

The Derivatives Market and Stability in Korea

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The Evolution of Derivatives in Korea

- ❖ The Korean derivatives market has evolved quickly

The Evolution of the Korean Derivatives Market

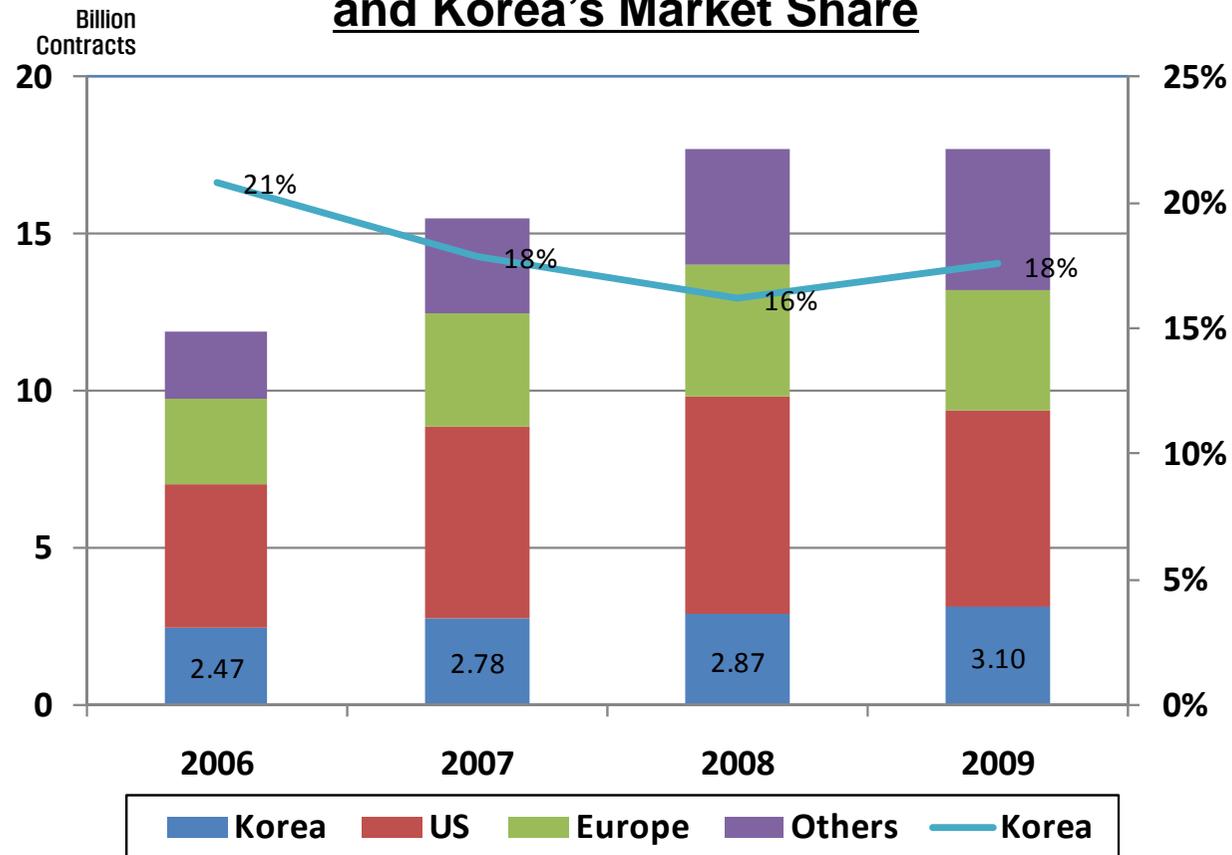
	Events	Products	Period
1 st stage	The emergence of the exchange derivatives market	KOSPI200 Futures/Options	1996~
2 nd stage	The rapid growth of the OTC derivatives market	FX products, IRS	2000~
3 rd stage	The introduction of securitized derivatives	ELS, ELW	2003~

- ❖ It showed more resilience during the global crisis than expected
- ❖ But, weaknesses have also been revealed

