
Korea Exchange's Global Strategy: Opportunities and Challenges

Hiromi Hayashi
Financial Industry Analyst
Nomura Institute of Capital Markets Research

I. Stock exchange global strategies

1. Introduction

There has recently been a noticeable tendency for leading Asian stock exchanges to collaborate in listing each other's flagship products to tap hitherto untapped investor demand and boost volumes on each other's markets. On 30 March 2012 stock exchanges in each of the BRICS countries embarked on the first stage of a process of collaboration¹ whereby they each listed futures contracts linked to each of their benchmark stock indices. Then, in September 2012, Singapore and Malaysia took the first step in forming an ASEAN Trading Link that will route orders for stocks traded on ASEAN member countries' stock exchanges via an electronic network. In October the link was extended to a third member country, Thailand².

Most of the stock exchanges in the US and Europe are now global exchanges spanning both continents following a spate of alliances towards the end of the last decade. A good example is the two largest stock exchanges in the US (the NYSE and the NASDAQ), which are now part of the NYSE Euronext Group and the NASDAQ OMX Group, respectively.

Asia, however, has yet to see the kind of M&A activity that US and European stock exchanges have engaged in. a proposal by Singapore Exchange in 2010 to acquire the Australian Securities Exchange was blocked by the Australian government in April 2011. As we mentioned at the beginning, Asian stock exchange markets have concentrated their efforts on cementing existing ties with each other (rather than on engaging in M&A activity) in order to broaden their product lineup and boost volumes.

¹ The exchanges involved in the BRICS' collaboration are the Hong Kong Stock Exchange (China), the Bombay Stock Exchange (India), the MICEX-RTS (Russia), the B&FBOVESPA (Brazil), and the Johannesburg Stock Exchange (South Africa). During the second stage of this process, the five exchanges are due to codevelop the new products to be listed on each other, while, during the third stage, it is envisaged that they will collaborate further in the development of these new products and services.

² For more on the ASEAN Trading Link, see Kadomae, Daisaku, "Tonan Ajia Shihon Shijou Tougou e no Daiippo to Naru Asean Toredingu Rinku no Shidou" (The Start of ASEAN Trading Link as the First Step towards Integrating Southeast Asia's Capital Markets), Capital Market Quarterly, Spring 2012 (in Japanese).

During this time, Korea Exchange (KRX) has been steadily pursuing a global strategy encompassing exporting trading systems, mainly to other Asian countries, helping countries without a stock exchange to establish and operate one, and forming closer ties with the Tokyo Stock Exchange (TSE) Group.

In this report we examine this strategy and what it has achieved, and consider the opportunities and challenges this presents in the light of the changing conditions we expect in 2012.

2. Stock exchange global strategies

Now that a growing number of issuers and investors are operating globally, it has become increasingly important for stock exchanges to have a global strategy.

We can think of five main ways in which stock exchanges can globalize: (1) by expanding the geographical areas in which they operate by engaging in M&A activity with overseas stock exchanges, as US and European exchanges have done; (2) by forming closer links with existing stock exchanges and boosting volumes by increasing the number of products traded on each exchange and attracting more potential investors; (3) by exporting their own trading platforms; (4) by attracting overseas companies and increasing the number of overseas companies applying to be listed; and (5) by helping countries without a stock exchange to establish and operate one.

We would expect these strategies to help to increase the number of overseas and domestic listings as well as the number of market participants and trading value, thereby improving stock exchange profitability and diversifying sources of revenue.

For example, the NYSE Euronext Group had 520 overseas companies listed on its exchanges in the US as of end-2011, nearly 100 more than the 421 listed there four years earlier in 2007, when the group was formed. This compared with 132 overseas companies listed on its exchanges in Europe. As a result, the group earned \$446 million from listings in 2011 compared with \$385 million in 2007.

