

Market Regulation on Abnormal Trading & Violation

Surveillance Department
July 2020

Building a Diversified, Open and World-class Derivatives Exchange



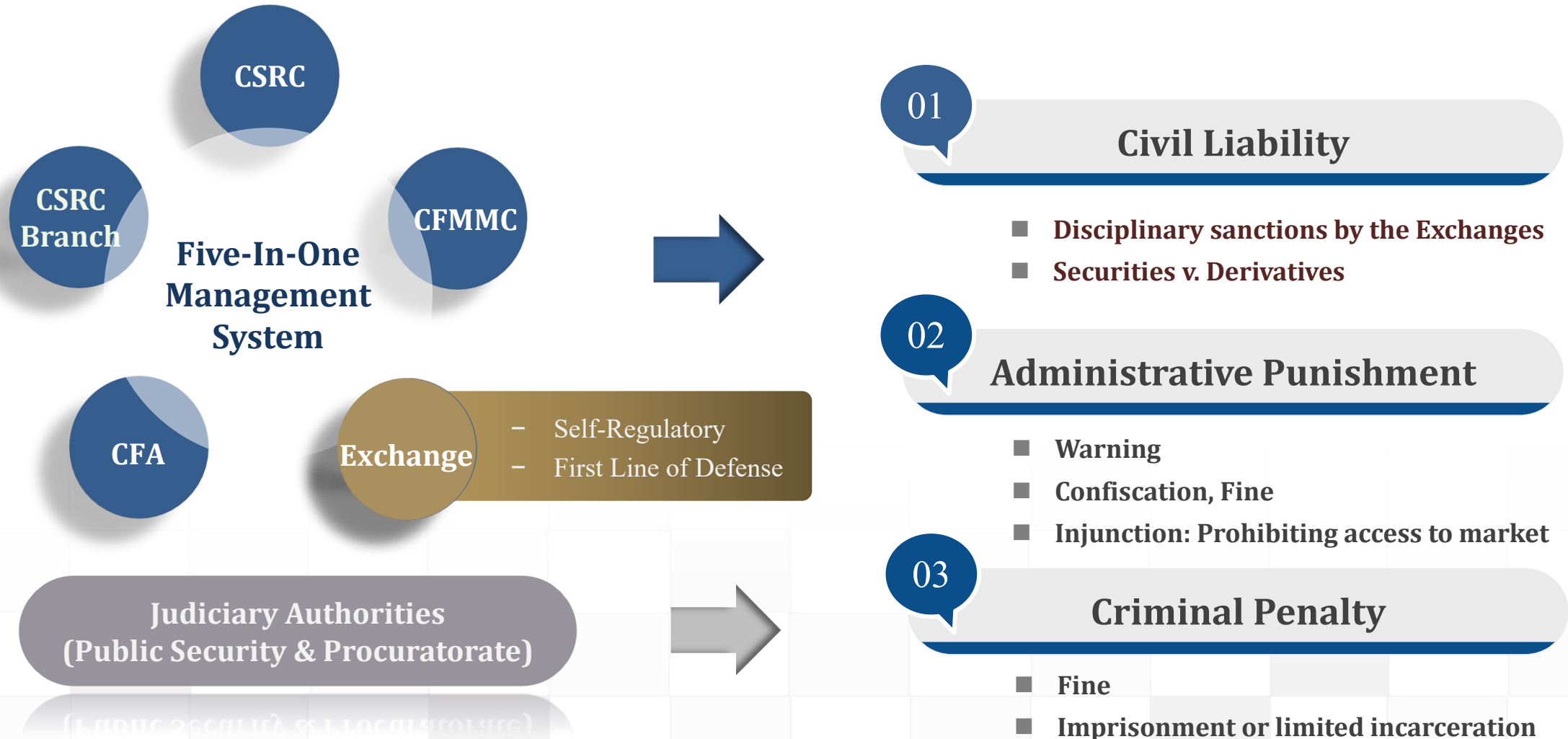
Agenda

1. CHN Regulatory Model & DCE Market Regulation Department Overview
2. Non-Judgmental Management to Abnormal Trading
3. Regulation on Rule Violation: Types of Misconducts and Featured Cases
4. Q & A

