



2017
ANNUAL REVIEW
KOFIA

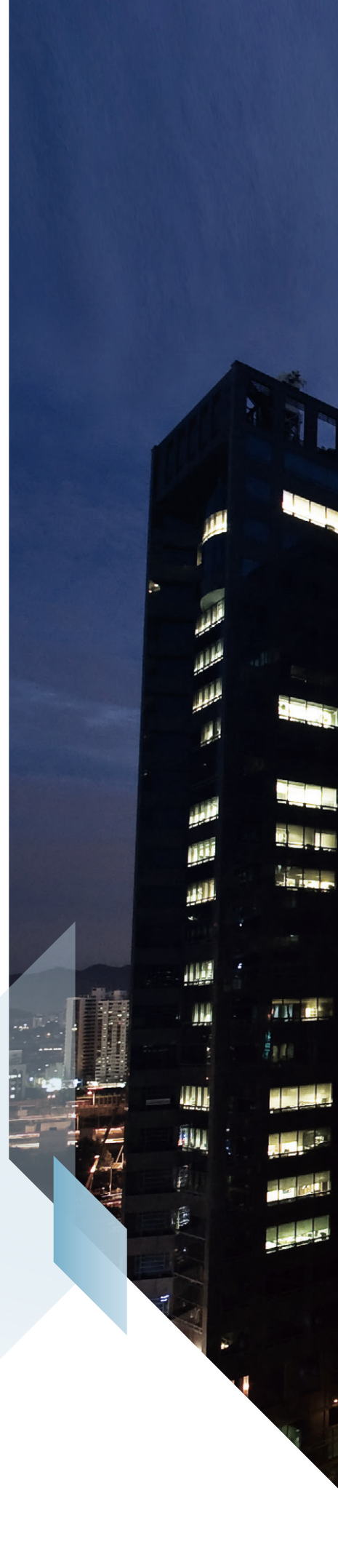
Welcome to **KOFIA**

The Korea Financial Investment Association (KOFIA) was founded in 2009 as a non-profit organization under the Financial Investment Services and Capital Markets Act (FSCMA), through the merger of the Korea Securities Dealers Association (established in 1953), Asset Management Association of Korea (established in 1996), and Korea Futures Association (established in 1996).

KOFIA's main role is ensuring that members observe fair business practices, conduct securities trading appropriately, and prioritize investor protection. Securities, asset management, futures and real estate trust firms in Korea are KOFIA members and adhere to the self-regulatory policies put forth by the Association. In addition, as the primary advocate for the financial investment industry, KOFIA spearheads the continued development and globalization of the Korean capital market.

KOFIA's History at a Glance

1953	Foundation of the Korea Securities Dealers Association (KSDA)
1977	Foundation of the Korea Securities Training Institute (KSTI)
1996	Foundation of the Asset Management Association of Korea (AMAK) Foundation of the Korea Futures Association (KFA)
2000	Launch of OTC Bulletin Board (OTCBB)
2005	Launch of FreeBoard Foundation of the Korea Council for Investor Education (KCIE)
2009	Foundation of the Korea Financial Investment Association (KOFIA) through the merger of the KSDA, AMAK and KFA
2010	Launch of FreeBond
2014	Launch of K-OTC
2015	Launch of K-OTCBB
2017	Launch of K-Bond



CONTENTS

- I Welcome to KOFIA**
- II Message from the Chairman**
- III KOFIA's Roles & Functions**
 - 1. Advocacy for the Financial Investment Industry
 - 2. Market Operations
 - 3. Self-Regulation
 - 4. Education for Professionals and Investors
- IV KOFIA's Activities**
- V Korean Capital Market Review**
 - 1. Korean Capital Market
 - 2. Equity Market
 - 3. Bond Market
 - 4. Derivatives Market
 - 5. Fund Market
 - 6. Real Estate Trust Market
 - 7. Advisory & Discretionary Market
 - 8. Pension Market
 - 9. K-OTC Market
- VI Membership & Websites**

Message from the Chairman

Welcome to the Korea Financial Investment Association (KOFIA)

KOFIA has put in great effort to develop the Korean capital market and financial investment industry since its inception in 1953. Our Association not only represents and advocates for the Korean financial investment industry, but also is a think tank that spearheads evolution by preemptively proposing plans to improve various laws and regulations that impact our industry. In 2017, KOFIA worked hard to support the growth of financial investment companies, the key players in the Korean capital market.

First and foremost, we pushed hard to enlarge the equity capital of Korean financial investment companies and strengthen their investment banking functions. We assisted in the designation and authorization of mega investment banks that are central to supplying venture capital through note issuance operations. We also successfully aided the bill amendment for raising the corporate credit granting ceiling of merchant banks. Our Association spared no effort to pitch the capital market as a tool to build up wealth of Koreans. Our support led to larger sales of non-taxable offshore equity funds as well as launching of a suite of new fund products including funds with performance-based fees and privately placed fund of funds. Our efforts were also put into supporting the introduction of robo-advisors, with the goal of promoting wealth management in Korea.

We also strongly promoted digital innovation across the financial investment industry. Our effort culminated in the opening of the "Chain ID," the world's first blockchain-based joint authentication system, in October 2017. Korea's capital market has matured and become stronger throughout the years. The year 2017 marked a turning point for the Korean capital market, which advanced another notch. The KOSPI index breached the 2,500pt level for the first time, while the market cap to GDP ratio surpassed 100%. Pension assets that fuel growth of the capital market have also displayed accelerated build-up. With these accomplishments and developments, KOFIA aims to further solidify the competitiveness of the Korean capital market. To this end, we will focus on the following initiatives.

First, we will support the Korean financial investment companies in their effort to enlarge and differentiate themselves. We will assist in improving a number of rules and regulations, such as the deregulation of leverage rules, so that brokerage firms can easily provide venture capital. We also plan to bring vibrancy

into the K-OTC market, the trading venue for unlisted stocks, and QIB (Qualified Institutional Buyer) market, the capital raising venue for SMEs and mid-caps.

Second, we will devote more energy to strengthen the role of the capital market in expanding wealth of Korean households. More efforts will be made towards introducing new schemes, such as the trust-based retirement pension scheme and default option scheme, promoting a wide range of publicly offered investment products, and obligating the adoption of the IPS (Investment Policy Statement).

Third, we will strengthen support for the globalization of financial investment companies and the Korean capital market. For the past two to three years, there has been both quantitative and qualitative growth in overseas entries of Korean financial investment companies. KOFIA will continue to promote the establishment of financial regulations and systems that meet global standards in order to support the overseas venture of Korean companies and increase the domestic presence of foreign companies.

Fourth, we will push for digital innovation in the Korean capital market in order to create a digital ecosystem needed for the 4th Industrial Revolution. KOFIA will search for ways to lead technological innovation in areas such as blockchain, and apply the innovation to the industry through close collaboration with member companies. Furthermore, we will promptly respond to the latest controversial issues in the global digital space such as virtual currency or ICO (Initial Coin Offering).

Fifth, we will drive deregulation and tax reform to further advance the Korean capital market. We will ensure that regulations and tax policies are revamped in a way that cater to industry needs and develop a mid- to long-term blueprint for practical tax reforms. In order to pursue these initiatives, KOFIA will reinforce its role as a think tank of the Korean capital market.

KOFIA is committed to actively participating in events arranged by international organizations such as ICSA (International Council of Securities Associations) and IIFA (International Investment Funds Association) to duly respond to global regulatory trends and foster global cooperation. I kindly request for your continued interest and support. Thank you.

KWON, Yong Won
Chairman
Korea Financial Investment Association

Yong Won Kwon



KOFIA's Roles & Functions

Advocacy for the Financial Investment Industry

Policy Advocacy

As an advocate for the development of the Korean capital market and financial investment industry, KOFIA examines various regulations in need of enhancement, and proposes opinions and solutions to the government, supervisory authorities, and lawmakers.

To this end, KOFIA actively engages in networking with the financial investment industry, academia, and research institutes over current issues, and organizes councils and task forces with CEOs and professionals from member firms. Such efforts allow industry concerns to be more effectively reflected into financial policies.

Throughout 2017, KOFIA worked on multiple fronts to advance the capital market. Support was provided for regulatory revisions as well as for the designation and licensing process of investment banks, in order to facilitate the businesses of mega investment banks. Furthermore, KOFIA assisted in legal amendment procedures and the introduction of new fund products, aiming to promote publicly offered funds. KOFIA also improved the business environment for hedge funds and provided support, fostering a ground conducive for their growth.

Member Services

In an increasingly interconnected world, establishing a presence in the global capital market has become a necessity for Korean financial investment firms. They are looking to expand their operations overseas, particularly in emerging markets, with the aim of bolstering business in the new financial environment under the FSCMA.

In response, KOFIA launched the New Portfolio Korea (NPK) program to help its member companies seek new business opportunities around the globe. This program allows member companies to visit markets that are of particular interest to them, such as Malaysia, Indonesia, and Turkey, as well as countries with promising but less accessible markets, such as Greece and Israel, so as to help them expand their business model. In 2017, KOFIA visited Australia and Russia to explore ways to reinforce cooperation with financial companies in those markets.

Furthermore, KOFIA is extensively involved in global collaboration as an active member of the International Council of Securities Associations (ICSA), International Investment Funds Association (IIFA), Asia Securities Forum (ASF), International Forum for Investor Education (IFIE), and many other international organizations.

Market Operations

K-OTC

Since KOFIA introduced FreeBoard in July 2005, KOFIA and the Financial Services Commission (FSC) redefined FreeBoard as a platform for promoting the transparent and robust transactions of unlisted stocks and renamed it to K-OTC. K-OTC is split into two divisions: K-OTC Market, which facilitates transactions for unlisted corporations that submit annual reports or meet KOFIA's disclosure requirements; and K-OTCBB, a Bulletin Board for all types of unlisted stocks regardless of a company's compliance with disclosure requirements, which opened in March 2015. Additionally, KOFIA established and began to operate K-OTC PRO, a membership-based trading platform, in July 2017 to assist financial professionals including institutional and professional investors in the convenient trading of unlisted stocks and corporate financing.

K-Bond

KOFIA plays an important role in ensuring the efficiency and transparency of the OTC fixed income market by collecting and disseminating essential trading data. In April 2010, KOFIA established FreeBond, an exclusive system for trading bonds, which enables financial investment companies and related entities to post quotations for trading or brokering, as well as negotiate with counterparties in the OTC market. In order to respond to the growing number of market participants and changing environment, the FreeBond system was upgraded and reborn as K-Bond in September 2017.

K-Bond is a professional system customized for bond trading. Security-wise, it is fully immune to external hacking risks, as all conversations and quotation information are encrypted. Confidence is built up among trading parties as KOFIA thoroughly checks and manages the qualifications of all K-Bond users.

Active utilization of the K-Bond can substantially improve the bond distribution structure. Stronger security functions can enhance the stability of transactions, which should all add up to integrating the fragmented bond markets. Determination of bond prices can also become more transparent with the electronic processing of quotation searches and trading intention confirmations, coupled with real-time disclosure of quotation information. Furthermore, investor convenience increases on reduced asymmetry of bond market information and easy counterparty search features.



KOFIA's Roles & Functions

Self-Regulation

Self-Regulation

KOFIA is the sole self-regulatory organization (SRO) of the Korean financial investment industry, overseeing a wide spectrum of industry areas. KOFIA believes that self-regulation should be responsive, flexible, and market-friendly. To effectively carry out its roles and functions as an SRO, KOFIA maintains the Self-Regulation Committee (SRC). The SRC is responsible for KOFIA's self-regulatory activities, such as making decisions on regulatory enactments and revisions, and imposing sanctions on member companies, corporate executives and employees who fail to comply with regulations. The Committee is headed by a standing chairman.

