A Study on Demutualization of Stock Exchanges
— Focusing on the Case of Korea Exchange —

Jung, Nu Ri
(이화여자대학교 국제학부 교수)

[ABSTRACT]
Demutualization generally refers to the process of reorganizing a mutualized, or member-owned, entity into a for-profit corporation with shareholders, and demutualization of stock exchanges means a process of converting exchanges from non-profit, member-owned organizations to for-profit, investor-owned stock corporations. The process of demutualization proceeds in several steps. Exchange demutualization commences when the membership of a traditional non-profit organization that operates a stock exchange reorganizes the exchange as a for-profit institution, and concludes when the exchange goes public and thus become listed.

Nowadays demutualization of stock exchanges is no longer unusual. Many stock exchanges around the world have already demutualized in order to achieve economies of scale as a response to increased competition. In response to such phenomenon, the Korea Exchange (KRX) announced its self-listing plan in the end of February 2011, purporting to make it easier to participate in the ongoing consolidation of global stock exchanges. KRX takes form of a stock company, but has not gone public yet. Thus being a listed exchange means the completion of demutualization to KRX. The exchange began to push for its
self-listing from 2003, but the current situation around KRX is somewhat different from before, because since January 29, 2009 the exchange has been designated a public institution.

The primary purpose of this paper is to study demutualization of KRX and related legal issues. Before examining the case of KRX, the paper first provides overview of exchange demutualization and discusses its implications.

Key Words: Stock exchange / Self-regulatory organization / Public institution / Demutualization / Going public / Self-listing / Conflicts of interest / Shareholding restrictions / M&A threats

I. Introduction

The Korea Exchange (KRX), the sole financial exchange in Korea, announced its self-listing plan in the end of February 2011. If the plan really works, then this means that demutualization of KRX is finally completed.

What is demutualization? Demutualization is the process of reorganizing a mutualized, or member-owned, entity into a for-profit corporation with shareholders.\(^1\) Sometimes the press refers to such transactions as “stockings” in reference to the process of granting stock to policyholders or, more generally, as “privatization.”\(^2\)

In regard to stock exchanges, demutualization means a process of converting exchanges from non-profit, member-owned organizations to for-profit, investor-owned stock corporations\(^3\) with a further step of becoming publicly traded companies.\(^4\) Organized securities and futures exchanges where traditionally operated as non-profit membership organizations, but advances in technology,

---

3) Keaveny, supra note 1, at 1438.
increased competition and other market forces have led numerous exchanges to demutualize.\(^5\) Today the demutualization of securities and futures exchanges is no longer unusual. The world’s major stock markets are now largely for-profit enterprises,\(^6\) Thus, on balance, the trend is clearly toward demutualization.\(^7\)

However, as discussed later, the process of demutualization takes place in stages and can ultimately take several different forms.\(^8\) Some exchanges have gone all the way through, while others have stopped in the middle of the process. KRX has been the one of the latter case. KRX once attempted to fully demutualize itself, but did not succeed at that time. This time the result may be same as before, because any further progress has not been known yet besides the aforementioned announcement regarding KRX’s self-listing plan in February 2011. However, even so, that would not be the end of the story. Someday, sooner or later, the same issue will be taken up for discussion again, as more and more stock exchanges are becoming demutualized.

The primary purpose of this paper is to study demutualization of KRX and related legal issues. The paper first discusses demutualization of stock exchanges in overall and then examines demutualization of KRX.

II. Demutualization of Stock Exchanges

1. Overview of Exchange Demutualization

Traditionally a stock exchange has been organized as a form of mutual, not-for-profit association, founded and owned by their members,\(^9\) brokers and

\(^{5}\) Keaveny, supra note 1, at 1422 n.16.
\(^{7}\) Ibid., at 127 n.184.
\(^{8}\) Aggarwal, supra note 4, at 107.
dealers who managed their stock exchange like an exclusive club, with high barriers for new entrants and a regional or even national monopoly, comparable to a medieval gild.\textsuperscript{10} However, today, domestic and international competition increasingly compels stock exchanges to give up their exclusivity, undergo restructuring, and become publicly traded for-profit companies—a process referred to as demutualization.\textsuperscript{11}

Demutualization, in the strictest sense, refers to the change in legal status of the exchange from a mutual association with one vote per member and possibly consensus-based decision making, into a company limited by shares, with one vote per share with majority-based decision making.\textsuperscript{12} The timing of demutualization is largely seen as being brought about by new competition from electronic communications networks (ECNs),\textsuperscript{13} but also by an increase in trading volume internationally, the integration of capital markets globally, and decimalization.\textsuperscript{14}

As stated earlier, the process of demutualization has several steps and can have several different shapes. In the first phase, members of an exchange are typically given shares in and so become legal owners of the organization.\textsuperscript{15}


\textsuperscript{11} Ibid., at 2542.


\textsuperscript{13} Electronic communications networks, or ECNs, are electronic trading platforms that allow buyers and sellers to match orders directly without routing the order to a broker-dealer or specialist. See Stephen F. Diamond & Jennifer W. Kuan, Ringing the Bell on the NYSE: Might a Nonprofit Stock Exchange Have Been Efficient?, 9 DUQ. BUS. L.J. 1, 4 n.16 (2007).

\textsuperscript{14} Ibid., Decimalization refers to the transition from quoting stock prices in 1/16ths or 1/8ths of a dollar to quoting in pennies, or decimals. The transition to decimal pricing in the United States occurred in 2000. See Daniel N. Budofsky, Current Market Structure Issues in the U.S. Equity and Options Markets, 1835 PLI/CORP 285, 329 (2010). Options markets, however, unlike equities markets, did not move to trading in pennies during the switch to decimalization. Instead, options priced at or above $3.00 traded in $0.10 quote increments, and options priced under $3.00 traded in $0.05 quote increments. See id., at 315–16.

\textsuperscript{15} Aggarwal, supra note 4, at 107.
through a private placement, typically from outside investors as well as members. The demutualized exchange as a privately owned company then has two basic options: the exchange can either (1) stay put as a private company; or (2) list itself by going public and eventually removing all restrictions on trading so as to become a listed company. In other words, self-listing or conducting an initial public offering (IPO) is the ultimate phase of demutualization.

The first exchange to adopt the private corporation format or to demutualize was the Stockholm Stock Exchange in 1993. Since then, a number of exchanges have followed suit — Helsinki followed Stockholm in 1995, Copenhagen in 2006, Amsterdam and Borsa Italiana in 1997, Australian Stock Exchange in 1998, Athens in 1999, and London, Deutsche Börse (Frankfurt) and Euronext (Amsterdam, Brussels and Paris) Hong Kong and Toronto in 2000.