PART
01

CHN Regulatory Model & DCE Market Regulation Department Overview

Mission & Vision : To Promote the Openness, Fairness, Impartiality and Integrity of Futures Market



■ Rule Construction

- The legislative process of Futures Law has been officially initiated.
- Judicial and administrative interpretations concerning the manipulation, insider trading & trading by using undisclosed information (Rat Trading) , were circulated last year.
- DCE, SHFE and CZCE are planning to make material modifications to our respective Measures against Rule Violations

■ RegTech Construction

- The RegTech 3.0 Working Rules
- Terminal Information Extraction System: Penetration Supervision; Overseas Clients?
- Futures Company Integrated Information Supervision System
- Trading Practice Integrated Analytical System

■ Focus on First Line Defense

- Attach greater importance to the regulatory function of Exchanges: higher efficiency lower cost
- Modification to Measures for the Administration of Futures Exchange-Expanding the Exchange's mandate

■ Focus on Members & Intermediaries

- Modification to Measures for the Administration of Futures Exchange: member's duty & responsibility to supervise clients' trading practices

Risk Assessment & Management

- Premasures: Margins, Price limit, Position limit, Trading limit
- Real-time Measures: Large position report, Risk warning
- Post Measures: Forced liquidation, Forced reduction

40 staff with diverse skill sets and backgrounds

Surveillance Department

Handling to Rule Violations

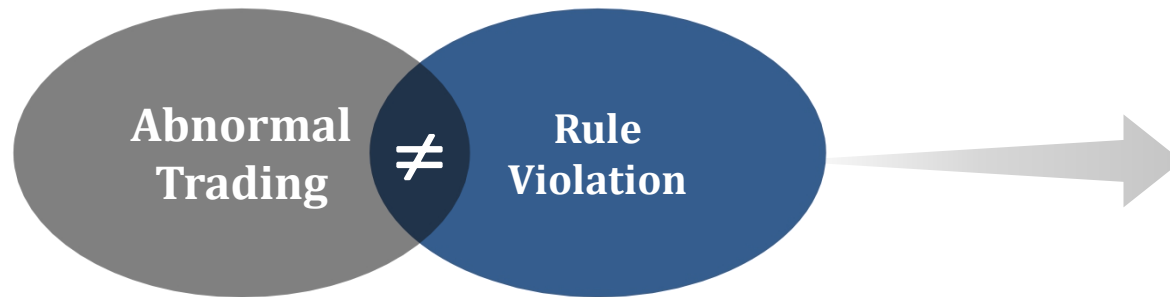
- Investigation & Prosecution
- Complaint review
- Member inspection
- De-facto control relationship management
- Compliance training & Education



▪ Market Monitoring: Alerts ▪ **Management to Abnormal Trading** ▪ Program Trading Filing

PART
02

Non-Judgmental Management to Abnormal Trading



Non-Judgmental Management

- Rule out actor's intention or motion
- Rule out impact or consequence of conducts
- Not generally encouraged by the Exchange
- Automatic detection and judgment by setting up relevant parameters

Dig into more?

- Measures for Administration of Abnormal Trading of DCE (For Trial Implementation)
- Regulatory Standards and Handling Procedures for the Measures for Administration of Abnormal Trading of DCE (For Trial Implementation)

■ Self-Trade

- Multiple trades between one's own accounts by acting as its own counterparty
- Multiple trades within a group of accounts with actual control relationship as identified by the Exchange
- Wash Trade?

■ Frequent Cancellation of Orders

- Not for the purpose of conducting transactions?
- Spoofing?

■ Cancellation of Large-amount Orders

■ Exceeding Position Limits within De-facto Control Accounts

- Not occurred since 2019.
- Exceeding position limits withing de-facto control accounts that has not been reported and filed to the Exchange?

