

September 30, 2014

Mr. Lee, Yoon Soo  
Director, Bank Division  
Banking & Insurance Bureau  
Financial Services Commission

Mr. Choi, Seong Il  
Director  
Bank Supervision Department  
Financial Supervisory Service

Re: Review of QCCP status of KRX

Dear Directors,

The International Swaps and Derivatives Association, Inc. (“ISDA”)<sup>1</sup> is grateful for the opportunity to raise the issue of Qualified Central Counterparty (“QCCP”) status of the Korea Exchange (“KRX”) with Korea’s CCP regulators, the Financial Services Commission (“FSC”) and the Financial Supervisory Service (“FSS”).

As you may be aware, the Basel Committee on Banking Supervision (“BCBS”) published the interim framework for determining capital requirements for bank exposures to CCPs in July 2012 (“BCBS 227”)<sup>2</sup> and completed its work on the capital treatment for bank exposures to CCPs in April 2014 (“BCBS 282”)<sup>3</sup>. The BCBS 282 requirements impose a capital charge on banks’ exposures to CCPs resulting from certain transactions, but provide for lower capital charges for banks’ trade and default fund exposures to QCCPs. BCBS 282 defines a QCCP as follows:

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<sup>1</sup> Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 62 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: [www.isda.org](http://www.isda.org).

<sup>2</sup> <http://www.bis.org/publ/bcbs227.pdf>, The Basel Committee on Banking Supervision, Capital requirements for bank exposures to central counterparties, July 2012.

<sup>3</sup> <http://www.bis.org/publ/bcbs282.pdf>, The Basel Committee on Banking Supervision, Capital requirements for bank exposures to central counterparties - final standard, April 2014

[1] *A qualifying central counterparty (QCCP) is an entity that is licensed to operate as a CCP (including a license granted by way of confirming an exemption), and is permitted by the appropriate regulator/overseer to operate as such with respect to the products offered.*

[2] *This is subject to the provision that the CCP is based and prudentially supervised in a jurisdiction where the relevant regulator/overseer has established, and publicly indicated that it applies to the CCP on an ongoing basis, domestic rules and regulations that are consistent with the CPSS-IOSCO Principles for Financial Market Infrastructure (“PFMIs”).*

*As is the case more generally, banking supervisors still reserve the right to require banks in their jurisdictions to hold additional capital against their exposures to such CCPs via Pillar 2. This might be appropriate where, for example, an external assessment such as an FSAP has found material shortcomings in the CCP or the regulation of CCPs, and the CCP and/or the CCP regulator have not since publicly addressed the issues identified.*

*Where the CCP is in a jurisdiction that does not have a CCP regulator applying the Principles to the CCP, then the banking supervisor may make the determination of whether the CCP meets this definition.*

[3] *In addition, for a CCP to be considered a QCCP, the terms defined in paragraphs 206 and 207 of this Annex for the purposes of calculating the capital requirements for default fund exposures must be made available or calculated in accordance with paragraph 208 of this Annex.*

In summary, in order to be designated as a QCCP, the CCP must meet three key requirements:

- [1]: Be licensed to operate as a CCP in its home jurisdiction;
- [2]: Be in demonstrated compliance with the PFMI; and
- [3]: Must calculate and distribute data required to calculate capital requirements against CCP default fund contributions.

The BCBS also issued a set of frequently asked questions (FAQs) relating to the interim framework for bank exposures to CCPs in December 2012 (“BCBS 237”)<sup>4</sup>, providing guidance for CCP regulators as follows:

*If a CCP regulator has provided a public statement on the status of a CCP (QCCP or non-qualifying), then banks will treat exposures to this CCP accordingly. Otherwise, the bank will determine whether a CCP is qualifying based on the criteria in the definition of a QCCP in Annex 4, Section 1.*

Application to KRX (for a non-Korean bank seeking to assess as QCCP):

- [1]: Authorized to operate as a CCP by FSC
- [2]: In respect of the KRX’s compliance with the PFMI, the FSC have taken the following actions:

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<sup>4</sup> <http://www.bis.org/publ/bcbs237.pdf>, The Basel Committee on Banking Supervision, Basel III counterparty credit risk and exposures to central counterparties - Frequently asked questions (update of FAQs published in November 2012), Dec 2012.