II. KRX's global strategy

KRX's global strategy dates back to 2005, when Korea's three exchanges—the Korea Stock Exchange (KSE), the Korea Futures Exchange (KOFEX), and the KOSDAQ—merged to form the Korea Stock and Futures Exchange, KRX's predecessor. Ever since KRX set itself the target of becoming "GLOBAL KRX; a premier capital market in Northeast Asia" in its three-year business plan for 2005–2007, it has made its global strategy a priority. It has redoubled its efforts to become a global operation by, for example, becoming a premier exchange playing a leading role on the world's capital markets by 2015.

In this context it is perhaps worth mentioning that KRX's global strategy has been facilitated by government efforts to make Korea an Asian financial hub (e.g., the government's April 2008 financial center initiative), while the *Financial Investment Services and Capital Markets Act* (FSCMA) of February 2009 has helped to speed up the process of bringing Korea's capital markets closer into line with global standards.

The four key aspects of KRX's global strategy are (1) the development and export of IT systems, (2) assistance in establishing and operating stock exchanges in Southeast Asia, (3) persuading overseas companies to list on KRX, and (4) forming closer ties with overseas stock exchanges.

Of these, (1) and (2) involve exporting KRX's expertise (namely, in IT systems and the establishment and operation of markets), presumably in order to gain acceptance of Korean standards as the de facto international standard, especially in the rest of Asia (Figure 1). As this would enable overseas market participants (especially issuers and investors) to familiarize themselves with the KRX model on their own stock

Figure 1: Examples of implementation of KRX's global strategy

Country	Partners	Form of collaboration	Overview
Thailand	Stock Exchange of Thailand (SET)	IT systems, etc.	Renewal of memorandum of understanding aiming to extend cooperation between both exchanges in exchanging information, improving IT structure, and promoting collaborative investment and business opportunities (June 2012)
Malaysia	Bursa Malaysia (BM)	IT systems	Installation of bond trading system at both first and second stage (completed in March 2008 and January 2009, respectively) Installation of market maker monitoring system (completed in April 2009) Development of Islam product trading (BCH) system (completed in August 2009)
Malaysia	Bursa Malaysia (BM)	IT systems	Development and rollout of derivative securities settlement system in conjunction with Bursa Malaysia and the CME Group (February 2012). System enables real-time risk management and real-time monitoring of market participants' exposure.
Philippines	Philippine Stock Exchange (PSE)	IT systems	Plan to roll out stock trading and market monitoring systems (as of 2011) KRX developed Total Market Surveillance (TMS) system introduced by Capital Markets Integrity Corporation (CMIC), a unit of the Philippines Stock Exchange, in May 2012.
Vietnam	Ho Chi Minh City Stock Exchange (HOSE) Hanoi Stock Exchange	IT systems	KRX selected by Vietnamese government as preferred bidder for project to build state-of-the-art trading system (October 2009). Scope of project includes development of 13 equity-related systems (for trading, market research, disclosure, data sharing, clearing, settlement, etc.) and their installation on the country's two stock exchanges.
Cambodia	Cambodian Ministry of Economy and Finance	Establishment and operation of stock exchange	Establishment and operation of Cambodia Securities Exchange as a joint venture.
Laos	Bank of the Lao PDR	Establishment and operation of stock exchange	Establishment and operation of Lao Securities Exchange as a joint venture.
Uzbekistan	Uzbekistan Stock Exchange	IT systems	System upgrade.
Mongolia	Mongolian Stock Exchange and Ministry of Finance	IT systems	Assisted stock exchange with system project and upgraded system.

Source: Nomura Institute of Capital Markets Research, based on various sources

exchanges, it should make overseas companies more willing to consider listing on the KRX, the third aim of KRX's global strategy. This, in turn, should make it easier to form closer ties with overseas stock exchanges, the fourth aim of KRX's global strategy, than if they were using different systems.

1. Export of KRX's stock exchange expertise

1) Development and export of IT systems

As part of its global strategy KRX exports IT systems based on the systems developed for it by its KOSCOM subsidiary. The exported systems are tailor-made to match the requirements of the country concerned. Although most of these systems have been exported to Southeast Asia, KRX has also exported an increasing number of systems to countries in Central Asia (e.g., Uzbekistan, Mongolia and Kazakhstan), the Middle East, and Eastern Europe.