KOFIA's main areas of self-regulation:

- 1) Enacting regulations and codes of best practices for fair business activities
- 2) Reviewing standard agreements and advertisements
- 3) Conducting member inspections
- 4) Registering and administering qualification exams for financial professionals
- 5) Mediating disputes between member companies and their customers

1. KOFIA establishes business conduct regulations for member companies on sales and other common business activities, as well as securities underwriting. The Association also sets various guidelines, such as standard rules for investment advice and standard internal control criteria for financial investment firms.
2. To ensure investor protection, KOFIA conducts preliminary reviews on advertisements of financial investment products and the business activities of financial investment firms. It also reviews terms and conditions, and sets standard agreements to support investment firms' business activities.
3. KOFIA conducts member inspections and imposes sanctions for regulatory violations.
4. Financial professionals must receive accreditation by passing qualification exams, completing training, and registering with the Association to conduct business activities such as investment solicitation and advice on financial instruments. KOFIA manages both the registration process and qualification exams.
5. To safeguard investor interests, KOFIA runs an investor protection center with an in-house attorney to arbitrate disputes.



REGULATION

Education for Professionals & Investors

Education and Training for Professionals

KOFIA firmly believes that well-educated and highly trained industry professionals are the most valuable asset to the financial investment industry. To this end, the Korea Institute of Financial Investment (KIFIN), KOFIA's educational arm, has been nurturing and developing financial talents and professionals over the past four decades, serving as a leading education center for Korea's financial investment sector.

In 2018, KIFIN offered 166 training courses across 7 different financial market fields*. These courses were grouped under three categories – General, Professional, and Qualification – and then further divided into Basic (theory), Intensive (case studies), and Expert (practical application) levels. This allowed KIFIN to better meet the needs of the industry and bring out the full potential of market professionals.

* Stock investment, bond investment, derivatives investment, alternative investment, investment banking, wealth management and financial sales support

Fostering a Sound Investment Culture

KOFIA highly values investor education, considering it vital to building a sound investment culture centered on investor protection. As such, it has played a key role in shifting the focus of the investment paradigm for individual investors from short-term speculative trading to long-term direct and indirect investments. It also played a leading role in founding the Korea Council for Investor Education (KCIE), and currently acts as its secretariat, with the KOFIA Chairman serving as head of the KCIE. Other KCIE members include government authorities such as the Financial Services Commission (FSC) and the Financial Supervisory Service (FSS), and major capital market institutions including the Korea Exchange (KRX), Korea Securities Depository (KSD), Korea Securities Finance Corporation (KSFC) and Koscom Corporation.

The KCIE offers online and offline education programs tailored to the needs of individual investors, which include the general public, young students, and teachers who provide financial education in the classroom. The KCIE, as an off-site educator, utilizes the Financial Village as a platform to enhance the public's financial literacy and asset management skills by providing education programs customized to each stage of a person's life. In particular, starting from 2017, the KCIE has created online/mobile investor educational systems that capitalize on internet portals like Naver or Daum, and SNS such as Facebook or Instagram, in order to develop and distribute video clips, web comics, card news and other digital content.

KOFIA's Activities

in 2017 & 1Q 2018

I Strengthened the Role of the Capital Market as Provider of Innovative Growth Capital

Facilitating securities firms' IB operations

- KOFIA provided support for the designation and authorization of mega investment banks that can play a larger role as provider of venture capital through their note issuance operations.
- KOFIA assisted in the amendment of the FSCMA, which lifted the ceiling for credit granting by comprehensive financial investment business entities to 200% of their equity capital from the previous 100%.
- KOFIA also played a vital role in obtaining the Ministry of Strategy and Finance's authoritative interpretation that allows mega investment banks to provide general foreign currency exchange services to corporate clients.

Creating a growth environment for securities companies

- With an aim to strengthen the competitiveness of securities companies, KOFIA formulated the "100 Initiatives" after comparing the business scope and institutional framework of securities firms with overseas IBs and other sectors within Korea.
- To help securities firms specialize their business functions and differentiate themselves, KOFIA supported the designation of SME-specialized securities firms as managers of policy funds and underwriters of P-CBO (primary collateralized bond obligations) issuances.

II Enlarged the Role of the Capital Market in Household Wealth Accumulation

Promoting Individual Savings Account (ISA)

- Various measures were introduced to improve the ISA scheme, such as raising the tax exemption limit from KRW 2.5mn to KRW 4mn for investors from the low-income bracket or the farming and fishing industries. In addition, investors are now allowed to make interim withdrawals within the payments made to the account.

Fostering the comprehensive wealth management services

- KOFIA supported the introduction of investment advisory business for financial products by establishing best practices and building a wealth management platform.
- In line with measures to foster the investment advisory business for financial products, KOFIA provided support for robo-advisors to be introduced and widely used in the investment advisory industry.
- KOFIA also supported the government's policy of allowing non-face-to-face selling of discretionary investment products based on preconditions that video calls take place for customer authentications.

Promoting fund sales and expanding distribution channels

- Thanks to support provided for the distribution of tax-exempt overseas equity funds, the fund sales balance increased from KRW 1tn to KRW 3.8tn on a year-on-year basis at the end of 2017.
- Furthermore, KOFIA devised measures to facilitate online fund sales and lent support to expand the fund distribution channels to include financial institutions targeting low credit classes, such as the Korea Post, savings banks and mutual finance companies.

III Supported the Digital Innovation of the Financial Investment Industry (1Q 2018)

Introducing the blockchain-based authentication services

- KOFIA unveiled "Chain ID," the world's first blockchain-based joint authentication services for the financial investment industry.

Creating a new department to support digital innovation

- A new department called the "Digital Innovation Team" was created in order to help financial investment companies respond to the 4th Industrial Revolution and promote digital innovations across the industry.

IV Improved the OTC Market Infrastructures

Advancing the OTC bond trading system (K-Bond)

- KOFIA revamped the existing FreeBond to establish K-Bond, in order to boost the stability and convenience of trading on the OTC bond market as well as to provide more detailed quotation information.

Launching the K-OTC PRO for institutional-professional investors

- The K-OTC PRO was established as an exclusive OTC platform for institutional and professional investors, aiming to support the smooth trading of unlisted stocks and fund shares.



V Building Trust for the Financial Investment Industry

Reinforcing financial consumer protection capacity of member companies

- KOFIA identified best case examples of financial consumer protection both in Korea and abroad and provided them to member companies. KOFIA also created a manual on protecting the elderly and supporting the disabled.

Strengthening internal control capacity of financial investment companies

- KOFIA established guidelines for publicly offered funds with performance-based fees as well as for monitoring excessive trading. Thanks to KOFIA's efforts, executives and employees of financial investment companies working in back offices can hold concurrent positions in affiliates. KOFIA also successfully reduced the restriction period on issuing new licenses for foreign financial companies whose major shareholder(s) received a warning to one year from the previous three years.

VI Fostering Financial Professionals

Expanding the professional training system and global programs

- Real estate finance and bond management were included in the Professional Career Program (PCP), which currently covers alternative investment, derivatives, investment banking and financial engineering.
- The number of global programs increased by 60% from five in 2016 to eight in 2017, while the number of students rose by 32% from 105 to 139 during the same period. Furthermore, KOFIA diversified the financial education centers, introduced a variety of topics and expanded the number of programs.

Strengthening services for financial professionals

- KOFIA operates a job search website for investment solicitors, as well as a service for issuing registration certificates in both Korean and English. In addition, KOFIA developed a system where professionals can view their course completion status.

VII Bolstering Support for Member Companies (1Q 2018)

Introducing an exclusive help desk for foreign companies and SMEs

- A help desk was established to provide one-stop service to foreign securities companies and small- to mid-sized Korean securities and asset management companies.

Creating a team to support hedge funds

- A "Hedge Fund Support Team" was established to provide systematic assistance for hedge funds, which are small in scale and thus require external business support.

2017 KOREAN CAPITAL MARKET REVIEW

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1. Korean Capital Market
2. Equity Market
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9. K-OTC Market

1. Korean Capital Market

Korea's total financial assets have steadily increased alongside the country's economic development. The total volume of financial assets in Korea remained on a growth trajectory since 2010, gaining 6.7% year-on-year to post KRW 16,515tn at the end of 2017.

Cash and deposits made up the largest share of total asset volume in 2017, standing at 19.2%, while equities stood at 18.5%, bonds at 15.6%, investment funds at 3.0%, insurance and pensions at 7.3%, and loans at 17.7%. The share of financial investment instruments, namely equities, bonds and investment funds, moved up by 1.2%pts year-on-year to 37.1%.

Korea's stock market capitalization was KRW 1,889tn at the end of 2017, 25.1% higher than the previous year. The outstanding balance of bond issues registered KRW 1,830tn, up by 4.5% year-on-year. The stock market capitalization to GDP ratio advanced 17.1%pts to 109.1%, while the bond market capitalization to GDP ratio recorded 105.7%, slightly retreating from a year earlier.

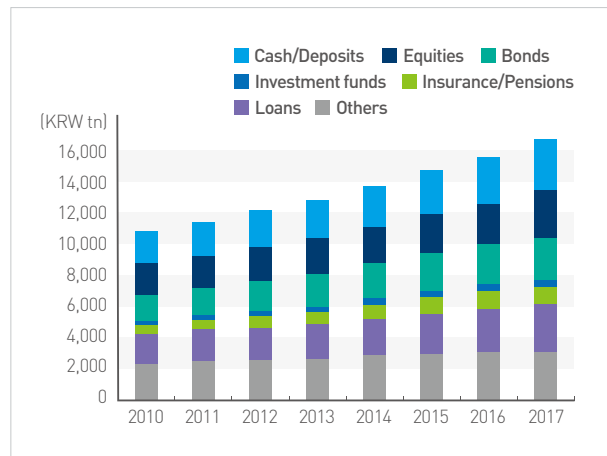
Put into a global context, Korea's stock market capitalization to GDP ratio is still lower than those of advanced economies, such as the US at 165.0%, UK at 169.0%, and Japan at 126.0%.

Among the financial sectors, the banking industry boasted the largest amount of total assets and equity capital. At the aggregate level, the securities sector came in third next to life insurance.

However, when it came to the average by company, securities firms ranked 5th after banks, life insurers, credit card companies and non-life insurers with KRW 7.1tn in total assets and KRW 0.9tn in equity capital.

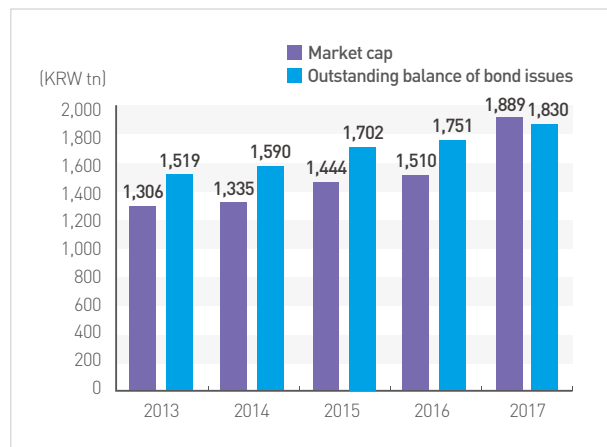
Meanwhile, the number of asset management companies markedly increased by 50 year-on-year. This resulted from the sharp increase in the number of hedge funds following the revamp of the private placement fund regime, which took place in October 2015.

