KOREA EXCHANGE

40 Munhyeongeumyung-ro, Nam-gu, Busan, 48400, Republic of Korea / www.krx.co.kr

Commodity Exchange Act Section 2(a)(1)(C)(ii) and (iv), and CFTC Regulation 30.13

October 6, 2021

Meghan Tente
Acting Director
Division of Market Oversight
Commodity Futures Trading Commission
1155 21st Street N.W.
Washington, D.C. 20581

Re: Request for No-Action Relief under Section 2(a)(1)(C)(ii) and (iv) of the Commodity Exchange Act ("**CEA**") and CFTC Regulation 30.13.

Dear Ms. Tente

The Korea Exchange ("**KRX**") is writing to request assurance in accordance with the requirements of Commodity Futures Trading Commission ("**CFTC**" or "**Commission**") Regulation 140.99 that the Division of Market Oversight (the "**Division**") will not recommend that the Commission commence an enforcement action against (i) KRX, (ii) registered futures commission merchants ("**FCMs**"), (iii) foreign futures and options brokers[1], (iv) foreign persons that have received an exemption from registration as an FCM under CFTC Rule 30.10, or (v) U.S. persons that are qualified institutional buyers ("QIBs")[2] with respect to the offer or sale to, or trading by, U.S. persons that are QIBs, of the KOSPI 200 futures contract months or Mini KOSPI 200 futures contract months newly listed on the KRX on and/or from December 1, 2021, and contract months without open interest that were listed prior to December 1, 2021. The requested relief would be effective from December 1, 2021 during the pendency of the Division's review of a submission to the Commission by KRX of a request for expedited review and notice of certification by the CFTC of the KOSPI 200 futures contracts and Mini KOSPI 200 futures contracts (the **"Contracts"**) as non-narrow based index futures contracts pursuant to CFTC regulation 30.13(e).

---

[1] As defined in CFTC Rule 30.1(e).

[2] As defined in Rule 144A under the Securities Act of 1933.

I. FACTUAL BACKGROUND

A. KRX

KRX, headquartered in Busan, Republic of Korea, is the sole securities and derivatives exchange operating in the Republic of Korea. KRX was formed as a result of the merger of the Korea Stock Exchange, the Korea Securities Dealers Automated Quotations Securities Exchange and the Korea Futures Exchange on January 27, 2005. The three formerly independent exchanges are now divisions of KRX. The KRX Derivatives Market, a separate market from the equity markets offers investors futures and options on several classes of assets across equities, currencies, interest rates, commodities and exchange-traded funds. There are 25 products listed on the KRX Derivatives Market, including the KOSPI 200 Futures contracts and the Mini KOSPI 200 Futures contracts. KRX is one of the leading derivatives marketplaces in Asia with abundant liquidity.

KRX serves as the central counterparty to exchange-traded securities and derivatives products that KRX offers. Aside from exchange-traded products, KRX also serves as the central counterparty for certain over-the-counter derivatives.

In 2016, KRX obtained an exemption from certain CFTC foreign futures and options regulations, including relief for its member firms from compliance with FCM registration requirements, under CFTC Rule 30.10. Pursuant to the relief, U.S. persons may access the index futures contracts offered by KRX through a member firm that is permitted to rely on the CFTC Rule 30.10 relief. In addition, U.S. persons may access the index futures contracts offered by KRX through the customer omnibus account of a U.S. registered FCM carried on the books of KRX member firms.

B. The KOSPI 200 Index

Information regarding the KOSPI 200 Index, which underlies the Contracts, is set forth in Appendix A to this letter and demonstrates that such Contracts satisfy the requirements for non-narrow based stock indices set forth in Section 2(a)(1)(C)(ii) of the CEA and Appendix D to Part 30 of the CFTC's Regulations because: (1) the Contracts are cash settled, (2) the Contracts are not readily susceptible to manipulation or to being used to manipulate any underlying security; (3) the index of securities underlying the Contracts is not a narrow-based security index; and there are more than 10 component securities.