2) Assistance in establishing and operating stock exchanges in Southeast Asia

KRX has exported its expertise, and provided all-round assistance, in establishing and operating stock exchanges in emerging Southeast Asian economies that had previously never had a stock exchange. Examples include the Lao Securities Exchange (LSX)³, established in October 2010 and operational since January 2011, and the Cambodia Securities Exchange (CSX), established in July 2011 and operational since April 2012. In both cases, the stock exchanges were established as joint ventures between KRX and the financial authority of the country concerned (in the case of Laos, the Bank of the Lao PDR, and, in the case of Cambodia, the Ministry of Economy and Finance (MEF)), with KRX taking a stake of 49% and 45%, respectively. Furthermore, KRX directors sit on the boards of both exchanges, having an important say in their decision-making processes.

Helping to establish and operate stock exchanges in emerging economies is a novel approach and one which distinguishes KRX's overseas strategy from that of NYSE Euronext, for example.

(1) Lao Securities Exchange

Operational since 11 January 2011, the Lao Securities Exchange (LSX) has only two listings: EDL Generation-Public Company, a subsidiary of the state owned energy company, Electricité du Laos, and Banque Pour Le Commerce Extérieur Lao (BCEL), the largest bank in Laos.

³ For more on the establishment of the Lao Securities Exchange, see Hayashi, Hiromi, "Ajia Kakkoku to no Renkei o Kyouka Suru Kankoku Torihikijo—Raosu Shouken Torihikijo Setsuritsu ni mo Kan'yo" (KRX Strengthens its Ties with Other Asian Stock Exchanges, Including via its Involvement in Establishing the Lao Securities Exchange), *Capital Market Quarterly*, Winter 2011 (in Japanese).

However, a few other companies are apparently also preparing to list on LSX. On 13 June 2012 Mr Somphent Mounthaly, the director advisor of Laos's largest cement producer, Lao Cement Industry, confirmed the company had applied to list on the exchange at the end of 2012 (i.e., after an eight-month preparatory period)⁴. Similarly, Mr Dethphouvang Moularat, chairman and CEO of LSX, has said that he expects Enterprise of Telecommunications Laos (ETL) and the Lao Indochina Group to list in the near future⁵.

(2) Cambodia Securities Exchange

Operational since 18 April 2012, the Cambodia Securities Exchange (CSX) has only one listing: Phnom Penh Water Supply Authority (PPWSA), which is 85% owned by the government. Two other government-owned companies, Telecom Cambodia and Sihanoukville Autonomous Port (PAS), are also preparing to list on CSX by the end of 2012. However, we are not aware of any such moves by any private-sector companies.

2. Persuading overseas companies to list on KRX

For some time KRX has sought to persuade overseas (and, especially, Chinese) companies to list. The first such listing (on the KOSDAQ) was by the Chinese NOD Digital Group in August 2007. As of end-2011 17 overseas companies were listed (Figure 2). A comparison with the number of Korean companies that listed on KRX during the same period (1,822) reveals that overseas companies accounted for only 0.9% of new listings and that attracting overseas companies has been no easy matter. In this context it is perhaps worth mentioning that in 2011 KRX decided to broaden its focus on Chinese companies and seek to attract overseas companies in general.

3. Forming closer ties with the Tokyo Stock Exchange

In December 2011 KRX signed a memorandum of understanding with the Tokyo Stock Exchange (TSE) Group to form closer ties. As a result and as a first stage, the two exchanges now post share price information about the companies listed on each other on their websites. At a later stage they plan to improve access to each other's markets by listing each other's ETFs, jointly developing and listing derivatives, and carrying out joint research on IT systems.

⁴ "Lao Cement Industry eyes stock market listing," Lao Voices, 15 June 2012.

⁵ "Laos Stock Exchange Outlook 2012," Lao Securities eXchange.