Graph 1-1. Annual Financial Asset Volume



Source : Economic Statistics System (ECOS), The Bank of Korea (BOK)

Graph 1-2. Size of the Capital Market in Korea



Source : ECOS, BOK
FreeSIS, KOFIA

Table 1-1. Size of Financial Sectors

(Units: No., KRW tn, %)

Category	Banking	Life insurance	Non-life insurance	Credit card	Securities	Asset management
No. of companies	19	25	32	8	55	215
Total assets	2,738.7	832.8	277.0	113.9	390.0	7.1
Equity capital	188.9	71.4	35.2	26.5	52.2	5.7
Net profit	11.9	3.9	3.9	2.2	3.9	0.6
ROE	6.5	5.7	11.4	5.0	7.7	11.7

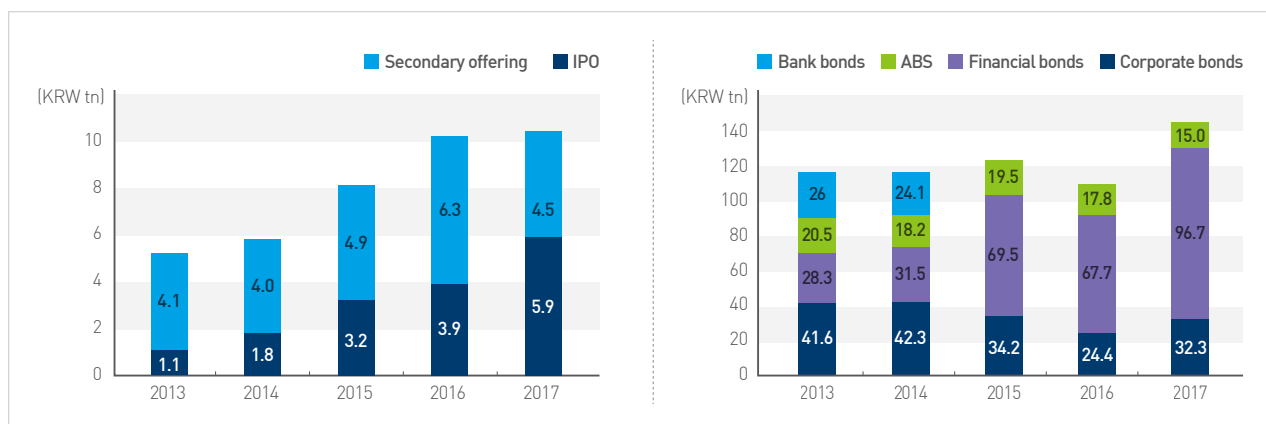
* As of 2017

Source : Monthly Financial Statistics Bulletin, Financial Supervisory Service (FSS)

Corporate financing through the capital market (equities and bonds) amounted to KRW 154tn in 2017, a 28.6% increase compared to 2016.

Market-based financing slightly increased year-on-year to KRW 10.4tn. IPO jumped 51.3% year-on-year, while secondary offering dropped 28.6% during the same period.

On the other hand, financing via the bond market grew 31% year-on-year to KRW 144tn. This was because the issuance of corporate and financial bonds with an investment grade of A or higher sharply increased on preemptive financing demand spurred by factors including a US rate hike.

Graph 1-3. Corporate Financing via the Capital Market

Source : 「Direct Financing of Korean Companies in 2017」 (Press release), FSS

Non-financial assets including real estate accounted for 62.4% of household assets in 2017, still higher than the share of financial assets, which stood at 37.6%. However, it should be noted that the share of financial assets continues to be on the rise.

Table 1-2. Share of Non-Financial & Financial Assets in Korean Households

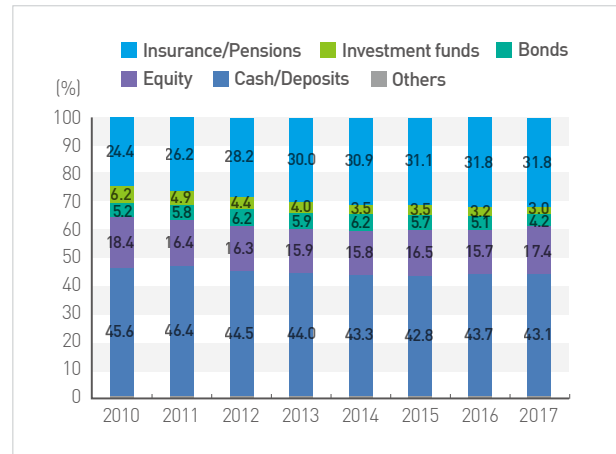
(Unit: %)

Category	2011	2012	2013	2014	2015	2016	2017
Non-financial assets	66.7	65.7	64.8	64.1	63.0	62.8	62.4
Financial assets	33.3	34.3	35.2	35.9	37.0	37.2	37.6

Source : ECOS, BOK

Although cash and deposits maintained the largest share of 43.1% among financial assets, their percentage is on a downtrend. Financial investment instruments such as equities, bonds and investment funds assumed 24.6%, a 0.6%pts increase year-on-year.

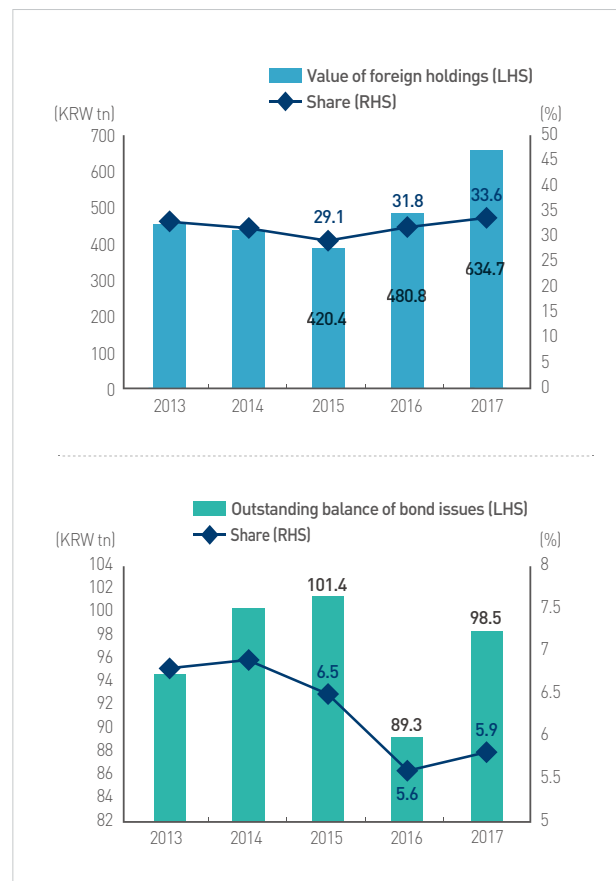
Graph 1-4. Breakdown of Household Financial Assets



Source : ECOS, BOK

Foreign holdings of listed stocks were worth KRW 634.7tn in 2017, up by 1.8%pts year-on-year. This comprises 33.6% of total market capitalization.

Graph 1-5. Foreign Investment Trend



Source : Shareholdings by Investor Group, Korea Exchange (KRX)
 「Trend in Foreign Securities Investment (December 2017)」
 (Press release), FSS

In the bond market, foreign holdings of listed bonds were valued at KRW 98.5tn, marking a 10.3% year-on-year growth. The large buying trend witnessed in the first half of 2017 had offset the three interest rate hikes implemented by the US Fed.

The share of listed bonds held by foreigners, mostly concentrated in government bonds and special bonds, accounted for 5.9% of the total listed-bond market. As with equities, a marginal year-on-year increase was witnessed.

2. Equity Market

When the KRX was established in 1956, there were only 12 listed companies with a turnover of merely KRW 390mn. Since then, Korea's stock market achieved remarkable qualitative and quantitative growth over the past six decades.

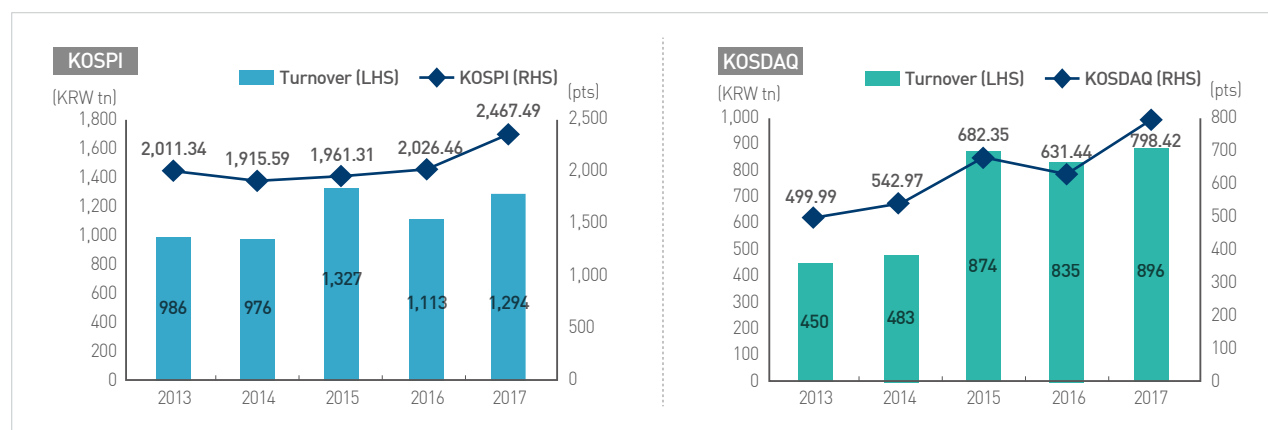
At the end of 2017, the KOSPI index advanced 21.7% to 2,467.49pts, with turnover growing by KRW 181tn compared to 2016 to reach KRW 1,294tn.

As for the KOSDAQ, the index soared 26.4% over a year to 798.42pts at end-2017, with turnover also increasing

by 7.32% year-on-year to KRW 896tn.

In 2017, the KOSPI index broke out of the trading channel for the first time in seven years and posted a historic high of 2,557.97pts on November 3. Thanks to positive factors including improved internal and external economic conditions and stronger corporate earnings momentum, the KOSPI remained on an upward trend for four consecutive quarters. The KOSDAQ index was boosted by 22.3% in the 4th quarter of 2017 on expectations over the Korean government's plan to facilitate the KOSDAQ market.

Graph 2-1. Stock Market Trend

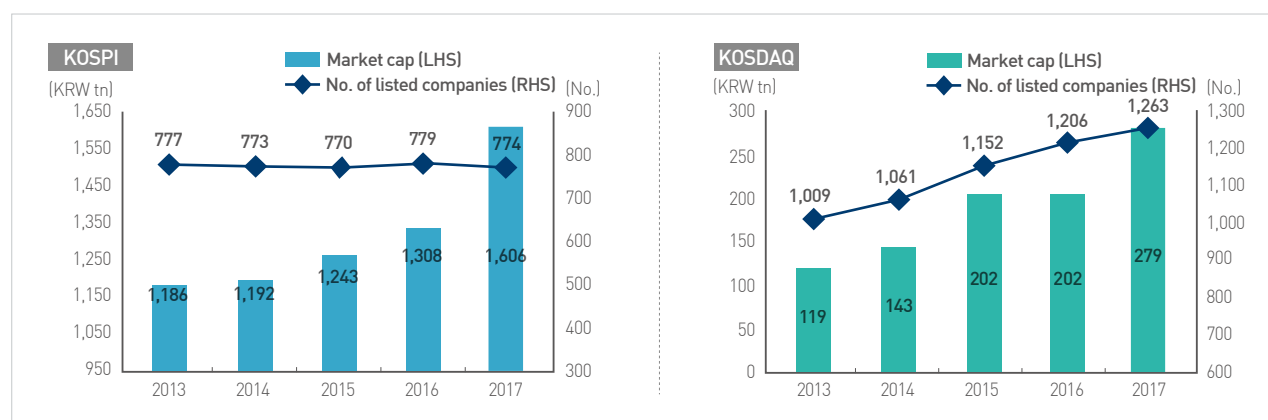


Source : KRX

In the KOSPI market, the total number of listed companies decreased by five to 774 at the end of 2017. However, market capitalization gained 22.7% year-on-year to reach KRW 1,606tn.

Meanwhile, the KOSDAQ market added 57 new listed companies, which brought the total number of listed companies to 1,263 at end-2017. Market capitalization soared 38.4% to KRW 279tn over the same period.