■ Program Trading Affecting Normal Trading Order

- Registered at DCE in advance.
- Certain actions would be taken against anyone that places trading orders via program trading in a manner that may adversely affect system security or the normal trading order.

Regulatory Standards

■ Self-Trade

- Five (5) or more Self-trades in the same contract on a single day

■ Frequent Submission and Cancellation of Orders

- Five hundred (500) or more times of order cancellations in the same contract on a single day

■ Cancellation of Large-amount Orders

- Four hundred (400) or more times of order cancellations in the same contract on a single day
- with the lots of a single cancelled order exceeding eighty percent (80%) of the largest order placed under this contract

Calculation Principles

■ Happen in the Same Contract on a Single Day

■ On a Consolidated Basis as to De-facto Control Accounts

■ Be Calculated Separately for Futures Contracts and Option Contracts

■ Reset Every Three times & Every Fiscal Year

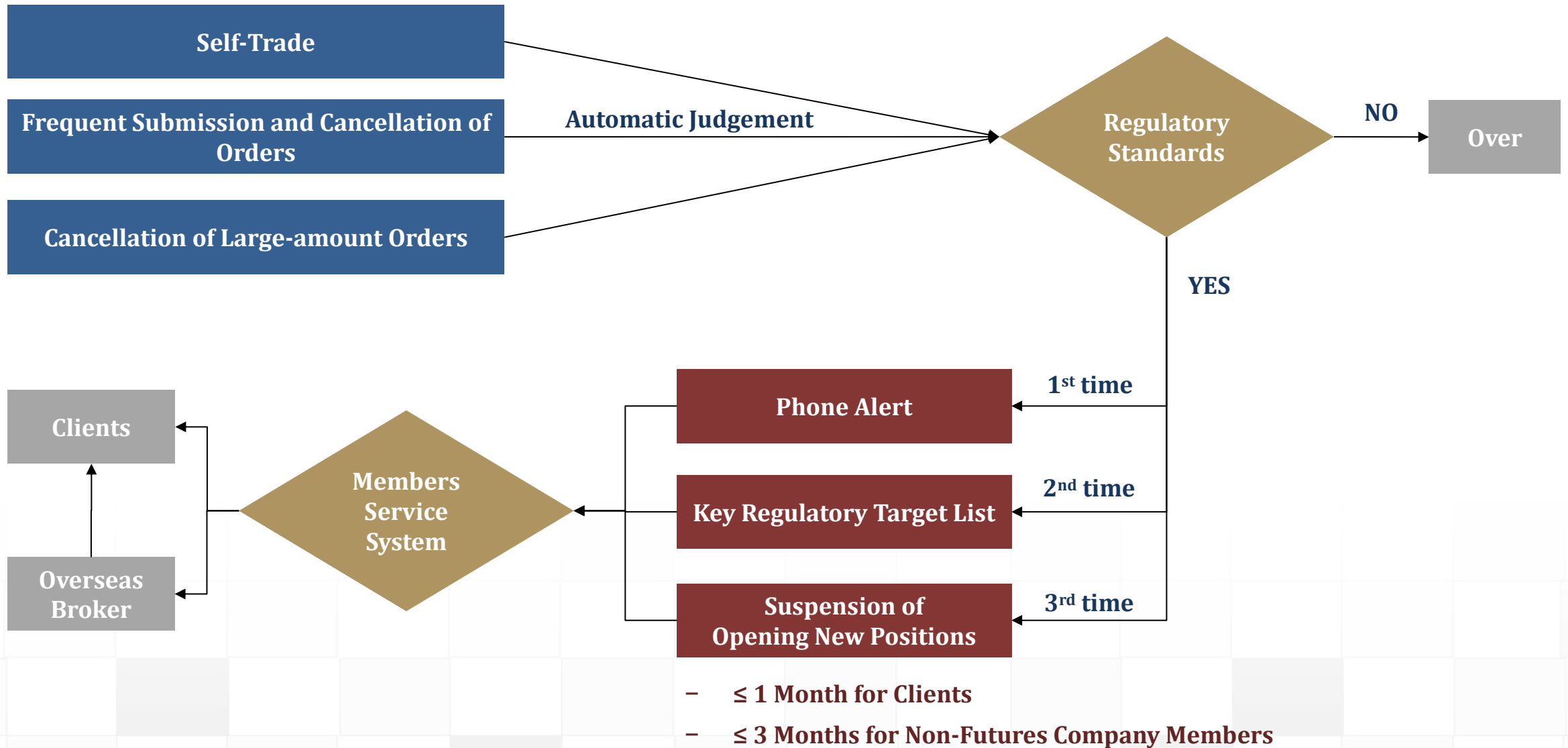
3ST(a2005)+2ST(a2009)	×	
3ST(a2005)(Aug.1st)+2ST(a2005)(Aug.2nd)	×	
5ST(a2005)+5ST(b2009)	ST-Futures-once	
5ST(a2005)(Aug.1st)+5ST(a2009)(Aug.2nd)	ST-Futures-twice	
5ST(a2005)+5ST(a2005-c-4000)	ST-Futures-once	ST-Options-once