Figure 2: List of overseas companies listed on KRX (as of end-2011)

	Company	Country	Listing	Market	Sector	Type of shares
1	3NOD Digital Group	China	August 2007	KOSDAQ	Multimedia speakers	Common stock
2	Huafeng Group Holdings	China	November 2007	KOSPI	Textiles/clothing	Depository receipts
3	Cowell e-Holdings	China	January 2008	KOSDAQ	Digital camera modules	Common stock
4	United Technology Holdings Company	China	December 2008	KOSPI	Textiles/clothing	Common stock
5	China Food Packaging	China	March 2009	KOSDAQ	Food containers	Common stock
6	China Ocean Resources	China	May 2009	KOSPI	Deep-sea fishing	Common stock
7	China Great Star International	China	May 2009	KOSDAQ	Sports footwear	Common stock
8	China Engine Group	China	December 2009	KOSDAQ	Machinery	Common stock
9	Global SM Tech	China	December 2009	KOSDAQ	Machinery	Common stock
10	China Hao Ran Recycling	China	February 2010	KOSDAQ	Paper manufacturing	Common stock
11	China King-Highway Holdings	China	March 2010	KOSDAQ	Health food	Common stock
12	New Pride Corporation	US	April 2010	KOSDAQ	Truck tires	Common stock
13	East Asia Sports International	China	April 2010	KOSDAQ	Sportswear	Common stock
14	Wayport	China	July 2010	KOSDAQ	Machinery	Common stock
15	Shenglong PV-Tech Investment	China	September 2010	KOSDAQ	Solar systems	Common stock
16	Kolao Holdings	Laos	November 2010	KOSPI	Auto sales	Common stock
17	China Gaoxian Fiber	China	January 2011	KOSPI	Polyester fabric	Depository receipts

Note: A Japanese company engaged in the online services business, Nepro IT, listed depository receipts on KOSDAQ in April 2009 but was delisted on 5 November 2011. Nepro IT was an equity-method affiliate of the Japanese mobile telephone sales company, Nepro Japan, which has now sold its entire shareholding in the company.

Source: Nomura Institute of Capital Markets Research, based on various sources

III. Impact of global strategy

We now consider to what extent KRX's global strategy has contributed to its revenue. Estimating the extent to which KRX's global strategy contributed to or diversified its revenue between its establishment in 2005 and 2011 is no easy matter (Figure 3). For example, KRX's export of its securities expertise (export of IT systems and assistance in establishing and operating exchanges), a key aspect of its global strategy, is included in its operating revenue under "Other," an item that accounted for less than 1% of its total revenue in each year during this period except for 2008 and 2009. Even in 2008, when "Other" accounted for its largest share of total revenue during this seven-year period, its share was a mere 2.9%.

It is perhaps worth mentioning that, although KRX's total revenue rose by some 80% (from KRW36.12 billion to KRW64.80 billion) in the six years from 2005 to 2011, much of that increase came from non-operating revenue, especially "gains related to funds" and "gains accounted for using the equity method."

Also, most of the direct impact on KRX's revenue from overseas company listings and closer market ties is reflected in items such as "listing fees & membership" and "transaction fees." As we have seen, however, KRX's efforts to persuade overseas companies to list have yet to bear fruit, while the details of how it will form closer ties with the Tokyo Stock Exchange (and therefore benefit financially from what could prove a key relationship) have yet to be worked out.

Figure 3: KRX's revenue

(Unit : KRW100 million)

	2005	2006	2007	2008	2009	2010	2011
Operating revenue	2,985	3,012	4,129	2,964	3,669	3,959	4,212
Transaction fees	2,655	2,691	3,776	2,372	3,067	3,256	3,422
Market data service	133	123	144	165	190	231	263
Rental income	99	87	77	125	148	152	152
Listing fees & membership	75	89	123	146	194	286	320
Other	23	22	9	156	70	34	55
Non-operating revenue	627	1,456	1,697	2,362	1,235	2,153	2,268
Interest income	127	129	80	127	75	124	206
Gains related to funds	141	492	822	377	70	753	1,036
Gains accounted for using the equity method	166	613	772	694	1,053	1,179	980
Other	193	222	23	53	37	97	46
Total revenue	3,612	4,468	5,826	5,326	4,904	6,112	6,480

