2014

CAPITAL MARKET
IN KOREA

Korea Financial Investment
Association

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PREFACE

Owing to its enhanced financial soundness in the wake of the 2008 financial crisis, Korea's financial industry experienced relative stability in 2013, in spite of the wave of increased volatility that struck financial markets in many emerging economies in the middle of the year.

However, many external risks still loom over the Korean financial sector, such as the tapering of the U.S. Federal Reserve's quantitative easing, sluggish economic growth in China, Europe's lingering debt crisis, and continued financial uncertainty in emerging markets. There are also domestic challenges we face, including an aging population and the push for changes in financial regulations. To overcome these difficulties and risks, the Korean financial industry continues to seek new growth engines and explore opportunities for revenue by offering more diversified investment products.

As the average age of the population increases, and the baby boomer generation gets close to retirement age, the financial services industry is taking steps to provide innovative products and services to meet the needs of these investors. And for its part, KOFIA is deeply committed to being an advocate for the industry, expressing the concerns of our members to regulators and lawmakers, along with putting education initiatives into place to promote greater market participation.

Although many challenges lie on the road ahead, we are making every effort to ensure that our financial industry is equipped to take them on and ascend to new heights. I hope this publication serves as a useful resource of information for investors seeking to understand and find success in Korea's capital market.

June 2014

Jong Soo Park
Chairman & CEO
Korea Financial Investment Association

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CHAPTER 01

KOREAN ECONOMY AND CAPITAL MARKET

I. THE NEED FOR AN ADVANCED DOMESTIC CAPITAL MARKET

Capital increasingly flows across borders in today's global economy, seeking more efficient, stable markets thanks to faster information transfers and increasingly efficient trading mechanisms. Under these circumstances, if a country's capital market remains isolated it will inevitably begin to lag behind the rest of the world, resulting in increased competition within the capital market itself. Recently, the world's financial markets have experienced accelerated securitization and a wide-scale expansion in business scope. Furthermore, a paradigm shift has occurred in the financial industry with the integration of the previously separate business areas of commercial and investment banking, aided by technological advances. IT development has enhanced work efficiency and opened the way for business partnerships to actively form across different industries, and low-cost, high value-added services have become available with the introduction of financial settlement systems.

Global trends show that the current financial industry is seeking ways to ensure a balance between bank-based and market-based financial systems in

order to increase corporate competitiveness, and to effectively channel capital to companies. In line with these global trends, the importance of capital markets in Korea has grown. Advanced markets help boost venture businesses and enhance market monitoring of corporate activities. Against this backdrop, Korea's capital market is expected to advance in the following ways: balanced growth within the financial industry, the emergence of innovative companies and the channeling of privately-held idle money into industry capital via the capital market, and greater participation by foreign investors in the domestic bond market.

II. FUTURE DIRECTIONS FOR THE FINANCIAL SYSTEM

A financial system is made up of financial markets and institutions, and the laws and practices that constitute and regulate them. The financial system can be further categorized into a bank-based system and a market-based system depending on several factors, including the types of financing methods employed: indirect financing or direct financing. Indirect financing consists of raising funds through bank loans while direct financing occurs through the issuance of bonds and stocks.

In a bank-based financial system, banks engage in cross-shareholding with companies and share the long-term risks and profits through a management control system. The bank-based system has certain advantages because it is less prone to breaches of contract. However, banks will regularly be required to bear the burden of shared investment risks, with their role extending beyond the monitoring function as a lender. This occurs as banks engage in management control through cross-shareholding and their long-term relationships with companies.

In the market-based system, on the other hand, companies finance themselves through direct financing. While banks provide short-term financing, their relationships with companies remain competitive. In addition, the relationship between a company and its counterparty is highly flexible as a company can change its counterparty at any time, depending on the level of competitiveness. Consistent market monitoring by credit rating agencies or investors in the retail market also plays an important role in the market-based system. Accordingly, capital can be efficiently allocated to where it is needed. This allows corporate restructuring to occur more naturally due to the competitive relationship

between financial institutions and non-financial companies, and the market monitoring function of this system.

However, under the market-based system, capital is highly likely to be allocated according to short-term variables in the financial market. Financial institutions and companies are more likely to invest for short-term profits, resulting in risk aversive behavior such as avoiding investments with long-term risks but potential efficiency. Therefore, it is up to each nation to choose the best system according to its own economic situation, with each system having both advantages and disadvantages.

The appropriate system for individual countries will vary according to each country's stage of economic development, current financial environment, and other conditions. Recently, many financially advanced countries have begun working to improve their financial systems by combining the advantages of the above mentioned systems to keep pace with rapidly changing financial environments.

TABLE 1-1. FEATURES OF MARKET-BASED AND BANK-BASED SYSTEMS

	Market-based system	Bank-based system
Features	- Greater role of the market compared to banks - Mostly direct financing - All investors have access to corporate information - Low information asymmetry - Investors act as an outside auditor in the market	- Greater role of banks compared to the market - Mostly indirect financing - Individual banks have exclusive access to corporate information - High information asymmetry - Banks act as an outside auditor

In Korea, the government has actively worked to advance its economy through strategic economic development since the 1960s. To raise the funds needed to implement advancement measures, the Korean government carried out policies which channeled funds extensively through banks to industries that needed to be nurtured. As a result, Korea's financial system was primarily bank-based. Under this government-led financial system, the non-performing loans of financial institutions rapidly accumulated in a series of corporate bankruptcies, acting as a key trigger for the 1997 financial crisis in Korea.

Since the Asian financial crisis, the banking sector has made profitability a priority, with its business activities focusing on household lending as opposed

to corporate lending. This has increased the need for companies to utilize direct financing for their fundraising. At the same time, financial restructuring has led to the emergence of large-sized financial institutions and the accompanying drive for a greater range of financial services. Additionally, foreign capital has also entered the domestic financial industry with the opening up of the capital market, and new financial products became more pervasive.

Looking to the future, the market-based financial system needs to be further developed in order to play its role as a checking mechanism on corporate management through the enhanced efficiency of the financial industry.

III. TRENDS IN THE SIZE OF FINANCIAL INSTITUTIONS AND CAPITAL MARKETS

1. The Size of Financial Institutions

The total asset value for financial institutions in Korea increased by 3.8 times from KRW 890tn in 1998 to KRW 3,417tn in 2013. During the same period, the figure for the banking sector increased about 3.7 times from KRW 565tn to KRW 2,101tn. For securities-related companies (securities, futures and asset management companies), their total asset value also showed a 7.9-fold growth from KRW 35tn to KRW 277tn.

Korea's banking sector makes up the lion's share of the financial market mainly because the banking sector was protected for decades under the principle of division of business within the financial industry, and also because the government provided credit guarantees for banks. As such, the banking sector's share of the market is still the largest portion, although it has gone down slightly from 63.5% in 1998 to 61.5% in 2013. During the same period, the proportion of securities-related companies more than doubled, from 3.9% to 8.1%. In addition, the competiveness of banks was seen as higher than that of non-bank deposit-gathering institutions such as merchant banks and mutual banks.

TABLE 1-2. TOTAL ASSETS OF FINANCIAL INSTITUTIONS

(Unit: billion won, %)

	Banks	Non-bank deposit-gathering institutions	Other	Insurance companies	Securities companies	Futures companies	Asset management companies	Total
1998	565,080 (63.5%)	111,552 (12.5%)	64,245 (7.2%)	114,513 (12.9%)	34,734 (3.9%)	- -	- -	890,124 (100.0%)
2000	829,338 (71.6%)	63,093 (5.4%)	62,351 (5.4%)	149,540 (12.9%)	52,171 (4.5%)	526 (0.02%)	1,273 (0.1%)	1,158,291 (100%)
2002	1,043,124 (72.2%)	48,225 (3.3%)	101,704 (7.0%)	198,549 (13.7%)	50,476 (3.5%)	526 (0.02%)	1,530 (0.1%)	1,444,133 (100%)
2004	1,141,652 (73.1%)	58,911 (3.8%)	53,913 (3.5%)	252,658 (16.2%)	52,361 (3.4%)	915 (0.1%)	1,636 (0.1%)	1,562,045 (100%)
2006	1,394,166 (71.2%)	78,294 (4.0%)	67,827 (3.5%)	321,580 (16.4%)	92,852 (4.7%)	1,327 (0.1%)	2,062 (0.1%)	1,958,107 (100%)
2008	1,869,269 (71.6%)	102,562 (3.9%)	101,627 (3.9%)	391,935 (15.0%)	140,643 (5.4%)	2,799 (0.1%)	3,017 (0.1%)	2,611,852 (100%)
2009	1,799,816 (68.1%)	126,853 (4.8%)	104,074 (3.9%)	444,431 (16.8%)	163,956 (6.2%)	2,481 (0.1%)	3,355 (0.1%)	2,644,966 (100%)
2010	1,841,707 (65.5%)	136,350 (4.8%)	120,774 (4.3%)	507,504 (18.1%)	199,805 (7.1%)	1,794 (0.1%)	3,670 (0.1%)	2,811,604 (100%)
2011	1,969,228 (64.5%)	119,579 (3.9%)	158,804 (5.2%)	566,011 (18.5%)	233,781 (7.7%)	2,280 (0.1%)	3,889 (0.1%)	3,053,538 (100%)
2012	2,031,268 (62.2%)	106,143 (3.2%)	164,915 (5.0%)	699,604 (21.4%)	259,910 (8.0%)	2,653 (0.1%)	3,983 (0.1%)	3,268,091 (100%)
2013	2,101,365 (61.5%)	96,502 (2.8%)	174,069 (5.1%)	786,036 (22.5%)	270,610 (7.9%)	2,247 (0.1%)	4,191 (0.1%)	3,417,020 (100%)

Source: Financial Supervisory Service, Monthly Financial Statistics Bulletin
Note: Figures as of the end of the year, and ( ) is represented as a percentage of whole assets.

2. The Size of the Domestic Capital Market

The domestic capital market was worth KRW 2,702tn at the end of 2013, up 5.7% from 2012. The stock market expanded by 3.4% from KRW 1,263tn to KRW 1,306tn on a year-on-year basis. At the same time, the bond market grew by 8.1% from KRW 1,291tn to KRW 1,396tn.

TABLE 1-3. SIZE OF THE CAPITAL MARKET IN KOREA

(Unit: billion won, %)

	2002	2004	2006	2008	2010	2011	2012	2013
Bonds	563,943	659,759	777,762	864,103	1,116,354	1,201,269	1,291,208	1,396,116
	(65.5%)	(59.8%)	(50.0%)	(58.1%)	(47.4%)	(51.1%)	(50.6%)	(51.7%)
Stocks	296,083	443,737	776,724	623,113	1,239,857	1,147,992	1,263,416	1,306,190
	(34.5%)	(40.2%)	(50.0%)	(41.9%)	(52.6%)	(48.9%)	(49.4%)	(48.3%)
Total	860,026	1,103,496	1,554,486	1,487,216	2,356,211	2,349,261	2,556,068	2,702,306

Source: KRX Information Center

Note: 1) Based on listed bonds. Foreign currency denominated bonds and Korean won denominated foreign bonds are excluded. The FSCMA enacted on Feb. 4, 2009 has realigned bond types, and some financial bonds have been recategorized as corporate bonds.

2) Based on the market capitalization of stocks listed on the KRX and KOSDAQ.

3) ( ) is represented as a percentage.

IV. CORPORATE FINANCING

1. Trends in Corporate Financing

According to an analysis of corporate financing data trends made by The Bank of Korea, the overall value of corporate financing has been on an upward trend since 2005, recovering from its plummet in 1998 due to the Asian financial crisis.

Indirect financing (loans) of domestic firms accounted for 36.9% of the total capital raised in 2013, a significant jump from the level a year ago, and direct financing (issuance of bonds and shares) accounted for 51.8% of the total. Although direct financing has dropped significantly in the aftermath of the global financial crisis of 2007 and 2008, it bounced back to its pre-crisis level in 2010.

TABLE 1-4. CORPORATE FINANCING TRENDS

(Unit: billion won, %)

Financing	2002	2004	2006	2008	2010	2012	2013
Bonds	-2,305 (-2.7%)	70 (0.1%)	45,823 (25.2%)	42,332 (18.4%)	33,975 (29.0%)	55,651 (40.8%)	39,586 (35.6%)
Loans	34,875 (40.8%)	3,282 (5.0%)	66,009 (36.3%)	115,033 (49.9%)	23,408 (20.0%)	18,967 (13.9%)	41,058 (36.9%)
Government Loans	-518 (-0.6%)	3,645 (5.6%)	-344 (-0.2%)	2,833 (1.2%)	2,460 (2.1%)	1,252 (0.9%)	2,382 (2.1%)
Stock & Equity Interest	32,837 (38.4%)	32,641 (50.0%)	38,888 (21.4%)	28,410 (12.3%)	29,582 (25.3%)	18,468 (13.5%)	18,035 (16.2%)
Other[1)]	20,565 (24.1%)	25,598 (39.2%)	31,659 (17.4%)	41,766 (18.1%)	27,700 (23.7%)	42,016 (30.8%)	10,259 (9.2%)
Total	85,455 (100.0%)	65,235 (100.0%)	182,035 (100.0%)	230,373 (100.0%)	117,124 (100.0%)	136,354 (100.0%)	111,320 (100.0%)

Source: The Bank of Korea, Economic Statistics System
Note: 1) Commerce credit, direct investment, call money, etc.

2. Financing through the Capital Market

Corporate financing through the capital market showed a downward trend since its peak in 2002 until 2006, but it has slowly begun to recover with the growing corporate debentures issues following the global financial crisis in 2008. With the recovery of the stock market in 2010, financing through IPOs and rights offerings rose, but the amount of capital being raised decreased drastically as the eurozone crisis and economic slowdown in the U.S. exacerbated uncertainty in the financial markets.

TABLE 1-5. DIRECT FINANCING BY LISTED COMPANIES

(Unit: # of financing activities, billion won, %)

		2002	2004	2006	2008	2010	2012	2013
Stocks	Volume	382	271	317	267	254	88	116
	Amount	9,885 (11.3%)	8,364 (14.2%)	6,499 (13.5%)	5,068 (6.4%)	10,340 (8.4%)	2,364 (1.8%)	5,398 (4.4%)
IPO	Volume	156	82	84	64	119	25	47
	Amount	3,163 (3.6%)	3,015 (5.1%)	2,041 (4.2%)	1,313 (1.7%)	5,977 (3.5%)	466 (0.4%)	1,289 (1.1%)
Paid- in capital increase	Volume	226	189	233	203	135	63	69
	Amount	6,722 (7.7%)	5,349 (9.1%)	4,459 (9.3%)	3,754 (4.7%)	4,363 (4.9%)	1,897 (1.4%)	4,109 (3.3%)
Corporate bonds	Volume	1,580	1,501	1,250	1,631	2,193	2,091	2,624
	Amount	77,522 (88.7%)	50,379 (85.8%)	41,678 (86.5%)	74,116 (93.6%)	112,919 (91.6%)	128,693 (98.2%)	116,295 (95.6%)
Total financing	Volume	1,962	1,772	1,567	1,898	2,447	2,179	2,740
	Total amount	87,407 (100.0%)	58,743 (100.0%)	48,178 (100.0%)	79,183 (100.0%)	123,259 (100.0%)	131,056 (100.0%)	121,693 (100.0%)

Source: Financial Supervisory Service, Monthly Financial Statistics Bulletin

V. BALANCE OF PAYMENTS

In the early 1980s, Korea's balance of payments showed a pattern of current account deficit and capital account surplus. Then, in the second half of the decade, the era of the so-called "three lows"– low interest rates, low oil prices and a depreciated won against the dollar exchange rate – Korea's current account turned to a surplus and the capital account turned to a deficit. Later, the current account surplus and capital account deficit reverted back to a deficit and a surplus state, respectively. During the Asian financial crisis, Korea's capital and financial account registered a US$ 33.5bn deficit due to shortages in the balance of its portfolio investments, derivatives and other investments. After the 2008 global financial crisis, the derivatives account registered a deficit of US$ 14.4bn, mainly as a result of drastic swings in the won-dollar exchange rates.

In 2013, the Korean economy recorded a current account surplus of US$ 79.9bn, a 57.1% jump from a year earlier, but the overall financial accounts saw a deficit of US$ 76.9bn, with deficits mounted in direct investment and other investment accounts.

TABLE 1-6. TRENDS IN BALANCE OF PAYMENTS

(Unit: million dollars)

	Current account balance	Capital/ financial account	Capital balance	Financial account	Direct account balance	Securities investment balance	Derivatives balance	Other investments
1990	-1,390	3,224	-331	3,555	-263	162	-78	2,549
1995	-8,012	9,236	-488	9,723	-1,776	11,712	-121	6,954
1998	10,057	-33,528	442	-33,969	1,769	-1,224	-654	-2,885
2000	10,444	-9,581	38	-9,620	6,667	12,177	-179	-4,513
2002	4,693	-6,240	-9	-6,231	2,038	346	362	2,822
2004	29,743	-34,323	10	-34,332	6,009	6,599	2,020	-10,340
2006	3,569	-12,615	-69	-12,546	-3,607	-23,386	484	36,076
2008	3,190	6,618	26	6,592	-8,445	-2,421	-14,369	-24,619
2010	28,850	-23,253	-63	-23,190	-18,783	42,365	829	-20,631
2012	50,835	-51,624	-42	-51,582	-21,136	6,748	2,628	-26,637
2013	79,884	-76,909	-28	-76,881	-16,952	-8,287	3,840	-41,004

Source: The Bank of Korea, Economic Statistics System

Note: Capital/financial account = Capital balance + Financial account
Financial account = Direct account balance + Securities investment balance + Derivatives balance + Other investments

VI. RATIO OF FINANCIAL ASSETS AND CAPITAL MARKET TO GDP

Both the ratio of financial assets and the size of the capital market compared to GDP continued to grow. Between 2000 and 2013, the value of financial assets and the capital market (market capitalization) increased by 3.9 times and 6.0 times, respectively, while GDP grew 2.4 times. This shows that the financial industry's rate of growth has been accelerating, with the size of financial assets and the capital market outpacing GDP.

TABLE 1-7. RATIO OF FINANCIAL ASSETS AND CAPITAL MARKET TO GDP

(Unit: billion won, multiplier)

	2000	2002	2004	2006	2008	2010	2012	2013
GDP	603,236	720,539	826,893	908,744	1,065,036	1,265,300	1,377,500	1,428,300
Financial assets	1,496,045	2,155,163	2,545,704	3,196,241	3,701,187	4,635,456	5,194,788	5,760,560
Market capitalization (MC)	217,057	296,083	443,737	776,724	623,113	1,239,857	1,263,416	1,306,190
Financial assets to GDP	2.5	3.0	3.1	3.5	3.6	3.7	3.8	4.0
Market capitalization to GDP	0.4	0.4	0.5	0.9	0.6	1.0	0.9	0.9

Source: The Bank of Korea, Economic Statistics System, KRX Information Center
Note: 1) GDP valuation before 2010 is based on the criterion of 2005, while after, the criterion of 2010 is used.
2) Financial assets combine the assets of individuals, non-financial corporations, and the government (excluding financial corporations and foreign sectors).
3) Market capitalization = KRX stock market + KOSDAQ market

VII. TRENDS IN FINANCIAL ASSETS HELD BY INVESTOR TYPE

1. Financial Institutions

As financial institutions' assets continued to grow, gross assets as of the end of 2013 stood at KRW 5,720tn, an increase of KRW 307tn (5.7%) from a year earlier. A breakdown by asset group shows that the percentage of stocks and investments held by the financial sector was 8.6%, a slight year-on-year increase, with bonds making up 27.5% of the market.

TABLE 1-8. SIZE OF FINANCIAL ASSETS HELD BY FINANCIAL INSTITUTIONS

(Unit: billion won, %)

	2000	2002	2004	2006	2008	2010	2012	2013
Currency and deposits	83,196 (4.6%)	126,812 (5.4%)	141,945 (5.5%)	196,702 (6.2%)	334,778 (7.9%)	351,161 (7.4%)	418,120.6 (7.7%)	424,262 (7.4%)
Insurance and pensions	0 (0.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)
Bonds	555,769 (30.6%)	659,684 (28.4%)	695,512 (27.1%)	869,586 (27.5%)	1,014,169 (24.0%)	1,235,334 (26.2%)	1,452,822 (26.8%)	1,575,054 (27.5%)
Loans	685,607 (37.7%)	953,268 (41.0%)	1,022,911 (39.8%)	1,250,037 (39.5%)	1,676,719 (39.6%)	1,824,160 (38.6%)	2,036,739 (37.6%)	2,145,744 (37.5%)

	2000	2002	2004	2006	2008	2010	2012	2013
Stocks and equity investments	78,922 (4.3%)	120,354 (5.2%)	134,814 (5.2%)	250,272 (7.9%)	292,508 (6.9%)	396,097 (8.4%)	462,941 (8.6%)	490,924 (8.6%)
Other	414,014 (22.8%)	466,762 (20.1%)	574,877 (22.4%)	596,581 (18.9%)	912,488 (21.6%)	915,964 (19.4%)	1,042,604 (19.3%)	1,084,962 (19.0%)
Total	1,817,507 (100.0%)	2,326,879 (100.0%)	2,570,058 (100.0%)	3,163,178 (100.0%)	4,230,661 (100.0%)	4,722,716 (100.0%)	5,413,227 (100.0%)	5,720,945 (100.0%)

Source: The Bank of Korea, Economic Statistics System

2. Corporations

Financial assets held by corporations continued to expand, with gross asset value standing at KRW 1,818tn as of the end of 2013, an increase of KRW 74tn (4.2% growth) from the value a year earlier. When examining the financial assets held by the corporate sector, the percentage of currency and deposits amounted to 33.3% of all corporate assets in 2000, with that figure gradually falling to 27.7% by 2013. On the other hand, the share of stocks and equity investments went up from 9.7% in 2000 to 26.0% in 2013.

TABLE 1-9. FINANCIAL ASSETS HELD BY CORPORATIONS

(Unit: billion won, %)

	2000	2002	2004	2006	2008	2010	2012	2013
Currency and deposits	148,847 (33.3%)	181,174.4 (25.9%)	198,718.8 (23.5%)	265,996.7 (25.1%)	345,876.9 (26.5%)	414,276 (25.6%)	469,798 (26.9%)	504,404 (27.7%)
Insurance and pensions	0 (0.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)
Bonds	37,239 (8.3%)	87,000 (12.5%)	102,425.7 (12.1%)	91,844.7 (8.7%)	93,022.8 (7.1%)	85,709 (5.3%)	71,799 (4.1%)	77,389 (4.3%)
Stocks and equity investments	43,251 (9.7%)	117,036 (16.8%)	197,678.3 (23.4%)	279,690.2 (26.4%)	259,189.1 (19.9%)	462,424 (28.6%)	482,507 (27.7%)	473,344 (26.0%)
Other	217,248 (48.6%)	313,351 (44.9%)	345,680 (40.9%)	421,934 (39.8%)	604,774 (46.4%)	655,446 (40.5%)	720,728 (41.3%)	763,006 (42.0%)
Total	446,584.5 (100.0%)	698,561.6 (100.0%)	844,503.1 (100.0%)	1,059,465.9 (100.0%)	1,302,862.7 (100.0%)	1,617,855 (100.0%)	1,744,833 (100.0%)	1,818,142 (100.0%)

Source: The Bank of Korea, Economic Statistics System

Note: The calculation was made based on the figures of companies (excluding financial companies) for the year 2000, and after 2002 the figures of non-financial corporations (public companies and private companies) were used.

3. Retail Investors

Individuals are increasingly holding a higher proportion of financial assets as well. As of the end of 2013, total financial assets held by individuals recorded KRW 2,641tn, a jump of KRW 156tn (6.3%) from a year earlier. When looking at financial assets held by individuals, the percentages of stocks/equity investments and bonds were quite modest, at 16.7% and 8.2%, respectively, in 2013. Meanwhile, the percentage of investments in insurance and pension stood at a higher level of 28.9%, and the amount for currency and deposits at 45.5%. This demonstrates that, while stocks and equities investments continue to grow, the percentage of total investments is comparatively low, as the majority of retail investments remain in currency and deposits.

TABLE 1-10. FINANCIAL ASSETS HELD BY RETAIL INVESTORS

(Unit: billion won, %)

	2000	2002	2004	2006	2008	2010	2012	2013
Currency and deposits	488,204 (61.1%	589,324 (54.3%)	625,001 (50.1%)	718,251 (46.9%)	790,154 (46.9%)	982,013 (45.0%)	1,129,424 (45.5%)	1,200,908 (45.5%)
Insurance and pensions	144,139 (18.1%	231,746 (21.4%)	281,604 (22.6%)	345,772 (22.6%)	422,469 (25.1%)	532,902 (24.4%)	680,424 (27.4%)	763,896 (28.9%)
Bonds	74,446 (9.3%	90,767 (8.4%)	119,328 (9.6%)	164,300 (10.7%)	183,493 (10.9%)	214,352 (9.8%)	231,425 (9.3%)	217,808 (8.2%)
Stocks and equity investments	68,456 (8.6%)	155,568 (14.3%)	207,055 (16.6%)	290,638 (19.0%)	274,446 (16.3%)	440,000 (20.1%)	426,960 (17.2%)	441,540 (16.7%)
Other	23,271 (2.9%)	17,699 (1.6%)	13,860 (1.1%)	12,967 (0.8%)	15,753 (0.9%)	15,151 (0.7%)	17,209 (0.7%)	17,756 (0.7%)
Total	798,516 (100.0%)	1,085,103 (100.0%)	1,246,849 (100.0%)	1,531,928 (100.0%)	1,686,314 (100.0%)	2,184,418 (100.0%)	2,485,443 (100.0%)	2,641,908 (100.0%)

Source: The Bank of Korea, Economic Statistics System

4. Foreign Investors

Domestic financial assets held by foreign investors are primarily in the form of stocks and equity investments and bonds. In 2013, the percentage of stocks and equity investments was 39.1% of all foreign investments in domestic financial assets, while bonds stood at 23.2%. This shows that foreign investors invest mainly in stocks and bonds.

Out of all of the stocks and equity investments in Korea, the share held by external entities rose sharply beginning in 1990, and peaked in 2000 at 22.1%. Following the financial crisis in 2008, the percentage gradually dropped to 13.7%, but rebounded in 2010 and plateaued at 19%. Among total bond assets, the percentage held by foreign investors continued a downward trend until 2006 after reaching 8.6% in 2000, but has started to recover since 2008, and recorded 9.9% in 2013. This shift can be attributed to strategies implemented to increase the percentage of bonds and lower the relative percentage of stocks and equity investments after the global financial crisis.

TABLE 1-11. FINANCIAL ASSETS HELD BY FOREIGN INVESTORS

(Unit: billion won, %)

	2000	2002	2004	2006	2008	2010	2012	2013
Currency and deposits	2,337 (0.8%)	5,517 (1.7%)	6,879 (1.6%)	10,226 (1.7%)	36,743 (4.9%)	18,941 (2.0%)	27,232 (2.7%)	28,734 (2.5%)
Insurance and pensions	0 (0.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)
Bonds	66,694 (23.9%)	48,659 (14.6%)	56,257 (13.0%)	70,654 (11.7%)	159,803 (21.1%)	198,637 (21.1%)	230,069 (22.5%)	242,160 (23.2%)
Stocks and equity investments	66,136 (23.7%)	90,829 (27.3%)	163,268 (37.8%)	256,930 (42.4%)	156,763 (20.7%)	360,309 (38.3%)	389,182 (38.1%)	409,374 (39.1%)
Other	143,758 (51.5%)	187,714 (56.4%)	205,202 (47.5%)	268,534 (44.3%)	402,849 (53.3%)	361,670 (38.5%)	376,049 (36.8%)	368,565 (35.2%)
Total	278,925 (100.0%)	332,718 (100.0%)	431,605 (100.0%)	606,345 (100.0%)	756,158 (100.0%)	939,558 (100.0%)	1,022,531 (100.0%)	1,045,833 (100.0%)

Source: The Bank of Korea, Economic Statistics System

TABLE 1-12. TRENDS IN SHARE OF BONDS AND STOCKS/EQUITY INVESTMENTS HELD BY FOREIGN INVESTORS

(Unit: %)

	2000	2002	2004	2006	2008	2010	2012	2013
Bonds	8.6	5.0	5.1	5.1	9.6	10.0	10.0	9.9
Stocks and equity investments	22.1	16.2	20.4	21.2	13.7	19.1	19.3	19.5

Source: The Bank of Korea, Economic Statistics System

Foreign stock ownership in domestically listed corporations stood at 32.97% of the entire stock market as of the end of 2013, with the figure dropping dramatically and then gradually rising up again following the 2004 peak of 40.1%. Nevertheless, the proportion of foreign stock ownership in the domestic stock market remains quite high.

TABLE 1-13. FOREIGN STOCK OWNERSHIP IN LISTED COMPANIES

(Unit: %)

	2000	2002	2004	2006	2008	2010	2012	2013
KRX	30.19	36.01	41.97	37.26	28.78	32.95	34.77	35.31
KOSDAQ	6.89	10.50	15.41	14.64	8.17	10.17	8.23	9.87
Total	26.98	32.79	40.1	35.16	27.25	31.14	32.47	32.97

Source: KRX stock statistics
Note: Based on market capitalization of stocks listed on the KRX and the KOSDAQ.

CHAPTER 02

DEVELOPMENT OF THE KOREAN CAPITAL MARKET

I. INTRODUCTION

Korea's securities market has developed significantly over the past few decades since the establishment of the Korea Stock Exchange (KSE), evolving in tandem with the development of the Korean economy. As Korea's economy successfully overcame such international crises as the oil shocks and the Asian financial crisis to emerge as the world's 11th largest trading nation, the KSE (now the Korea Exchange - KRX) has also shown tremendous achievements, growing from unstable beginnings into the world's 10th largest stock exchange through consistent market liberalization.

To further advance its capital market, Korea passed the Financial Investment Services and Capital Markets Act (FSCMA) in 2009. A revolutionary act that introduced a single consolidated legal framework, the FSCMA laid the foundation for the further development of the financial services industry so that it can become a key industry driving Korea's economic development, just as the manufacturing industry had in the past.

To realize this goal, the financial industry has been working to enhance the competitiveness of the capital market by promoting balanced development among the banking, insurance and securities sectors.

II. EARLY STAGES OF MODERNIZATION (1953 -1967)

The securities market is where stocks and bonds are traded as a means to raise long-term funds. In Korea, securities were first issued in 1899 when Chun-il Bank, a predecessor of Woori Bank, was incorporated. Bonds were introduced in 1905, when the Joseon Dynasty issued Korea's first government bonds with the promulgation of the Government Bond Act.

Korea's capital market was officially organized in March 1956 with the incorporation of the Korea Stock Exchange (KSE) with joint contributions from banks, insurance and securities companies. Although there had been previous exchanges before the KSE, such as the Joseon Exchange (est. 1931) and the Joseon Stock Exchange (est. 1943), they were exclusively designed to create capital for Japanese companies operating in Korea and both closed in 1946. In 1949, the first Korean securities companies and the Korea Stock Dealers Association were established in an attempt to assist Korean companies with raising funds, but their roles were still limited to arranging over-the-counter (OTC) trading of certain government bonds.

With the launch of the KSE, 12 corporations, 3 government bonds and 49 securities firms were listed. Since the fiscal conditions of the country called for immediate and extensive capital, most of the securities issued were in the form of government bonds. Both securities trading and later settlements were permitted in the KSE, which allowed traders to purchase large amounts of securities by depositing a small margin in a clearing house, making the market extremely speculative and leading to a series of market crashes. Government bond crashes in January 1958, and the excess accumulation of KSE, Korea Electric Power Corporation (KEPCO) and other securities firms' shares in May 1962 made the market extremely vulnerable. As a result, it suffered from settlement failures, causing the long-term suspension of the KSE, the bankruptcy of certain securities firms and a dampening of investor confidence in the market.

TABLE 2-1. TRADE IN GOVERNMENT BONDS

(Unit: million hwan[1)], %)

	Stocks		Government bonds		Total	
Year	Amount	Proportion	Amount	Proportion	Amount	Proportion
1956	3,942	56.8	2,994	43.2	6,936	100.0
1957	4,140	17.1	20,007	82.9	24,147	100.0
1958	1,802	10.8	14,820	82.2	16,622	100.0
1959	7,632	26.5	21,164	73.5	28,796	100.0
1960	2,752	17.1	13,302	82.9	16,054	100.0
1961	4,401	32.2	9,109	67.4	13,510	100.0
Total	24,669	23.2	81,396	76.8	106,065	100.0

Note: "Hwan" is an old korean currency. hwan= 0.001 won

TABLE 2-2. NATION-BUILDING GOVERNMENT BOND TRADING BY TRANSACTION TYPE

(Unit: 10,000 hwan[1)], %)

	Securities trading		Settlement		Total	
Year	Amount	Proportion	Amount	Proportion	Amount	Proportion
1956	1,023	34.2	1,971	66.8	2,994	100.0
1957	3,812	19.1	16,196	80.9	20,007	100.0
1958	3,938	26.6	10,882	73.4	14,820	100.0
1959	5,971	28.2	15,193	71.8	21,164	100.0
1960	4,314	32.4	8,988	67.6	13,302	100.0
1961	4,754	52.2	4,355	47.8	9,109	100.0

Note: hwan= 0.001 won

In response to these incidents, in January 1962, the Korean government enacted the Securities and Exchange Act (SEA) and the Commercial Code, in an attempt to create a legal framework for the development of the securities market. In order to enhance stability, in 1963, the government reorganized the KSE from a corporation into a government-owned entity, promoting the capital adequacy of securities firms and improving the securities transaction systems.

TABLE 2-3. STATUS OF THE SECURITIES MARKET: POST-GOVERNMENT OWNERSHIP

Year	Number of listed companies	Number of securities firms	Listed capital stock (million won)	Trading volume (million shares)	Trading amount (million won)
1963	15	40	16,971	57,654	26,000
1964	17	36	22,228	317	27,039
1965	17	35	23,162	43	9,171
1966	24	26	32,451	49	11,160
1967	24	25	46,083	72	24,917

III. CAPITAL MARKET DEVELOPMENT (1968 -1978)

Even after such drastic measures were implemented, the Korean securities market remained in the doldrums. In 1967, Korea implemented economic development plans designed to modernize its industrial infrastructure. As international borrowing was no longer as feasible as it had once been, the demand for domestic capital surged significantly. Thus, the importance of the securities market and its role as a means of channeling capital to the industry began to be recognized. At this time, however, the securities market only had a limited role in channeling capital to corporations, serving primarily as a secondary market that merely traded already issued securities.

From the late 1960s, the government began focusing its policies on promoting Korea's securities market and announced that 1969 would be "the year for fostering the capital market." In addition, the government also undertook a series of measures to boost the securities market by enacting relevant laws and improving the institutional framework.

TABLE 2-4. CAPITAL MOBILIZATION OF CORPORATIONS

(Unit: billion won, %)

	1966		1967		1968	
Year	Amount	Proportion	Amount	Proportion	Amount	Proportion
Equity capital	36.2	23.9	46.6	20.8	67.7	18.8
External funds	115.2	76.1	178.0	79.2	291.6	81.2
Total	151.4	100.0	224.6	100.0	359.3	100.0

Year	1966		1967		1968	
	Amount	Proportion	Amount	Proportion	Amount	Proportion
External funds	115.2	100.0	178.0	100.0	291.6	100.0
Indirect financing	43.5	37.8	73.6	41.3	137.5	47.1
Direct financing	22.9	19.8	39.8	22.4	45.4	15.6
International borrowing	48.8	42.4	64.6	36.3	108.7	37.3

Note: Corporate credit and government loans are excluded.
Source: Capital Cycle of Korea by The Bank of Korea, 1976

In December 1968, the government enacted the Capital Market Promotion Act (CMPA) which encouraged corporations to become publicly listed by providing extensive tax relief. At the same time, the state-owned Korea Investment Corporation (KIC) was established to take responsibility for issuing securities. Additionally, in order to boost demand for stock investment, steps to strengthen the securities market were undertaken. For the primary market, the dividends of one-year deposits were guaranteed and entry barriers for securities firms to enter the market were lowered, requiring that they simply register rather than receive approval. For the secondary market, the securities transaction system was improved, shifting from the later settlement system into the regular-way system.

The Securities Investment Trust Business Act (SITBA) was introduced in August 1969 and the regular-way transaction system was enhanced in June 1971 to root out the deeply entwined culture of market speculation and to restore investor confidence.

TABLE 2-5. PUBLIC OFFERINGS OF STOCKS AND CORPORATE BONDS

(Unit: million won)

Year	Stocks						Corporate bonds	
	Offerings		Sales		Total			
	Cases	Amount	Cases	Amount	Cases	Amount	Cases	Amount
1968	2	160	-	-	2	180	-	-
1969	12	2,211	-	-	12	2,211	-	-
1970	9	2,068	-	-	9	2,068	-	-
1971	4	850	-	-	4	850	-	-
1972	6	955	1	125	7	1,080	35	9,928
1973	35	17,756	12	3,719	47	21,475	12	3,450
1974	12	9,227	7	5,110	19	14,337	59	27,870

Source: Korea Investment Corporation

TABLE 2-6. GROWTH OF INVESTMENT TRUST FUNDS

(Unit: million won)

Year	No. of issues	No. of management companies	No. of bene-ficiaries	Fund size			Sales balance		
				Stock types	Bond types	Total	Stock types	Bond types	Total
1968	1	1	96	100	-	100	53	-	53
1969	1	1	102	200	-	200	48	-	48
1970	1	1	664	400	-	400	372	-	372
1971	3	1	1,362	2,100	-	2,100	1,731	-	1,713
1972	10	2	1,316	2,100	4,630	6,730	1,461	3,868	5,329
1973	17	2	10,086	4,600	14,430	19,030	3,997	10,808	14,805
1974	27	3	74,811	23,300	25,600	48,900	18,880	23,623	42,503

Source: A Decade of Securities Supervisory Board (SSB) by the SSB

At the same time, in order to mobilize domestic capital, the government privatized state-owned companies and urged corporations to go public by implementing securities market promotion policies designed to boost demand for stock investment. In December 1972, the Public Corporation Inducement Law was enacted to provide tax incentives for companies that became publicly listed, and to allow the government to force corporations to publicly list by prescribing financial and tax restrictions for those that refused.

In August 1972, the government announced the Emergency Order for Economic Development and Stability, freezing private loans for corporations and encouraging debt-equity swaps of private loans. The government also promulgated the Short-term Finance Business Act, the Credit Unions Act and the Mutual Savings and Financing Act with the aim of institutionalizing private financing. In 1973, the SEA regulations were revised with new stipulations added to improve the securities registration statement, enhance the external audit system, increase the capital stock of securities firms and introduce book-entry clearing.