KRX previously certified to the CFTC non-narrow based security index futures contracts on the KOSPI 200 index.[3] However, during April 2020, this index became recharacterized as a narrow-based security index due to the weight in the index of the largest component of the KOSPI 200

3 CFTC No-Action Letter No. 08-20 (Nov. 26, 2008), https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/08-20.pdf.

Index exceeding 30%. As a result, the Contracts became security futures contracts subject to the joint jurisdiction and regulation of the CFTC and U.S. Securities and Exchange Commission ("**SEC**"). Since that time only U.S. Persons that are QIBs may trade in the Contracts pursuant to the terms of an SEC Order[4] and related CFTC Advisory[5] relating to foreign security futures. Based on its observations of the KOSPI 200 index, KRX believes that the index is now poised to become a non-narrow based index once again.

II. APPLICABLE LAW

A. Definition of Broad-Based Security Index

The term "broad-based security index" means any index of securities that does not meet the definition of narrow-based security index as set forth in the Act and the Securities Exchange Act of 1934 ("**Securities Act**").[6] An index must not have any of the four characteristics of the narrow-based security index definition to be considered a broad-based security index. Accordingly, to qualify as a broad-based security index, the underlying index must satisfy all of the following criteria: (1) have at least 10 component securities; (2) no component of the index can comprise 30% or more of the index weighting; (3) the five highest weighted components of the index cannot comprise more than 60% of the index weighting; and (4) the lowest weighted components comprising the aggregate 25% of the index weighting must have an aggregate dollar value over a six-month period of over $50 million, or over $30 million if there are at least 15 component securities.

B. CFTC Jurisdiction Over Broad-Based Indices

Under Section 2(a)(1)(C)(ii) of the CEA, the Commission has exclusive jurisdiction over futures on broad-based security index contracts, including the offer and sale of foreign listed contracts to U.S. persons. Unlike other foreign futures and options contracts, which are not required to be formally approved by the CFTC before they may be offered and sold to U.S. persons, the CFTC

---

4 Order under Section 36 of the Securities Exchange Act of 1934 Granting an Exemption from Exchange Act Section 6(h)(1) for Certain Persons Effecting Transactions in Foreign Security Futures and under Exchange Act Section 15(a)(2) and Section 36 Granting Exemptions from Exchange Act Section 15(a)(1) and Certain Other Requirements. (Release No. 34-60194; International Series Release No. 1311) June 30, 2009. The "**SEC Order**".

5 Division of Clearing and Intermediary Oversight (DCIO) Advisory Concerning the Offer and Sale of Foreign Security Futures Products to Customers Located in the U.S. June 8, 2010. The "**CFTC Advisory**".

6 Pursuant to the CEA and the Securities Act, a narrow-based security index is defined as an index of securities that meets any one of the following four requirements: (1) it has nine or fewer components; (2) one component comprises more than 30 percent of the index weighting; (3) the five highest weighted components comprise more than 60 percent of the index weighting; or (4) the lowest weighted components comprising in the aggregate 25 percent of the index's weighting have an aggregate dollar value of average daily volume over a six-month period of less than $50 million ($30 million if there are at least 15 component securities). Section 1a(35)(A) of the Act and Section 3(a)(55)(B) of the Securities Exchange Act of 1934; 7 U.S.C. § 1a(35)(A) and 15 U.S.C. § 78c(a)(55)(A).

must certify a broad-based security index futures contracts before such contracts may be offered or sold to U.S. persons.[7]

C. Characterization of the KOSPI 200 Index

KRX previously certified to the CFTC broad-based security index futures contracts on the KOSPI200 index.[8] However, during April 2020, this index became recharacterized as a narrow-based security index. As a result, the futures contracts on the KOSPI200 index became a security futures contract subject to the joint jurisdiction and regulation of the CFTC and SEC. After closely monitoring the index during the past year and a half, the Exchange has determined that the index will qualify as a broad-based index after the conclusion of the three-month transition period set forth in CFTC Rule 41.14 on November 30, 2021.[9]