(Share, %)

	2005	2006	2007	2008	2009	2010	2011
Operating revenue	82.6%	67.4%	70.9%	55.7%	74.8%	64.8%	65.0%
Transaction fees	73.5%	60.2%	64.8%	44.5%	62.5%	53.3%	52.8%
Market data service	3.7%	2.8%	2.5%	3.1%	3.9%	3.8%	4.1%
Rental income	2.7%	1.9%	1.3%	2.3%	3.0%	2.5%	2.3%
Listing fees & membership	2.1%	2.0%	2.1%	2.7%	4.0%	4.7%	4.9%
Other	0.6%	0.5%	0.2%	2.9%	1.4%	0.6%	0.8%
Non-operating revenue	17.4%	32.6%	29.1%	44.3%	25.2%	35.2%	35.0%
Interest income	3.5%	2.9%	1.4%	2.4%	1.5%	2.0%	3.2%
Gains related to funds	3.9%	11.0%	14.1%	7.1%	1.4%	12.3%	16.0%
Gains accounted for using the equity method	4.6%	13.7%	13.3%	13.0%	21.5%	19.3%	15.1%
Other	5.3%	5.0%	0.4%	1.0%	0.8%	1.6%	0.7%
Total revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Nomura Institute of Capital Markets Research, based on KRX's annual reports

IV. Creation of a new exchange for recently established SMEs (KONEX)

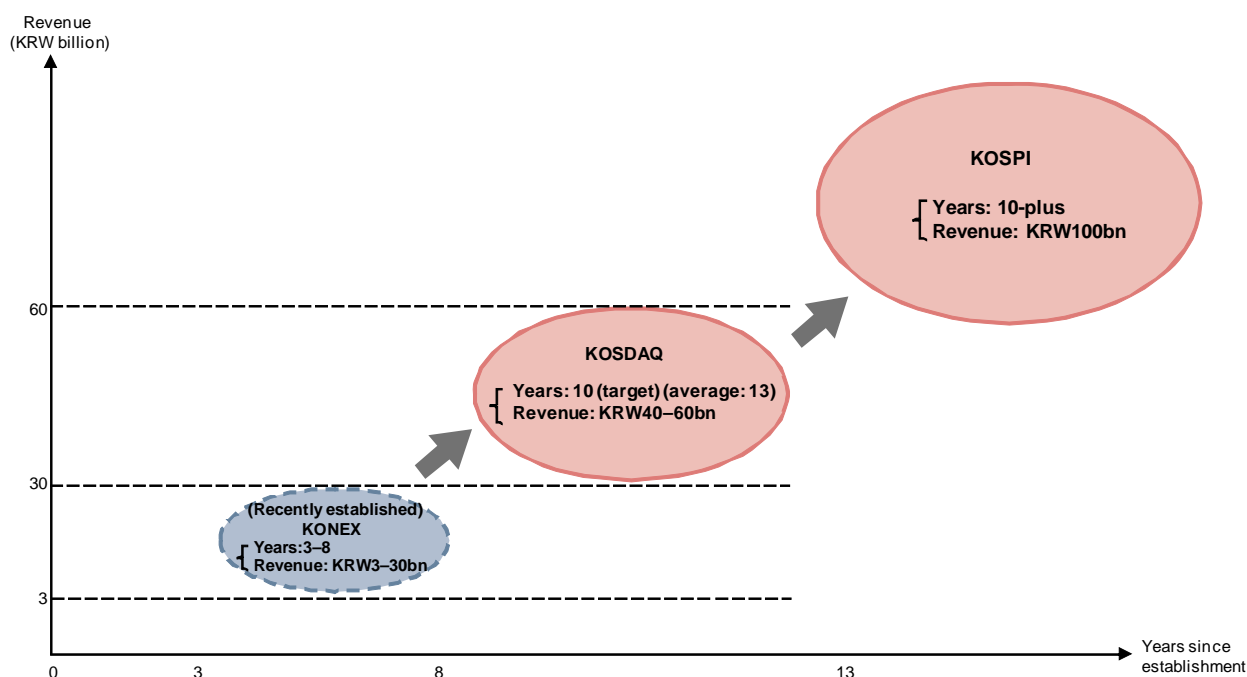
In accordance with an initiative by Korea's Financial Services Commission (FSC), KRX is planning to set up a new exchange for venture start-ups and SMEs (i.e., companies smaller and established more recently than those listed on the KOSDAQ) by the end of 2012. The new exchange will provisionally be called the Korea New Exchange or KONEX.