In May 1974, a Special Presidential Order was announced to increase the supply of blue chip stocks by encouraging investors to reduce the proportion of shares in listed companies, as well as to introduce firm commitment underwriting, establish investment trust companies, improve the securities savings system and expand employee stock ownership plans.

TABLE 2-7. SECURITIES SAVINGS

(Unit: million won)

Year	1972		1973		1974		1975		1976		Total assets
	Savings	With-drawals	Savings	With-drawals	Savings	With-drawals	Savings	With-drawals	Savings	With-drawals	
Mandate-type	184	54	1,196	711	7,788	5,703	3,572	3,603	1,660	3,966	363
Trust-type	-	-	-	-	1,172	518	61,875	49,929	343,138	326,257	29,481
Total	184	54	1,196	711	8,960	6,221	65,447	53,532	344,798	330,223	29,844

Source: Korea Investment Corporation

TABLE 2-8. EMPLOYEE STOCK OWNERSHIP UNIONS

Year	1972	1973	1974
No. of unions	8	183	281
No. of members	2,781	58,807	102,355
No. of depository associations	8	147	217
No. of depository shares (thousand)	294	13,262	27,249
Acquisition cost (million won)	147	10,043	16,938
Savings amount (million won)	-	193	242

Source: Korea Investment Corporation

The sudden growth of the securities market in the 1970s brought with it new regulatory concerns. Thus, along with other major reforms, reorganization of the regulatory institutions was implemented. In 1976, the Securities and Exchange Commission (SEC) and its executive body, the Securities Supervisory Board (SSB), were established as Korea's principal financial regulators. Measures to support and stabilize the managerial rights of listed companies such as tender offers, regulation of total equity investments, limits on proxy statements and the registered corporation system were introduced. In addition, regulations on disclosure, insider trading and restrictions on the securities transactions of executives in securities companies were also introduced to promote fair transactions and modernize the securities industry. Additionally, the Korea Securities Computer Corporation (KOSCOM) was established to provide a computer system for the securities market. It was during this period that the KSE moved to Yeouido.

Due to these comprehensive policies taken to stimulate demand in securities and encourage corporations to publicly list, there have been several significant achievements in the Korean securities market. The number of companies listed increased from 66 in 1972 to 356 in 1978, and market capitalization during the same period rose from KRW246bn to KRW2,892.5bn, a growth of more than 11-fold. The issuance of corporate bonds also increased more than 30-fold from KRW9.9bn in 1972 to KRW326.3bn in 1978.

TABLE 2-9. GROWTH OF THE SECURITIES MARKET

Year	No. of listed companies	No. of shareholders (10k)	Listed capital stock (mil won)	Market cap of listed stocks (mil won)	Trading volume (mil shares)	Stock financing (mil won)
1968	34	40	95,585	64,323	76	9,247
1969	42	54	119,902	86,569	98	6,099
1970	48	76	134,292	97,923	79	7,151
1971	50	82	141,357	108,706	50	2,940
1972	66	103	174,339	245,981	84	24,741
1973	104	200	251,620	426,247	130	54,548
1974	128	200	381,344	532,825	157	74,287
1975	189	291	643,315	916,054	310	156,255
1976	274	568	1,153,325	1,436,074	591	262,225
1977	323	395	1,492,375	2,350,835	1,272	362,452
1978	356	963	1,913,505	2,892,512	1,368	653,062
1979	355	872	2,202,262	2,609,414	1,561	841,432

IV. MARKET LIBERALIZATION (1979 -1985)

In the early 1980s, Korea's capital market suffered significant upheavals. At the outset, the market was bullish with the nation's economic policies focusing on stable growth and surging construction stock prices, thanks to the industry's performance in overseas markets. In 1982, however, the market plunged due to negative growth resulting from the second oil shock and the large amount of corporate fraud discovered in April of that year.

To overcome such hardships and to revive the ailing economy, measures were undertaken to fortify the capital market and globalize the securities market. A

new system to ensure market pricing was introduced, entry barriers into the bond market were eased and the market management system was improved.

In 1980, repurchase agreements, which previously had only been utilized by the Korea Securities Finance Co. to finance securities firms, became available to all market participants in order to facilitate growth in the securities market and to restore investor confidence. The Act on the External Audit of Stock Companies was also enacted, requiring stock companies valued above a certain level to implement an external audit system.

The government announced a four-phased Capital Market Globalization Plan in 1981. Accordingly, the Korea International Trust (KIT) and Korea Trust (KT) were established as investment vehicles for foreign portfolio investors. In May 1984, the Korea Fund was listed on the New York Stock Exchange (NYSE), the first example of indirect foreign participation in the Korean market. In addition, the first issuance of convertible bonds overseas provided an opportunity for Korean companies to directly raise funds from overseas capital markets.

Furthermore, a series of new measures to ease regulations were undertaken to allow foreign investors into the domestic market and, reciprocally, local investments in overseas markets. In December 1980, Nomura Securities established the first foreign representative office in Seoul, followed by Merrill Lynch in 1985 and other foreign securities companies. Large Korean securities companies were also permitted to establish overseas offices: Daewoo, Daishin, Ssang-yong Investment and LG established branch offices in Tokyo and New York; while Dong-seo Securities established branch offices in Tokyo and London.

TABLE 2-10. CAPITAL MARKET GLOBALIZATION PLAN

Year	Contents
Phase 1 (1981-1984)	- Limited permission granted for international investment trusts - Establishment of the Korea Fund - Issuance of beneficiary certificates for foreign investors - Allowance of foreign securities firms to open representative offices in Korea - Nurturing of financial professionals in securities related institutions - Improvement of legal/institutional framework for globalization
Phase 2 (1985-1987)	- Limited permission granted for foreign direct investment - Gradual relaxation of limits on international investment trust
Phase 3 (1988-1989)	- Full permission on foreign investment granted - Allowance of companies to issue and list stocks on foreign securities markets - Permission for foreign securities firms to establish subsidiaries in Korea, and domestic firms overseas
Phase 4 (1990-)	- Allowance of Korean investors to make investments in foreign securities markets - Permission for foreign stocks to be issued and listed on domestic securities market

In 1982, the SEA was further revised to promote fair trading by strengthening its regulations on insider trading and market price manipulation, expanding its disclosure requirements and introducing an investment advisory system. The Act also stipulated improved measures to limit stock ownership, and improved minority shareholder protection by introducing appraisal rights for dissenting shareholders. In order to respond to the liberalized securities market, limits on foreign ownership of stock were also prescribed.

Meanwhile, the securities trading system was also improved by adopting a market capitalization weighted stock price index, providing online securities services and allowing securities to be issued at market price. The securities deposit system was established to circumvent outflows of investors' deposits from the securities market, prevent any mishaps while holding securities and enhance the effectiveness of the book entry clearing system. In order to facilitate the money market and liberalize the bond market, ceilings on CP issuance and corporate bond payment guarantees were expanded in 1984, and the requirements for issuing non-guaranteed bonds and convertible bonds were also relaxed.

New regulations were established to institutionalize the OTC bond market. The government revised the Commercial Code to facilitate capital increases by relaxing the limits on authorized capital stock to four times higher than the paid-in capital, and issuance limits on corporate bonds to no more than two times of equity. Tax exemptions for income resulting from capital gains, temporarily granted under the Regulation Law on Tax Reduction and Exemption, were restated under the Corporate Income Tax Law of 1985, with the exemption limits and duration relaxed.

V. EXPANSION OF THE CAPITAL MARKET (1986-1995)

From 1986 to 1995, the Korean securities market was full of hope and vigor. Starting in the 1980s, the market mechanisms had worked to drive the country's economic direction to focus more on the private sector, with the Korean economy beginning to open and interest rates liberalized. In addition, the so-called three lows – low oil prices, low international interest rates and a low dollar exchange rate – spurred the Korean securities market out of its long-term bearish trend. Thanks to stable growth in the real economy, the KOSPI

recorded 1007 basis points on April 1, 1989, the first time it had reached above 1000, and marked a dramatic climb from its level of 180 points at the end of 1985. During the same period, the market's trading volume increased from KRW12bn to KRW280bn.

The vibrant growth of the securities market had a significant impact on Korea's financial market structure. In the second half of 1980, companies began to voluntarily go public and rushed to increase their capital through public offerings, resulting in 690 companies being listed on the market, with additional national stocks also provided. Due to these market movements, direct financing surpassed private credit as a means of supplying capital, leading to a tremendous structural change in the financial market. As the public began to increasingly invest in stocks, securities firms began to flourish with the average amount of capital per company reaching about KRW100bn by the end of 1989. Financial institutions also began to modernize, adopting advanced computerized business processes.

In November 1987, the SEA was revised to allow investment advisors to operate and introduce a membership system for the KSE. The Public Corporation Inducement Law was integrated into the Law on Fostering the Capital Market, stipulating provisions to recommend IPOs and paid-in capital increases for companies. In addition, a series of measures was undertaken to encourage venture companies and small and medium-sized enterprises (SME) to partake in the securities market. The OTC stock trading system and the computerized trading settlement system were both introduced in March 1988, brokerage commissions were liberalized and autonomy in securities companies' business affairs was permitted from June 1988. Plans to globalize the securities market were also presented in December 1988, and the KSDA Investor Protection Center was launched in January 1989.

In the second half of 1989, the international stock market bubble burst, taking a significant toll on the Korean securities market. In response, the government introduced measures to stabilize the stock market by controlling its supply and demand. To reduce supply, the securities issuance notice system, the capital increase coordination committee and the issuance coordination council were established. Also, the distribution of national stocks was suspended, requirements for IPOs enhanced, and capital increases through public offering discouraged.

On the other hand, other measures to stimulate market demand were also taken. For example, securities firms were encouraged to borrow money for stock purchases, banks provided loans to investment trust companies, investment trust companies in rural areas were established and stock market stabilization funds were created. Additionally, listed companies and institutional investors were encouraged to sell less and purchase more, the Matching Fund was established to create overseas demand, the Korea Asia Fund was created, and account receivables or outstanding loans were required to be repaid.

The securities market liberalization plan, which began in the early 1980s, was fully implemented in 1991 with the opening of the KSE to all certified securities companies in June, the further liberalization of brokerage commissions in August, and foreign securities firms being permitted to enter the Korean market in September. Although a Japanese securities firm had already opened an office in Seoul during the 1980s, foreign branch offices and joint-venture companies only became widespread after the British securities firm Jardine Fleming established a branch in Korea, in October 1991.

With the SEA revised again in December 1996, the ceiling on foreign share holdings in local securities firms was lifted, and foreign securities companies were allowed to establish joint-venture companies in Korea. In March 1998, foreign investors were permitted to establish local subsidiaries that were 100% owned by foreign securities firms. In addition, domestic investors were encouraged to invest in overseas markets pursuant to the Overseas Securities Investment Promotion Plan, announced in June 1988. In line with the first phase of foreign currency reforms, investment ceilings on institutional investors were completely lifted, while the ceiling on individual investors was gradually lifted until full liberalization was obtained in 1996. Foreign investment trusts and investment advisors were permitted to hold shares in existing domestic companies and establish representative offices in Korea in January 1993. Foreign investment advisors were permitted to establish branch offices in December 1995 and foreign investment trust companies in December 1996.

In order to promote stability in the securities market, measures were undertaken in 1992 to control supply and boost the demand for stocks. The Bank of Korea provided special support for three major investment trust companies, and pension funds were encouraged to invest in the stock market. Additionally, financial institutions were encouraged to purchase more and sell fewer stocks in order to raise additional funds for the Securities Market Stabilization Fund, and to establish a treasury fund for the three major investment trust companies.

TABLE 2-11. CEILINGS ON STOCK INVESTMENT FOR FOREIGN INVESTORS

(Unit: %)

	Securities listed corporations				KOSDAQ listed corporations	
	Private companies		Public companies			
Year/Month	Per investor	All investors	Per investor	All investors	Per investor	All investors
1992.01	3	10	1	8	-	-
1994.12	3	12	1	8	-	-
1995.07	3	15	1	10	-	-
1996.04	4	18	1	12	-	-
1996.10	5	20	1	15	-	-
1997.05	6	23	1	18	-	-
1997.11	7	26	1	21	-	-
1997.12	50	55	1	25	5	15
1998.04	50	55	1	25	50	55
1998.05	100	100	3	30	100	100
2000.11	100	100	3	40	100	100

TABLE 2-12. TREND OF FOREIGN INVESTMENT AFTER COMPLETE MARKET LIBERALIZATION

(Unit: million dollars, %)

	2001	2002	2003	2004
Stocks	1,300.5 (16.6)	1,793.7 (15.6)	3,415.8 (19.7)	9,009.0 (31.8)
Bonds	6,512.9 (83.4)	9,698.0 (84.4)	13,926.9 (80.3)	19,357.7 (68.2)
Total	7,813.4 (100)	11,491.7 (100)	17,342.7 (100)	28,367.7 (100)

Source: The Bank of Korea
Note: Figures in ( ) refer to the proportion of stock/bond investments.

The Korean securities market achieved significant progress in 1993, thanks to stable growth in the real economy and capital market liberalization. To live up to such quantitative growth, the relevant rules and regulations were revised to meet international standards and drive further growth. In 1993, a comprehensive revision of the six laws governing securities was conducted to advance the framework of the securities system. The Acts revised were the SEA, the Law on Fostering the Capital Market (LFCM), the Securities Investment Trust Business Act, the Act on External Audit of Stock Companies, and the Certified Public Accountant Act.

To further boost the autonomy and transparency of the market, the SEA was revised lifting the ceiling on listed stock ownership. In addition, listed companies were allowed to own treasury stock, the tender offer system was improved, the securities dispute settlement system was revised to enhance investor protection and the legal grounds for creating a Stock Index Futures Market (SIFM) were established. The LFCM and other revised laws governing securities trust businesses were revised to relax limits on the issuance of non-voting stock by listed companies. Additionally, paid-in capital increases were no longer recommended, and CPs and CDs were included as trusted assets.

In order to achieve balanced development between the stock and bond markets, the method for issuing government bonds shifted from underwriting to a competitive bidding system in January 1994. The settlement of bonds traded between institutional investors was required to be carried out through wire transfer via the Korea Securities Depository in order to avoid risks and inefficiency in the settlement process.

Meanwhile, in September 1993 and February 1994, respectively, comprehensive measures were taken to further develop the bond market and improve the CB market with the intention of balancing development in the stock and bond markets.

The Futures Trading Act was enacted in December 1995 in order to regulate the stock index futures market (SIFM, est. May 1995) and the finance and commodity futures trading market. In addition, in order to meet international standards, the Securities Investment Trust Business Act was revised in December 1995 allowing securities firms and securities investment trust companies to share services by establishing subsidiaries, and permitting investment advisors to shift their services into investment trust management companies. Regulatory jurisdiction over securities investment trust companies moved from the Ministry of Finance and Economy (MOFE) to the Securities and Exchange Commission (SEC).

TABLE 2-13. PLAN FOR FINANCIAL LIBERALIZATION AND MARKET OPENING

Year	Phase 1 (1993)	Phase 2 (1994-95)	Phase 3 (1996-97)
Stock market	- Lifting investment restrictions on companies that have 50% or higher foreign ownership through direct investment (Aug.1993)	- Lifting the ceiling on foreign investment - Foreign investors living in Korea viewed as residents (1994)	- Further lifting the ceiling on foreign investors stock investments
Bond market		- Allowing direct investment into CBs issued by SMEs (1994) - Allowing the underwriting of government bonds which have interest rates similar to international rates in the primary market (1994) - Operation of bond funds (1995) - Allowing international organizations to issue won-denominated bonds (1995)	- Allowing direct investment in non-guaranteed long-term bonds of SMEs (1997)

VI. ASIAN FINANCIAL CRISIS AND REFORM MEASURES (1996 -2003)

Due to the Asian financial crisis, 1997-2003 marked the Korean capital market's longest recession. However, a series of drastic reforms and restructuring measures allowed the market to successfully overcome this period of hardship, and set the stage for it to develop on par with advanced capital markets.

In 1996, as the global financial market became smaller and increasingly globalized, the Korean government pursued further financial reforms and attempted to boost the capital market's competitiveness by introducing new securities systems; the dividend distribution system was improved in January 1996, ceilings on treasury bond ownership were raised from 5% to 10% in February 1996 and the KOSDAQ market was established in July 1996 to help venture companies and SMEs better utilize direct financing based on the OTC Market Promotion Plan. Securities lending and borrowing was permitted from September 1996 and price fluctuation limits were increased from 6% to 8%. In addition, in order to encourage domestic companies to become more competitive in the global market, overseas investment by both institutional and individual investors was fully liberalized without any restrictions on the amount. In July 1997, the Stock Index Option trading system was introduced with the Korea Futures Exchange (KFX) established in April, 1999.

At the end of 1997, as Korea received an IMF bailout package and underwent significant corporate and financial restructuring, the capital market faced a devastating downturn. The KOSPI plunged from 653 basis points to 376 basis points in early 1997 – its lowest level since 1980 – and 11 listed companies were forced to liquidate or merge. In response, the government announced the implementation of the Securities Markets Revitalization Plan, enacting the Depositor Protection Act and introducing the Stock Option and Investor Protection Fund. Additional measures to boost the market were also undertaken, including raising the limits on stock investment by foreign investors, tax exemptions for income from stocks, as well as permitting stock splits and interim dividends.

In January 1997, the Foreign Investment and Foreign Capital Inducement Act was amended to attract foreign financial institutions. The revised act eliminated existing ceilings on equity partnerships of foreign portfolio investments in domestic securities companies (less than 10%), and foreign securities firms were permitted to establish representative offices in Korea by simply registering. Furthermore, in April 1998, all seven types of financial business including securities were fully liberalized and investment restrictions on foreign investors were removed, thus allowing them to establish subsidiaries.

TABLE 2-14. POST ASIAN FINANCIAL CRISIS RESTRUCTURING OF MERCHANT BANKS, SECURITIES FIRMS, INVESTMENT TRUSTS

		Restructuring						
Financial sector	No. of entities at the end of 1997(A)	Revocation of authori-zation	Merger	Bankruptcy/ business suspension	Total (B)	Weight (B/A)	New entities	No. of entities in Jul. 2004
MB	30	22	7	-	29	96.7	1	2
SF	36	5	4	2	11	30.6	18	43
IT	30	6	1	-	7	23.3	22	45

Source: Changes in Competitive Structure through Financial Restructuring after the Asian Financial Crisis by SERI, July 2004.
Note: MB - Merchant Banks, SF - Securities Firms, IT - Investment Trusts

Ceilings on equity partnerships of domestic investment trust companies were relaxed for foreign investment trust companies and investment advisory services, and they were permitted to set up branch offices and joint-venture companies with equity holdings of less than 50%, all of which were completely liberalized in December 1998. Securities investment by foreign portfolio investments was also liberalized. In December 1997, immediately after the

Asian financial crisis, foreign portfolio investments were permitted to make stock investments of up to 50% in a single issue, and up to 55% of the total amount allocated for foreign investors.

Beginning in 1997, foreign investors were permitted to purchase equity-type beneficiary certificates for indirect investment. Later, in September of that year, the ceiling on investment amounts for purchasing foreign beneficiary certificates in the OTC stock market was lifted, and indirect investments in stock index options and futures were also permitted.

The Stock Index Futures (SIF) market opened in May 1996, allowing foreign direct investment, though with some restrictions which were later eased in July 1997. The Stock Index Options (SIO) market also permitted FDI, imposing the same level of restrictions as the SIF market. In May 1998, foreign investment restrictions in the stock market (excluding public corporations), SIF and SIO markets, and beneficiary certificates were all lifted, and investments in unlisted stocks and primary market securities were also permitted.

Direct investment in the bond market by foreign portfolio investments was allowed through bond-type country funds from October 1996. Non-guaranteed foreign corporate bonds of SMEs were permitted, and all investment restrictions for listed bonds, including SME bonds, government bonds and specific law bonds, were lifted. In February 1998, foreign investors were permitted to invest in corporate-issued money market funds (MMFs) such as commercial papers, commercial bills and trade bills, and other MMFs issued by financial institutions, including CDs, cover bills, merchant bank bills and repurchase agreements.

Government efforts to relax entry barriers into the securities market continued to enhance market liberalization and boost competitiveness. In April 1999, the SEA was again revised to ease the requirements for engaging in securities business activities. The qualification for engaging in securities business activities was expanded from authorized banks and trust companies to authorized corporations. Additionally, the requirements for registering investment advisory services were also relaxed with registration, not government approval, required to provide discretionary investment advisory services.

Considering the drastic changes taking place in the global financial environment due to the Asian financial crisis, the government revisited the

licensing and approval system for financial institutions in order to meet international standards. In this context, in January 2000, the institutional criteria for securities businesses were laid out in detail and reasonable grounds for nullifying approval were established, enhancing transparency within the industry.

The business scope of securities firms was also expanded. In 1996, securities companies could purchase and preserve foreign currency valued up to 1% of their equity, and borrow foreign currency up to the amount needed to underwrite foreign securities. In December 1997, the business scope was further expanded to deal with currency exchange issues relating to bonds, stock index futures and option investments, as well as short-term forward exchanges. In September 1998, the Securities Investment Company Act was enacted, allowing both company-type investment trusts and contract-type investment trusts. In March 2001, wrap accounts were introduced to meet the needs of customers in an aging society by providing low interest rates and comprehensive asset management services. Later in December, the Indirect Investment Asset Management Business Act was enacted in an attempt to shift savings into investments.

Moreover, in order to live up to a more liberalized financial environment, the financial supervision system was also reshuffled with the accounting and disclosure systems for corporations and financial institutions strengthened. In April 1998, the Financial Supervisory Commission (FSC) was established. As a consolidated supervisory organization encompassing the formerly separate securities, banking and insurance regulators and the Korea Non-Bank Deposit Insurance Corporation, the FSC took responsibility for oversight over the entire financial sector with the goal of enhancing the regulatory system and its effectiveness.

To promote transparency in the accounting system, in December 1999, the Korea Accounting Standards Board was established under the Korea Accounting Institute to meet international standards in accounting. In addition, to prevent fraudulent accounting, the 30 largest chaebols (a form of conglomerate) were required to prepare consolidated financial statements, and companies whose assets were valued at KRW 7bn or more were required to set up an internal accounting system. In 1999 and 2003, quarterly reports were introduced to enhance the disclosure system, and business reports were required to be certified by both the CEO and CFO. To enhance the credibility

of accounting information, consolidated financial statements were required, with a certified public accountant signing an audit opinion. Additionally, the function of accounting supervision in the Securities and Futures Committee was enhanced.

VII. ENHANCED COMPETITIVENESS OF THE CAPITAL MARKET (2004 - 2013)

Since 2004, the capital market has undergone a revolutionary reform in terms of shifting its function from merely supporting other industries into a high value-adding industry in itself. Since the Asian financial crisis, foreign portfolio investments in the domestic securities market have surged dramatically, which in turn has made domestic institutional investors suffer from reduced profits, spurring the creation of short-term investments with lowered trading commissions. Therefore, measures to stabilize the securities market were required.

In December 2004, the Framework Act on Fund Management was enacted, which allowed the National Pension Fund and Pension Funds to invest in the stock market. In July 2005, the Trust Business Act was revised to permit securities companies to engage in trust business, and retirement pension plans (similar to the US 401(k) plans) were introduced with pension funds permitted to invest in the stock market, pursuant to the Employee Retirement Benefit Security Act. In June 2005, the Korea Council for Investor Education was launched with the participation of various financial supervisory organizations and securities-related firms to promote an indirect and long-term investment culture.

A series of efforts to improve market infrastructure and financial laws were introduced to make the securities business a high value-adding industry. In January 2005, the KRX, a consolidated exchange that integrated the operations of the KSE, KOSDAQ, and KOFEX markets, was launched pursuant to the Korea Securities and Futures Exchange Act of January 2004. Later in July, the FreeBoard, a third market for non-listed stocks, was established to support promising venture companies and SMEs. Finally, in December 2007, the Bond Quotation System (BQS) was introduced to enhance transparency and liquidity in the OTC bond market.

In February 2009, the infrastructure for disclosing bankruptcy and collection rates was established to facilitate a high-profit bond market. In June, the government real-time bond index was launched to introduce new bond instruments. In January 2005, the SEA was revised to improve the tender offer system and require substantial shareholding of stocks to be reported as the number of hostile M&As increased. Later in July, controlling shareholders of securities companies were required to receive authorization in advance from the FSC.

In August 2007, the government enacted the FSCMA, with the Act coming into effect in February 2009. The FSCMA integrated the six previously separate statutes governing Korea's capital market, including the SEA, the Futures Trading Act and the Indirect Investment Asset Management Business Act, in an attempt to enhance competitiveness and promote investor confidence through stronger investor protection measures. This was the most significant and comprehensive reform of the financial market's legal framework, and it created a foundation for the Korean capital market to develop on par with the global markets.

In February 2008, the Korean government's cabinet was reorganized to help further advance and deregulate the financial services industry. A new Financial Services Commission (FSC) was established, taking over the role of drafting laws from the Ministry of Finance and Economy and regulatory authority from the previous incarnation of the FSC. The chairman of the FSC was no longer permitted to hold the post of governor of the FSS, separating financial policy-making from its execution. In July 2009, the Financial Holding Companies Act was revised to raise the ceiling on stock ownership of bank holding companies from 4% to 9% and limits on contributions to private equity funds from 10% to 18%. In addition, securities and insurance holding companies were allowed to control non-finance subsidiaries.

The financial investment industry continued to play a vital role in 2010, assisting the government with the G20 Seoul Summit held in November of that year. The industry worked to support the government's preparations for the summit and to develop an agenda relating to the capital market that actively reflected its concerns. During the G20 Summit, in-depth discussions were held on foreign exchange issues in the capital market, financial safety nets, regulations on OTC derivatives and hedge funds, and so forth.
In 2011, the government announced its intention to revise the FSCMA in order to further innovate and improve the capital market by allowing the nurturing of advanced investment banks and introducing hedge funds. These revisions

aim to fulfill the original purpose of the Act – deregulation – which had not been fully satisfied at the early stages of its enforcement due to the global financial crisis. As a result, the partial revision of the Enforcement Decree of the FSCMA led to the launch of "Korean" hedge funds. In line with this change, the government also modified relevant regulations, enforcing more reasonable Chinese Wall policies in the prime brokerage business and relaxing credit extension limits for hedge funds.

Korean hedge funds were actively launched at the year-end of 2012, and in the following year, grew to mark KRW1tn in the amount outstanding. As of December 2012, there are 19 Korean hedge funds offered at 12 companies, while the number of professional investment managers also rose to 69. In terms of fund type, there is an increasing diversity, owing to a shift from mostly long/short funds to include arbitrage transactions and event-driven hedge funds. Investors have also become more diversified, departing from the initial prime brokers or affiliates to include institutional investors and individual large asset holders.

Meanwhile, Korea succeeded in issuing 30-year treasury bonds for the first time in 2012. Since the initial issuance, worth KRW406bn, in September 2012, KRW1.6355tn worth of 30-year bonds has been issued as of December 2012. This 30-year bond issuance facilitates stable government financing for long-term fiscal demand. It is also viewed as having contributed to developing the long-term financial market and enhancing Korea's sovereign credit rating by providing a benchmark rate for ultra long-term financial instruments.

The year 2013 saw major changes in laws and regulations regarding the capital market. First of all, laws on large IBs, the Alternative Trading System (ATS), and the OTC Central Counterparty (CCP) were legislated in 2013, which is viewed as great progress considering the fact that financial regulatory authorities have been pushing for these changes in order to transform the financial environment and advance the financial industry since 2011. In addition, the Korea New Exchange (KONEX) was launched, and is expected to facilitate financing of small- and medium-sized local venture companies in their early stages. However, there were unfortunate events that deeply depressed investor confidence, as major conglomerates including Woongjin Group, STX, and Tongyang Group, filed for court receivership after going bankrupt. In particular, the liquidity crisis at Tongyang, which occurred during the latter half of 2013, was a reminder of the importance of investor protection in the wake of inappropriate sales of financial products, and the need for thorough supervision and regulatory reforms.

CHAPTER 03

STOCKS : PRIMARY MARKET

I. DEFINITION OF EQUITIES

Companies permitted under the Commercial Law are categorized into stock companies, partnerships, limited partnerships, and limited liability companies (LLC), depending on the scope of investor liability. Among them, the stock company involves the separation of ownership and management, and the recovery of invested funds through the sale of equities in order to achieve the aims of management and to finance short-term, small-cap funds.

Equity refers to the position and rights of the company's investors. A shareholder invests in a company by paying the acquisition price of the shares, and is not liable for any of the company's debts, obligations or liabilities. In addition, the shareholder cannot have his or her investment returned by the company. The invested funds can only be recovered by transferring the equities to another party. In order to increase liquidity, shares are divided equally into units of one share each and are held in the form of stock certificates, which are a form of security.

Shareholders have the right to vote at shareholders' meetings, claim dividends, claim on residues and the right to raise representative lawsuits. Different types of securities to the same capital endow the holder with different rights; i.e.; shareholders of a particular company have different rights from bondholders. For example, the principal and interest of a corporate bond are guaranteed by the issuing company, while the value of a single equity is not.

TABLE 3-1. MAJOR SHAREHOLDERS' RIGHTS

Private interest rights (Right to personal economic gain)	Public interest rights (Right to participate in management)
Claim to a dividend, claim to interest, claim to the residue, appraisal rights of dissenting shareholders, pre-emptive rights, right to transfer of shareholders name, right to stock conversion	Voting rights, right to revoke resolution, right to injunction against additional share issue, right of inspection of books, right to convene an extraordinary general meeting, right to inspection of the affairs and status of company's property, right to injunction against malfeasance, right to raise representative lawsuit, right to demand removal of directors, etc., shareholders' right to make proposal, right to concentrated vote, right to inspect documents, right to judgment for dissolution

II. TYPES OF ISSUANCE

Equities are generally issued when a company is established. When a company is established through the contributions of investors, it has the advantage of ensuring that the equities issued are limited to the scope of the investors' ability for capital contributions. On the other hand, there is incorporation by subscription where stock is publicly offered to establish a company. While this brings a large amount of capital to an entity, it has the disadvantages of taking time for all the shares to be sold, and establishment is not possible if the prerequisite amount of capital is not raised. Both par value and no par value stocks may be issued, with the par value of each equity being KRW 100 and over. In addition, when a listed company issues shares whose par values are less than KRW 5,000, the value of one equity must be KRW 100, KRW 200, KRW 500, KRW 1,000, or KRW 2,500.

After establishment, a stock company generally issues new stocks in order to finance capital, transfer control rights and increase the trading volume of its equity. New issues of stock are generally categorized into rights offerings and stock splits. Rights offerings refer to issuing new common stocks to investors that currently hold shares entitling them to buy subsequent issues at

a discount from the offering price in order to increase the company's capital. Depending on the variety of investors to whom the stocks will be offered, they are categorized into offerings to existing shareholders, allotments to third parties, and public offerings. Most listed companies in Korea generally have controlling shareholders and accordingly have preferred offerings to existing shareholders or allotments to third parties that are friendly stakes, rather than public offerings, in order to prevent the dilution of stock holdings. In particular, while public offerings are the primary method of initial public offerings (IPO) for listed corporations after 2000, they still make up an insignificant part of the total amount of rights offerings. In 2012, a decrease in corporate capital demand due to the European debt crisis and economic recessions both domestically and abroad led to a reduction of rights offerings in Korea. However, a big jump was seen in 2013, as corporations increased allotments to third parties and shareholder priority offerings in order to improve their balance sheets, and transformed themselves into holding companies through large-scale rights offerings. In 2013, among the different forms of offerings, allotments to third parties made up the largest proportion with 62.2%, shareholder priority offerings with 16.0%, followed by public offerings with 13.8%, and offerings to existing shareholders with 8.0%.

Stock splits refer to splitting stock, including the dividing of one stock into two. This means that the assets or capital of a company do not increase. However, new stocks are issued, lowering the price of each share and increasing its trading volume, thereby facilitating the raising of new capital going forward. Although past regulations used to stipulate that stock splits should be voted on at shareholders' meetings, these regulations were revised in 1999. The revision enabled boards of directors in the process of preparing for M&A deals to decide on stock splits in order to adjust the differences in share price, and to increase trading volume for high-priced stocks.

Other instances where new stocks are issued include bonus issues, conversion of convertible bonds to stocks, exercise of bonds with warrants, conversion of convertible stocks, consolidation of shares, and transfer/exchange of shares (this was introduced in 2001 with the revision of the Commercial Code in order to facilitate the establishment of subsidiaries for corporate restructuring).

TABLE 3-2. TYPES OF NEW STOCK ISSUANCE

Payment required	Payment not required
- Public offerings - Allotment to third parties - Offering to existing shareholders - Exercising bonds with warrants	- Bonus issues - Stock splits - Takeovers - Stock exchanges - Stock transfers

TABLE 3-3. RIGHTS OFFERINGS BY LISTED CORPORATIONS

(Unit: billion won, %)

Year	Type	Stock market	KOSDAQ market	Total	Growth
2008	No. of rights offerings	109	593	702	-
	Amount	77,359	43,689	121,048	-
2009	No. of rights offerings	154	627	781	11.3
	Amount	84,474	57,452	141,926	17.2
2010	No. of rights offerings	110	416	526	-32.7
	Amount	108,898	36,490	145,388	2.4
2011	No. of rights offerings	77	244	321	-39.0
	Amount	115,362	15,593	130,955	-9.9
2012	No. of rights offerings	84	174	258	-19.6
	Amount	65,745	12,052	77,797	-40.6
2013	No. of rights offerings	-	-	289	10.7
	Amount	96,141	16,601	112,742	31.0

Source: Korea Securities Depository

TABLE 3-4. RIGHTS OFFERINGS BY TYPE IN 2013

(Unit: billion won, %)

	Amount	Ratio
Shareholder priority offerings	18,065	16.0
Offerings to existing shareholders	8,974	8.0
Public offerings	15,539	13.8
Allotments to third parties	70,164	62.2

Source: Korea Securities Depository

III. PROCEDURES IN NEW STOCK ISSUANCE

New stock issuances that come with payment can be performed as offers to existing shareholders, public offerings, or allotments to third parties.

Offerings to existing shareholders are the most common among these options. This involves giving existing shareholders the right to purchase new stocks. The unclaimed stock is taken care of at the discretion of the company's board of directors (BOD). Unless the company's articles of incorporation state otherwise, the company's shareholders have the right to be allotted new stocks depending on the number of shares they hold, as set forth in the Commercial Code. When the offerings are made to existing shareholders, the role of the underwriter is often limited to the paperwork involved in issuing shares. Accordingly, the risks of the new shares not being completely sold due to a lack of shareholders wishing to purchase is borne by the issuer.

Allotment to a third party is to be made when a certain third party is given a bond with warrant (BW) due to a special law, the company's articles of incorporation, or a special decision at the shareholders' meeting. It has a critical impact on the interests of existing shareholders and the company's management rights. Accordingly, it is strictly regulated, being set forth separately in the articles of incorporation or decided upon by a special resolution at the shareholders meeting. A BW is often allotted to parties that have a particular relationship with the company, including the government, partners in overseas joint ventures, and other business partners. It is commonly used to raise foreign capital or for government investment.

Public offerings completely rule out the right to exercise BWs by shareholders, and receive applications for new shares from ordinary investors through the joint signing of the managing companies (lead manager, etc.). Given that it offers shares to the public, the administrative work is onerous and complex, making it difficult to handle the day-to-day work of the issuance. Furthermore, there are no guarantees that the issued shares will sell. With firm commitment underwriting, if some shares go unsold, the underwriters are obligated to purchase the entire shortfall in accordance to the ratio of the purchased allotments under their responsibility. If best efforts underwriting is used, any shortfall in subscriptions is handled according to the discretion of the issuer's BOD. A public offering is required to have an issuing price that is closest to the market price in order to avoid putting existing shareholders at a disadvantage.

In regards to the issuing procedures, the articles of incorporation of the company state in advance the authorized shares (the total number of shares) that the company may issue. As such, issuing new stocks within that limit merely requires a decision by the BOD. However, the BOD may only decide upon the issuing price of new shares when the stock issuance price is being determined by par value or a value exceeding par value.

The Financial Investment Services and Capital Markets Act (FSCMA) states that the shares of a listed company are highly transferable when being offered to shareholders or allotted to third parties. Accordingly, all offerings that are similar to public offerings require the submission of a registration statement if the issuing price exceeds KRW 1bn.

IV. RECENT DEVELOPMENTS IN THE PRIMARY MARKET

Raising capital through the primary market was sluggish in the first half of the 1980s due to an economic environment characterized by very high inflation, the deceleration of economic growth and a large current account deficit. After 1986, the so-called "three lows" (low international interest rates, low oil prices, and a weak dollar) drove the current account to surplus. The resulting economic expansion was accompanied by a bullish stock market and the primary market accordingly witnessed an unprecedented boom. In particular, the capital market increased in size 49-fold, from KRW 290bn in 1985 to KRW 14,170bn in 1989.

During the 1990s, a prolonged slump in the secondary market dragged the primary market down. In the early and mid 1990s, the requirements for going public were made more stringent, national stock issues were delayed, unlisted financial institutions were discouraged from going public, and the foreign exchange market became unstable, causing financing through the primary market to decline drastically. However, in the second half of 1998, the establishment of low interest rates increased the flow of capital into equity market funds, creating optimism that an economic recovery was imminent and energizing the primary market again. In 1999, 109 small and medium-sized start-ups were listed in KOSDAQ. This flurry of capital-raising through the KOSDAQ market led to the creation of two major funding sources: the Stock Market Division and the KOSDAQ Market Division.

In the 2000s, overinvestment in the IT sector and controversies over a global stock market bubble caused financing through the primary market to decline. In 2003, new listings on the stock market and KOSDAQ declined to 79, worth a total of KRW 1,101bn and representing a 35.7% year-on-year decline. At the same time, financing through rights offerings increased 32.7% year-on-year, reaching a total of KRW 7,166bn. In 2007, improved corporate results and a bullish global market centering around emerging markets such as China dramatically increased financing through IPOs and rights offerings (the number of rights offerings reached 65, worth a total of KRW 10,479bn, an increase of approximately 340% year-on-year). In 2008, however, Korea's share prices dropped dramatically due to instability in the international financial market including the bankruptcies of major financial institutions in developed nations due to distressed subprime mortgage loans, as well as the large-scale net selling by foreign investors over concerns of an economic downturn. The KOSPI market saw a mere 5 IPOs worth a total of KRW 320bn, and rights offerings numbered a only 38 cases worth a total of KRW 1,468bn, approximately 14% of the previous year's activity. However, investment sentiment revived in 2009 due to the government's stimulus package in the first half of the year, positive corporate results and expectations of a continued economic recovery in the second half of the year. As a result, new IPOs on the KOSPI and KOSDAQ markets in 2009 recorded a whopping 463.7% year-on-year increase worth KRW 4.036tn, and financing through rights offerings saw a 285.6% year-on-year increase worth KRW 5.66tn. In 2010, IPOs recorded KRW 2.9385tn, a 717.3% year-on-year increase, with blue-chip companies that had delayed their listing beginning to issue IPOs on the back of a strengthening stock market. However rights offerings witnessed a decline from the previous year as large corporations completed the capital-raising they began during the financial crisis. In 2011, the financial status of SMEs stagnated, and small companies in particular suffered from unfavorable direct financing conditions. However capital-raising for large corporations to advance into the investment bank (IB) business increased dramatically.