Exemption Conditions



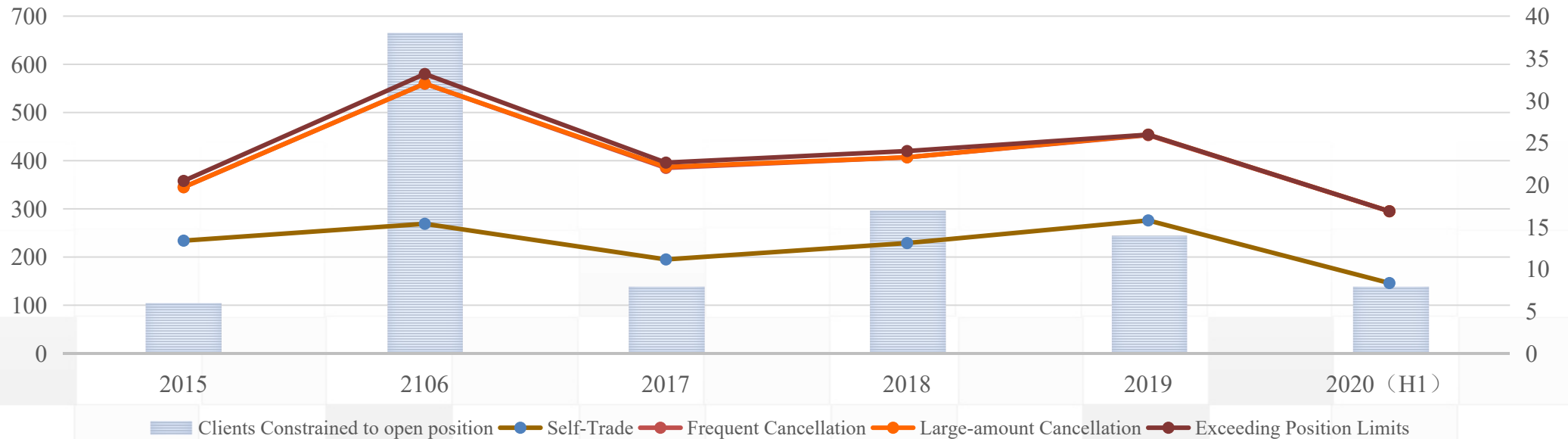
Types	Self trade	Frequent Cancellation	Large-amount Cancellation	Since When	Note
Arbitrage Trading	×	×	×	2010	Cancelled in 2016
Hedge Trading	○	○	○	2010	
Specific Orders: market order, Stop-loss(profit) order、spread orders、FOK、 FAK	○	○	○	2010	
Market-making orders in options Trading	×	○	×	2017	
Market-making orders in Futures Trading	×	○	×	2018	

