

November 17, 2014

Mr. Kim, Seong Jun  
Deputy Director, Capital Market Division  
Capital Market Bureau  
Financial Services Commission

Re: Review of recent amendments to KRX's default waterfall

Dear Mr. Kim,

The International Swaps and Derivatives Association, Inc. ("ISDA") is grateful for the opportunity to submit comments on some amendments of the Financial Investment Services and Capital Markets Act ("FISMA"), which your committee announced on October 8, 2014, as below:

The committee's amendments	ISDA's suggestion
<p>Article 399 (Exchange's Liability for Damage)</p> <p>(1) An Exchange shall be liable for damages incurred from violation of transaction contracts by any member on the securities market or the derivatives market.</p> <p>(2) Where an Exchange compensates for damages pursuant to paragraph (1), the Exchange's financial resources prescribed by Presidential Decree shall be appropriated in preference.</p> <p>(3) Where an Exchange has compensated for damages pursuant to paragraphs (1) and (2), the joint compensation fund set aside pursuant to Article 394 could be appropriated for some amount that an Exchange has compensated as above.</p>	<p>Article 399 (Exchange's Liability for Damage)</p> <p>(1) the same as on the left</p> <p>(2) the same as on the left</p> <p>(3) Where an Exchange has compensated for damages pursuant to paragraphs (1) and (2), the joint compensation fund set aside pursuant to Article 394, <u>in the case that the Exchange's financial resources abovementioned are not sufficient for damages</u>, could be appropriated for some amount that an Exchange has compensated as above.</p>

- ISDA understands that your committee intends to set a new provision 399(2) in order to revise the current regulation stating that the Korea Exchange (KRX), a clearing house for transactions on the securities market and the derivatives market in Korea, can compensate for damages incurred from clearing member's default using the joint compensation fund reserved by non-defaulting clearing members.
- In other words, ISDA understands that your committee intends to introduce the skin-in-the-game to the KRX, which means that a clearing house maintains a meaningful amount of contributed capital to the default waterfall to be utilized prior to the joint compensation fund of non-defaulting clearing members. Since ISDA have advised KRX to introduce the skin-in-the-game through an official letter dated March 17, 2014, we are pleased that your committee advances the amendment of Article 399(2) of the FISCMA to serve the same purpose.
- However, Article 399(3), another new provision seems that it could be construed as meaning that the KRX could shift the burden of their own capital compensated for damages to the joint compensation fund. The skin-in-the-game does not only mean that a clearing house's financial resources shall be appropriated in preference in time but also be utilized in order for the clearing house to bear the loss of damages prior to the joint compensation fund. Therefore, ISDA advises your committee to specify that in the case that the Exchange's financial resources are not sufficient for damages, the joint compensation fund shall be utilized for its shortfall.
- According to ISDA's research, all major clearing houses such as LCH, SGX, HKEx, and JSCC have adopted such a framework. In Europe, EMIR requires a Clearing house to contribute the skin-in-the-game greater than or equal to 25% of its minimum capital requirement. ISDA considers that your committee's recent amendment of Article 399 of FISCMA is in accordance with this international trend. Furthermore, ISDA expects that this amendment will bring positive effects such as motivating the KRX to manage relevant risks more rigorously and easing clearing members' burden accordingly.
- Should you have any questions, please contact the undersigned.

**For International Swaps and Derivatives Association, Inc.**



**Keith Noyes**  
**Regional Director, Asia Pacific**

**For Kim & Chang**

A handwritten signature in blue ink, appearing to read 'SK Cheong', with a long, sweeping flourish extending to the right.

**Seong-Koo Cheong, Esq.  
Partner**