Level 18, Centennial Tower
3 Temasek Avenue
Singapore 039190
Tel +65 6950.0691

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FIA PAPER ON THE NECESSITY, PATH AND RELATED ISSUES OF OPENING THE FINANCIAL FUTURES MARKET

FIA appreciates the opportunity to submit this paper.

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in London, Brussels, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, law firms and other professionals serving the industry.

FIA's mission is to support open, transparent and competitive markets, protect and enhance the integrity of the financial system, and to promote high standards of professional conduct[1]. As the principal members of derivatives clearinghouses worldwide, FIA's clearing firm members help reduce systemic risk in global financial markets. Equally important, our clearing firm members provide access to the commodity futures markets, which allows a wide range of companies in the commodity supply chain to manage their price risks.

Introduction

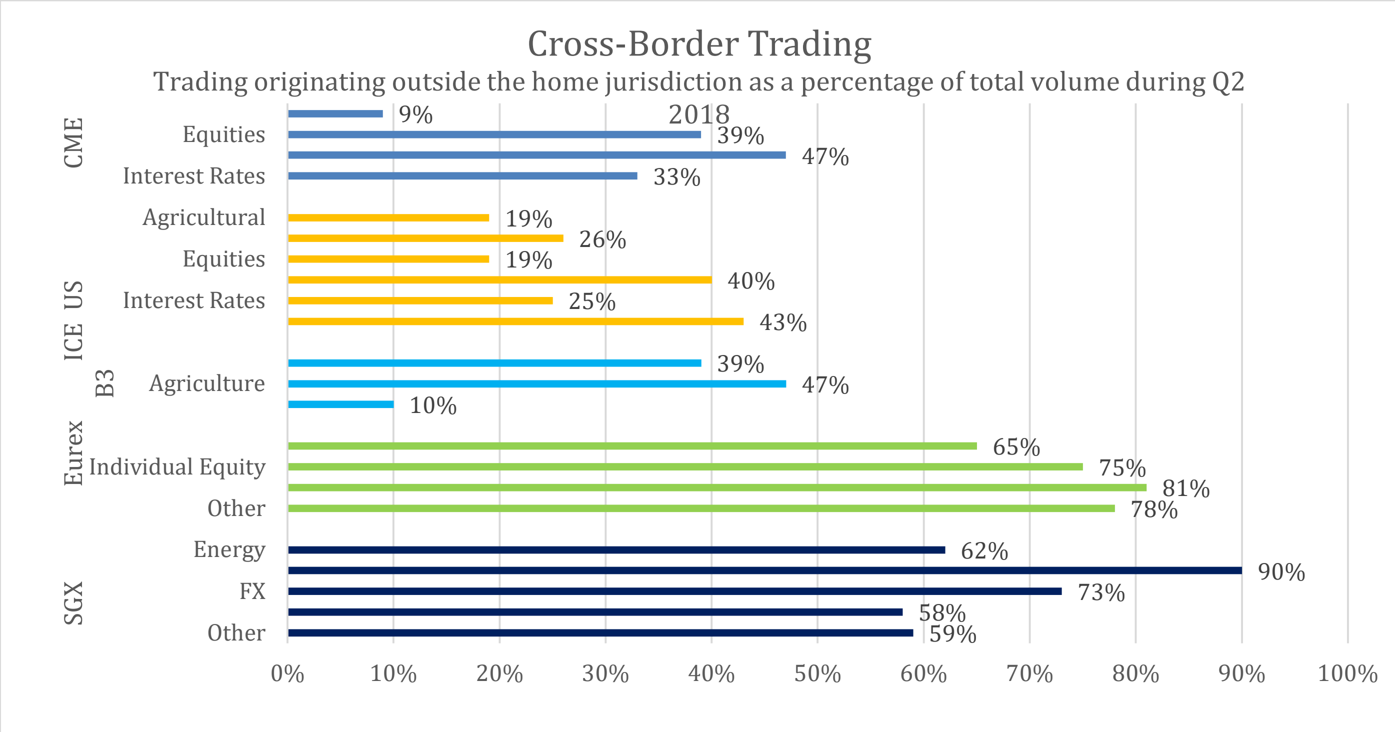
Derivatives markets are global in nature. Transactions, clearing and settlement often take place in different countries and across different time zones and continents.

Ultimately, market participants benefit from the global nature of the markets. The more participants, the stronger the market for those seeking to hedge risks. Open markets improve competition, keep costs affordable for customers and grow the economy.

Cross-Border Trading Statistics

To illustrate the global nature of the markets, FIA has polled several of its member exchanges regarding the percentage of their volume that comes from foreign counterparties. The results are notable.

[1] Further information is available at www.fia.org.



As made clear by these statistics, the ability to access customers on a cross-border basis strengthens markets. CME Group reports 42 percent of its metals contract volume originating in jurisdictions outside the U.S. ICE Futures US data shows that approximately 35 percent of the volume in its agricultural business comes from overseas. Without access to global futures and options markets, many companies in the real economy such as commodity producers, utilities, manufacturers and transportation companies will find it more difficult and expensive to hedge their risks.

Importance of Cross-Border Trading and Clearing

An active, liquid, and well-supervised futures and derivatives market allows participants to hedge large positions quickly and reduce risk more effectively. In addition, based on experiences in other markets, an actively traded futures market enhances the liquidity of the underlying cash markets.

China's continual efforts to open its financial markets has resulted in more active participation by foreign investors in its economy.