Graph 2-2. Listed Companies and Market Capitalization



Source : KRX

In the Korean stock market, individual investors contribute the most to turnover, followed by foreign investors and institutional investors.

Individual investors accounted for 46.7% of the total turnover in the KOSPI market in 2017, while foreigners took up 31.0%. Institutional investors, encompassing investment trusts, pension funds and mutual aid associations, assumed 21.0%.

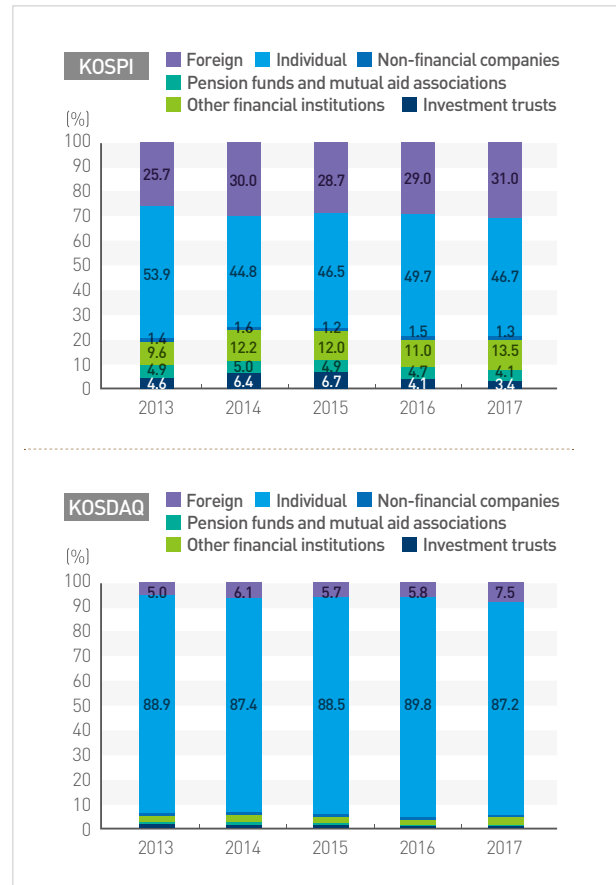
The higher share of foreign investors since 2014 contributed to a more balanced market. However, the percentage of individual investors picked up again in 2016, before slightly slowing down in 2017.

Unlike the KOSPI market, the KOSDAQ market is still dominated by individual investors, who comprised 87.2% of the total turnover. The portion of foreign investors moved up by 1.8%pts compared to the previous year.

There were a total of 55 securities firms in Korea at the end of 2017, an increase by two compared to a year earlier. The number of securities firms peaked in 2013 at 62, but then dropped by nine over the next three years. This was due to the corporate restructuring and re-organization of securities companies following a prolonged market recession, and consequently two new players began operations in 2017.

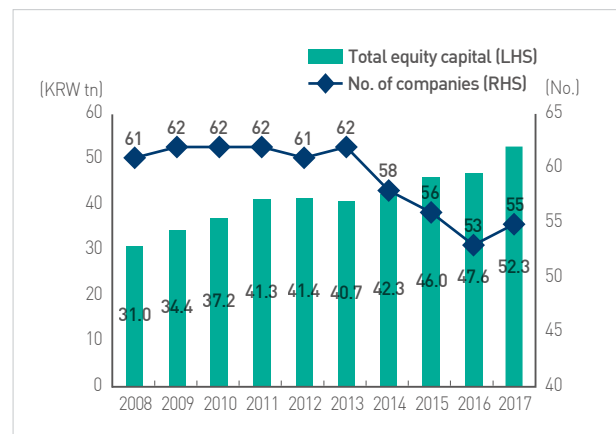
Total equity capital, which displays the size of a securities company, remained on an upward track. At end-2017, the equity capital of securities companies totalled KRW 52.3tn, increasing the average equity capital per one securities firm to KRW 0.95tn. This is a result of securities firms growing their size through measures including capital increases on the back of the government's policy to foster mega investment banks.

Graph 2-3. Stock Market Breakdown by Investor Type



Source : KRX

Graph 2-4. No. of Securities Companies and Equity Capital



Source : Monthly Financial Statistics Bulletin, FSS

3. Bond Market

The Korean bond market enjoyed trading volume growth in 2016. However, bond trading declined overall in 2017 as market rates moved up on normalized monetary policies of major countries (e.g. The US Fed's three interest rate hikes and the Bank of Korea's first benchmark interest rate hike in 6.5 years) coupled with stronger expectations for better economic conditions. Bond trading volume dropped 12.0% to KRW 6,943.8tn in 2017.

The share of OTC market trading in total bond trading remains at around 70% (90.5% in 2010; 65.0% in 2017).

An analysis of trading volume by bond type shows that the proportion taken up by Korea Treasury Bonds (KTB) steadily increased since the 2000s, currently accounting for a lion's share of more than 50% in the secondary bond market.

Improvements in government policies to nurture the KTB market, such as the introduction of fungible issues in May 2000 and the increase in KTB issuance, greatly aided this growth.

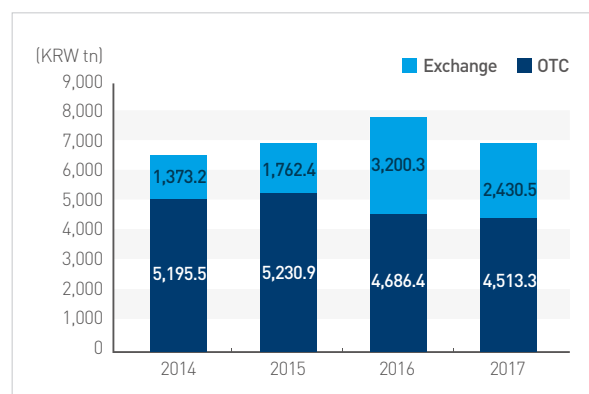
With government and public bonds having come to represent a bigger slice of the pie, the share of corporate bonds, including ABS, has comparatively diminished. Corporate bonds assumed 14.7% of total trading volume back in 2000. However, the share declined since 2004 to a mere 3.7% at the end of 2017.

Another special aspect of the Korean bond market that can be found after breaking it down by bond type is that the exchange market is more concentrated on KTBs compared to the OTC market. When excluding KTBs, monetary stabilization bonds (MSB), municipal bonds and other bonds comprise less than 1% of the exchange market.

This mostly owes to the exchange trading of on-the-run KTBs required for primary dealers by the government. (This policy was repealed in July 2008.)

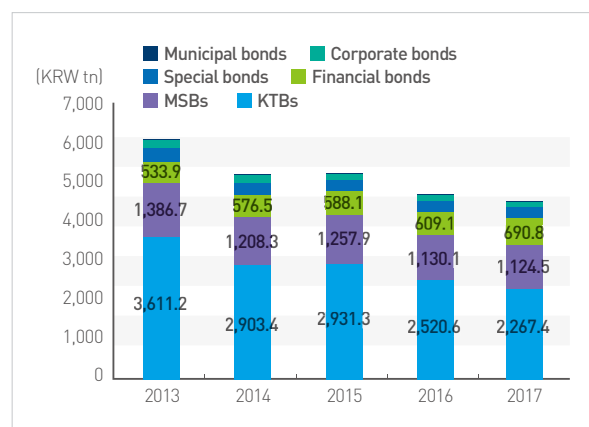
Simply put, institutional investors that are the major participants of the Korean bond market are rarely using the exchange market for trading bonds other than KTBs and MSBs. In the case of special bonds, financial bonds and corporate bonds, the majority of trading takes place on the OTC market.

Graph 3-1. Annual OTC and Exchange Trading Volume



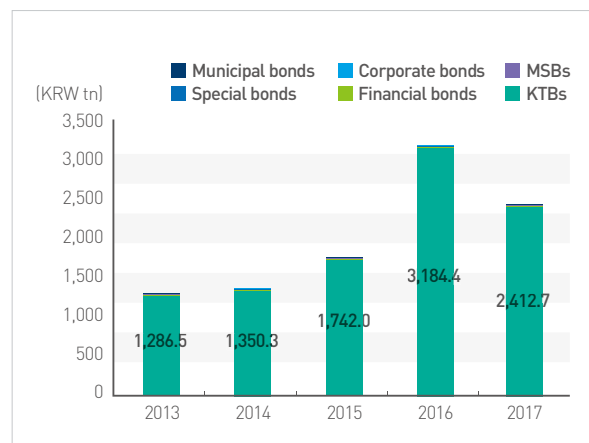
Source : KOFIA, KRX

Graph 3-2. Annual OTC Trading Volume by Bond Type



Source : KOFIA

Graph 3-3. Annual Exchange Trading Volume by Bond Type



Source : KOFIA

Investors that trade bonds on the OTC market in Korea are mostly domestic institutional investors. A breakdown of trading volume by investor type demonstrates that securities companies make up the largest share with approximately 60%, followed by asset managers, banks, insurers and funds/mutual aid associations. Domestic institutional investors are responsible for more than 95% of the trading.

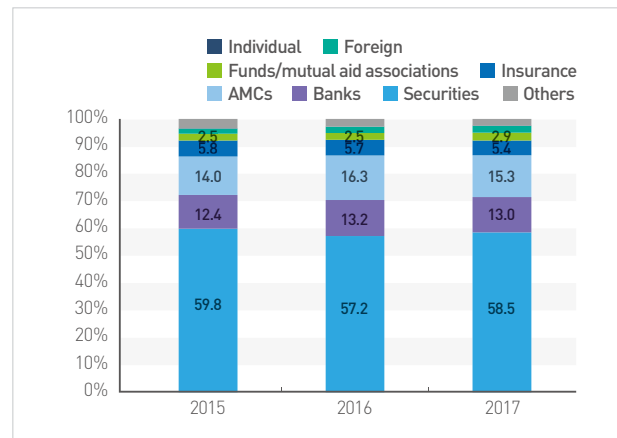
In 2017, the trading volume of securities companies, funds/mutual aid associations and foreign investors inched up by 1.3%pts, 0.4%pts, and 0.2%pts, respectively, while that of banks, asset managers and insurers edged down by 0.2%pts, 1.0%pts, 0.3%pts, respectively.

Foreigners net bought KRW 13tn in 2017, a KRW 0.4tn or 2.9% drop from a year ago. They net purchased KRW 9.4tn of KTBs, a decline of KRW 0.5tn or 4.8% from the previous year. Figures remained mostly unchanged for MSBs.

As part of its reform plan to expand foreign currency liquidity, the Korean government began granting tax exemptions to foreigners in 2009 on interest income and capital gains for KTB and MSB investments. As a result, investment in KTBs and MSBs became more appealing for foreigners.

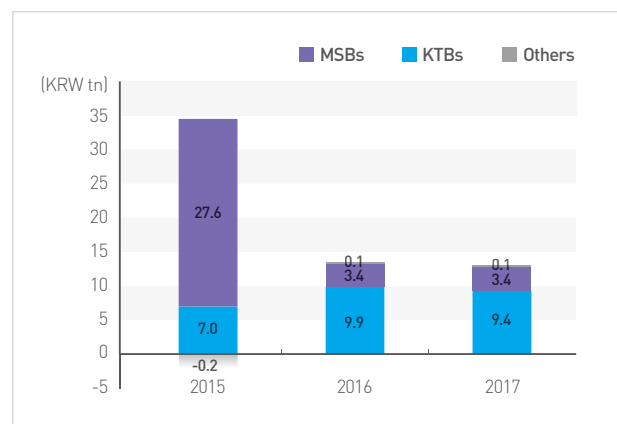
These tax benefits were suspended in 2011. Still, foreigners continued to net buy Korean bonds with central banks across the globe taking an approach to diversify their foreign currency assets alongside persistent expectations for a stronger Korean won. At end-2017, the outstanding balance of foreign-held domestic bonds stood at KRW 98.5tn.