- In July 2013, The FSC stipulated the requirements for the authorization of a CCP that articles of incorporation and the rules on clearing business should reflect the PFMI.
- The FSC designated the FSS to examine whether the KRX is complying with the PFMI and subsequently granted the authorization of the over-the-counter (“OTC”) derivatives clearing business to KRX in September 2013.

Nevertheless, the FSC/FSS have not publicly articulated that they apply domestic rules and regulations that are consistent with the PFMI to the KRX on an ongoing basis, whereas the KRX has disclosed its self-assessment report on the observance of PFMI in July 2013 and the International Monetary Fund (IMF) announced that the CCP of the KRX broadly complies with the PFMI in its Report on the Observance of Standards and Codes on the Republic of Korea in May 2014<sup>5</sup>. Korea’s CCP regulator(s), therefore, is required to publicly indicate that it applies to the CCP, on an ongoing basis, Korean financial rules and regulations that are consistent with the PFMI for KRX to be a QCCP defined under the BCBS 282. Furthermore, if Korea’s CCP regulator(s) do not plan to provide a public statement on the status of a CCP (QCCP or non-qualifying), then Korean banks will have to perform their own QCCP assessment on KRX according to BCBS’ guidance abovementioned.

For EU banks, as long as the KRX is recognized by the European Securities and Markets Authority (“ESMA”) as a third-country CCP (TC-CCP), the adherence to the PFMI is inherent. If the KRX does not achieve ESMA recognition as a TC-CCP, all EU banks’ exposures to the KRX would be treated as non-QCCP exposures. For US banks, the US banking agencies require that US banks perform their own QCCP assessment.

- [3]: The KRX must make available or calculate the required data for the calculation of the capital requirements for default fund exposures. Capital text in the EU is not very clear if this will remain an explicit requirement. However, in the US, it is compulsory.

In other jurisdictions in Asia, the Reserve Bank of Australia (“RBA”) and the Australian Securities and Investment Commission (“ASIC”) jointly issued a statement designating the Australian Securities Exchange (“ASX”) as a QCCP in April 2013, and the Reserve Bank of India (“RBI”) and the People’s Bank of China (“PBOC”) have granted the status of a QCCP to the Clearing Corporation of India Ltd. (“CCIL”) in January 2014 and the Shanghai Clearing House (“SCH”) in February 2014 respectively.

We appreciate the opportunity to provide this information. As Basel III was implemented in Korea in December 2013 and BCBS’ capital requirements allow for full implementation of Basel III, the QCCP status of KRX is a significant issue for banks that should prepare capital charges for their trade and default fund exposures to KRX. We hope this information will help you prepare the KRX for QCCP status as defined under BCBS 282.

Should you have any questions, please contact the undersigned.

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<sup>5</sup> <http://www.imf.org/external/pubs/ft/scr/2014/cr14127.pdf>, The International Monetary Fund, Report on the Observance of Standards and Codes on the Republic of Korea, April 2014.



Yours sincerely,

For the International Swaps and Derivatives Association, Inc.

A handwritten signature in black ink that reads "Keith Noyes".

Keith Noyes  
Regional Director, Asia Pacific

A handwritten signature in black ink consisting of stylized initials, likely "CK".

Claire Kim  
Assistant Director, Policy

A handwritten signature in black ink that reads "Ryan Ingram".

Ryan Ingram  
Assistant Director, Risk & Capital

cc.

Mr. Lee, Myong Soon, Director, Capital Market Bureau, Capital Market Division, FSC  
Mr. Kwon, Oh Sang, Director, Derivatives Trust, Structured Products and Pension Department, FSS  
Mr. Yoon, Suk Youn, Executive Director, Derivatives Market Division, KRX