After the grant of exchange status to the Nasdaq (acronym of National Association of Securities Dealers Automated Quotations), now the NASDAQ OMX, and the completion of the merger between the New York Stock Exchange and Archipelago to form the NYSE Group, Inc. (NYSE) in 2006, most major stock exchanges of the world have now demutualized. More recently, the Chicago

---

16) A private placement is a transaction in which securities are offered by the issue to a very small number of purchasers who are typically very sophisticated. See Stuart M. Litwin & William A. Levy, Chapter 14: Securitization of Equipment and Auto Leases, from PLI’s Equipment Leasing—Leveraged Leasing, Fifth Edition, Ian Shrank and Arnold G. Gough, Jr. Editors, 1866 PLI/CORP 333, 372(2011).
17) Ibid.
18) Ibid.
20) At the 1999 Annual Meeting of the World Federation of Exchanges, as many as fifteen out of fifty-two exchanges had demutualized, fourteen exchanges had member approval for demutualization, and another fifteen were thinking about demutualization, which means that only eight exchanges were committed to retaining the mutual form. In another survey in 2003, forty-two out of eighty-five exchanges were demutualized, sixteen were in the process of demutualization, and twenty-seven had no plans to demutualize. Eighteen out of the forty-two demutualized exchanges were listed, See Fleckner, supra note 10, at 2555.
Board of Options Exchange, a U.S. options exchange, made its demutualization IPO in June 2010, and the Warsaw Stock Exchange in Poland was self-listed in November 2010.\footnote{23}

The following (Table 1) provides a summary list of demutualization of major stock exchanges.

\begin{table}[h]
\centering
\begin{tabular}{|l|c|c|l|}
\hline
\textbf{Major European exchanges} & Year of demutualization & IPO/listing date & Major products \\
\hline
London Stock Exchange & 2000 & July 20, 2001 & Equity \\
NYSE Euronext (Europe) & 2000 & July 10, 2001 & Equity, and equity, currency, commodity & interest rate derivatives \\
Deutsche Börse & 2000 & Feb. 5, 2001 & Equity, and equity & interest rate derivatives \\
BME Spanish Exchanges & 2001 & – & Equity, and equity & interest rate derivatives \\
SIX Swiss Exchange & 2002 & – & Equity, and equity & interest rate derivatives \\
OMX Group & 1993 & Jan. 1, 1993 & Equity, and equity & interest rate derivatives \\
Borsa Italiana & 1997 & Oct. 1, 2001 & Equity, and equity derivatives \\
Oslo Børs & 2001 & May 28, 2001 & Equity, and equity derivatives \\
\hline
\textbf{Major North American exchanges} & & & \\
NYSE Euronext (U.S.) & 2006 & Mar. 7, 2006 & Equity \\
NASDAQ OMX & 2001 & July 1, 2002 & Equity \\
Toronto Stock Exchange & 2000 & Nov. 12, 2002 & Equity \\
Chicago Mercantile Exchange & 2002 & Dec. 6, 2002 & Equity, currency, commodity & interest rate derivatives \\
Chicago Board of Trade & 2005 & Oct. 19, 2005 & Equity, commodity & interest rate derivatives \\
Chicago Board of Options Exchange & 2010 & June 15, 2010 & Equity & interest rate derivatives \\
International Securities Exchange & 2002 & Mar. 8, 2005 & Equity derivatives \\
\hline
\end{tabular}
\caption{Demutualization of Major Exchanges\footnote{24}}
\end{table}


\footnote{24}{Reena Aggarwal & Sandeep Dahiya, \textit{Demutualization and Public Offerings of Financial Exchanges}, 18 (5) J. APPLIED CORP. FIN. 96, 98(2006), available at http://faculty.msb.edu/aggarwal/18final.aggarwal.pdf [hereinafter Aggarwal & Dahiya, \textit{Public Offerings}], Changes since 2006 have been updated by the author of this paper. Also the author has amended the sections of Japan, South Korea and Taiwan.}
NYSE Group Inc., the operator of the New York Stock Exchange, and Euronext N.V., the Pan-European stock exchange operator, merged and began trading under the new name, NYSE Euronext, Inc. on April 4, 2007.

Derivative exchanges.

Borsa Italian was merged with the London Stock Exchange, creating London Stock Exchange Group, in an all-share takeover on October 1, 2007.

On June 1, 2006, NYSE and Euronext, two separate publicly held companies at the time, signed an agreement to combine the two securities trading exchanges in a "merger of equals" resulting in the creation of the first trans-Atlantic merger of its kind and the world's first global exchange. The proposed combination was approved by Euronext shareholders on December 19, 2006, and by NYSE shareholders on December 20, 2006. Today, NYSE Euronext Inc., is a U.S. holding company with U.S. headquarters in New York and international headquarters in Paris. The company operates six cash equities exchanges in five countries and six derivatives exchanges in six countries, and it represents a combined $30.3 trillion total market capitalization of listed companies with approximately $139 billion in average daily trading. See Sara M. Saylor, Are Securities Regulators Prepared for a Truly Transnational Exchange?, 33 BROOK. J. INT'L L. 685, 685(2008).

Borsa Italiana itself was listed on the stock market from October 1, 2007, following the takeover of the Italian bourse operator by the London Stock Exchange (LSE). New shares in common holding company LSE Group PLC are traded in London. The merger between the two bourses created a stock exchange with 3,600 listed companies. See Luigi Grassia, LSE Group Begins Trading, LA STAMPA, Oct. 1, 2007, at 21, available at 2007 WLNR 19181129.

---

<table>
<thead>
<tr>
<th>Major Asian/Oceania exchanges</th>
<th>Year of demutualization (25)</th>
<th>IPO/listing date (26)</th>
<th>Major products (27)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tokyo Stock Exchange</td>
<td>2001</td>
<td>–</td>
<td>Equity, and equity derivatives</td>
</tr>
<tr>
<td>Osaka Securities Exchange</td>
<td>2001</td>
<td>Apr. 2, 2004</td>
<td>Equity, and equity derivatives</td>
</tr>
<tr>
<td>Hong Kong Stock Exchange</td>
<td>2000</td>
<td>June 27, 2000</td>
<td>Equity, and equity &amp; interest rate derivatives</td>
</tr>
<tr>
<td>Taiwan Stock Exchange Corp.</td>
<td>1961</td>
<td>–</td>
<td>Equity</td>
</tr>
<tr>
<td>Korea Exchange</td>
<td>2005</td>
<td>–</td>
<td>Equity, and equity, currency &amp; interest rate derivatives</td>
</tr>
<tr>
<td>Singapore Stock Exchange</td>
<td>1999</td>
<td>Nov. 16, 2000</td>
<td>Equity, and equity &amp; interest rate derivatives</td>
</tr>
<tr>
<td>Bursa Malaysia</td>
<td>2004</td>
<td>Mar. 18, 2005</td>
<td>Equity, and equity &amp; interest rate derivatives</td>
</tr>
<tr>
<td>Philippines Stock Exchange</td>
<td>2001</td>
<td>Dec. 15, 2003</td>
<td>Equity</td>
</tr>
<tr>
<td>New Zealand Stock Exchange</td>
<td>2003</td>
<td>June 3, 2003</td>
<td>Equity</td>
</tr>
<tr>
<td>Sydney Futures Exchange</td>
<td>2000</td>
<td>Apr. 16, 2002</td>
<td>Equity, currency, commodity &amp; interest rate derivatives</td>
</tr>
</tbody>
</table>

[1] NYSE Group Inc., the operator of the New York Stock Exchange, and Euronext N.V., the Pan-European stock exchange operator, merged and began trading under the new name, NYSE Euronext, Inc. on April 4, 2007.


[3] Borsa Italian was merged with the London Stock Exchange, creating London Stock Exchange Group, in an all-share takeover on October 1, 2007.


