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HANDS-ON CHINA REPORT
January 8, 2010

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China's Securities Regulator Confirms Approval of Stock Index Futures, Margin Trading

The China Securities Regulatory Commission has given approval in principle for the launch of stock index futures, margin trading and short selling according to media reports. Chinese market authorities have largely completed the necessary preparatory work and are weighing the appropriate timing and entry point for the launch of these initiatives. Shares of major Chinese securities firms have benefited in recent trading from speculation of an imminent launch of margin trading, which would boost trading fees. Foreign institutions may also be allowed to trade index futures using a portion of their Qualified Foreign Institutional Investor (QFII) Quota.

Following the recent establishment of ChiNext, the introduction of margin trading and the launch of CSI 300 futures are now widely seen as the next logical steps in the development of China's financial markets. These initiatives will provide tools for institutional investors to hedge risks, and should reduce market volatility in the long-term. Preparations for the launch of stock index futures are expected to take three months.

Although the State Council issued regulations formally sanctioning trade in financial futures and options in 2007, the introduction of derivatives in China has proceeded slowly – with authorities mindful of the potential impact of speculation and the legacy of scandals surrounding early derivatives trading experiments in the 1990s. The China Financial Futures Exchange (CFFE) began simulation trading of stock index futures shortly after its establishment in 2006 with the participation of futures brokerages, securities firms, fund management companies, commercial banks and insurers' asset management units.

In June 2007, the CFFE approved the first index futures contract tied to the Shanghai-Shenzhen 300 Index, setting rules to prevent excessive volatility, such as a trading halt if the price of a contract moves more than 6% from the previous day's close and remains at that level for more than five minutes. Additionally, stock-index futures may not rise or fall by more than 10% in one day, from the previous session's close.

Figure 1: Cost of an index futures contract (index, RMB/contract)



Source: Bloomberg, J.P. Morgan estimates

To deter speculation, draft rules provide a cost barrier to retail participation – each point of the CSI 300 Index is valued at RMB300, with a minimum 10% margin requirement. Thus at the 3500 level, investors would need to spend RMB105,000 to buy a single futures contract (see Figure 1).

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