One of the World-leading Exchange Markets

- ❖ Korea is a major market for exchange traded derivatives

**Annual Volume in Exchange Traded Derivatives
and Korea's Market Share**

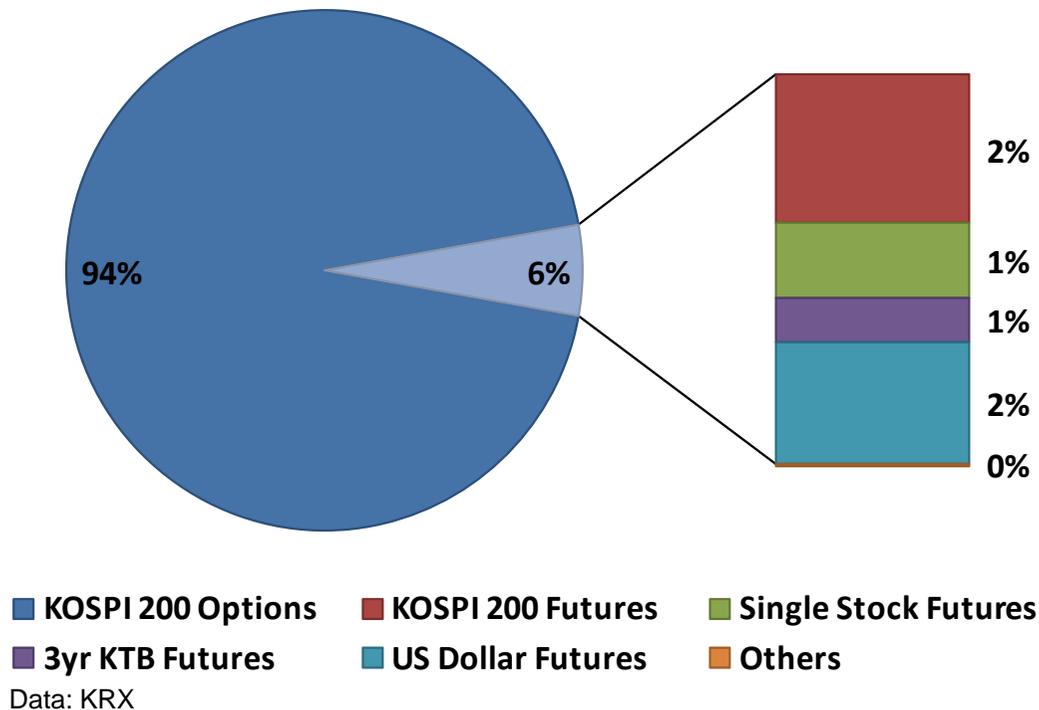


Data: Futures Industry Association

But, the Market is Highly Concentrated

- ❖ Trading is heavily concentrated in KOSPI 200 options

**Percent of Korean Exchange Derivatives Volume
by Product (Aug. 2010)**

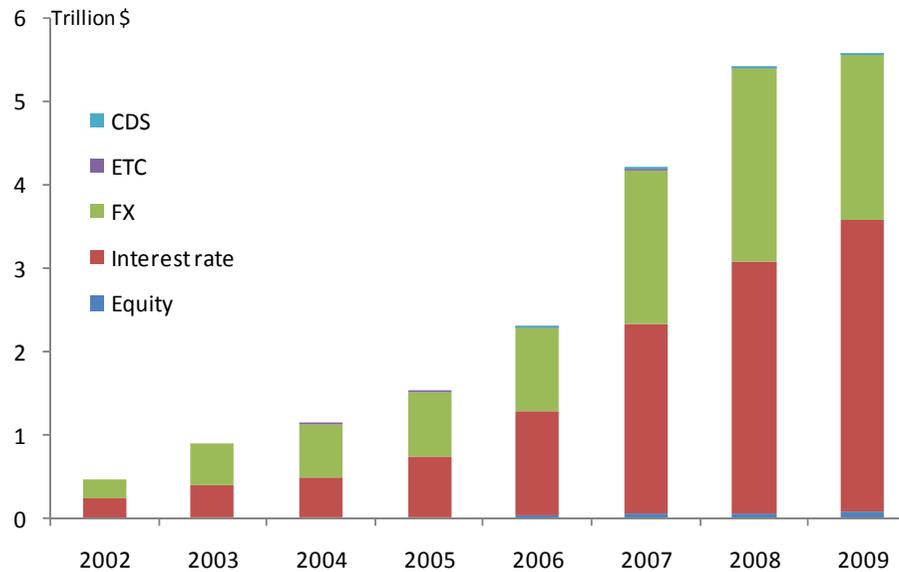


- ❖ The exchange market does not offer sufficient protection from various types of risk