27) On June 1, 2006, NYSE and Euronext, two separate publicly held companies at the time, signed an agreement to combine the two securities trading exchanges in a "merger of equals" resulting in the creation of the first trans-Atlantic merger of its kind and the world’s first global exchange. The proposed combination was approved by Euronext shareholders on December 19, 2006, and by NYSE shareholders on December 20, 2006. Today, NYSE Euronext Inc., is a U.S. holding company with U.S. headquarters in New York and international headquarters in Paris. The company operates six cash equities exchanges in five countries and six derivatives exchanges in six countries, and it represents a combine $30.3 trillion total market capitalization of listed companies with approximately $139 billion in average daily trading. See Sara M. Saylor, Are Securities Regulators Prepared for a Truly Transnational Exchange?, 33 BROOK. J. INT’L L. 685, 685(2008).

28) Borsa Italiana itself was listed on the stock market from October 1, 2007, following the takeover of the Italian bourse operator by the London Stock Exchange (LSE). New shares in common holding company LSE Group PLC are traded in London. The merger between the two bourses created a stock exchange with 3,600 listed companies. See Luigi Grassia, LSE Group Begins Trading, LA STAMPA, Oct. 1, 2007, at 21, available at 2007 WLNR 19181129.
(Table 1) indicates that most major European and North American stock exchanges have completed the demutualization including IPO or self-listing, while major Asian stock exchanges are rather reluctant to go public.

Demutualization of stock exchanges has frequently led to consolidation among stock exchanges\(^{29}\) not only within the border but also across the border. For example, exchanges in Amsterdam, Brussels and Paris have recently combined to form the Euronext N.V. (Euronext).\(^{30}\) The Singapore Exchange Limited (SGX) announced to pursue alliance with Japanese stock exchange and has an existing alliance with the Australian Securities Exchange (ASX)\(^{31}\) — SGX and ASX even entered into a merger implementation agreement on October 25, 2010,\(^{32}\) although the proposed merger was eventually terminated after the Treasurer of Australia officially blocked the deal on April 8, 2011.\(^{33}\) The Hong Kong Exchange is currently expanding its linkages with the Chinese exchanges.\(^{34}\)

---

\(^{29}\) Special Study Group of the Committee on Federal Regulation of Securities, American Bar Association, Section of Business Law, Special Study on Market Structure, Listing Standards and Corporate Governance, 57 BUS. LAW., 1487, 1552(2002) [hereinafter Special Study Group].

\(^{30}\) Euronext N.V. is a holding company for the exchanges incorporated under Dutch law operating as a pan-European exchange with a single platform for cash products and one for derivative products and is the result of a merger in 2000 of the Paris Bourse, the Amsterdam Stock Exchange and the Brussels Stock Exchange. The three exchanges from France, the Netherlands and Belgium, respectively, became subsidiaries under the merger with Euronext N.V. acting as the holding company. Additionally, in 2002 Euronext N.V. expanded further by acquiring LIFFE and merging with BVIP. LIFFE is the London International Financial Futures and Options Exchange, which was founded in 1982 in London, United Kingdom and deals mainly with derivatives, its combination with Euronext was to move all of the derivative products that area part of Euronext to a single platform with a state-of-art trading platform, BVIP, a Portuguese exchange, stand for the Bolsa de Valores de Lisboa e Porto, which was also known as Proto Stock Exchange. After merging with Euronext N.V., its name became Euronext Lisbon. These additions brought Euronext’s presence across most of Europe by establishing subsidiaries in France, Belgium, the Netherlands, United Kingdom and Portugal. See Christopher Osborne, A Look at the Globalization of the Exchanges and Its Effects on the United States Market through an Analysis of the NYSE and Euronext Merger, 1 J. BUS. ENTREPRENEURSHIP & L. 447, 450-51 (2008).


\(^{33}\) Special Study Group, supra note 29, at 1552.
The following (Table 2) provides a list of completed cross-border mergers among major stock exchanges since 2000.

**Table 2** Transnational Integration of Major Exchanges since 2000

<table>
<thead>
<tr>
<th>Year</th>
<th>Acquirer</th>
<th>Target</th>
<th>New operation name</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct. 2008</td>
<td>NYSE Euronext</td>
<td>American Stock Exchange</td>
<td>NYSE Amex Equities</td>
</tr>
<tr>
<td></td>
<td>Nasdaq</td>
<td>OMX</td>
<td>NASDAQ OMX</td>
</tr>
<tr>
<td>June 2007</td>
<td>London Stock Exchange</td>
<td>Borsa Italiana</td>
<td>London Stock Exchange</td>
</tr>
<tr>
<td>Apr. 2007</td>
<td>NYSE</td>
<td>Euronext</td>
<td>NYSE Euronext</td>
</tr>
<tr>
<td>2004</td>
<td>OMX</td>
<td>Copenhagen Exchange</td>
<td>OMX</td>
</tr>
<tr>
<td>2003</td>
<td>OMX</td>
<td>Helsinki Exchange</td>
<td>OMX</td>
</tr>
<tr>
<td>2002</td>
<td>Euronext</td>
<td>LIFFE Portuguese Exchange (BVIP)</td>
<td>Euronext</td>
</tr>
<tr>
<td>2000</td>
<td>Euronext</td>
<td>Paris Bourse</td>
<td>Euronext</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Amsterdam Stock Exchange</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Brussels Stock Exchange</td>
<td></td>
</tr>
</tbody>
</table>

Cross-border mergers have been active particularly among the U.S. and European exchanges. Recent financial market mergers include the link between the NYSE and Euronext in April 2007; the Chicago Mercantile Exchange and the Chicago Board of Trade in July 2007; the London Stock Exchange and Borsa Italiana in October 2007; Deutsche Börse and the International Securities Exchange in December 2007; Nasdaq and OMX Nordic exchange in February 2008; the mergers between the stock exchanges and futures exchanges in Canada and Brazil in May 2008; and the August 2008 link-up between the Chicago Merchantile Exchange and Nymex futures markets.

Even after the completion of the major mergers between the NYSE and the Euronext to form NYSE Euronext in 2007 and the Nasdaq and the OMX to form NASDAQ OMX in 2008, each exchange has sought further possible mergers. For example, on February 9, 2011, NYSE Euronext and Deutsche Börse confirmed

---

35) Aggarwal & Dahiya, *Public Offerings*, supra note 24, at 100. Changes since 2006 have been updated by the author of this paper.

they would merge to become the world’s largest trading platform.\(^{37}\) On October 12, 2011, The Luxembourg Commission de Surveillance du Secteur Financier (CSSF) approved the merger of Deutsche Börse and NYSE Euronext.\(^{38}\)

2. Implications of Exchange Demutualization

Demutualization of stock exchanges brings about both advantages and challenges. First, demutualization brings with it a different corporate governance structure where shareholder interests are likely to dominate over the constituent groups who used to be in a position to exercise veto powers when the exchanges were operated as not-for-profit, member-owned corporations.\(^{39}\) In other words, demutualization is likely to result sooner or later in changes in the corporate mindset to emphasize shareholder value and customer focus.\(^{40}\) Consequently demutualization changes the regulatory framework of stock exchanges and brings about the tension between an exchange’s role as a self-regulatory organization (SRO) and at the same time being a for-profit entity.\(^{41}\) A SRO is a non-governmental entity responsible for regulating its members through the adoption and enforcement of rules and regulations governing the business conduct of its members.\(^{42}\)

---


\(^{39}\) Saylor, supra note 27, at 94.


(Table 3) identifies some of main differences of corporate structures of a mutual and a demutualized exchange.