D. CFTC Index Transition Period

In 2001, the CFTC and the SEC (together, the "**Commissions**") jointly issued final rules setting forth the requirements for an index underlying a futures contract to be excluded from the definition of "narrow-based security index", among other rules.[10] Because the composition of stock indexes can evolve over time, the rules provide for a three-month transition period for futures contracts whose underlying index changes from narrow-based to broad-based, with the specific goals of minimizing market disruption and providing certainty to market participants as to the applicable regulatory regime. CFTC Rule 41.14 specifies a three-month transition period for indexes that cease being narrow-based security indexes.[11]

E. Guidance Related to the Transition Period

---

[7] Section 2(a)(1)(C)(iv) of the Act; 7 U.S.C. § 2(a)(1)(C)(iv).

[8] CFTC No-Action Letter No. 08-20 (Nov. 26, 2008), https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/08-20.pdf.

[9] CFTC Rule 41.14(b) ("Transition period for indexes that cease being narrow-based security indexes for more than forty-five days. An index that is a narrow-based security index that becomes a broad-based security index for more than 45 business days over 3 consecutive calendar months shall continue to be a narrow-based security index for the following 3 calendar months.").

[10] *See* Method for Determining Market Capitalization and Dollar Value of Average Daily Trading Volume; Application of the Definition of Narrow-Based Security Index; Joint Final Rule, 66 Fed. Reg. 44,490 (adopted Aug. 23, 2001).

[11] CFTC Rule 41.14(b). "An index that is a narrow-based security index that becomes a broad-based security index for more than 45 business days over 3 consecutive calendar months shall continue to be a narrow-based security index for the following 3 calendar months."

The adopting release to the final rules acknowledges that the transition from a narrow-based index to a broad-based index has the potential to disrupt the market, particularly in light of the change in the regulatory regime.[12] The CFTC noted that the three-month transition period "will provide certainty to the market and investors that the index has indeed become broad-based, and is not in the midst of more fluctuation."[13] Moreover, the transition period will prevent market participants that trade in a futures contract with an underlying index that switches from narrow-based to broad-based "from being taken by surprise" when the regulatory regime changes.[14] Thus, one of the goals of the three-month transition period is to provide certainty for traders so that they know when trading in a certain contract will come to an end or when a new regulatory regime begins to govern.[15] In consideration of the potential market disruption that could occur when a futures contract's underlying index changes from narrow-based to broad-based, the CFTC determined to permit markets to continue trading futures contracts when the underlying index has become broad-based without restricting trading to liquidating trades.[16]

In the proposing release the Commissions noted that one of the purposes of the CFTC Rule 41.14 three-month transition period is to provide time for an exchange to come into compliance with CFTC requirements. The Commissions stated that an exchange would need "to take such action as may be necessary to trade the index as a broad-based index subject to the sole jurisdiction of the CFTC" if the exchange intended to trade an index after the transition period.[17] The Commissions reiterated this purpose in the adopting release, and the CFTC further noted that it would provide a "no-action" position for an exchange trading a narrow-based security index futures contracts that became recharacterized as a broad-based security index futures contracts provided that the exchange administers the contracts in accordance with Rule 41.14.[18] The CFTC explained that it would not take enforcement action for violations of the Act when an exchange "is in the midst of the 45-day tolerance provision of paragraph (a), the three-month grace period of paragraph (b), or the unwinding period of paragraph (c)."[19]

---

[12] *See* 66 Fed. Reg. at 44,503.

[13] *Id.*

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] Method for Determining Market Capitalization and Dollar Value of Average Daily Trading Volume; Application of the Definition of Narrow-Based Security Index, 66 Fed. Reg. 27,560, 27,568 (proposed May 17, 2001).

[18] 66 Fed. Reg. at 44,503.

