

# **FX AND FINANCIAL AUTHORITIES REVIEW PROGRESS AFTER ONE MONTH OF OFFICIAL IMPLEMENTATION OF FX MARKET IMPROVEMENT MEASURES**

- *Over the last month, the Korean FX market has performed well, maintaining system stability, liquidity, and low levels of volatility.*
- *To sustain the current favorable market conditions and encourage greater participation from domestic and foreign financial institutions in Korea's FX market, the market conditions and the entire transaction process will be reviewed monthly.*

First Vice Minister Beom-seok Kim convened a Consultative Council of Foreign Exchange Soundness meeting\* on August 7 at the International Financial Center to evaluate the progress made in the month since the official implementation of the FX market improvement measures. This includes the opening of the onshore FX market to foreign financial institutions (FIs) and the extension of FX market trading hours (from 09:00-15:00 p.m. to 09:00-02:00 a.m.).

\* The vice-ministerial-level consultation group for information sharing and policy discussion and coordination among relevant agencies in the foreign exchange sector

\* Participants: the Ministry of Economy and Finance (chaired by the First Vice Minister), the Financial Services Commission, the Bank of Korea, the Financial Supervisory Service

Participants agreed that the FX market has been performing well in terms of system stability, liquidity, and volatility over the past month, with transactions, confirmation, and settlements continuing smoothly until 2 a.m. Korea Standard Time (KST), which is equivalent to 6 p.m. GMT. They particularly valued that overall trading volume in the FX market has increased<sup>1</sup> from previous years, and that trading volume and bid-ask spreads<sup>2</sup>, indicators of ample liquidity and competitive pricing, remained stable even during the extended hours. However, even considering the early stage of implementation, they shared recognition of the need to increase the participation and trading activities of RFIs<sup>3</sup> and the importance of ensuring liquidity in the late night hours after 23:00 KST (15:00 GMT).

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<sup>1</sup> The average daily volume in July increased by 10.7% year-on-year and 37.4% compared to the last 5-year average

<sup>2</sup> The average spread during extended hours (15:30-2:00 a.m. KST) was 0.39 KRW, compared to 0.63 KRW for NDF during the same period

<sup>3</sup> Registered Foreign Institution: A foreign financial institution located outside Korea that has registered with FX authorities in accordance with the requirements under the Foreign Exchange Act to engage directly in the Korean FX market.

1st VM Kim emphasized that in order for the new system to be established swiftly and stably, the FX and financial authorities should not be complacent with its performance of the past month and must closely examine all processes, including trade execution, confirmation, and settlement for any discrepancies when compared to global standards to encourage more domestic and foreign FIs to actively participate and trade in the Korean FX market. In particular, he mentioned that foreign FIs registered as RFIs or those interested in registering, expressed that they would observe the market liquidity and volatility for at least six months to a year before fully engaging in the Korean FX market. Therefore, we should continue to actively address any improvement needs identified in the course of operations to make trading more convenient for foreign FIs and investors during business hours, while ensuring minimum safeguards are in place. All participants concurred on this and decided to improve the system based on the specific needs of various participants, including foreign FIs, domestic commercial FIs such as domestic banks and securities firms, foreign branches, and local subsidiaries of foreign FIs, in order to further expand Korea's FX market and promote late-night trading over the next six months.

**First, the requirements for RFI registration and the obligation to submit reports to the BOK's FEIS (Foreign Exchange Information System) will be eased to allow more foreign FIs to participate in our FX market.**

Foreign FIs interested in the Korean market but with no prior operations here often hesitate to enter due to the need to establish new credit lines with multiple domestic FIs\* and the lengthy two to three-year legal review process before they can engage in trading financial instruments. To address this issue, foreign FIs will be permitted to trade in the Korean FX market by using the trading infrastructure established by domestic FIs(Substitutional Institutions) or affiliated entities which have already registered as RFIs, which have more than 10 credit lines with Korean domestic banks or securities companies, including subsidiaries and Seoul branches of foreign FIs\*\*.

