

“A Capital Market Partner Adding to Customer Value”

Stimulation Plan for Long-term KTB Futures Trade

The Ministry of Strategy and Finance, Financial Services Commission and Korea Exchange (“KRX”) have jointly prepared the plan to stimulate trading of long-term Korea Treasury Bond (“KTB”) Futures.

Recently, an opportunity to promote the trading of long-term KTBs has been presented as a result of growing issuance amount and trading volume of long-term KTBs. As the need to stimulate the 10-year KTB Futures trading volume grew, the task force made of representatives of research community, public sector and private sector was created in January 2010 to prepare the plan for promotion of long-term KTB Futures trade.

The causes for poor trading of long-term KTB Futures may be examined in terms of cash market, market making and trading regulations.

First, although the annual issuance amount of short-term and long-term KTBs is balanced, the trading condition in the secondary market is dominated by the short-term KTBs. For example, as of the end of June 2010, the outstanding amount of KTBs with maturity longer than 10-year is 46% of total outstanding amount of KTBs, but the trading volume of KTBs with maturity longer than 10-year is mere 13% of total trading volume of KTBs.

Second, the market making for 10-year KTB Futures is rather inadequate and the primary dealers (“the PDs”) who account for over 53% of trading volume of 10-year KTBs do not actively participate in trading or market making of 10-year KTB Futures.

Last, the physical delivery, which is the method used for final settlement of 10-year KTB Futures, acts as constraint in trading long-term KTB Futures. The investors are not familiar with the physical delivery settlement and as trading of long-term KTBs in the cash market is not brisk, the investors felt burdened in securing the deliverable KTBs for the final settlement by physical delivery.

As the favorable condition has been created to stimulate the trading of long-term KTB Futures,

it is expected that trading of long-term KTBs in the cash market would thrive subsequent to the balanced development of cash and derivative markets.

The issue amount and trading volume of long-term KTBs are increasing. For example, the issue amount of KTBs with maturity longer than 10-year accounted for 25.4% of total issue amount of KTBs in the second half of 2008, but it has increased to 38.8% in the first-half of 2010. The demand for long-term KTBs is increasing as the retirement pension market grows and the overseas investors have shown an interest in long-term KTBs. Then, several financial institutions have expressed their interest in acting as market maker for 10-year KTB Futures.

The basic plan in stimulating the trading of long-term KTB Futures are the stimulation of long-term KTB trade in the cash market, the reinforcement of market making function for long-term KTB Futures and the enhancement of market participants' convenience.

1. Stimulation of long-term KTB trade in the cash market: To increase the matching probability by narrowing the spread between best bid and best ask prices by increasing the issuance of long-term KTBs and reinforcing the market making function of PDs. Additionally, to respond to various demands for long-term KTBs such as hedging against inflation by resuming the issuance of inflation-linked KTBs.

2. Reinforcement of market making function for long-term KTB Futures: To encourage the participation of PDs in promoting long-term KTB Futures trade by taking into account the trading volumes of 10-year KTB Futures in the performance assessment of PDs. In addition, to rebate a percentage of derivatives fee revenue to the market maker for 10-year KTB Futures as an incentive.

3. Enhancement of market participants' convenience: To change the final settlement method of 10-year KTB Futures from the physical delivery to cash settlement, thus making the settlement more convenient. To improve the predictability and transparency of closing price by making public the expected matching price during the single price auction period (15:05~15:15). However, the distortion of expected matching price is prevented by prohibiting the cancellation and correction of quotes during the last 1 minute before the market closing. To make the trading regulations similar for all KTB Futures by harmonizing the trading regulations for 10-year KTB Futures with those for 3-year KTB Futures.

	Existing Regulation		Amended Regulation (3-yr, 5-yr & 10-yr KTB Futures)
	3-yr & 5-yr KTB Futures	10-yr KTB Futures	
Settlement method	Cash settlement	Physical delivery	Cash settlement
Trading unit	KRW 100 million	KRW 50 million	KRW 100 million
Coupon rate	8/100 per year	5/100 per year	5/100 per year
Contract month	2 within 6 months	3 within 9 months	2 within 6 months
Quotation unit	0.01	0.02	0.01

To expand the range of quotes published in the market from the best quote \pm 4 ticks to the best quote \pm 4 quotes with the remaining quotation quantity.

Subsequent to the implementation of the above noted plan, it is expected that the issuance amount and trading volume of long-term KTBs would grow and the reliability and credibility of long-term KTB market would be improved.

- After amending the Derivatives Market Business Regulation and updating the trading system of KTB Futures, the KRX intends to introduce the above noted stimulation plan in October 2010.

- End -

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 Markets which boast 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>.