1. Overview of KONEX

In April 2012 the FSC announced a plan to set up KONEX by the end of 2012 in order to facilitate direct financing of venture start-ups and SMEs through the capital market. If the plan is implemented, KRX will comprise three markets: the KOSPI (the main stock market), the KOSDAQ (for existing start-ups), and the KONEX.

The KONEX is intended for more recently established companies than the KOSDAQ, and the aim is that companies should be able to transfer their listing seamlessly from the KONEX to the KOSDAQ and eventually the KOSPI as they grow (Figure 4). It is therefore unlikely that the FSC will allow companies that are

Figure 4: Relationship between KRX's different stock markets



Source: Nomura Institute of Capital Markets Research, based on data from Financial Services Commission's English blog

eligible to list on the KOSDAQ to list on the KONEX. The facility to transfer a listing from one market within a stock exchange group to another as a company grows is modeled on a similar scheme operated by NYSE Euronext (see above), which permits a company to transfer from (1) the group's free markets (in Paris and Brussels) to (2) NYSE Alternext and (3) NYSE Euronext as it grows and enables the stock exchange operator to "capture" a company when it is still young.

The FSC's plan for the KONEX envisages the following⁶:

First of all, the only investors who would be allowed to invest directly in the shares of companies listed on the KONEX would be (1) 'professional investors' as defined by the FSCMA and (2) those, while not 'professional investors' as defined by the FSCMA, with investment expertise in SMEs⁷. The former category would include financial investment firms (securities companies), mutual funds, policy banks (e.g., Industrial Bank of Korea), banks, insurance companies, and pension funds (National Pension Service), while the latter would include "venture capital"⁸ as defined by the *Support for Small and Medium Enterprise Establishment Act* and retail investors permitted to invest more than KRW500 million in hedge funds.

⁶ "Establishment of Korea New Exchange," press release, Financial Services Commission, 16 April 2012.

⁷ As a rule, retail investors will only be allowed to invest indirectly via investment trusts.

⁸ This is based on the definition in the *Support for Small and Medium Enterprise Establishment Act*.

Second, the KONEX would be required to designate advisors to assist companies wishing to list. Although KRX would have some responsibility for conducting a listing eligibility review, the designated advisor (usually a securities company) would be responsible for ensuring that the listing was carried out properly. Designated advisors would be responsible for (1) (prior to listing) discovering candidate companies, conducting listing eligibility reviews, and arranging sales of the to-be-listed companies' shares to professional investors, and (2) (after listing) assisting the listed SMEs in submitting business reports and holding events for investors. Advisors will be designated by KONEX, and their eligibility will be reviewed on a regular basis by KONEX as well as the financial regulator. KONEX's designated advisor system is modeled on the well known nominated advisor (NOMAD) system of the UK's Alternative Investment Market (AIM) for SMEs and start-ups.

Third, the disclosure requirements will be less stringent than those for companies listed on either the KOSDAQ or the KOSPI. In order to reduce the cost of maintaining a listing, KONEX-listed SMEs will be exempted from having to submit (1) a securities registration or (2) semiannual and quarterly reports⁹. It is perhaps worth mentioning in this context that the FSC is currently drafting detailed rules, including listing, delisting and disclosure requirements, for the KONEX.