TABLE 3-5. EQUITY ISSUANCE BY LISTED KOREAN COMPANIES

(Unit: billion won)

	Type of equity issuance								
	IPOs in the stock market				Rights offerings in the stock market		IPOs on KOSDAQ		
	Primary offering		Secondary offering						
Year	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.	Total
1980	6	0.3	-	-	52	170			170.3
1985	10	33	1	1.2	60	259			350
1989	110	1,468	16	1,582	274	11,124			14,174
1990	33	315	3	20	169	2,581			2,916
1995	35	531	-	-	163	5,583			6,114
1996	40	1,391	-	-	146	3,651			5,042
1997	23	479	-	-	109	2,676	34	100	3,255
1998	3	37	-	-	122	13,452	5	262	13,751
1999	15	1,720	-	-	250	33,426	109	2,122	37,268
2000	-	-	-	-	86	5,788	182	2,568	45,624
2001	3	217	-	-	99	5,097	166	1,313	6,627
2002	8	594	3	632	124	6,207	122	1,115	8,548
2003	9	524	1	35	100	7,166	70	577	8,302
2004	8	555	2	85	57	4,526	46	436	5,602
2005	10	449	1	2	44	1,876	67	849	3,176
2006	9	1,116	-	-	37	2,389	51	589	4,094
2007	9	1,525	-	-	65	10,479	59	776	12,780
2008	5	320	-	-	38	1,468	37	396	2,184
2009	10	473	-	-	74	5,660	235	3,563	9,696
2010	21	2,939	-	-	35	3,139	100	1,224	7,302
2011	13	1,358	-	-	13	1,358	54	1,079	2,437
2012	5	205	-	-	5	205	20	260	465
2013	3	516	2	145	5	661	42	628	773

Source: Financial Supervisory Service, Monthly Financial Statistics Bulletin
Note: This excludes rights offerings and other public offerings in the KOSDAQ market.

V. EQUITY UNDERWRITING

The issuance of equities is generally categorized into public offerings (subscription and sales offerings) and private offerings, depending on how the buyers are found. It is also divided into direct and indirect offerings, depending on which party takes on the risk and handles the paperwork of the issuance. Generally, public offerings (subscriptions and sales offerings) are indirect issuances, while private offerings are direct issuances. In direct

issuances, the issuing party shoulders all of the issuing risk, and takes care of all the administrative work involved. If the total amount of stocks issued falls short of the total subscription, the issuer must take care of the unsold amount at the discretion of the BOD. If it cannot purchase the remaining shares, the company will not be established.

On the other hand, with indirect investment the shares are issued indirectly through an underwriter - a financial investment company (a financial investor or a dealer) that has expert knowledge and resources in that area. In this case, the issuing party hires and pays a fee to a specialized institution to take on the issuance (the administrative work of the subscription), as well as the risk involved in the issuance. Indirect issuances are categorized into offering on consignment, stand-by underwriting, or firm-commitment underwriting, depending on the extent of issuing risk.

Since a single financial investment company underwriting a large issuing value cannot shoulder all of the underwriting risk, it is common for multiple securities companies to form an underwriting syndicate. The lead manager brings together the underwriters and signs the underwriting agreement with the issuing company as the representative for the other members. The other securities companies, which do not take responsibility for the underwriting risk and only sell the stocks, are called selling companies. Currently, only financial investment companies (securities companies, specifically) can take on the role of underwriting syndicates. Prior to 1974, stand-by underwriting was the most common form of issuance. But most issuances today are comprised of firm-commitment underwriting, and as this poses a heavy burden to the underwriter, it comes with the highest underwriting fee.

TABLE 3-6. UNDERWRITING BY DOMESTIC SECURITIES COMPANIES

(Unit: billion won)

		2004	2005	2006	2007	2008	2009	2010	2011	2012	2013 3Q
Equity	IPO	1,089.9	1,239.8	755.8	1,903.2	681.1	4,054.6	5,933.9	2,810.3	606.4	784.7
	PO	2,935.8	1,570.3	1,547.6	3,227.3	2,555.6	3,544.4	2,572.0	2,324.2	1,230.7	1,265.5
	Total	4,025.7	2,810.1	2,303.4	5,130.5	3,236.7	7,599.0	8,506.0	5,134.4	1,837.1	2,050.2
Government and public bonds	KTB Muni	36,728.6	30,215.4	28,771.9	27,181.4	27,827.7	39,534.6	33,221.1	35,271.0	34,314.4	30,289.2
	Special	25,025.3	35,642.3	33,659.2	39,792.5	68,099.2	102,202.3	112,445.9	131,102.2	119,079.8	90,798.9
	Financial	105,442.4	94,321.3	149,216.3	113,909.3	129,618.9	113,428.6	62,492.2	69,067.1	58,345.0	53,700.7
	Sub-total	167,192.2	160,179.0	211,647.4	180,883.2	225,540.5	255,165.5	208,159.2	235,440.3	211,739.3	174,788.8
Corporate		24,459.8	33,628.7	1,950.3	23,680.6	41,098.4	56,934.8	63,702.1	87,415.1	94,743.4	65,150.5
DR		977.9	1,190.3	2,192.4	4,878.4	2,000.2	570.1	5,036.1	1,739.8	836.5	287.1
Total		196,659.5	197,808.1	236,093.5	214,572.7	271,875.8	359,918.0	334,389.5	457,351.8	466,618.0	330,679.8

Source: Financial Supervisory Service, Monthly Financial Statistics Bulletin

VI. OVER-THE-COUNTER MARKET

Almost all the companies that increase their capital through public offerings to ordinary investors are listed on the stock exchange. This does not mean that capital increase by unlisted companies is specifically restricted by law. In fact, the ability for unlisted companies to raise capital has been deregulated. The FSCMA states that any company with under KRW 1bn in market capitalization or with less than 50 target investors to solicit investment is not required to submit a registration statement. Instead, a simple statement for a small-amount offering suffices. The latter, unlike registration statements, does not require documentation detailing the company's sales and accounting since it is not intended to disclose investor information, but rather it is merely a procedure to report the advent of the company's stock issuance.

Although these regulations place the cost of making a public statement on the issuing company, from the point of view of investors, unlisted shares have high risks and very little disclosed information. Above all, since there is no market for them to be traded in, any investment in them cannot be recovered. In addition to the absence of a market, trading by a securities company is also in effect unlikely. Accordingly, recovering any investment is difficult until the company goes public, and thus any investment in unlisted stocks is generally limited to those who invest in high-risk shares, including venture capital, and can invest over the long term.

In March 2003, the Korea Securities Dealers Association (now KOFIA) launched an OTC trading system in order to supplement the KRX and to enhance convenience in the trading of OTC shares. This increased the trading volume of unlisted shares and enabled small venture companies to legally raise new capital. Moreover, intensified competition in the market has gradually eased IPO requirements, shortening the time from the establishment of a company to its public listing.

Moreover, as part of the "Finance and Tax Benefits for the Promotion of Venture Companies" policy, market regulations, including the exemption of capital gains tax on venture start-ups for minority investors, have been eased. The name of the OTC market was changed to the FreeBoard Market in July 2005. At the end of 2013, 61 issues with a market capitalization of KRW 620.1bn were traded on FreeBoard, with an average daily trading volume of 130,000 shares, and average daily trading value of KRW 100mn.

CHAPTER 04

STOCKS : SECONDARY MARKET

I. THE SECONDARY MARKET

The secondary market comprises of the KRX (established with the merger of the Korea Stock Exchange, Korea Futures Exchange and KOSDAQ in January 2005 in accordance with the 2004 Korea Securities and Futures Exchange Act), and the FreeBoard market – the over-the-counter (OTC) market operated by the Korea Financial Investment Association (KOFIA).

The securities exchange is a physical market that is established, operated, and maintained for the trading of securities at the KRX (Stock Market Division). It has the following characteristics: 1) orders are concentrated at certain trading hours through steady transactions; 2) it depends on certain trading policies including the principle of auction; and 3) trading is systematic and follows a fixed set of rules. The KOSDAQ is operated by the KRX (specifically, the KOSDAQ Market Division) and lists venture companies and promising small and medium-sized enterprises (SMEs) with growth potential and technological expertise. These equities are traded through auction under fixed rules for trading. Aside from that, unlisted stocks are traded on the FreeBoard market

(an OTC market that enables innovative SMEs to obtain funding through the capital market; SMEs include venture companies that are in the initial growth stage, as well as innovative technology companies). However, the market is not very large.

TABLE 4-1. SECONDARY MARKETS FOR EQUITY

	Stock market	KOSDAQ	FreeBoard
Trading hours	- Regular trading session: 09:00 -15:00 - Off-hours trading session: 07:30-08:30, 15:10 -18:00	Same as stock market	09:00-15:00
Price fluctuation limit	Previous day's closing price ±15%	Same as stock market	30% of base price
Trading method	Competitive bidding	Same as stock market	Private sale
Entrustment guaranty money	Financial investment company (brokerage) Autonomous decision	Same as stock market	Buy: 100% Cash Sell: 100% Cash
Capital gains tax	Tax-free	Same as stock market	Large companies (20%), SMEs (10%)
Credit loan	Possible	Same as stock market	Not possible
Quotation	Limit order, market price, conditional limit, best available order price, first priority order	Same as stock market	Limit order
Basis price	Previous day's closing price	Same as stock market	Previous day's weighted average equity price
Trading unit	10 shares (one share with previous day's closing price of over KRW50,000)	1 share	1 share

II. DEVELOPMENTS IN THE EQUITY SECONDARY MARKET

1. Recent Developments in the Equity Secondary Market

With low interest rates since the 1997 Asian financial crisis, there was an active inflow of funds to indirect investments including mutual funds as well as stock-type funds. In addition, the Korean economy garnered positive evaluations from foreign investors, which led to a concentration of investments that significantly boosted the market. The KOSPI surged to 1,028.07 points at the end of 1999, up from 562.46 points at the end of 1998. In particular, the KOSDAQ market attracted large amounts of capital due to the government's

aggressive development policy and the impact of IT-related technological stocks, including information and communication technology equities.

The Korean stock market then experienced a prolonged slump. The KOSPI, which started out at 1,028.33 points in early January 2000, plunged to 504.62 points in the same year due to repercussions of the Daewoo debacle in mid-1999 and ongoing restructuring. Likewise, the KOSDAQ steadily declined after registering an all-time high of 283.44 points in March 2000, dropping to a record low of 34.64 points in March 2003. This resulted in a loss of investor confidence, largely attributed to imbalances in supply and demand caused by excessive numbers of IPOs and capital increases, controversy over the IT stock bubble, stock price manipulation, and the moral hazard of some business leaders.

After 2006, increased net buying by foreign investors and the anticipation of improved corporate results led to a continued uptrend for the KOSPI, which hit 1,467.7 points that year. Notably, the stock market posted 51 all-time highs despite record net selling by foreign investors and the subprime mortgage crisis in the US. The rise was driven by increased inflow of capital into equity funds, strong stocks in emerging markets and favourable corporate earnings.

In late 2008, the KOSPI dropped sharply by 41% compared to the end of the previous year to 1,124.47 points (the KOSDAQ fell 52.8% from the prior year to 332.1 points). This downward trend was mainly due to increased net selling by foreign investors (KRW 24.7tn in 2007 → KRW 33.6tn in 2008), low investor confidence amid a worsening global financial crisis after the Lehman Brothers' bankruptcy, and an accelerating domestic and global economic slowdown.

In 2009, however, the KOSPI recovered faster than any other market in the world and posted an increase of 49.7% year-on-year to reach 1,682.77 points, with the KOSDAQ seeing a 54.7% rise to mark 513.57 points. Foreign investors led the market with net buying worth KRW 32.4tn. In 2010, backed by a continuing economic recovery and liquidity supplied by advanced countries, the KOSPI surpassed the 2,000 mark for the first time in three years, reaching 2,051.00 points, a 21.9% year-on-year increase. However, the KOSDAQ witnessed a 0.6% decline from the previous year to 510.69 points since the market was mainly driven by large corporations and blue chips. The year 2011 experienced high volatility and fluctuation in the equity market due to unfavourable external factors, such as the fiscal crisis in Europe and a downgrade of the US credit rating.

Recently, an important factor in the Korean stock market has been the proportion of foreign investors. The inflow of foreign investment capital has risen dramatically on increased confidence in the Korean market and the notion that its securities market has been undervalued. As a result, foreign investors have become the most influential group of investors in the secondary market for equities. After accounting for 26.98% of market capitalization in 2000, the proportion of foreign investors increased gradually. But after surpassing 40% in 2003, their market share decreased steadily to about 27% in 2008, impacted by the global financial crisis. In 2009, the figure jumped back up to over 30%, as net buying by foreign investors increased with the global economy showing signs of recovery. In the following year, foreign investors' shareholdings registered a record high, pushed by continued net buying and rising stock prices. In July of 2012, the KOSPI fell below 1,800 points, but fewer concerns over a eurozone crisis and increased global liquidity drove the index to rise 9.4% year-on-year. The KOSPI remained under 1,800 points during the first half of 2013 due to concerns raised about the U.S. Fed's exit from quantitative easing, but returned above the 2,000 point-level during the second half of the year as foreign investors increased buying.

TABLE 4-2. TRENDS IN THE KOREAN SECONDARY MARKET

(Unit: billion won)

Year	No. of listed companies	Capital stock listed	Market capitalization	Trading volume (million shares)	Trading value
1980	352	2,421	2,526	1,645	1,134
1985	342	4,665	6,570	5,563	3,620
1989	626	21,211	95,476	3,397	81,199
1990	669	23,981	79,019	3,162	53,454
1995	721	38,047	141,151	7,656	142,914
1996	760	42,991	117,369	7,785	142,642
1997	1,135	49,647	78,057	12,172	163,447
1998	1,079	60,273	145,690	28,738	194,452
1999	1,178	91,151	448,208	78,033	973,732
2000	1,308	100,058	217,057	124,835	1,205,623
2001	1,410	97,490	307,668	210,810	916,544
2002	1,526	124,403	296,083	287,349	1,036,241
2003	1,563	101,389	392,737	234,711	813,892
2004	1,573	97,843	443,737	164,291	711,491
2005	1,620	93,464	725,972	265,329	1,232,635
2006	1,694	95,974	776,724	202,987	1,275,994

Year	No. of listed companies	Capital stock listed	Market capitalization	Trading volume (million shares)	Trading value
2007	1,769	85,589	1,051,898	240,758	1,863,625
2008	1,803	89.662	623,114	213,613	1,596,144
2009	1,798	92,468	974,039	319,643	1,997,236
2010	1,806	98,412	1,239,857	256,998	1,893,653
2011	1,822	115,908	1,147,992	222,497	2,260,067
2012	1,789	116,578	1,263,416	267,125	1,724,291
2013	1,831	116,292	1,306,189	178,694	1,436,792

Note: KOSDAQ statistics have been compiled from 1997
Source: KRX Market

TABLE 4-3. MAKEUP OF MARKET SHARE BY OWNER

(Unit: %)

Year	Government and Government-Controlled Entities	Institutional Investors	Other Companies	Individuals	Foreign Investors	Total
2000	13.20	16.43	19.93	23.47	26.98	100.00
2001	8.94	15.35	17.12	26.42	32.17	100.00
2002	6.56	15.28	19.82	25.55	32.79	100.00
2003	4.58	15.70	18.77	23.29	37.67	100.00
2004	4.13	17.01	17.95	20.80	40.10	100.00
2005	3.65	18.56	18.02	22.59	37.17	100.00
2006	3.93	20.80	18.13	21.98	35.16	100.00
2007	2.87	19.98	20.96	25.25	30.94	100.00
2008	2.75	11.69	28.34	29.96	27.25	100.00
2009	1.71	12.04	21.24	34.57	30.44	100.00
2010	3.28	13.45	28.01	24.09	31.17	100.00
2011	2.4	13.0	29.6	24.4	30.6	100.00
2012	3.3	15.8	24.5	24.0	32.4	100.00

Source: Korea Exchange
Note: Based on market capitalization of KOSPI + KOSDAQ

2. Trends Seen Through Major Indices

1) TRADING VALUE IN THE KOSPI AND KOSDAQ MARKETS

As shown in the above tables, the KOSDAQ market grew dramatically, even surpassing the growth of the KOSPI, as a result of aggressive government

measures to foster the market, along with the emergence of the IT bubble. The year 2000, however, marked the beginning of a lengthy slump for the KOSDAQ, and trading value drastically decreased. In contrast, the KOSPI fared relatively well and, from 2005, its trading value grew as the stock market returned to an upward trend on the back of increased net buying by foreign investors and expectations of improved corporate results. In particular, the KOSPI's trading value soared 60.6% year-on-year to KRW 1,362.7380tn in 2007, and although it fell during the global financial turmoil in 2008, it bounced back to KRW 1,466.2745tn when the economy recovered in 2009. In 2010, the trading value of the KOSPI fell from the previous year, despite better performances from domestic companies and increasing global liquidity, as it was weighed down by issues such as the European debt crisis (January and May) and the sinking of the South Korean warship ROKS Cheonan (May). In 2011, despite the US credit rating downgrade and other mounting external uncertainties, the trading value rose from the previous year on the back of strong performance demonstrated by major domestic stocks (automotive and semi-conductor). In 2012, however, a sluggish stock market caused the trading value to plunge, and this trend continued into 2013.

TABLE 4-4. TRADING VALUE BY MARKET

(Unit: billion won)

Year	Stock Market	KOSDAQ	Total
2000	627,132	578,490	1,205,622
2001	491,365	425,179	916,544
2002	742,150	294,092	1,036,241
2003	547,509	266,383	813,892
2004	555,795	155,696	711,491
2005	786,257	446,377	1,232,634
2006	848,489	427,504	1,275,993
2007	1,362,738	499,515	1,862,254
2008	1,287,031	308,077	1,595,108
2009	1,466,275	530,961	1,997,236
2010	1,410,562	483,091	1,893,653
2011	1,702,060	558,007	2,260,067
2012	1,196,263	528,028	1,724,291
2013	986,375	450,369	1,436,744

Source: Korea Exchange

2) KOSPI AND TRADING VALUE

There was no particular correlation between the KOSPI and trading value between 2000 and 2004. This changed, however, during the period of 2005 to 2009, when share prices steadily increased and a strong positive correlation became evident. The trading value in the second half of 2010, when the KOSPI started to conclusively show a strong rise, increased KRW 11tn compared to the same period in 2009. In contrast, the opposite pattern was observed in 2011.

TABLE 4-5. THE KOSPI AND TRADING VALUE

(Unit: points, billion won)

Year	KOSPI	Stock Market Trading Value
2000	504.62	627,132
2001	693.70	491,365
2002	627.55	742,150
2003	810.71	547,509
2004	895.92	555,795
2005	1,379.37	786,257
2006	1,434.46	848,489
2007	1,897.13	1,362,738
2008	1,124.47	1,287,031
2009	1,682.77	1,466.275
2010	2,051.00	1,410,562
2011	1,825.74	1,702,060
2012	1,997.05	1,196,263
2013	2011.34	986,375

Source: Korea Exchange
Note: KOSPI value is based on year-end figure.

3) MAKE-UP OF MARKET SHARE BY INVESTOR

The most notable trend in shareholding by investor is that the market share of individual investors, which had previously been steadily declining, surged from 2007. The proportion of shareholdings by individual investors peaked at 26.42% in 2001, and then dropped to a mere 21.98% in 2006. However, it has again been on the rise, reaching 25.25% in 2007, 29.96% in 2008, and 34.57% in 2009, due to rekindled investment sentiment following the economic recovery.

In 2010, however, the share of individual investors dropped sharply to 24.09%. Foreign investors, on the other hand, have generally represented an ever increasing percentage of investments in the stock market since 1992, when caps on investments by foreign investors were first eased, reaching 40.1% in market capitalization by the end of 2004. However, foreign investment in the Korean stock market began to decline from 2005, with market capitalization shrinking to 27.25% at the end of 2008. This represented a 9.2% decrease over three years, and was attributable to the diversification of investment destinations around the world and the concentration of investments in emerging markets. In 2009, however, with the Korean stock market recovering faster than major economies, foreign investment rebounded, with market capitalization reaching 30.44%. The portion of foreign investors increased further in 2010 to 31.17%, prompted by their continuous net buying.

Institutional investors have also gradually increased their presence in terms of market share since 2002. Pension funds have led the increase in institutional investments, increasing their equity investments. Equity investment by institutional investors reached 20.8% in 2006, but then dropped sharply to 11.69% in 2008 due to the surge in fund redemptions, before rising slightly to 12.04% as the market recovered in 2009. Also in 2010, although institutional investors sold their stocks with fund redemption requests following a rise in stock prices, their proportion increased slightly.

TABLE 4-6. MAKEUP OF MARKET SHARE BY INVESTOR

(Unit: %)

Year	Government and government-controlled entities	Institutional investors	Other companies	Individuals	Foreign investors	Total
2000	13.20	16.43	19.93	23.47	26.98	100.00
2001	8.94	15.35	17.12	26.42	32.17	100.00
2002	6.56	15.28	19.82	25.55	32.79	100.00
2003	4.58	15.70	18.77	23.29	37.67	100.00
2004	4.13	17.01	17.95	20.80	40.10	100.00
2005	3.65	18.56	18.02	22.59	37.17	100.00
2006	3.93	20.80	18.13	21.98	35.16	100.00
2007	2.87	19.98	20.96	25.25	30.94	100.00
2008	2.75	11.69	28.34	29.96	27.25	100.00
2009	1.71	12.04	21.24	34.57	30.44	100.00
2010	3.28	13.45	28.01	24.09	31.17	100.00
2011	2.4	13.0	29.6	24.4	30.6	100.00
2012	3.3	15.8	24.5	24.0	32.4	100.00

Source: Korea Exchange
Note: Based on market capitalization

4) NUMBER OF EQUITY INVESTORS

The number of equity investors increased sharply in the 1980s as a result of a surge in IPOs, selling of national stock, and the spread of employee stock ownership plans. In the 1990s, however, the stock market entered a stabilization period and the number of equity investors decreased. From 1993, the number of equity investors gradually increased until 1997, when it fell during the Asian financial crisis. Equity investors have increased in number since, boosted by the venture and IT booms.

TABLE 4-7. NUMBER OF EQUITY INVESTORS

(Unit: 1,000 persons, %)

Year	No. of equity investors (A)	Fluctuation(%)	Economically active population (B)	A/B(%)
1999	4,182	-	21,666	19.3
2000	4,000	-4.3	22,016	18.2
2001	3,888	-2.8	22,742	17.3
2002	3,974	-2.2	22,877	17.4
2003	3,937	-0.9	22,966	17.1
2004	3,763	-4.4	23,394	16.1
2005	3,537	-6.0	23,526	15.0
2006	3,613	-2.1	23,773	15.2
2007	4,441	+22.9	23,993	18.5
2008	4,627	+4.1	24,347	19.0
2009	4,665	+0.8	24,394	19.1
2010	4,787	+2.6	24,538	19.5
2011	5,284	+10.4	24,880	21.2
2012	5,015	-5.1	25,139	19.7

Source: Korea Exchange

With indirect equity investment gradually increasing after 1999, fewer people were engaging only in direct investment. Owing to the booming stock market in 2007, preferences for direct investments increased, pushing up the number of equity investors by 22.9% year-on-year, with this trend continuing into 2010.

The percentage of equity investors as a part of the economically active population peaked at 19.3% in 1999, when investment in the KOSDAQ became highly popular due to the venture and IT booms. This percentage later dropped and was on a gradual decline, but surged again from 2007 to reach

19.5% in 2010. The number of equity investors in Korea has continued to grow, exceeding 5,000 investors for the first time in history in 2011, boosted by an increasing awareness of the importance of health and quality of life with longer life expectancies.

5) DIVIDEND YIELDS

Dividend yields in the stock market peaked at 2.44% in 2000 and then steadily treaded downwards, returning upwards of the 2.0% range in 2003 and 2004. They dropped again continuously after 2006 before surging back to 2.58% in 2008 with the indices falling due to the global financial crisis. Dividend yields have been on a downward trend since then, dropping to 1.12% in 2010, with stock prices rising as a result of the economic recovery. They increased again in 2011, but then took another downturn in 2012 and continued to decline in 2013.

TABLE 4-8. CHANGES IN DIVIDEND YIELD

(Unit: %)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Dividend Yields	1.77	2.09	2.06	1.74	1.66	1.39	2.58	1.17	1.12	1.54	1.33	1.14

Source: Korea Exchange

6) P/E RATIO AND P/B RATIO

The P/E ratio in the stock market peaked at 29.29x in 2001, and remained in the range of 10x-15x, until dropping to the single digits in 2008, demonstrating that the KOSPI declined relative to corporate results. However, in 2009, the ratio reached 23.68x as the rapid economic recovery led to a steep increase in the stock market. In 2011, it dropped to 10.90x due to a surge in net income for companies, and increased slightly in the following year.

The P/B ratio maintained a gentle incline from 2002-2007, and then dropped to 0.94x in 2008. The ratio rebounded in 2009 as the recovery of the stock market led to an increase in market capitalization, and recorded 1.50x in 2010. However, since 2011, the ratio has remained little changed, hovering at the 1.20x level.

TABLE 4-9. CHANGES IN P/E AND P/B RATIOS

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
P/E Ratio (x)	15.61	15.61	10.06	10.98	11.40	16.84	8.99	23.68	17.80	10.90	12.92	14.95
P/B Ratio (x)	1.15	1.02	1.16	1.63	1.46	1.75	0.94	1.34	1.50	1.19	1.25	1.20

Source: Korea Exchange

3. Margin Transactions

1) TYPES OF MARGIN TRANSACTIONS

Credit lines are divided into cash and stock loans depending on whether the credit line is provided in cash or securities. Depending on the funding source, dealers and brokers lend their own funds or securities to customers in the form of broker's loans. Margin loans are when a dealer or broker obtains a loan from securities finance and lends it to the investor.

Securities that can be traded through margin transactions are stock certificates (including relevant entrusted securities) and ETFs. However, securities that the exchange has designated as a caution, alert or risk, or going through administrative issues, and securities for which the exchange requires payment of a deposit prior to quotation or a deposit prior to settlement, cannot be involved in new margin transactions.

2) MANAGEMENT OF MARGIN TRANSACTIONS

In order to begin margin transactions, a margin account is needed and KRW 1mn should be paid as fidelity deposit guaranty money. The loan and the limit, term, interest rate, and default interest rate, etc. for cash and stock loans are decided by the dealer or broker.

If the dealer or broker desires to consign margin transactions, a deposit is required. The deposit is in the ratio of the limit price (daily upper limit if there is no limit price) multiplied by the sale quantity to the investor's credit standing and trading status of each issue. In addition, the dealer or broker should demand collateral of over 140% of the market price of the cash loan and stock loan in consideration of the investor's credit standing and trading status of each issue.

3) MARGIN TRADING

As shown in Table 4-10, the share of margin transaction volume in total equity trading volume from 2000 onwards has maintained a relatively stable trend of less than 10%. This shows that retail investors are aware of the relative risk from investment strategies aiming to use leverage.

TABLE 4-10. PERCENTAGE OF MARGIN TRADING AMONG TOTAL EQUITY TRADING VOLUME

(Unit: million shares, %)

Year	Total equity trading volume (A)	Margin trading volume (B)	B/A(%)
2000	124,835	-	-
2001	210,810	10,105	4.79
2002	287,349	21,028	7.31
2003	234,711	17,321	7.37
2004	164,291	12,205	7.42
2005	265,329	25,890	9.75
2006	202,987	15,045	7.41
2007	240,478	14,018	5.48
2008	213,111	21,353	10.01
2009	319,643	21,225	6.64
2010	256,999	20,624	8.02
2011	222,497	21,088	9.47
2012	267,124	13,042	4.88
2013	178,694	9,241	5.17

Source: Financial Supervisory Service

CHAPTER 05

BONDS : PRIMARY MARKET

The primary bond market is where a company issues bonds through a brokerage firm, thus providing bond certificates to investors in return for funding. Although bonds may be issued directly to the investor, bond issuance generally occurs through a financial investment company that is licensed to underwrite securities. In this sense, the primary market comprises of three parties: the issuer, investor, and financial investment company (issuing broker).

The primary bond market, like the secondary market, is a comprehensive reflection of economic, political, and social conditions. In other words, it follows changes in the real economy and has a significant impact on the flow of funds. Ultimately, this has a large influence on the issuer, issuing method and issuing size.

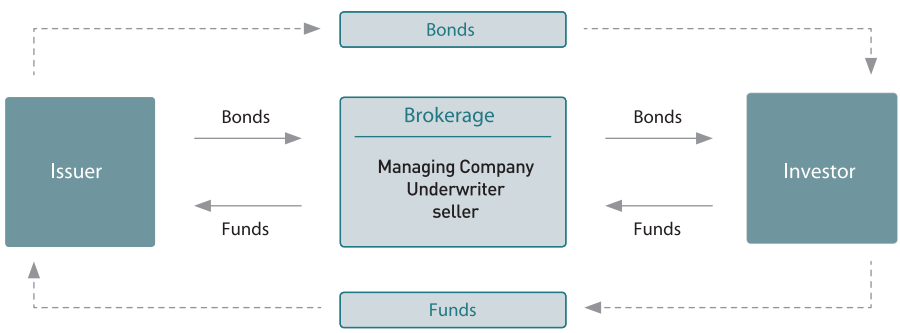
Accordingly, the primary bond market in the Korean capital market lately has been connected to the vitalization of the secondary market, and has demonstrated pronounced changes stemming from the wider variety and amounts of bonds issued.

I. STRUCTURE OF THE PRIMARY BOND MARKET

Like the equity market, the bond market comprises of a primary and secondary market. The primary market is where bonds are supplied by issuers to the investors. The secondary market is where issued bonds are traded among investors. Specifically, the primary bond market involves the issuance of bonds by an issuing company through a broker – providing a bond certificate to the investor and receiving funds. These activities occur sporadically and do not involve a physical market.

1. Structure of the Primary Bond Market

CHART 5-1. STRUCTURE OF THE PRIMARY BOND MARKET



2. Participants in the Primary Market

1) ISSUER

Issuers raise capital by issuing bonds. They include the government, local governments, companies established by a special law and stock companies.

2) INVESTOR

Investors provide capital by participating in book building in the primary market for bonds that are offered and sold, thereby purchasing the issued

bonds. Investors include institutional investors that form a corporation, have expert knowledge and large amounts of funding, as well as individual investors who invest in bonds for personal asset management. In general, bond investors are mostly institutional investors.

3) BROKERAGE

This refers to institutions specializing in handling the details involved in issuing bonds between the issuer and investor, as well as assuming the risk from issuance and their sales.

(a) Managing Company

The managing company is consigned the underwriting of the relevant bonds from the issuer or seller, and decides on the underwriting conditions. It oversees the entire process regarding offers or sales.

When the amount of bonds to be issued is large, a management group is formed for joint management. The leader which performs the key role is referred to as the lead manager, and other managing companies are referred to as co-managers.

(b) Underwriter

Underwriters are the institutions that underwrite issued bonds in collaboration with the managing companies. They sell purchased bonds to ordinary investors and sellers.

(c) Seller

The sellers directly sell issued bonds to ordinary investors.

II. THE CURRENT STATUS OF THE PRIMARY BOND MARKET

In the past, government and public bonds were primarily issued in Korea, beginning with the issuance of nation-building government bonds in 1949 in order to supplement the fiscal deficit. Recently, however, the types of bonds issued have become diversified, ranging from bank bonds to corporate bonds.

A quick look at bond issuance trends shows the value of bonds issued has increased 221.1% from KRW 470.2tn in 2000 to KRW 1,510tn in 2013. The amount of bonds issued as a proportion of GDP was 74.0% in 2000 but increased by 31.7 percentage points to 105.7% as of the end of 2013.

In 2000, special bonds and corporate bonds accounted for the largest share of the market at 21.6% each, followed by financial bonds (15.7%), Korea Treasury bonds (KTBs – 15.2%), and monetary stabilization bonds (14.2%). However, in 2013, KTBs accounted for the largest share (30.0%), followed by special bonds (23.2%), financial bonds (17.2%), and monetary stabilization bonds (10.7%). In 2013, the amount of KTBs issued had nearly doubled from its 2000 level, while the percentage of corporate bonds has shown a steady upward trend since 2009 after recovering from a continuous decline that began in 2000.

TABLE 5-1. TYPES OF BONDS ISSUED

(Unit: trillion won)

Year	Govt.	Muni	Special	MSB	Financial	Corp	ABS	Total (A)	Current price GDP (B)	% (A/B)
2000	71.6	10.5	101.6	66.8	74.0	101.7	44.0	470.2	635.2	74.0%
2001	83.0	10.0	136.4	79.1	86.0	95.8	67.4	557.7	688.2	81.0%
2002	99.0	9.1	136.3	83.9	122.3	90.1	67.6	608.3	761.9	79.8%
2003	137.0	9.7	119.9	105.5	126.0	86.4	63.9	648.5	810.9	80.0%
2004	178.9	10.1	116.0	142.7	137.7	75.5	48.3	709.3	876.0	81.0%
2005	224.0	10.8	117.7	155.2	148.8	76.6	39.6	772.8	919.8	84.0%
2006	258.3	11.6	104.3	158.4	191.3	74.7	34.8	833.3	966.1	86.3%
2007	274.7	12.3	116.5	150.2	237.7	80.5	27.4	899.3	1043.3	86.2%
2008	285.0	13.1	135.7	126.9	271.6	98.0	20.7	951.1	1104.5	86.1%
2009	330.1	15.3	177.7	149.2	272.8	140.7	31.2	1117	1151.7	97.0%
2010	360.1	16.0	225.7	163.5	245.6	163.1	29.3	1203.4	1265.3	95.1%
2011	389.9	16.9	256.7	159.8	244.3	189.8	30.0	1287.4	1332.7	96.6%
2012	413.3	17.1	318.4	163.1	242.3	217.0	33.2	1404.5	1377.5	102.0%
2013	452.6	18.3	349.7	161.2	260.6	227.8	39.9	1510	1428.3	105.7%
Percentage (2000)	15.2	2.2	21.6	14.2	15.7	21.6	9.5	100	-	-
Percentage (2013)	30.0	1.2	23.2	10.7	17.2	15.1	2.6	100	-	-

Source: Koscom, The Bank of Korea

III. BOND ISSUANCE METHODS

Bond issuance generally comprises of public offerings and private placements depending on how the demand side is found. They can also be categorized into direct issues and indirect issues.

1. Public Offering and Private Placement

1) PUBLIC OFFERING

Public offerings generally refer to actions with the aim of selling to multiple ordinary investors. The Financial Investment Services and Capital Markets Act (FSCMA) defines a public offering as an offering and sale.

The term "public offering" in the Act refers to gathering 50 or more investors, as calculated under the conditions prescribed by the Presidential Decree, to solicit an offer to acquire newly-issued securities (FSCMA Article 9 (7)). In other words, this means solicitation of an offer of acquisition to 50 or more investors (the sum of whom have received recommendations) who have not purchased or applied for the same type of securities as the securities being offered within the past six months.

The term "public sale" in the Act refers to gathering 50 or more investors, as calculated under the conditions prescribed by the Presidential Decree, to make an offer to sell or invite offers to purchase securities already issued (FSCMA Article 9 (9)).

2) PRIVATE PLACEMENT

Private placement refers to a private offering of securities for new issuance to investors. Therefore, private placement entails that the securities are issued directly to certain demand-side parties so that they may raise capital from them. This means that the bond certificate is only issued to the subscriber or has third party underwriting. It is referred to as private placement since it is not intended for the public.

2. Direct Issues and Indirect Issues

1) DIRECT ISSUES

Direct issues refer to the issuer taking on responsibility for all the issuing risk, estimates, and paperwork. If the total issued amount falls short of the total subscription amount, the issuer must assume responsibility for the remainder through a decision made by the Board of Directors (BOD). If underwriting is not possible, the company is not established and the bonds are not issued. Therefore, this method is only viable when the issuer has sufficient capability for the offer, or the scale of the bonds being issued is small, thus reducing the risk and paperwork.

2) INDIRECT ISSUES

Indirect issues refer to issuances through a brokerage. The issuer uses specialized institutions such as financial investment companies or financial institutions, which possess specialized knowledge and information. In such cases, the issuer, in principle, designates the paperwork and risk of the issuance to institutions with the expertise and pays them a fee.

(a) Firm Commitment

Firm commitment involves the lead manager underwriting the entire publicly offered security amount and shouldering all of the issuing risk, as well as the issuing and administrative activities for the subscription. In other words, it purchases a part or all of the securities with the purpose of selling them to a third party.

(b) Stand-by Agreement

The stand-by agreement separates the issuance and subscription administrative work and consigns them to an issuing institution. First it consigns the issuance and subscription administrative work to an issuer and offers bonds in the name of the issuing company for a certain amount of time. When that period expires or the number of subscribers falls short, the underwriter takes care of the balance according to the underwriting agreement.

(c) Best-effort Basis

Best-effort basis involves a third party receiving a commission and leading the offering or the sale of the relevant securities for the issuer. At times, the third party, either directly or indirectly, takes on part of the offering and/or sale. It is therefore called an offering on consignment. Given that this method involves higher risk, third-party issuers (underwriters) are only used when consigning the issuing paperwork.

IV. ISSUING METHODS BY BOND TYPE

1. Categorization by Issuer

Bonds are categorized into government bonds, municipal bonds, special bonds, and corporate bonds depending on the issuer. Government bonds are issued by the central government, and comprise of Korea Treasury Bonds (KTB) and National Housing Bonds (NHB). Municipal bonds, issued by local governments, comprise of industrial development bonds and subway construction bonds. Special bonds are those issued by entities established by law, and include public bonds and corporate bonds. Corporate bonds are those issued by stock companies or local public corporations in accordance with the Commercial Code.