\* (Current) RFI registration requires a credit line agreement with 10 domestic FIs, including at least four leading banks → (Update) Foreign FIs that have a credit line with either a substitutional institution or an RFI(that has already established a credit line with 10 domestic FIs) can register as RFIs

\*\* Example 1: A London-based Bank B wishes to conduct FX transactions with domestic Bank H. However, since there is no credit line between Bank B and Bank H, Bank B instead conducts a back-to-back trade with another domestic Bank K(Substitutional Institution of bank B), which has a credit line with both Bank B and Bank H. Then, Bank K conducts FX transactions with Bank H at the same price and maturity to conclude the transaction.

Example 2: German Bank G, a subsidiary of the London-based Bank S(RFI), wishes to offer spot or deliverable forwards to its customers. Since Bank G has no credit lines with domestic banks, it instead conducts back-to-back FX transactions with Bank S. Bank S then covers its position in the Korean interbank FX market.

We will also allow RFI applicants to leverage the credit ratings of affiliated entities with which they have financial relationships, such as parent companies within the same corporate group. This change will enable not only foreign FIs but also domestic banks and securities firms\*\* that have established subsidiaries abroad to register these overseas entities as RFIs under the updated criteria.

\* An investment-grade rating (BBB- or higher) from S&P, Fitch, or Moody's is required to register as RFIs.

\*\* Many entities, including those that do not raise funds through bond issuance, have no credit ratings at all.

Meanwhile, in the Consultative Council of Foreign Exchange Soundness meeting in June, it was decided to suspend certain reports for RFIs that are either physically unable to report or are restricted by local laws as foreign FIs. Nevertheless, foreign FIs have expressed concerns about the potential uncertainty and the risk of having to submit new reports if the grace period expires without advance notice. Given this, we decided to completely abolish the reporting obligation for information that would impose a substantial burden on RFIs or that can be indirectly verified through other statistical sources.

#### < Lists of RFI's Reports to FEIS and Major Changes >

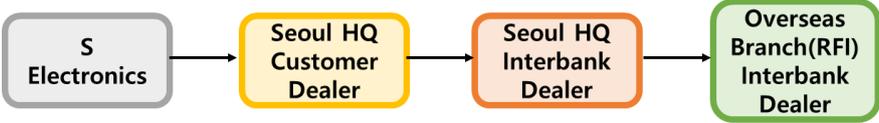
Name	Content	Cycle	Change
FX0028	Balance of RFI's KRW borrowing	Monthly	<b>Disciplinary actions are suspended until year-end</b>
FX0029	Details of RFI's KRW borrowing and repayment	Monthly	<b><u>Intraday KRW borrowing reporting: suspended</u> → <b>abolished</b> Disciplinary actions are suspended until year-end</b>
FX2101 <sup>1)</sup>	RFI's FX trading	T+2	<b>Disciplinary actions are suspended until year-end</b>
FX2111 <sup>1)2)</sup>	Balance of RFI's derivatives trading	Monthly	
FX4410	Intraday position status	T+2	<b><u>Submission of reports: suspended</u> → <b>abolished</b></b>
FX4420	Intraday FX trade status	T+2	

1) Reporting of identifying information, such as the non-resident customer's name (IRC, LEI), is excluded.

2) **Deferred reporting of total forwards positions including NDF positions by RFIs has been abolished.**

**Second, we will increase incentives to strengthen the role of overseas branch RFIs of domestic FIs and to support sustainable after-hours trading desk operations of domestic commercial banks.**

To promote nighttime trading and reduce the fatigue of domestic banks during extended trading hours, overseas branch RFIs of domestic FIs will be allowed to handle resident volumes. Previously, only customer/interbank dealers at the Seoul headquarters could handle resident trading volumes, but from now on, overseas RFIs of domestic FIs will also be able to process such volumes. However, in this case, all transactions with residents must be conducted in the name and under the legal responsibility of the Seoul headquarters given the need to protect customers. (See table below: (2) Allowed)