<table>
<thead>
<tr>
<th>Area</th>
<th>Mutual Exchange</th>
<th>Demutualized Exchange</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership</td>
<td>Members who trade on the exchange</td>
<td>Public shareholders. These may include members, but trading rights and ownership are separated</td>
</tr>
<tr>
<td>Aims of the Exchange</td>
<td>Usually to maintain:</td>
<td>Usually to:</td>
</tr>
<tr>
<td></td>
<td>• an efficient, low-cost trading environment;</td>
<td>• maximize gains from shares;</td>
</tr>
<tr>
<td></td>
<td>• risk-minimized settlement; and</td>
<td>• grow earnings and dividends;</td>
</tr>
<tr>
<td></td>
<td>• quality regulatory framework,</td>
<td>• improve product range and distribution; and</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• protect brand quality including by having a quality regulatory framework.</td>
</tr>
<tr>
<td>Composition of board</td>
<td>• The board usually comprises mostly or solely member representatives,</td>
<td>• The board is usually more diversified,</td>
</tr>
<tr>
<td>and decision-making</td>
<td>• Decisions are usually made on one member, one vote basis,</td>
<td>• Decisions are usually made on a one share, one vote basis,</td>
</tr>
<tr>
<td></td>
<td>• Decision making power is vested with the board,</td>
<td>• Decision making power is vested with the board, but it is likely to be more strategic leaving management to operate the business,</td>
</tr>
<tr>
<td>Acquisitions and alliances</td>
<td>Not usually a priority,</td>
<td>Likely to be a priority, given a desire to maximize growth,</td>
</tr>
<tr>
<td>Capital management</td>
<td>Not usually a priority. Mutual exchanges may maintain high levels of capital backing on the basis of better safe than sorry and to meet statutory requirements,</td>
<td>A key priority as management attempts to maximize shareholder share value. It may be undesirable for the exchange to maintain high cash/liquid reserves as it can weigh down the company’s return on assets.</td>
</tr>
</tbody>
</table>

Second, on the one hand, as seen in the end of the previous chapter, demutualization allows exchanges not only to form alliances with other exchanges around world but also to merge and acquire other exchanges. On the other hand, however, demutualization can expose a self-listed exchange to mergers.

43) Shaw, supra note 40, at 268.
and acquisitions (M&A) threats. It has been said, in light of demutualization, that "the rate of M&A activity seems likely to grow" since the dominant consideration of stock exchanges is now profitability. Consequently the number of stock exchanges operating around the world is likely to shrink.

According to the 2010 Annual Report of the World Federation of Exchanges (WFE), in 2009, 83 percent of its 53 member exchanges was for profit, and 48 percent was publicly listed. In meantime, the WFE’s 2008 Annual Report indicates that in 2007, 8 of the 27 regulated exchanges publicly listed since 2001 were targets of M&A deals, and listed exchanges represent about $300 billion in market capitalization, of which around $100 billion were subject of mergers.

---

44) Saylor, supra note 27, at 694.
45) Ibid.
Third, Asian stock exchanges are less active in completing demutualization—particularly conducting demutualization IPO—than Western stock exchanges. For example, because the Taiwan Stock Exchange Corp. was originally organized in the company form in 1961, no demutualizing plan is needed.\textsuperscript{49} However, according to Article 127 of \textit{Taiwanese Securities and Exchange Law}, stocks of a company-type stock exchange shall not be listed on its own centralized securities exchange market or on a stock exchange owned by any other person.\textsuperscript{50}

In the meantime, the Tokyo Stock Exchange Group Inc. (TSE) was demutualized on November 1, 2001,\textsuperscript{51} but has not listed yet despite its several attempts to go public. At first, TSE’s planned listing was postponed partially due to disagreements between the exchange and the Financial Services Agency over the exchange’s management structure as a listed entity, because the regulator had demanded the exchange to separate its regulatory division from the stock trading-related division.\textsuperscript{52} Later TSE planned to conduct an IPO again by the end of 2009, but on March 25, 2009, the exchange announced to delay going public until the fiscal year starting April 2010 or later, because the global financial crisis caused the Tokyo stock market to tumble.\textsuperscript{53} Postponing an IPO could be viewed as an effective form of risk management during times of large financial shocks, because launching an IPO during times of great turbulence in

\begin{footnotesize}
\begin{enumerate}
\item Ibid.
\item Aggarwal & Dahiya, \textit{Cross-Country Merger}, supra note 41, at 146.
\end{enumerate}
\end{footnotesize}
financial markets requires a great deal of flexibility, focus and patience among companies and their bankers. On March 10, 2011, TSE announced its plans to start preparing its IPO and to hold merger discussions with Osaka Securities Exchange Co.\textsuperscript{55}

III. Demutualization of the Korea Exchange

1. Structure of the Korea Exchange

Until 2004, the Korean stock markets consisted of the Korea Stock Exchange (KSE), established in February 1956, the Korean Dealers Automated Quotations (KOSDAQ), established in July 1996, and the Korea Futures Exchange (KOFEX), established in April 1999.\textsuperscript{56} Then, on January 19, 2005, KRX was created through the merger of the KSE, the KOFEX and the KOSDAQ, under the \textit{Korea Securities and Futures Exchange Act}, and is now the sole exchange in Korea.\textsuperscript{57} In the process, the structure of KRX was chosen to be a stock company, converted from a membership organization. This conversion signifies KRX’s completion the first phase of exchange demutualization. Because KRX has not conducted its IPO yet, KRX is still on the verge of the first and second phases of the demutualization process. In other words, KRX has not completely demutualized and thus is not a (fully) demutualized exchange yet.

Since the enactment of the \textit{Financial Investment Services and Capital Markets Act} (FSCMA) which was approved by the National Assembly on July 3,
2007 and became effective on February 4, 2009, KRX is primarily regulated under Articles 373 to 414, Part VII of FSCMA and provisions of the Commercial Act on stock companies. KRX is established in order to fix and stabilize fair prices in transactions of securities and exchange-traded derivatives as well as to facilitate the stability and efficiency of other transactions. Under FSCMA, KRX, headquartered in Busan, is structured to be a stock company with a capital of not less than 100 billion won. According to the WFE, domestic market capitalization of KRX was around $1,091,911 million in the end of 2010. The highest decision-making body of KRX is its shareholders’ meeting.

The exchange which was originally a government-owned company became privatized and was incorporated into a membership organization on March 1, 1988. However, since January 29, 2009 the exchange has been designated a public institution that is subject to audit by the Board of Audit and Inspection and under government control in terms of budget and human resources. Under the Act on the Management of Public Institutions (AMPI), the Ministry of Strategy and Finance (MOSF) may designate an organization producing over 50 percent of its income from a monopolistic business as a public institution. Since the 2005 merger among the KSE, the KOFEX and the KOSDAQ, the new exchange has been the only bourse in Korea and has been generating over 50 percent of its income from a monopolistic business. Discussion of whether such

---

58) Financial Investment Services and Capital Markets Act (hereinafter FSCMA) §374 (2007) (“Except as otherwise provided in this Act [FSCMA], the provisions of the Commercial Act on stock companies shall apply to the Exchange [KRX].”)

59) Ibid., §373.

60) Ibid., §375.

61) WFE 2010, supra note 47, at 74.


