ISDA®

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BY FAX AND COURIER

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National Policy Committee, the National Assembly of the Republic of Korea

Copy: Financial Services Commission ("FSC") (Fax: 822 2156-9869)

Attn: Mr. Soo Young Lee, Deputy Director, Capital Market Division

Copy: FSS Financial Hub Korea Office (Fax: 822 3145-7159)

Attn: Mr. Juhyung Lee, Director

Mr. Jaichoon Kim, Deputy Director

Dear Sir or Madam,

On behalf of the International Swaps and Derivatives Association, Inc. (“ISDA”), we are writing to express our concern with the new legislative initiative underway, aimed at introducing a mandatory New Product Approval ("NPA") process which would require certain OTC derivative products to be reviewed and pre-approved by the Korea Financial Investment Association ("KOFIA") (acting with delegated

authority of FSC) prior to the introduction of said products in Korea. We understand that the scope of such prior approval process would cover the following:

1) Any new OTC derivatives product introduction to Korea of which the underlying is referenced to credit risk, natural or environmental or economic risks

2) Any new OTC derivatives product offered to "General Investors" as defined in the Financial Investment Services and Capital Markets Act ("FISCMA").

As you may be aware, ISDA is the leading global trade association in the privately negotiated or over-the-counter derivatives industry with over 830 members from more than 58 countries worldwide, including many Korean members. ISDA's membership also includes many of the international banks who introduce the majority of new OTC derivative products into the Korean market. ISDA's primary purpose is to encourage and assist in the establishment of sound financial risk management systems and to ensure the prudent and efficient development of derivative markets.

Our concerns with the NPA legislation can be summarized as follows:

1) Most fundamentally, the problem is never with the products themselves, but rather with the way they are sold (issues of mis-selling) and to whom they are sold (issues of appropriateness and suitability). A product that is suitable and could provide great utility to one investor may be completely inappropriate for another investor. The NPA legislation puts a misplaced focus on the product when in fact the merit of the product can only be judged in the context of the investor to whom it is being sold. A new product that is approved can still be mis-sold with very negative consequences while a product that is not approved might have been exactly what was needed by an investor with specific hedging needs.

2) Under the proposed legislation, for products that would be sold to non-professional investors, the NPA committee would base its judgment on whether the product was for hedging or speculative purposes. Without knowing who the investor is, no committee would be able to make that decision and even if the identity of the investor is known to the committee, it is unlikely that the committee would understand the investor's business well enough to say whether the trade is a hedging transaction or not.

3) The NPA legislation may lead to dangerous complacency among both investors and product sellers. Once a product has been approved, there will be a tendency for investors to rely on that approval and make less of an effort to understand what they are purchasing. This runs counter to the goal of having investors perform their own due diligence and understanding their investments. Similarly, sales people may use the product approval stamp as a selling tool rather than making the effort to understand the product and evaluate whether or not it is suitable for a particular client.

4) FISCMA already contains a substantial number of safeguards designed to enhance investor protection for general investors (as defined in FISCMA). These new protection measures include (1) enhanced product disclosure requirements (in Korean language), (2) a rigorous Know-Your-Client and suitability / appropriateness review process, (3) professional qualifications for sales persons, and (4) limitation of the use of OTC derivatives for hedging purposes only. Finally, the scope of "General Investors" was enlarged to also include listed companies. We believe that the FSCMA appropriately puts the onus for new product review at the product originator/bank level while the NPA legislation would demonize the products themselves. We submit that Korean regulators and/or KOFIA would help the Korean market the most by focusing on and supporting the development of new product approval procedures at the firm level. Focusing on firm level review would also have a direct and positive impact on sales practices and this would better serve the needs of the Korean market and the Korean economy than the NPA legislation in its current form.

5) At the implementation level, we are concerned with the lack of details as to how the NPA process is supposed to work in practice. Would the new product approval committee meet on an ad hoc basis whenever a new application is submitted? Or would it meet daily? weekly? monthly? What would the composition of the committee be? If it is made up of market practitioners then there is no way to ensure that intellectual property is not transferred to competitors. If it is made up of KOFIA staff or academics then they will be too far removed from the market to understand the products and the needs of the investors.

6) It is also very difficult to define what a new product is. Most new products are in fact very minor adjustments to existing products made in response to the specific needs of end investors. Most of the time these products are market timing sensitive and it is easy to envision a lot of transactions not getting done because the product is stuck in NPA committee and the market moves. An important feature of OTC derivatives products is that products are transacted on a bi-lateral basis and the terms are always subject to negotiation of the parties. If the terms of an approved product are amended due to market moves or clients' request, would the bank be required to re-submit the application? Also, what happens if the product is the same as the one approved before but the market conditions or the conditions of the client's financial position have changed materially and as a result the risk profiles of the trades have changed significantly?

7) Whatever committee takes on the responsibility of approving new products, they will be exposing themselves to legal liability. If KOFIA provides a sign-off for certain product and the product leads to some problems down the track (e.g., a large number of investors who have invested in the product lose money), the NPA committee can expect to be named together with banks in future lawsuits. Inevitably this will make the NPA committee reluctant to approve new products and slow the pace of innovation even further. It will also be a large financial burden to litigate these claims.

8) We also note that in China, all new banking products must be submitted to the China Banking Regulatory Commission for approval. This however, has not stopped Chinese corporations from suffering well-publicized trading losses. Returning to the point we made at the outset, the issue is not the product, but rather how it is used and by whom.

9) Lastly, we would like to point out that none of the major developed jurisdictions, e.g., the US, the UK, Japan, Australia, Singapore or Hong Kong has a similar requirement for OTC derivatives products. What is proposed under the NPA legislation is not in line with the prevailing international practice and will hinder Korea's ambition to develop Seoul as an international financial center.

ISDA thanks you in advance for your attention to this matter. Should you or your colleagues have any questions regarding international practices or would like an elaboration on the issues raised in this letter, please do not hesitate to contact Mr. Keith Noyes (knoyes@isda.org) in Hong Kong at telephone number +852 2200 5909 or Ms. Jing Gu (jgu@isda.org) at +852 2200 5908.

Yours sincerely,
For The International Swaps and Derivatives Association, Inc.

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