28 May 2021

Legislative Affairs Commission of the Standing Committee of the National People's Congress
No.1 Qianmenxi Dajie
Xicheng District
Beijing 100805

Dear Honourable Representatives and Officers of the Legislative Affairs Commission of the Standing Committee of the National People's Congress ("**NPCSC**"),

Re: Submission on the Futures Law of the People's Republic of China (Draft)（中华人民共和国期货法（草案）征求意见）

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1 Scope of this letter

We refer to the Futures Law of the People's Republic of China (Draft) ("**Draft Futures Law**") published on the website of the National People's Congress ("**NPC**") for public consultation on 29 April 2021.[1]

The International Swaps and Derivatives Association, Inc. ("**ISDA**") and the Asia Securities Industry and Financial Markets Association ("**ASIFMA**" and together with ISDA, the "**Associations**"[2]) welcome the release of the Draft Futures Law and applaud the NPCSC's significant efforts to introduce a comprehensive legal framework for the operation of futures and over-the-counter ("**OTC**") derivatives markets in China.

For the past 35 years, ISDA has consistently advocated for the enforceability of close-out netting as an indispensable foundation for safe and efficient derivatives markets.[3] In particular, the Associations have made a number of written submissions to, or engaged in discussions with, the NPC Financial and Economic Affairs Committee, the Supreme People's Court ("**SPC**"), the People's Bank of China ("**PBOC**") and the China Banking and Insurance Regulatory Commission ("**CBIRC**")[4] on the enforceability of close-out netting, set-off and financial collateral arrangements in China's OTC derivative market in the past two decades.[5] The Associations have also communicated with the China Securities Regulatory Commission ("**CSRC**") on issues relating to clearing and settlement finality in the futures market.

The uncertainties regarding close-out netting enforceability in China has put Chinese financial institutions at a disadvantage – Chinese entities often face higher transaction costs and have to provide margin on a gross basis when they enter into financial transactions with foreign counterparties. Therefore, it would be impossible to overstate the significance of netting legislation for China's derivatives markets. As China continues to liberalize its financial markets, legislative recognition of netting (through the finalized Futures Law) would remove a major barrier to international participation and support the development of liquid and efficient capital markets. This creates more favorable conditions to attract greater international participation in domestic financial markets. It also means financial institutions have more capacity to provide liquidity and extend credit to local economies.

The Associations have received very positive feedback from their members on the provisions confirming netting enforceability and settlement finality in the Draft Futures Law. We commend the NPCSC and Chinese regulators on your tremendous effort to strengthen close-out netting enforceability under Chinese law.

This letter summarises the key comments on the Draft Futures Law of the Associations' members. Our proposed amendments to the relevant Articles are set out in **Annex A** to this letter.[6]

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1 http://www.npc.gov.cn/flcaw/userIndex.html?lid=ff80818178f9100801791b69a3425052

2 A brief introduction of the Associations are set out in **Annex D** to this letter.

3 Please refer to **Annex B** to this letter for a detailed explanation on the importance of close-out netting and an overview of financial collateral arrangements in the OTC derivatives market.

4 The Associations are members of the China Netting Working Group chaired by CBIRC pursuant to the 9th UK-China Economic and Financial Dialogue.

5 The submission to PBOC's consultation on amendments to Commercial Banks Law is attached as **Annex C** to this letter.

6 Members of the Associations may also choose to make their own individual submissions to the NPCSC.

Consistent with the Associations' mission, we are primarily concerned in this submission with the impact of the Draft Futures Law on the viability and efficiency of China's OTC derivatives market (including both non-centrally cleared and centrally cleared derivative transactions) and the enforceability of close-out netting and related collateral arrangements under Chinese law.

In this letter, references to "Chapter" and "Article" are to chapters and articles of the Draft Futures Law unless otherwise indicated.

2 Overview of the Associations' comments

The Associations' key comments on the Draft Futures Law are summarised below.

2.1 Application scope of the Draft Futures Law and definition of "other derivative transactions" (see proposed amendments to Articles 2 and 3 as set out in Annex A to this letter)

2.1.1 Application scope of the Draft Futures Law

Article 2 specifies the application scope of the Draft Futures Law in relation to "futures" and "other derivatives transactions" (i.e., OTC derivatives transactions). It provides that the Draft Futures Law shall apply to activities conducted (i) "within" the territory of China; or (ii) "outside" the territory of China where such transactions or activities have disturbed the market order within the territory of China or damaged the legitimate interests of onshore trading participants.

It is not entirely clear if a cross-border OTC derivatives trade conducted between a Chinese counterparty and an offshore counterparty using an internationally recognised standardised template agreement constitutes an "other derivatives transaction" under Article 2 and, if so, one that is conducted "within" or "outside" of the territory of China.

Our members are of the view that industry master agreements used for cross-border transactions (such as ISDA Master Agreements) should enjoy the protection for close-out netting under Chapter 3 of the Draft Futures Law given the same netting enforceability issue exists for both onshore and cross-border OTC derivative transactions.

2.1.2 Definition of "other derivatives transactions"

It is important for the product scope of the Draft Futures Law to be drafted in a way that both provides the greatest amount of legal certainty *and* is capable of accommodating continuing development and innovation in the financial markets.

Article 3 provides:

> *"Under this Law, "other derivatives transactions" refer to non-standardised forward settlement contracts which values depend on the changes in the value of the underlying reference asset, including non-standardised options contracts, swap contracts and forward contracts.*

The reference asset(s) underlying the futures trading and other derivatives transactions include agricultural products, industrial products, energy and other commodities, services and related indexes, as well as financial products such as securities, interest rates, exchange rates and related indexes, etc."

We welcome this principle-based definition which covers a wide range of OTC options, swaps or forward referencing a security, commodity, rate, FX or any other financial product or index. Our members welcome further clarification on the scope of this definition and have raised the following questions and comments.

2.1.2.1 OTC credit derivatives, freight derivatives, weather derivatives, emissions derivatives (such as an emissions allowance or emissions reduction transaction) and economic statistics derivatives (such as an inflation derivatives)

Since Article 3 lists various underlying assets in a non-exhaustive manner, it would appear that the definition of "other derivatives" should also cover an OTC derivative referencing other underlying assets which are not specifically listed in Article 3, such as credit, freight, weather, emissions or other economic data. However, as there appears to be some ambiguity as to whether the definition would include those products, we would welcome confirmation and further clarification from the NPCSC.

2.1.2.2 Repurchase and other securities financing transactions

While the development of listed and OTC derivatives contracts are necessary for the further development of safe, deep and liquid financial markets, repurchase transactions and securities lending and borrowing transactions are also of fundamental importance to the development of these markets. Currently, in China, most repurchase transactions are based on the "pledge" model and operate as financing mechanisms as title transfer is not normally undertaken. If close out netting enforceability can be extended to repurchase agreements as well, we expect many more transactions to be conducted either under the relevant NAFMII or GMRA master agreements as cost efficient "classic" true sale repurchase transactions. This will in turn enhance the Chinese bond market liquidity bringing it closer to its international peers.

Although, it appears that the "Other Derivatives" definition in Article 3 does not capture explicitly repurchase agreements (or securities lending and borrowing) transactions (together, "**SFT Transactions**"), they are commonly included as qualified financial contracts ("**QFCs**") and enjoy legislative protection in most "clean" netting jurisdictions[7] and play an important role in providing liquidity for a dynamic financial markets. The Draft Futures Law's provisions around close-out netting and performance assurance are highly relevant for the repurchase

[7] ISDA has obtained netting opinions in 86 jurisdictions where netting enforceability is confirmed by local counsel.

transactions and have been top of our agenda during our engagements with the PRC regulators.