2. Issuance of Government Bonds

1) TYPES OF GOVERNMENT BONDS

The first government bonds in Korea were nation-building government bonds issued in 1949. Since then, a wide variety of government bonds have been issued and integrated into KTBs, originally the Fund for Management of Government Bonds (renamed KTBs in 1998) that were first issued in 1994. Currently, government bonds issued include KTBs, treasury bills, National Housing Bonds (NHB) Types 1, 2, and 3, and Foreign Exchange Equalization Fund Bonds (FEEFB), which are denominated in foreign currency. Among

them, KTBs are issued in the largest volume and trading is highly active. Accordingly, the on-the-run KTB market yield serves as a benchmark yield.

There are currently five types of KTBs issued with varying terms of maturity: 3-year, 5-year, 10-year, 20-year and 30-year, and, depending on the interest payment, there are fixed-interest KTBs (3-year, 5-year, 10-year, 20-year, and 30-year maturity) and inflation-linked KTBs (10-year maturity).

Inflation-linked KTBs link the principal and coupon rate of the KTBs to prices, thereby eliminating the risk from inflation that comes with investing in KTBs, and thus ensuring the purchasing power parity of the bonds. They are issued in approximately 20 countries including Finland (1945), the U.K. (1981), the U.S. (1997), France (1998), Japan (2004), and Korea (2007).

TABLE 5-2. OUTSTANDING ISSUES BY GOVERNMENT BOND TYPE

(Unit: trillion won)

KTB	NHB Type 1	NHB Type 2	NHB Type 3	Total
400.7	47.8	2.9	0.6	452

Note: As of December 31, 2013

2) SCALE OF KTB ISSUANCE

The scale of KTB issuance has steadily increased, with outstanding issues growing by 7.2 fold to KRW 400.7tn as of the end of 2013 from a meager KRW 55.6tn in 2002. The portion of KTBs out of total outstanding bond issues jumped 17.4 percentage points, from 9.1% in 2002 to 26.5% by the end of 2013.

TABLE 5-3. PERCENTAGE OF KTB ISSUED AMONG TOTAL BONDS

(Unit: trillion won)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
KTB	55.6	81.5	123.1	170.5	206.8	227.4	284.5	281.9	310.1	340.1	362.9	400.7
(percentage)	(9.1)	(12.6)	(17.4)	(22.1)	(24.8)	(25.3)	(29.9)	(25.2)	(25.8)	(26.4)	(25.8)	(26.5)
Total	608.3	648.5	709.3	772.8	833.3	899.3	951.1	1,117.0	1,203.4	1,287.4	1,404.5	1,510.0

3) ISSUING PROCEDURES FOR KTBS

TABLE 5-4. ISSUING PROCEDURES FOR KTBS

1. Establish plans to issue KTBs	- The Ministry of Strategy and Finance discusses with relevant agencies any plans to issue KTBs and the issue is subject to deliberation by the National Assembly - Establishment of a detailed issuing plan within the annual KTB issuance limit approved by the legislature
2. Announcement of issuing plans and bidding	- The Minister of Strategy and Finance announces annual/monthly plans for each year - In principle the date/time of bidding, issuing amount, coupon rate and settlement, etc. are disclosed up to three days prior to the commencement of bidding
3. Bidding	- Bidding date • 3-yr/30-yr KTB: Every first Monday • 5-yr KTB: Every second Monday • 10-yr KTB, inflation-linked KTB: Every third Monday • 20-yr KTB: Every fourth Monday - Bidding time: 10:40am - 11:00am (except for 3-yr KTB, held from 9:40am – 10:00am) - Bidding type and method of selecting successful bids • Bidding is electronic, using BOK-Wire (a network operated by The Bank of Korea) • The bid interest rates are grouped in intervals of 3bp from the highest successful bid downwards within the range of the amount to be issued, and the highest successful bid's interest rate in each group is applied - Participants in the bidding • Only KTB primary dealers are eligible to participate in KTB auctions • Non-primary dealer bidders may bid through KTB primary dealers who act as proxy agents • However, if a retail investor bids through a primary dealer, the bid security deposit and written bid should be submitted in advance
4. Announcement of bidding results	- The Minister of Strategy and Finance announces the details of bidding and the accepted bids when they are complete
5. Issuance of KTBs and settlement of successful bids	- Issuance of KTBs and payment of the successful bid amount are done after the bidding date - On the day of settlement, the Korea Securities Depository (KSD) is notified by BOK-Wire immediately after the underwritten amount is remitted and the settlement and issuance are completed • All KTB types are registered and issued and deposited at KSD. Accordingly, transaction and exercise of rights are possible without issuance of physical bond certificates

4) KTB TERMS AND CONDITIONS

KTBs are issued as fungible issues, meaning that the issuing terms in the maturity and the coupon rates of the bonds issued within a certain period are the same, and the bonds issued during that period are treated as the same type. 3-year KTBs are currently issued on June 10 and December 10; 5-year KTBs and 10-year KTBs are issued on March 10 and September 10; 20-year KTBs on December 10 of every odd year; and, 30-year KTBs on December 10 of every even year. By raising the trading volume by increasing the volume of each type issued, interest expenses are saved and a credible benchmark rate is established.

The coupon rates of KTBs are set to be multiples of 0.125%, with the successful interest rate written off for each KTB issuance.

5) REDEEMING KTB

There are two means for redeeming KTBs; redemption at maturity and redemption before maturity. For redemption at maturity, the principal is redeemed in a lump sum, while the interest is paid every six months from the issue date. If the date of the principal redemption is a public holiday, it is due the next business day. If it does not coincide with a public holiday, it is paid one working day in advance. The amount paid corresponds to the amount designated for the original maturity date, regardless of the public holiday.

For redemption before maturity, when the Minister of Strategy and Finance deems it necessary, KTB reverse biddings are held for Primary Dealers (PD) and are purchased directly from KTB holders. There is no bidding limit for PDs, and the minimum amount for each issue is KRW 1bn (par value), and increases in whole number multiples of KRW 1bn. The winning bid from a PD is decided consecutively from interest rates that have been bid, spanning from the highest interest rate down. The purchased amount is derived by applying the rates bid by the successful bidders.

The Bank of Korea (BOK) handles the redemption before maturity and interest payment of KTBs. The BOK deposits the relevant amount to the Korea Securities Depository's (KSD) current deposit account, and the KSD transfers the principal and interest to the current deposit account that handles the transactions for the institution that holds the KTBs.

3. Issuing Corporate Bonds

1) TYPES OF CORPORATE BONDS

Corporate bond issuances are divided into direct and indirect types, depending on the entities bearing the risk related to issuance. Indirect issuance comprises of firm commitments, stand-by agreements, and best-effort basis, based on the degree of risk assumed by underwriters. In addition, bonds comprise of par value, discount issue, and issues at a premium.

Corporate bonds with guarantees or collateral fall into guaranteed bonds, collateral bonds, and non-guaranteed bonds. Guaranteed bonds refer to corporate bonds where a financial institution guarantees the redemption of the principal and interest. Guarantees of the principal and interest payments are provided by banks, the Korea Credit Guarantee Fund, the Korea Technology Finance Corporation, merchant banks, financial investment companies, and surety insurance companies. The issuing company pays a guarantee fee to the guaranteeing company. Collateral bonds are secured by physical collateral in order to physically guarantee redemption of the principal and payment of interest. They are issued in accordance with the Secured Bond Trust Act. Non-guaranteed bonds are issued by the issuer's credit without the guarantee or collateral provided by a financial institution for principal redemption. Most Korean corporate bonds are issued as debentures. The underwriters can only underwrite corporate bonds rated by two or more credit rating agencies.

Corporate bonds are categorized by type of interest payment as coupon bonds, discount bonds, and compound bonds. Coupon bonds refer to corporate bonds with coupons denoting the payment of interest at a regular schedule. Discount bonds are corporate bonds where the principal and interest are the par value and the interest is discounted in the lump sum. Compound bonds involve the computing of compound interest for the interest cycle. Thereafter, the principal and interest are paid in a lump sum on the date of maturity.

In addition, bonds are again divided into fixed-rate and floating-rate notes (FRNs) depending on the variability of the interest rate. Fixed-rate bonds involve the payment of fixed periodic returns. FRNs have a variable interest rate linked to the benchmark interest rate.

Bonds are also categorized by holder or ensuing rights as convertible bonds, bonds with warrants, exchangeable bonds, participating bonds and bonds with embedded options. Convertible bonds (CB) can be converted to the issuing company's equity on certain conditions. Bonds with warrants entitle the holder to purchase a certain quantity of any future issue of the company's stocks at a fixed price after a set period of time has passed. Exchangeable bonds permit the holder to exchange his/her bond holdings for the listed shares of a company under previously agreed conditions within a set timeframe. Participating bonds entitle the holder to receive dividends. Bonds with embedded options allow the issuer to redeem all or part of the bond before it reaches its maturity date. The options include call options, where the issuer can redeem the principal and interest before maturity, and put options, which grant the holder of the bond the right to demand the issuer repay the principal on the bond.

2) IMPROVED CORPORATE BOND ISSUANCE PROCEDURES

In the past, managing companies played a rather insignificant role in the domestic corporate bond primary market during the underwriting process as evaluators of corporate value and risks. As securities companies focused more on price competition to secure sufficient quantities of bonds rather than their core responsibility of risk assessment or pricing, their capabilities as investment banks remained stagnant. At the same time, the expansion of the demand base for corporate bonds has been hindered due to weakening investor protection as investors have gradually lost confidence in the data and prices calculated at the time of corporate bond issuance. To address such bottlenecks, the Financial Services Commission (FSC) adopted measures to improve the current system as part of the "Plan to Improve the Primary Market for Corporate Bonds to Promote Investment Banks" (announced on Oct. 17, 2011), aiming to strengthen the responsibilities and underwriting capacity of securities companies in an effort to encourage their investment bank business arm and the sound development of the primary market for corporate bonds.

Measures to improve the primary market for corporate bonds mainly consisted of two parts: a systematic due diligence and a mandatory book-building.

First, to streamline the due diligence process, KOFIA's Regulations on Securities Underwriting Business have been revised to require a contract between a lead manager and an issuing company for corporate bond issuance, which must include details regarding due diligence (business performance of the issuing company, financial status, review of comments regarding information provided in securities reports, etc). Also, the revised Regulation on Securities Issuance and Disclosure mandates that the managing company show due diligence details in the securities registration statements. In line with these measures, the Financial Supervisory Service (FSS) set Standard Instructions on Due Diligence for Non-Guaranteed Bond Issuance, recommending a standard procedure for due diligence to enhance its efficiency.

The second action involves compulsory book building, which requires the lead manager responsible for underwriting corporate bonds to perform book building in order to determine the price at which an IPO is to be offered. In the new process, the lead manager is mandated to record details regarding pricing decisions based on the outcomes of book building in the securities registration statement. The lead management contract was revised to include provisions on book building when issuing non-guaranteed corporate bonds. In addition, restrictions against unfaithful book building participants have been established, under which participants who fail to subscribe for shares

allotted as a result of participating in book building, or who fail to pay for shares allotted, will face disciplinary actions including, but not limited to, prohibition against participating in future book buildings for a specific period of time. To support book building in the primary markets, KOFIA developed and has been providing a book building function through its FreeBond system since April 2, 2012.

Such enhancements in corporate bond issuance and book building procedures helped securities companies reinforce their underwriting activities, and ensured transparency in the price determination process. Investors also benefit from these improvements, as investment opportunities will likely expand, backed by a higher level of corporate information. Moreover, while the primary market in the past generally depended on credit ratings, it secured a stronger demand and supply base as well as a reinforced money brokerage function thanks to enhanced access to corporate information and greater confidence in the market.

CHART 5-2. CORPORATE BOND ISSUANCE

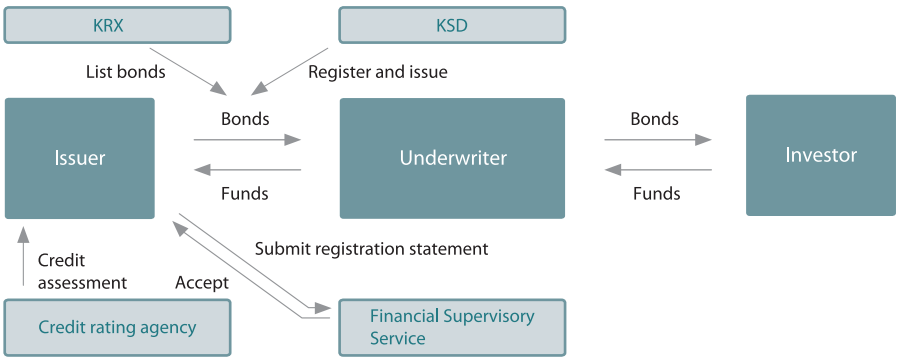


TABLE 5-5. CORPORATE BOND ISSUING PROCEDURES

1. Company registration	- Register with the Financial Services Commission (FSC) for public issue of non-guaranteed bonds.
2. Issue credit rating	- Submit for credit assessment, evaluation (requires two to four weeks). - Credit rating from two or more credit rating agencies is required.
3. Decision by BOD	- Issues related to issuing corporate bonds are decided upon resolution by the BOD. (The BOD's resolution may be made after a lead management contract is signed based on the decision by the issuing company)
4. Sign agreement to pay principal and interest as agent	- Decide where to make payment for corporate bonds and which institution will pay principal and interest after the corporate bond is issued as its agent indicates on application form and bond certificate.
5. Select manager and indenture trustee	- Select a managing company that will underwrite and manage corporate bonds, and an indenture trustee that will take the necessary measures to protect the bond holders from the period of time involving payment for bonds to principal repayment.
6. Sign a lead management contract and report to KOFIA	- To issue non-guaranteed bonds, the issuing company must sign a contract with a lead manager, which must include information concerning due diligence and book building. - A lead management contract shall be signed at least 10 days before the submission of a securities report, and it must be reported to KOFIA within 5 business days of the contract signing date.
7. Due diligence	- The lead manager, etc. checks for risk factors through due diligence of companies.
8. Submit securities report	- Submit securities report and attached documents (subscription agreement, trustee agreement, principal and interest payment agency agreement, etc.) to the FSC.
9. Book building	- The lead manager provides guidance on the price desired by the issuer to determine the interest rate, and captures investor demand for purchasing price, interest rate, and quantities of shares.
10. Taking effect	- Unsecured corporate bonds: Seven days after registration statement submission. - Secured bonds, collateral bonds, ABS: Five days after registration statement submission.
11. Submit prospectus	- When the bond takes effect after the submission of the registration statement, the issuer distributes and discloses the prospectus at its branches, the FSC, and firms that will accept applications.
12. Issuance and payment	- Issuance, payment and listing take place simultaneously.
13. Issuance reporting	- After issuance is complete, an issuance report is submitted to the FSS.
14. Report underwriting by managers	- Report underwriting performance by managing companies to KOFIA within 5 days of the issuance date.

3) INDENTURE TRUSTEE SYSTEM

A new system called the "indenture trustee system" has been adopted under the revised Commercial Act effective from April 15, 2012. According to the revised law, the term "standard non-guaranteed corporate bond trust agreement" has changed to "standard non-guaranteed corporate bond trust indenture agreement," and "trustee" to "indenture trustee." The law stipulates that institutions designated to assume the role of indenture trustee are

accredited financial institutions, such as banks, trust companies, securities companies, the Korea Securities Depository, and the Korea Securities Finance Corporation. In addition, a company is disqualified as an indenture trustee if there is a potential conflict of interest between the bond issuing company and the indenture trustee, or if the indenture trustee has a special interest in the bond issuing company. The adoption of the indenture trustee system is contributing to investor protection and further growth of the corporate bond market.

4) QUALIFIED INSTITUTIONAL BUYER (QIB) SYSTEM

As part of the FSC's "Plan to Improve the Corporate Bond Issuance Market to Promote Investment Banks," the Qualified Institutional Buyer (QIB) system has been implemented to expand financing opportunities for small- and medium-sized enterprises (SMEs) through the capital markets. Under the system, relaxed disclosure and other requirements are applied (e.g. securities report submission) when securities are traded only between Qualified Institutional Buyers who meet a certain minimum level of sophistication, size and market savvy with respect to complicated or risky securities. It was already adopted by the U.S. in 1990, the U.K. in 1995, Singapore in 2007, and Japan in 2008. The scope of QIB investors is limited to the Small & Medium Business Corporation (SBC), venture capitals, and professionals, as defined in Article 11 of the Enforcement Decree of the FSCMA, and excludes small-loan financial agencies such as mutual banks. Domestic QIB securities must be issued to QIBs, and may be resold only to QIBs. Unlisted domestic companies with total assets of KRW 500bn or less (excluding financial institutions and public enterprises) are eligible to issue QIB securities in Korea, as are foreign companies and government agencies.

QIB securities include straight bonds and securities-related corporate bonds such as CBs and BWs. As the FSC was attempting to prevent the resale of QIB securities by retail investors, it authorized KOFIA's FreeBond system as the official trading system for QIB securities. KOFIA launched a QIB trading platform through FreeBond as the Qualified Institutional Buyer system took effect on May 2, 2012. For this purpose, KOFIA has established relevant operating regulations for a number of issues, including trading system rules, user registration and de-registration, QIB securities registration, trading system operation, duty of disclosure, data submission and reports, and special provisions for foreign companies.

CHAPTER 06

BONDS : SECONDARY MARKET

I. STRUCTURE OF THE SECONDARY BOND MARKET

The secondary bond market consists of the over-the-counter (OTC) and the exchange market. The OTC market refers to a market outside the exchange where the trading of all bonds, including listed and unlisted bonds, takes place as negotiated transactions among financial investment firms or between financial investment firms and their customers (investors). On the other hand, the exchange market is where trading takes place through competitive bidding with a concentration of buying and selling for listed bonds at a particular location, i.e., the Korea Exchange (KRX).

Unlike equities, bonds come in a large number of items (approximately 19,643 different items as of the end of 2013), are difficult to standardize, and the main investors are limited to institutional investors. Accordingly, the OTC market, where private sales take place, accounts for the majority of the market. This is a global phenomenon and is not limited to Korea.

1. OTC Market

Over-the-counter bond trading accounts for roughly 80-90% of the entire Korean bond market. Before the Korean government made it mandatory for Primary Dealers (PDs) to deal in the exchange market in order to develop the Korea Treasury Bond (KTB) market (in October 2002), 98-99% of all bond trading took place in the OTC market. After adopting the measure, PDs increased bond dealings on the exchange market, shifting the ratio to 8 to 2 for the OTC to exchange market trading.

The OTC market refers to a market outside the exchange. There is no physical exchange like the KRX and purchase and sell orders are not concentrated, so it is difficult for laypeople to gain information about bonds traded in the OTC market. From retail investors' point of view, it appears similar to exchange trading given that the bonds are purchased or sold through financial investment firms. However, there are fundamental differences since the purchase and sell orders are not delivered to the KRX, and the financial investment firms become the counterparty to the retail investors.

The main participants in the OTC bond market are institutional investors, including banks, asset management companies, pension funds, and insurance companies. Institutional investors trade bonds through financial investment firms that serve as brokers. In other words, each institutional investor presents a bid/ask price to the financial investment firm they trade with and the investment firm matches the bid/ask price to complete the deal. The investment firms that serve as brokers exchange offers and bid prices among themselves, thereby facilitating trading. In other words, financial investment firms are central to facilitating bond trading in the OTC market among institutional investors.

Bonds are mainly traded through the OTC market since it is difficult to standardize them given the large number of bond types as mentioned above. Moreover, trading is conducted by a negotiated transaction. Another important factor is that the trading unit is traditionally KRW 10bn.

When the OTC bond market in Korea presents the bid/ask prices, the yield (interest rate) is presented as a quotation. KTBs, which have the highest liquidity, have a bid/ask spread (the difference between bid and ask prices) of approximately 1bp (0.01%).

Imagine a scenario where Asset Management Company A presents an ask price for a bond entitled "KTB0400-1206" at 4.50% and Pension Fund B presents a bid price of 4.51% to Brokerage House C. Brokerage House C delivers the bid price of 4.51% to Asset Management Company A, and delivers the ask price of 4.50% to Pension Fund B. After negotiations where interest rates are slightly adjusted, the transaction may be fixed with a yield of 4.50%. This marks a fundamental difference to the exchange market where transactions take place through competitive bidding. In the exchange market where primary dealers present an ask price, if there is a purchase order of the same amount or higher than the ask price, the transaction takes place automatically. In other words, the largest difference between the OTC market and the exchange market lies in the difference between the negotiated transaction (a transaction is fixed upon negotiation of the bid/ask terms) and competitive bidding method (transaction takes place automatically).

After a transaction takes place in the OTC market, settlement is made on the settlement date. Here the delivery versus payment (DVP) of the transaction amount and the securities form the majority of the settlements. In other words, the delivery of the bonds and the settlement are conducted simultaneously. Settlement is made through BOK-Wire, The Bank of Korea financial network, and bonds are delivered at the same time through transfers among escrow accounts through the KSD's SAFE-Line. The settlement date can range from T+1 to T+30, but mostly occurs at T+1. When foreign investors trade Korean bonds, the time differences result in T+3 and T+4 settlements being commonplace. Repo bonds, MMF bonds and retail bond transactions are all settled on the same day (T+0).

In the OTC market, there are inter dealer brokers (IDB) which are intermediaries among financial investment firms. Currently two IDBs, KIDB and KMB, have been licensed for IDB operations and they account for a portion of the OTC market. Originally, in developed nations, IDBs were brokers specializing in intermediating among dealers by steadily presenting bid and ask prices while holding their own bonds, thereby forming a market. In Korea, however, due to the absence of specialized dealers, the necessity for inter-dealer brokerage was not large. Accordingly, the authorities added bond brokerage to institutional investors to the services IDBs may offer. Currently their function is not different from that of financial investment firms.

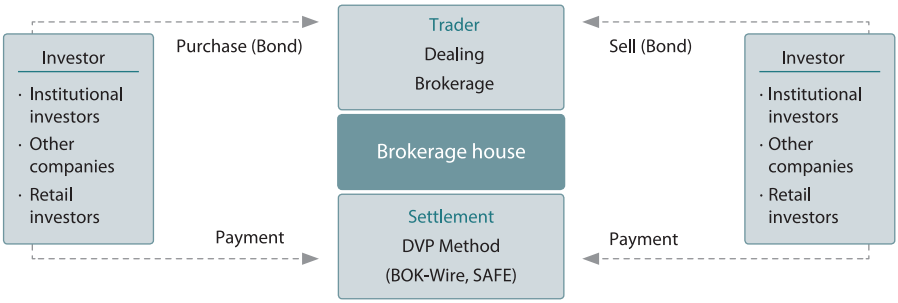
In December 2007, KOFIA introduced the OTC Bond Quotation System (BQS). BQS was introduced in order to increase transparency in the OTC

bond market. It concentrates and reports the bid and ask prices of all bonds with par value over KRW 5bn that are formed in the Korean OTC market. Then the collected bid/ask prices are disclosed to all market participants through KOFIA's Bond Quotation System (BQS, www.bqs.or.kr) and through information terminals (CHECK, INFOMAX, etc.). Before the introduction of BQS, transactions in the Korean market primarily took place through the exchange of bid/ask prices through Yahoo Messenger. This method of using instant messengers delivers information faster than other methods such as telephones, and is very efficient. However, it has been criticized for being closed off and not transparent given that they take place in separate messenger groups. Thus, in order to resolve this issue, the regulatory authorities and KOFIA introduced BQS with the consensus of market participants. As a result, the OTC market is now far more transparent.

The bond market needs to evolve in balance with the equity market to ensure the stable development of the capital market and capital-raising over the long term. In particular, an overhaul of the secondary bond market's infrastructure is urgently needed in order to prepare for the introduction of a wide variety of new bond-related products following the implementation of the FSCMA, and to reflect the different features of bonds (fund transaction, institutional investor market, price negotiations among participants, etc.).

For this reason, in October 2009, the FSC announced the "Plan for Improving the Secondary Market for Bonds", which focused on the bond trading system. Based on this, KOFIA has established and is operating FreeBond, an exclusive bond trading system. FreeBond, which consists of an instant messenger, a chat room and a trading board, enables financial investment companies, etc. to exchange quotations for trading/brokerage and negotiate with counterparties in the OTC market. As of April 2014, 200 institutions and 2,594 individuals were registered with FreeBond, of which 160 institutions and 1,432 individuals are active users. At this time, KOFIA is looking into the feasibility of implementing an ATS (alternative trading system) as part of the FreeBond platform. The introduction of a bond ATS is expected to bring various innovations and improvements to the secondary bond market, thereby reducing trading costs, enhancing the price discovery function of the bond market, improving market efficiency, etc.

CHART 6-1. STRUCTURE OF THE OTC BOND MARKET



2. Exchange Market

The Korean bond exchange market comprises of the inter dealer market (IDM) and the retail market. Among these markets, the primary dealers (PD) mainly participate in the IDM. Before the Asian financial crisis in the late 1990s, the Korean bond market was comprised mostly of corporate bonds. In 1998, during the financial crisis, the IMF bailout prompted the Korean government to announce "Measures to Improve Government Bond Policies and Vitalize the Bond Market". As part of the process to facilitate development of the government bond market, PDs were introduced in 1999 and the IDM was launched on the KRX.

Participants in the IDM are limited to financial investment firms and banks. The bid and ask order details presented by each dealer are collected and disclosed on the system, and transactions are made among dealers. The tick size is KRW 1 and uses the limit order method. The order quantity consists of whole number multiples of KRW 1bn. The market opens from 9:00 to 15:00, and transactions are made through individual competitive bidding using multiple prices, depending on the priority of best quotation and time principle from the presented bid/ask price. Settlement generally takes place through BOK-Wire and the bonds are transferred through escrow accounts at the KSD. As such, it is similar and yet slightly different from the OTC market DVP. In other words, the OTC DVP method settles the total amount for each transaction, while in the exchange market funds are settled depending on the participant and bonds are subtracted depending on the participant and [bond] issues. The settlement date is T+1.

In the ordinary bond market, transactions generally involve retail bonds, small-cap government and public bonds, and equity-linked corporate bonds, with ordinary investors being the main participants. Retail and small cap bonds are traded in units of KRW 1,000, while equity-related corporate bonds and ordinary bonds are traded in units of KRW 100,000. Transactions are concluded through individual competitive bidding, based on four types of competitive bidding principles, depending on the priority of price, time, brokerage, and quantity.

TABLE 6-1. DIFFERENCE BETWEEN THE OTC BOND AND EXCHANGE BOND MARKETS

	OTC		Exchange Market	
	Broker	IDB	Ordinary bond market	IDM
Trading party	No restrictions	Dealers, institutional investors, etc	Regular members KRX	PDs
Trading broker	Securities companies	IDBs	KRX	KRX
Main trading instrument	All bonds	All bonds	Small-amount government and public bonds, equity-linked corporate bonds	KTBs
Trading method	Negotiated trading	Negotiated trading	Competitive auction	Competitive auction
Quotation method	Yield quotation	Yield quotation	Price quotation	Price quotation
Trading hours	No restrictions, but usually 09:00 -15:30	No restrictions, but usually 09:00 -15:30	09:00 -15:00	09:00 -15:00
Settlement date	Next day (T+1-30). However, BWs, MMF-included bond transactions and retail bond transactions are same-day (T+0)	Next day (T+1-30)	Same day (T+0)	Next day T+1
Minimum trading unit	No restrictions, but usually KRW10bn	No restrictions, but usually KRW10bn	Retail/small cap bonds: KRW1,000 Others: KRW100,000	KRW1bn

Source: Korea Financial Investment Association, Korea Stock Exchange

II. THE CURRENT STATUS OF THE SECONDARY BOND MARKET

As described above, the Korean bond market consists mainly of the OTC market, with the ratio of the OTC transactions to exchange markets transactions at approximately 8-9:1 since 2004.

Bond transactions have steadily increased in Korea. In 2001, the annual

trading volume of the OTC and exchange market combined was valued at KRW 2,808tn. By 2004 it had reached KRW 3,363tn, demonstrating a sharp increase. While the trading volume decreased in 2007 to KRW 2,722tn, it has been continuously on the rise since 2009. In 2013, the trading volume stood at KRW 7,401tn.

If we look at how the percentages of different types of traded bonds have changed, government bonds account for a steadily increasing volume, approximately 60% of the trading volume after 2004. In other words, government bonds are dominant in the Korean secondary bond market. This is largely the result of various regulatory improvements following the Korean government's commitment to develop the government bond market. These include the introduction of fungible issues in May 2000, and the sustained increase in the amount of KTBs issued. Trading volume increased due to fungible issues, with their cycle being extended to six months from the previous three months, increasing their trading volume even further. In addition, the issuing volume of KTBs, which was a mere KRW 15tn in 2000, increased to KRW 34.5tn in 2003, KRW 62.6tn in 2005, and KRW 88.4tn in 2013. This led to a surge in KTB transactions.

Aside from KTBs, the primary drivers of the Korean bond market are government and public bonds, including government bonds, monetary stabilization bonds, special bonds, etc., which make up the largest share of bonds. This has pushed down the relative proportion of financial bonds and corporate bonds (including ABS) transactions. Financial bonds and corporate bonds accounted for 12.5% in 2004 and have maintained a similar level since. Although this occurred naturally with no-risk bonds such as KTBs and monetary stabilization bonds, etc. taking up a larger share in transactions, it is also true that the amount of corporate bonds has remained relatively low. Corporate bonds accounted for 14.7% of all transactions in 2000, and then slid to under 5% from 2004. In addition, among the various government and public bonds, KTBs have established their dominance, leaving a smaller share for special bonds and monetary stabilization bonds.

TABLE 6-2. ANNUAL TRADING VOLUME BY BOND TYPE

(Unit: trillion won, %)

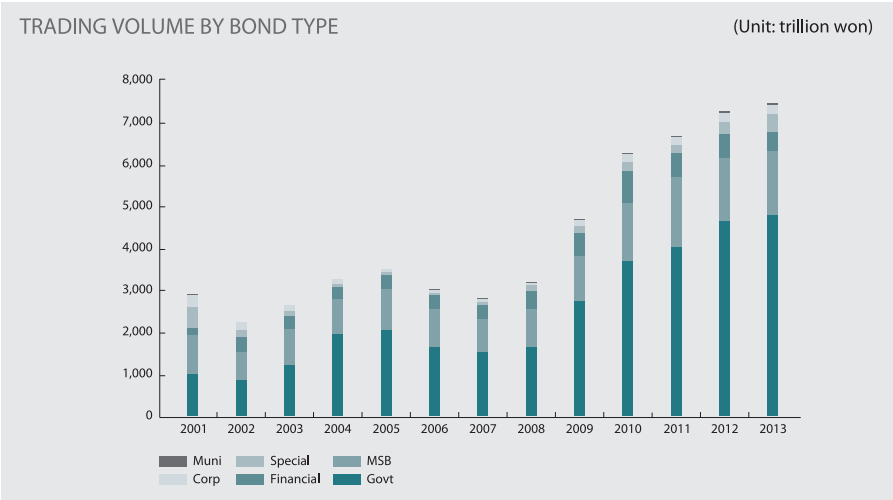
		2004		2005		2006	
		Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age
Govt. and public bonds	Govt. bonds	1,898.9	58.3	2,031.3	58.9	1,677.5	56.3
	Muni	11.5	0.4	10.3	0.3	10.7	0.4
	Special	96.6	3.0	78.8	2.3	62.4	2.1
	MSB	842.3	25.9	966.4	28.0	833.7	28.0
Financial		266.7	8.2	243.9	7.1	301.8	10.1
Corporate		139.2	4.3	116.6	3.4	92.2	3.1
Total		3,255.2	100	3,447.3	100	2,978.3	100

		2007		2008		2009	
		Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age
Govt. and public bonds	Govt. bonds	1,519.4	55.8	1,614.2	50.6	2,658.0	57.1
	Muni	11.5	0.4	14.9	0.5	18.2	0.4
	Special	61.2	2.2	124.2	3.9	203.9	4.4
	MSB	766.5	28.2	895.8	28.1	1,071.9	23.0
Financial		293.0	10.8	468.4	14.7	548.8	11.8
Corporate		70.3	2.6	73.4	2.3	150.8	3.2
Total		2,721.9	100	3,190.9	100	4,651.6	100

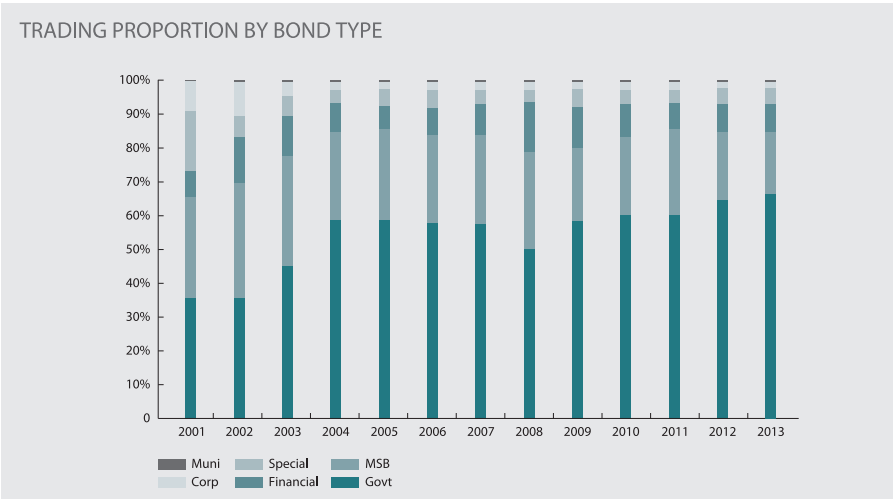
		2010		2011		2012		2013	
		Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age
Govt. and public bonds	Govt. bonds	3,703.4	60.2	3,937.5	59.7	4,628.3	63.9	4,897.6	66.2
	Muni	28.1	0.5	17.7	0.3	20.5	0.3	20.7	0.3
	Special	231.7	3.8	239.1	3.6	366.7	5.1	334.6	4.5
	MSB	1,403.7	22.8	1.606.8	24.4	1,485.1	20.5	1,399.8	18.9
Financial		628.0	10.2	589.3	8.9	512.9	7.1	534.0	7.2
Corporate		156.2	2.5	206.1	3.1	225.2	3.1	214.6	2.9
Total		6,151.1	100	6.596.5	100	7,238.8	100	7,401.3	100

Source: Korea Financial Investment Association, Korea Stock Exchange
Note: Sum of OTC and exchange trading (both sides)

GRAPH 6-1. ANNUAL TRADING VOLUME BY BOND TYPE



Source: Korea Financial Investment Association, Korea Exchange



Source: Korea Financial Investment Association, Korea Exchange

A comparison of the trading volumes in the OTC and exchange markets shows that a substantial change occurred when benchmark government bonds were required to be traded in the exchange market in October 2002. Prior to that, OTC transactions had a dominant share, but afterwards primary dealers conducted their benchmark government bond transactions through the exchange market, which pushed the percentage of exchange transactions up to 7.9% in 2003, a 5.7%p increase year-on-year. Since 2004, the percentage of

exchange transactions has remained at approximately 10%. The requirement for primary dealers to trade benchmark government bonds in the exchange market was repealed in July 2008 in order to increase transparency in the OTC market following the introduction of BQS for OTC traded bonds in December 2007. The proportion of exchange-based trading had been continuously decreasing since 2007, but began to grow again after 2010 on the back of increasing sources of bond demand, including foreign investors, and the promotion of Primary Dealers.

Although the ratio of OTC to exchange traded market transactions is approximately 8-9:1, a breakdown by bond type shows that transactions in the exchange traded market have concentrated on government bonds only. In short, other bond types such as monetary stabilization, special, financial, and corporate bonds excluding government bonds and municipal bonds (issued to raise capital for government projects, the purchase of which is mandatory) accounted for 0-3% of the entire exchange traded market. Government bonds, which account for an absolute share in the exchange traded market, have remained at approximately 20-30% since 2003. This is due to the government's development of the KTB market by introducing the primary dealer system. In particular, the large percentage of government bonds is the result of the requirement that only primary dealers may trade the benchmark index of government bonds on the exchange market. Seen from the perspective of institutional investors – the major participants in the Korean bond market – bonds other than KTBs, including monetary stabilization bonds, special bonds, financial bonds, corporate bonds, etc., are primarily traded in the OTC market.