Fast Growing, yet Underdeveloped and Opaque

❖ The OTC derivatives market in Korea has grown dramatically

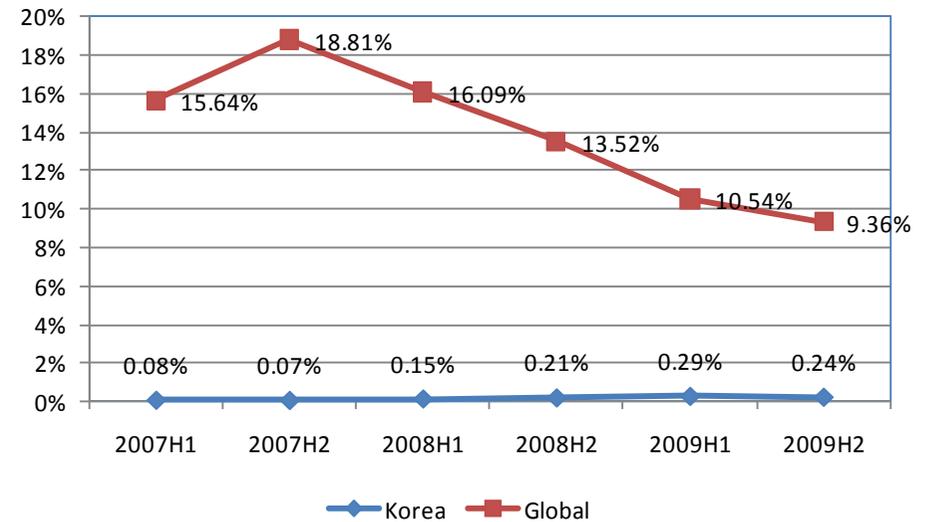
Growth in OTC Derivatives



Data: FSS Korea (USD adjusted)

CDS volume ratio over IRS

Korea vs. Global



Data: FSS Korea, BIS

❖ It is still underdeveloped and remains opaque

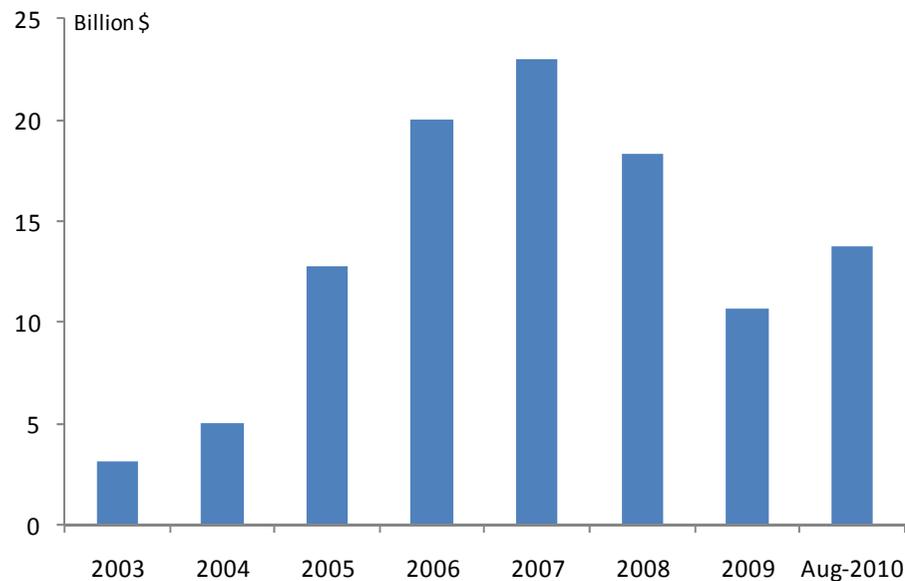
- Especially, illiquid CDS market
- No infrastructure to ensure market integrity