Graph 3-4. OTC Trading by Investor Type



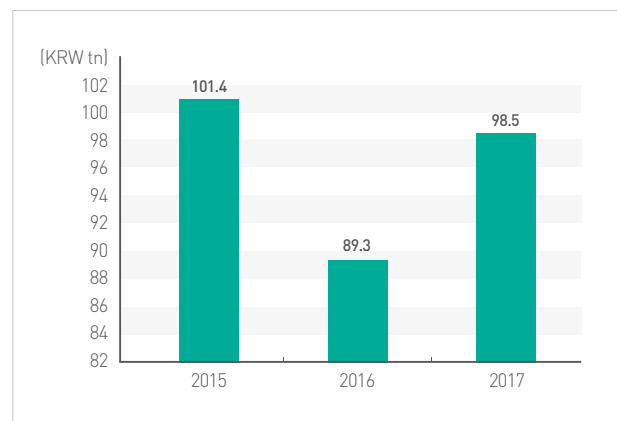
Source : KOFIA

Graph 3-5. Net Bond Purchases by Foreign Investors



Source : KOFIA

Graph 3-6. Korean Bond Holdings of Foreign Investors



Source : FSS

4. Derivatives Market

Korea's derivatives market is divided into the Korea Exchange (KRX), where standardized products are traded, and the over-the-counter (OTC) market, where non-standardized products change hands.

The KRX has steadily introduced new products to the Korean market. A major example is EURO STOXX 50 Futures, the first derivatives product in South Korea with overseas indices as underlying assets, which was listed in June 2016 in cooperation with Eurex. Also, the ETF futures market was opened in June 2017 to enhance risk management of ETF investors and allow coupled growth of the derivatives and ETF markets.

The KRX strengthened risk control for blue chip stocks and provided further investment opportunities by additionally listing equity futures and options. Equity options with KOSDAQ-listed stocks as underlying assets were listed for the first time in June 2017.

The turnover of the OTC derivatives market has been on a steady uptrend since 2014, increasing 7.9% year-on-year to KRW 13,962tn in 2017. Derivatives-linked securities (DLS) that were first introduced to South Korea in 2003 saw issuance volume soar 30 times from KRW 3.5tn to KRW 101tn in just over ten years, earning them recognition as attractive mid-risk and mid-return products in the low economic growth and interest rate environment.

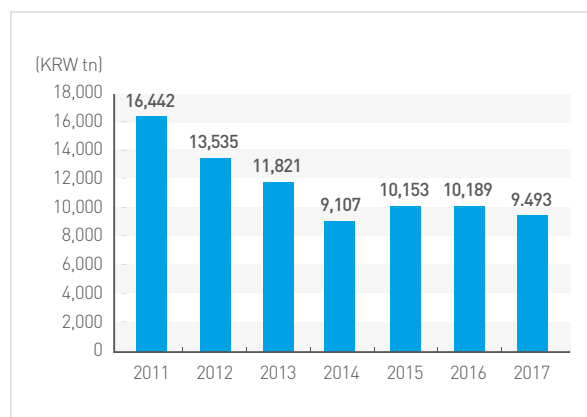
Exchange-Traded Derivatives Market Trends

After reaching a peak in 2011, the exchange-traded derivatives market has been severely dampened due to factors including contraction in the spot market and reduced volatility.

The total trading volume of exchange-traded derivatives was approximately 1.02bn contracts in 2017, a 28.5% gain year-on-year, but a 74.1% slip from the roughly 3.9bn contracts recorded in 2011.

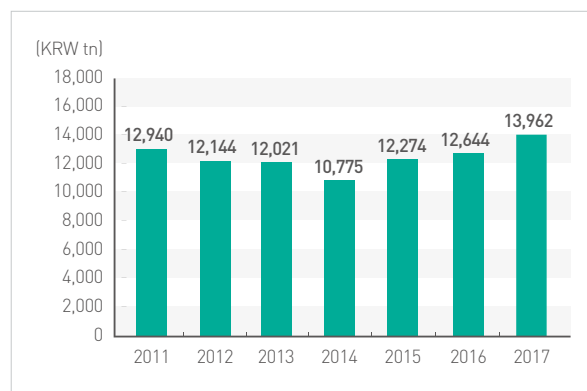
The trading volume of KOSPI 200 futures and options, which assumes the largest share, also increased by 18.7% year-on-year in 2017, but sharply contracted by 83.5% when comparing with 2011.

Graph 4-1. Annual Turnover of Exchange-Traded Derivatives



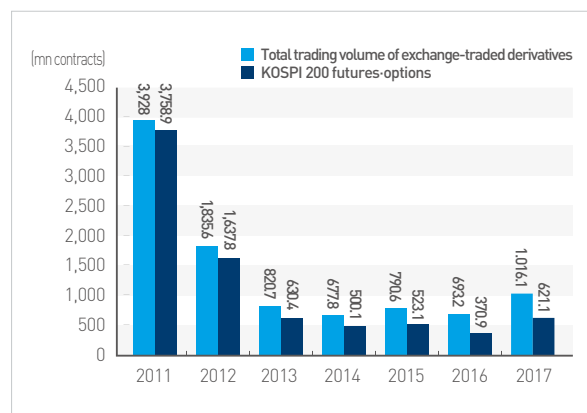
Source : KRX

Graph 4-2. Annual Turnover of OTC Derivatives



Source : FSS

Graph 4-3. Annual Turnover of Exchange-Traded Derivatives



Source : KRX

In the KOSPI 200 futures and options market, the share of trading by retail investors has overall declined from 32.0% in 2011 to 29.3% in 2017. A general drop has also been witnessed for the share of trading by institutional investors, from 29.8% in 2011 to 20.4% in 2017. In contrast, the share of trading by foreign investors has substantially increased, from 38.2% in 2011 to 50.2% in 2017.

The exchange-traded derivatives market has become more stagnant mostly because of the series of new regulations imposed on retail and institutional investors by the government.

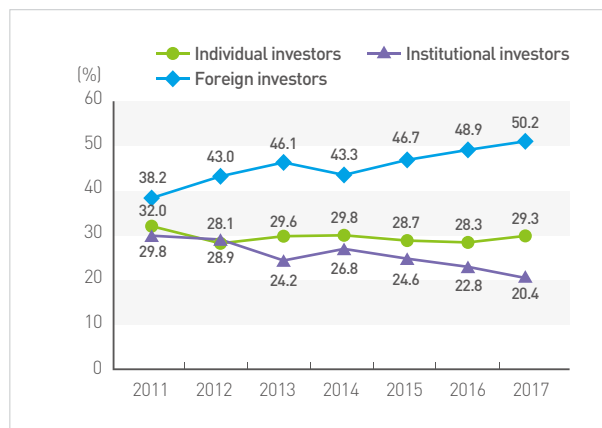
Retail investors steadily left the market due to regulations that limit their entry, including the abolishment of call option-dedicated accounts that had been exempt from margin requirements in 2011, a raise of the option multiplier in 2012 and stronger margin requirements in 2013.

In order to boost the global competitiveness of KOSPI 200 products and enhance investor convenience, the Korean government partially eased entry requirements in March 2017, including the lowering of the option multiplier.

The participation of institutional investors in the market has continued to decrease with the phase-out of tax exemption provided for arbitrage trading. The securities transaction tax of 0.3% that has been applied to arbitrage trading by Korea Post from April 2017 has been temporarily lifted until end-2018. This move is expected to balance out the concentration of foreign investors in the derivatives market.

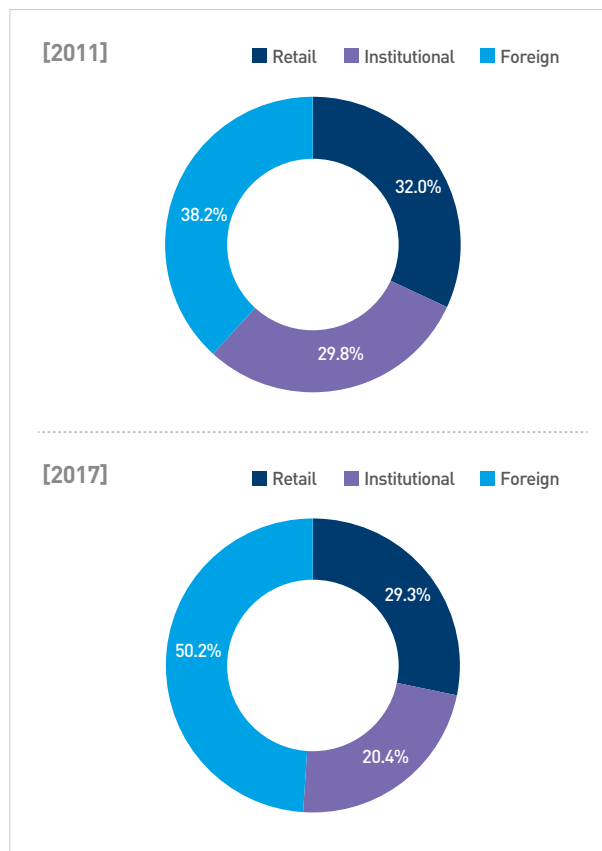
More foreign investors are investing in the market, but their turnover is caught in a downward spiral due to the absence of counterparties following weakened participation of retail and institutional investors.

Graph 4-4. KOSPI 200 Futures and Options Trading by Investor Type



Source : KRX

Graph 4-5. Trading by Investor Type



Source : KRX

OTC Derivatives Market Trends

The turnover of the OTC derivatives market stood at KRW 13,962tn in 2017. OTC derivatives with currency as underlying assets accounted for the lion's share at 79.8%, followed by those using interest rates (18.6%) and equities (1.3%). By investor, banks comprised the largest share (85.7%) followed by securities firms (9.7%), investment trusts (3.4%) and insurers (1.1%).

Table 4-1. Underlying Assets of OTC Derivatives

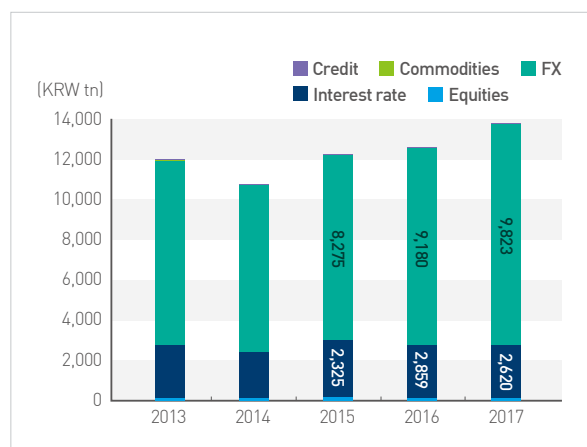
(Unit : KRW tn)

Year	FX	Interest rate	Equities	Credit	Commodities
2017	11,142	2,592	180	25	23
2016	9,823	2,619	160	25	17

Equity-linked securities (ELS) and derivatives-linked securities (DLS) were first issued in 2003 in the amount of KRW 3.5tn. In only 13 years, the market exponentially expanded by more than 30 times to post a record high of KRW 101.3tn in 2015 including ELS (KRW 77tn) and DLS (KRW 24.3tn), allowing them to position themselves as mid-risk, mid-return products.

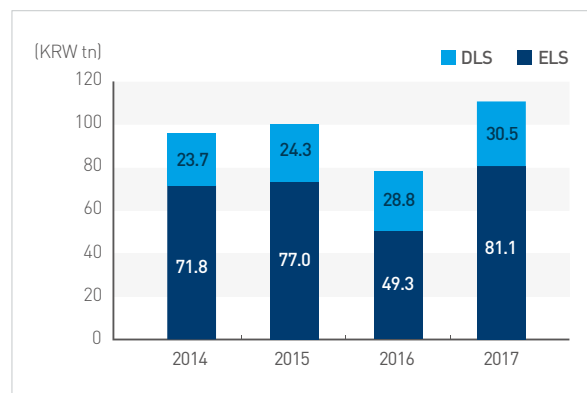
The issuance volume of ELS and DLS was valued at KRW 111.6tn in 2017, a 42.9% increase compared to 2016, when issuance had faltered.

