



Press Release

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FSC ROADMAP FOR FURTHER DEVELOPMENT OF KOREA'S DERIVATIVES MARKET

OVERVIEW

The FSC announced its roadmap for further development of Korea's derivatives market. The plan has set a clear goal and regulatory principle tailored to each type of derivatives market as follows:

- **Exchange-traded derivatives market** will be developed into a risk-managed market with focus on professional investors through greater autonomy in the market and creation of new markets.
- **Over-the-counter derivatives market** will be grown into a more transparent market with lower trading risk by phasing in central counterparty(CCP) and introducing trade repository (TR) systems.
- **Derivatives-linked securities market** will be fostered into a sound investment market for retail investors by providing more diversified products and making it easier for investors compare and choose products.



EXCHANGE-TRADED DERIVATIVES MARKETS

[MARKET AUTONOMY]

1. Greater autonomy in market operation

Markets will be granted greater autonomy under the condition that it would not undermine stable operation of the markets and investor protection. Details related with market operation such as quotation price units or exercise price of options will be deliberated and decided by a derivatives market committee within the KRX.¹

Currently, the items of underlying assets for individual equity futures and options are specified by the Derivatives Market Business Regulation of the KRX. The Regulation will be revised to allow automatic listings of equities that meet certain requirements as underlying assets.

2. Introduction of new derivatives markets

The exchange-traded derivatives market has been strictly limited with only 15 products listed on the KRX, while 1,303 products traded on CME in the U.S., 274 on Eurex in Germany and 100 in Japan.

Reflecting the trading volume of spot transactions, the FSC will actively introduce new derivatives markets in high demand such as V-KOSPI 200 futures, sector index futures and night time trading of US dollar futures, which will provide professional investors with an instrument of risk hedging.

Time	Products to be introduced
By end-2014	V-KOSPI200 futures, sector index futures, USD night time futures
One to two years later	20-year Treasury bond futures
To be reviewed for introduction	Short-term interest rate futures(e.g. KORIBOR), currency exchange futures(e.g. Yuan), commodities (e.g. oil)

[IMPROVEMENTS FOR MARKET PARTICIPANTS]

1. Introduction of qualified retail investors

In order to prevent retail investors from making reckless investments and incurring huge losses in derivatives markets, the FSC plans to allow only “qualified” retail investors to newly enter derivatives markets by establishing two stages of entry barriers.

¹ Matters listed in Article 393 and 412 of the Financial Investment Business and Capital Markets Act (FSCMA) – types and items of exchange-traded derivatives, settlement months, margin deposits, methods of settlements, and etc – will still require an approval by the FSC.

- **(1st stage)** Retail investors who have completed prior education program and mock trading; and deposit at least KRW 30 million as initial margin will be allowed to trade simply-structured futures such as KOSPI200 futures or individual stock futures.
- **(2nd stage)** Retail investors with more than one-year trading experience allowed under the 1st stage and KRW 50 million of minimum margin will be allowed to trade complicatedly structured-futures and options such as V-KOSPI200 futures.

< “Qualified Retail Investor” Scheme (draft)>

		1 st stage	2 nd stage
Qualifications	Prior knowledge & investment experience	1) prior education (30 hours) 2) mock trading (50 hours or more)	More than one-year experience of futures trading allowed under 1 st stage
	Risk-taking ability	KRW 30 million of minimum margin	KRW 50 million of minimum margin
Products allowed to invest		Simply structured futures	Futures & options with complex structures

2. Expanded participation of professional investors

Currently, only securities companies are allowed to directly trade exchange-traded derivatives.² It restricts further transactions of treasury bond and currency derivatives, which account for only small portion of securities firms’ portfolio.

The FSC plans to allow banks to directly trade treasury bond and currency derivatives on the KRX, given that banks have expertise in transaction of treasury bonds and currencies and sufficient experience of trading in OTC derivatives markets. The direct trading of banks will be limited to USD futures and 20-year treasury bond futures newly introduced; and gradually expanded to other products depending on market situations within the next five years.