We therefore submit that this definition should be given a wide interpretation to cover a broader range of financial contracts in line with international standards as set out in ISDA's Model Netting Act and UNIDROIT Principles.

Alternatively, if the NPCSC considers this change is controversial and may delay the legislative process, we would ask NPCSC to consider authorising a regulator to extend the protection given to OTC derivatives under Articles 34 to 37 to SFT Transactions, which have similar master agreement and netting agreement as OTC derivatives (see our proposed amendments to Article 37 as set out in **Annex A** to this letter). This would enable a regulator to designate other financial transactions as a contract protected under Article 37 in a way that takes into account market developments in the future but without the need to amend the legislation which often takes a long time to complete.

2.1.2.3 Clarification amendments to cover hybrid derivatives products and contracts whose value does not depend on changes in the value of the underlying assets

We note that the "derivative products" definition in Article 3 of the Interim Measures for the Management of the Dealings of Derivative Products of Financial Institutions (2011) ("**CBIRC Derivatives Measure**")[8] as extracted below covers contracts with any combination of futures, swaps and options and does not require there to be changes in the value of the reference assets (for example, the value of forward may not rely on any change in the value of the underlying assets):

> *"The term "derivatives product" as mentioned in these Measures shall refer to a financial contract with its value depending on one kind or a number of underlying assets or indexes and the basic categories of such contracts include forwards, futures, swaps and options. Derivatives products also include structured financial instruments with features of one or more combinations of forwards, futures, swaps and options."*[9]

We recommend that Article 3 adopt the same approach and be amended to:

(a) cover not only "non-standardised options contracts, swap contracts and forward contracts" but also any combination of these products; and

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8 《银行业金融机构衍生产品交易业务管理暂行办法》issued by the former China Banking Regulatory Commission (CBRC) on and effective as of 5 January 2011.

9 The original Chinese version provides: "第三条　本办法所称衍生产品是一种金融合约，其价值取决于一种或多种基础资产或指数，合约的基本种类包括远期、期货、掉期（互换）和期权。衍生产品还包括具有远期、期货、掉期（互换）和期权中一种**或多种特征的混合金融工具**。"

(b) delete the reference to "*changes in*" before "*the value of the underlying reference asset*…".

2.1.2.4 Expand the definition of the "futures" to include all standardised contracts uniformly formulated by futures exchange

We respectfully invite the NPCSC to consider expanding the definition of "futures" under Article 3 to cover standardised options, as defined in accordance with Article 171 of the Draft Futures Law, and other standardised products that may be traded on the futures exchanges in the future.

2.2 Removal of the filing requirement for standardised templates of the relevant master agreement (see our proposed amendments to Articles 34, 35 and 37 as set out in Annex A to this letter)

Articles 35 and 37 appear to require that the validity of "single agreement" and "close-out netting" is conditional upon the filing of the relevant standardised master agreement templates in accordance with Article 34 (i.e., Articles 35 and 37 only apply to "standardised templates of the relevant master agreement or such other standardised contracts adopted in other derivatives transactions" that have been filed with departments authorised by the State Council in accordance with Article 34, and do not apply to template agreements that have not been filed).

2.2.1 Primary proposal (deletion of the filing requirement under Article 34) and our members' comments on this filing requirement

Most netting jurisdictions do not require that the validity of close-out netting under a master agreement be subject to a filing requirement. We note that the 2013 UNIDROIT Principles on the Operation of Close-Out Netting Provisions ("**UNIDROIT Principles**") specifically mentioned that:

> "*The law of the implementing State should not make the operation of a close-out netting provision and the obligations covered by the provision dependent on the compliance with any requirement to report data relating to those obligations to a trade repository or similar organization for regulatory purposes*."[10]

As explained in the UNIDROIT Principles, formal requirements that impinge on the legal enforceability of close-out netting provisions (such as registration or reporting requirements) have considerable potential to create legal uncertainty. Accordingly, the operation of close-out netting provisions should not depend on requirements such as filing with a regulatory agency or other registration requirements.

We request the deletion of the filing requirement under Article 34 and amendments to Articles 35 and 37 such that the validity of "single agreement" and "close-out netting" are not conditional upon satisfaction of any filing requirement. Our members' comments on the filing requirement are as follows.

[10] See Principle 5(2) of the UNIDROIT Principles, available at https://www.unidroit.org/english/principles/netting/netting-principles2013-e.pdf

2.2.1.1 The "legally binding" effect provided under Article 35 should not be conditional upon the filing requirement

We believe that the "legally binding" effect provided under Article 35 should not be conditional upon the filing requirement because it would cause unintended consequences for all outstanding derivatives contracts entered into by Chinese entities.

The principal focus of netting legislation has always been on ensuring enforceability of a netting agreement against a party that is subject to bankruptcy proceedings. This is because mandatory insolvency rules come into operation that could potentially disrupt close-out netting and/or a related collateral arrangement regardless of the governing law of the netting agreement. [11]

Imposing the filing requirement under Article 34 as a condition to the enforceability of the single agreement and close-out netting provisions would lead to the conclusion that a derivatives agreement which has not been filed according to Article 34 may not be enforceable as a single agreement under Article 35 and the protection for close-out netting under Article 37 may not be available upon default (whether prior to, or after the commencement of, bankruptcy).

Under a derivatives master agreement, the non-defaulting party has the right to terminate all outstanding transactions and calculate a net amount payable upon occurrence of an event of default or a termination event[12], including but not limited to the circumstances when a party enters into bankruptcy proceedings. Chinese entities have entered into numerous derivative transactions in the domestic market as well as on a cross-border basis in the past few decades. Some are documented under an industry standard master netting agreement such as the Master Agreement published by National Association of Financial Market Institutional Investors ("**NAFMII**") ("**NAFMII Master Agreement**") or ISDA ("**ISDA Master Agreement**") and some are under the relevant financial institution's own bespoke netting agreement forms. The Civil Code promulgated by the NPCSC on 28 May 2020 ("**Civil Code**") recognizes the principle of autonomy in contracts and provides that a contract is effective upon the acceptance of an offer and is legally binding and enforceable on parties under the applicable governing

[11] Even if the netting agreement and a related collateral arrangement are governed by a foreign law, when it comes to enforceability of close-out netting against a Chinese entity, a legal opinion about enforceability under China's Bankruptcy Law has to be obtained.

[12] Events of Default under the ISDA Master Agreement include (i) failure to pay or deliver, (ii) breach or repudiation of agreement, (iii) credit support default, (iv) misrepresentation, (v) default under specified transaction, (vi) cross-default and (vii) bankruptcy. Termination Events under the ISDA Master Agreement includes (i) illegality, (ii) force majeure events, (iii) tax events, (iv) tax event upon merger and (v) credit event upon merger. Under the NAFMII Master Agreement, Events of Default include (i) failure to pay, (ii) default under the performance assurance document, (iii) refusal to perform obligations or denial of validity of the agreement, (iv) misrepresentation, misleading information or material omission, (v) division, consolidation, amalgamation, restructuring and asset transfer and the surviving entity fails to perform its obligations, (vi) cross-default; (vii) default under specified transactions, (viii) dissolution or bankruptcy events and (ix) breach of other obligations under the agreement without remedial action taken within the specified period. Termination Events under the NAFMII Master Agreement include (i) illegality, (ii) merger events (if applicable) and (iii) force majeure events.

law.[13] The very limited circumstances when a contract will be found invalid *ab initio* are as follows*:*

(a) a party has no capacity;
(b) fraudulent conducts;
(c) the parties intend to harm the legitimate interests of a third party;
(d) the contract is in violation of China's public policy; or
(e) the contract violates a mandatorily applicable law or regulation (except when the law or regulation does not lead to invalidity of the civil action).[14]

ISDA's China counsel is of the view that the terms of the industry standard master agreements and other derivative contracts (including, but not limited to, the close-out netting provisions in these agreements) are valid and enforceable under its respective governing law prior to the commencement of bankruptcy proceedings - there has never been any doubt on this.