Handling Procedure



Supervision Stats Since 2015

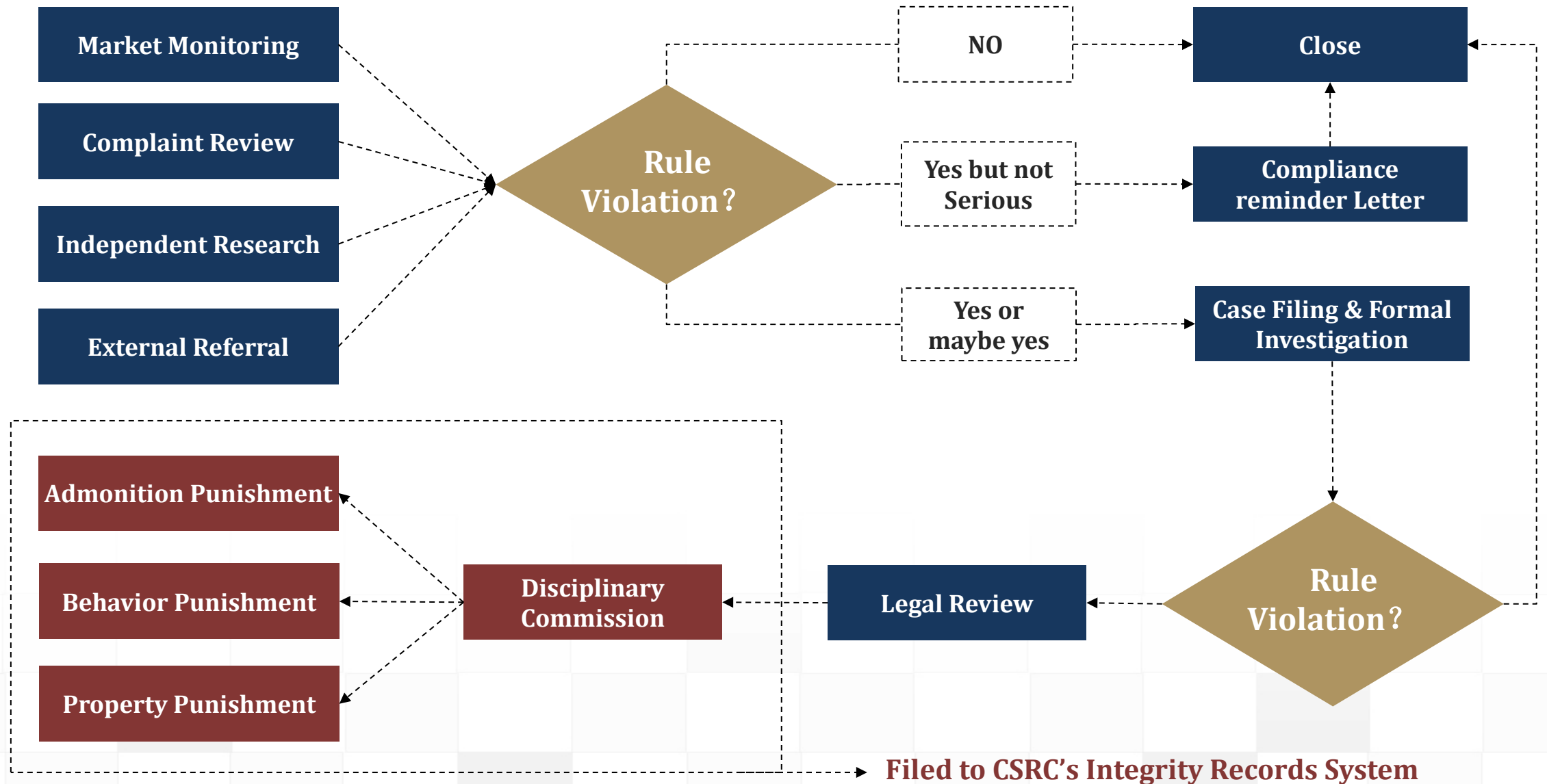
Year	Self-Trade	Frequent Cancellation	Large-amount Cancellation	Exceeding Position Limits	Clients Constrained to open position
2015	234	111	0	13	6
2106	269	291	0	20	38
2017	195	190	2	9	8
2018	229	178	0	13	17
2019	276	177	1	0	14
2020(H1)	146	149	0	0	8
Total	1349	1096	3	55	91