Retail Derivatives Boom



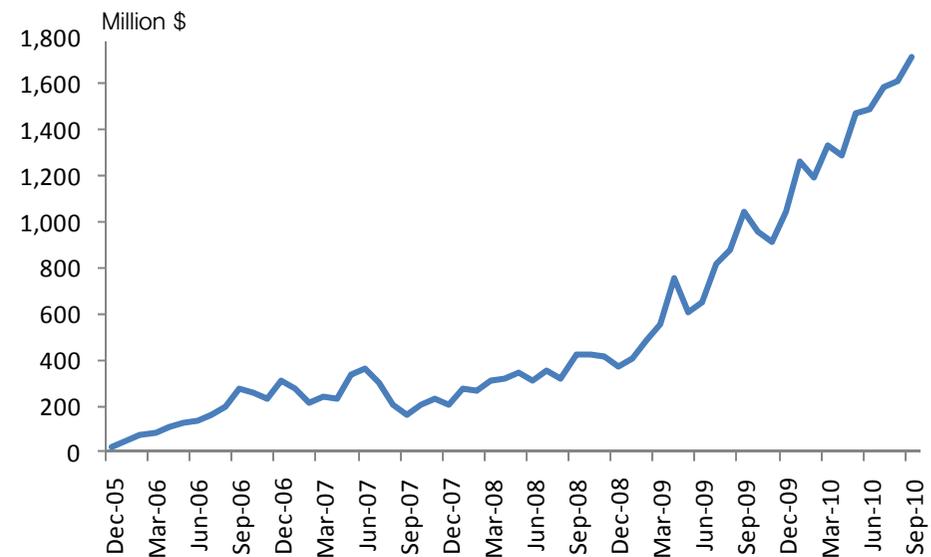
- ❖ Securitized derivatives have attracted retail investors successfully
 - Equity-linked Securities (ELS) and Equity-linked Warrants (ELW)

Annual ELS Issuance



Data: KSDA (USD adjusted)