[19] *Id.*

The SEC did not adopt a parallel rule to CFTC Rule 41.14 and said that it was not authorized to adopt such a rule "because the SEC has no jurisdiction over broad-based security index futures."[20] Thus, the operation and administration of the transition from a narrow-based to broad-based index is solely within the purview of the CFTC.

III. NEED FOR NO-ACTION RELIEF

After closely monitoring the KOSPI 200 index during the past year and a half, KRX has determined that the index will qualify as a non-narrow based index after the conclusion of the three-month transition period on November 30, 2021. Pursuant to the provisions of CFTC Rule 41.14(c), U.S. persons (that are QIBs) may, after the transition period, continue to trade contract months in KOSPI 200 futures contract months and Mini KOSPI 200 futures contracts with open interest that were listed prior to December 1, 2021. However, new contract months in the KOSPI 200 futures and Mini KOSPI 200 futures (listed on or after December 1, 2021), which would be non-narrow-based futures contracts subject to the sole U.S. jurisdiction of the CFTC, and contract months without open interest that were listed prior to December 1, 2021, may not be offered or sold to any U.S. persons, including QIBs, absent certification of the contracts pursuant to CFTC Rule 30.13 or relief from the CFTC.

KRX believes that one fair reading of CFTC Rule 30.13(a) and the index transition rule would permit KRX to submit a request for certification to the CFTC during the three-month index transition period, such that the CFTC could issue a certification for the KOSPI 200 futures contracts and the Mini KOSPI 200 futures contracts as non-narrow based effective as of December 1, 2021. It appears, however, that the CFTC's index transition rule is susceptible to alternative readings, and to our knowledge there is no prior precedent for certification during the index transition period of a futures contract based on an index that is transitioning from narrow-based to non-narrow based status. KRX understands that the DMO Staff believe that the language of the index transition rules may not support the approach of submitting a request for certification during the three-month index transition period, and therefore advised KRX that Staff may not be able to act on a request to certify the futures contracts based on the KOSPI 200 Index that is submitted before December 1. Based on that guidance KRX is submitting this request for no-action relief to avoid the potential market disruption that could occur on December 1, 2021 if new contract months of the Contracts and contract months without open interest that were listed prior to December 1, 2021could not be offered or sold to U.S. persons that are QIBs. Through the no-action relief KRX also wishes to provide regulatory certainty to market intermediaries and U.S. persons (QIBs) regarding their ability to access all KOSPI 200 futures contract months and Mini KOSPI 200 futures contracts (i.e., all contract months listed before and after December 1, 2021) following December 1, 2021.

[20] *Id.* at 44,504.

IV. RELIEF REQUESTED

We respectfully request the following relief:

- Effective December 1, 2021 (Korea time), all KOSPI 200 futures contracts and Mini KOSPI 200 futures contracts (regardless of contract month, including all contract months listed before or after December 1, 2021) may be offered or sold to U.S. persons that are QIBs.

- The scope of this relief would apply to KRX, and registered FCMs, Rule 30.10 exempt firms, and foreign brokers acting on behalf of U.S. Persons that are QIBs.

- KRX would submit its request for expedited review and certification to the CFTC pursuant to CFTC Regulation 30.13(e) on December 1, 2021.

- The relief would expire upon the CFTC issuing a notice of certification of the KOSPI 200 futures contracts and the Mini KOSPI 200 futures contracts as being based on a non-narrow based index (which certification would allow the offer and sale of KOSPI 200 futures contracts and Mini KOSPI 200 futures contracts to all U.S. persons (not just QIBs)).

V. CONCLUSION

We believe that providing the requested no-action relief under the circumstances described above is consistent with the established principles of the Commission with respect to the transition of indexes. The Commissions adopted the index transition rules with the goal of minimizing market disruption and providing regulatory certainty to market participants that trade futures contracts with an underlying index that converts from a narrow-based index to a broad-based index. That is precisely what KRX wishes to accomplish through the requested no-action relief.