According to the announcement by the MOSF on January 24, 2011, KRX is categorized as a "commissioned-service-based quasi-government institution" which makes it difficult to categorize KRX as a SRO anymore. First of all, it is because SROs are basically non-governmental organizations, although entrusted with quasi-governmental authority. In other words, while SROs are considered to be quasi-public institutions, they have traditionally been recognized as private entities—not public or government entities. Secondly, it becomes clearer if compared with designated business of

---

67) Public institutions are classified into three categories in large—public corporations, quasi-governmental institutions and non-classified public institutions. Quasi-governmental institutions are further subcategorized into fund-management-based quasi-government institutions that are quasi-governmental institutions to which the management of a fund is assigned or commissioned under the National Finance Act; and commissioned-service-based quasi-governmental institutions that are quasi-governmental institutions other than the fund management the fund-management-based quasi-governmental institution. AMPI §5.
69) Jay A. Dubow et al., Should the 1st Choice Involve Taking the 5th?: Some Possibilities and Consequences in SEC Probe, 13-AUG BUS. L. TODAY 23, 24(2004). For this reason, the author of this paper does not agree with the statement presented in Asian Capital Market Law and Regulation Forum on July 10, 2009. See Suk Hyun, Regulation and Self Regulation for Asian Bond Markets Development 8, in Asian Capital Market Law and Regulation Forum: Japan, China and Korea (July 10, 2009), available at http://www.globalcoe-waseda-law-commerce.org/activity/0710seoul/Hyun_BOK.pdf (indicating KRX as a SRO). The author’s argument can be somewhat supported by the World Bank’s Policy Research Working Paper, entitled "Self-Regulation in Securities Markets," published in January 2011. Throughout the paper, KRX is never mentioned even once, although the Korean Financial Investment Association (KOFIA) is mentioned quite a few times. In addition, the paper does not include KRX in its list of SROs. Examples of SROs in the list include ASX, Financial Industry Regulatory Authority, Hong Kong Exchanges & Clearing, Japan Securities Dealers Association, KOFIA, LSE, Nasdaq, National Stock Exchange in India, NYSE, Osaka Stock Exchange in Japan, SGX, TMX Group in Canada, TSE—but not KRX. Of course, the list selects only a few exchanges in the world that are relevant to the topic of the paper. However, considering the fact that the list has KOFIA but not KRX may imply a subtle issue of uncertainty whether KRX can still be considered to be a SRO or not. See John Carson, Self-Regulation in Securities Markets 64-65 (World Bank Sec. Markets Group, Global Cap. Markets Dep’t., Fin., & Private Sector Dev., Policy Research Working Paper No. 5542, 2011), available at http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2011/01/24/000158349_20110124091038/Rendered/PDF/WPS5542.pdf,
the Korea Financial Investment Association (KFIA)\(^{70}\) under Article 286 of FSCMA. The statute explicitly states that the KFIA shall perform self-regulation to maintain sound trade practice among the members and to protect the interest of investors,\(^{71}\) but does not indicate such part in regard to KRX.

2. Issues Involved in Demutualization of the Korea Exchange

(1) Overview

Under the regime of FSCMA, KRX may conduct its IPO subject to the supervision of the Financial Services Commission, Article 409 of FSCMA opens the way for KRX to self-list on its bourse upon approval of the Financial Services Commission.\(^{72}\) When KRX self-lists its own securities, KRX shall conduct any investigation of abnormal trading, surveillance of members, ongoing disclosure and any other management of such listing by itself and report the results thereof to the Financial Services Commission.\(^{73}\)

In the end of February 2011, KRX announced its IPO plan purporting to make it easier to participate in the ongoing consolidation of global stock

\(^{70}\) The KFIA was established on February 4, 2009, which was the enforcement date of FSCMA, in response to the Act’s implementation. Korea Financial Investment Association, http://www.kfsa.or.kr/english/intro/welcome.cfm (last visited Sept. 24, 2011). The KFIA was created through the integration of the Korea Securities Dealers Association, established in November 1953, the Asset Management Association of Korea, established in May 1996, and the Korean Futures Association, established in December 1996, as a non-profit organization, FINANCIAL SUPERVISORY SERVICE, FINANCIAL SUPERVISORY SYSTEM IN KOREA 24(2008), available at http://english.fss.or.kr/fsseng/emdc/prs/fss_v.jsp?btmIndex=169&fsIndex=5140&selectType=0&find=. The KFIA aims to coordinate conflicts of interest among market participants, to establish a consolidated self-regulatory system, and to advance the Korean capital and derivative markets. Hyo-sik Lee, Universal Financial Investment Firms to Be Established, KOREA TIMES, Dec. 24, 2008, available at 2008 WLNR 24676720.

\(^{71}\) FSCMA §286 ("The Association [KFIA] shall perform the business falling under each of the following subparagraphs as prescribed by the articles of incorporation: 1. Self-regulation to maintain sound trade practice among the members and to protect the interest of investors; ..."),

\(^{72}\) Ibid., §409(1) ("The Exchange [KRX] shall, when it lists or de-lists securities issued by the Exchange itself, obtain approval of the Financial Services Commission.")

\(^{73}\) Ibid., §409(2).
However, this is not the first IPO consideration of KRX—the exchange began to push for its self-listing from 2003. For example, the exchange launched its IPO plan on September 22, 2006, but announced on August 28, 2007 to indefinitely delay the plan after failing to narrow differences on several key issues with the government—the MOSF (the former Ministry of Finance and Economy) and the Financial Services Commission.

One of the controversial issues at that time was the revision of securities regulation to detach from KRX the exchange’s Market Oversight Commission which monitors irregularities in stock trading before KRX gets listed on bourse. KRX, however, was against the idea because of the fear that the exchange would be nothing more than a simple mediator of stock transactions in that case. Also the exchange wanted to decide stock trading commissions on its own, while the ministry argues that a public operation committee should play the role. In addition, the federation of unions of securities firms strongly opposed the exchange’s IPO plans, saying that KRX is not ready for such a task yet and the listing will expose the exchange to M&A threats.

The current situation is not exactly the same as before, although the fundamentals have not changed much. The reason is that technically at present KRX is not a SRO but a public institution. Nonetheless, because the government designates public institutions each year from a zero base, it is possible for

---

78) Ibid.
79) Ibid. The reasoning behind the ministry's arguments is that as a profit seeking corporation monopolizing the market, KRX should not be in charge of judging listing of companies, because public interest could be damaged if KRX continuously has such power even after getting listed. See Ibid.
KRX to be reclassified as a non-public organization, when the exchange no longer satisfies terms and conditions for a monopoly under relevant regulations. Two big issues involved in demutualization of KRX — particularly in regard to the exchange’s self-listing — are: (1) conflicts of interest; and (2) ownership restrictions and M&A threats. Each is separately discussed in more detail below.

(2) Conflicts of Interest

Conflicts of interest are inherent in a demutualized exchange, because the exchange now attempts to maximize profits while still performing its regulatory functions. Incentives to under-regulate abound and may lead to problems such as underfunding an exchange’s regulatory arm for a more impressive income statement, or hesitating to discipline a member at fault for fear of losing that member’s business. Conversely, an exchange’s for-profit status may create an incentive to over-regulate because the fines the exchange levies against their members go directly into their coffers, providing immediate revenue.

Self-listing would pose issues of conflicts of interest to KRX, even though KRX is now a public institution. To be a public institution does not mean to be totally deprived of its self-controlling management. Some duties that KRX shall perform under Article 377 of FSCMA are: establishment of and operation of the securities and derivative markets; transactions of securities and exchange-trade derivatives; listing of securities; and report and disclosure of a listed corporation. Pursuant to Article 377, FSCMA further allows the exchange to prescribe the Listing Regulations of securities for reviewing the securities to be listed and for managing listed securities in Article 390, and to make the Disclosure Regulations


83) Ibid., at 424.

