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Press Release

July 16, 2009

State of FX Margin Trading and Plans for Regulatory System Improvement

1. Summary

FX margin trading had gained considerable popularity from retail investors in such countries as Japan and the United States for its advantage of making it possible to invest in the fluctuating currencies of other countries with only a small deposit. But a rise in fraud cases and swindles, and heightened risk to investors caused regulations to be strengthened around related activities.

Retail investor interest in FX margin trading also started picking up in Korea in 2008 from a number of factors that included low interest rates and increased currency volatility from the global economic crisis. This has brought to the fore a host of concerns with a spike in related crimes, such as illegal transactions and fraud as well as mounting investor losses.

To prevent the equivalent of the 'Mrs. Watanabe Syndrome' in Japan from taking hold in Korea, the financial supervisory authority will raise domestic investors' awareness of FX margin trading and take measures to ensure the transparency of the market.

2. State of FX Margin Trading

Transaction Volume

The volume of transactions increased sharply after currency volatility became amplified after 2008 with contracts approximating KRW361.0 trillion as of end-May 2009. From 2007 to 2008, contracts increased by 594%.

Entering 2009, the growth of transaction volume and concentration of transactions to retail investors have been markedly prominent with a low interest rate trend and investor sentiment recovering.

The volume of transactions for the first five months of this year already exceeded 85% of all transactions in 2008 while the percentage of transactions by retail investors accounted for 99% of all transactions in 2009, up from 92% in 2008.

FX Margin Transaction Volume

(In KRW, billions)

	2005	2006	2007	2008	01-05/2009
Retail investors	1,282.2	7,516.2	55,927.4	418,759.5	357,724.1
(% of total)	(100%)	(97%)	(85%)	(92%)	(99%)
Non-financial companies	0.0	211.5	9,454.1	35,043.3	3,735.8
Financial companies	0.0	0.0	0.0	21.6	0.5
Total	1,282.2	7,727.7	65,381.5	453,824.4	361,460.4

Trading Losses

Retail investor losses have risen noticeably from KRW11.8 billion in 2007 to KRW48.9 billion in 2008 and KRW44.9 billion as of May 2009.

Losses are being borne to the vast majority of retail investors as short-term investments are being made without adequate information in cross currency fluctuations. This includes a number of cases, such as USD-EUR FX where the direction of the US dollar against the Euro must be projected at the same time as the Korean won against the US dollar since the Korean won must be first converted before margin trading can occur in USD/EUR.

Gains/Losses from FX Margin Trading

(In KRW, billions)

	2006	2007	2008	Q1/08	Q2/08	Q3/09	Q4/09	01-05/2009
Retail investors	-1.6	-11.8	-48.9	-7.3	-6.9	-17.4	-17.3	-44.9
Non-financial companies	-0.1	-3.6	2.2	1.4	2.9	-2.8	0.7	-0.6
Total	-1.7	-15.4	-46.7	-5.9	-4.0	-20.2	-16.6	-45.5

More than 90% of all FX margin trading accounts reported a loss.

Most of the funds for investment are lost with even small changes in exchange rates. With a low margin requirement of 2%, even minor fluctuations of 1-2% in the other direction of the currency in question causes significant losses to accrue from forced settlement and loss-cuts, which forces positions to be liquidated should the maintenance margin fall under 1%.

Approximately 70% of all trading accounts have been forced to liquidate their positions while those accounts that were forced to liquidate within 3 days exceeded 40%.

Liquidated Accounts

Within 3 days	Within 5 days	Within 10 days	Within 15 days	Within 1 month	Within 3 months	Within 6 months	Within 1 year	Over 1 year
41.5%	6.3%	12.6%	8.1%	13.9%	13.0%	3.1%	1.3%	0.2%

Rise in FX Margin Trading Related Crimes

- Unauthorized Intermediation & Direct Transactions

The Financial Investment Services and Capital Markets Act (FSCMA) requires retail investors to go through an authorized domestic investment broker in trading FX on margin. It has been found, however, that there were in excess of 600 cases where direct transactions were conducted with overseas forex dealer members (FDMs). Legally banned transactions such as these are being facilitated through overseas FDMs made known by internet communities and illegal investment cafés.

