

MEASURES FOR IMPROVEMENT OF DERIVATIVES MARKETS

The FSC announced a set of measures to make South Korea's derivatives markets more advanced and sounder as this year marks the 20th anniversary of the establishment of derivatives markets in 1996.

Key Points

✓ **EXCHANGE-TRADED DERIVATIVES MARKET**

To boost derivatives trading and enhance diversity of derivatives in the market, improvements will be made on both supply and demand sides.

- **Supply side:** *simplification of listing procedures, diversification of derivatives, adjustment of trading units for KOSPI200 futures and options*
- **Demand side:** *flexible requirements for investors, introduction of the 'omnibus account' for foreign investors*

✓ **OVER-THE-COUNTER(OTC) DERIVATIVES MARKET**

Risk management system will be established with the introduction of global regulatory standards such as margin requirements for non-centrally cleared derivatives and electronic trading platforms.

✓ **DERIVATIVE-LINKED SECURITIES MARKET**

The FSC will strengthen risk management and investor protection, while pursuing more diversification of products to meet various investment needs.

- For **ELS & DLS markets**, stress tests will be conducted on regular basis to strengthen risk management of securities firms. To enhance transparency in fund management, assets of ELS issuance and management will be separately managed.
- Investor protection will be strengthened in ELS & DLS markets with the introduction of tougher "Know-your-Product Rule" and a "cooling-off period" for investors.
- Development and listings of more derivatives-linked products will be promoted as alternatives to ELS products.

Detailed Measures

1. EXCHANGE-TRADED DERIVATIVES MARKET

Supply Side

(1) Simplification of listing procedures

Listings of derivatives linked to new underlying assets, which currently requires the FSC's approval, will be streamlined. Relevant rules will be revised to allow the KRX to decide on the listings of new derivative products, while the FSC will only approve the scope of the underlying assets.

(2) Diversification of derivative products

Exchange-traded market, currently weighted towards stock index-linked products, will be diversified with listings of new derivatives such as ETF-linked derivatives, super long-term government bond futures and dollar mini futures.

(3) Adjustment of trading units for KOSPI futures & options

Trading units for KOSPI futures and options, which is much bigger than those in overseas derivatives markets, will be reduced¹ to provide investors with smaller hedging tools.

Demand Side

(1) Improvement of requirements for investors

Requirements for retail investors will be made more flexible and tailored in accordance with their risk profiles and investment products. A 'hedge-only' account will be introduced to allow investors to trade derivatives in the purpose of hedging without placing minimum deposit. The education requirement for investors, currently requiring 30 hours, will be split into a 20 hour requirement for the first stage trading and an extra 10 hour requirement for the second stage trading.

(2) Introduction of 'omnibus account' for foreigners

The omnibus account² will be introduced for trading for exchange-traded derivatives, which would enable an overseas securities firm to open a single account with a domestic securities firm to process trading orders from multiple overseas investors.

※ *The omnibus account for stock trading is under a test operation since May 2016, to be officially introduced in 2017.*

¹ e.g. Trading units will be reduced to KRW 250,000 from the current KRW 500,000 for KOSPI 200 futures & options, and to KRW 50,000 from the current KRW 100,000 for mini KOSPI200 futures & options.

² For further details about 'omnibus account', please read the FSC press releases dated February 1 and May 20, 2016, available on the FSC English website.

2. OVER-THE-COUNTER(OTC) DERIVATIVES MARKET

(1) More products to be cleared through a CCP

Currently, KRW-denominated interest rate swaps(IRS) are cleared through the KRX. The KRX will widen the types of OTC derivatives to be centrally cleared to USD-denominated IRS, NDF and other foreign currency-denominated IRS, CRS, CDS.

(2) Trade Repository(TR) System

For a comprehensive reporting of OTC derivatives trading, a trading repository (TR) system will be established. The KRX was designated as a TR in August 2015. The FSC will continue to work with the KRX to have relevant rules and institutions in place.

(3) Establishment of Guidelines on margin requirements

Guidelines on margin requirements for non-centrally cleared OTC derivatives will be established taking global standards into account.

(4) Introduction of electronic trading platforms

The FSC will consider the introduction of electronic trading platforms and conduct a study on its feasibility in line with global trends, in which the introduction of such platforms are in process or under discussion in advanced countries.

3. DERIVATIVE-LINKED SECURITIES MARKET

(1) Risk management on ELS & DLS

The surge in issuance of ELS & DLS with growing investment demand amid low interest rates could threaten financial soundness of securities firms and spill over into a systemic risk. Against such risks, stress test will be conducted on a regular basis with a close monitoring on liquidity and financial health of securities firms. Securities firms will be required to separate ELS-related assets from their own assets for transparency. Clear standards and electronic system will be established to separate and manage ELS-related assets in a transparent manner.

(2) Protection for investors of ELS & DLS

To protect investors, particularly risk-averse or elderly investors, from mis-selling of high risk products, sales persons will be subject to tighter rules such as “Know-your-product Rule”, which requires sales persons well informed of product risks, and “cooling-off period,” in which investors can withdraw within a couple of days after they sign a contract.

(3) Promotion of alternative products

Alternative derivative products such as exchange-traded notes(ETNs) will be promoted to provide investors a wider range of investment products.

Schedule

Tasks	Measures to be taken	Schedule
1. Exchange-traded Derivatives Market		
Supply side improvements	KRX regulation and system to be revised, new products to be developed	Q4, 2016~
Demand side improvements - Introduction of hedge-only account - Introduction of omnibus account	- KRX regulation and system to be revised - KRX regulation and system to be revised	Q2, 2017 Q2, 2017
2. OTC Derivatives Market		
CCP clearing of more OTC derivatives	KRX regulation and system to be revised	Q4, 2016
Trade Depository(TR) system	Measures for TR to be outlined	Q1, 2017
Guideline on margin requirements	- Guideline to be established, - Relevant system to be revised	Q1, 2017
Introduction of electronic trading platforms	- Study on feasibility	Q3, 2017
3. Derivative-Linked Securities Market		
Risk management on ELS & DLS - Stress test on regular basis - Separation of ELS-related assets	- Financial Investment Business Regulation and Rules to be revised - FSS and KoFIA to revise relevant regulation and system	Q3, 2017 Q1, 2017
Protection for investors of ELS & DLS - Strengthen "Know-your-product Rules" - Introduction of "cooling-off" period	- Guidelines to be established - Administrative guidance by FSS	Q4, 2016 Q1, 2017
Promotion of alternative products (e.g. ETN)	KRX regulation and system to be revised	Q1, 2017

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