TABLE 6-3. PROPORTION OF OTC AND EXCHANGE TRANSACTIONS

(Unit: %)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
OTC	88.4	89.4	90.1	86.9	88.3	89.2	90.5	87.6	81.4	82.3
Exchange	11.6	10.6	9.9	13.1	11.7	10.8	9.5	12.4	18.6	17.7

Note: Sum of OTC and exchange trading (both sides)

TABLE 6-4. BREAKDOWN OF OTC AND EXCHANGE TRANSACTIONS BY BOND TYPE

(Unit: trillion won, %)

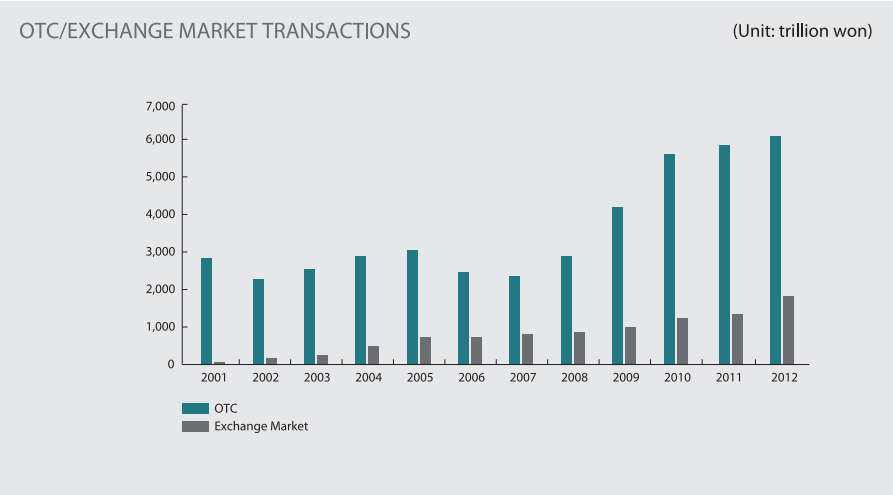
			2004		2005		2006	
			Trading volume	Percentage	Trading volume	Percentage	Trading volume	Percentage
Govt. and public bonds	Govt.	OTC	1,529.7	80.6	1,672.0	82.3	1,388.2	82.8
		Exchange	369.2	19.4	359.3	17.7	289.3	17.2
	Muni	OTC	5.7	49.6	6.7	65.0	6.9	64.5
		Exchange	5.8	50.4	3.6	35.0	3.8	35.5
	Special	OTC	95.5	98.9	78.5	99.6	62.3	99.8
		Exchange	1.1	1.1	0.3	0.4	0.1	0.2
	MSB	OTC	842.1	100.0	966.3	100.0	833.1	99.9
		Exchange	0.2	0.0	0.1	0.0	0.6	0.1
Financial		OTC	266.6	100.0	243.7	99.9	301.1	99.9
		Exchange	0.1	0.0	0.2	0.1	0.4	0.1
Corporate		OTC	138.1	99.2	114.8	98.5	90.9	98.6
		Exchange	1.1	0.8	1.8	1.5	1.3	1.4
Total		OTC	3,082.0	89.4	3,082.0	89.4	2,682.8	86.9
		Exchange	365.3	10.6	365.3	10.6	295.5	13.1

			2007		2008		2009	
			Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age
Govt. and public bonds	Govt.	OTC	1,173.2	77.2	1,251.8	77.5	2,166.1	81.5
		Exch-ange	346.2	22.8	362.4	22.5	491.9	18.5
	Muni	OTC	7.1	61.7	9.4	63.1	13.6	74.7
		Exch-ange	4.4	38.3	5.5	36.9	4.6	25.3
	Special	OTC	61.0	99.7	123.9	99.8	203.2	99.7
		Exch-ange	0.2	0.3	0.3	0.2	0.7	0.3
	MSB	OTC	765.0	99.8	894.1	99.8	1,069.8	99.8
		Exch-ange	1.5	0.2	1.7	0.2	2.1	0.2
Financial		OTC	291.3	99.4	465.8	99.4	547.7	99.8
		Exch-ange	1.7	0.6	2.6	0.6	1.1	0.2
Corporate		OTC	68.4	97.3	71.7	97.7	146.9	97.4
		Exch-ange	1.9	2.7	1.7	2.3	3.9	2.6
Total		OTC	2,366.0	86.9	2,816.7	88.3	4,147.3	89.2
		Exch-ange	355.9	13.1	374.2	11.7	504.3	10.8

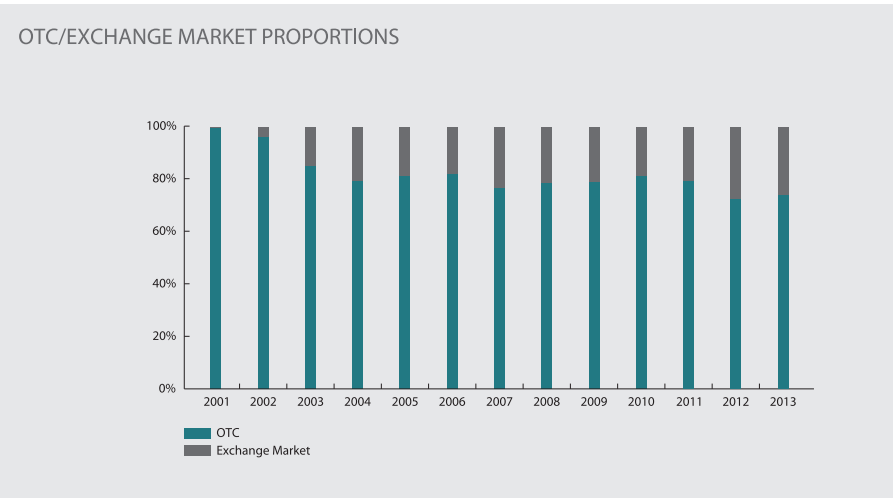
			2010		2011		2012		2013	
			Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age
Govt. and public bonds	Govt.	OTC	3,149.6	85.0	3,146.0	79.9	3,310.1	71.5	3,611.1	73.7
		Exch-ange	553.8	15.0	791.5	20.1	1,318.2	28.5	1286.5	26.3
	Muni	OTC	14.4	51.2	11.7	66.1	14.4	70.1	14.9	72.0
		Exch-ange	13.7	48.8	6.0	33.9	6.1	29.9	5.8	28.0
	Special	OTC	230.9	99.7	238.2	99.6	366.0	99.8	334.2	99.9
		Exch-ange	0.8	0.3	0.9	0.4	0.7	0.2	0.4	0.1
	MSB	OTC	1,392.6	99.2	1,596.8	99.4	1,469.7	99.0	1,386.6	99.1
		Exch-ange	11.1	0.8	10.0	0.6	15.4	1.0	13.2	0.9
Financial		OTC	627.0	99.8	588.0	99.8	511.9	99.8	533.9	100.0
		Exch-ange	1.0	0.2	1.3	0.2	1.0	0.2	0.1	0.0
Corporate		OTC	152.2	97.4	200.7	97.4	218.9	97.2	207.8	96.8
		Exch-ange	4.0	2.6	5.4	2.6	6.3	2.8	6.8	3.2
Total		OTC	5,566.7	92.5	5,781.4	87.6	5,891.0	81.4	6,088.5	82.3
		Exch-ange	584.4	9.5	815.1	12.4	1,347.8	18.6	1312.8	17.7

Note: Sum of both OTC and exchange trading (both sides)

GRAPH 6-2. COMPARISON OF OTC/EXCHANGE MARKETS

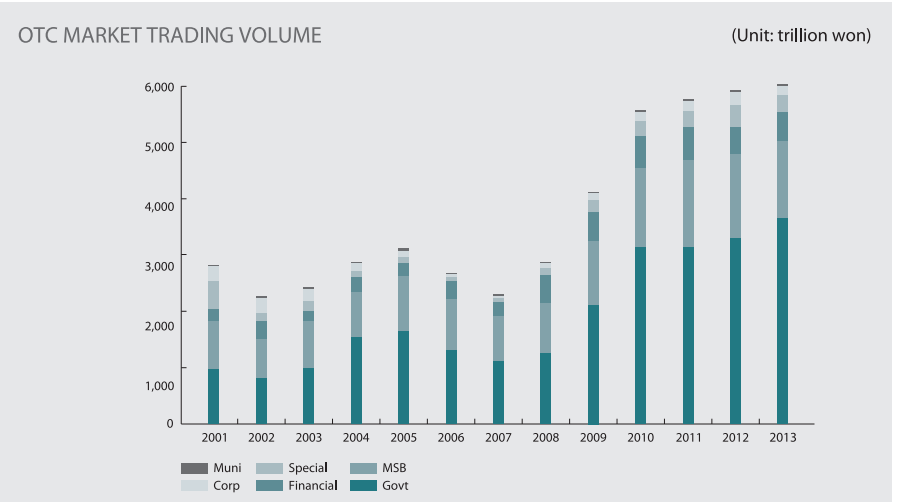


Source: Korea Financial Investment Association, Korea Exchange

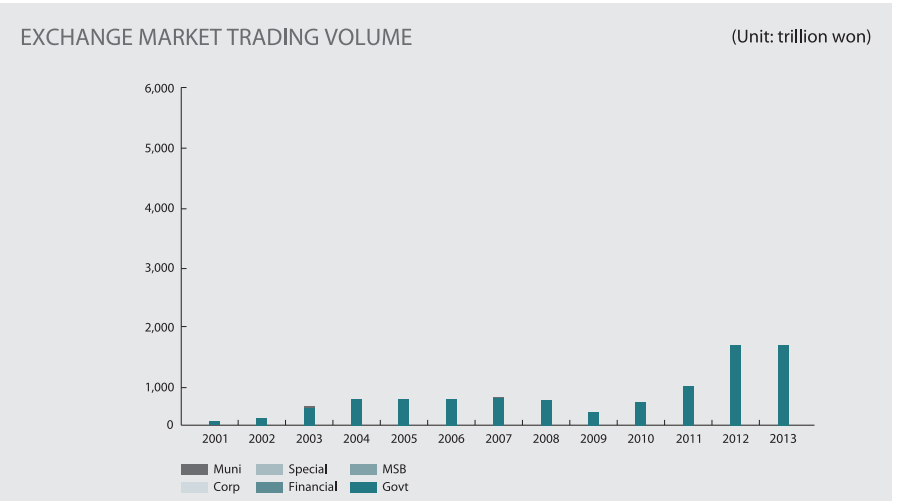


Source: Korea Financial Investment Association, Korea Exchange

GRAPH 6-3. OTC/EXCHANGE MARKET TRADING BY BOND TYPE



Source: Korea Financial Investment Association, Korea Exchange



Source: Korea Financial Investment Association, Korea Exchange

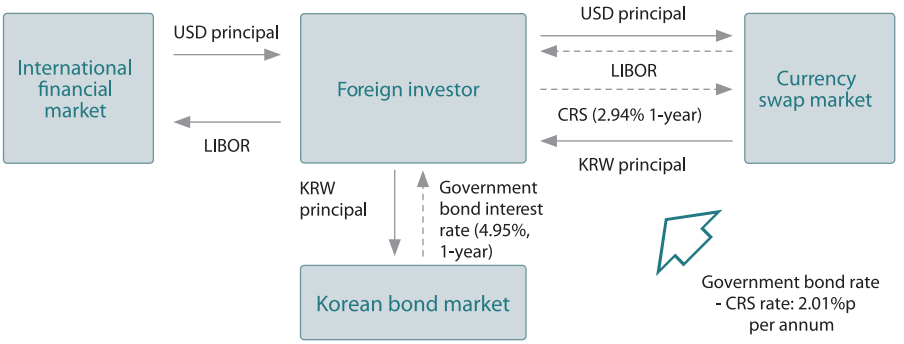
III. FOREIGN INVESTMENT IN THE KOREAN BOND MARKET

Foreign investment in Korean government bonds took off in full swing from the second half of 2007, when the distortion of the foreign currency market (swaps market) was exacerbated. Before then, foreign investment in Korean bonds had been insignificant and little noted. However, in the second half of 2007, the interest rates for currency swaps (CRS) dropped considerably due to a massive sell-off of forward exchange contracts for foreign exchange hedging purposes, driven by the then-booming shipbuilding industry, and growing investment in overseas funds. As a result, the swap basis (difference in the interest rates of CRS and interest rate swaps) was widened, giving substantial room for arbitrage transactions (non-risk arbitrage trading).

In the second half of 2007, the foreign currency market was characterized by an imbalance in supply and demand, as well as the July restrictions on foreign currency loans by Korean branches of foreign banks (cuts in the deductible expense limit from 6 times to 3 times on borrowings interest earned by the head office of foreign banks with branches in Korea). The U.S. subprime mortgage debacle that followed (from the end of July to the end of October 2007) added to the mix and exacerbated concerns of a credit crunch for the U.S. dollar. These multiple factors had a comprehensive effect, further pushing down interest rates for currency swaps, and expanding the swap basis even further.

With the wider swap basis, the market became conducive to managing capital in KRW, thereby generating arbitrage gains. Specifically, foreign currency capital was raised under Libor then swapped to KRW through a currency swap (fixed interest rate) and Korean bonds purchased. The difference between Korean bond rates and currency swap rates (CRS) determined the size of the arbitrage gains. The following chart shows that if a foreign investor raised dollars that matured in one year, swapped them into KRW in the currency swap market and then purchased one-year government bonds in KRW, the investor would make 2.01% (201bp) in arbitrage gains, or the difference between the 1-year government bond rate of 4.95% and the currency swap rate (fixed rate) of 2.94%.

CHART 6-2. PROCEDURES FOR FOREIGN INVESTMENT IN KOREAN BONDS (Example)



Evidence of how foreign investment in Korean bonds generally targets arbitrage transactions is that they are mainly in monetary stabilization bonds, which have short maturities (two years at the most). Although investment was mostly in government bonds in 2007, investment in monetary stabilization bonds became dominant in 2008 and 2009. However, the proportion of investment in government bonds has begun increasing gradually since 2010. From the point of view of foreign investors, they are the safest among Korean bonds. As such, government and monetary stabilization bonds are seen as identical. The slightly higher rate of monetary stabilization bonds, as compared with KTBs with the same maturities, appears to have been the appealing aspect, and it looks as if the effectiveness of having a short investment horizon for arbitrage trading influenced foreign investors.

Foreign investment in Korean bonds for arbitrage trading demonstrated explosive growth during the second half of 2007, continuing into the first half of 2008. However, the worsening global financial crisis, triggered by Lehman Brothers' filing for bankruptcy in September 2008, caused foreign investment in Korean bonds to decrease temporarily. However, with the stabilization of the global financial market from 2009, foreign investment in Korean bonds again began to rise.

Swap basis (1-year), which increased in the second half of 2007, remained in the 200-300bp range. However, in the second half of 2008, with the severe liquidity crunch, the swap basis temporarily surpassed 500bp. Although the size of gains available from arbitrage trading in simple numeric terms expanded rapidly, the deleveraging and rolling back of fiscal commitments by

foreign investors in their globally invested assets temporarily pushed down their scale of investment in Korean securities.

In February 2009, as part of its revision of policies aiming to increase foreign exchange liquidity, the Korean government made a bid to encourage foreign investment in Korean bonds by announcing tax exemptions for withholding corporate and income tax on interest income and transfer income when foreigners invest in government and monetary stabilization bonds. The relevant law was passed at the National Assembly in April and took effect from May 21, 2009. Accordingly, there was more incentive for foreign investment in government and monetary stabilization bonds. Foreign investment in domestic bonds accelerated further in 2010, stimulated by rapid economic recovery and the strong won. In 2011, tax exemptions for investment income for foreigners investing in government and monetary stabilization bonds were repealed, due to possible volatility in the financial market triggered by the increase in global liquidity concerns, and economic instability coming from excessive capital flows. However, given the current global trend of diversifying foreign currency assets in central banks and prospects for a strong won, the net foreign buying of domestic bonds continued, and the outstanding amount reached KRW 94.7tn by the end of 2013.

TABLE 6-5. INVESTORS' NET BUYING BY BOND TYPE (BASED ON OTC TRADING)

(Unit: trillion won)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Government	0.1	△1.5		1.0	1.4	2.2	21.1	1.4	13.3	24.8	19.6	6.7	12.4
Muni							0.1						
Special	0.1	0.1	0.2	0.1		0.1		0.6			1.8	1.1	-0.4
MSB	0.4	1.3	1.5	0.5		2.7	9.8	18.7	39.3	38.8	19.4	31.2	28.3
Financial		0.3	0.4	0.1	0.1	1.4	0.6	0.1	0.1	△0.7	0.6	0.1	
Corporate	0.1	0.2	0.6	0.1	0.3	△0.1	0.1	0.4			0.1	0.1	0.2
Total	0.6	3.5	2.6	1.8	1.2	6.5	31.7	21.2	52.5	64.3	41.5	39.2	40.5

Source: Korea Financial Investment Association

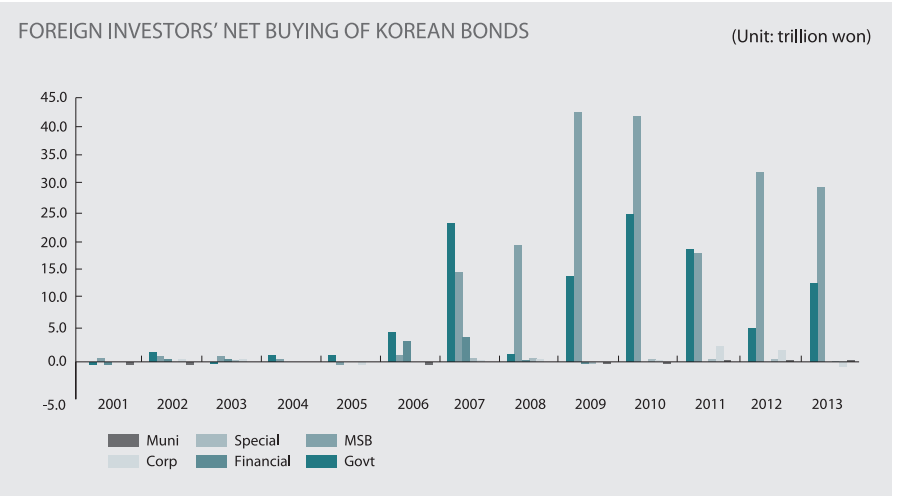
TABLE 6-6. FOREIGN INVESTMENTS IN DOMESTIC BONDS

(Unit: trillion won)

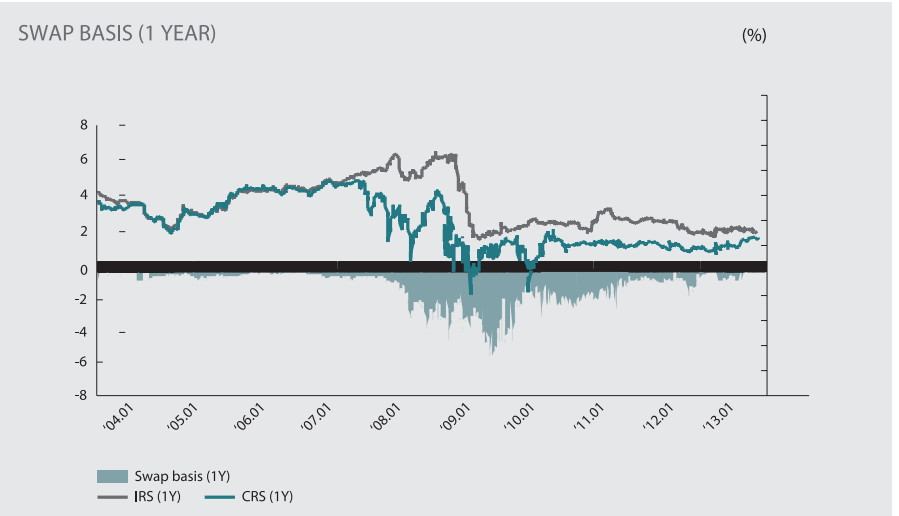
Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Amount	0.6	1.8	3.2	3.3	4.6	37.0	37.5	56.5	74.2	83.0	91.0	94.7

Source: Financial Supervisory Service

GRAPH 6-4. CHANGES IN FOREIGN INVESTMENT IN KOREAN BONDS

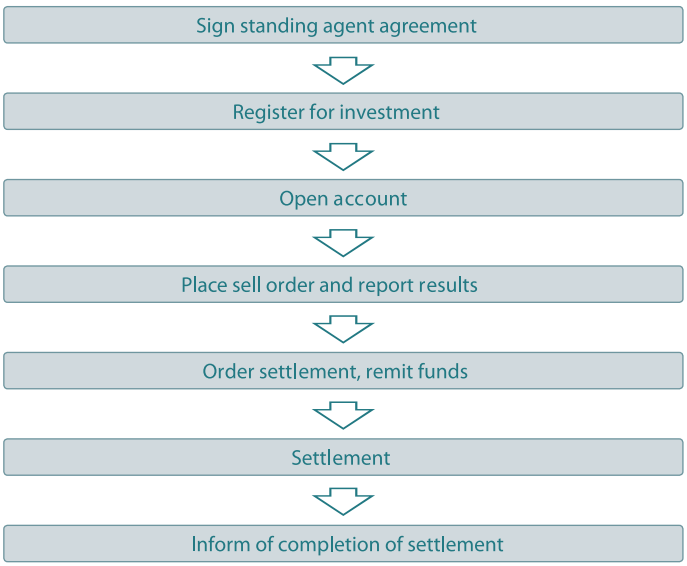


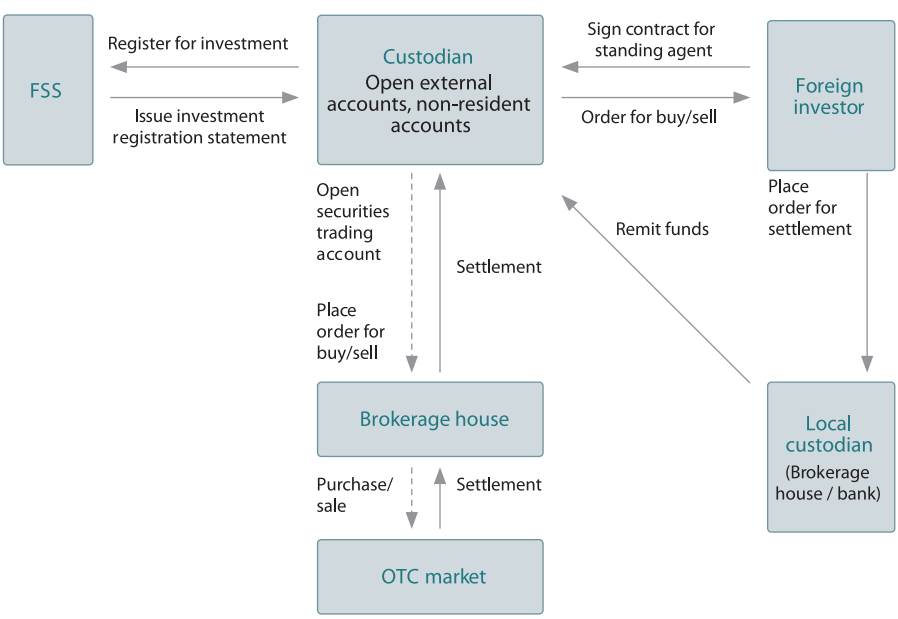
Source: Korea Financial Investment Association, Prebon



Source: Korea Financial Investment Association, Prebon

CHART 6-3. PROCEDURES FOR FOREIGN INVESTMENT IN THE KOREAN BOND MARKET





Note: 1) The measures include the phased introduction of the Alternative Trading System (ATS) to the Korean bond market. The early stage will be to establish an alternative trading platform by combining instant messenger and BQS functions – where market participants are able to search trading counterparts, and negotiate and confirm trades. In the long term, an ATS containing all the functions from signing to settlement will be created. ATS refers to an alternative trading platform to the regulated exchange.

2) Article 386 (2) of FSCMA: Any person other than the Exchange shall not establish markets or any other similar facility and shall not trade securities or exchange-traded derivatives through any other similar facility.

- Sign agreement for standing agent and domestic custodian: Foreign investor
  - Designate a standing agent who will handle all paperwork regarding securities transactions in Korea and a custodian who will store the purchased securities.
  - Qualifications for a custodian and standing agent:
    - Eligible institutions are banks dealing in foreign exchange-related issues, financial investment firms, asset management companies, futures commission merchants (FCM) and internationally recognized foreign custodians who have been approved by the Korea Securities Depository (KSD) and the Foreign Exchange Act.
    - Qualifications for standing agents are identical to the qualifications for custodians.
  - The custodian and standing agent may be separate institutions or they may be one institution that handles both activities.
- Investment registration: Standing agent
  - The standing agent receives a proxy from a foreign investor and the FSS issues an investment registration certificate.
- Opening an account: Standing agent
  - Foreign investors open an external account exclusively for securities investment and a non-resident account at a domestic custodian for foreign currency remittance and exchanges to KRW.
  - The standing agent opens a securities trading account at a brokerage house as a proxy to the foreign investor.
- Buy/sell order and report of buy/sell results
  - Directly by the foreign investor or through the standing agent.
  - Non-resident foreign investors report results of buy/sell transactions to the standing agent.
- Settlement order and remittance of settlement amount
  - Remittance of the foreign currency settlement amount to the domestic custodian by the foreign investor is followed by the domestic custodian exchanging it to KRW and settling it with the brokerage house.
- Settlement
  - DVP (Delivery versus Payment) in OTC market
    - Settlement is remitted through BOK-Wire or through the bank's current account; bonds are settled through transfer among accounts using the KSD's SAFE system.
- Notification of settlement completion
  - The custodian sends the settlement details to the foreign investor.

IV. KOFIA'S RECENT EFFORTS TO DEVELOP AN EFFICIENT OTC MARKET

1. FreeBond (launched in April 2010)

1) BACKGROUND

Similar to developed nations, the bond market in Korea has traditionally used telephone voice trading as the negotiated sale method. With the advances in IT technology after the Asian financial crisis, instant messenger programs became an important trading method, particularly among young brokers, as the advantages of speed and storage function became widely known.

This new method sped up the way trading is executed and enabled market participants to overcome limitations, contributing to the development of the Korean bond market. However, private instant messengers undermined price discovery function, and when they crashed or slowed down, the bond market as a whole was paralyzed. In addition, there were structural problems since it was difficult to adapt to the needs of market participants.

Against this backdrop, the financial authorities created a taskforce in March 2009 and announced the Reformation of Bond Trading Market that October, which aimed to establish a specialized bond trading system. Based upon this measure, KOFIA established the online bond trading system, FreeBond.

2) MAIN CONTENT

(a) Definition and Composition of FreeBond

FreeBond, operated by KOFIA, enables financial investment firms and market participants to discover quotes and supports trade negotiations. Participants refer to bond trading brokers, dealers, managers, and traders who apply to use the system and are approved by KOFIA pursuant to regulations on registration of financial investment companies.

In addition, KOFIA's operation enables continuous communication with market participants, better reflecting the needs of participants.

CHART 6-4. OPERATION OF FREEBOND

① Market participants discover bid/ask price on FreeBond and execute orders.
② Quote information is automatically transmitted to BQS.
③ The concentrated information is disclosed to the market through KOFIA's Bond Information System (BIS) and information vendors.

FreeBond comprises of two main components: the instant messenger and T-Board. Unlike private instant messengers, chat rooms are included in the system.

T-Board offers trading functions such as quote discovery, orders, negotiation and trade confirmation, book building, Qualified Institutional Buyer (QIB) support functions as well as analytical and reporting interfaces. Instant Messenger, a replacement of the current private messenger, provides functions specialized for bond trading including 1:N chatting and automatic storage of chatting records, on top of the general functions of a private instant messenger.

As part of the FSC's "Plan to Improve the Corporate Bond Issuance Market to Promote Investment Banks" (announced on Oct 17, 2011), the QIB system has been implemented, and book building has been made compulsory.

Accordingly, KOFIA developed the QIB trading system and the book building program on FreeBond, and began providing the services on May 2, 2012 and April 2, 2012, respectively.

The QIB system has been launched within the existing T-Board. To prevent the possibility of resale to non-QIB accredited investors, quotes discovery, orders, and trade confirmation for QIB securities are allowed only between QIBs. In addition, a screen displaying issuance disclosure information of QIB securities is provided, which facilitates easier use by classifying the information by issue, specific time period, disclosing institution, and issuing institution.
The book building program is also provided on FreeBond. When the Book

Runner/Lead Manager registers the corporate bond in the system, investors participate in the book building process on the basis of an expected interest rate band and expected issue price suggested by the lead manager. On the close of the book building period, the lead manager decides the final price and interest rates at which the QIB securities will be issued based on investors' orders. Investors can check the allocation results on the system. As lead management and underwriting performance data are accumulated within the program, effective capital market league tables will be provided to the market in the future.

(b) Characteristics of FreeBond

The major strengths of FreeBond are its specialization, security, and stability. In terms of specialization, the system can only be used by bond trading professionals in line with the Regulation on Business and Operation of Financial Investment Companies. When a financial investment company has registered and applies to use the system and receives approval from KOFIA, bond traders from that company are able to access FreeBond. Under this system, FreeBond can develop into a specialized system, unlike private instant messengers, which anyone can access. In addition, T-Board enables market participants to find real-time quotes, issues of interest, and information on bond issuance, and also offers a bulletin board for trading.

Unlike private messengers, chat histories and quotes are encrypted, preventing hacking from occurring. Furthermore, its use is managed by KOFIA's registration process, enhancing credibility in the system. To boost the stability of FreeBond, the system is backed up with double servers to prevent system failures from trade concentration, and it is managed around the clock.

3) EXPECTED EFFECTS

Broader use of FreeBond would result in a number of benefits. First, it significantly improves the bond trading infrastructure. The formalized and safer FreeBond not only boosts the security of bond trading, but also enhances the integration of the market, which had been fragmented by different messenger groups. In addition, transparency in bond prices is enhanced, as searches for quotes and trade checks are conducted automatically and quote information is disclosed in real time. Users can enjoy the ease and convenience of bond trading on FreeBond with less information asymmetry and handy price discovery and counterpart matching.

FreeBond is a market-driven system designed by bond traders for bond traders. The system enables frequent updates to embed necessary functions for trading, such as trading techniques and reporting functions. When FreeBond adds the settlement function and builds a global network with advanced bond trading systems in the future, foreign investors will find it more convenient to participate in the Korean bond market, and domestic financial institutions will be able to expand into overseas markets. This will eventually lead to the globalization of the Korean bond market. In addition, the use of bond market information concentrated in the system will make it possible to calculate real-time bond indices and facilitate the development of new products, such as bond ETFs and interest derivatives.

2. BondMall (launched in Feb. 2010)

1) BACKGROUND

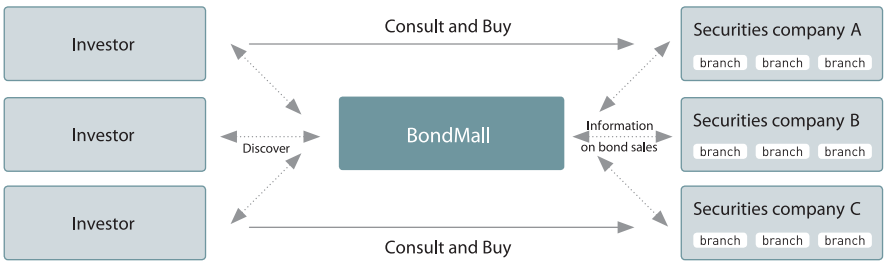
With Korea's aging population and low yield rates, high interest bonds such as corporate bonds are becoming popular with individuals and small investors. However, the retail bond market in Korea is dominated by small bond markets centered on securities firms and categorized according to the types of bonds, issuing entities, and credit ratings. Consequently, in 2009, the government and industry began discussions to find ways to reduce the excessive costs borne by investors searching for bonds (i.e. visits, telephone calls, internet searches), and opportunity costs arising from the failure to discover appropriate investments. The result was the launch of a specialized website (www.bondmall.or.kr) in February 2010, where information on retail bonds by securities firms is collected, compared, and disclosed.

2) MAIN CONTENTS

BondMall is an information concentration system on baby bonds. Its purposes are to reduce investors' market discovery costs by concentrating information on baby bond sales scattered across securities firms, and to improve investors' convenience by encouraging competition among securities firms.

- Name of the System: BondMall
- Domain: www.bondmall.or.kr
- Structure: Information on bond sales is offered in real time.
  (Transactions are conducted by securities firms)

CHART 6-5. BONDMALL STRUCTURE



3) EXPECTED EFFECTS

Investors will be able to enjoy reduced market costs and trade costs due to the collected information. In addition, competition will develop among the securities companies, so they will perceive bonds as an alternative investment method, leading to enhanced public access to bond investments. Backed by the popularity of bonds, securities companies will be able to develop new business models related to retail and IB, and see their marketing costs reduced. Issuing companies on the other hand can capitalize on a new investor base to issue bonds more readily and enjoy additional promotion effects through their exposure on BondMall.

4) ACHIEVEMENTS

As of May 2014, approximately 730 issues are posted daily on average on Bondmall, indicating that securities firms are actively using BondMall as a major distribution channel. A breakdown of the issues shows that local and government bonds guaranteeing stability and profitability take the lion's share, while corporate bonds represent a mere 7%, as the issuance of corporate bonds is limited to bonds with credit ratings of A or higher to protect investors.

V. BOND MARKET INFRASTRUCTURE

1. Credit Rating

1) CORPORATE BOND RATING

When a company issues corporate bonds, it is required to obtain a credit rating from a specialized credit rating agency for all non-guaranteed bonds. This is done to ensure fair pricing of bonds based on the creditworthiness of issuers. Also, investors will have access to an independent evaluation and assessment of bonds, which in turn enables investors to make informed investment decisions.

Bonds are rated in 10 grades depending on how much of the principal and interest is payable, from AAA to D. Grades AAA to BBB indicate the principal and interest are deemed to be recoverable, while BB to C are classified as speculative as they are heavily influenced by changes in the investment environment.

TABLE 6-7. CORPORATE BOND GRADES AND DEFINITIONS

Grade	Definition
AAA	Highest ability to repay principal and interest
AA	Excellent ability to repay principal and interest but slightly less than AAA-rated bonds
A	Very good ability to repay principal and interest but vulnerable to economic conditions and environment
BBB	Good ability to repay principal and interest but possibility exists of economic conditions and environmental deterioration lowering its ability to repay principal and interest going forward
BB	Although its ability to repay principal and interest is not immediately problematic, the bond has speculative factors since stability going forward is not guaranteed
B	Ability to repay principal and interest are lacking; is speculative; in recession repayment of interest is not certain
CCC	Uncertainties currently exist in its ability to repay principal and interest. Highly speculative given the high risk of default
CC	Higher uncertainty factors exist compared with the upper grades
C	High risk of default; lacks ability to repay principal and interest
D	Unable to repay

Source: Korea Investors Service (KIS)
Note: Among the above grades, AA to B are marked with the signs + or – to denote the superior or inferior recoverability of principal and interest

2) COMMERCIAL NOTE RATING

The decision to invest and issuance conditions are determined by the credit rating given to issuers of commercial paper, which is issued to raise short-term operating funds. Accordingly, the government has selected objective credit rating agencies to rate the credit of the issuing companies and disclose the results in order to develop the commercial note market into a market where blue chip companies may raise short-term capital. This rating is used to protect investors, to enable financial institutions to serve as brokerages, and to ensure the financial soundness of management.

Companies that seek to obtain short-term financing from merchant banks, securities companies, and banks by issuing commercial paper are required to undergo credit assessments for their commercial paper. Credit rating grades for commercial paper are used to determine the soundness of the commercial paper and are used as criteria for deciding terms and conditions of issuance.

Credit ratings for commercial paper comprise six grades, from A1 to D. Among the grades, A1 to A3 are investment grades that recognize the issuers' ability to repay the principal and interest in a timely manner; B and C are speculative grades, evaluating that on-time repayment of principal and interest is heavily influenced by changes in the environment.

TABLE 6-8. COMMERCIAL NOTE GRADES AND DEFINITIONS

Grade	Definition
A1	Best ability to repay on time and best stability of repayment ability
A2	Very good ability to repay on time but stability slightly inferior to A1
A3	Good ability to repay on time with good stability but inferior to A2
B	Adequate ability to repay on time but speculative issues exist in its stability depending on short-term changes in conditions
C	Highly speculative issues regarding the ability to repay on time and in its stability
D	Cannot repay

Source: Korea Investors Service (KIS)
Note: Among the above grades, A2 to B are marked with the signs + or – to denote the superior or inferior ability to repay principal and interest.

3) ELECTRONIC SHORT-TERM BOND RATINGS

Electronic short-term bonds, which are electronically issued bonds with a maturity of one year or less, were introduced on January 15, 2013, pursuant to the Act on Issuance and Trading of Electronic Short-Term Bonds, in order to complement the shortcomings of commercial paper, such as the tendency to have weak consumer protection and distribution. These bonds are quickly replacing commercial paper as a major source of short-term financing. The same credit rating grades and definitions for commercial notes are applied to electronic short-term bonds, and are used as criteria for determining terms and conditions of issuance for issuers based on their ability to redeem short-term debt, taking into consideration their operational status and risk of facing a liquidity crisis.

4) ASSET-BACKED SECURITIES RATING

Asset-backed securities (ABS) are given credit rating grades the same way as non-guaranteed corporate bonds or commercial paper, depending on the type (ABS and ABCP). The credit rating system and definitions are the same as the system and definition of non-guaranteed corporate bonds and commercial paper, thereby easing decisions on the issuer's ability to repay principal and interest on the asset backed securities.

TABLE 6-9. KOREAN CREDIT RATING AGENCIES

	Korea Ratings	KIS	NICE	SCI
Capital	KRW24.45bn	KRW5bn	KRW5bn	KRW17.75bn
Website	www.korearatings.com	www.kisrating.com	www.nicerating.com	www.sci.co.kr
Largest shareholder	Fitch (73.55%)	Moody's (50%+1 share), NICE Infra Co., Ltd. (50%-1)	NICE Holdings (100%)	Jinwon E&C (45.91%)
CEO	Yoon In-sub	Jo Wang-ha	Lee Sang-gwon	Joo Sung-do
Initiation of operations	Nov. 1987	Sep. 1985	Jun. 1987	Established in Apr.1992 Began credit assessment from Jan. 2000
Bonds for evaluation	Corporate bonds, CP, ABS, Electronic short-term bond	Corporate bonds, CP, ABS, Electronic short-term bond	Corporate bonds, CP, ABS, Electronic short-term bond	CP, ABS
Partner companies in credit assessment	Fitch	Moody's	Japan- R&I, China- Dagong Rating	Japan JCR

Note: As of the end of March 2014

2. Mark-to-Market Valuation of Bonds

1) SUMMARY

In November 1998, after the Asian financial crisis, the government introduced the mark-to-market valuation in order to enhance the transparency of trusted asset management, secure confidence, and raise the asset quality of financial institutions. Before the mark-to-market system was introduced, bonds were evaluated on book value. This method prompted questions on its accuracy given that it derived a mathematical average of the principal and interest during the time it was held, regardless of any changes in the value of the bonds due to interest changes in the market. This resulted in a difference between the market price and book value and became problematic when it was sold before maturity or if a company went bankrupt.

Mark-to-market aligns market value and valuation by assessing the value of a bond by reflecting changes in the interest and credit of the issuer. Bond prices change depending on the market interest rate, akin to daily fluctuations in the price of equity. Mark-to-market refers to evaluating this changing bond price and using the market or fair price.

To this end, KOFIA announced the "mark-to-market base yield" in November 1998 in order to enhance the mark-to-market system. After valuations by bond rating agencies became mandatory in 2004, KOFIA halted its mark-to-market efforts/reporting and changed its mark-to-market base yield to types of bonds, yield to maturity (YTM), and market yield, which is a type of reference yield KOFIA discloses. From November 2009, the companies reporting yields changed from financial investment firms to credit assessment companies.

In addition, KOFIA has also been monitoring the valuation price of each credit rating agency according to its sampling standards, aiming to evaluate each bond rating agency as per the "Regulations on the Operations and Business of a Financial Investment Company". The results are reported to each company and to the FSS. These results are posted at KOFIA's Bond Information Service (www.kofiabond.or.kr) each quarter.

2) PRIVATE CREDIT RATING AGENCIES FOR BONDS ESTABLISHED

In July 2000, the FSS designated three companies - KAP, NICE P&I, and KIS Pricing - to implement the mark-to-market policy by providing the

market value of all bonds held by financial institutions, thereby increasing the effectiveness of the mark-to-market policy's risk management. The three companies have been rating bonds since November 2000. Currently, there are four FSS-designated credit rating agencies, as Fn Pricing began to provide the mark-to-market base yield in April 2012.