The uncertainties regarding close-out netting enforceability under Chinese law is mainly due to the risk that close-out netting provisions are found to be inconsistent with China's Bankruptcy Law (e.g., Article 18 of the Bankruptcy Law) in the absence of an express legislative protection for netting during the bankruptcy proceedings of a Chinese counterparty.

As mentioned in the UNIDROIT Principles, if the registration of close-out netting provisions is required as a condition for the validity and enforceability against third parties, this means that all domestic and foreign parties, including those acting in good faith and in the absence of any fraudulent behaviour, as well as in the absence of insolvency of one of the parties, would be hit by the unenforceability of the close-out netting provision as a consequence of non-compliance with the registration requirement, e.g., due to a simple operational mistake. This situation might potentially create great legal uncertainty, and this is why registration should not be linked to the unenforceability of the close-out netting provision.

Therefore, we submit that the imposition of a filing requirement in Article 34 would not only undermine the effectiveness of the protection for netting provided by the Futures Law during bankruptcy proceedings but also create legal uncertainties for the enforceability of all outstanding derivative contracts entered into by a Chinese entity under non-bankruptcy related scenarios.

We believe this is not the intention of the NPCSC and therefore request that the filing requirement under Article 34 be removed as a condition to the protections set out in Article 35 and Article 37.

[13] Articles 119 and 483 of the Civil Code.

[14] Article 119, 143, 144. 146, 153, 154, 483 of the Civil Code.

2.2.1.2 It is not entirely clear whether the industry standard master agreement used in cross-border trades are included

Although Article 34 does not exclude an industry standard master agreement used in cross-border trading such as the ISDA Master Agreement, our members are concerned that the reference to "trade association" in Article 34, when read together with Article 2, may lead to the conclusion that only a domestic self-regulatory organization or association may file its agreement with Chinese regulators and accordingly netting under a master agreement published by a foreign trade association such as ISDA or Securities Industry and Financial Markets ("**SIFMA**")[15] will not be protected under the Draft Futures Law.

We understand that Chinese financial regulators are aware that close-out netting enforceability for cross-border trades has been one of the major obstacles to further growth of China's financial markets. As such, we believe the Chinese financial regulators would agree with the Associations' view that the netting protection provided by the Futures Law should apply to master agreements used in cross-border OTC derivatives transactions and SFT Transactions as well. Given that PBOC has allowed the ISDA Master Agreement to be used by foreign central banks, sovereign wealth management funds and other foreign institutional investors when entering into RMB derivative transactions to hedge their RMB bond holdings,[16] we believe limiting the protection to master agreements issued by onshore trade associations would not only exclude cross-border transactions from the protection of netting enforceability under the Futures Law but also introduce different treatment on this issue and increase systemic risk in China's financial markets.

2.2.1.3 The filing requirement may not accommodate the variety of documents used in domestic and cross-border derivatives transactions

Although financial institutions in China often use the ISDA Master Agreement for cross-border transactions and the NAFMII or Securities Association of China ("**SAC**") Master Agreement for domestic trades, some financial institutions use their own template when trading with their corporate and individual clients (such bespoke agreement are often referred to as "mini-master agreements"). Such bespoke agreements have similar close-out netting provisions as the industry standard agreements. However, Article 34 of the Draft Futures Law does not appear to cover those mini-master agreements which are also used in derivatives trading.

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[15] In addition to the ISDA Master Agreement which is commonly used to document OTC derivatives in international markets, GMRA co-published by SIFMA and International Capital Market Association is commonly used to document repurchase transactions.

[16] See the "Opinions for Further Accelerating the Construction of Shanghai as an International Financial Center and Providing Financial Support for the Integrated Development of the Yangtze River Delta Region" issued by the PBOC, CBIRC, CSRC and SAFE which expressly permit foreign investors to choose its master agreements for their derivatives transactions including the NAFMII and ISDA Master Agreement.

Recommendations:

If the intention of the filing requirement under Article 34 is to prevent any potential abuse of the protection set out in paragraph 2 of Article 37 (which provides that close-out netting cannot be invalidated or revoked because a party has entered into bankruptcy proceedings), we submit that the existing regulatory requirements imposed by financial regulators in respect of derivative business of domestic regulated entities are adequate to mitigate the risk. For example, most onshore derivative transactions are documented under the master agreements issued by NAFMII and SAC and the use of those master agreement has been approved by PBOC and CSRC, respectively. In addition, the CBIRC requests a commercial bank to obtain an approval before it may engage in any derivative business and the required documents include information on internal risk management system with a specific reference to counterparty credit risk, legal risks and documentation issues.[17] We understand that the CSRC has similar requirements regarding derivative business of securities companies and risk management subsidiaries of futures companies. As to the ISDA Master Agreement which is commonly used in cross-border derivative transactions, we understand the agreement is filed with the China Foreign Exchange Trade System (a trading platform supervised by the PBOC and the State Administration of Foreign Exchange ("**SAFE**")) when foreign investors use the agreement to hedge its FX risk associated with their onshore bond investments.

The key protection for close-out netting is set out in Article 37 which expressly confirms that close-out netting effected according to the terms of master agreement should not be revoked or invalidated during bankruptcy proceedings. During bankruptcy proceedings, the court hearing the case will have the ultimate power to decide whether a claim will be accepted or rejected and to sanction fraudulent behaviours. Therefore, a claim from a creditor that tries to enjoy the protection of Article 37 through fraudulence will not be upheld during bankruptcy proceedings.

If the NPCSC nonetheless prefer to retain some requirements regarding the derivative agreements which may benefit from the protection under Article 37 during bankruptcy proceedings, we would recommend replacing the filing requirement with the following changes:

2.2.1.4 defining what is a "qualified financial contract" (QFC, as set out in the ISDA Model Netting Act[18]) or an "eligible obligation" (as set out in the

[17] See Article 12, 19, 29 and 30 of the CBIRC Derivatives Measures. Article 29 provides "*A banking financial institution shall establish and enhance the mechanism and system for controlling legal risks, and strictly examine the legal status and transaction qualification of its counterparties. A banking financial institution entering into a derivative contract with a counterparty shall refer to the international practices, adequately consider issues such as operability of recourse and preservation by legal means after occurrence of an event of default, and take effective measures to prevent the legal risks arising from the drafting, negotiation and signing of a transaction contract*." and Article 30 provides "*A banking financial institution shall formulate sound evaluation and management rules for derivative contracts and other relevant legal documents, and evaluate the effectiveness and effects of the involved derivative contracts at least once a year according to the situations of its counterparties, so as to have a further understanding and control thereof and effectively prevent legal risks*."

[18] ISDA's Model Netting Act is designed to provide a template that can be used by jurisdictions considering legislation to ensure the enforceability of close-out netting. ISDA's Model Netting Act draws on ISDA's 30 years of experience of working with policy-makers and regulators across the globe on close-out netting legislation, and provides guidance and model provisions for those legislators looking to increase legal certainty under local law for netting. The latest example is India which passed its netting legislation based on ISDA's Model Netting Act in 2020 after two decades of ISDA's work with the Indian regulators. A copy of the 2018 Model Netting Act is included in the Associations' Commercial Banks Law Submission.

UNIDROIT Principles), "netting agreement" and "collateral agreement"; and

2.2.1.5 adding a sentence to Article 37 to make it clear that the protection of close-out netting during bankruptcy proceedings is applicable to QFCs only.[19]

This proposal aims to clearly define the scope of the netting agreements protected under Article 37 and strikes a right balance between regulatory oversight and legal certainty regarding close-out netting.