Currently, U.S. market participants who are QIBs are permitted to trade the existing narrow-based index futures under the SEC Order and related CFTC Advisory. If, on December 1st (after the transition period has concluded), there is no broad-based index certification or no-action relief in effect, all U.S. market participants, including QIBs, would be restricted in their trading of newly listed Contracts and contracts without open interest that were listed prior to December 1, 2021. The absence of CFTC certification or no-action relief effective as of December 1, 2021 would be potentially very disruptive to the KRX derivatives and equity markets and would cut against the stated purpose of the index transition period.

KRX
KOREA EXCHANGE

* * * * * *

We appreciate your attention to this matter. Please do not hesitate to contact Kyungwha Noh at lujinghe@krx.co.kr and Hyungun Ji at hyungun.ji@krx.co.kr or our outside counsel, Michael Philipp at 312-324-1905 or Michael.philipp@morganlewis.com if you wish to discuss this request or require further information.

If for any reason the Division is considering declining to issue relief along the lines requested, we would ask that we be given the opportunity to further discuss this request with you at that time.

The undersigned hereby certifies that the material facts set forth above are true and complete to the best of his knowledge. If, at any time prior to the issuance of the requested no-action letter, any material representation made in this letter ceases to be true and complete, the undersigned will ensure that the Division staff is informed promptly in writing of all materially changed facts and circumstances. If a material change in facts or circumstances related to this request for no-action relief should occur subsequent to issuance of a letter by Division staff, the undersigned will ensure that Division staff is informed promptly in writing of all materially changed facts or circumstances.

Very truly yours,

조효제

Hyojae Cho

President

Derivatives Market Division, Korea Exchange

cc:
Grey Tanzi, Division of Market Oversight
Sanam Gouloubandi, Division of Market Oversight
Chris Goodman, Division of Market Oversight
Michael Philipp, Morgan, Lewis & Bockius LLP

Appendix A

1. KOSPI 200 Index Futures Contract Information

The following information describes the KOSPI 200 and Mini KOSPI 200 Futures contracts (the "**Contracts**") admitted to trade on KRX and demonstrates that such contracts meet the criteria as set out under section 2(a)(1)(C)(ii) of the Commodity Exchange Act (the "**Act**") and Appendix D to Part 30 of the U.S. Commodity Futures Trading Commission ("**CFTC**" or the "**Commission**") regulations, specifically that:

- the Contract provides for cash settlement (section 1.1);
- the Contract is not readily susceptible to manipulation or to being used to manipulate any underlying security (section 1.2); and
- the group or index of securities is not a narrow-based security index (section 1.3).

1.1 Cash Settlement

The Contracts are cash-settled.

The Contracts' final settlement method and final settlement price is stipulated in Article 14 of KRX Derivatives Market Business Regulation and Article 5 of its Enforcement Rules.

The final settlement price of the Contracts is the closing value of the KOSPI 200 Index (the **"Index"**) on the last trading day. In cases where there is no Index value or the calculation of the Index is not possible on the last trading day, it shall be the value of the Index calculated by KRX in accordance with the calculation method of the Index on the basis of the opening price of its constituents on the next trading day.

1.2 Not Readily Susceptible to Manipulation

The Contracts are not readily susceptible to manipulation or to being used to manipulate any underlying security as the Index is not concentrated and trading volume of each underlying stock is liquid. To manipulate the Contract, a market participant would need to manipulate the value of the underlying Index or shares of constituent securities. However, the Index is not concentrated and, with 200 constituent securities, it is improbable that a market participant could manipulate the Index. The liquidity and trading volume of the constituent securities underlying the Index make it unlikely that a market participant could successfully engage in such manipulation. Moreover, KRX has well developed market surveillance system and market management system to detect and prevent manipulation. More information about the Index and KRX's market surveillance system is below.

- The number of stocks underlying the Index is 200.

- Aggregate value of average daily trading volume of stocks underlying the Index is USD 9.651 billion for the six month period of time from March 1, 2021.

- The total market capitalization of stocks underlying the Index is USD 1.673 trillion as of August 31, 2021.