ELW Daily Trading Volume

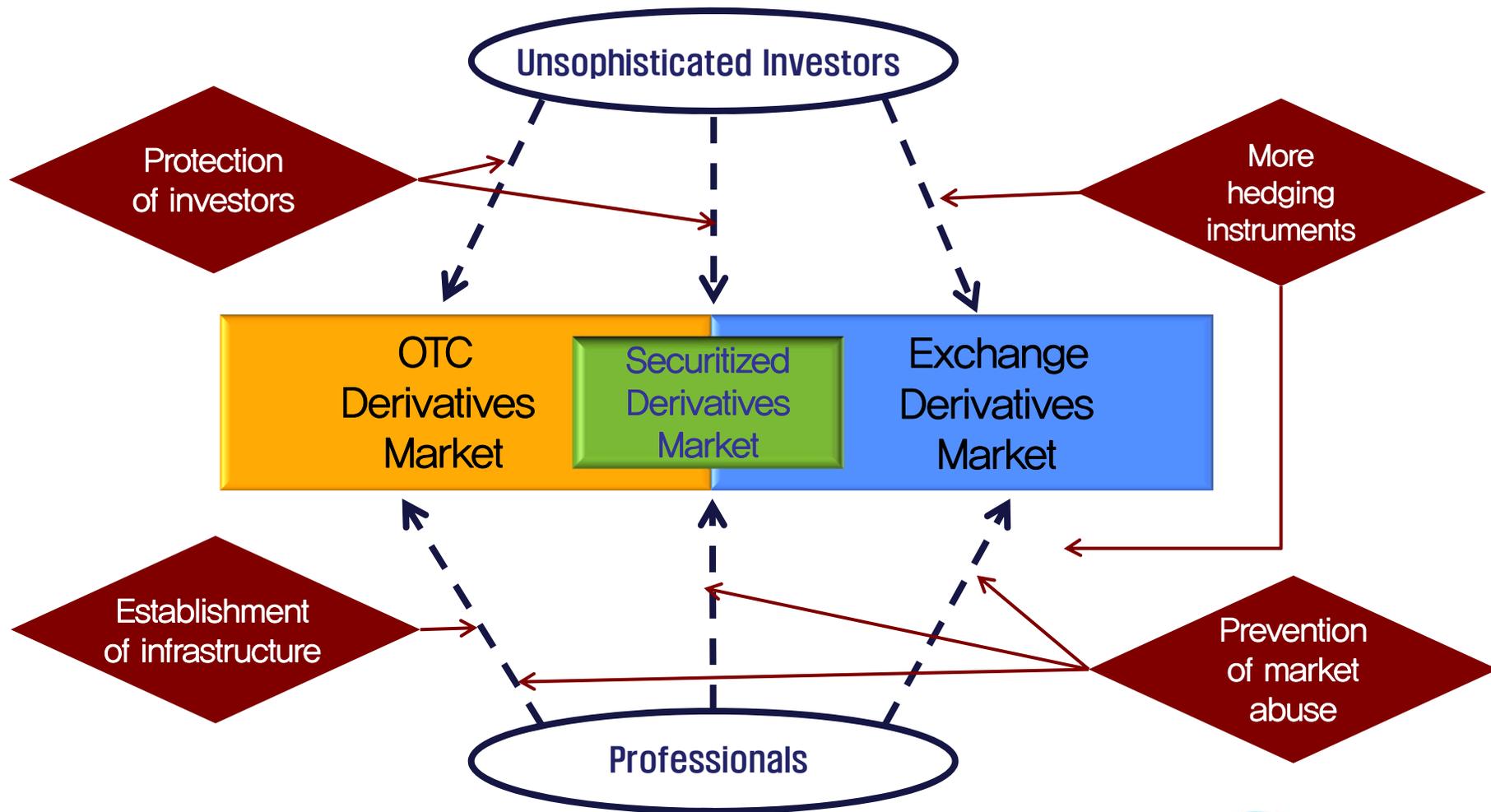


Data: KRX (USD adjusted)

- ❖ Alleged mis-selling and market abuse cases occur frequently
 - Alleged ELS issuer's market manipulation