We attach for your reference the Associations' submission to PBOC on the proposed amendments to the Commercial Banks Law dated 16 November 2020 ("**Commercial Banks Law Submission**") which sets out examples of definitions of QFCs, netting agreement, collateral arrangement and other netting related provisions (see **Annex C** to this letter).

2.2.2 Alternative proposals

If NPCSC prefers to retain the filing requirement under Article 34, we invite the NPCSC to refine the filing requirement based our following comments:

2.2.2.1 provide clarification on, and/or amending Chapter 3 to clarify, the following issues:

(a) clarify that standardised master agreement templates published by ISDA or other international industry associations are eligible for filing by such industry association;

(b) where any of the departments authorised by the State Council to regulate other derivative transactions has approved the use of a standardised template of a master agreement or such other standardised contract adopted for OTC derivatives transactions, that such approved template be exempt from the filing requirement for all transactions documented under the master agreement, not limited to a specific asset class regulated by that regulator only. Please see our proposed amendments to Article 34 as set out in **Annex A** to this letter; and

(c) clarify what "other institution which organize derivative trading" refers to; and

2.2.2.2 from a practical perspective, we also request the NPCSC to consider our following recommendations:

(a) that the filing requirement should not be onerous; the filing should be made with one single designated regulator such that trade associations and "other institutions" referred to in the preceding paragraph do not need to make multiple filings of their

[19] Given that this is an alternative proposal, we have not proposed any amendments in Annex A to this letter.

master agreement templates with all the regulators which have regulatory powers over the OTC derivatives market. The ISDA Master Agreement is used to document the majority of cross-border OTC derivatives transactions, which cover a wide range of underlying assets including (without limitation) interest rates, exchange rates, credit, securities and commodities which are regulated by PBOC, SAFE, CSRC and CBIRC, respectively; and

(b) that a list of filed agreements should be published on the website of the designated regulator for filing for transparency.

2.3 Financial collateral arrangements and stay issue during bankruptcy proceedings (see our proposed amendments to Articles 36 and 37 as set out in Annex A to this letter)

As set out in **Annex B** to this letter, it is important that takeover, resolution and bankruptcy proceedings applicable to Chinese financial institutions and corporates not only support the enforceability of close-out netting but also the related collateral arrangement involving a Chinese counterparty.

2.3.1 Inclusion of an express reference to financial collateral arrangements

Collateral in derivative transactions is often taken by way of either title transfer or in the form of security interest. It is critical that the protection under the bankruptcy proceedings covers collateral arrangements, including any margin, collateral or security arrangement or other credit enhancement related to or forming part of a netting agreement or one or more contracts to which a netting agreement applies.

2.3.1.1 Title transfer

Title transfer is one of the most commonly used collateral arrangements in cross-border derivative transactions. Under a title transfer collateral arrangement, the collateral provider transfers the full legal title of the relevant collateral (such as cash in local and foreign currencies, securities, etc.) to the collateral taker with a value that matches the mark-to-market risk exposure of the collateral taker.

A title transfer collateral arrangement is undertaken under a master agreement for derivative transactions, and constitutes a transaction under the single agreement mechanism of the master agreement. A title transfer does not constitute a security interest. Upon the collateral provider's default, all transactions under the master agreement will be early terminated, with all outstanding amounts due between the parties being netted with a single net amount payable pursuant to the close-out netting provisions. The outstanding amount due under a title transfer collateral arrangement is valued and netted against other transactions under the master agreement in the calculation of a final early termination amount.

It is important to note that a title transfer arrangement is fundamentally different from the transfer of the ownership of an asset by way of

security[20]for particular obligations on the condition that it will be re-transferred on the discharge of the secured obligations (e.g., legal mortgage under Hong Kong or English law). Most jurisdictions where ISDA has obtained a collateral opinion recognize the enforceability of a title transfer collateral arrangement and do not re-characterize it as a security interest.

Title transfer arrangements are commonly used to provide variation margin in cross-border transactions by Chinese financial institutions and many market participants use the ISDA 2016 Credit Support Annex (English law - title transfer) to comply with the variation margin rules of the jurisdictions which have adopted the "Margin Requirements for Non-Centrally Cleared Derivatives" jointly publicised by the Basel Committee on Banking Supervision and the Board of The International Organization of Securities Commissions ("**IOSCO**") ("**WGMR Framework**")[21]. Outright transfer arrangements have been adopted in the China Inter-bank Market Financial Derivatives Transactions Title Transfer Performance Assurance Document (2009), the Bond Repurchases Master Agreement – Special Provisions for Outright Repurchases (2013) published by NAFMII and Global Master Repurchase Agreement ("**GMRA**") commonly used in the international market.

Although the reference to "other contract with security features" under Article 36 appears to be worded broad enough to include title transfer arrangements, we recommend including an express reference to title transfer collateral arrangement in Article 36 to remove any residual doubt.

2.3.1.2 Security interest

Collateral provided in the form of security interest (e.g., a pledge) is not protected under Article 37 (as currently drafted). Different from the title transfer based financial collateral arrangement whose enforcement occurs via the close-out netting mechanism, a security interest relies on the applicable security law when it comes to enforcement. It is therefore important that Article 37 extends the protection of close-out netting to the security agreement entered into for the purpose of collateralizing a protected OTC derivative transaction during bankruptcy proceedings.

2.3.2 Protection of close-out netting under Article 37 should cover any **stay** on enforcement of close-out netting and financial collateral arrangement (including both a title transfer and a security agreement)

Given the systemic importance of ensuring that close-out netting and financial collateral arrangements are safeguarded during a resolution and can ultimately be effectively enforced, we submit that the protection for close-out netting in

[20] Referred to as "让与担保" in Chinese.

[21] The April 2020 version of the WGMR Framework is available at https://www.bis.org/bcbs/publ/d499.pdf. Variation margin can be taken by way of title transfer or security interest and initial margin is often taken in the form of a security interest.

bankruptcy proceedings under Article 37 should cover not only revocation or invalidation but also any stay on operation of close-out netting provisions.

The 2013 UNIDROIT Principles provide that it is important for netting legislation to ensure that upon the commencement of an insolvency proceeding or in the context of a resolution regime in relation to a party to a close-out netting provision, the operation of the close-out netting provision is not stayed.

In the Key Attributes of Effective Resolution Regimes for Financial Institutions ("**FSB Key Attributes**") issued by the Financial Stability Board ("**FSB**")[22], the FSB Key Attributes set out the consensus of the G20 Heads of State and Government on the core elements of an effective resolution regime for financial institutions. The FSB Key Attributes underline the importance of close-out netting and financial collateral arrangements and how they must be safeguarded in the event of a resolution and propose to limit stay during a resolution. [23]

Article 75 of China's Bankruptcy Law provides that the enforcement of a security during reorganization proceedings will be stayed. It is critical that paragraph 2 of Article 37 covers enforcement of any related security arrangement in OTC derivative transactions so as to provide a safe-harbor from the stay under Article 75 of China's Bankruptcy Law. Since the implementation of the initial margin requirements in 2016, Japan, Singapore and New Zealand have amended laws to provide that security agreements related to or forming part of a netting agreement and QFCs are not subject to any stay in bankruptcy reorganization or similar proceedings.

2.4 Protection for settlement finality and clearing of futures contracts and centrally cleared derivatives OTC derivatives

2.4.1 Settlement finality for futures trading (see our proposed amendments to Article 21 as set out in **Annex A** to this letter)

According to the "Principles for Financial Market Infrastructures" issued by IOSCO[24], in considering settlement finality, there should be a clear legal basis regarding when settlement finality occurs in financial market infrastructure (such as a clearing house) in order to define when key financial risks are transferred in the system, including the point at which transactions are irrevocable. Settlement finality is a critical building block for risk-management systems. A key question is whether transactions undertaken by an insolvent participant would be honoured as final, or could be considered void or voidable by an administrator and relevant authorities.