FX transactions that bypass authorized derivative investment brokers are illegal under the FSCMA and the Foreign Currency Transaction Law governing illegal remittances. Further to this, all acts that solicit and/or recommend FX trade are liable to prosecution for unauthorized derivatives brokering.

- Unlawful solicitation of investors

Unauthorized companies that raise funds with promises of high rates return in the vicinity of 30-60% per year have also been identified in the recent FSS/KOFIA joint review. From the end of 2008 up to the present, the FSS identified 26 cases involving unlawful solicitation of investors and referred them to the police for investigation.

- Unauthorized training program

The number of illegally-run training programs has increased to take advantage of the heightened investor interest in FX margin trading. Companies that offer such programs give rise to concerns of indirect fraud that causes additional losses as fees are collected under the guise of providing consulting and education services.

Structural Issues of FX Margin Trading

- An Embedded Structure of High Trading Fees

FX margin trading is characterized by a high transaction fee structure that investors must not only cover for the brokerage commission, but also upfront for the spread set by the FDM.

- Spread Structure Unilaterally by Overseas FDM

The overseas FDM sets the bid/ask price without providing such information as an order backlog of bid/ask prices. This is a structure where the spread is the only information offered to the investor, and where the investor has no choice but to accept.

The investor is without recourse even if the FDM were to offer the investor a spread that is disadvantageous to the investor.

In particular, investors are raising questions about the appropriateness of the spread itself as six of the seven domestic futures firms currently facilitating FX trades are in business with one overseas FDM that is effectively in a monopolistic position.

3. Strengthened Regulation on FX Margin Trades

Increased margin requirement: 2% → 5%

Margin requirement will be raised from 2% to 5% to limit the leverage effect to 20 rather than 50. This will be in effect from September 1, 2009.

Strengthened supervision on intermediaries – effective immediately

- Mystery shoppers will be dispatched by the FSS to inspect and monitor sales and client subscribing activities of security houses, futures companies and other FX margin trade intermediaries. The FSS inspections will also be carried out on related firms at least once a year.
- Companies found to be carrying out any unlawful trading activities itself or directly or indirectly related to illegal investment facilities or unregistered private investment enterprises, including but not limited to FX margin trading education facilities and internet investment cafes, will be dealt with the strictest sanctions.
- Advertisement regulations will be strictly enforced and amended if necessary to prevent related companies from luring private investors.
- FX margin trading is classified under derivatives. As such, the following regulations concerning investor protection apply under the FSCMA:

    a. It can only by recommended to investors with the highest level of risk tolerance.
    b. It can not be traded under consignment.
    c. Even when an investor voluntarily, without prior recommendation, requests such trade, he must be properly warned of the dangers and proper suitability.

Through mystery shoppers and other inspection methods, the FSC/FSS will monitor to see if related companies comply with the standards for investment recommendations. Moreover, the investment recommendation requirements specifically for FX margin trading will be revised for a more detailed and precise definition.

<Key areas of supervision>

- ✓ Whether the company's website has sufficient and accurate fee schedule relating to FX margin trades, as well as inherent risks.
- ✓ Whether a system of assessing the client's level of risk averseness and suitability of the trade is in place before setting up an account or downloading the HTS. The system must also give a warning sign when the trade is judged too risky for the client's risk profile.
- ✓ Whether the employee remuneration is excessively tied to the sales performance on FX margin trades.

Systemic enhancements for transparency

Enhance FX trading environment by encouraging domestic futures firms to make available bid/ask prices of multiple FDMs to the investors in order to essentially reduce the spread. Due to lengthy process in getting affiliated with other FDMs and time it takes to revise the trading systems, this will be in effect starting 2010.

Further supervisory measures

The FSS and the Korea Financial Investment Association (KOFIA) will jointly operate a special reporting center for illegally run FX margin trading operations. The centers will open immediately.

The FSC/FSS will cooperate closely with the Ministry of Strategy and Finance and the Bank of Korea to monitor and regulate overseas wire transfers related to FX margin trades by utilizing the FX margin trade reporting system and the FX trading network.

Bring out closer coordination with foreign regulating agencies, such as the U.S.'s CFTC to discourage their local firms to deal directly with Korean nationals.

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