To Ensure Financial Stability

- ❖ Regulatory measures are necessary without discouraging innovation



Recent Derivatives Regulations

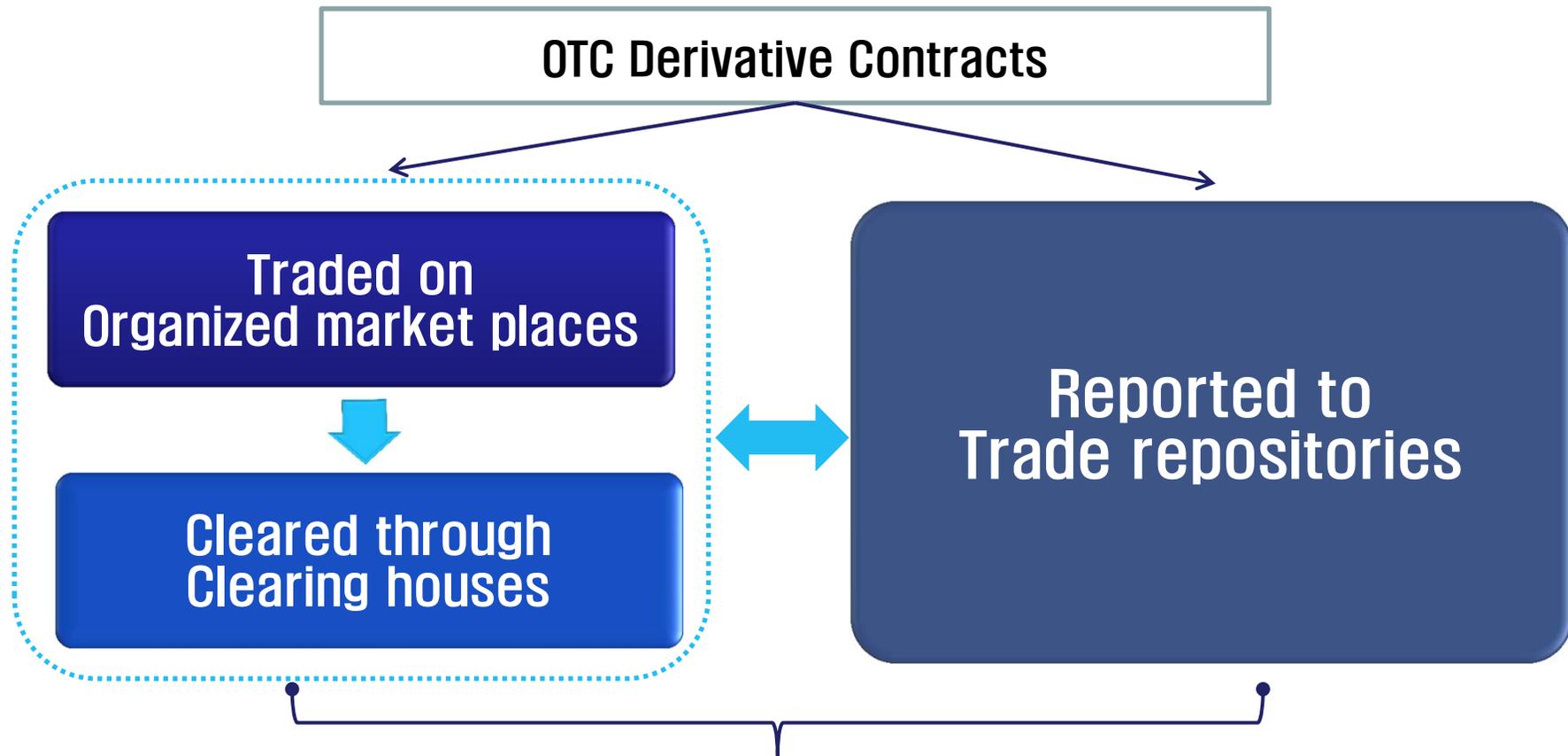


- ❖ To Create More Risk Management Tools
 - “The Capital Markets Act” encourages new derivatives by enlarging the scope of underlying assets (Feb. 2009)

- ❖ To Strengthen Investor Protection
 - “The Capital Markets Act” introduces “Principle of Suitability”
 - “The New Product Review Process” went into effect (Jun. 2010)
 - It covers securitized derivatives and OTC derivatives offered to unsophisticated investors and credit derivatives

- ❖ To Monitor Derivatives Activities
 - “The Integrated Derivatives Information System” was launched (Jan, 2010)
 - New derivatives should be reported to the system
 - The Bank of Korea has operated “the FX reporting System” since 1999
 - More than 300 financial institutions have reported their transactions related to foreign currency to the system

Infrastructure for OTC Derivatives in G20



Regulators can have a complete picture of the derivatives market

Plans to Build Infrastructure

- ❖ The FSC announced plans in Feb. 2010
 - Creating a roadmap for building a CCP clearing house for OTC derivatives
 - A service provider is expected to be selected in 2011
 - A CCP is expected to provide its service in 2012
 - Providing legal grounds
 - Necessary revision will be made to the Financial Investment Services and Capital Markets Act to provide legal grounds for OTC derivatives CCP clearing
 - Further research on other regulatory measures in the OTC derivatives market such as reporting to trade repositories and trading on exchanges or electronic trading platforms

- ❖ Infrastructure and services will be introduced in stages

Conclusions

- ❖ The Korean derivatives market and authorities have developed measures to ensure financial stability
 - By the enactment of the Capital Markets Act and adoption of New Product Review Process
 - By building the Integrated Derivatives Information System and the FX reporting System
 - By announcing plans to implement the G20 Agreement

- ❖ But, there are some policy issues to be discussed under the G20 framework
 - Regulatory arbitrage
 - Non-G20 countries
 - Increasing costs

Thank you.