Market Notice

"A Capital Market Partner Adding to Customer Value"

Revision of Regulations Related to Ex-post Margin System and Position Limit of KRX Derivatives Market

I. Background

To prevent the reoccurrence of event similar to that occurred on November 11, 2010 (the option expiry day) and reduce the risks associated with the non-fulfillment of settlement obligation by the institutional investors, the KRX has revised the regulations related to the ex-post margin and position limit in its Derivatives Market.

II. Main points of revision

A. Ex-post margin system

1. Reinforcement of selection criteria of qualified institutional investors (QIIs)

Existing regulation: According to the Financial Investment Services and Capital Market Act, the professional investors who meet the institutional category criteria* may be selected and allowed to pay the ex-post margin**.

* Institutional category criteria – Banks, insurance companies, financial investment companies, collective investment vehicles, pension funds, etc.

** Only the QIIs may be eligible for ex-post margin (the system permitting to pay the customer margin after the market closing).

Revised regulation: Only the QIIs who meet both the institutional category criteria and asset-size criteria (at least KRW 500 billion of total asset or at least KRW 1 trillion of total asset under management) may be allowed to pay the ex-post margin.

However, if the risk management unit of KRX member company accepts that the QII has the satisfactory settlement capability, the asset-size criteria may not be applied to the concerned QII.

The KRX member companies are required to obtain the materials necessary for selecting the QIIs from the institutional investors.

2. Establishment of maximum exposure amount per ex-post margin account of QII and administration thereafter

Existing Regulation: The KRX member company autonomously sets and administers the exposure amount of QIIs.

Revised Regulation: The KRX member companies are required to set the maximum exposure amount during the market session per ex-post margin account and monitor if the exposure amount of QII as of the time of order matching exceeds the maximum exposure amount (10 times the total margin deposited, i.e., the sum of the cash or substituted securities, foreign currency, etc. deposited in the account). If the exposure amount of QII exceeds the maximum exposure amount, the member company requests the concerned QII to voluntary reduce the exposure amount by specified time (the time specified by the member company, which is within 1 hour of exceeding the maximum exposure amount) in the day. If the concerned QII fails to reduce the exposure amount by the specified time, the member company must take an action such as requiring the QII to pay the upfront margin or clearing out the excess quantity of open interests by reverse trade.

3. Establishment of the guidelines for risk management of QIIs

Existing Regulation: The KRX member companies autonomously establish the guidelines for risk management.

Revised regulation: To manage the risks of QIIs, the KRX member companies are required to autonomously establish the guidelines for risk management of QIIs*.

* Matters such as the selection criteria for QIIs, types of documents necessary for QII selection, method of setting the maximum exposure amount, measures to be taken in case of exceeding the maximum exposure amount and payment deadline of ex-post margin must be stipulated.

B. Revision of position limit (quantity limit of open interests)

1. On the normal trading day, the position delta [the number of open interests, which was calculated using the delta (the ratio of futures/options price change to the change of underlying asset price)] of 10,000 contracts (5,000 contracts for retail investor) for all KOSPI 200 futures and options contracts

Violation criteria: Both the position delta calculated at the previous day's market closing time and the position delta calculated at the today's market closing time exceed 10,000 contracts (5,000 contracts for retail investor).

Refusal to accept order entrustment: The KRX member companies are required to turn down the order placed by an investor who exceeded the position delta on the previous day from the next day, if the order results in the increase of position delta.

Exception: If the evidence proving that the order is for arbitrage/hedge trade is submitted, the quantity of concerned order is excluded from the calculation of position delta. Also, the definition of arbitrage/hedge trade has been broadened to include some exchange-traded or over-the-counter traded products like ETFs, ELWs, etc.

2. On the last trading day, position delta of 10,000 contracts (5,000 contracts for retail investor) for all KOSPI 200 futures and options contracts for which the last trading day has arrived, regardless of trading type

Violation criteria: For the contracts that are on their last trading day, both the position delta calculated at the previous day's market closing time and the position delta calculated at the today's market closing time exceed 10,000 contracts (5,000 contracts for retail investor).

Refusal to accept order entrustment – The KRX member companies are required to turn down the order placed by an investor who exceeded the position limit on the previous day or during the today's session, if the order results in the increase of position delta of the contract on its last trading day.

III. Expected Results

1. Reduction of risks resulting from the non-fulfillment of settlement obligation

As a result of reinforcement of selection criteria for QIIs, only those QIIs proven to have the adequate settlement capability would be permitted to pay ex-post margin.

With the establishment of maximum exposure amount, the excessively leveraged trading by QIIs would be curbed.

By requiring the member companies to establish the guidelines for risk management of QIIs, it is possible to systematically manage the risks of QIIs eligible for ex-post margin.

2. As a result of imposing the position limit on the contracts for which the last trading day has arrived, the impact of spot market on the last trading day of futures/options is reduced and the market reliability is enhanced.

3. The broadening of definition of arbitrage/hedge trade when setting the position limit would promote the arbitraging and hedging.

IV. Effective Date

Revision of position limit will be put into practice on March 7, 2011.

Revision of ex-post margin system will be put into practice on March 28, 2011.

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About KRX

Korea Exchange (KRX) is the operator of Korea's Securities and Derivatives Market under the 'Financial Investment Services and Capital Market Act (FSCMA).' KRX operates three markets; KOSPI Market as a main board, KOSDAQ Market as a venue to small and medium sized enterprises, and Derivatives Market which boasts of the most liquid products in the World. Within its consolidated trading platform, KRX offers vast product line-up including equity shares, bonds, ETFs, ELWs, futures and options. For more information please visit our website at http://eng.krx.co.kr.