PART
03

**Regulation on Rule Violation: Types of
Misconducts and Featured Cases**

Dealing Process of Rule Violations



■ DCE's Limited Powers and Avenues to Obtain Information and Evidence

- Document-based Investigation, Onsite Examination, Regulatory Talk (Formal interview)
- Kinds of Evidence: Statement by Customers or Members; Testimony; Market Data; Bank statements; Annual Report
- Generally, DCE Requests information from Clients via Futures Company Members
- An information request Does NOT necessarily mean a market participant has committed a violation

■ Cooperate With the Exchange on Filed Investigation

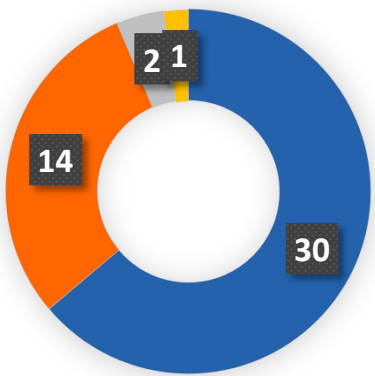
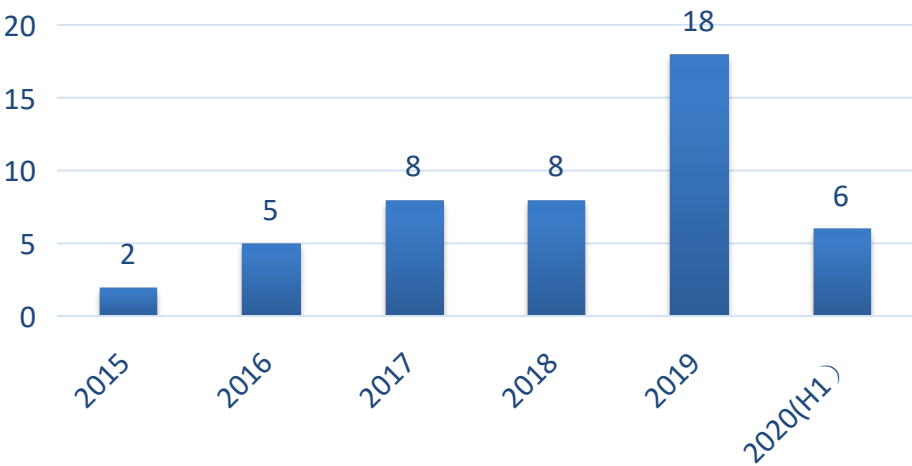
- Provide thorough, precise and timely feedback to the information request from DCE
- Cooperate or not is a key element in determining the category and severity of sanction
- Refusal to provide statements, explanations may be deemed as waiving the rights to defense
- Refusal to cooperate with the Exchange itself can also be treated as a rule violation

■ Emergency Actions & Interim Measures

- Restricting the withdrawal of funds; suspending the opening positions for trading; implementing forced liquidation