The measure is expected to provide institutional investors and commodity traders with effective tools for hedging currency- or interest rate-related risks and contribute to a balanced growth of derivatives markets, currently skewed toward equity derivatives.

[ENHANCED STABILITY IN TRANSACTION]

1. Settlement stability

In response to growing risks of default and huge losses with an increase in algorithm trading, the FSC plans to give the KRX greater authority to monitor and supervise default risks of security firms. The FSC is also considering revising the so-called default “waterfall,” the procedure of using default fund to repay counterparties to match global standards.

² Europe, the U.S. and Japan allowed banks and commodity traders directly trade derivatives on exchanges depending on their expertise on underlying assets – for example, Treasury & currency derivatives for banks; and gold or oil futures for commodity traders.

Under the current FSCMA Act, the pool of default fund is injected prior to the KRX's own capital to cover a defaulting member's losses in case of default. The FSC is looking to revise the default procedure in accordance with international standards³ so that the capital of the clearing house will be used prior to the pool of default fund to absorb the losses. Details will be set out by the end of 2014.

2. Transaction stability⁴

The FSC plans to introduce price banding limits on futures and options trading to mitigate excessive price fluctuations. The KRX will be granted authority to take remedies for huge losses incurred by erroneous orders.

3. Monitoring on high-frequency trading

The KEZ will strengthen relevant regulations and tighten monitoring on high-frequency trading in order to prevent market abuse and unfair trading.

OVER-THE-COUNTER(OTC) DERIVATIVES MARKET

The central counterparty(CCP) for OTC derivatives was introduced in 2013, following the agreement of the G20 in the Pittsburgh summit in 2009. Starting from June 30 this year, qualified won-denominated interest rate swaps(IRS) transactions will be required to be cleared through the CCP. The scope of derivatives contracts subject to the CCP clearings will be gradually expanded from IRS to NDF to CDS and other derivatives.

Trade Repository(TR) system will be introduced to improve transparency of OTC derivatives trade in accordance to the G20 after considering domestic conditions and international standards.

DERIVATIVES-LINKED SECURITIES(DLS) MARKET

The current law allows issuance of a variety of structured securities. Rypes of products actually being traded in the market, however, are limited to equity-linked securities(ELS), derivatives-linked securities(DLS) and equity linked warrant(ELW). To such backdrop, exchange-traded note(ETN) will be introduced to be listed and traded on the KRX. Issuance structure of ELS will be diversified. Public disclosure and sales method of ELS and DLS will be improved to make it easier for investors to compare and choose products. Issuance terms of ELW will be standardized.

³ Principles for Financial Market Infrastructure (PFMI, April 2012) by IOSCO-CPSS

⁴ Please refer to the press release 'Plan to Improve Security of Derivatives Transactions' (January 17, 2014) for further details.

IMPLEMENTATION SCHEDULE

	Tasks	Measures to be taken (schedule)
Exchange-traded Derivatives Market	Grant greater autonomy in market operation	Revise KRX regulations (2 nd half of 2014)
	Automatic listing & de-listing of individual stock futures and options	Revise KRX regulations (2 nd half of 2014)
	Create new derivatives markets	Revise KRX regulations (2 nd half of 2014)
	Introduce qualified individual investor system	Revise KRX and Korea Financial Investment Association regulations (2 nd half of 2014)
	Permit expanded participation of professional investors	Grant approval to KRX derivatives investment participants
	Strengthen payment security	Revise Financial Investment Services and Capital Markets Act(FSCMA)
	Introduce price banding limits	Revise KRX regulations (2 nd quarter of 2014)
OTC Derivatives Market	Expand the scope of derivatives contract to be cleared through the CCP	Revise Enforcement Decree of the FSCMA and KRX regulations
	Introduce TR	Launch consultations with relevant institutions and research (within 2014)
DLS Market	Introduce ETN	Revise KRX regulations (3 rd quarter of 2014)
	Enable ELS product comparison	Consult with the industry and establish necessary system (2 nd half of 2014)
	Standardize ELW issuance terms	Revise KRX regulations (3 rd quarter of 2014)

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