Graph 4-6. OTC Derivatives Trading



Source : FSS

Graph 4-7. Annual Issuance Volume of Structured Products



Source : FSS

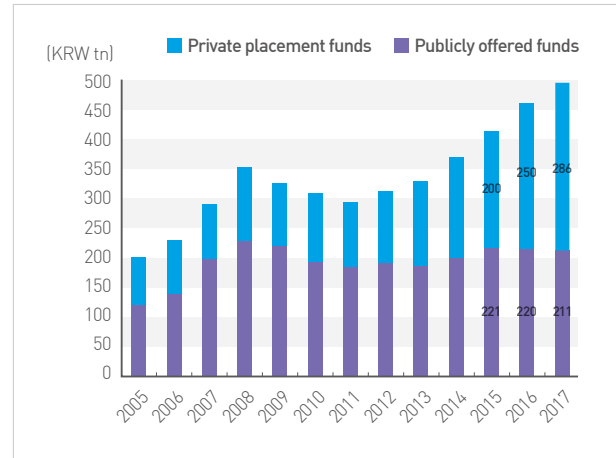
5. Fund Market

Amid the growth of pension assets in an ageing society, the importance of the asset management industry is being highlighted.

As of the end of 2017, the total fund AUM reached KRW 497tn and the number of funds was 12,848, both showing upward trends.

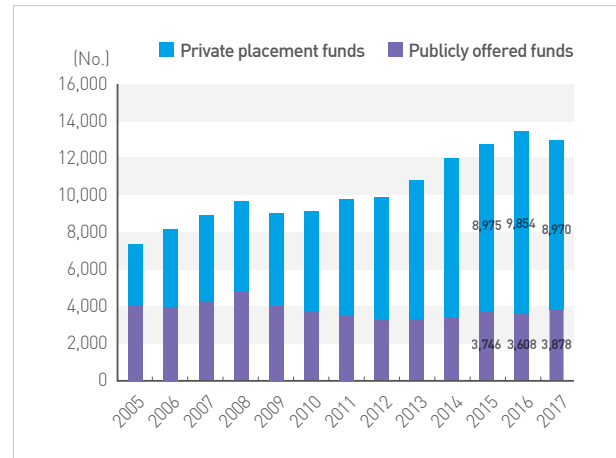
With the reform of the private placement fund scheme in October 2015, entry requirements have been eased for hedge funds. As a result, the number of asset management companies rapidly surged to 215 (193 domestic, 22 foreign) as of the end of 2017.

Graph 5-1. Fund AUM



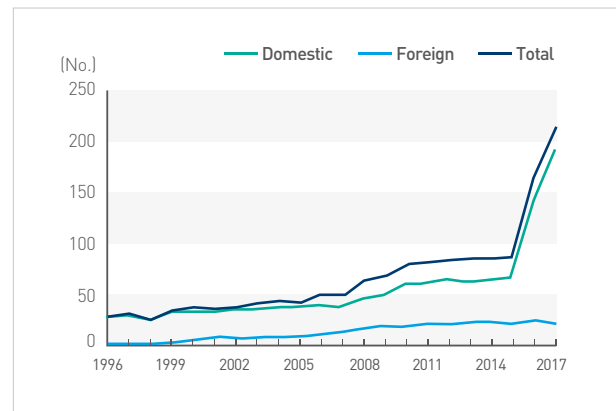
Source : KOFIA

Graph 5-2. Total Number of Funds



Source : KOFIA

Graph 5-3. Number of Asset Management Companies



Source : KOFIA

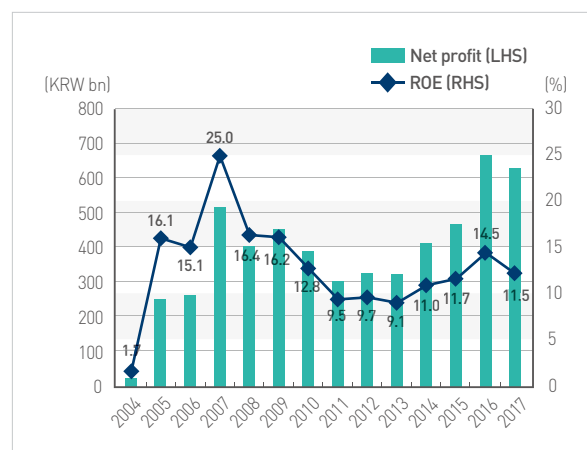
The fund AUM increased by KRW 28tn or 5.9% to reach KRW 497tn as of the end of 2017, compared to the same period last year, which posted KRW 469tn. Performances of asset management companies have trended upwards since FY-11, amid improved profitability on the back of increased AUM and soaring non-operating income.

The AUM of equity funds have grown amid rising stock prices, and alternative investments such as real estate and special asset funds are consistently expanding. Meanwhile, bond funds are on a downward trajectory due to increased interest rates.

* The NAV of equity funds (KRW 4.2tn), derivatives funds (KRW 6.7tn), real estate funds (KRW 14.1tn), special asset funds (KRW 9.7tn) have increased, while the NAV of bond funds (KRW 8.6tn) and MMF funds (KRW 7.0tn) have decreased.

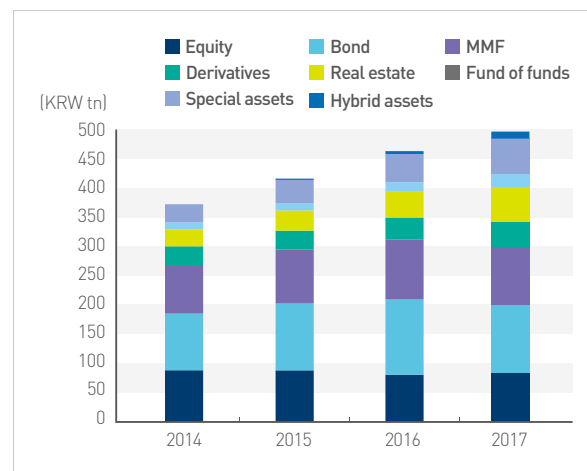
Most funds are distributed through securities companies and banks, which each accounted for 69.5% and 21.1%, followed by insurance companies at 1.7% and others at 7.8% as of the end of 2017.

Graph 5-4. Net Profit and ROE of Asset Management Companies



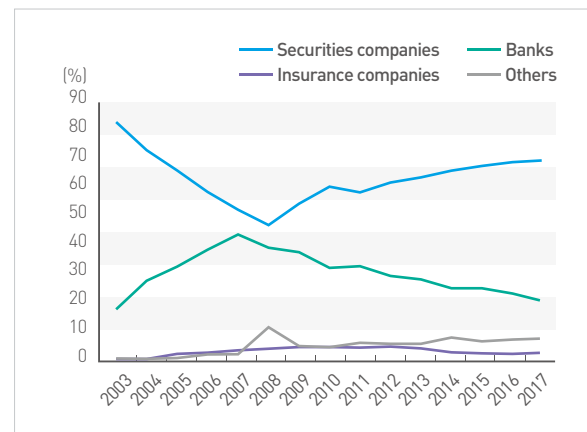
Source : FSS

Graph 5-5. Investment by Fund Type



Source : KOFIA

Graph 5-6. Distribution by Institution Type



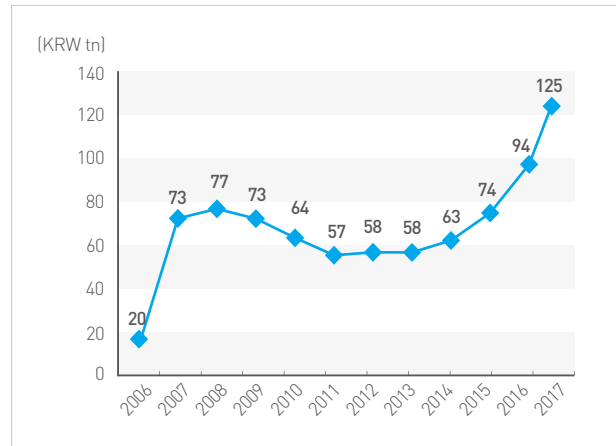
Source : KOFIA

Although overseas investment funds have faltered in the aftermath of the 2008 financial crisis, overseas investment is showing strong recovery amid the recent global stock market rally.

With growing interest on mid-risk and mid-return products in a low interest rate environment, investor demand for passive funds such as ETFs has risen. In particular, Korea's stock prices have seen a huge surge in 2017, adding to the popularity of ETFs and pushing the AUM to reach KRW 36tn.

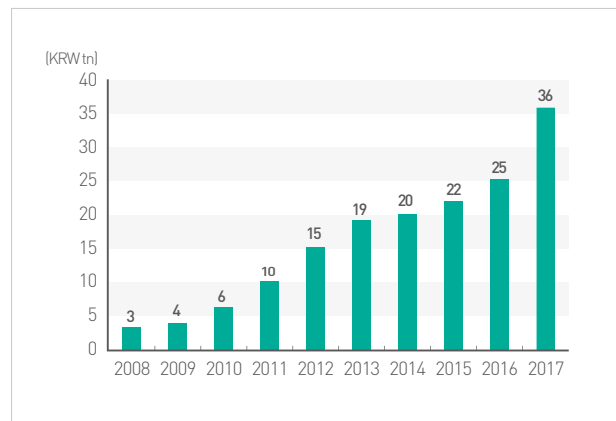
Bonds took up the largest proportion of fund investments in 2017 at 37.1%. It is noteworthy that the proportion of other assets was as high as 27.8%, reflecting the increased demand for alternative investments, which have driven up the AUM for real estate and special asset funds.

Graph 5-7. AUM of Overseas Investment Funds



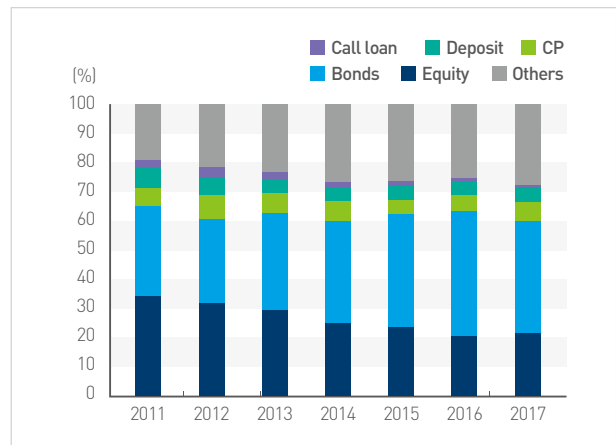
Source : KOFIA

Graph 5-8. AUM of ETFs



Source : KOFIA

Graph 5-9. Fund Investment by Asset Type



Source : KOFIA

6. Real Estate Trust Market

As of the end of 2017, 45 concurrently-run trust companies (20 securities companies, 19 banks, 6 insurance companies) and 11 companies dedicated to the real estate trust business were engaged in the trust business with a trust license.

The total outstanding amount of real estate trusts reached KRW 215.2tn as of the end of 2017, and real estate trust companies accounted for 83% (KRW 178.6tn), which is a 14.6% (KRW 22.7tn) increase compared to the previous year. This increase was mainly driven by the year-on-year growth of land trusts (KRW 8.9tn or 18.9%) and collateral trusts (KRW 13.6tn or 14.8%), which posted an outstanding amount of KRW 56.0tn and KRW 105.2tn, respectively.