Therefore, we would be grateful if Article 21 could clarify that any trading and settlement activities conducted under the business rules formulated by the futures exchanges cannot be altered, stayed, invalidated or revoked due to the commencement of any bankruptcy or liquidation proceedings with respect to any

[23] See paragraph 4.3 and Annex IV of the FSB Key Attribute. The Commercial Banks Law Submission also discuss the stay issue in both resolution and China's Bankruptcy Law in detail.

[24] A copy of which is available at this website: https://www.bis.org/cpmi/publ/d101a.pdf.

futures clearing institutions, future exchanges, futures business institutions, futures participants and other entities.

2.4.2 Extending the protections under Article 17 (margin), Article 21 (settlement finality), Article 43 (segregation of margin) and Article 98 (close-out netting) to centrally cleared OTC derivatives in addition to Article 46, and covering bankruptcy or liquidation of a central clearing party ("**CCP**") in relevant provisions (see our proposed amendments to Articles 39, 46 and 98 as set out in **Annex A** to this letter)

To enhance the protection of close-out netting with respect to futures and centrally cleared OTC derivatives, we submit that:

2.4.2.1 Articles 46 (which applies to both futures and centrally cleared OTC derivatives) does not expressly provide that, upon the commencement of a bankruptcy or liquidation proceeding in respect of a CCP, margin held by the CCP and assets transferred by the CCP for settlement purposes will be ring-fenced to ensure first priority is given to clearing and settlement. We request that Article 46 clarify that margin held by the CCP and assets transferred by the CCP for settlement purposes are applied despite the bankruptcy or liquidation of a CCP;

2.4.2.2 Central cleared OTC derivative transactions are subject to the margin requirements of CCPs. We request that the protections for margin under Article 17 and 43 be extended to cover centrally cleared OTC derivatives.

2.4.2.3 the second paragraph of Article 98 confirms that net settlement made in accordance with the first paragraph of Article 98 of the Draft Futures Law will not be invalidated or revoked due to the commencement of bankruptcy proceedings with respect to a clearing participant. We request that close-out netting in respect of centrally cleared OTC derivative transactions be protected under Article 98 instead of Article 34 given the filing requirement is not practicable for those cleared trades which do not have an industry standard client clearing agreement; and

2.4.2.4 Article 98 should be expanded (1) to cover bankruptcy of a clearing client and CCP in a similar way as Article 46; and (2) to provide that netting applicable to centrally cleared OTC derivatives trades should not be **stayed**, invalidated or revoked in the event of the commencement of any bankruptcy proceeding with respect to the relevant CCP, clearing member or a client.

2.5 Clarification of the meaning of "transfer by agreement" (see our proposed amendments to Article 31 as set out in **Annex A** to this letter)

We understand that "transfer by agreement" is commonly used in the rules of China's exchanges (such as the Guidelines of the Shanghai Stock Exchange on Handling the Transfer

of Listed Companies' Shares by Agreement[25]) and provide a way for market participants to conduct non-trade transfers (i.e., transfer exchange-traded securities from a seller to a buyer). Such transfer by agreements is usually a concept used in the context of exchange-traded securities, and is subject to prior approval of the exchanges in accordance with relevant rules.

However, the term "transfer by agreement" as used in Article 31 of the Draft Futures Law appears to refer to trading OTC derivatives pursuant to OTC bilateral agreements (such as ISDA Master Agreements and NAFMII Master Agreements). If that is the case, we suggest amending the term "transfer by agreement" to "OTC bilateral agreements"[26].

2.6 Application of Chapter 12 (cross-border jurisdiction and coordination) to the OTC derivatives market

We note that Article 40 allows the State Council to issue rules applicable to OTC derivatives based on the principles of Chapter 12. We submit that due to the differences between the market structure of OTC and futures, it may not be entirely appropriate to apply all provisions of Chapter 12 regarding cross border futures trading to the OTC derivatives market. We would welcome a dialogue with the regulators on how the principles of Chapter 12 should be applied to the OTC derivatives market when the State Council considers cross border issues regarding OTC derivatives when formulating implementing regulations. In this regard, we invite the regulators to consider the following comments from the Associations' members:

2.6.1 the Associations believe that policymakers should implement a risk-based framework for the evaluation and recognition of the comparability of derivatives regulatory regimes, and that national regulators should implement substituted compliance determinations in a predictable, consistent, and timely manner. The alternative results in regulatory driven market fragmentation which leads to inefficiencies and higher costs for derivatives market participants, and ultimately results in increased risk;

2.6.2 the Associations encourage regulators around the world to:

2.6.2.1 reduce the gap between global standards and national regulations to ensure greater consistency in implementation; and

2.6.2.2 implement a risk-based framework for the evaluation and recognition of the comparability of derivatives regulatory regimes;

2.6.3 the Associations strongly supports the substituted compliance model that has been the foundation of the derivatives industry for years; and

2.6.4 global derivatives markets enable firms to efficiently and cost-effectively raise financing and manage their risk. The Associations strongly believe that the Futures Law could provide a solid foundation for international financial institutions and investors to participate in the Chinese financial markets. To ensure this is the case, we encourage attention to be paid to cross-border regulation in the legislative phase of this policymaking.

[25] 《上海证券交易所上市公司股份协议转让业务办理指引》

[26] 场外双边协议

2.7 Cross-border data sharing (see our proposed amendments to Article 136 as set out in Annex A to this letter)

Our members submit the following observations and comments on Article 136:

2.6.5 cross-border data transmission is a key issue as China continues to open up its futures market, allowing more foreign investors to participate in futures trading in China either by setting up a foreign owned subsidiary or via the Qualified Foreign Institutional Investor (QFII) and Renminbi Qualified Foreign Institutional Investor (RQFII) regimes. Therefore, a certain degree of cross-border information sharing (for example, providing transaction details and documents to foreign clients of a domestic futures company, information sharing with offshore shareholders and sharing for outsourcing purposes) becomes essential for futures trading activities conducted on a cross-border basis;

2.6.6 China has promulgated and/or is in the process of enacting and implementing laws and regulations to regulate cross-border data transmissions (such as PRC Cybersecurity Law[27], PRC Data Security Law (Draft) [28] and PRC Law on the Protection of Personal Information (Draft) [29]). We recommend the Futures Law defer to those laws which are designed to regulate cross-border data transmissions to ensure there is a consistent regulatory regime governing cross-border data sharing issues;

2.6.7 as China continues to open up its futures market to attract foreign participation, a blanket prohibition under Article 136 may impede or cause unnecessary inconvenience to foreign futures businesses accessing China's futures market pursuant to the Futures Law and affect these businesses' ability to benefit from resources from their foreign shareholders. Therefore, we submit that futures companies should be permitted to provide certain information (except for information relating to national secret or security) to their foreign head office and affiliates, particularly (i) information that are reasonably necessary for their inbound/outbound investments, (ii) financial data such as profit and key employee information and (iii) basic information that enables the futures companies to utilize its group's information technology systems and resources. As to what information should be allowed and the applicable requirements and safeguards, these could be set out in the implementing regulations for data sharing and privacy to be enacted in the future; and

2.6.8 a Chinese entity participating in offshore futures business or holding an offshore futures license may also need to provide certain documents and materials pursuant to the reporting and disclosure requirements of the offshore CCP or to regulators in other jurisdictions.

Our proposed amendments to Article 136 are set out in **Annex A** to this letter.