84) AMPI §3 (“The Government shall guarantee the self-controlling management of public institutions to establish the accountable management system in public institutions.”).
of stock-listed corporations to report, disclose and manage the matters related to such corporations in Article 391.

In other words, although being a public institution, KRX is a primary institution that reviews an applicant for listing and makes a decision on the result of listing eligibility review pursuant to its Listing Regulations. Furthermore, listed companies are required to submit their disclosure documents to KRX pursuant to its Disclosure Regulations. This means that self-listing of shares of KRX may pose issues of conflicts of interest if listing or disclosure standards and its oversight are composed by the exchange concerned. However, the listing standards for KRX should be the same for other listed companies, and so do the disclosure standards for the exchange. As a public institution now KRX is subject to stricter audit, inspection and scrutiny of the government. Such government involvement should work in a way that helps monitor conflicts of interest issues more closely.

Under Article 32 of the KOSPI Market Listing Regulation, unless otherwise indicated, requirements for initial listing of stocks include, but not limited to, the following: the companies issuing such stocks have been in continuous operation for at least three years; the number of shares to be listed shall be at least 1,000,000 and the equity capital shall be at least KRW 10 billion or the base market value shall be at least KRW 20 billion; the largest shareholder on the date that is one year before the application date for listing eligibility review shall not have been changed for one year period thereafter; no restriction shall be placed on transfer of shares; and the companies should meet requirements regarding stock distribution, business performance, auditor’s audit opinion.\(^{85}\) As a stock company established under the special laws, KRX is eligible for exemption from the aforementioned requirements except the stock distribution requirement.\(^{86}\) In addition, as previously mentioned, KRX should receive approval from the Financial Services Commission when it becomes listed.

\(^{85}\) KOSPI Market Listing Regulation §32(1) (2005).

\(^{86}\) Ibid., §32(4).
According to the KOSPI Market Disclosure Regulation, a listed company shall faithfully report any matters subject to disclosure obligations—including but not limited to material information, information subject to fair disclosure, annual reports—and be diligent in order to avoid any change or reversal of details already reported. After going public, KRX should observe such disclosure obligations like other listed companies.

Some other duties of KRX under Article 377 of FSCMA are: surveillance of abnormalities in trading, including abnormal fluctuation of prices or volumes of securities or exchange-traded derivatives and the investigation of members; and self-resolution of disputes (limited to cases where any related party applies for resolution) arising from transactions in the securities market, KOSDAQ and the derivatives market. FSCMA further requires the exchange to establish the market supervision committee and the market supervision committee to make Market Surveillance Regulations as well as Dispute Resolution Regulations.

Accordingly KRX internally has the Market Oversight Commission. According to KRX’s current website, “the Market Oversight Commission is an internal agency of KRX pursuant to laws governing the [exchange] and performs self-regulation duties on securities and futures markets.” However, because precisely KRX is not a SRO anymore, it would be more appropriate to state that the Market Oversight Commission performs designated authorities related to self-controlling management rather than self-regulation duties. The term, “self-controlling management”, is used in Article 3 of AMPI, KRX’s more emphasized public characteristics as a public institution would mandate greater separation between its regulatory and operational functions.

In detail, the Market Oversight Commission conducts the following business:

---

88) FSCMA §402.
89) Ibid., §403.
90) Ibid., §405.
91) Korea Exchange, About KRX: Divisions, https://eng.krx.co.kr/m9/m9_1/m9_1_5/m9_1_5_5/UHPENG09001_05_05.html (last visited Sept. 30, 2011).
such as: market surveillance, investigation of abnormal trading and supervision of members; cross-market surveillance among the securities market, KOSDAQ and the derivative market; discipline of members or decision on the requests for disciplinary measures against executives or employees concerned as a result of the investigation of abnormal trading, supervision of members, cross-market surveillance among the securities market, the KOSDAQ and the derivative market; self-resolution; and establishment, amendment and repeal of the Market Surveillance Regulations and the Dispute Resolution Regulations.\(^{92}\)

As previously mentioned, according to Article 409(2) of FSCMA, it is KRX itself that shall conduct any investigation of abnormal trading, surveillance of members, ongoing disclosure and any other management of its self-listing. Thus it is the Market Oversight Commission, an internal body of KRX, which would perform such investigation and surveillance of the exchange. What the Financial Services Commission does in the process is just to get reported the results from the exchange.\(^{93}\) Although FSCMA requires KRX to obtain approval from the Financial Services Commission when the exchange lists or de-lists securities issued by KRX itself,\(^{94}\) this measure may not be sufficient to handle potential conflicts of interest.

Different jurisdictions have dealt with conflicts of interest in different ways — some such as Australia and the United Kingdom took away some regulatory oversight functions that had been delegated to exchanges, while others such as Singapore kept both commercial and supervisory functions within one exchange. Cases of Australia and Singapore are introduced in more detail below.

When the Australian exchange went public, its government was assigned the task of overseeing exchange disclosure to shareholders.\(^{95}\) The *Corporations

---

\(^{92}\) FSCMA §402(1).

\(^{93}\) Ibid., §409(2).

\(^{94}\) Ibid., §409(1).

Act 2001 has conferred power on the Australian Securities and Investments Commission (ASIC) to administer listing of ASX in relation to ASX as a self-listed exchange. ASIC and ASX have entered into a number of Memorandum of Understanding (MOU) regarding roles of ASIC and ASX upon ASX’s self-listing. ASIC supervises ASX’s self-listing and undertakes the day-to-day supervision of its compliance with listing rules to ensure that the exchange is subject to independent scrutiny. ASX is obligated to notify ASIC of its rules and pay fees related to self-listing to ASIC.

To ensure fair operation of its markets, ASX has placed its operational supervisory functions in a wholly-owned subsidiary, ASX Market Supervision Pty Limited (ASXSM), which operates under safeguards of independence and monitors compliance with ASX listing requirements, ASX rules as to broker participation in its markets, and ASX clearing and settlement rules. ASXSM was established on July 1, 2006 to assume responsibilities for all of ASX’s key operational supervisory functions, and as a result ASX Supervisory Review Pty Limited (ASXSR) ceased operations on October 30, 2006. ASXSR embodied a unique experiment among regulatory responses to conflicts of interest facing self-regulation following the demutualization and listing of ASX in 1998.


98) Hughes, supra note 95, at 172.

99) Shamshad Akhtar, supra note 12, at 22.

100) Gadinis & Jackson, supra note 12, at 1321.


102) Gadinis & Jackson, supra note 12, at 1321 n.277.
exercise the regulatory powers granted by law to ASX and rather acted as an independent auditor that reviewed ASX’s own performance of its regulatory functions.\(^{103}\)

In the meantime, capital markets of Singapore operate under a dual-level regulatory framework. The Monetary Authority of Singapore (MAS), as the statutory regulator, has overall supervision of the financial and capital markets, including SGX itself, and maintains oversight of the exercise of regulatory responsibilities delegated to SGX, while SGX functions as the frontline market regulator.\(^{104}\) Such dual-level regulatory framework became more settled on September 1, 2007 when oversight of corporate governance practices of listed companies was transferred to MAS and SGX from the Council on Corporate Disclosure and Governance (CCDG).\(^{105}\) CCDG was created in August 2002 to set accounting standards, strengthen the framework on disclosure practices and reporting standards, and to review and make recommendations to the Ministry of Finance on revisions to the Code of Corporate Governance.\(^{106}\)

The Exchanges (Demutualization and Merger) Act 1999 has given MAS the power to issue directives to SGX in the interest of ensuring fair and orderly securities and futures markets and proper management of systemic risks, and thus MAS has the authority to put things right, where any potential conflicts of interest become real.\(^{107}\) In addition, a series of Deeds of Undertaking by SGX

\(^{103}\) Ibid.