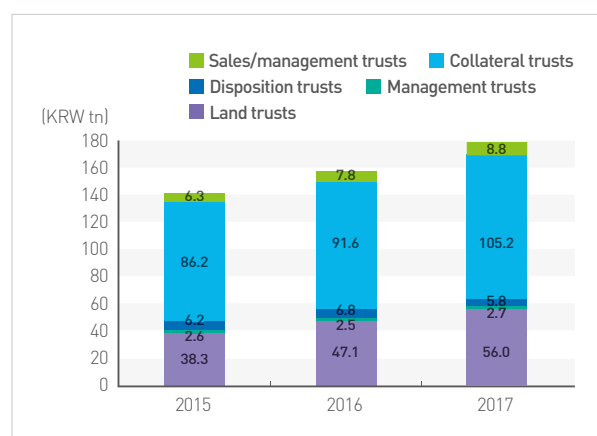
On the back of improved business conditions in the housing market and increased contracts of leveraged land trusts, real estate trust companies recorded an operating revenue of KRW 1,030.2bn in 2017, up KRW 244bn (31.0%) from a year earlier. Their net profit posted a record high of KRW 504.7bn, a KRW 111.4bn (28.3%) increase year-on-year.

Table 6-1. Number of Trust Companies (Unit : No.)

Category		2015	2016	2017
Companies with concurrently-run trust business	Securities	20	20	20
	Banking	19	19	19
	Insurance	7	6	6
Sub-Total		46	45	45
Real estate trust companies		11	11	11
Total		57	56	56

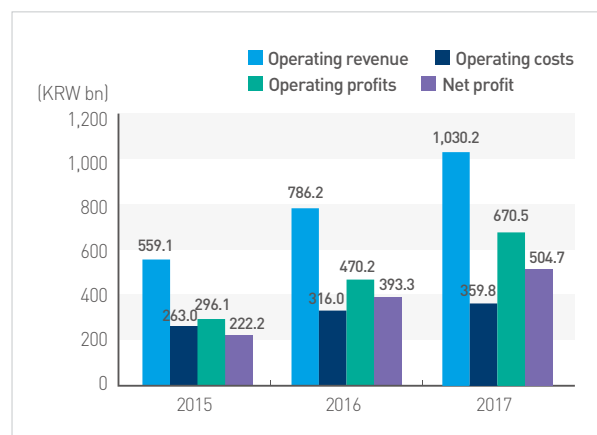
Source : FSS

Graph 6-1. Outstanding Amount of Real Estate Trust Companies



Source : KOFIA

Graph 6-2. Operating Revenue of Real Estate Trust Companies



Source : KOFIA

7. Advisory & Discretionary Market

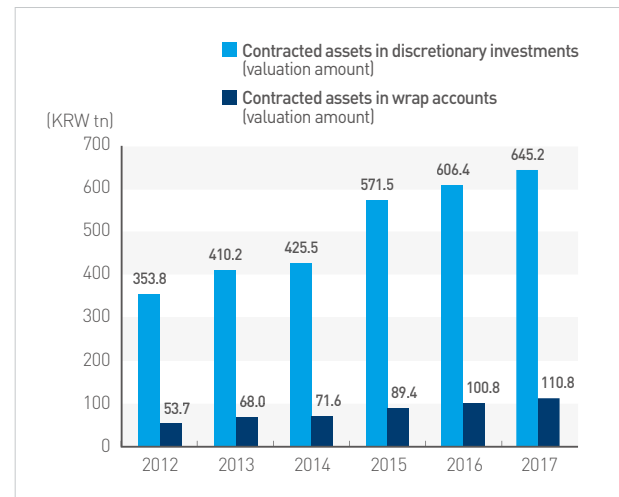
As of the end of 2017, 267 companies were registered as discretionary investment service providers, and the total AUM for discretionary investment recorded KRW 645.2tn. The balance of contracted assets in securities companies' wrap accounts reached KRW 110.8tn, a KRW 10tn increase compared to the previous year.

Meanwhile, a total of 179 companies were registered as investment advisors as of the end of 2017, with the number of executives and employees posting 1,227. The total advisory contracts recorded KRW 13.1tn, with KRW 8.4tn for discretionary investment and KRW 4.7tn for investment advisory business.

Regulatory revisions made for the financial advisory business during 2016 include the alleviation of entry requirements and introduction of the IFA (Independent Financial Advisors) and robo-advisors.

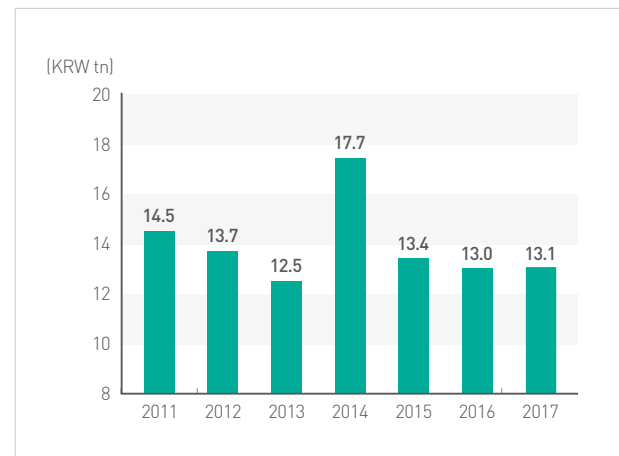
Further legal amendments related to the discretionary investment business have been made to the FSCMA in 2017. One of the main details is the allowance of non face-to-face discretionary contracts to be signed on the precondition that investor protection measures are taken such as thorough explanation through video calls. The other is the exemption of distributing discretionary investment reports in the case investors express their refusal to receive them, and diversifying the distribution method from the current e-mails to smart phone applications and text messages.

Graph 7-1. Volume of Discretionary Investment Contracts



Source : FreeSIS, KOFIA

Graph 7-2. Volume of Investment Advisory Contracts



Source : FreeSIS, KOFIA

8. Pension Market

Retirement Pensions

Korea's pension system is structured into a 3-tiered scheme, with the National Pension Service (NPS) consisting the first tier, retirement pension the second, and private pensions forming the last tier. The retirement pension scheme was introduced in 2005 to guarantee post-retirement income for employees and the reserves have grown to KRW 168.4tn as of late 2017.

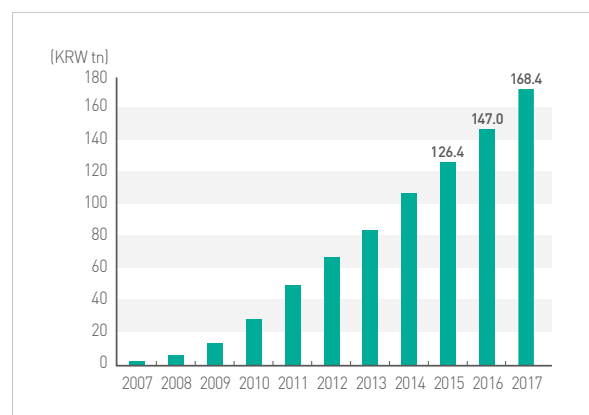
There are three type of retirement pension schemes : Defined Benefit (DB), Defined Contribution (DC) and Individual Retirement Pension (IRP).

At the end of 2017, the DB type accounted for the largest market share of 65.8%, followed by the DC type (25.1%) and IRP (9.1%). The proportion of the DC type is recently showing an upward trend.

Among different product categories, principal-protected products showed a dominant share of 88.1% (KRW 148.3tn), with dividend-paying products accounting for 8.4% (KRW 14.2tn) and others including standby capital, 3.5% (KRW 5.9tn).

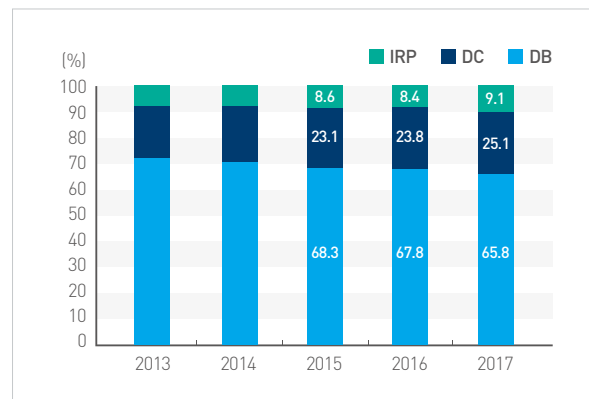
In order to alleviate the concentration on principal-protected products, the government is making various efforts such as reducing the requirements related to reserves management and pushing forward with the introduction of a trust-type retirement pension scheme, which is currently undergoing the legislative process.

Graph 8-1. Pension Reserves



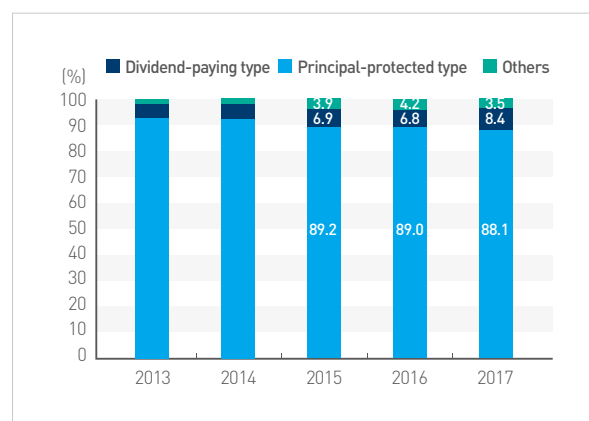
Source : FSS

Graph 8-2. Retirement Pension Schemes by Pension Type



Source : FSS

Graph 8-3. Portfolio Composition of Pension Reserves



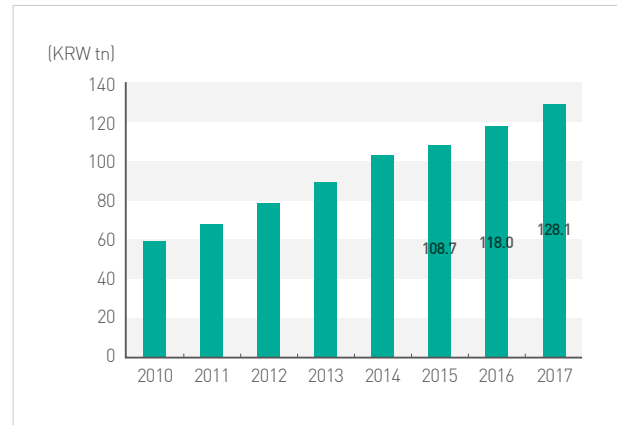
Source : FSS

Private Pension

The private pension scheme was first introduced back in 1994, as products that provide tax credit to investors for their year-end tax settlement. The private pension market is maintaining an annual growth rate of around 10%, and the reserves reached KRW 128.1tn as of the end of 2017.

Looking at the reserves according to each sector, the insurance sector took up the dominant proportion of 74.1% (KRW 94.9tn), followed by the banking sector of 13.2% (KRW 16.8tn), securities sector of 9.5% (KRW 12.2tn), and others of 3.2% (KRW 4.2tn) as of the end of 2017.