3 Conclusion

The implementation of the Futures Law will support the further development of liquid, efficient, stable and robust futures and OTC derivatives markets in China. It will not only enhance

[27] Issued by the NPCSC on 7 November 2016, effective on 1 June 2017《中华人民共和国网络安全法》

[28] 《中华人民共和国数据安全法（草案）》

[29] 《个人信息保护法（草案）》

financial stability in China but also facilitate the further opening-up of China's futures and OTC derivatives markets and encourage more active participation by foreign investors in those markets.

We look forward to working closely with the NPCSC to enhance legal certainty of close-out netting and enforceability of financial collateral for the further development of China's financial market. If you have any questions regarding the letter, please feel free to contact Ms. Gu Jing, Head of Legal, Asia Pacific at ISDA's Singapore office (jgu@isda.org; tel: +65 66534173).

Yours faithfully,

Jing Gu
Head of Legal, Asia Pacific
International Swaps and Derivatives Association, Inc.

Mark Austen
CEO
Asia Securities Industry and Financial Markets Association

Encl.

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Annex A

Proposed amendments to the relevant provisions of the Draft Futures Law

ISDA Safe, Efficient Markets

asifma Growing Asia's Markets

Annex A

Proposed drafting amendments to the Draft Futures Law

Article	Reference paragraph in the Letter	Proposed amendment (Chinese original text)	Proposed amendment (English translation)
Article 2	Paragraph 2.1.1	在中华人民共和国境内,期货交易和其他衍生品交易及相关活动,适用本法。 本法第三章的规定，也适用于中华人民共和国境内设立的机构从事的跨境其他衍生品交易。 在中华人民共和国境外的期货交易和其他衍生品交易及相关活动,扰乱中华人民共和国境内市场秩序,损害境内交易者合法权益的,适用本法。	This Law shall apply to futures trading and **other derivative transactions** and related activities conducted within the territory of the People's Republic of China. Chapter 3 of this Law shall also apply to cross-border **other derivative transactions** conducted by entities established within the territory of the People's Republic of China. This Law shall apply to futures and **other derivative transactions** and related activities conducted outside the territory of the People's Republic of China where such transactions or activities have disturbed the market order within the territory of the People's Republic of China or damaged the legitimate interests of onshore trading participants.
Article 3	Paragraph 2.1.2	本法所称期货,是指由期货交易场所统一制定的、将来在某一特定的时间和地点交割一定数量标的物的标准化合约和其他标准化合约。 本法所称其他衍生品，是指价值依赖于标的物价值~~变动~~的、非标准化的远期交割合约,包括非标准化的期权合约、互换合约和远期合约及其组合。 期货交易和其他衍生品交易的标的物包括农产品、工业品、能源等商品、服务及相关指数,以及有价证券、利	Under this Law, "futures" refer to standardised contracts uniformly formulated by a futures exchange for the settlement of a certain amount of the relevant underlying reference asset at a specified time and place and other standardised contracts formulated by a futures exchange. Under this Law, "**other derivative transactions**" refer to non-standardised forward settlement contracts which values depend on ~~the changes in~~ the value of the underlying reference asset, including non-standardised options contracts, swap contracts and forward contracts, and any combination of the aforementioned products. The reference asset(s) underlying the futures trading and **other derivative transactions** include agricultural products, industrial products, energy and other commodities, services and related indexes, as well as financial products such as securities, interest rates, exchange rates, credit, emissions, freight, property index, or economic statistics and related indexes, etc.

Article	Reference paragraph in the Letter	Proposed amendment (Chinese original text)	Proposed amendment (English translation)
		率、汇率、信用、碳排放、货运、房地产指数、经济指标等金融产品及相关指数等。	
Article 21	Paragraph 2.4.1	依照期货交易场所依法制定的业务规则进行的交易或结算，不得改变其交易结果，也不因期货结算机构、期货交易场所、期货经营机构、期货交易者或其他机构进入破产或清算程序而暂停、无效或者撤销。 发生本法第九十一条规定的情形导致期货交易价格出现重大异常的，期货交易场所按照业务规则可以取消交易或者调整交易价格，并及时向国务院期货监督管理机构报告并公告。 对依照前款规定采取措施造成的损失，期货交易场所不承担民事责任，但存在重大过错的除外。	An executed trade or settlement conducted under the business rules formulated by the futures exchanges in accordance with the law cannot be altered, and cannot be stayed, invalidated or revoked due to the commencement of any bankruptcy or liquidation proceedings with respect to any futures clearing institutions, future exchanges, futures business institutions, futures participants and other entities. If there is any material abnormality in the futures trading prices caused by situations stipulated in Article 91 of this Law, the futures exchanges may cancel the transaction or adjust the trading price in accordance with the business rules, upon which it shall promptly report such decision to the futures regulatory body of the State Council and make a public announcement of such decision. The futures exchanges shall not assume any civil liability for losses incurred as the result of measures adopted in accordance with the preceding paragraph except in the case of manifest error.
Article 31	Paragraph 2.5	其他衍生品交易,可以采用场外双边协议~~转让~~等交易方式,也可以采用经国务院认可的其他交易方式。	**Other derivative transactions** may be conducted through ~~transfers by~~ over-the-counter bilateral agreements or other trading methods approved by the State Council.
Article 34	Paragraph 2.2	**第一种修改建议：删除第 34 条** ~~行业协会或者组织开展其他衍生品交易的机构应当将其他衍生品交易中采用的主协议等格式合同文本,报送国务院授权的部门备案。~~	**Option 1 (Deletion of Article 34 in its entirety)** ~~Industry associations or institutions carrying out other derivative transactions shall file the standardarised templates of the relevant master agreement or such other standardised contracts adopted in other derivatives transactions with the departments authorised by the State Council for their records.~~

Article	Reference paragraph in the Letter	Proposed amendment (Chinese original text)	Proposed amendment (English translation)
		第二种修改建议：【如果全国人大常委会认为确有必要保留第三十四条的备案要求】 境内外行业协会或者组织开展其他衍生品交易的机构应当将其他衍生品交易中采用的主协议等格式合同文本,报送国务院授权的部门备案。国务院授权的部门已许可使用的相关主协议等格式合同文本，免予备案。	**Option 2 (if the NPCSC considers it necessary to retain the filing requirement in Article 34)** Industry associations or institutions carrying out **other derivative transactions** (whether onshore or offshore) shall file the standardised templates of the relevant master agreement or such other standardised contracts adopted in other derivatives transactions with the departments authorised by the State Council for their records. If any of the departments authorised by the State Council to regulate **other derivative transactions** [1]has approved the use of a standardised templates of the relevant master agreement , such template shall be exempted from filing.
Article 35	Paragraph 2.2	~~依照本法规定备案~~适用于本法第三条规定的其他衍生品交易的主协议、主协议项下的全部补充协议以及交易双方就各项具体交易做出的约定等,共同构成交易双方之间一个完整的单一协议,具有法律约束力。	A master agreement ~~filed in accordance with~~ applicable to **other derivative transactions** as defined in Article 3 of this Law together with all the supplementary agreements pursuant to the master agreement and agreements made by both parties to each specific transaction constitute a complete single and legally binding agreement between the parties.
Article 36	Paragraph 2.3.1	其他衍生品交易参与者可以依法通过订立质押合同和转让式履约保障协议等其他具有~~担保~~履约保障功能的合同~~等~~方式对其他衍生品交易提供履约保障。	Participants in **other derivative transactions** may provide performance assurance for their **other derivative transactions** by methods such as entering into pledge contracts ~~or other contracts with security features~~ or other collateral arrangements, including without limitation, title transfer performance guarantee arrangements in accordance with the law.
Article 37	Paragraph 2.2 Paragraph 2.3.2	按照~~本法第三十五条规定的~~净额结算协议方式从事其他衍生品交易的,发生约定的情形时,可以依照协议约定终	Where **other derivative transactions** are documented under a netting agreement ~~effected by way of an agreement in accordance with Article 35 of this Law~~, the relevant transactions may be terminated in accordance with the agreement upon the occurrence of certain events specified therein, ~~and~~ with the profits and losses of all

[1] "Other derivative transaction" is a defined terms under article 3 of the Futures Law.