Finally, the FSC has said that is discussing with other government departments whether KONEX-listed companies should be granted tax privileges and whether the rules governing the transfer of listings from the KONEX to the KOSDAQ should be eased to encourage such transfers¹⁰.

2. Background to establishment of KONEX

The reason the FSC has taken the initiative to establish the KONEX is its great concern that it takes Korean SMEs an average of 13 years before they can list on the KOSDAQ and that during this time their inability to access Korea's capital markets makes them dependent on bank loans. So long as they are unable to raise the capital they need, they will be unable to realize their full growth potential. As it is, in 2011 Korean SMEs raised 83.3% of the funds they needed in the form of bank loans.

It is also clear from the FSC's 2012 policy agenda of 6 January 2012, which includes "Financial Accessibility for SMEs" along with a "Risk-focused, Forward-looking Approach" and "Microfinance for Low-Income Households," that policies to foster the development of SMEs are one of its priorities. We see the FSC's proposal to establish KONEX as such a policy.

3. Challenges KONEX may have to face

Will KONEX be able to fulfill its role as a source of capital for start-ups and SMEs? If we compare the above three main features of the KONEX with the situation

⁹ It appears that an abridged version of an annual report will be considered acceptable.

¹⁰ "SME stock market to launch this year: FSC," Korea Herald, 5 April 2012.

on existing markets such as the KOSDAQ, it is apparent that this will be no easy matter.

With regard to the first feature (i.e., the restriction to professional investors and the like), we think it is doubtful whether professional investors will want to participate in a market for companies that are even younger than those listed on the KOSDAQ, which is already much more dependent on retail investors than the KOSPI (Figure 5). A breakdown by investor group of transactions on the KOSDAQ in 2011 shows that retail investors accounted for 92.1% of the transactions while institutional investors accounted for only 3.6%. Similarly, a breakdown by investor group of shareholdings on the KOSDAQ in 2011 shows that retail investors held 61.3% of the shares while institutional investors held only 6.6%. It is perhaps worth mentioning in relation to the KOSDAQ that the trading value of KOSDAQ Star Index futures between January and May 2012 was zero. In other words, there is no way for institutional investors to hedge positions in KOSDAQ stocks.

With regard to the second feature (i.e., the requirement for designated advisors), we need to be aware that not all of the markets that copied this requirement from AIM necessarily function properly. We wonder whether the heavy responsibility of being a designated advisor (e.g., having to decide whether a listed company is still suitable for the market concerned or whether it is fulfilling its disclosure requirements properly)

Figure 5: Comparative overview of KOSDAQ and KOSPI

	KOSDAQ	KOSPI
No. of listed companies (as of end-2011)	1,031	791
of which, overseas companies	12	5
Market capitalization (end-2011)	KRW106trn	KRW1,042trn
Average daily trading volume (million shares, 2011)	543.41	353.76
Average daily trading value (KRW billion, 2011)	2,250	6,863.1
Breakdown of trading by investor group (trading value basis, 2011)		
Individuals	92.1%	55.5%
Foreigners	3.3%	18.5%
Institutional investors	3.6%	21.3%
of which, securities companies	0.5%	4.3%
of which, insurance companies	0.5%	2.8%
of which, asset management companies	0.6%	8.3%
of which, private equity funds	0.3%	1.3%
of which, banks	0.2%	1.2%
of which, pension funds	0.6%	3.3%
Government	0.2%	3.1%
Breakdown of shareholdings by investor group (market cap basis, end-2011)		
Individuals	61.3%	20.7%
Foreigners	7.9%	32.9%
Government & public agencies	0.1%	2.6%
Institutional investors	6.6%	13.6%
Non-financial corporations	24.2%	30.2%

Source: Nomura Institute of Capital Markets Research, based on KRX data

discourages advisors from becoming actively involved and limits the number of companies listed on such markets. One example from Japan is the TOKYO-AIM market, formed as a joint venture between the Tokyo Stock Exchange (TSE) and the London Stock Exchange (LSE). This failed from the very start to get off the ground and became a wholly owned subsidiary of the TSE in July 2012.