TABLE 6-10. KOREAN BOND RATING AGENCIES

Name	KAP	KIS Pricing	NICE P&I	Fn Pricing
Capital	KRW5.32bn	KRW3bn	KRW3.02bn	KRW5bn
Largest shareholder	TWOSUN PEF1	KIS	NICE	Fn Guide
CEO	Lee Hak-gyun	Kim Seon-dae	Hong Woo-sun	Choi Won-suk

Note: As of the end of December 2013

3) EFFECTS OF BOND MARK-TO-MARKET VALUATION

(a) Vitalizing the Secondary Bond Market

With bond transactions being limited to a few issues, the trading of certain issues that had not been purchased or sold recently often plunged due to price uncertainty. However, with the mark-to-market policy resulting in the disclosure of the fair prices of all issues, their prices were benchmarked and trading became reinvigorated. In addition, with the price of bonds and the value of funds changing each day, financial institutions started trading bonds proactively, avoiding the previous practice of holding them until maturity.

(b) Energizing the Primary Bond Market

Previously, the trading of corporate bonds was sluggish, and despite the bond ratings, trading prices were uncertain, making setting yields difficult. This depressed lead managers' business and underwriting. However, due to the introduction of the mark-to-market policy, the fair prices of issued corporate bonds given by bond rating agencies are now benchmarked as market prices. This has facilitated greater issuance of corporate bonds.

(c) Facilitating New Product Development

Providing fair prices for new products that are issued in response to market demands, including option embedded bonds, swaps, and structured notes, has

facilitated the issuance and distribution of these products. It has also enabled the design of structured notes and pricing models to be presented to financial institutions and the market, thereby facilitating investment and new issuances. In addition, it has provided market prices and spot yield curves, which are the basics of risk management and enable the prior analysis of risk factors for new products.

(d) Enhancing the Transparency and Expertise of the Investment Trust Industry

The practice of mark-to-market pricing of bonds included in funds has enhanced the transparency of fund management. It has also promoted specialization in bond investments and the rational valuation of investment performance, thereby raising investor awareness of trust products. In addition, through mark-to-market pricing of held bonds, the rational valuation of assets was enabled, providing market values to all bonds held by financial institutions, and thereby increasing the effectiveness of the mark-to-market policy's risk management.

3. Delivery Versus Payment

The settlement of bond purchases in the OTC market is possible from the same business day, to the following business day (T+1), through to the 30th business day (T+30) under the agreement between the parties in the transaction. T+1 is most common. However, repo, retail bonds, and MMF-inclusive bond transactions may be settled the same day.

Settlement of bonds in the OTC market is done by the Delivery versus Payment (DVP) system of securities and payment, which aims to simultaneously deliver the bonds and settle the payment in order to increase the safety and efficiency of bond trading.

Introduced in November 1999, DVP involves simultaneous bond settlement, where remittance between the customer's account using the KSD's SAFE system and settlement using a BOK-Wire account takes place at the same time. In other words, the KSD sends the securities for sale to the purchasing institution's escrow account from the selling institution's escrow account, while the purchasing institution orders the BOK to remit the settlement to the selling institution through their current account at the KSD.

4. Bond Registration

Bond registration refers to bond holders or their interested parties not holding the actual bond certificates, but instead registering their rights as bond holders, including the holder's name, address, and bond amount on the bond registry, at a registration institution, thereby securing rights as a bondholder and enabling the investor to assert his/her rights with the issuer or a third party.

Through the bond registration policy, the bond issuer can reduce the issuing expenses and the relevant paperwork while retaining his or her rights, reduce the risk of fraud, and ensure early liquidity. In addition, seen from the perspective of the entire market, the actual bond certificate has been eliminated, which reduces the burden of managing the bond certificates for the relevant parties, including the issuer, investor and depository, etc. In addition, there is no need for the frequent transportation of bond certificates, which facilitates bond circulation. Thus, the costs required for handling, shipping, and storing bond certificates are cut, reducing overhead cost.

According to the Enforcement Decree of the Registration of Bonds and Debentures Act, the KSD performs the registrations, and according to the General Banking Act, the registering institutions are financial institutions, including the Korea Development Bank and the Industrial Bank of Korea.

5. Loan Transactions

Loan transactions for bonds refer to transactions where bond holders loan commodity bonds to investors who desire them for a certain amount of time. After the period ends, the original bond holder receives the relevant bonds back. The bond leaser can secure a commission fee by lending its bond holdings, while the lessee can use the leased bond for his or her own end, thereby increasing utility of the bond.

Securities for loan transactions are stock or bond certificates or beneficiary certificates that are listed on the exchange market or on KOSDAQ. However, it excludes equity-linked corporate bonds and bonds that mature during the loan period. However, if the lessee is an institutional investor (including

financial investment companies) the certificates for loan transactions may be designated otherwise upon agreement by the involved parties.

If the financial investment company (dealer, broker, KSD, brokerage house, etc.) is a relevant party to the loan transaction or is a broker to such transactions, the initial collateral ratio and maintenance collateral ratio, which the lessee must pay the lessor, may be decided upon agreement; however, it must be over 100%. If the counterparty to the financial investment company, etc. is a professional investor, the terms and conditions may be decided differently upon mutual agreement.

The financial investment company must report the status of the securities, and the issues and quantity of loan transaction securities to KOFIA, which discloses them in an announcement.

6. The Role of KOFIA

KOFIA, based on the FSCMA, FSC Regulations under the FSCMA, and FSC Enforcement Rules under the FSCMA, manages the information related to the transactions of bonds and their disclosure. Through these actions, KOFIA enhances the price discovery function of the OTC bond market and increases price transparency. In addition, KOFIA is working toward developing a wide variety of policies in order to help the development of the Korean bond market.

1) DISCLOSURE OF OTC TRADE EXECUTION DETAILS

After a brokerage house sells a bond in the OTC market, it must report to KOFIA the details of the transaction within 15 minutes, categorized by the nature of the transaction. KOFIA then discloses this information. The disclosure mandate was introduced in 2000 to enhance market transparency and increase credibility in trade prices.

Behind the introduction of the 15-minute rule were aspirations towards enhancing market transparency and encouraging more bond derivatives on the market. Previously, the details of a transaction were reported to KOFIA after 15:00, when the market was closed. Under such a system, transaction details could not serve as market information in a timely manner, undermining

discovery function of the appropriate price, which hindered the development of bond derivatives.

In 2000, when the disclosure of trade execution details was introduced, the details of the transaction had to be reported within 30 minutes. This was reduced the following year to within 5 minutes, and then settled to within 15 minutes in 2002. In order to increase the accuracy of reporting details of OTC bond transactions, KOFIA has created the Bond-Trade Report & Information Service (B-TRiS), which enables real-time management of data between KOFIA and financial investment companies.

As of April 2014, an average of 4,000-5,000 daily transactions are reported through the 15-minute rule. The 15-minute rule not only enhanced market transparency, but reduced the cost of searching for price information. Furthermore, it increased the pace of the information distributed through the real-time provision of issues, trading volume, yields, and investor categorization codes, and encouraged more investors to trade bonds.

2) DISCLOSURE OF OTC QUOTATION INFORMATION

Besides the 15-minute rule, which promotes post-trade transparency, it was also necessary to introduce a service for enhancing pre-trade transparency so that market transparency in general and liquidity could be enhanced. Therefore, KOFIA introduced the Bond Quotation System (BQS) in 2007.

At the time of the introduction, most OTC bond trades were made using private instant messenger services, such as Yahoo, as the main negotiating method. Compared to telephone negotiations, private instant messengers contributed, in part, to a reduction in bid/ask spreads and increased liquidity. However, they were also comprised of multiple messenger groups, and thus dispersed liquidity and made it difficult to access market quotation information in real time. In fact, private messengers served as an entry barrier for new participants such as retail investors and foreigners. Therefore, the government announced the introduction of the disclosure of OTC quotation information in line with the Reformation of the Bond Trading Market (December 12, 2006).

KOFIA requires financial investment firms (including banks and merchant banks) as well as IDBs to report, in real time, all the information on quotes and exercise prices of all bonds traded in the OTC market through FreeBond. Through this system, all OTC quotes are collected and disclosed, enhancing

the function of price discovery and increasing transparency and liquidity in the OTC market.

3) DISCLOSURE OF FINAL QUOTATION YIELDSC.

When the market closes, KOFIA posts the final quotation yield of each bond that is represented on the Korean bond market on its Bond Information Service. Thus, they can be used as major indices for economic policies, financial institutions' asset management, and the appraisal of investment performance (tallied at 11:30 and 15:30 each working day/disclosed at 12:00 and 15:30 each working day).

In addition, to help energize the OTC bond market, KOFIA discloses base yields that are used for daily closings and derives the final settlement price for interest rate futures (3-yr, 5-yr, 10-yr), and market-making quotation yields for bond-specialized dealers. KOFIA also discloses CP transactions information management, yields and indices, CD yields and transaction status, customer RP transaction status, and intermediary transactions of RP among institutions.

Since February 2009, KOFIA has disclosed default rates and recovery rates to enhance the price discovery function of the high-yield bond market, and promote the development of new bond-related products, and to use as raw data for risk management. In addition, from June 2009, KOFIA has provided real-time bond indices, enabling real-time assessment of the bond market and the development of new index-linked bond products, including ETFs. Related to this, the first Korean KTB ETF was listed on the KRX on July 29, 2009.

4) RELEASE OF BOND MARKET INDICES

KOFIA developed various bond market indices in January 2006, and announces them each month. The indices serve as warnings to detect potential risks in the bond market, thereby enabling bond market participants to systematically forecast market movements, credit risks, and fund concentration levels. The indices involve the Bond Market Survey Index (BMSI), Herfindahl Hirschman Index (HHI), and the Market Credit Risk Index (MCRI).

BMSI involves the formation of an Opinion Leader Group comprised mainly of bond market insiders who are surveyed on their market forecasts. The results of these analyses are quantified for BMSI. They are used to diagnose and forecast benchmark interest rates, foreign exchange rates, and prices. HHI

analyzes and quantifies fund concentration levels in the bond market, and is used to prevent credit risk from the concentration of bond issuance on a particular industry, etc. The Market Credit Risk Index categorizes bond issuers by credit rating and industry, then their credit risks are gauged, based on their spread, and are quantified. This provides information on credit risks for the entire bond market and for each industry.

5) OPERATION OF BOND INFORMATION SERVICE

The Bond Information Service (BIS: www.kofiabond.or.kr) operates to provide overall information on the bond market, including issuance and circulation of bonds. KOFIA uses BIS to balance the availability of information in the bond market and increase access to information, thereby serving as a comprehensive portal site to bond market information. In addition, by operating an English website, it gives foreign investors easy access to Korean bond-related information.

KOFIA also contributes to the protection of bond investors through the standard debenture entrustment contract, which sets forth the roles and responsibilities of the trustees and monitors whether they are maintaining their ability to repay the principal and interest on their loans. When an event of default occurs for the issuer, which is one of the major details of an entrustment contract based on relevant provisions in the contract, the trustee announces this information to the trust and BIS, which enables notification to all the investors.

6) OPERATION OF REAL-TIME BOND INDICES

Bond indices are indicators of changes in investment yields in the bond market over a certain period of time, and fluctuate along with changes in bond yields. Real-time bond indices reflect bond quotation information (buy, sell, execution) in real time, and are used as a tool to assess the real-time trend of the bond market and as a benchmark index for ETFs. The calculation of real-time bond indices has been made possible by the launching of KOFIA's BQS. Currently, seven types of real-time bond indices are provided, which are calculated using the source information on the BQS.

TABLE 6-11. STATUS OF REAL TIME BOND INDICES

Index	Participating Organization	Update Interval	Source	Starting Index (Point)	Base Date
MKF KTB Index	Maeil Business Newspaper Fn Guide KOFIA	30 sec	KOFIA BQS	100	Jun 16, 2004
KEBI KTB Index	Hankyung KBP KOFIA	5 min	KOFIA BQS	100	Jun 30, 2009
MK MSB Index	Maeil Business Newspaper KIS Pricing KOFIA	1 min	KOFIA BQS	10,000	Jan 2, 2010
MK MM Index	Maeil Business Newspaper KIS Pricing KOFIA	1 min	KOFIA BQS	10,000	Jun 1, 2010
KOBI Credit Index	KIS Pricing KOFIA	1 min	KOFIA BQS	10,000	Sep 1, 2010
KRW Cash Index	Fn Guide KOFIA	30 sec	KOFIA BQS	100	Jan 2, 2006
KIS MSB 3M Index	KIS Pricing KOFIA	1 min	KOFIA BQS	10,000	Jan 1, 2012
KAP Barbell Index	KAP KOFIA	1min	KOFIA BQS	100	Jun 30, 2009
KAP MM Index	KAP KOFIA	1min	KOFIA BQS	100	Dec 31, 2011
KIS MSB Index	KIS Pricing KOFIA	1min	KOFIA BQS	10,000	Jan 1, 2013
KIS MSB 5M Index	KIS Pricing KOFIA	1min	KOFIA BQS	10,000	Jan 1, 2013

There are eleven real-time bond indices set up based on the indices using KOFIA's BQS as a source, and with the exception of the KEBI KTB index, 10 are used as benchmark indices for bond ETFs. As of May 20, 2014, 10 bond ETFs are listed on the Korea Exchange, with a total market capitalization of KRW 2.4332tn.

TABLE 6-12. BOND ETF STATUS

ETF	Asset Manager	Benchmark Index	Market Cap* (KRW 100 mil)	Current Price* (KRW)	Listing Date
KODEX TB	Samsung Asset Mgt.	MKF KTB Index	488	54,230	Jul 29, 2009
KOSEF MSB	Woori Asset Mgt.	MK MSB Index	1,206	101,345	Jan 14, 2010
KOSEF Short Term Money	Woori Asset Mgt.	MK MM Index	1,332	101,295	Jul 29, 2010
Kstar High Grade Corporate Bond	KB Asset Mgt.	KOBI Credit Index	547	103,255	Apr 11, 2011
KODEX Short Term Bond	Samsung Asset Mgt.	KRW Cash Index	11,162	101,025	Feb 22, 2012
TIGER Monet Market Fund	Mirae Asset Mgt.	KIS MSB 3M Index	4,694	101,030	May 16, 2012
ARIRANG Barbell Bond	Hanwha Asset Mgt.	KAP Barbell Index	1,436	101,835	Dec 19, 2013
ARIRANG Short Term Bond	Hanwha Asset Mgt.	KAP MM Index	1,752	101,100	Dec 19, 2013
KINDEX Short Term Money	Korea Inv. Mgt.	KIS MSB Index	704	101,030	Dec 23, 2013
Kstar Short Term MSB	KB Asset Mgt.	KIS MSB 5M Index	1,011	100,060	May 19, 2014

* Based on the closing price of May 20, 2014.

CHAPTER 07

DERIVATIVES MARKET

I. INTRODUCTION

1. Definition of Financial Investment Products

The Financial Investment Services and Capital Markets Act (FSCMA) defines financial investment products by adopting an inclusive approach for the different types of financial products. The concept of "investment risk" was introduced to enable financial investment companies to more actively pursue the development and sale of new financial investment products. In addition, the FSCMA stipulates that a financial investment instrument is composed of the following four elements – the intention of investment, investment risk, transfer of money, and rights stipulated in an agreement.

First, a financial investment instrument shall be operated with the intention to earn profit and avoid loss. Second, a financial investment instrument shall contain an investment risk, which is defined as the possibility of a loss of principal. Specifically, investment risk refers to the possibility that the total amount of money paid or payable for the acquisition of a financial investment

instrument might exceed the total amount of money recovered or recoverable from a financial investment product, depending on market risks arising from fluctuations in prices, interest rates, f/x rates, etc. This definition renders all financial instruments bearing the possibility of a loss of principal subject to the FSCMA.

Third, a financial investment instrument shall entail the payment of money or any other form of assets at a specific time in the present or future. Unlike traditional products, such as stocks, where payments are involved upon the start of the investment, payments for derivatives can be initiated at a specific time in the future. In this regard, the timing of the payment is defined as "in the present or in the future" in the FSCMA to cover new products such as derivatives. Fourth, the FSCMA states that a financial investment instrument is a right acquired by an agreement. As a result, risk arising from matters occurring outside of the agreement such as credit risk cannot be included as an element constituting a financial investment product.

2. Definition of Derivatives

A derivative is a financial instrument that is derived from other assets, which are referred to as underlying assets. In general, contracts on financial instruments such as foreign currencies, bonds, and stocks reflect the market value of the instruments at the time of the agreement, and payment for acquiring them is made no later than a week from the contract date. But derivatives are different from general products in several aspects. For example, a forward contract - a form of derivative - is an agreement to buy or sell an asset on a future date at a price specified at the time of the agreement. Another example is an option, which is a contractual right given to an individual allowing him or her to buy or sell an underlying asset at an agreed price on or before a certain date.

Derivatives came into existence with the trading of agricultural futures in Chicago in the middle of the 19th century. Later, underlying assets were expanded into foreign currencies, bonds and stocks, which heralded the advent of financial futures, beginning in the 1970s.

Foreign currency futures traded at the Chicago Mercantile Exchange (CME) in May 1972 marked the start of financial futures. In October 1975, the Chicago Board of Trade (CBOT) began trading interest rate futures with Government

National Mortgage Association-Collateralized Depository Receipts (GNMA-CDR), a type of collateralized debt obligation. The financial futures market dealing with short-term financial instruments also appeared with the launch of Treasury bill futures on the International Monetary Market (IMM) of the CME in January 1976.

Financial futures are used for either hedging or speculative purposes. By entering into a futures contract, investors can hedge against foreign exchange or interest rate risks by holding a position opposite to that of the underlying asset held by the investors, or they can make a profit by exiting a futures commitment before the settlement date, without the delivery of the physical assets.

Futures have gained popularity since the collapse of the Bretton Woods system in the late 1970s. Faced with increasing volatility in f/x rates and interest rates, individuals, companies and institutional investors increasingly began to turn to futures as a means of hedging against risks or gaining profits. Large commercial banks also actively use the futures market to hedge against possible risks.

As a result, the volume of futures trading surpassed that of spot trading in the 1990s. In addition, the combination of underlying asset and futures trading or the mixing of multiples of futures transactions have recently emerged, bringing new products into the market and leading to a diversification in the types and methods of futures trading.

After the outbreak of the global financial crisis in 2008, the risks carried by OTC derivatives were viewed as a major culprit behind the financial turmoil. This has led countries to strengthen regulations for the enhanced transparency of OTC derivatives. At the G20 summit in September 2009, leaders agreed on plans to build and operate central counterparties for increased transparency of OTC derivatives. The Dodd-Frank Act in the US and the European Market Infrastructure Regulation (EMIR) in the EU were also enacted to provide regulatory measures for more transparency by adopting central counterparties, swap execution facilities, and trade repositories. As such, exchanges around the world are seeking more profit opportunities through clearing and settlement.

TABLE 7-1. TYPES OF DERIVATIVES

Types / Underlying assets	Futures/ Forwards	Options	Swaps
Interest rates	Interest rate futures / FRA	Interest rate options	Interest swaps
Foreign currency (spots)	Currency futures / Forward exchanges	Currency options	Currency swaps / FX swaps
Stock/Stock index	Stock (stock index) futures	Stock (stock index) options	Equity swaps
Credit	CDS, TRS, CLN, Syndicated CDO, etc.		
Others	ELW, ELS, DLS, etc.		

TABLE 7-2. COMPARISON BETWEEN EXCHANGE-TRADED AND OTC DERIVATIVES

Category	Exchange-traded derivatives	Over-the-counter derivatives
Types	Futures, options	Forwards, options, swaps
Transaction method	Trades on an exchange where open trades or an electronic trading system creates prices	Negotiated between parties in the transaction privately and individually
Transaction terms	Standardized with specified underlying assets, transaction units and settlement	Customized according to decisions made by transaction parties
Price transparency	Transparent and disclosed real time	Relatively non-transparent
Counterparty	Not specified	Must be specified
Price	Changes frequently	Agreed once contract is made
Guarantee of transactions	Clearing houses	Counterparty
Market participants	Available to the general public	Not available to individuals or small and medium-sized enterprises with lower credit ratings
Clearing house	Involved	Not involved
Daily settlement	Done at an exchange	Not done
Credit risk	Does not exist as the exchange's clearing house acts as a counterparty on all contracts	Always exists as the execution of a contract is dependent on the reliability of counterparties
Margin	Order margin and maintenance margin are deposited for every contract	Margin deposit is sometimes required for a counterparty with insufficient credit rating
Physical delivery	Most contracts are closed before the contract expiration date through cash settlements, and only some of the contracts are held to expiration for physical delivery	Most contracts are settled by physical delivery at expiration
Transaction fee	Brokerage fee as agreed	Bid-ask spread
Settlement date	Specified as a particular date in the month of expiration	Not specified
Regulation	Regulated by the government, associations and the exchange	Freely regulated by the market

II. RECENT STATUS OF THE KOREAN EXCHANGE-TRADED DERIVATIVES MARKET

Reinforced regulations on the derivatives market, contraction of the spot market, and reduced volatility dampened the Korean exchange-traded derivatives market in 2013. Total trading volume for the year was approximately 820 million contracts, a decrease of 55.3% from 2012, and the daily average trading volume of the futures market decreased by 7.3%, recording 972,424 contracts in 2013. The options market experienced a drop of 63.0% in the daily average trading volume, amounting to 2,350,042 contracts in 2013, resulting from a decline in investments due to the FSC's measures aimed at enhancing the soundness of the KOSPI 200 options market (multiplier increased from KRW 100,000 to KRW 500,000, cash deposit ratio raised from one-third to one-half).

TABLE 7-3. COMPARISON ON THE DAILY AVERAGE TRADING VOLUME OF MAJOR EXCHANGE-TRADED DERIVATIVES

(Unit: Contracts, %)

Category	2012	2013	Variance Rate (year-on-year)
KOSPI 200 futures	251,736	202,311	△19.6
Stock futures	405,205	375,344	△7.4
3-year KTB futures	119,871	118,591	△1.1
US dollar futures	215,925	209,775	△2.8
Futures market total	1,049,288	972,424	△7.3
KOSPI 200 options	6,352,396	2,350,042	△63.0
Total	7,401,684	3,322,466	△55.3

*The KOSPI 200 futures and options include transactions executed during the day and at night. All contracts include spread transactions.

By investor type, excluding the US dollar futures market, the proportion of foreign investors rose in the overall market.

In the KOSPI 200 futures market, the proportion of financial investment business entities and individual investors fell -11.69%p and -2.24%p, respectively, while that of foreign investors grew 13.88%p. As for the KOSPI 200 options market, financial investment business entities decreased -4.32%p, while that of individual investors and foreign investors increased 0.91%p and 3.34%p, respectively.

Looking at stock futures, individual investors saw a drop of -1.56%p, while financial investment business entities and foreign investors grew 2.69%p and 6.46%p, respectively.

The proportion of investor types in USD futures ranked from highest to lowest in 2012 was financial investment business entities, foreign investors, and banks, but the proportion of banks (16.03%) increased in 2013 and surpassed that of foreign investors (15.81%). In the KTB futures market, there was an increase in foreign investors. As for the 3-year KTB futures market, the proportion of foreign investors grew 2.97%p, while banks witnessed a decrease of -1.41%p. In the case of 10-year KTB futures, foreign investors grew 9.02%p, while financial investment business entities declined -8.76%p.

TABLE 7-4. COMPARISON OF THE TRADING VOLUME OF MAJOR EXCHANGE-TRADED DERIVATIVES BY INVESTOR TYPE

(Unit: %, %p)

		Institutions								
	Year	Financial Investment	Insurance	Investment Trust	Bank	Other Finance	Pension Fund,etc.	Other Corps.	Individual	Foreign
KOSPI 200 futures	'12	25.89	0.31	1.20	0.37	0.01	0.66	0.79	32.18	38.59
	'13	20.60	0.27	1.45	0.22	0.00	0.35	1.27	30.71	45.13
	Diff	-5.29	-0.04	0.25	-0.15	-0.01	-0.31	-0.48	-1.47	6.54
Stock futures	'12	8.05	0.81	1.29	0.03	0.01	4.21	15.17	51.05	19.38
	'13	10.74	1.06	3.01	0.00	0.00	0.81	9.06	49.47	25.85
	Diff	2.69	0.25	1.72	-0.03	-0.01	-3.40	-6.11	-1.58	6.47
3-year KTB futures	'12	62.97	1.04	1.76	18.28	0.03	0.70	0.16	2.51	12.55
	'13	62.69	0.47	1.92	16.87	0.05	0.68	0.09	1.73	15.50
	Diff	-0.28	-0.57	0.16	-1.41	0.02	-0.02	-0.07	-0.78	2.95
10-year KTB futures	'12	72.92	0.37	0.75	13.28	0.00	0.27	0.02	1.61	10.79
	'13	64.16	0.60	1.77	10.43	0.01	0.62	0.09	2.51	19.81
	Diff	-8.76	0.23	1.02	-2.85	0.01	0.35	0.07	0.90	9.02
US dollar futures	'12	38.26	0.82	5.76	18.20	2.23	0.09	3.06	11.11	20.46
	'13	40.66	1.33	5.24	16.03	2.01	0.00	3.11	15.80	15.81
	Diff	2.40	0.51	-0.52	-2.17	-0.22	-0.09	0.05	4.69	-4.65
KOSPI 200 options	'12	15.44	0.10	0.12	0.02	0.00	0.02	0.74	30.21	53.35
	'13	11.12	0.03	0.15	0.02	0.01	0.04	0.83	31.12	56.69
	DIff	-4.32	-0.07	0.03	0.00	0.01	0.02	0.09	0.91	3.34

*Note: "Diff" represents the year-on-year increase or decrease, %p

III. RECENT STATUS OF THE KOREAN OTC DERIVATIVES MARKET

The trading volume in the domestic OTC derivatives market decreased by 6.2% from the previous year to KRW 12,144 trillion in 2012, and declined by 1.0% year-on-year to KRW 12,021 trillion in 2013 due to decreased trading of stock and currency-related products, which account for the largest portion of the market.

By investor type, banks made up 90.0% of the trading, followed by securities firms (6.9%), insurance companies (0.3%), trusts (2.7%), and others (0.1%). The higher creditworthiness of banks contributed to their dominance because of the importance of credibility in a market where transactions are directly entered between counterparties.

TABLE 7-5. OTC DERIVATIVES TRADING BY KOREAN FINANCIAL INSTITUTION

(Unit: billion won, %)

Underlying	2011	2012	Total	2013				
				Banks	Securities companies	Insurance companies	Trusts	Other
Equity [KRW]	299,759 [245,231]	162,835 [152,089]	121,456 [113,432]	24,412 [24,410]	92,918 [85,546]	3,511 [3,269]	605 [199]	9 [9]
Interest rate [KRW]	2,939,224 [2,568,778]	2,419,011 [2,191,300]	2,658,592 [2,461,932]	2,254,302 [2,067,344]	400,500 [391,208]	590 [549]	1,832 [1,612]	1,368 [1,218]
Foreign currency [KRW]	9,675,240 [9,056,668]	9,521,268 [8,756,501]	9,182,467 [8,540,542]	8,527,084 [7,957,331]	290,777 [272,253]	35,815 [32,027]	323,060 [274,208]	5,731 [4,723]
Commodity [KRW]	13,796 [2,244]	12,715 [5,401]	17,240 [6,761]	12,134 [3,044]	4,528 [3,710]	9 [7]	569 [88]	0 [ ]
Credit [KRW]	11,830 [5,686]	27,980 [9,959]	40,879 [14,232]	3,093 [1,433]	36,902 [12,512]	574 [256]	310 [32]	0 [ ]
Total [KRW]	12,939,848 [12,112,489]	12,143,808 [11,115,249]	12,020,633 [11,136,899]	10,821,025 [10,053,562]	825,625 [765,229]	40,498 [36,107]	326,376 [276,052]	7,108 [5,950]

Source: Financial Supervisory Service

Due to the continuing low interest rate environment in 2013, equity-linked securities (ELS) and derivatives-linked securities (DLS) saw an increase, while OTC derivatives trading between financial companies showed lackluster performance amid the lingering impact of the global financial crisis.

With low interest rates being a global trend, the domestic interest rate derivatives market also lowered the benchmark rate by 25bp in May. This triggered an increase in volatility, which led to a rise in interest rate swap

trading among banks and securities companies as the demand for speculation and hedging jumped. As for foreign currency derivatives, lower exchange rate volatility led to a decrease in banks' currency forwards contracts, which dampened the market. Meanwhile, credit derivatives witnessed steady growth as securities companies increased credit default swaps (CDS) trading in order to issue credit-linked DLS and asset-backed commercial paper (ABCP).

Meanwhile, work on the financial regulatory framework for the OTC derivatives market, as per the G-20 agreement, continues, and the framework is taking shape. In the domestic market, there were amendments to the Financial Investment Services and Capital Markets Act (FSCMA) in May 2013, which allows the establishment of a Central Counterparty (CCP) for financial investment products. This has paved the way for the clearing of OTC derivatives to start in 2014, as the CCP will be used as a clearing house for certain OTC derivatives.

IV. RECENT STATUS OF THE GLOBAL DERIVATIVES MARKET

In 2013, the trading volume of global exchange-traded derivatives increased despite the contraction of stock index derivatives, prompted by the recovery of interest rate derivatives trading amid higher global interest rate volatility, and the growth of commodity derivatives, including energy and metal. The volume reached 21.64 billion contracts – an increase of 2.1% compared to 2012.

The Korean derivatives market fell 55.3% from the previous year, caused by decreased volatility and the government's market stabilization measures (released June 15, 2012). In particular, trading volume in the options market dropped 63.0%. To this end, Korea's ranking in global trading volume also slipped from 3rd place in 2012 to 8th place in 2013.

China saw a big jump in the volume of exchange-traded commodity derivatives thanks to a boost in domestic consumption, and consequently the economy ranked 3rd in global trading volume. Among major economies, the US showed an overwhelming lead in trading volume (1st place with an increase of 9.9% YoY), followed by India (2nd, -0.2%), China (3rd, 39.5%), Brazil (4th, -2.0%), and Germany (5th, -6.5%). In particular, China and Japan (9th place with an increase of 39.9% YoY) demonstrated the highest growth rates.

The rise and development of emerging economies had steadily driven up trading volume around the world following the financial crisis in 2008, until 2012, when the volume fell 15.1% from the previous year due to the European debt crisis and US financial uncertainties. However, the number rebounded in 2013, showing an increase of 2.1% from the previous year to reach KRW 21.64bn, backed by the growth of the commodity derivatives market.

TABLE 7-6. TRADING VOLUME OF DERIVATIVES BY COUNTRY

(Unit: number of contracts in millions, %)

Rank	Country	2007	2008	2009	2010	2011	2012	2013	
								Volume (Difference)	Proportion
1	U.S.	6,091 (32.5)	6,954 (14.2)	6,315 (-9.2)	7,121 (12.8)	8,119 (4.5)	7,157 (-11.8)	7,868 (9.9)	36.4
2	India	484 (66.6)	709 (46.5)	1,333 (85.0)	2,737 (105.3)	3,791 (4.7)	3,268 (-14.1)	3,262 (-0.2)	15.1
3	China	452 (69.0)	781 (72.8)	1,177 50.7)	1,566 (33.1)	1,054 (-2.3)	1,572 (-49.1)	2,192 (39.5)	10.1
4	Brazil	794 (39.0)	742 (-6.5)	920 (24.1)	1,422 (54.6)	1,500 (0.3)	1,636 (9.0)	1,604 (-2.0)	7.4
5	Germany	1,900 (24.4)	2,165 (13.9)	1,687 (-22.1)	1,896 (12.4)	2,043 (0.7)	1,660 (-18.8)	1,552 (-6.5)	7.2
6	U.K.	927 (33.4)	1,076 (16.1)	1,246 (15.8)	1,495 (20.0)	1,506 (0.7)	1,348 (-10.5)	1,378 (2.2)	6.4
7	Russia	229	371 (62.0)	494 (33.0)	655 (32.6)	1,099 (2.0)	1,062 (-3.4)	1,134 (6.8)	5.2
8	Korea	2,776 (12.2)	2,867 (3.3)	3,103 (8.2)	3,748 (20.8)	3,928 (4.8)	1,836 (-53.5)	821 (-55.3)	3.8
9	Japan	258 (18.4)	316 (22.5)	312 (-1.4)	375 (20.2)	398 (0.1)	328 (-17.5)	459 (39.9)	2.1
10	Australia	116 (16.0)	95 (-18.4)	82 (-13.3)	106 (29.4)	225 (111.8)	260 (15.4)	262 (0.7)	1.2
Total		15,483 (30.3)	17,668 (14.1)	17,709 (0.2)	22,295 (25.9)	24,972 (12.0)	21,190 (-15.1)	21,643 (2.1)	100.0 100.0

Note: ( ) represents the year-on-year increase or decrease.

CHAPTER 08

SECURITIZED PRODUCTS MARKET

I. INTRODUCTION

1. Basic Concepts of Asset-backed Securities

An asset-backed security (ABS) is a security that is issued based on underlying assets originating from corporations or financial institutions. By standardizing and pooling the financial assets from originators in specific terms, such assets are securitized utilizing the cash flows of the underlying assets and credit enhancement. The asset-backed security then channels the principal and interest to the concerned parties.

An asset-backed security is bankruptcy remote from the originator, which means the credit risks of an asset-backed security are segregated from the credit risks of the originators: thus an asset-backed security is issued with the credit ratings of the underlying assets. In addition, the credit rating of an asset-backed security is determined by assessing the credit risk of the underlying assets and credit enhancement. Through credit enhancement and structuring, an ABS is highly likely to receive a higher credit rating than that of the originators.

An asset-backed security provides a wide range of benefits for originators, investors and other market participants. From the perspective of originators, asset-backed securities are advantageous in that they allow corporations or financial institutions to issue securities with higher credit ratings and therefore raise capital at relatively lower costs, since an asset-backed security usually receives a higher credit rating than the originators by assessing the structural features, cash flows and credit enhancements of underlying assets. Moreover, through asset-backed securitization, asset portfolios can be diversified or the risk therein can be dispersed among different classes of debtors.

From the investor's perspective, on the other hand, asset-backed securities are attractive products that fit various investment preferences in terms of risk and maturity. Moreover, an asset-backed security is likely to yield relatively higher profits than other bonds with the same credit rating thanks to the liquidity premium as well as its structural premium.

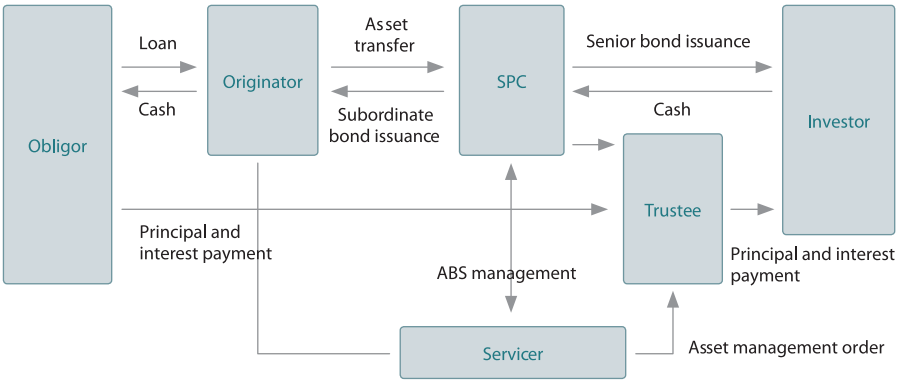
Asset-backed securities contribute to the development of the overall financial market in that they encourage securities firms to analyze various assets and build knowledge regarding the issuance of new types of securities, thereby providing new sources of profits for a wide range of interested parties.

2. Issuance Structure of Asset-backed Securities

1) BASIC ISSUANCE STRUCTURE

When an originator issues asset-backed securities, it establishes a special purpose company (SPC) and transfers the assets to the SPC so that it may issue asset-backed securities based on its underlying assets. After the issuance, the asset-backed securities are managed by a servicer and, after being converted into cash, they are sent to the account of the trustee's SPC by wire transfer and utilized to be repaid at the time of maturity.

CHART 8-1. BASIC STRUCTURE OF ABS



2) MAJOR PARTICIPANTS

Entities that are involved in ABS issuance include an originator, a servicer, an issuer (SPC), a business trustee, and credit enhancement agencies.

Originators are the ultimate beneficiaries of asset-backed securities and they own the underlying assets that are subject to securitization.

A servicer is an entity that manages and maintains the underlying assets and the cash flows of such assets. The servicer plays a significant role in managing the redemption of the asset-backed securities. It establishes a separate asset management system to take care of claims, redemption and debt collection, collects and provides relevant information, and prepares reports.

An SPC refers to a company that is established to issue asset-backed securities and segregate the underlying assets from the originators. Pursuant to the ABS Act, an SPC shall be in the form of a limited company. The SPC is only allowed to engage in the issuance and redemption of asset-backed securities in a way that is described in the asset-backed securitization plan.

Since an SPC is generally a paper company set up only for asset securitization, its business is trusted to a business trustee who is responsible for the settlement of accounts, book keeping and tax affairs of the SPC.

A trustee takes care of the payments, management and reinvestment. The major role of the trustee is to monitor the overall asset management business

on behalf of investors, manage cash and bank accounts relating to the ABS redemption, engage in custodial business such as reinvestment following the order of the servicer as is previously agreed, and carry out the ABS redemption as a proxy.

3) ASSET-BACKED SECURITIES STRUCTURE

The features of underlying assets and cash flows are critical factors in creating the structure of asset-backed securities. Collateral for an asset-backed security can be classified as either amortizing or non-amortizing assets. Amortizing assets are loans in which the borrower's period payment consists of scheduled principal and interest payments over the life of the loan. In contrast, non-amortizing assets do not have a schedule for the periodic payments that the individual borrower must make. Amortizing assets include residential mortgage loans, auto loans, corporate loans, and bonds, while credit card receivables and account receivables of corporations fall into the category of non-amortizing assets. To sum up, the features of the collateral for an asset-backed security have a significant impact on its structure.