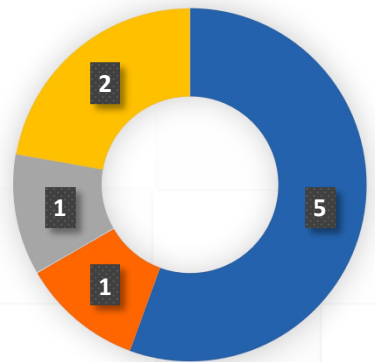
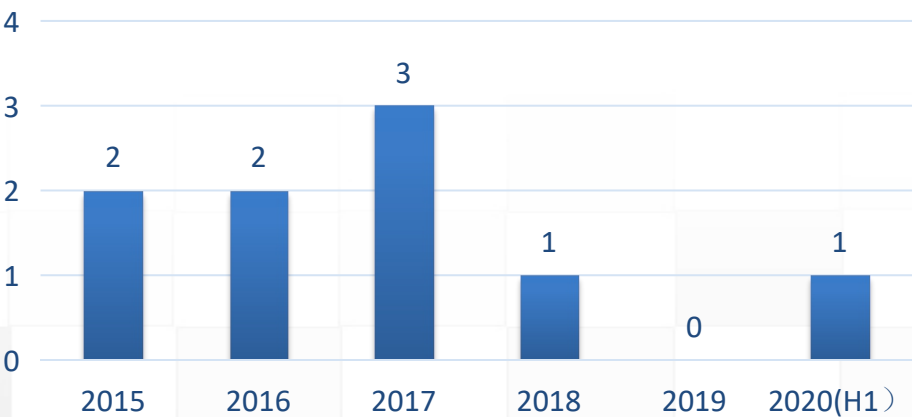
Enforcement Outcomes

Disciplinary Sanctions by DCE



- Illegal Money Passing
- Price Disruptive
- Lending Trading Account
- Not Cooperating in Investigation

Leads & Clues Referred to CSRC



- Manipulation
- Illegal Money Passing
- Insider Trading
- Fabricating or Disseminating False Information

Traditional Manipulative Actions

■ Manipulation by Using Advantage in Positions, Funds & Info.

- Push up or drive down the market price by placing orders prevailing to the best bid/offer price

■ Manipulation by Wash Trade

- Self-trade
- Pre-arrangement Trade

■ Manipulation by Hoarding Underlying Assets

- Jiang Wei, MA1501, CZCE

New Manipulating Modus Operandis

■ Scalping (Black Mouth)

- Public evaluation, forecast or investment advice
- Conduct transaction on the contrary

■ Manipulation by Deception

- Fabricate or disseminate false or misleading information
- Conduct relevant transaction

■ Manipulation by False Orders (Spoofing)

- Frequent or large-amount cancellation: abnormal trading
- Typically conduct transaction on the contrary

■ Squeeze & Corner

- Exceed position limit
- In the approaching delivery month or delivery month

- CSRC: Regulation on the Administration of Futures Trading-Article 70 & its administrative explanation
- Judiciaries: SPC & SPP's Interpretation on concerning regarding the Manipulation of Securities or Futures Market in Criminal Cases
- DCE: Measures against Rule Violations-Article 34

Manipulating the Price of bb1502 - Tao Yang & Fu Xiangnan

Case Summary

By means of pre-arranged trade & self trade, Tao & Fu caused the illusion of an active contract to induce the attendance of other investors. Then they drove up the contract price through continuous bids, pre-arranged trade and self trade, and took the profits by closing their own positions:

- Controlled and used 14 accounts to avoid detection
- Caused the illusion of an active contract:
- Drove up the contract price by continuous bids, pre-arranged trade & self trade
 - Trading volume on the buyer side: 75%
 - Long Positions: 88%
 - Pre-arranged trade & Self-trade: 44%
- Adverse Impact on the Price
 - settlement price of bb1502: 13.35%
 - deviation from the spot price

Action Taken

- Prohibition order of **5-year & 3-year**
- Confiscation of illegal proceeds **1.14million**
- A fine of **2 times** the illegal proceeds

Compliance Tips

- The percentages concerning trading volume and position listed here are only for reference
- Whether or not the offender has made a profit, is not a critical element or a precondition to determine a manipulation action. (Case Liu Zengcheng in manipulating v1501)

Major Concerns in Investigating, Determining and Punishing Such Misconducts

■ Information ----- meet the following Descriptions

- Relevant to the futures market and be price sensitive
- Considered important by a reasonable person in deciding whether to trade on a particular contract and the trading strategy
- False or misleading

■ Fabrication or disseminating

- “and” vs. “Or”: Place more weight on fabricating
- CTR, likes or thumb-ups, reposts -----the Norm set up in the Defamation judicial interpretation may be applied by analogy

■ Adverse Impact of the Conduct

- Affected the futures trading price or futures trading volume
- Disturbed the futures trading market

■ The Trading Practices in the Future market?