Status Overview	Detailed Process
<p><b>(1) (Possible)</b>                      customer sales: HQ                      Interbank trading: HQ</p>	 <pre>                     graph LR                     A[S Electronics] --&gt; B[Seoul HQ Customer Dealer]                     B --&gt; C[Seoul HQ Interbank Dealer]                     </pre>
<p><b>(2) (Allowed)</b>                      Customer sales: HQ                      Interbank trading: HQ                      Transfer positions to RFI</p>	 <pre>                     graph LR                     A[S Electronics] --&gt; B[Seoul HQ Customer Dealer]                     B --&gt; C[Seoul HQ Interbank Dealer]                     C --&gt; D[Overseas Branch(RFI) Interbank Dealer]                     </pre>
<p><b>(3) (Under consideration)</b>                      Customer sales: HQ                      Interbank trading: RFI</p>	 <pre>                     graph LR                     A[S Electronics] --&gt; B[Seoul HQ Customer Dealer]                     B --&gt; C[Overseas Branch(RFI) Interbank Dealer]                     </pre> <p>* Review permissibility by year-end</p>

In addition, to encourage nighttime trading, the volume calculation for selecting the leading bank\* in the USD/KRW market will be weighted differently\*\* across various time zones. Overseas branch RFIs' transactions through the books of their Seoul headquarters, including resident volume processing, will also be included in the volume calculation.

\* System outline: Incentives including a reduction in the bank levy are provided to domestic banks which have been chosen for their contribution to facilitating USD/KRW trading on a yearly basis.

\*\* Weighting scheme: 1 x for 9:00-18:00, 2 x for 18:00-22:00, 3 x for 22:00-(T+1) 02:00

**Third, to alleviate the burden of transaction, verification, and settlement processes for foreign investors managed by local custodian banks(Seoul branches or domestic subsidiaries of foreign banks), we will conduct monthly reviews and implement necessary improvements to ensure the entire process of FX transactions by foreign investors runs smoothly.**

As an initial step, we will specify in the Guidelines for Third-Party Foreign Exchange Transactions that only if the real name of the account holder is not involved, the Act on Real Name Financial Transactions does not apply to the verification of the nature or purpose of the account for the purpose of the prevention of payment failure in advance between domestic custodian banks and substitutional institutions in third-party FX transactions.

In addition, a monthly working group will be set up to examine FX transactions and settlement procedures involving local custodian banks and substitutional institutions, the Korea Exchange (KRX), the Korea Securities Depository (KSD), and the Korea Financial Telecommunications and Clearings Institute (KFTC). The major areas for improvement will be reviewed by the FX and financial authorities in the director general level Consultative Council of Foreign Exchange Soundness meetings on a monthly basis.

**<Proposed Structure of Task Force >**

✓ **(Outline)** MOEF and BOK to hold a meeting, collect opinions from relevant agencies and proceed with the discussion.

**1) (Transaction Group)**

- Topics: Third-party FX, inter-institutional credit line agreements, KYC procedures, electronic trading system (eFX), etc.
- Participants: local custodian banks, major domestic commercial banks, etc.

**2) (Settlement Group)**

- Topics: Securities settlement procedures and payment cut-off, CLS settlement, etc.
- Participants: Substitutional institutions, local custodian banks, KRX, KSD, KFTC, etc.

✓ **(Process)** Each group holds a discussion at least once a month, and major issues are discussed monthly at the director general level meeting.

Going forward, the authorities will elaborate on the issues discussed today through the Seoul Foreign Exchange Market Committee and meetings with financial institutions to collect market opinions and finalize decisions. In addition, the implementation progress of the tasks discussed today and the result of the six-month progress in improving the structure of Korea's FX market will be reviewed at the end of the year at the vice-ministerial level Consultative Council of Foreign Exchange Soundness meeting.