Press Release

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PLAN TO IMPROVE SECURITY OF DERIVATIVES TRANSACTIONS

The FSC, the FSS, the KRX, and the KoFIA jointly announced a plan to improve security of derivatives transactions in a bid to prevent accidents of huge losses caused by erroneous orders as well as to reduce settlement risks and excessive price fluctuation in derivatives trading.

BACKGROUND

Algorithmic trading through direct market access (DMAs) has been increasing in Korea's derivatives market. For KOSPI 200 options trading, for example, algorithmic trading accounts for about 40%.[1] However, there is a potential risk in algorithmic trading that huge losses could be incurred by erroneous orders due to system errors as witnessed in a recent incident of Hanmag Securities.[2] Huge losses consequent on erroneous orders could undermine derivatives markets' stability as well as securities firms' soundness. The FSC and relevant agencies came up with a plan to improve security of derivatives transaction, while ensuring such measures would not curtail derivatives trading.

KEY CONTENTS

1. Strengthen securities firms' internal control

The FSC will encourage securities firms to voluntarily reinforce their internal control standards to prevent excessive orders that exceed limit bid or limit offer.[3] The FSS and the KRX will also strengthen their oversight on such trading.

2. Introduce price banding limits

Current safety mechanisms such as price limits[4] and circuit breakers (CBs)[5] exposed limitations in responding to excessive price fluctuations. To such backdrop, the FSC plans to

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[1] The share of algorithmic trading in derivatives market has been increasing from 24.1% in 2008; 37.9% in 2009; 38.2% in 2010; to 44.1% in 2011.

[2] Erroneous orders by Hanmag Securities in KOSPI 200 options trading on December 12 last year incurred KRW 46 billion losses.

[3] Current regulations do not place any limits on securities firms' proprietary trading orders and KoFIA's standards do not apply on DMAs and automatic orders.

[4] Price limits only set the maximum ceiling for daily price changes (KOSPI200 Futures: ±10% of the previous closing price for KOSPI200 Futures, ±15% for KOSPI 200 Options)

[5] Futures and options trade is stopped for 5 minutes and traded based on single price transaction for 10 minutes when the price of KOSPI 200 Futures products with the largest trading volume on the previous day changes drastically compared to the spot price.

introduce price banding limits on futures and options trading. Upon implementation, investors will only be allowed to place orders of futures and options transaction within a certain range of the latest trade price during market hours[6].

3. Improve remedies for erroneous orders

Currently, derivatives price could only be corrected when the two respective parties of the transaction reach to an agreement. However, the KRX will be given direct authority to cancel orders if such transaction is deemed to pose threats to the security of trading settlement. For those who erroneously place orders, punitive commission will be charged.

IMPLEMENTATION SCHEDULE

The plan will be implemented within the first half of 2014 after revising related regulations. Detailed measures will be finalized based on discussions with related experts from the industry.

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[6] Each product's optimal price banding range will be set based on analysis of the past price data.