Conflicts of interest are inherent in demutualized exchanges. There is no single resolution of the issue that is appropriate for all countries. Nevertheless possible types of regulatory structure to deal with conflicts of interest upon the completion of KRX’s demutualization can be narrowed down into two in large. One is that of Australia – separation of oversight from KRX, and the other is that of Singapore – delegation of oversight to KRX. However, either way, KRX should be assumed as an issuer like other listed companies when KRX lists and delists on its bourse.

Because KRX is currently a public institution subject to a higher level of government scrutiny, the former method appears a bit more suitable for the case of KRX. Then there would two further options – either to have an independent body similar to ASXSM of ASX to perform the exchange’s operational supervisory functions, or to shift regulatory authority from KRX to a financial regulator as in case of the United Kingdom. As to the first option, rather than creating a new body, making the Market Oversight Commission, now an internal body of KRX, independent of KRX can be considered. As to the second option, enhancing powers of the Financial Services Commission can be considered.

The Financial Services Authority in the United Kingdom undertook many powers that the London Stock Exchange (LSE) previously monopolized, including the power to decide on listing applications for the stock exchange’s markets.110) As

---

109) DOU ¶ 3.6.
110) Gadinis & Jackson, supra note 12, at 1266.
a result, since May 1, 2000, the Financial Services Authority, in its capacity as the UK’s listing authority, has set listing standards for the Official List of the LSE.\footnote{A. Douglass Harris, *The Impact of Hot Issue Markets and Noise Traders on Stock Exchange Listing Standards*, 56 U. TORONTO L.J. 223, 233(2006).}

The case of Australia is distinguished from that of the United Kingdom. ASIC assumed direct listing authority over the ASX, as a listed issuer of securities, but permitted the ASX to retain listing authority over all other listed issuers.\footnote{Special Study Group, supra note 29, at 1552.}

Furthermore, according to KRX’s Membership Regulation which stipulates necessary matters with respect to administration of its members pursuant to Article 387 of FSCMA, members of KRX pay membership-related fees to KRX. In addition, the members are required to pay fees related to listing to KRX in accordance with KRX’s Listing Regulations and Enforcement Rules of Listing Regulations. When KRX gets listed, KRX should meet criteria for member admission under the Membership Regulation. However, fees related to self-listing should be managed by an independent authority from and other than KRX—probably the Financial Services Commission.

In the process of going public, it is required for KRX to work in close cooperation with the Financial Services Commission. A series of agreements such as memorandum of understanding or deed of undertaking might be necessary between KRX and the Financial Services Commission.

### (3) Shareholding Restrictions and M&A Threats

The primary driver for demutualization is common among exchanges— to meet increased competition from other exchanges, including non-traditional trading markets such as ECNs or alternative trading markets.\footnote{Roberta S. Karmel, *Motivations, Mechanics and Models for Exchange Demutualizations in the United States, in DEMUTUALIZATION OF STOCK EXCHANGES: PROBLEMS, SOLUTIONS AND CASE STUDIES* 59, 61 (Shamshad Akhtar ed., 2002), available at http://www.adb.org/documents/books/demutualization_stock_exchanges/demutualization.pdf.} The growing competitive pressure has further triggered a wave of mergers and alliances among securities markets to maximize economies of scale, accessibility and...
market reach, while providing global trade facilities through around the clock trading.\footnote{114)}

KRX has attempted to catch up with such trend by setting up new stock exchanges abroad and building up alliances with overseas exchanges through exporting its IT system to those exchanges and helping them become modernized. Although this kind of international cooperation is desirable and thus should be encouraged, it does not directly achieve economies of scale. Because KRX has not been listed on a bourse yet, shares of KRX can only be traded through private placement. This makes it difficult for KRX to pursue M&As, stake swaps and cross-listings with other bourses. It is what concerns KRX and why KRX wants to go public.\footnote{115)}

In addition, shares of KRX are subject to shareholding or ownership restrictions. Ownership restrictions are a controversial issue. On the one hand, such restrictions fetter a market for corporate control and thus cause inefficiency; while on the other hand, ownership restrictions are necessary because it is undesirable on public policy grounds to allow an individual or a small group to control a stock exchange.\footnote{116)} Securities regulators often place restriction on ownership by one holder or a group of holders to non-controlling stakes of five to ten percent in order to avoid stock exchanges operating in special or limited interests.\footnote{117)} In this regard, such shareholding limit is recognition of a potential conflict of interest.

In case of SGX, other than strategic owners should receive MAS’s approval for holdings beyond five percent, while strategic owners – financial institutions

\footnote{114) Shamshad Akhtar, supra note 12, at 6.}
\footnote{115) The following is an excerpt from an interview of Mr. Kim, Bong-soo, marking his first anniversary as chairman and CEO of KRX on February 25, 2011. "Going public is a matter of survival. … If we do not get bigger, we will get relegated to a small stock market in the corner of Asia." See Da-ye Kim, supra note 37.}
\footnote{117) Shamshad Akhtar, supra note 12, at 8.
or government-linked entities — are allowed to go beyond five percent but should obtain MAS’s approval for holdings above ten percent.\footnote{118} Subsequently the shareholding limit on SGX is generally considered to be 10 percent. In the meantime, MAS holds 23 percent stake in SGX as of February 17, 2011.\footnote{119}

In case of ASX, shareholding was initially subject to a five percent limit, but at the request of the ASX, the Australian Government proposed to lift the limit to fifteen percent.\footnote{120} ASX considered that the five percent limit would provide little benefit as a means of promoting market integrity.\footnote{121} Anyone wanting to buy more than 15 percent has to apply to the Minister for Financial Services and Regulation to seek a variation of the limit, and a higher limit may be approved if the acquisition is the national interest.\footnote{122} Accordingly the proposed merger agreement between ASX and SGX required a change to the ownership limit on ASX, and the Australian government blocked the deal amid national interest concerns. It was claimed that such a merger would diminish Australia’s economic and regulatory sovereignty over the exchange, which could only be justified if there were very substantial benefits for Australia, but opportunities offered under the proposal were not sufficient enough to justify the loss of sovereignty.\footnote{123}

In case of KRX, no one shall hold stocks in excess of five percent of the total number of outstanding stocks with voting rights issued by KRX except for cases allowed under Article 406 of FSCMA.\footnote{124} Exceptions to the five percent

\footnote{120} Ho, supra note 118, at 315.
\footnote{121} Holthouse, supra note 116, at 76-77.
\footnote{123} Jeremy Thompson, Swan Vetoes ASX Takeover, AUSTL. BROAD. CORP. (ABC) NEWS, Apr. 7, 2011, available at 2011 WLNR 6780874.
\footnote{124} FSCMA §406(1).}
rule are allowed for situations such as where a collective investment scheme, excluding a private equity fund, holds the stocks; where the approval from the Financial Services Commission is obtained for the necessity of cooperating with foreign exchanges; or where the government holds the stocks.\textsuperscript{125} Although KRX is classified as a quasi-governmental organization, shares of KRX are still owned by securities and futures companies.\textsuperscript{126} Accordingly KRX does not have any shareholder with more than five percent of its shares.