TABLE 8-1. ABS STRUCTURE BY THE FEATURES OF UNDERLYING ASSETS

Asset class	Amortizing assets			Non-amortizing assets		
	Auto installment	MBS	CDO	Credit card	Account receivables	Future cash flows
Asset features	- Principal consumer financial asset - Purpose-driven - Stable performance of asset	- Low possibility of bad debts - Early redemption affects cash flow	- Concentration and probability of bankruptcy of companies affect ABS structure	- Short-term asset - Asset quality, delinquency rate and cap rate affect ABS structure	- Delinquency rate, asset volume management and trading terms affect ABS structure	- Capitalization is needed - Securitization is limited to certain industries
Factors influencing the cash flows of assets	- Delinquency - Early redemption	- Delinquency - Early redemption - Cap rate	- Bankruptcy - Concentration - Cap rate	- Cap rate of the month - Delinquency rate - Credit card usage rate	- Bankruptcy of trading companies - Dilution	- Sales - Delinquency rate - Plausibility
Structural features of securitization	- Securitization in line with asset cash flows	- Securitization considering the cap rate of collateral value	- Credit rating assessment for each company is required - Concentration shall be controlled	- Securitization that controls asset volatility is required	- Securitization that controls asset value change is required	- Expected future cash flow shall be identified
Factors influencing credit enhancement	- Delinquency - Early Redemption	- Delinquency - Early redemption rate - Level of credit enhancement considering the value of collateral	- Bankruptcy rate - Concentration - Bankruptcy timing - Cap rate	- Delinquency - Cap rate of the month - Usage rate - Allocation structure	- Credit ratings of trading companies - Sales terms - Delinquency and bad debt	- Level of additional collateral - Credit rating of originators - Plausibility
Complexity of structure	Simple	Simple	Simple	Complex	Complex	Complex

The critical elements of structuring asset-backed securities are true sales, methods of asset segregation and management, methods of wire transfer, and other measures to control the structural risks of securitization. Asset true sales are about upholding the legal rights of SPCs to the asset-backed securities, even after originators or servicers have been declared bankrupt, by transferring the assets from the originators with a certain transfer structure.

Credit enhancements refer to what increases the credit ratings of asset-backed securities over and above the certainty of the underlying cash flow. The credit rating agency determines the credit quality of an asset-backed security by considering its cash flow and its ability to withstand financial stress through stress testing. There are two primary types of credit enhancement: internal and external. The most common forms of internal credit enhancement are senior/subordinate structures and excess spreads, while credit lines, credit guarantees and letters of credit fall under external credit enhancement.

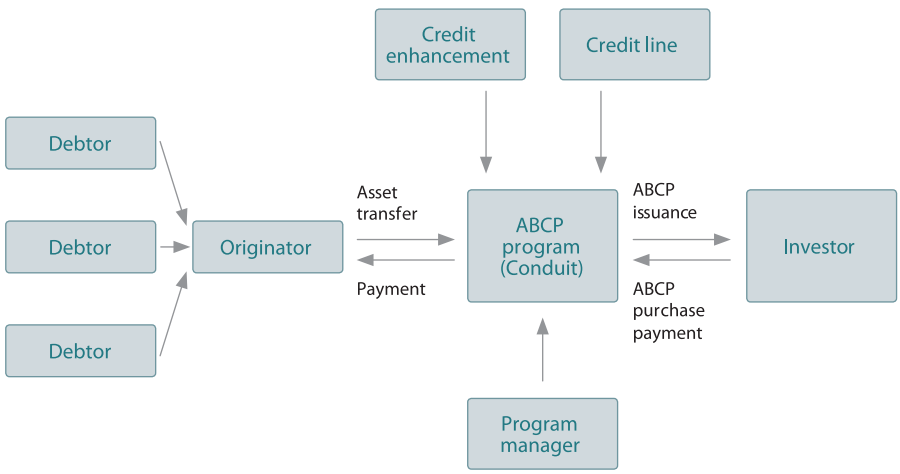
3. ABCP (Asset-backed Commercial Paper)

An ABCP is a short-term investment vehicle that corporations or financial institutions issue to raise capital based on their assets or future cash flows. Commercial paper is a short-term loan that many companies rely on to supplement their liquidity to pay for immediate expenditures. Since commercial paper is easy to issue through a simple process compared to corporate bonds, many companies use CPs for short-term financing. Unlike a conventional CP which is issued with credit and no collateral, an ABCP is issued with the underlying assets of corporations or financial institutions. In particular, most ABCPs are not governed by the ABS Act and are issued by a company established for CP issuance.

The ABCP market participants are issuers, program managers, bill brokerage agencies, liquidity providers and credit enhancement agencies. The issuers of ABCP are in the form of conduit or SPC, and they raise capital by issuing CPs to purchase assets from originators. Program managers are usually commercial banks that manage the overall businesses of the ABCP program and are responsible for the issuance and redemption of ABCPs. Bill brokerage agencies are mainly securities firms that sell the ABCPs to investors. Liquidity providers purchase ABCPs that are not underwritten in the market to enhance

liquidity and maintain the ABCP program, and also engage in approval and supervision matters. Credit enhancement agencies provide credit guarantees and take other measures to enhance the credit ratings for ABCPs.

CHART 8-2. STRUCTURE OF ABCP ISSUANCE



II. CURRENT STATUS OF ASSET-BACKED SECURITIZATION IN KOREA

The ABS market in Korea has developed within the framework of the Asset-Backed Securitization Act. The Special Purpose Company for Mortgage-Backed Bonds Act was also enacted in order to lay the foundation for issuing mortgage-backed securities (MBS) by establishing an SPC, and the Korea Housing Finance Corporation Act was enacted to establish the Korea Housing Finance Corporation.

1. Current Legal Status of Asset-backed Securities

1) ASSET-BACKED SECURITIZATION (ABS) ACT

Asset-backed securitization was first introduced to Korea's capital market in September 1998, when the ABS Act was enacted. The ABS Act prescribes the

definition of an asset-backed security, the procedure of asset securitization and special cases for the promotion of asset securitization.

A notable fact of the ABS system in Korea is that the Act stipulates which originators are qualified for securitizing assets. These include qualified financial institutions, corporations authorized by the FSC and corporations prescribed in the Presidential Decree. To be more specific, the Act defines qualified originators as financial institutions such as banks, merchant banks, insurers, securities companies, investment trust companies, mutual savings banks, specialized credit financial companies, public corporations, including the Korea Asset Management Corporation, the Korea Land Corporation, the Korea National Housing Corporation, the manager and administrator of the National Housing Fund, and corporations of good credit. Corporations specified in the Presidential Decree include the Korea Deposit Insurance Corporation, resolution finance institutions, the Small and Medium Business Corporation, trust companies, specialized corporate restructuring companies, local public enterprises, etc. When such entities engage in asset securitization, they are subject to special benefits pursuant to the ABS Act.

The Act broadly defines securitized assets as claims, immovable property and other property rights that are the subject matter of asset-backed securitization. In reality, however, securitized assets are property rights that can be transferred and registered, since securitized assets must be transferred and registered with the FSC.

The Special Purpose Vehicle (SPV) that engages in the business of asset-backed securitization includes special purpose companies pursuant to the ABS Act, trust companies pursuant to the Trust Business Act, and foreign corporations specializing in the business of ABS.

In order to issue asset-backed securities, the SPV must first register the asset-backed securitization plan, then transfer the assets, register the transfer of the assets, issue the asset-backed securities and make payment. The asset-backed securitization plan should be registered with the FSC before any issuance occurs. The ABS Act requires that when securitized assets are transferred, they meet the requirement of a true sale. True sale means the transfer should be effected by the means of sale and purchase or exchange; the right to make profits from and the right to dispose of the assets will be deemed as held by the transferee; the transferor should not have the right to claim back the securitization assets and the transferee should not have the right to claim

back the price paid for the transferred securitization assets; and the transferee should undertake risks associated with the securitization assets. By specifically stipulating such provisions for the methods of transfer, the ABS Act clearly states the segregation of the originator from the securitized assets.

In order to promote asset-backed securitization, the ABS Act prescribes special requisite cases for setting-up against transfer of claims, registration completion certificate and for the application of the Trust Business Act.

In general, a transfer is effective against the obligor of the claims only when the transferor gives notice or obtains consent from the obligor. However, the Act states that a transfer is effective against the obligor of the claims when the transferor or transferee gives notice or obtains consent from the obligor. If such notice is returned to the transferor or the transferee because of the failure to locate the obligor, etc., the transferor or the transferee may place a public notice, in which case such a public notice shall be deemed a required notice.

In addition, with respect to the transfer of claims in accordance with an ABS plan, when registration with the FSC is complete, the requirement of effective transfer shall be deemed to be satisfied as far as its effectiveness against any third parties other than the obligor is concerned, from the date of its registration.

2) SPECIAL PURPOSE COMPANY FOR MORTGAGE-BACKED BONDS ACT

The Special Purpose Company for Mortgage-Backed Securities (SPCMBS) Act prescribes the matters necessary for the establishment and operation of a special purpose company for mortgage securitization and for the issue of mortgage-backed securities. The organization that intends to operate a mortgage securitization business shall be a stock company with capital of KRW 25bn or more, and shall obtain authorization from the Financial Services Commission (FSC). Mortgage-backed securities refer to a collateralized debt, while, in the case of asset-backed securities, their underlying assets are not collateralized.

3) KOREA HOUSING FINANCE CORPORATION ACT

The Korean government enacted the Korea Housing Finance Corporation (KHFC) Act in December 2003, in order to establish the Korea Housing Finance Corporation and facilitate the supply of housing funds with low

interest rates on a long-term, stable basis. Based on the Housing Stabilization Act and the Special Purpose Company for Mortgage-Backed Securities Act, the KHFC Act states that the business scope of the corporation includes the issuance of mortgage-backed securities, student loan-backed securities, credit guarantees for housing loans, and other housing finance businesses. In addition, in order to enhance the credibility of the corporation, the Act stipulates that the corporation's capital shall be invested by the government and The Bank of Korea, and any losses arising at the closing of the corporation's books shall be covered by the financial resources reserved and if such reserves are not sufficient, the government shall cover any losses.

The corporation may issue MBS by establishing a trust and making itself a trustee, and it may provide payment guarantee services for such asset-backed securities issued by the corporation within the scope, but not exceeding 50 times the equity capital of the corporation. The KHFC Act recently raised the amount of payment guarantee from 30 times to 50 times the equity capital of the corporation, and has expanded the class of assets subject to securitization.

In addition, the Act allows the Corporation to hold mortgages transferred from financial institutions to issue MBS in a timely manner, and also created a foothold for the corporation to extend credit, such as lending of funds, etc., to financial institutions.

2. Development of Asset-backed Securities Policies in Korea

In response to the changing economic and financial environment, the Korean government revised the relevant policies and regulations to introduce new structures for asset-backed securitization. For example, when insolvent debts were skyrocketing in the trust sector after the bankruptcies of the Daewoo affiliates, the government allowed the securitization of high-yield bonds and high-yield funds. Accordingly, investment and trust companies were able to issue a large volume of the secondary CBOs with the underlying asset of non-performing loans (NPLs).

In addition, when corporations, in particular SMEs, encountered a serious credit crunch in the second half of 2000, the government undertook a series of stabilization measures to help them finance by permitting them to issue primary CBOs. Thanks to such measures, financially distressed SMEs were

able to issue corporate bonds that were utilized as the underlying asset of primary CBOs.

At the end of 2000, the government introduced yet another supportive measure, the revolving structure of asset-backed securities that issues long-term bonds based on short-term assets in order to help corporations finance funds. Many corporations were attracted to the securitization of account receivables on a revolving basis. Credit card companies, in particular, transferred credit card receivables for securitization, which became the major asset-backed security in the market.

In 2002, the delinquency rate in consumer finance increased and the stability of credit card companies' assets deteriorated, which resulted in the introduction of provisions for repayment by credit card asset-backed securities issued in 2003. Over the course of the crisis, some credit card companies encountered a credit crunch, dampening investor confidence in credit card asset-backed securities. The credit crisis in the credit card sector spread throughout the entire financial market, causing a credit crunch in all financial sectors, and most conspicuously in the ABS market.

In order to resolve the issue, a newly structured asset-backed security was introduced – asset-backed securities issued in a master trust structure to help inject capital for a major domestic credit card company, which had been taken over by creditors after failing to raise the required capital. Asset-backed securities issued in a master trust structure refers to securities that are set up in a trust and then added to underlying assets when necessary to issue subordinate asset-backed securities. This is an effective tool for enhancing the efficiency of ABS issuance and managing asset-backed securities in a more comprehensive manner.

Since 2005, the market focused mainly on the securitization of project finance (PF) loans, as demand for raising capital surged among construction companies. However, regulatory authorities reinforced regulations on the securitization of PF loans at the end of 2006, which depressed the issuance of ABS and fuelled the ABCP issuance market. Following the global financial crisis in 2008, there was an increase of CBO issuance and the government currently deploys CBOs as an important policy tool for stabilizing the financial market.

In 2013, one of the factors that had the most significant impact on the ABS market was the strengthening of ABCP regulations. As of May 6, 2013,

securities registration statements have to be submitted for CPs that either have a maturity of one or more years, or are incorporated into a specified money trust with 50 investors or more.

3. Disclosures on Asset-backed Securities

Considering the distinct characteristics of asset-backed securities, the ABS Act prescribes the requirements for registration and disclosure. For publicly offered asset-backed securities, an SPC must disclose the information in accordance with the corporate disclosure system.

When an SPC seeks to issue ABS, it must register the asset-backed securitization plan and the transfer of assets, and then submit the registration certificate of the securities beforehand. After the issuance, the SPC must submit an issuance certificate and disclose periodic reports, including an annual report.

According to Article 3 of the ABS Act, when an SPC, a foreign corporation, or a trust company specializing in the business of asset-backed securitization proposes to offer asset-backed securities, it shall register an asset-backed securitization plan with the FSC containing the scope of the securitized assets, the classes of asset-backed securities, the methods of management of securitization assets, etc. The Act also prescribes detailed matters to be included in the asset-backed securitization plan, and stipulates the registration of the transfer of the securitized assets. The issuance of asset-backed securities pursuant to the securitization plan shall be in accordance with the Commercial Code, FSCMA and other relevant Acts and subordinate statutes unless otherwise provided in the ABS Act. The detailed procedures for the registration and disclosure of ABS are outlined in the FSC Supervisory Regulations on ABS Business, and the FSS registration application form for ABS businesses, and relevant Best Practices.

In March 2000, the Data Analysis, Retrieval and Transfer (DART) System of the Financial Supervisory Service (FSS), a comprehensive online disclosure system for ABS businesses, was launched in order for investors to have access to the ABS disclosure information immediately after SPCs post reports via the system.

III. ABS ISSUANCE

1. Development of Asset-backed Securities Issuance

1) ISSUANCE

Asset-backed securities were first issued in Korea in 1999 and grew rapidly, recording issuance amounts as high as KRW 50.9tn in 2001. However, in 2002, issuance declined sharply to roughly KRW 40tn due to a significant drop in the NPL volume of financial institutions. In addition, increasing credit card delinquency in 2003 caused another plunge in ABS volume, leading to a sudden cooling of the market in the second half of the year. The trend continued into 2004, causing the issuance of asset-backed securities to shrink drastically, down to KRW 27tn, and the ABS market persisted in its decline in size from 2005 to 2007. However, because it was relatively less affected by the global financial crisis, the increased issuance of primary CBOs supported by the government led to a sharp rise in ABS issuance, totalling KRW 36tn in 2009. Issuance declined by KRW 8tn in 2010 compared to the previous year, but this was largely attributed to the suspension of P-CBO issuance for bond market stabilization funds. In 2011, the ABS issuance rebounded to the KRW 32tn level and rose further in 2013, reaching KRW 51.3tn, a record high.

TABLE 8-2. ABS ISSUANCE

(Unit: trillion won, cases)

Type	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Amount	49.4	50.9	39.8	39.9	27	28.6	23.2	19.8	20.6	36.0	28.0	32.4	47.5	51.3
No. of Issuance	154	194	181	191	170	236	183	106	81	138	133	131	172	180

Note: Sum of OTC and exchange trading (both sides)
Source: Financial Supervisory Service

2) ASSET-BACKED SECURITIES ISSUANCE BY ORIGINATORS

Originators of asset securitization have changed dramatically with the development of the ABS market. In the initial stages, KAMCO was the principal originator to securitize assets based on NPLs that are segregated from financial

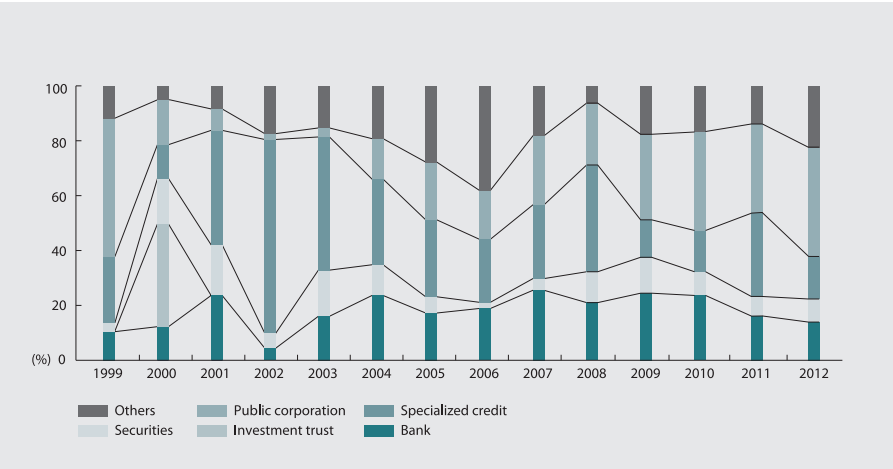
institutions. The core objective of introducing asset-backed securities in the market in 1999 was to carry out the disposal of NPLs, a widespread market disturbance, through asset-backed securitization. Similarly, in the U.S., the ABS market grew sharply when asset-backed securitization was utilized as a means of disposing of NPLs that were assumed by the Resolution Trust Company in the course of S&L restructuring. The only difference between the two markets was that the U.S. market focused more on issuing MBS. In Korea, as the Non-performing Asset Management Fund was allowed to purchase NPLs until December 2002, the NPLs in the market were almost entirely cleared, and the role of KAMCO in the ABS market diminished.

From 2000, investment and trust companies became the largest originators of asset-backed securities to cleanse the massive volume of debt left by the Daewoo affiliates, with banks emerging as the major originators as they voluntarily pooled NPLs to issue CLOs in 2001. Specialized credit financial institutions issued a large volume of asset-backed securities in 2002, but their market share sharply declined in 2003 as the credit card companies assumed many delinquent loans.

With the development of the ABS market, corporations issued an increasing amount of asset-backed securities. In particular, construction companies have actively utilized asset-backed securities as a means of project financing since 2004, with other corporations also taking up a growing portion in the ABS market. However, as the performance of the construction industry deteriorated and the uncertainty of PF securitization became prevalent, corporations' appetite for asset securitization has also fallen.

Additionally, the Korea Housing Finance Corporation (KHFC) was established in 2004 to facilitate mortgage-backed securitization, which led to an increasing issuance of MBS by public corporations.

GRAPH 8-1. ABS ISSUANCE BY ORIGINATORS



Source: Financial Supervisory Service

3) ASSET-BACKED SECURITIES ISSUANCE BY UNDERLYING ASSETS

Asset securitization is directly linked with the underlying asset holder. The ABS Act defines the term "underlying asset" as claims, immovable property and other property rights. At the initial stage, NPLs were the major underlying assets for securitization, meaning that loans made up the largest portion of the underlying assets of asset-backed securities, while the composition of assets diversified as the market developed.

In 2000, when investment and trust companies adopted the ABS structure designed for asset cleansing, a large volume of asset-backed securities based on existing bonds were issued. In addition, primary CBOs were introduced to the market in order for corporations to easily finance capital by securitizing newly issued bonds.

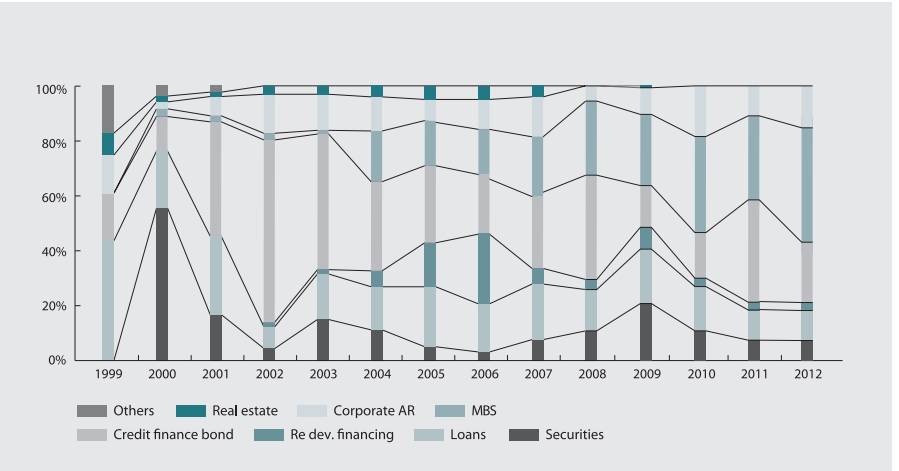
Since 2001, specialized credit financial institutions have utilized asset-backed securities as a means of raising funds, which has led to an increasing volume of ABS issuance underlying the assets of credit card companies and consumer financing. However, in the wake of the credit card liquidity crisis of 2003, the assets of credit card companies sharply declined and, accordingly, the amount of asset-backed securities based on credit card assets also decreased significantly.

Since 2007, auto financing and other specialized credit financing institutions have again actively issued asset-backed securities, increasing the proportion based on consumer finance.

Real estate development financing increased from 2003 as project financing utilizing securitization grew. However, the construction industry has been depressed since 2006 and asset-backed securities backed by real estate development financing have accordingly declined rapidly.

Although MBS only accounted for a small portion of the ABS market until 2003, it has grown drastically with the establishment of the Korea Housing Finance Corporation (KHFC) in 2004. The KHFC greatly expanded its market size by providing housing financial products with long-term fixed interest rates through bank loans and then immediately securitizing the assets.

GRAPH 8-2. ABS ISSUANCE BY UNDERLYING ASSETS



Source: Financial Supervisory Service

2. Development of ABCP Issuance

In Korea, ABCP is divided into two classes: the ABCP issued pursuant to the ABS Act, and the ABCP issued pursuant to the Commercial Code. When the market began to grow in 2006, the total volume of ABCP stood at KRW 14.7tn, increasing to KRW 21tn in 2007. In 2008, it decreased to KRW 15.2bn, while 2009 marked a small increase, reaching KRW 16.1tn. In particular, ABCP

issued pursuant to the Commercial Code comprised 89.4% of the ABCP market in 2009, equal to KRW 14.4tn. Most of the ABCP issued is related to project financing. For instance, in 2009, 59.0% of the ABCP issued was based on project financing, amounting to KRW 9.5tn.

In 2010, the issuance of ABCP increased sharply from the previous year to KRW 19.2. As such, the share of ABCP trading in the ABS market climbed to 50.6%. In 2009, the ABS market's growth was driven by the increasing issuance of P-CBO, RMBS, and NPL ABS, which were issued mainly in the form of ABS; since 2010, the share of ABCP trading has increased due to the decreasing issuance of P-CBO and NPL ABS.

In contrast, ABCP issuance fell from the previous year to KRW 14.6tn in 2011, which seems to have resulted from a sharp drop in real estate PF ABCP trading as well as the increased issuance of undisclosed ABCPs. In the following year, ABCP issuance went on to fall slightly as there was a rise in the issuance of asset-backed securities. Starting from February 1, 2013, undisclosed ABCPs were included in the ABCP issuance statistics; subsequently, the recorded issuance volume of ABCPs for 2013 was four times higher than the previous year.

TABLE 8-3. ABCP ISSUANCE

(Unit: trillion won)

	2006	2007	2008	2009	2010	2011	2012	2013
ABCP issuance	14.7	21.0	15.2	16.1	19.2	14.6	13.3	55.8
ABCP issuance based on the Commercial Code	11.5	18.0	13.5	14.4	18.7	13.7	12.8	54.2
PF ABCP issuance	9.2	9.6	8.3	9.5	13.9	9.9	8.6	15.5

Source: Korea Ratings Issue Report, "Analysis of the 2013 ABS Primary Market"

3. Factors Affecting the Growth of Korea's Asset-backed Securities Market

1) INTRODUCTION OF ASSET-BACKED SECURITIES WITH THE ENACTMENT OF THE ABS ACT

Korea's ABS market has developed and evolved thanks largely to the government's efforts to facilitate the market. The government provided the legal framework by enacting the ABS Act and undertook a series of supportive

measures to promote the growth of the market. The ABS Act was legislated in a way that would remove the existing legal obstacles to securitizing assets and lay the foundation for the further expansion of the ABS market. Notably, the ABS Act is not a restrictive statute as is the case for most laws in Korea.

2) CLARIFICATION OF TRUE SALE CONDITIONS

The key attractiveness of asset-backed securities is that a note can be issued with the credit rating of the asset, since the underlying asset is bankruptcy remote from the originator through the segregation of the credit risk of the underlying assets from that of the originator. In addition, in order to enhance the credibility of the asset-backed security, Article 12 of the ABS Act[1)] also prescribes that in the event of bankruptcy of the servicer, the securitized assets administered in a trust shall not become a part of the servicer's bankrupt estate. By providing such provisions of true sale, the Act eliminates the uncertainty of asset securitization and thereby facilitates the growth of the ABS market.

3) REGULATIONS IN FAVOR OF ASSET-BACKED SECURITIES

The regulatory authority's positive attitude toward the ABS market to promote rapid, but not excessive, market development is also cited as a major contributor for asset-backed securities' rise as an attractive investment product.

In Korea, asset-backed securitization plans must be registered with the FSC, and the asset transfer must also be registered to achieve the requisite standards for ensuring against transfer of claims. These registrations are promptly publicized through the electronic public disclosure system, adding more reliability and credibility to asset-backed security notes and allowing investors easy access to the information. All of these regulatory systems help improve note credibility and information efficiency, and accordingly promote the growth of the ABS market. As a result, corporations and financial institutions have been willing to utilize asset securitization and have succeeded in restructuring their business.

Note: 1) Article 12 (Bankruptcy, etc. of Caretaker): ① In the event of a bankruptcy of the caretaker, the securitization assets administered in trust (including the funds and other property rights received as a result of the administration, operation, and disposition of such assets; hereafter the same shall apply in this Article) shall not become a part of the caretaker's bankrupt estate, and the special purpose company, etc. may require the caretaker or the trustee in bankruptcy to return such assets. ② Paragraph (1) shall apply mutatis mutandis to the case where a rehabilitation proceeding under the Debtor Rehabilitation and Bankruptcy Act has commenced. ③ The creditors of the caretaker may not execute compulsorily the securitization assets managed in trust by the caretaker pursuant to Article 10 (1), and such assets shall not be subject to a preservation order or injunction order under the Debtor Rehabilitation and Bankruptcy Act.

IV. IMPROVEMENT OF ABS MARKET SYSTEM

1. Subprime Mortgage Crisis and Asset-backed Securitization

1) DEVELOPMENTS OF THE SUBPRIME MARKET TURMOIL

TThe U.S. subprime mortgage crisis has rapidly changed the structure of the ABS markets across the world. Since subprime mortgages were securitized and used throughout each financial sector, when the underlying assets became insolvent, the losses passed through into the financial sectors that made investments in subprime MBS. Such credit risk transfer, caused by the defaults of underlying assets and securitization, ultimately resulted in the global financial crisis. Notably, while structured ABS products were utilized as a means to transfer a massive amount of credit risk, a proper supervisory and regulatory system was not in place, which made it impossible for financial sectors to prevent or avoid such a massive crisis.

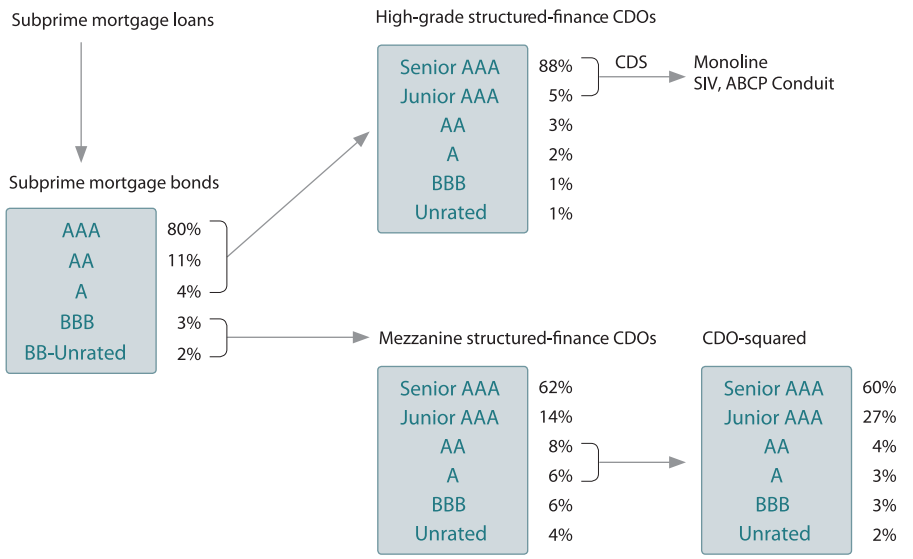
The reason behind such a rapid expansion of the subprime mortgage crisis is that hedge funds and major investment banks made leveraged investments, repackaged the underlying assets through securitization, and transferred the credit risk into the credit derivatives market. At a time of low interest rates, hedge funds were trying to achieve higher returns by actively investing in mezzanine tranche subprime mortgage-backed RMBS, and the mezzanine tranche non-agency MBS were securitized again in the form of CDOs. Some of the subprime mortgages and related ABS were used as the underlying assets for ABCPs as structured investment vehicles (SIVs). In addition, many credit derivatives were also issued based on the subprime mortgage exposures of financial institutions.

Under these circumstances, subprime mortgages became insolvent, leading to defaults on RMBS and then defaults on CDOs, ABCPs, and credit derivatives underlying RMBS. These defaults inflicted significant losses on the financial institutions that made investments in such structured finance vehicles. In addition, liquidity guarantee agencies for SIVs did not properly play their part either.

To sum up, the spill-over effects of the subprime mortgage crisis took place as follows. First, due to the declining prices and increasing delinquency rates

in the real estate sector, mortgage companies, mortgage lenders, and banks that extended subprime mortgage loans became insolvent. Second, monoline insurers that provided guarantees for subprime MBS became insolvent. Third, hedge funds, insurance companies and investment banks that made investments in MBS, CDOs, and credit derivatives based on subprime mortgages saw the value of their assets plummet and faced defaults. The defaults of investment banks and the shrinking value of assets consequently led to the global financial crisis. In particular, the bankruptcy of Lehman Brothers in 2008 rapidly magnified the subprime mortgage crisis throughout the globe.

CHART 8-3. SECURITIZATION OF SUBPRIME MORTGAGE



Source: IMF

2) MAJOR CAUSES OF SUBPRIME CRISIS

The principal causes of the turmoil in the financial markets are as follows. First, underwriting standards for U.S. subprime mortgages were weakened dramatically. As subprime mortgages increased sharply, the underwriting standards for subprime mortgages were eased drastically which, in turn, led to the poor quality of the underlying assets. Since 2000, financial institutions had suffered from lowered profitability due to low interest rates and therefore began to invest in higher-yield subprime mortgages, rapidly increasing the volume of subprime MBS.

Second, investors were overly reliant on credit ratings when making investment decisions. Credit rating agencies, however, had given subprime mortgages far better ratings than they should have received, misleading investors and intensifying the subprime mortgage crisis. Credit rating agencies established assessment models based on data collected in the past, but as the circumstances changed dramatically in the financial market, the parameters of such models were outdated and, accordingly, produced inaccurate credit ratings. In addition, as subprime mortgages became insolvent, the credit rating agencies suddenly downgraded the ratings of existing asset-backed securities, lowering the value of the subprime MBS and the credit derivatives of financial institutions, thereby worsening the crisis. Moreover, rating agencies were involved in the process of structuring asset-backed securities by providing advisory services to make them more profitable, while some of the asset-backed securities were even found to have been rated without a due assessment process.

Hedge funds also appeared to expand the volume of subprime MBS by making investments in the mezzanine tranches of subprime MBS or CDOs, based mainly on subprime MBS, and making leveraged investments again by taking structured financial instruments as collateral. Consequently, as the value of the underlying assets declined due to the defaults on subprime mortgages, hedge funds had to pay massive amounts of margin calls.

The crisis can also be attributed to the excessively complex structures of securitized products such as CDOs of ABS and CDO-squared CPDOs, which made it difficult to precisely identify the risk structure of such financial instruments. In addition, financial institutions and investors underestimated the liquidity risk of securitized products. They believed that subprime MBS had no liquidity risk and the AAA grade securities, in particular, would not be influenced by volatile market prices.

3) CHANGES IN THE REGULATIONS ON ASSET-BACKED SECURITIES

Since the global financial crisis, international organizations and supervisory authorities have made efforts to improve the regulatory system of asset-backed securities. The improvement measures focused mainly on enhancing disclosure requirements to precisely identify the risk of asset-backed securities, collecting information on asset-backed securities from across the world to identify the concentration of risk in advance, and strengthening the asset requirements for asset-backed securities investment to prevent the insolvency of financial institutions due to reckless investment in asset-backed securities.

Information disclosure requirements on the underlying assets and the structure of asset-backed securities have also been enhanced. In June 2009, the International Organization of Securities Commissions (IOSCO) proposed the Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities. The proposed ABS Disclosure Principles outline information which should be included in the disclosure: the functions and responsibilities of the significant parties involved in the securitization transaction, description of the asset-backed securities, significant obligors of pooled assets, structure of the transaction, risk factors, credit enhancement, and other support.

The European Securitization Forum and the American Securitization Forum established task forces and proposed principles for ABS disclosure. The principles recommend that regulatory authorities inspect the originators and parties involved in the securitization transaction, provide data required to precisely identify the risk of securitization, recommend practical examples for ABS disclosure, and then establish proper regulatory measures. In addition, the parties involved in securitization shall submit a pre-issuance disclosure as well as ongoing post-issuance reporting. Moreover, additional information that may have an impact on the timely redemption of asset-backed securities is to be included in the reports.

In June 2009, the U.S. government announced reforms to its financial supervision and regulations to enhance transparency of the asset securitization market by requiring issuers to disclose the structure of securitization and strengthening regulations on asset-backed securities. The principles also recommend that the Securities and Exchange Commission collect data on market risk, credit risk and liquidity risk that might occur in the course of the issuance and redemption of asset-backed securities.

In addition, the supervisory authorities are striving to collect information on credit risk concentration by supervising transactions associated with credit risk transfers. The European Central Bank, in a joint effort with the Committee of European Banking Supervisors (CEBS), plans to establish principles to collect information on credit risk transfers including the transactions of asset-backed securities. The principles will outline the requirements for selling loans for European financial institutions and the requirements for the transactions of asset-backed securities and credit derivatives. The supervisory authorities also propose details on information concentration through exemplary cases, and collect and concentrate the data associated with credit risk transfer with the cooperation of the central banks in other countries.

Measures aiming to enhance the structural stability of asset-backed securities are also contained in the recent financial supervision and regulatory reforms made by the U.S. One of the most significant changes proposed requires that the originators of loans underlying asset-backed securities retain at least 5 percent of the loss risk. According to the Treasury, requiring originators to keep "some skin in the game" will incentivize banks and securitizers to consider the performance of loans underlying ABS well after such securities have been issued. Other aspects of the proposal to reform the securitization market call for better alignment of the compensation structure for parties involved in securitization to the long-term performance of the financial assets underlying ABS.

Furthermore, the Basel Committee on Bank Supervision, as well as other supervisory authorities in different countries, plan to improve the incentive schemes in order to encourage regulated institutions to better manage the credit risk associated with securitization, and establish an international system to provide stronger liquidity cushions by 2011.

Another regulatory initiative is to enhance the capital requirements for ABS investments, thereby helping financial institutions better manage the risks associated with asset securitization. In April 2008, the Financial Stability Forum proposed new capital requirements for asset-backed securities to prepare for possible financial crises in the future. The Basel Committee is expected to propose amended capital requirements for ABS including CDOs, trading accounts of banks and securities firms, and ABCP transactions.

The CEBS plans to extensively review and revise the Capital Requirement Directives (CRD) at the EU level. The amendment of the CRD is expected to cover the incremental costs by requiring that major countries prepare delays in the selling, recovery, or the possible loss of structured and securitized financial products, or imposing incremental risk charges in accordance with the price changes of structured products.

The international supervisory authorities put emphasis on the improvement of the regulatory systems for asset-backed securities by promoting the stability of ABS transactions and establishing measures to avoid systemic risks. It is notable, however, that such enhanced initiatives might result in a higher cost for ABS issuance as well as reduced investment. For example, introducing enhanced disclosure rules for asset securitization will make it more time-consuming and costly for financial institutions to issue asset-backed securities.

In addition, enhanced investment requirements are likely to dampen investors' demand for asset-backed securities. Likewise, enhanced capital requirements and enhanced due diligence by investors make the investment process far more complex, which is likely to reduce investment in the ABS market. If the credit rating system is revised to apply differentiated credit ratings to asset-backed securities, the investment prospectus has to be modified, which would be time-consuming and costly.

2. Improvement Plan for Korea's Asset-backed Securities Market

In Korea, the ABS Act provides the means for properly regulating the ABS market. Recently, however, as asset-backed securities have been recklessly utilized as a means of transferring credit risk throughout the world, resulting in the global financial crisis, additional measures to supplement the current rules and regulations on ABS are required.

The Korean asset-backed securities market is equipped with a supportive legislative framework and investor protection measures. Based on the experience gained from the Asian financial crisis, Korea has built its asset performance data under the worst-case scenario, which made it possible for the market to precisely analyze the performance of asset-backed securities. In regards to MBS, the government-owned KHFC takes the initiative to securitize prime mortgage loans.

Recently, however, concerns have been raised over ABCPs as they are not governed by the ABS Act. Since these are largely issued based on mortgage loans, it is highly likely that the risks of the depressed real estate sector will pass through into other sectors, undermining the stability of the overall financial market. Therefore, in order to stabilize the market, additional regulatory measures against the ABCP are also required.

The government plans to take appropriate steps to improve the market system in order to prevent asset-backed securities risk from spreading throughout the market, while also promoting the future growth of the asset-backed securities market. As asset-backed securities are an effective and stable tool for corporations and financial institutions to finance capital and an attractive investment vehicle for investors, the government plans to continue taking supportive measures for the promotion of the asset-backed securities market.

In addition, the government needs to come up with comprehensive legislation for governing a wide range of securitized products, including asset-backed securities and credit derivatives, in order to minimize the side effects of asset securitization, while maximizing its proper functions in the financial market.

CHAPTER 09

ASSET MANAGEMENT MARKET

I. FUND MARKET

1. FUNDS

1) DEFINITION OF FUNDS

The Financial Investment Services and Capital Markets Act (FSCMA) defines a fund as a collective investment scheme – a vehicle for collective indirect investment where a pool of money sourced from various investors is collected into an investment fund that is managed by professional fund managers or asset management companies. The returns from the investment are then shared among the investors.