Article	Reference paragraph in the Letter	Proposed amendment (Chinese original text)	Proposed amendment (English translation)
		止交易,并按净额对协议项下的全部交易盈亏进行结算，并执行相关履约保障安排。 依照前款规定做出的终止净额结算行为和相关履约保障安排的执行不因交易任何一方的~~依法进入~~破产程序而暂停、无效或者撤销。 在中华人民共和国境内或涉及中华人民共和国境内交易对手的跨境买断式回购交易及证券借贷交易，参考适用本法第三章第三十四条、第三十五条、第三十六条和第三十七条有关对净额结算的保护性规定。	the transactions under the agreement ~~shall be~~ settled on a net basis, and the related collateral arrangement enforced according to its terms. The ~~net settlement made~~ close-out netting and enforcement of the related collateral arrangements effected in accordance with the provisions of the preceding paragraph shall not be stayed, invalidated or revoked due to ~~the commencement of~~ any bankruptcy proceeding with respect to any party to the transaction in accordance with the law. The close-out netting protective provisions of Chapter 3 of the Law (Article 34, 35, 36 and 37) may be referenced in regulations applicable to outright transfer repurchase agreements and securities lending and borrowing transactions conducted within the territory of the People's Republic of China or for cross border transactions with an onshore trading counterparty within the territory of the People's Republic of China.
Article 39	Paragraph 2.4.2	其他衍生品交易,按照国务院授权部门的规定应当集中结算的,由其他衍生品交易的结算机构作为中央对手方参照本法的有关规定进行集中结算。 负责其他衍生品交易的结算机构,应当向国务院授权的部门履行审批程序。 其他衍生品交易活动中涉及的结算财产安全保护参照本法第十七条，第二十一条，第四十三条，第四十六条和第九十八条规定执行。	Where a central counterparty of other derivative transactions is authorised by a regulatory body of the State Council to carry out the central clearing activities for other derivative transactions, the relevant clearing institution shall act as the central counterparty to conduct central clearing of such transactions in accordance with the relevant provisions of this Law. The clearing institutions responsible for **other derivative transactions** shall follow the examination and approval procedures of the departments authorised by the State Council. The safeguarding and protection of the property involved in the clearing of **other derivative transactions** shall be implemented according to Article 17, 21, 43, 46 and 98 of this Law.

Article	Reference paragraph in the Letter	Proposed amendment (Chinese original text)	Proposed amendment (English translation)
Article 46	Paragraph 2.4.2	期货结算机构或结算参与人依照其业务规则收取和提取的保证金、权利金、结算担保金、风险准备金等资产，不得被查封、冻结、扣押或者强制执行。 期货结算机构、结算参与人、交割库进入破产或者清算程序的,保证金、进入交割环节的交割财产应当优先用于结算和交割。 期货结算机构、交易者进入破产或者清算程序的,其保证金、进入交割环节的交割财产应当优先用于结算和交割，其委托的结算参与人有权将该交易者的合约强行平仓。 在结算和交割完成之前，任何人不得动用用于担保履约和交割的保证金、进入交割环节的财产。	All assets collected and withdrawn by a futures clearing institution or a clearing participant in accordance with its business rules (including margin, options premium, guarantee fund and risk reserve fund) shall not be impounded, frozen, seized or subject to any compulsory enforcement. Upon commencement of a bankruptcy or liquidation proceeding in respect of a futures clearing institution, a clearing participant or a delivery warehouse, all margin and assets that are due for settlement shall be applied first for clearing and settlement. Upon commencement of a bankruptcy or liquidation proceeding in respect of a futures clearing institution, a trading participant, the margin and assets that are due for settlement process shall be first applied for clearing and settlement, and the clearing participant appointed by the trading participant is entitled to proceed with forced liquidation of the trading participant's outstanding contractual positions. Pending completion of clearing and settlement, no person shall use any margin (that is designated to secure the performance and settlement), or any asset due for clearing and settlement.
Article 98	Paragraph 2.4.2	期货结算机构作为中央对手方，是~~结算参与人共同对手方~~在期货交易达成后介入期货交易双方，成为所有买方的卖方和所有卖方的买方，进行净额结算，为期货交易提供集中履约保障的法人。	The futures clearing institution, acting as the central counterparty, is the counterparty ~~to all clearing~~ which imposes itself between the trading participants to futures transaction as the seller to every buyer and the buyer to every seller. It conducts net settlement and provides centralised performance assurance for futures trading. ~~Net~~ The close-out and net settlement made in accordance with the provisions of the preceding paragraph and the business rules of futures clearing institutions shall not be stayed, invalidated or revoked due to ~~the commencement of~~ any bankruptcy proceeding with respect

Article	Reference paragraph in the Letter	Proposed amendment (Chinese original text)	Proposed amendment (English translation)
		依照前款规定和期货结算机构业务规则作出终止净额结算行为，不因该期货结算机构或有关结算参与人~~依法进入~~的破产程序而暂停、无效或者撤销。 期货结算机构按照其业务规则作出终止净额结算行为，不因期货结算机构或有关结算参与人的破产程序而暂停、无效或者撤销。 结算参与人按照期货结算机构业务规则和其与客户之间的合同作出终止净额结算行为，不因有关期货结算机构、结算参与人或[交易者/该期货结算机构客户] 的破产程序而暂停、无效或者撤销。	to ~~any~~ such futures clearing institutions or the relevant clearing participants in accordance with the law. The close-out and net settlement made by a futures clearing institution in accordance with its business rules shall not be stayed, invalidated or revoked due to any bankruptcy proceeding with respect to such futures clearing institution or the relevant clearing participant in accordance with the law. The close-out and net settlement made by a futures clearing participant in accordance with the business rules of futures clearing institutions and any contract between itself and its clients shall not be stayed, invalidated or revoked due to any bankruptcy proceeding with respect to the relevant futures clearing institution, futures clearing participant or [trading participants/the client of such futures clearing participant] in accordance with the law.
Article 135	不适用 – 此拟议修订旨在明确已经取得第 133 条规定的许可的境外期货经营机构应可在中国从事市场营销等活动（即该等境外期货机构无需取得其他许可或批准以进行市场营销等活动）。 N/A – This proposed amendment is a drafting change to clarify that an approved overseas futures firm under Article 133 should be allowed to engage in marketing activities in China (i.e., there should not be	境外期货经营机构以及其他境外机构在境内直接或者设立分支机构从事期货市场营销、推介及招揽交易者,应当经国务院期货监督管理机构批准,适用本法的相关规定。 未经国务院期货监督管理机构批准,任何单位或者个人不得为境外期货交易场所、期货经营机构从事期货市场营销、推介以及招揽活动，境外期货经营机构已经取得本法第一百三十三条规定的许可的除外。	Overseas futures business institutions and other overseas institutions which directly engage in, or set up branches within the territory to engage in, futures marketing, promotion and solicitation of trading participants shall obtain approval from the futures regulatory body of the State Council and shall be subject to the application of this Law. In the absence of the approval from the futures regulatory body of the State Council, no unit or individual shall engage in futures marketing, promotion and solicitation activities for overseas futures exchanges and futures business institutions, except for those overseas futures business institutions that have been approved in accordance with Article 133.