- Market surveillance

  - Pursuant to Article 402 of the Financial Services and Capital Markets Act (**"FSCMA"**) of Korea, KRX establishes the Market Oversight Commission (the "**MOC**") to perform surveillance on trading activities of exchange-traded securities and derivatives products as well as oversight of the KRX Member activities.

  - To detect unfair trading such as manipulation, KRX's MOC operates real-time systems that generate alerts. MOC analysts will closely monitor the detected alerts and conduct an investigation. If the alert demonstrates that a person may be violating Korean law, then the case is reported to the Financial Services Commission (the "**FSC**"), which is a governmental regulatory agency in Korea with oversight of securities and derivatives trading activities. The FSC would conduct a further investigation and either close the case, refer the case to the prosecutors, or take an enforcement action against the alleged individuals or companies.

  - Aside from market surveillance (ex-post), the MOC has introduced some measures (ex-ante) to prevent any possible or potential unfair trading at an earlier stage. If a trading pattern is "seemingly" unfair (e.g., layering, spoofing), then the MOC requests KRX's member firms to give a warning right away to the owner of the account regardless of how abusive the conduct is. The purpose of the preventive measure is to mitigate against further market misconduct. If an investor receives a fourth warning, the investor will be banned for a certain period of time. If member firms do not carry out the preventive action upon the MOC's request, then the MOC may take an enforcement action (which may occur during a regular examination).

  - To prevent manipulation, KRX has implemented controls such as position limits, quotation price limits, quotation quantity limits pursuant to the Derivatives Market Business Regulation and has imposed obligations for member firms to check the suitability of the quotation from customers and deliver the quotation to the KRX derivatives system only when the suitability of quotation is verified.

  - KRX also checks position limits of each account daily just after the closing of market.

  - In case where a customer fails to make the deposit of customer margin or to deliver the net settlement amount, member firms shall conduct the purchase or sale that closes out the open interests held by the concerned customer pursuant to the Derivative Market Business Regulation.

- When the KOSPI Market experiences a trading halt, KRX also imposes a trading halt on all futures contracts on equity and equity indices of the relevant stock market for the same period.

1.3 Index Description

The **Index** is a broad-based index; it is not a narrow-based security index as such term is defined in Section 1a(35) of the Act.

(A) The term "narrow-based security index" means an index:

(i) that has 9 or fewer component securities;

- The **Index has 200 constituents** – see the attached spreadsheet containing data about the Index.

(ii) in which a component security comprises more than 30 percent of the index's weighting;

- On August 31, 2021, the weight within the index of the largest single constituent of the Index was 28.83%.
- The weight within the index of the largest single constituent of the Index was below 30% for 57 business days in past three calendar months from June 2021 through August 2021.
- KRX monitors the Index on a daily basis to check if there are any changes in the weight of the largest single constituent of the index.

(iii) in which the five highest weighted component securities in the aggregate comprise more than 60 percent of the index's weighting; or

- The five highest weighted stocks in the Index comprise less than 60% of the Index's weighting.
- The combined weight maintained below 60% for 65 business days in past three calendar months from June 2021 through August 2021.
- KRX monitors the Index on a daily basis to check if there is any change in the weight of the five highest weighted constituents of the index.

(iv) in which the lowest weighted component securities comprising, in the aggregate, 25 percent of the index's weighting have an aggregate dollar value of average daily trading volume of less than $50,000,000 (or in the case of an index with 15 or more component securities, $30,000,000), except that if there are two or more securities with equal weighting that could be included in the calculation of the lowest weighted component securities comprising, in the aggregate, 25 percent of the index's weighting, such securities shall be ranked from lowest to highest dollar value of average daily trading volume and shall be included in the calculation based on their ranking starting with the lowest ranked security.

- The aggregate value denominated in USD of ADV of the constituents comprising the bottom 25% weighting of the Index is USD 4.416 billion for the 6 month period preceding August 31, 2021.