- The essential difference between information fabricating and manipulation by deception

Fabricating and Disseminating False Information Re jd1609 - Zeng Gaixiong

Case Summary

- Zeng and his suspicious associated accounts build certain short positions on jd1609
- Zeng made up an open letter in the name of China Egg Circulation Association, which is not a real organization and in the letter, China Egg Circulation Association claimed that the price of jd1609 has been illegally manipulated so that the price had been deviated from the spot price and the price of jd1606. China Egg Circulation Association also appealed to DCE to make a formal investigation.
- The letter was forwarded by several financial media and many market participators were misled to close their long positions
- The price of jd1609 went down by 4.1% after the issuance of the open letter and the daily settlement price went down by 3.87%.

Action Taken

- Warning
- Confiscation of illegal proceeds **1,223.82 RMB**
- A fine of **400,000 RMB**

Compliance Tips

- Both CSRC & the Exchanges have set up several complaint channels for investors and the complaint shall be submitted in a regular way.
- The Amount of fine is not determined by the illegal proceeds only. The impact of the misconduct is also an important element.

Always happened on the inactive contracts with very small daily trading volumes

Money Stolen

Case Summary

An individual client surnamed Huang entrusted Dong Ling through a third-party agent to trade in the futures market using Huang's own account. Dong Ling transferred CNY 220,587.5 from Huang's account to Dong Ling's own account by means of 14 pre-arranged trading in 6 inactive contracts, resulting in a max price volatility of 2.87%.

Action Taken

Dong Ling: Reprimand with a suspension of position opening for 3 months

Huang: Warning

Money Transferred

Case Summary

Two individual clients surnamed Niu and Wang had business contact and used to traded together. Niu had owed Wang CNY 12,000 in their business dealings and they decided to settle the debt by means of futures trading. They did a prearranged trade on an inactive contract with an amount of CNY12,000 transferred, resulting in a price volatility of 3.23%.

Action Taken

Warning with a suspension of position opening for 10 trading days

Compliance Tips for Investors

- The contract price is the core product of the Exchange, including the price of inactive contract, which shall be determined by public & fair trading for bona fide.
- The kind and severity of disciplinary sanctions to such cases are determined by the amount of money transferred , the price disturbance range and the degree of cooperation to the investigation from the offenders .
- Clients whose money is transferred by others may also be given certain sanctions for inappropriate management of trading account.

Induced Others by Self-trade – by Institutional Client Corporation A

Case Summary

In order to close its own short positions, Corporation A did a self-trade at a lower price on the last trading day of i2005, which misled other investors to place orders with approximate price:

- Gradually built 11 lots of short positions on i2005 beforehand
- Did a self-trade at the price of 700 which was lower than the previous execution price by 6.91%
- It was the last trading day of i2005 and the daily trading volume was small. Usually, clients who did not plan to do physical delivery or held positions less than the delivery unit (100 lots) had to close their position before the delist of the contract.
- The self trade misled other investors to think that 700 is the prevailing price then and placed orders with a approximate price.
- Corporation A closed his own position at a price of 707.5 and made a profit of CNY 65,764.18

Action taken

- Reprimand
- Suspension of position opening for 6 months
- Confiscation of illegal proceed CNY 65764.18

Tips

- The motion or intention is critical to determine a price disruptive conduct. Basically, the investigators will identify the motion or intention from the offender's behavior model as well as the market conditions

Thank You !



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