Article	Reference paragraph in the Letter	Proposed amendment (Chinese original text)	Proposed amendment (English translation)
	another approval requirement for the marketing activities conducted by such approved foreign futures companies).		
Article 136	2.7	国务院期货监督管理机构可以和境外期货监督管理机构建立监督管理合作机制，或者加入国际组织，实施跨境监督管理，进行跨境调查取证，追究法律责任，处置跨境市场风险。 国务院期货监督管理机构应境外期货监督管理机构请求提供协助的，应当遵循国家法律、法规的规定和对等互惠的原则，不得泄露国家秘密，不得损害国家利益和境内单位和个人的合法权益。 ~~未经国务院期货监督管理机构和国务院有关主管部门同意，~~任何单位和个人~~不得擅自~~向境外提供与期货业务活动有关的文件和资料应当遵守国家有关主管部门规定。	The futures regulatory body of the State Council may establish supervision and management cooperation mechanisms with overseas futures regulatory authorities, or join international organisations to implement cross-border supervision and management, carry out cross-border investigations and evidence collection, investigate legal liabilities, and deal with cross-border market risks. If the futures regulatory body of the State Council provides assistance at the request of overseas futures regulatory agencies, it shall comply with the provisions of national laws and regulations and follow the principle of reciprocity, without disclosing state secrets or damaging the interests of the state and the legitimate rights and interests of domestic units and individuals. ~~In the absence of the consent from the futures regulatory body of the State Council and the relevant competent departments under the State Council, no~~ Any unit or individual ~~shall~~ may provide documents and materials related to futures business activities to overseas ~~without authorisation~~ in accordance with the relevant regulatory requirements.

Annex B

Importance and benefits of close-out netting and an overview of financial collateral arrangements in the OTC derivatives market

The Associations have consistently advocated for the enforceability of close-out netting and related financial collateral arrangements as an indispensable foundation for safe and efficient derivatives markets. As China continues to liberalize its financial markets, recognition of netting will remove a major barrier to international participation, supporting the development of liquid and efficient capital markets. Every country that recognizes netting in its domestic legislation represents a positive step forward. It is therefore vitally important that (i) takeover, resolution and bankruptcy proceedings applicable to Chinese financial institutions and corporates not only support the enforceability of close-out netting but also any related collateral arrangement involving a Chinese counterparty and (ii) the regime for enforcing financial collateral arrangements aligns, to the extent possible, with the international standards.

Close out netting

Close-out netting is the single most important mechanism for the reduction of credit risks associated with financial contracts including OTC derivatives, exchange traded derivatives and other financial transactions (such as bond repurchase agreements).

Close-out netting is a contractual process set out in a netting agreement under which, following an event of default or termination event, the following three stages generally occur:

Stage 1	Transactions under the netting agreement are terminated by notice given by the non-defaulting party or, in certain circumstances, automatically.
Stage 2	The terminated transactions are valued at their then-prevailing mark-to-market value (that is, replacement values) at or about the time of early termination.
Stage 3	Positive values (those owed to the non-defaulting party), and negative values (those owed by the non-defaulting party) are netted against each other under the single agreement in order to determine a final early termination amount.

In particular, recognition of close-out netting:

- allows exposures to be recognised on a net instead of gross basis, resulting in a more efficient use of credit lines, facilitates the taking of collateral to offset exposures and lowers capital reserves required to satisfy regulatory capital requirements;
- reduces costs, increases market liquidity and reduces credit and systemic risks; and
- is a prerequisite to the creation of repurchase markets and the development of liquid derivatives hedging markets.

In jurisdictions where there is a sufficiently high degree of legal certainty as to the enforceability of close-out netting (such as jurisdictions with netting legislation), financial regulators permit it to be

recognized as risk-reducing for the purposes of determining the level of regulatory capital a supervised institution must hold in respect of its derivatives positions, enhancing the efficiency of use of regulatory capital and reducing the associated cost. This is an extremely important aspect of the use of close-out netting. It is therefore critical that close-out netting be enforceable, including in the event of insolvency of a party, with a high degree of legal certainty.

ISDA has worked with authorities across the globe to help them draft legislation on the enforceability of close-out netting and collateral arrangements. ISDA has published netting opinions on 86 jurisdictions and collateral opinions on 59 jurisdictions.

ISDA's Model Netting Act is designed to provide a template that can be used by jurisdictions considering legislation to ensure the enforceability of close-out netting. ISDA's Model Netting Act draws on ISDA's 30 years of experience of working with policy-makers and regulators across the globe on close-out netting legislation, and provides guidance and model provisions for those legislators looking to increase legal certainty under local law for netting. The latest example is India which passed its netting legislation based on ISDA's Model Netting Act in 2020 after two decades of ISDA's work with the Indian regulators.

As set out in ISDA's Model Netting Act, "*the principal objective of netting legislation is to provide legal certainty. A high degree of legal certainty as to the enforceability of close-out netting is required by financial institutions not only to ensure safe and sound management of credit risk but also under international standards for the recognition of close-out netting as risk-reducing for the purposes of bank regulatory capital requirements. That high standard is reflected in the bank regulatory capital rules implemented in the leading financial markets. Accordingly, even in jurisdictions where close-out netting is likely to be enforceable post-insolvency on the basis of general principles, netting legislation may be necessary to resolve any material uncertainty and put the question beyond reasonable doubt in order to meet the necessary high standard."*

Financial collateral arrangements

Financial collateral (also known as "margin") for derivatives is taken to secure the net exposure of the collateral taker under a netting agreement. Close-out netting is the primary form of credit risk reduction used in the global derivatives market. Financial collateral deals only with the net credit exposure that remains. Collateral is often taken by way of either title transfer or in the form of security interest. Under a title transfer based financial collateral arrangement, enforcement typically occurs via the close-out netting mechanism.

Close-out netting and financial collateral are closely related but are interdependent concepts. It is therefore important that the Draft Futures Law captures both close-out netting and also financial collateral. This is especially so given the increasing importance of financial collateral in the regulatory regime that has been developed and implemented globally since the global financial crisis. One of the principal international responses to the financial crisis of 2008 has been the introduction of mandatory margin rules for non-centrally cleared derivatives, following the joint publication by the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions of their "Margin Requirements for Non-Centrally Cleared Derivatives" (the "**WGMR Framework**"). The WGMR Framework has been widely implemented in a number of jurisdictions, including the US, the European Union, the UK, Japan, Switzerland, Canada, Hong Kong Special Administrative Region, Singapore, Australia, Brazil and Mexico, with some Asian jurisdictions (such as India and Indonesia) currently considering draft rules. Chinese financial institutions (including banks) therefore need to exchange margin when trading with overseas financial institutions subject to the mandatory margin rules.

It is therefore vitally important that (i) takeover, resolution and bankruptcy proceedings applicable to Chinese financial institutions and corporates not only support the enforceability of close-out netting but also the related collateral arrangement involving a Chinese counterparty and (ii) the regime for enforcing financial collateral arrangements aligns, to the extent possible, with international standards.

Annex C

A copy of the Associations' Commercial Banks Law Submission

Annex D

About the Associations

The International Swaps and Derivatives Association (ISDA)

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 71 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and depositories, as well as law firms, accounting firms and other service providers. Additional information on ISDA is available at http://www.isda.org.

The Asia Securities Industry and Financial Markets Association (ASIFMA)

ASIFMA is an independent, regional trade association comprising a diverse range of over 100 leading financial institutions from both the buy and sell side, including banks, asset managers, professional services firms and market infrastructure service providers. Through the Global Financial Markets Association (GFMA) alliance with Securities Industry and Financial Markets Association (SIFMA) in the US and Association for Financial Markets in Europe (AFME), ASIFMA also provides insights on global best practices and standards to benefit the region. Additional information of ASIFMA is available at https://www.asifma.org.