With regard to the third feature, frequent cases of market abuse and the resulting delisting of companies on start-up markets, whose rules are less stringent than those of main markets, risk destroying investor trust in start-up markets. In the case of the KOSDAQ, for example, the number of companies delisted as a result of being involved in market abuse rose from 23 in 2008 to 74 in 2010.

If KONEX is to have a future as a market where young companies can raise capital, it will have to find solutions to problems such as these.

V. Changes in the competitive environment as a result of alternative trading systems and the emergence of other stock exchanges

Of the various changes that may affect KRX's global strategy in the course of 2012, the biggest impact may come from increased competition as a result of alternative trading systems and the emergence of other stock exchanges.

1. Current state of alternative trading systems in Korea

KRX is currently the only stock exchange permitted in Korea. The only other institution in Korea where stock trading goes on is KoreaCross, an independent securities crossing network founded in 2009 and operated by Instinet. KoreaCross takes orders from customers but uses KRX prices and is therefore considered not to violate the rule prohibiting the formation and operation of any stock exchange other than KRX. KoreaCross is mainly (and widely) used by overseas institutional investors as it is designed to minimize the market impact of block trades (e.g., by using volume-weighted average price (VWAP) trading).

2. Possible amendments to the FSCMA

We expect a bill amending the FSCMA and permitting, as is now normal in other major economies, alternative trading systems and exchanges other than KRX (in order

to counteract the negative results of KRX's monopoly) to be passed by the current (19th) session of Korea's National Assembly¹¹.

We expect the alternative trading systems that emerge as a result of the bill, which defines alternative trading systems as "financial investment agents," which have to be approved by Korea's monetary authorities, to be mainly order-driven. The bill also allows alternative trading systems to become exchanges once they reach a certain size.

In such cases, however, alternative trading systems are also required to perform a listing and supervisory function. Therefore, those that become exchanges are in a different league from those that depend on KRX for clearing and market supervision.

VI. Outlook

As we have seen, KRX's global strategy has achieved some things, including (1) increasing the number of countries to which Korea exports IT systems for stock exchanges and (2) helping to establish and operate the recently established stock exchanges in Laos and Cambodia. As far as KRX's overall global strategy is concerned, however, not only has its success in attracting overseas companies been limited, but it has also failed to contribute significantly to revenue, partly because the process of forming closer ties with overseas stock exchanges has yet to get off the ground. Even the two recently established stock exchanges have only two listings and one listing, respectively, and therefore have a long way to go before they can be said to be fully operational.

With leading Asian countries due to form closer ties, be it in the form of the ASEAN Trading Link or the mutual listing of stock index futures on the main BRICS stock exchanges, KRX will have its work cut out trying to take the initiative in projects aimed at forming such ties. This is because, for example, the ASEAN Trading Link initiative needs to be seen against a backdrop not only of a common membership of ASEAN but also of a growing desire by member states to form an ASEAN Common Market by 2015 and to integrate their capital markets ("ASEAN Exchanges"). Similarly, we cannot rule out the possibility that, by the time the two stock exchanges that KRX has helped to establish and operate (in Laos and Cambodia) become fully operational and look like contributing to KRX's globalization, their role within ASEAN may take precedence. It will be interesting to see what KRX seeks to make of its global strategy and whether it is able to implement it.

¹¹ The bill amending the FSCMA was presented to the National Assembly in 2011 but was abandoned when the session expired. The bill due to be presented in 2012 is basically the same one, the only difference being that, whereas the previous bill was due to be implemented six months after it was passed by the National Assembly, the new bill is apparently due to be implemented three months after it is passed. For more on the bill see Hayashi, Hayami, "The Revisions to Korea's *Financial Investment Services and Capital Markets Act* and Korean Securities Companies' Efforts to Diversify Their Earnings," Nomura Journal of Capital Markets, Winter 2012.