Based on the "*Study on Trading and Clearing Trends in Derivatives Markets*"[2] released by FIA in March 2020, the interest in Chinese markets from firms based in the U.S., Europe and other parts of Asia only adds to the importance of efficient cross-border laws that allow for more efficient cross border trading and clearing. According to the abovementioned study, 29% of respondents stated that they are already active in Chinese futures, 20% are planning to enter the market soon, while 18% are exploring opportunities there. The growing

[2] https://www.fia.org/resources/fia-greenwich-associates-release-new-derivatives-market-research

interest goes hand in hand with the gradual opening of China's futures markets to international participation, as shown by the creation and expansion of the QFII program, the creation of INE oil market, and the internationalization of the iron ore and several other commodity futures contracts.

Based on the aforementioned survey, the global industry’s top request in terms of the changes they would like to see from policymakers in all regions of the world is to lower barriers for cross-border trading and clearing. Jurisdictions naturally have their own laws and national issues that make cross-border trading and clearing of derivatives difficult. Global businesses are significantly challenged by having to operate within multiple layers of redundant and sometimes conflicting regulations.

Cross-Border Challenges

The listed and cleared derivatives markets are facing potential regulatory change driven by a range of geopolitical developments that pose a threat to the global markets.

As jurisdictions around the world implemented the G20 principles from the 2009 summit in Pittsburgh, they sometimes varied, overlapped or contradicted with the implementation of other jurisdictions.

Below are some specific examples of problematic approaches which have taken place or been proposed in recent years:

Clearing: Japan requires certain transactions to be cleared within its borders, rather than by a third country CCP. In this case, the level of local compliance is such that a local entity must be established, which is costly and inefficient for many market participants. These requirements greatly impact the number of market participants available to offer clearing services in a specific jurisdiction.

Reporting: The EU and the U.S. have introduced similar but separate derivatives trade reporting rules. Although the goals are the same, they did not coordinate the substance of what is reported nor the timing of the implementation. As a result, regulators in these two jurisdictions have imposed highly operationally intensive rules that require firms to devote significant operational resources on multiple separate occasions to ensure effective compliance with the separate rule sets.

FIA Recommendations to Reduce Market Fragmentation

Complete consistency between all major jurisdictions is not possible, and regulators have legitimate public policy reasons for their national approaches. However, FIA believes this must be balanced against the clear risks of market fragmentation caused by divergent, overlapping or conflicting rules.

To better identify and address these growing concerns and the cross-border uncertainty driven by a range of geopolitical developments, FIA published a white paper in March 2019 titled "*Mitigating the Risk of Market Fragmentation*[3]".

To summarize, we encouraged regulators around the world to:

- Rely on counterparts in other jurisdictions to supervise certain cross-border activity through "deference" or "substituted compliance";
- Work collectively to develop international standards and implementation guidelines while recognizing local flexibility and conditions; and
- Put in place mechanisms for cross-border cooperation, information-sharing, and crisis-management planning, which is critical for the day-to-day supervision of cross-border business.

As noted in the March white paper, FIA strongly supports the regulatory recognition and deference model that has been the foundation of the futures industry for years.

Reliance by regulatory authorities on agreed international standards and supervision by fellow regulators in other jurisdictions is the best way to prevent market fragmentation and ensure deep, efficient, liquid and competitive derivatives markets.

Together with the consultation and cooperation which it necessitates, reliance can also demonstrate respect for the sovereignty of each jurisdiction while still encouraging competition and efficient risk-management in the era of global and interconnected derivative markets.

FIA encourages all regulatory authorities to use existing international bodies such as IOSCO to further enhance international standards for the regulation of the derivatives markets. Participating in the development of international standards and then implementing them will permit greater reliance on foreign laws and regulations.

Furthermore, FIA believes strongly that existing international standards should be reviewed with an eye towards practical application for outcomes-based equivalence determinations and not simply a soft statement of principles. Reliance will result in better outcomes for both regulatory authorities and market participants than attempting to restrict cross-border activity.

The current landscape of regulation for cross-border cleared derivatives markets is an opportunity for regulators to reset relations among themselves and move forward on the basis of cooperative approaches.

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[3] https://fia.org/sites/default/files/FIA_WP_MItigating%20Risk.pdf

We were excited to see that on 4 June 2019, the Financial Stability Board (FSB) published a report[4], which was delivered to G20 Finance Ministers and Central Bank Governors ahead of their meetings in Fukuoka, Japan on 8 and 9 June 2019. The report lays out approaches and mechanisms to improve international cooperation and mitigate market fragmentation.

Additionally, we were pleased to see that the issues of market fragmentation were discussed at the highest levels of government as it was on the agenda for G20 Summit that took place in Osaka, Japan on 28 and 29 June 2019 and to see the G20 Osaka Leader's Declaration in paragraph 29 reaffirm their endorsement of international standards, stating: "An open and resilient financial system, grounded in agreed international standards, is crucial to support sustainable growth.

Conclusion

FIA greatly appreciates CFFEX's interest in these critical topics that affect the global financial markets and the end-users who rely on derivatives products for price certainty and to hedge their risks.

FIA strongly supports the regulatory recognition and deference model that has been the foundation of the futures industry for years. Identical rules, on a line-by-line basis, implemented globally across jurisdictions is impracticable. Rather, the goal we should strive to achieve is ensuring equivalent regulatory outcomes. To make regulatory recognition possible, regulators should strive for convergence by participating and implementing international standards. That adoption of standards and recognition of course is followed by close cooperation and coordination among regulators. Recognition, implementation of global standards and cooperation avoids market fragmentation, protectionism and regulatory arbitrage and supports the global nature of today's markets.

It is imperative we get these cross-border issues right. The stakes are incredibly high. Without common ground, we may find ourselves with fragmented markets and regulation. That doesn't benefit anyone, especially customers and end-users.

[4] https://www.fsb.org/wp-content/uploads/P040619-2.pdf