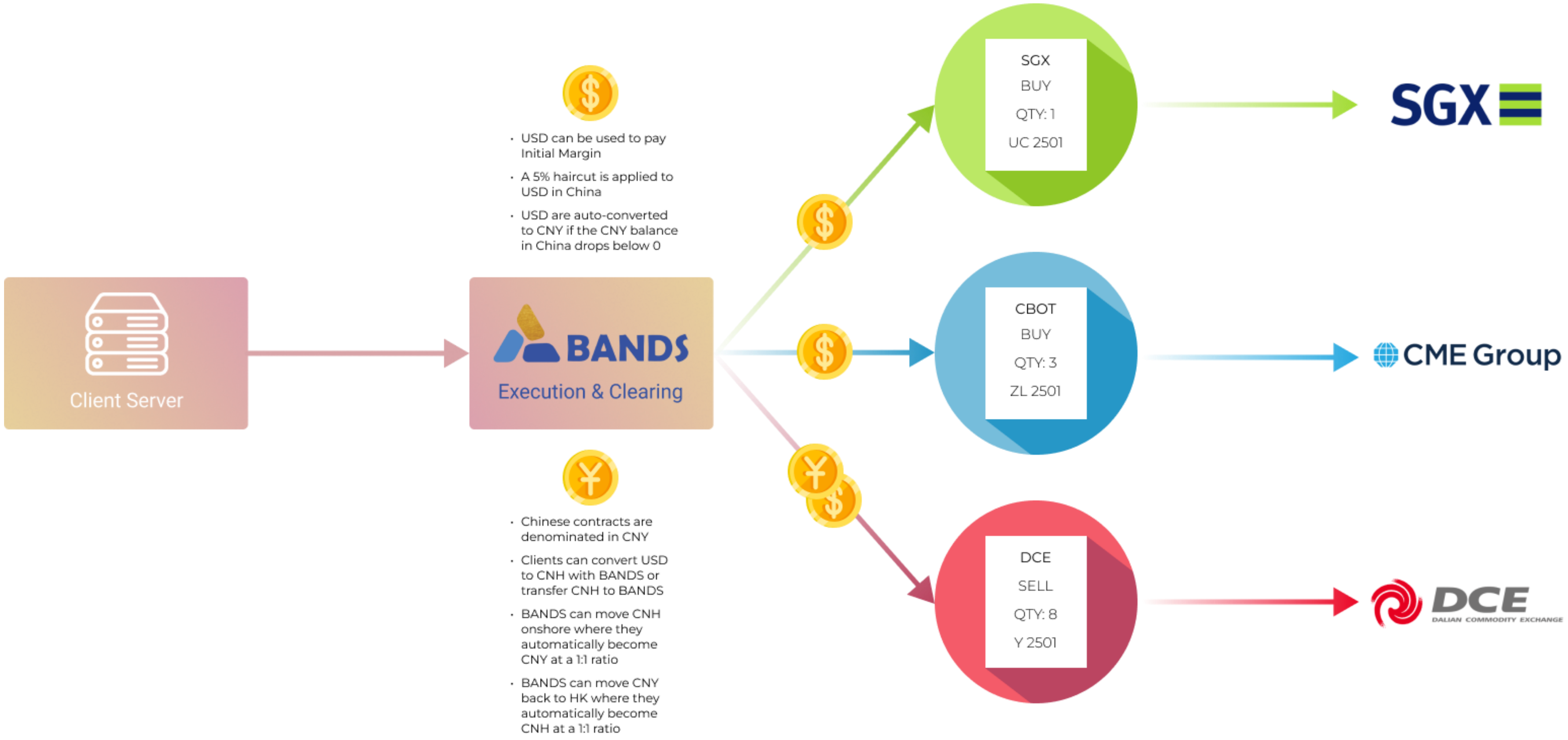
The OI Mechanism: Trade Execution



Why BANDS?

ASX

eurex

SGX

BURSA MALAYSIA

HKEX 香港交易所

JPX TOKYO COMMODITY EXCHANGE

Cboe

ICE

CME Group

INE

JPX OSAKA EXCHANGE

大连商品交易所 DALIAN COMMODITY EXCHANGE

LME An HKEX Company

郑州商品交易所 Zhengzhou Commodity Exchange

Conclusion

- China can be traded like any other market using the OI/OSBP mechanism
- The Chinese market offers a wide range of highly liquid futures and options contracts
- China’s advanced futures market regulatory regime provides stability and protects investors
- The OI mechanism enables efficient cross-border fund transfers in and out of China so foreign investors can repatriate their funds in less than 2h
- Client funds in China are not subject to currency controls; even RMB profits can be freely withdrawn and converted back to USD, EUR, etc.

Q&A

Any questions?

What products are accessible via overseas brokers?
- 24 futures and options contracts, more contracts like nickel expected soon
- Updated list & contract information can be found at https://bands.financial/overseas-intermediary.html

How much does it cost to trade in China?
- Historical market data is freely available on the exchange websites
- BANDS offers a trading platform with live Chinese market data to clients at no extra cost
- Trading fees (incl. exchange fees) vary by product but are typically in the range of RMB 10-30 per lot for most contracts
- SHFE & INE are waiving brand registration fees in 2025
- China's exchanges support industrial hedgers with reduced exchange fees and lower margin levels as well as expanded position limits if necessary

What's the process for trading in China?
- Trading in China using the OI mechanism is just like trading on any international exchange

How can foreign market participants engage in physical delivery?
- Depending on the product, foreign participants can engage in delivery via their OI broker

What opportunities are there in the Chinese commodity futures markets in general?
- Liquidity, diversification, cross-border arbitrage, hedging

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