Financial Services Commission

Press Release

May 30, 2023

AUTHORITIES PLAN TO OVERHAUL RULES ON CFD TRADES WHILE RESTRICTING NEW TRANSACTIONS FOR 3 MONTHS

The Financial Services Commission held a meeting with the Financial Supervisory Service, the Korea Exchange and the Korea Financial Investment Association on May 26 and held discussions to finalize a set of measures intended to strengthen regulations on trading of contracts for difference (CFDs). The measures include (a) enhancing transparency in the provision of information on the actual type of CFD investors and investment balances by item, (b) closing loopholes to prevent regulatory arbitrage by including the amount of CFDs provided in the securities firms' maximum credit extension limit, (c) requiring individual investors applying for the qualified professional investor status to go through an in-person (including video call) verification process, and (d) establishing a new investment requirement for over-the-counter (OTC) derivatives transactions such as trading of CFDs.

Enhancing transparency in provision of relevant investment information

To help investors make more rational decisions about their CFD investments, authorities will improve the system to ensure the provision of more appropriate investment information. Even though those making investments in CFDs are mostly individual retail investors (making up about 96.5 percent), currently, when securities firms submit stock transaction orders following retail investors' CFD trading, the investor type is currently marked as "institutional investor" when orders are submitted by a domestic securities firm or as "foreign investor" when orders are submitted by a foreign securities firm. This has created the problem of misrepresenting the flow of investment funds into particular investment items by institutional and foreign investors. In order to prevent this sort of misunderstanding by market participants, for stock transactions resulting from CFD trading, actual investor type (e.g., individual investor) will be recorded. In addition, as in the case of credit loans, the total and item-by-item CFD balances will be disclosed for reference purposes, which will allow market participants to check the inflow of leveraged investment funds.

Closing loopholes to prevent regulatory arbitrage

As in the case with the regulation on credit loans, CFDs will be included in the maximum credit extension limit of securities firms to have them manage the entire limit within each company's equity capital level. In addition, a set of best practice guidelines on handling CFDs will be prepared, including standards for brokering and covering CFDs, to restrict dealings of CFDs on low-liquidity items. So far, CFDs have been categorized as OTC derivatives products and excluded from the securities firms' credit extension limit or from being subject to comply with the industry's best practice guidelines for risk management. Authorities find that this has led to excessive expansion of unsound sales practices and pushed up volatility in stock prices as CFDs were used in investments of low-liquidity items, which ultimately created damages not only to investors but also to the soundness of securities firms. Moreover, authorities plan to submit a revision bill of the Financial Investment Services and Capital Markets Act (FSCMA) to the National Assembly in the third quarter of this year to enable authorities to require CFD sellers to report on balances and restrict them from taking part in a paid-in capital increase, since their interest relationship in substance is similar to that of short sellers.

Strengthening identity verification for qualified professional investors & establishing new requirement for OTC derivatives transactions

The process of granting the qualified professional investor status to individual investors will be strengthened and a set of new requirements will be established for OTC derivatives transactions such as CFDs. In addition, securities firms will be required to check whether qualified professional investors are maintaining their qualifications once every two years and any act of solicitation (through incentives) by a securities firm to encourage individual investors to apply for the qualified professional investor status will be prohibited.

Also, while keeping the current requirements on qualified professional investors intact, a separate requirement will be set up to verify their qualifications to trade OTC derivatives products such as CFDs through an in-person verification process (including video call). In other words, even for a qualified professional investor, if he or she does not have sufficient investment experience[1] with high-risk investment products (stocks, derivatives and highly complex derivative-linked securities), investing in OTC derivatives products such as CFDs will be restricted. The purpose of having qualified professional investors is to promote various types of investment activities, for instance, to supply venture capital, along with investments in OTC derivatives such as CFDs. In this regard, by introducing a new requirement (minimum investment amount) for trading in OTC derivatives products which will be equivalent to the one currently in place for making investment in private equity funds, authorities plan to strictly review the qualification and experience of investors to ensure that they are capable of handling high-risk investments such as OTC derivatives products without significantly undermining the base of venture capital supply.

Until these measures are actually put into enforcement, financial authorities plan to recommend that new CFD transactions by qualified professional investors be put on hold for the next three months. Starting with the securities firms that have finished setting up a required system and an internal control framework, new transactions of CFDs will be resumed.

At the beginning of today's meeting, FSC Vice Chairman Kim So-young delivered opening remarks and said that due to the unfair transactions that took place recently in the capital market, public trust has been eroded and investor confidence has also been shrinking. Vice Chairman Kim stressed that the government and the relevant institutions feel highly responsible for this and plan to quickly and thoroughly carry out reforms to address the problems that have been pointed out. Since a drop in

[1] Having average end-month investment account balance of at least KRW300 million for at least one year within the past five years.

investor confidence can be the biggest threat to the financial investment industry itself, Vice Chairman Kim said that the industry should be well aware of this and play a leading role in actively taking up the regulatory improvement measures and promoting sound investment practices.

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