Graph 8-4. Pension Reserves



Source : FSS

Table 8-1. 2017 Pension Reserves by Financial Institution

(Units : KRW tn, %)

Category	Insurance	Banks	Securities	Others	Total
Reserves	94.9	16.8	12.2	4.2	128.1
Share	74.1	13.2	9.5	3.2	100.0

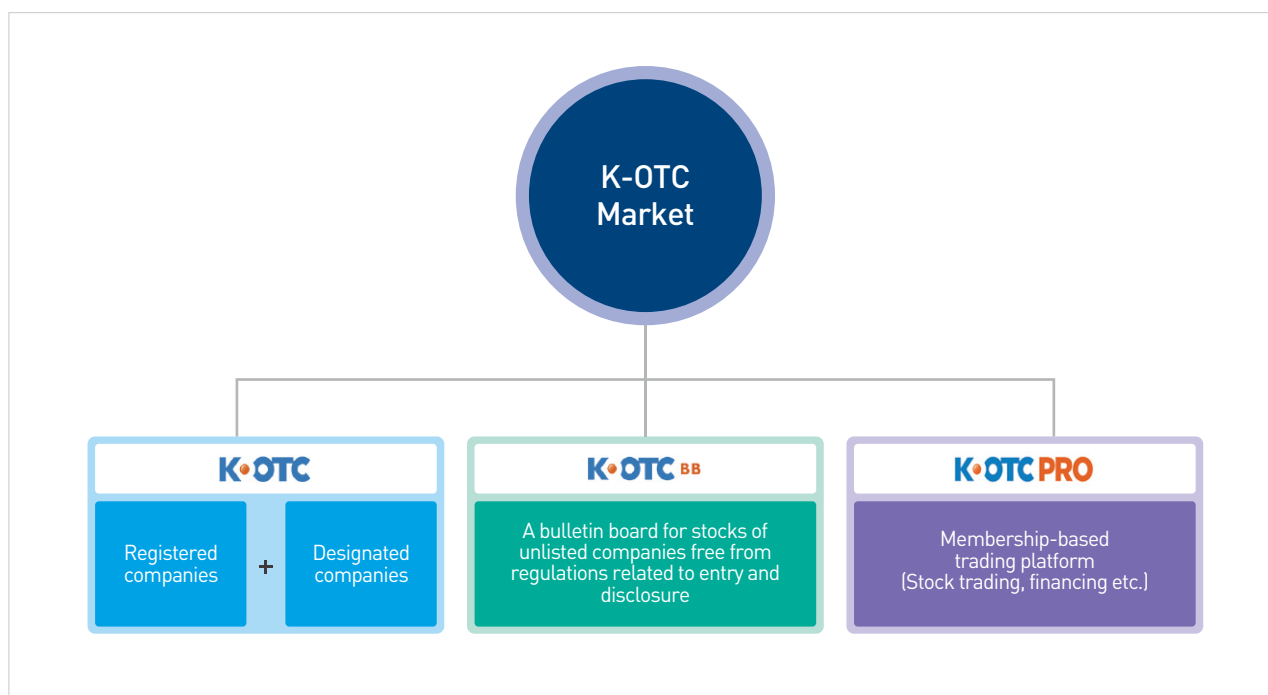
Source : FSS

9. K-OTC Market

1. Role and Function

The OTC markets operated by KOFIA consist of the K-OTC, K-OTCBB and K-OTC PRO.

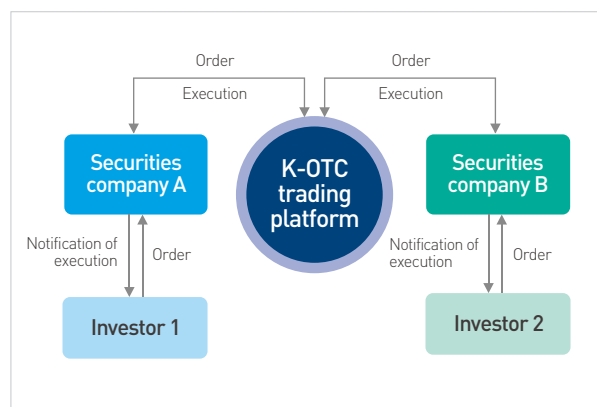
Chart 9-1. K-OTC Market



1) K-OTC Market

The K-OTC Market is an institutional OTC platform established and operated pursuant to the FSCMA. Investors can trade the stocks of unlisted companies which have either registered with or have been designated by KOFIA, with the help of brokerage firms.

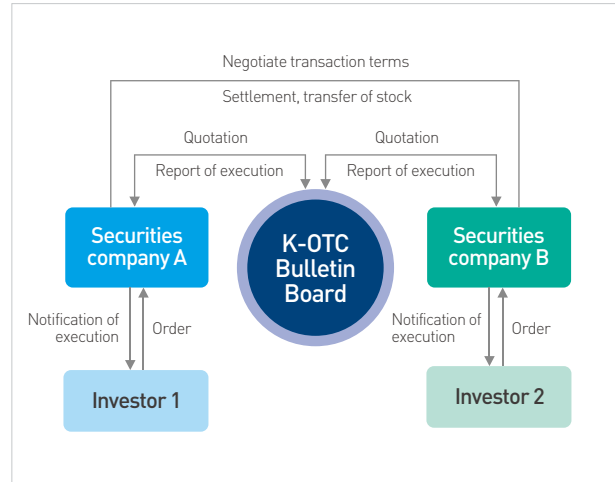
Chart 9-2. K-OTC Market Trading Process



2) K-OTCBB

K-OTCBB is a bulletin board that permits the trading of unlisted stocks including those that are not traded on the K-OTC market, as long as the company meets the minimal entrance requirement.

Chart 9-3. K-OTCBB Trading Process

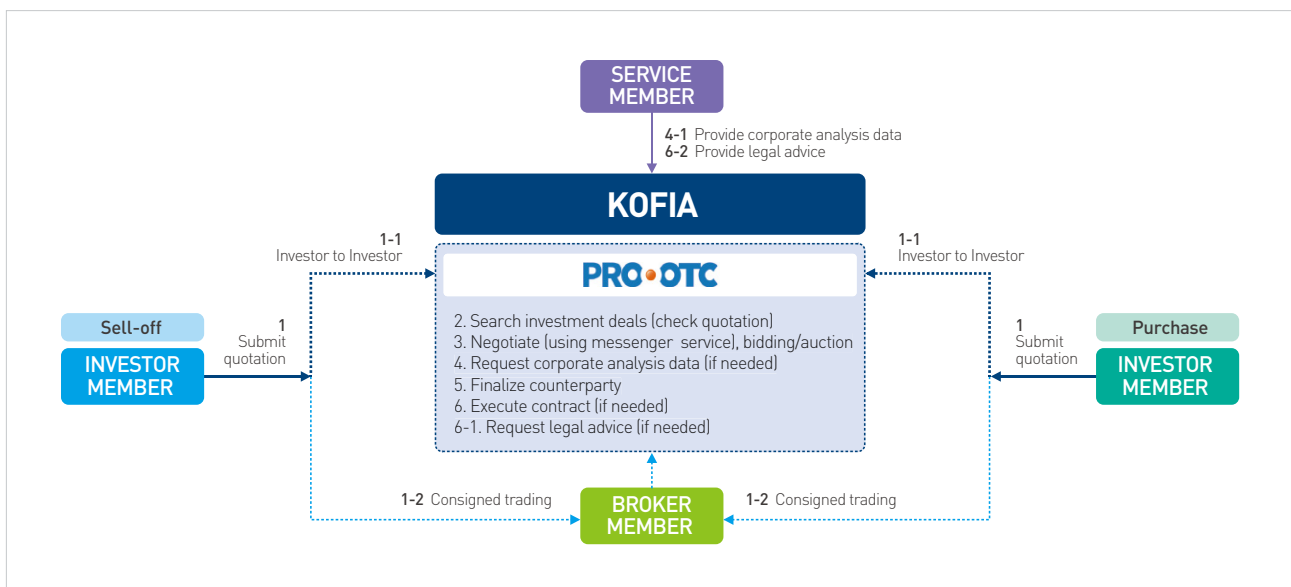


3) K-OTC PRO

K-OTC PRO is a members-only trading platform introduced and operated by KOFIA to support the financing of companies and smooth transaction of unlisted stocks for institutional and professional

investors. Investors can take part in various ways such as negotiation, bidding and auction to trade stocks issued by unlisted companies.

Chart 9-4. K-OTC PRO Trading Process



* Details must be reported to KOFIA when the counterparty is designated and contract is executed.

2. Major Changes in Indicators and Statistics over the Past Year

As of the end of 2017, a total of 119 companies (89 designated companies, 30 registered companies) were participating in the K-OTC market, posting a market capitalization of KRW 14.2tn. Meanwhile, the

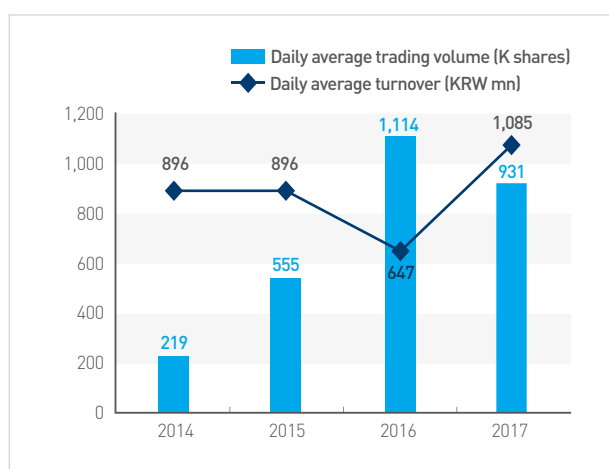
average daily trading volume and turnover for the K-OTCBB market was 931,000 shares and KRW 1.09bn, respectively, throughout the year 2017.

Table 9-1. Current Status of Companies Participating in the K-OTC Market

(Units : No., KRW tn)

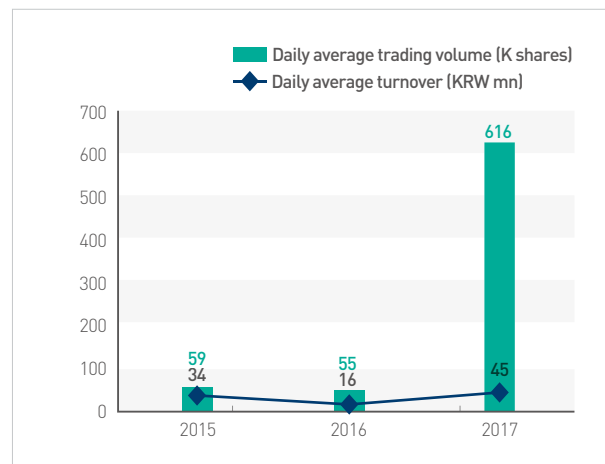
Category	2014	2015	2016	2017
No. of companies	117	128	138	119
New registration/designation	74	30	16	6
Cancelled registration/designation	9	19	6	25
Market capitalization	12.7	11.1	10.7	14.2

Graph 9-1. K-OTC Market: Trading Volume & Turnover



* Statistics before August 25, 2014 are from the Freeboard Market, the previous version to the K-OTC.

Graph 9-2. K-OTCBB: Trading Volume & Turnover



* The 2015 data has been calculated using the daily trading volume and turnover from the date of establishment (April 27, 2015) to the end of 2015.

Membership

As of July 17, 2018, KOFIA has a total of 406 members, comprised of 268 regular members, 114 associate members, and 24 special members.

KOFIA Members

Member Type	Number	Business Type
REGULAR	268	<ul style="list-style-type: none">- Asset Management : 195- Securities : 56- Real Estate Trust : 11- Futures : 6
ASSOCIATE	114	<ul style="list-style-type: none">- Investment Advisory : 73- Banking : 23- Insurance : 6- Regional Cooperative : 4- Crowdfunding : 5- Merchant Banking : 1- Securities Finance : 1- Others : 1 (Korea Post)
SPECIAL	24	<ul style="list-style-type: none">- General Administration : 7- Bond Rating : 4- Fund Rating : 4- Credit Rating : 4- Others : 5 (Korea Listed Companies Association, KOSDAQ Listed Companies Association, Korea Securities Depository, Korea Investment Corporation, CME Group)
TOTAL	406	

As of July 17, 2018



Websites

KOFIA Website : www.kofia.or.kr

Affiliated Websites

Korea Institute of Financial Investment : www.kifin.or.kr

- Training of financial investment industry professionals

K-OTC : www.k-otc.or.kr

- K-OTC market data for investors

Bond Market: www.kofiabond.or.kr

- Bond market data, yields, trading activities

Investor Education: www.kcie.or.kr

- Education service for individual investors





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