Here the question is whether KRX should lift the ceiling on shareholding which is currently set at five percent upon its full demutualization. As a matter of public policy, no individual investor should be allowed to hold a predominant position in an exchange. Meanwhile, a shareholding limit which is sufficiently high enough to facilitate investment by strategic investors would be desirable in line with the exchange’s efforts to globalize, thereby increasing its effectiveness to compete in the global market place. It gets harder to find an optimal level of ownership restrictions when also considering that such restrictions function as a safeguard against takeovers, Thus the one question regarding the scope of ownership restrictions on KRX leads to another: whether KRX is ready to face M&A threats. In other words, the other question is whether there are enough countermeasures against potential hostile takeovers particularly by foreign investors or foreign exchanges.

\textsuperscript{125} Ibid., §406(1).

The exceptions clause under Article 406 of FSCMA can be used as a safeguard to prevent potential threat of a hostile takeover particularly by foreign bourses as well as foreign investors after the completion of KRX’s self-listing, if occurs. Currently the Korean government does not hold any share of KRX, but the government can acquire shares of KRX for the purpose of protecting KRX. Because nowadays KRX is a public institution, such measure would be more easily justified than before. As stated before, MAS is a major shareholder of SGX.

In addition, the requirement to obtain the Financial Services Commission’s approval when cooperating with foreign exchanges can be employed to block a merger plan in the future as in case of the Australian government’s action taken with regard to the proposed merger between ASX and SGX. As previously indicated, the Australian government blocked the deal on national interest grounds, “National interest” specifically includes “sovereignty and security interests”, competition issues, economic impacts, other government policies and the character of the investor.\(^\text{127}\) The Financial Services Commission needs to set legal standards to avoid ambiguity and confusion when a similar deal is proposed between KRX and some foreign exchange in times to come.

As the matter stands, it is not so definite whether defensive measures to repel future hostile takeover attempts are completely prepared in connection with KRX’s going public. Even so, increasing ownership limits on KRX to 10 percent from 5 percent would be worth deliberation and could be feasible. Applying special or higher restrictions to foreign ownership can be thought as a protective device to prevent hostile takeovers by foreign investors including foreign exchanges. However, such foreign ownership restrictions may impede KRX’s ability to achieve global alliances and cooperation so that the exchange would find itself hard to compete for listings and investment capital.

IV. Conclusion

Nowadays demutualization of stock exchanges is no longer unusual. Many stock exchanges around the world have already demutualized in order to achieve economies of scale as a response to increased competition. Exchange demutualization commences when the membership of a traditional non-profit organization that operates a stock exchange reorganizes the exchange as a for-profit institution, and concludes when the exchange goes public and thus become listed.

KRX takes form of a stock company, converted from a membership organization, but has not conducted its IPO yet. Thus demutualization of KRX is not fully completed. In order to achieve economies of scale and successfully survive in this era of tough global competition, it would be desirable for KRX to get listed. It is because the eventual winners in the process would be exchanges that attract order flow and thus provide liquidity to investors.\(^\text{128}\) Although KRX is currently designated as a public institution, fundamental issues revolving around KRX’s self-listing are still the same as when KRX was a SRO.

It is true that a demutualized exchange can invite public besides its own members and more actively pursue mergers and other forms of strategic alliances with other exchanges in the world. However, the converse can also happen at the same time – the exchange gets exposed to threats of mergers, acquisitions and takeovers by other exchanges. It has not been proved whether KRX is ready for exposure to future M&A upon its IPO. However, setting a stricter bar for foreign ownership is not recommendable as a defensive measure against hostile takeovers, considering that such foreign ownership restrictions may damage KRX’s relationship with foreign exchanges or foreign investors. In addition, lifting ownership limits on KRX to 10 percent from 5 percent would be worthy to

\(^{128}\) Aggarwal, supra note 4, at 107.
Besides, self-listing can cause conflicts of interest. When KRX lists itself on its bourse, KRX must be treated fairly and equally like other listed companies. There is no single model that is appropriate for all countries, and neither is there a perfect model for a single country. Nevertheless in order to handle conflicts of interest upon the completion of KRX’s demutualization, the following alternatives can be considered to adopt: to let both commercial and supervisory functions stay within KRX so as KRX to be the frontline market regulator; to have an independent body performing KRX’s operational supervisory functions, or to shift regulatory authority from KRX to the Financial Services Commission. In the meantime, pay fees related to KRX’s self-listing should be managed by an independent authority from and other than KRX—most likely the Financial Services Commission.

For KRX to be a listed exchange and thus to be completely demutualized, KRX should resolve many issues posed in the process. In order to prepare well for post-demutualization and reap benefits of demutualization, KRX should plan in advance, including, but not limited to, an appropriate organization structure, risk management strategy, corporate governance model, business model, and ownership structure.

- Bibliography


Act on the Management of Public Institutions, Republic of Korea.


Da-ye Kim, Korea Exchange Seeks to Get Bigger through IPO, KOREA TIMES, Feb. 27, 2009,


Ernest E. Badway & Joanthan M. Busch, Ending Securities Industry Self-Regulation as We Know It, 57 RUTGERS L. REV. 1351(2005).


KOREA EXCHANGE, 2010 ANNUAL REPORT (2011), available at http://eng.krx.co.kr/m9/m9_1/m9_1_7/JHPENG09001_07.jsp.

Korea Exchange, http://eng.krx.co.kr/.


KOSPI Market Listing Regulation, Republic of Korea.


Special Study Group of the Committee on Federal Regulation of Securities, American Bar Association, Section of Business Law, Special Study on Market Structure, Listing Standards
and Corporate Governance, 57 BUS. LAW, 1487(2002).
______ http://www.world-exchanges.org/.
중권선물거래소의 디뮤추얼라이제이션에 대한 법적 연구
- 한국거래소를 중심으로 -

장 누 리

【초 록】
디뮤추얼라이제이션란 일반적으로 제한된 조직원만을 대상으로 하는 배타적 단체가 회원제 영리법인으로 체제를 개편하는 과정을 말한다. 한편 증권선물거래소의 디뮤추얼라이제이션란 거래소가 조직원 소유의 비영리단체에서 주주 소유의 영리 목적 주식회사로 전환되는 과정을 의미한다. 증권선물거래소의 디뮤추얼라이제이션은 증권거래소가 기존의 비영리 배타적 회원제 조직에서 주식회사제의 영리법인으로 조직개편되는 단계의 시점에서부터 증권거래소가 공시상장되는 단계의 기점까지, 여러 단계를 거쳐 진행된다.


본고는 한국거래소의 디뮤추얼라이제이션 및 이와 관련된 법적인 문제를 다루는
것을 주요 목적으로 한다. 한국거래소 관련 사안을 본격적으로 다루기에 앞서, 본고는 먼저 증권선물거래소의 디뮤추얼라이제션 전반적인 개요 및 그 의미에 대해 검토한다.

주제어: 증권선물거래소 / 자율규제기관 / 공공기관 / 디뮤추얼라이제션 / 상장 / 자기상장 / 이해상충 / 소유권제한 / 인수·합병 위협