The UK Financial Services and Markets Act of 2000 defines a collective investment scheme in the following three ways: first, it is an arrangement that enables persons taking part in the arrangement to participate in or receive income or profit from such an arrangement; second, persons who participate in the arrangement must not have any day-to-day control over the investment

assets; and third, contributions by the participants in the arrangement shall be pooled and managed as a whole.

2) CHARACTERISTICS OF FUNDS

The outstanding characteristic of a fund is that the provider of the investment asset is separate from the manager of the asset. As a result, the role of the investor is limited while the investment is being conducted. This kind of separate structure can be found when an individual, the provider of the assets, entrusts his or her own assets to a professional asset manager. But funds are different from this type of investment in that investments from many different investors, not a single investor, are combined into a "pool" that is managed by a professional investment manager. Funds are also different from investment arrangements made by a group of investors combining their assets as they are managed by professional managers.

Another characteristic of funds is that the investment assets should be clearly separated from any other assets of an asset management company. Depending on the legal method of separation, funds are classified into trust-type (contractual) funds that use trusts as the method of separation, and mutual funds that are established by selling shares of a fund to investors. A mutual fund is given a corporate entity while a trust-type fund is not.

The rationale for fund investment can be understood from both legal and economic perspectives. For example, acquiring stocks of a corporation through fund investment is regarded as a legal act, since it concerns the obtaining of a company's shares by providing capital. But from an economic perspective, fund investment is an act of purchasing an investment product by investors seeking to achieve profits from investing in indirect investment products, rather than by participating in the company's management.

In terms of financing, funds stand midway between traditional indirect financing and direct financing. Like banks, the representative example of an indirect financing institution, funds pool capital from investors and act as an intermediary in the flow of money. However, unlike banks, funds issue securities. In this regard, funds are categorized as a type of financial product in the U.S. But compared with banks, funds make investments on a limited range of assets, such as securities and real estate, to meet their fundamental purpose of achieving a specific investment goal. In addition, while bank loans – the capital raised by banks – are given out to customers in an undisclosed market,

fund investment is performed in an open market. Therefore, funds also have certain characteristics of direct financing.

3) CHANGES IN GOVERNING REGULATIONS

Asset management in Korea was previously regulated by the Securities Investment Trust Business Act (1969) and the Indirect Investment Asset Management Business Act (IIAMBA – 2004). Now, the asset management business is governed by the Financial Investment Services and Capital Markets Act (FSCMA), which came into effect on February 4, 2009. The key regulatory goal of the FSCMA was the introduction of a comprehensive definition for financial products, and permitting financial companies to operate different financial investment services concurrently in previously separate business areas. The recent enforcement of the FSCMA brought about several changes to the asset management business in Korea.

First of all, the legal forms of collective investment schemes permitted have been increased. Under the IIAMBA, legally permitted collective investment schemes were limited to investment trusts, investment companies in the form of corporations, and investment limited partnerships (only for PEFs). This was expanded by the FSCMA to include any form of investment scheme permitted under the Civil Act or the Commercial Act. As such, collective investment schemes have been expanded to include limited partnership companies, limited liability companies, associations under the Civil Act, and undisclosed associations under the Commercial Act. The scope of the assets used in a collective investment scheme has also been comprehensively expanded. While investment securities, exchange-traded/OTC derivatives, real estate and commodities were previously defined as investment assets under the IIAMBA, the FSCMA has widened the definition to include any asset that holds monetary value. The FSCMA has also eased restrictions on the types of assets allowed for investment by each collective investment scheme.

In addition, with the FSCMA breaking down barriers between the six major areas of financial investment businesses, a financial investment company can now offer multiple forms of investment services concurrently. As a result, restrictions that were placed on the concurrent operation of securities and asset management services were lifted. The FSCMA has also relaxed the regulations on the sales of collective investment securities, setting forth that a licensed investment brokerage entity is qualified to sell collective investment securities.

Stronger measures for investor protection are part of the notable changes introduced with the enforcement of the FSCMA. The act stipulates that a financial investment entity shall confirm the investors' suitability for the investment instrument in question, that it has the duty to explain the details of a financial investment instrument to the investor and that it shall not make unsolicited investment recommendations. As part of the push for enhanced investor protection, the FSCMA also sets forth measures to prevent conflicts of interest that might arise among various parties involved in investments.

2. Status of the Fund Market

1) CURRENT STATUS OF THE TOTAL NET ASSETS AND TOTAL AUM OF FUNDS

As of the end of 2013, the total net assets of funds stood at around KRW 328tn, a growth of 1.73 times from the 2004 figure of KRW 190tn. The aggregate assets under management (AUM) totaled KRW 335tn by the end of 2013, an increase of 1.79 times from 2004's KRW 187tn.

TABLE 9-1. TOTAL NET ASSETS AND TOTAL AUM OF FUNDS

(Unit: billion won, %)

	Total Net Assets	Total AUM	Ratio of funds to KOSPI market capitalization	
			Stocks[1)]	Bonds[2)]
2004	190,119	186,993	(3.25)	(16.78)
2005	216,809	204,346	(5.67)	(12.26)
2006	242,433	234,615	(6.59)	(11.47)
2007	318,420	296,460	(8.18)	(7.68)
2008	288,507	359,487	(9.63)	(7.58)
2009	318,467	331,834	(8.49)	(8.84)
2010	318,812	315,183	(6.27)	(9.15)
2011	277,341	298,480	(6.40)	(6.95)
2012	307,592	317,273	(6.09)	(6.57)
2013	328,445	334,896	(5.89)	(7.46)

Source: Korea Financial Investment Association

Note: 1) Stock ratio refers to the ratio of stock valuations held by funds to the total capitalization of the KOSPI market.

2) Bond ratio refers to the ratio of bond valuations held by funds to the total capitalization of the bonds and debentures market.

Among the total deposits received by domestic financial institutions, banks' deposits and trusts make up the largest portion, though the amount of funds has been on a steady rise. With the global financial crisis and the fiscal crisis in Europe hitting the Korean economy, the bank ratio of deposit and trust holdings increased as investors moved to safer assets in fear of declining asset value. However, as investor sentiment toward funds recovers, the ratio of funds is expected to turn around.

TABLE 9-2. DEPOSITS RECEIVED BY DOMESTIC FINANCIAL INSTITUTIONS

(Unit: trillion won, %)

	Funds	Bank deposits	Bank trusts	Securities firms	Merchant banks	Total
2004	187.0 (23.0)	549.3 (67.6)	45.2 (5.6)	13.3 (1.6)	17.3 (2.1)	812.1 (100)
2005	204.3 (23.1)	587.6 (66.5)	47.6 (5.4)	20.7 (2.3)	23.2 (2.6)	883.4 (100)
2006	234.6 (24.1)	616.8 (63.3)	62.2 (6.4)	27.9 (2.9)	33.2 (3.4)	974.7 (100)
2007	296.5 (26.9)	643.1 (58.3)	70.0 (6.3)	41.8 (3.8)	52.5 (4.8)	1,103.9 (100)
2008	359.5 (28.6)	724.0 (57.6)	69.7 (5.5)	47.7 (3.8)	55.2 (4.4)	1,256.1 (100)
2009	331.9 (25.2)	812.2 (61.8)	68.1 (5.2)	58.4 (4.4)	43.9 (3.3)	1,314.5 (100)
2010	315.2 (22.2)	868.3 (61.1)	80.8 (5.7)	112.8 (7.9)	45.0 (3.2)	1,422.1 (100)
2011	298.5 (20.1)	933.9 (63.0)	100.5 (6.8)	114.9 (7.8)	34.4 (2.3)	1,482.2 (100)
2012	317.3 (20.4)	973.7 (62.7)	109.6 (7.1)	119.9 (7.7)	33.0 (2.1)	1,553.5 (100)
2013	334.9 (20.8)	996.3 (61.9)	130.3 (8.1)	125.3 (7.8)	23.9 (1.5)	1,610.7 (100)

Source: Korea Financial Investment Association, The Bank of Korea

2) CLASSIFICATION OF FUNDS AND AUM BY FUND TYPE

(a) Classification of Funds

Funds can be classified into several different types depending on a diverse range of standards, such as a fund's legal entity, possibility of an additional purchase of securities, availability of early redemption, offering method, investment region and investment assets. In terms of the legal entity, funds can take the form of an investment trust, a corporation, (e.g. an investment company, investment limited

liability company or investment limited partnership company) and an association (e.g. an investment association or an undisclosed investment association). Funds can be also classified into open-type and unit-type based on whether the additional purchase of securities is possible or not. In addition, there are open-ended and close-ended funds, with the former allowing investors to redeem their funds at any time while the latter does not.

In terms of inviting investors, publicly offered funds are established by offering securities to the general public while private equity funds are only offered to select investors, numbering no more than 49 individuals, in accordance with the relevant act. They are also divided into domestic and overseas investment funds, depending on the investment region. Overseas investment funds are further categorized into on-shore and off-shore funds, with the former established in Korea and the latter registered in off-shore jurisdictions.

The introduction of the FSCMA has brought about changes in the way funds are classified. While the Indirect Investment and Asset Management Business Act defined fund types based on the structure of a fund itself, the FSCMA focuses more on the characteristics of a fund's portfolio. In addition, the FSCMA's comprehensive definition of financial investment products has enabled the launch of mixed assets funds that hold a variety of assets such as securities, real estate and special assets in their portfolios. In general, funds are subject to restrictions in terms of the ratio of assets to be included in their portfolios rather than the type of assets eligible for investments.

While the definition for securities funds (equity, bond and hybrid funds), MMFs, and real estate funds remain the same, the classification of commodity funds has changed into special assets funds. In addition, all types of funds, except for MMFs, are eligible to be derivatives funds if certain conditions are met. Within each type of fund, funds of funds are further divided into collective investment securities and real estate, special assets funds. Fund of funds are composed of assets, such as securities (except for collective investment securities), real estate and special assets.

TABLE 9-3. CLASSIFICATION OF FUNDS BY INVESTMENT ASSETS

Type		Investment assets
Securities fund	Bond type	60% or more of total assets invested in bonds
	Equity type	60% or more of total assets invested in equity securities
	Hybrid equity type	Maximum equity portion of total assets should be 50% or more
	Hybrid bond type	Maximum equity portion of total assets cannot exceed 50%
	Investment contract securities	60% or more of total assets invested in investment contract securities; If the figure stands lower than 60%, the fund is categorized as a hybrid equity type
Fund of funds		40% or more of total assets invested in collective investment securities
Short-term finance (MMF)		Free to include any ratio of securities in its investment assets that are mostly composed of short-term financial instruments such as call loans, CPs and CDs
Real estate fund		50% or more of total assets in the collective investment scheme invested in real estate in the form of loans to corporations related with real estate development and investment in other real estate-related securities as prescribed by the Presidential Decree of the FSCMA
Special assets fund		50% or more of total assets invested in special assets that refer to investment assets other than securities and real estate
Mixed assets fund		Collective investment schemes that are not subject to restrictions imposed on securities, real estate and special assets CIS

(b) Net Value Asset of Funds

Funds can be divided into contractual-type and corporation-type based on the form of their legal entity. A contractual-type fund, also referred to as a unit trust in Korea, is a financial investment arrangement where the funds pooled together from investors are entrusted to a trustee which is required to invest and manage the funds according to instructions from an asset management company. Any beneficiary interests from the fund's management are shared among the investors. On the contrary, a corporation-type fund is a company in itself that invests its assets and pays returns to its shareholders. The corporation-type fund is also referred to as a mutual fund.

At the end of 2013, the net asset value (NAV) of unit trusts stood at KRW 317tn, marking an increase of 73.3% from the 2004 figure of KRW 183tn. The NAV of mutual funds has also seen an increase of 57.7%, from KRW 6tn at the end of 2004 to KRW 10tn. Unit trusts account for over 96% of the total AUM in the domestic asset management market.

TABLE 9-4. NET ASSET VALUE OF UNIT TRUSTS AND MUTUAL FUNDS

(Unit: billion won, %)

	Unit trusts		Mutual funds		Total NAV	
2004	183,295	(96.4)	6,824	(3.6)	190,119	(100)
2005	204,171	(94.2)	12,638	(5.8)	216,809	(100)
2006	229,916	(94.8)	12,571	(5.2)	242,433	(100)
2007	304,018	(95.5)	14,403	(4.5)	318,420	(100)
2008	277,335	(96.1)	11,172	(3.9)	288,507	(100)
2009	306,342	(96.2)	12,174	(3.8)	318,515	(100)
2010	306,856	(96.2)	11,957	(3.8)	318,812	(100)
2011	266,537	(96.1)	10,804	(3.9)	277,341	(100)
2012	296,605	(96.4)	10,987	(3.6)	307,592	(100)
2013	317,684	(96.7)	10,761	(3.3)	328,445	(100)

Source: Korea Financial Investment Association

As of the end of 2013, the NAV of funds for public offering was KRW 184tn, an increase of 68.2% from the 2004 figure of KRW 109tn. The NAV of privately placed funds also got a boost of 79.0% from the 2004 figure of KRW 80tn to stand at KRW 144tn.

TABLE 9-5. NET ASSET VALUE OF PUBLIC OFFERING FUNDS AND PRIVATE PLACEMENT FUNDS

(Unit: billion won, %)

	Public offering funds		Privately placed funds		Total NAV	
2004	109,642	(57.7)	80,477	(42.3)	190,119	(100)
2005	132,476	(61.1)	84,334	(38.9)	216,809	(100)
2006	148,926	(61.4)	93,507	(38.6)	242,433	(100)
2007	222,770	(70.0)	95,651	(30.0)	318,420	(100)
2008	166,700	(57.8)	121,807	(42.2)	288,507	(100)
2009	210,306	(66.0)	108,209	(34.0)	318,515	(100)
2010	198,606	(62.3)	120,207	(37.7)	318,812	(100)
2011	169,191	(61.0)	108,150	(39.0)	277,341	(100)
2012	186,293	(60.6)	121,299	(39.4)	307,592	(100)
2013	184,411	(56.1)	144,034	(43.9)	328,445	(100)

Source: Korea Financial Investment Association

As of the end of 2013, the NAV of equity funds and bond funds recorded KRW 80tn and KRW 56tn, respectively.

TABLE 9-6. NET ASSET VALUE BY ASSET TYPES IN WHICH FUNDS INVEST

(Unit: billion won)

	Securities					MMFs	Derivatives	Other[1)]	Total NAV
	Equity type	Hybrid		Bond type	Sub total				
		Equity type	Bond type						
2004	8,916	8,399	27,056	76,713	121,084	60,654	4,829	3,552	190,119
2005	33,231	9,917	35,969	51,724	130,842	65,812	12,569	7,586	216,809
2006	50,144	9,104	40,005	51,122	150,376	58,394	16,886	16,777	242,433
2007	135,590	13,073	32,954	41,156	222,773	47,859	21,863	25,925	318,420
2008	83,943	9,143	25,112	31,260	149,458	90,615	18,009	30,425	288,507
2009	115,044	12,464	18,423	46,933	192,864	72,425	17,946	35,280	318,515
2010	102,912	12,040	21,217	53,378	189,546	67,669	19,055	42,542	318,812
2011	87,464	10,645	18,044	45,310	161,463	53,883	21,322	40,673	277,341
2012	86,261	9,315	19,455	47,251	162,283	63,986	31,640	49,683	307,592
2013	80,056	9,823	22,936	56,115	168,930	67,090	32,211	60,214	328,445

Source: Korea Financial Investment Association
Note: 1) "Other" refers to funds investing in real estate, commodities, special assets and funds of funds.

Overseas funds are divided into on-shore funds and off-shore funds. On-shore funds are registered in accordance with domestic law, have domestic investors as an investment entity and invest 30% or more of their net assets in overseas assets. Off-shore funds are established under overseas jurisdictions and are sold to domestic investors wishing to invest in overseas assets. The AUM of on-shore funds posted a record 9.5-fold growth from KRW 5tn at the end of 2004 to KRW 53tn as of the end of 2013. As a result, their share of the total AUM of funds jumped from 3.0% to 16.4%, an increase of about 5.5 times. However, after a dramatic growth in 2006, on-shore funds have been on the decline and have experienced continuous fund outflows due to the global financial crisis and the termination of tax exemption benefits for on-shore funds at the end of 2009.

TABLE 9-7. NAV AND FUNDS ASSETS OF DOMESTIC AND OVERSEAS INVESTMENT FUNDS

(Unit: billion won, %)

	NAV			Funds Assets (Amount invested by investors)		
	Domestic funds	Overseas funds[1)]	Total	Domestic funds	Overseas funds[1)]	Total
2004	184,460 (97.0)	5,659 (3.0)	190,119 (100)	181,310 (97.0)	5,683 (3.0)	186,993 (100)
2005	207,666 (95.8)	9,144 (4.2)	216,809 (100)	195,535 (95.7)	8,810 (4.3)	204,346 (100)
2006	220,529 (91.0)	21,904 (9.0)	242,433 (100)	214,925 (91.6)	19,690 (8.4)	234,615 (100)
2007	233,687 (73.4)	84,734 (26.6)	318,420 (100)	223,420 (75.4)	73,040 (24.6)	296,460 (100)
2008	245,354 (85.0)	43,153 (15.0)	288,507 (100)	282,529 (78.6)	76,958 (21.4)	359,487 (100)
2009	257,682 (80.9)	60,834 (19.1)	318,515 (100)	258,640 (77.9)	73,240 (22.1)	331,880 (100)
2010	261,505 (82.0)	57,307 (18.0)	318,812 (100)	251,398 (79.8)	63,785 (20.2)	315,183 (100)
2011	233,247 (84.1)	44,094 (15.9)	277,341 (100)	241,843 (81.0)	56,637 (19.0)	298,480 (100)
2012	256,212 (83.3)	51,380 (16.7)	307,592 (100)	259,386 (81.8)	57,887 (18.2)	317,273 (100)
2013	274,724 (83.6)	53,722 (16.4)	328,445 (100)	276,749 (82.6)	58,147 (17.4)	334,896 (100)

Source: Financial Supervisory Service, Korea Financial Investment Association

Note: 1) Overseas investment funds refer to on-shore funds that are established in Korea to invest 30% or more of their net assets in overseas assets.

TABLE 9-8. TOTAL NET ASSETS OF OFF-SHORE FUNDS[1)]

(Unit: billion won)

Category	2005	2006	2007	2008	2009	2010	2011	2012	2013
Net assets	6,125	12,891	8,927	1,939	1,721	1,311	925	785	705

Source: Financial Supervisory Service, Korea Financial Investment Association

Note: 1) Off-shore funds are established in overseas regions for investment in overseas assets and distribution to Korean investors.

(c) Portfolio by Types of Funds

Out of the total asset holdings of funds, bonds and equities amounted to 57.8% and 8.0%, respectively, at the end of 2004. Since then, the portion of bonds has steadily decreased while equities' share has increased significantly. As of the end of 2013, the ratio of equities was similar to that of bonds in the funds' aggregate portfolio, standing at 29.6% and 33.3% of the total.

In terms of the assets of specific types of funds, equity funds have increased the amount invested in equities. The share of equities in their total portfolio increased from the 80% range by the end of 2008 to the 90% range in May 2009, while the share of bonds and call loans has continued to decrease.

TABLE 9-9. AGGREGATE PORTFOLIOS OF FUNDS

(Unit: billion won, %)

	Total assets	Equity	Bond	CP	Deposit	Call loan	Other
2004	193,542 (100)	15,555 (8.0)	111,825 (57.8)	8,865 (4.6)	12,120 (6.3)	14,335 (7.4)	30,842 (15.9)
2005	223,081 (100)	43,962 (19.7)	89,375 (40.1)	9,653 (4.3)	17,206 (7.7)	20,585 (9.2)	42,299 (19.0)
2006	244,750 (100)	59,897 (24.5)	90,414 (36.9)	12,893 (5.3)	19,011 (7.8)	17,707 (7.2)	44,828 (18.3)
2007	335,296 (100)	147,508 (44.0)	65,092 (19.4)	18,111 (5.4)	22,881 (6.8)	17,134 (5.1)	64,570 (19.3)
2008	294,135 (100)	87,878 (29.9)	66,635 (22.7)	22,772 (7.7)	47,791 (16.3)	11,291 (3.8)	57,769 (19.6)
2009	331,692 (100)	125,954 (38.0)	92,158 (28.1)	20,681 (6.2)	26,676 (8.0)	9.99 (3.0)	55.229 (16.7)
2010	336,052 (100)	116,551 (34.7)	106,489 (31.7)	20,464 (6.1)	24,290 (7.2)	11,341 (3.4)	56,918 (16.9)
2011	292,497 (100)	100,874 (34.5)	89,425 (30.6)	17,802 (6.1)	20,612 (7.1)	8,012 (2.7)	55,772 (19.1)
2012	326,232 (100)	103,623 (31.8)	94,415 (28.9)	27,146 (8.3)	19,066 (5.8)	12,005 (3.7)	69,977 (21.5)
2013	349,574 (100)	103,371 (29.6)	116,501 (33.3)	23,176 (6.6)	15,565 (4.5)	9,572 (2.7)	81,388 (23.3)

Source: Korea Financial Investment Association

TABLE 9-10. PORTFOLIOS OF EQUITY FUNDS

(Unit: billion won, %)

	Total assets	Equity	Bond	CP	Deposit	Call loan	Other
2004	9,300 (100)	7,155 (76.9)	324 (3.5)	2 (0.0)	149 (1.6)	1,120 (12.0)	552 (5.9)
2005	36,309 (100)	31,837 (87.7)	371 (1.0)	56 (0.2)	462 (1.3)	2,238 (6.2)	1,345 (3.7)
2006	51,878 (100)	46,503 (89.6)	320 (0.6)	12 (0.0)	492 (1.0)	2,850 (5.5)	1,702 (3.3)
2007	149,108 (100)	128,816 (86.4)	516 (0.4)	12 (0.0)	1,394 (0.9)	5,833 (3.9)	12,537 (8.4)
2008	87,568 (100)	74,498 (85.1)	304 (0.4)	13 (0.0)	3,469 (4.0)	2,523 (2.9)	6,761 (7.7)
2009	119,151 (100)	108,544 (91.1)	144 (0.1)	1 (0.0)	874 (0.7)	3,115 (2.5)	6,473 (5.7)
2010	107,890 (100)	97,456 (90.3)	209 (0.2)	92 (0.1)	898 (0.8)	2,687 (2.5)	6,547 (6.1)
2011	90,660 (100)	81,742 (90.2)	151 (0.2)	8 (0.0)	753 (0.8)	1,977 (2.2)	6,030 (6.7)
2012	90,026 (100)	81,497 (90.5)	102 (0.1)	5 (0.0)	1,132 (1.3)	1,850 (2.1)	5,441 (6.0)
2013	82,921 (100)	76,106 (91.8)	84 (0.1)	5 (0.0)	1,016 (1.2)	1,437 (1.7)	4,273 (5.2)

Source: Korea Financial Investment Association

TABLE 9-11. PORTFOLIOS OF HYBRID FUNDS

(Unit: billion won, %)

	Total assets	Equity	Bond	CP	Deposit	Call loan	Other
2004	36,951 (100)	7,151 (19.4)	19,141 (51.8)	2,352 (6.4)	1,564 (4.2)	2,995 (8.1)	3,748 (10.1)
2005	47,088 (100)	10,205 (21.7)	22,426 (47.6)	2,675 (5.7)	3,140 (6.7)	4,230 (9.0)	4,412 (9.4)
2006	49,695 (100)	8,580 (17.3)	21,728 (43.7)	3,496 (7.0)	6,602 (13.3)	4,245 (8.5)	5,044 (10.1)
2007	46,482 (100)	12,884 (27.7)	16,595 (35.7)	5,328 (11.5)	4,013 (8.7)	4,088 (8.8)	3,573 (7.7)
2008	35,315 (100)	7,670 (21.7)	13,597 (38.5)	5,397 (15.2)	4,080 (11.6)	1,494 (4.2)	3,096 (8.8)
2009	33,441 (100)	9,953 (29.8)	15,584 (46.6)	2,471 (7.4)	1,189 (3.6)	1,953 (5.8)	2,292 (6.9)
2010	35,797 (100)	106,030 (29.6)	18,646 (52.1)	784 (2.2)	1,129 (3.2)	2,375 (6.6)	2,261 (6.3)
2011	27,305 (100)	8,575 (31.4)	13,261 (48.6)	782 (2.9)	648 (2.4)	1,992 (7.3)	2,048 (7.5)
2012	27,170 (100)	8,048 (29.6)	13,038 (48.0)	489 (1.8)	686 (2.5)	2,164 (8.0)	2,744 (10.1)
2013	31,542 (100)	10,371 (32.9)	15,332 (48.6)	364 (1.2)	685 (2.2)	2,196 (7.0)	2,595 (8.2)

Source: Korea Financial Investment Association

TABLE 9-12. PORTFOLIOS OF BOND FUNDS

(Unit: billion won, %)

	Total assets	Equity	Bond	CP	Deposit	Call loan	Other
2004	78,084 (100)	298 (0.4)	64,339 (82.4)	2,182 (2.8)	2,924 (3.7)	2,854 (3.7)	5,487 (7.0)
2005	52,244 (100)	322 (0.6)	42,845 (82.0)	1,602 (3.1)	2,729 (5.2)	1,464 (2.8)	3,283 (6.3)
2006	50,774 (100)	308 (0.6)	41,550 (81.8)	2,123 (4.2)	2,164 (4.3)	1,951 (3.8)	2,678 (5.3)
2007	41,702 (100)	148 (0.4)	31,145 (74.7)	3,882 (9.3)	2,786 (6.7)	1,586 (3.8)	2,156 (5.2)
2008	32,722 (100)	53 (0.2)	26,896 (82.2)	1,650 (5.0)	2,358 (7.2)	643 (2.0)	1,123 (3.4)
2009	53,566 (100)	107 (0.2)	44,754 (83.6)	1,888 (3.5)	2,928 (5.5)	1,381 (2.6)	2,510 (4.7)
2010	60,323 (100)	69 (0.1)	50,064 (83.0)	3,322 (5.5)	1,823 (3.0)	2,682 (4.5)	2,363 (3.9)
2011	48,976 (100)	73 (0.2)	42,459 (86.7)	2,546 (5.2)	1,244 (2.5)	964 (2.0)	1,690 (3.5)
2012	51,014 (100)	9 (0.0)	43,371 (85.0)	1,355 (2.7)	838 (1.6)	2,222 (4.4)	3,220 (6.3)
2013	59,693 (100)	1 (0.0)	51,359 (86.0)	2,131 (3.6)	572 (1.0)	2,011 (3.4)	3,619 (6.1)

Source: Korea Financial Investment Association

TABLE 9-13. PORTFOLIOS OF MMFS

(Unit: billion won, %)

	Total assets	Equity	Bond	CP	Deposit	Call loan	Other
2004	59,297 (100)	97 (0.2)	26,256 (44.3)	4,319 (7.3)	7,002 (11.8)	6,540 (11.0)	15,084 (25.4)
2005	64,330 (100)	92 (0.1)	19,937 (31.0)	5,298 (8.2)	10,423 (16.2)	11,341 (17.6)	17,240 (26.8)
2006	56,654 (100)	168 (0.3)	22,099 (39.0)	7,163 (12.6)	8,191 (14.5)	6,835 (12.1)	12,199 (21.5)
2007	47,399 (100)	91 (0.2)	10,755 (22.7)	8,736 (18.4)	9,750 (20.6)	3,218 (6.8)	14,848 (31.3)
2008	90,758 (100)	7 (0.0)	19,206 (21.2)	15,514 (17.1)	31,571 (34.8)	5,724 (6.3)	18,736 (20.6)
2009	72,440 (100)	6 (0.0)	25,877 (32.6)	16,200 (19.4)	15,463 (24.0)	2,181 (5.8)	12,712 (18.1)
2010	67,401 (100)	6 (0.0)	26,523 (39.4)	16,207 (24.1)	14,351 (21.3)	2,059 (3.1)	8,255 (12.3)
2011	53,691 (100)	1 (0.0)	21,216 (39.5)	14,422 (26.9)	11,712 (21.8)	1,640 (3.1)	4,700 (8.8)
2012	63,581 (100)	0 (0.0)	17,919 (28.2)	25,123 (39.5)	10,691 (16.8)	3,782 (6.0)	6,057 (9.5)
2013	66,510 (100)	0 (0.0)	28,851 (43.4)	20,697 (31.1)	6,898 (10.4)	2,281 (3.4)	7,784 (11.7)

Source: Korea Financial Investment Association

3. Miscellaneous

1) SALES BALANCES BY DISTRIBUTION CHANNEL

Securities companies and banks are the dominant fund distribution channels in Korea. As of the end of 2013, 63.2% of funds were distributed by securities companies, 27.7% by banks, 3.7% by insurance companies, and 5.4% by other institutions. The share of securities companies in funds sales, which showed a downward trend until 2008, has increased, while the share of banks has declined sharply since the 2008 financial crisis. Among the types of funds sold, bond-type funds and MMFs make up a high portion of the total sales of securities companies, and equity funds make up a high share of the sales by banks.

TABLE 9-14. FUND SALES BALANCES AND SALES RATIO BY DISTRIBUTION CHANNEL

(Unit: KRW trillion, %)

	2008		2009		2010		2011		2012		2013	
Securities companies	164.5	(46.6)	176.0	(54.0)	182.8	(60.0)	164.3	(58.0)	183.1	(61.4)	196.2	(63.2)
Banks	136.7	(38.7)	121.2	(37.2)	96.6	(31.7)	91.6	(32.3)	86.3	(28.9)	86.0	(27.7)
Insurance companies	12.7	(3.6)	13.7	(4.2)	12.7	(4.2)	11.4	(4.0)	12.9	(4.3)	11.6	(3.7)
Other	39.1	(11.1)	14.8	(4.5)	12.6	(4.1)	16.1	(5.7)	15.9	(5.3)	16.6	(5.4)
Total	352.9	(100.0)	325.7	(100.0)	304.8	(100.0)	283.3	(100.0)	298.3	(100.0)	310.4	(100.0)

Source: Korea Financial Investment Association

2) FEES AND EXPENSES

Fund investors are charged either front/back-end sales loads or sales fees for the services they receive after opening a fund account. In Korea, most funds charge sales fees that are paid out continuously from fund assets.

Sales fees are paid out to a fund distributor for providing account management services such as an advisory on funds and the sale of funds, with the fees charged from fund assets at a certain ratio every year. On the contrary, sales loads are charged directly to investors by fund distributors for providing one-off services upon the sale of funds such as assessment of investment appetite or an advisory on choosing adequate funds.

The total costs associated with managing and operating a fund are measured by the Total Expense Ratio (TER). These costs cover management fees, sales fees, custodian fees, administration fees, and other transaction fees that are paid out from a fund's assets. The average TER of all funds stood at around 0.87% as of the end of 2013. Real estate and hybrid funds recorded the highest TER of 1.65% and 1.54%, respectively, while MMF and bond funds posted the lowest ratio of 0.26% and 0.48%, respectively.

Despite a dramatic rise in the assets managed by AMCs in Korea, fee ratios have been gradually decreasing due to intensified competition and the passing of a regulation in 2010 which reduced fee ratios from 1.5% to 1% or below. Due to these factors, total fees for equity funds stood at 1.39% in 2013, 0.62% lower than the level in 2009. In most funds, the portion of sales fees outnumbers management fees by a ratio of six to four.

TABLE 9-15. TOTAL EXPENSE RATIO BY FUND (END OF 2013)

(Unit: %)

Fund type	Fees					Other expense ratio	Total expense ratio	Commission		Brokerage commi-ssion
	Manage-ment fees	Distri-bution fees	Custody fees	Admini-stration fees	Total fees[1)]			Front	Back	
Equity	0.61	0.74	0.03	0.02	1.39	0.02	1.41	0.99	2.01	0.22
Hybrid equity	0.73	0.76	0.04	0.02	1.48	0.05	1.54	0.95	1.00	0.33
Hybrid bond	0.33	0.65	0.03	0.02	1.01	0.02	1.03	0.60	0.97	0.12
Bond	0.21	0.28	0.02	0.02	0.46	0.02	0.48	0.33	1.35	0.01
MMF	0.07	0.16	0.02	0.01	0.26	0.00	0.26	0.24	0.00	0.00
Derivative	0.35	0.33	0.02	0.01	0.61	0.02	0.63	0.67	2.87	0.16
Real estate	0.80	0.60	0.05	0.04	1.16	0.49	1.65	1.46	0.00	0.03
Fund of funds	0.29	0.82	0.04	0.02	1.17	0.02	1.19	0.97	0.84	0.09
Special assets	0.36	0.24	0.02	0.03	0.61	0.57	1.18	0.95	0.00	0.01
Total	0.36	0.48	0.03	0.02	0.85	0.02	0.87	0.91	1.08	0.12

Source: Korea Financial Investment Association

Note: 1) Total Expense Ratio refers to the ratio of all the expenses that are paid out from a fund's assets with expenses including management fees, distribution fees, custody fees, fund administration fees and other expenses.

3) TAXATION ON FUNDS

In order to protect investors from double taxation, a fund itself is not liable for taxes for any income arising from it. Instead, an investor is subject to

withholding tax at the time the investor receives income arising from the fund. As the fund distributors such as the banks and securities companies pay the income to investors, the distributors are required to withhold tax at the source of the fund's income, which is categorized as dividend income. As a result, an individual investor is subject to income tax while a corporate investor is subject to corporation tax for any income from fund investment. Income subject to withholding tax is the fund's income, or dividend, which is taxed as dividend income. For individual investors, fund income is consolidated with other income from financial investment products for the fulfillment of tax payment.

As funds invest both in equities and bonds, a fund investor is subject to a withholding tax for any interest gained from bond investment even if losses occurred in the fund's equity investment. If the financial income exceeds KRW 40mn, it should be combined with other types of income in the global income tax return. As interest or dividend income is distributed to investors at the time of a fund's financial settlement, any income occurring at the time of the settlement is subject to a withholding tax, even though a customer incurred losses when he or she redeemed the fund. Once again, any financial income exceeding KRW 40mn is combined with other types of income for taxation under the global income tax.

TABLE 9-16. CHARACTERISTICS OF INCOME FROM FUND INVESTMENTS

Investment type		Income type
Fund (Indirect investment)	Investment trust (Contractual type)	Dividend income
	Mutual fund (Corporation type)	
Trust (Trust instruments except for investment trusts)		Income types divided by the source of income

Source: Korea Institute of Public Finance

4) STATUS ON FUND INVESTMENTS BY RETIREMENT PENSION PLAN AND VARIABLE ANNUITY

(a) Fund Investments by Retirement Pension Plan

IIn December 2005, the retirement pension plan was introduced to ensure stable income and livelihood after retirement. The plan is a corporate benefit system in which an employer sets aside funds for an employee's retirement

benefits at a financial institution separate from the company. The funds are managed according to the instructions of the employer or an employee, allowing the employee to receive the benefits as an annuity or lump sum payment upon retirement.

There are three types of pension plans depending on the benefit payment method and the entity managing the fund: defined benefit (DB) plan, defined contribution (DC) plan and individual retirement plan (IRP). As of the end of March 2014, DB plans accounted for 71% (KRW 60.1tn), DC plans 21% (KRW 18.1tn), individual IRPs 7.5% (KRW 6.4tn), and corporate IRPs 1.0% (KRW 0.7tn) of all pension plans managed in Korea, indicating that DB plans are the main reason behind the gradual growth in pension plans in Korea – both in terms of the number of investors and investment assets.

As pension plan investment has a direct impact on retirement benefits and contributions made by an employer, a stable return is a critical element in the investment of pension plans. In this regard, the Regulation on Supervision of Retirement Pension Plan divides assets into risky and risk-free and set limits on investments in risky assets such as stocks and corporate bonds, which do not protect the investment principal.

Both DB and DC plans can invest in risk-free assets such as bond funds without any limit in their asset holdings. But for DB plans, the asset holdings should be limited to less than 30% for each asset-type such as stocks listed on the domestic or overseas market, convertible bonds, subordinated bonds, and overseas bonds of investment grade. The limit increases to 50% for each risky asset such as equity funds, hybrid funds, derivative funds, real estate funds, commodity funds and high-risk bonds. All in all, investment in risky assets should consist of less than 70% of total assets. For DC plans, up to 40% of the total assets can be invested in equity and equity-focused hybrid funds, and rental property funds. In general, DC plans are more strictly regulated than DB plans when it comes to the make-up of assets.

As of the end of March 2014, the outstanding balance of retirement pension plans in Korea stood at KRW 85tn, and the subscription rate reached 48.3%. Among them, KRW 79.0tn (93%) was invested in principal-protected products, and KRW 5.0tn (6%) in dividend products. A closer look at the breakdown of the pension industry shows that banks are accountable for KRW 43.953tn, life insurance companies KRW 20.6816tn, securities companies KRW

14.2161tn, non-life insurance companies KRW 6.898tn, and Korea Workers' Compensation & Welfare Service KRW 343.1bn.

As for the investment portfolios, DB plans invested in principal-protected products at 98% (KRW 58.7323tn), while investments made by DC plans in the same type of products stood at 79% (KRW 14.2916tn).

TABLE 9-17. STATUS OF PENSION PLAN INVESTMENT BY PENSION TYPE AND FINANCIAL INSTITUTION (AS OF MARCH 2014)

(Unit: KRW 100 million, %)

	DB		DC		Coroporate IRPs		Individual IRPs		Total	
		Percentage		Percentage		Percentage		Percentage		Percentage
Principal-protected products	587,323	97.7	142,916	79.0	6,243	90.5	53,367	83.1	789,849	92.6
Dividend products	8,577	1.4	35,505	19.6	623	9.0	5,717	8.9	50,422	5.9
Other1)	4,956	0.8	2,473	1.4	29	0.4	5,108	8.0	12,566	1.5
Total	600,856	100.0	180,893	100.0	6,895	100.0	64,193	100.0	852,837	100.0

Note: 1) Others include lending to a financial institution's own account, bills issued and other cash assets including stand-by capital.

(b) Personal Pension

Personal pension was first introduced in Korea in June 1994, while pension savings accounts came out on the market in 2001, pursuant to the former Special Tax Treatment Control Act. Under this plan, 100% of the sum of paid premiums was deducted from taxable income within a set limit, but pensioners were subject to income tax upon receiving pensions. In 2013, a new type of pension savings account was released, with a sweeping revision made to taxation on pension income. Previously, plans were subject to a high income tax when holders wished to cancel the product before the agreed termination date, but the revised plans allowed for product changes within the same account without additional tax imposition.

Pension savings products can also be categorized according to the financial institution responsible for the management; pension savings insurance products from insurance companies, pension savings trust products from banks, and pension savings fund products from securities companies. While principal is guaranteed for pension savings insurance and pension savings

trusts, it is not protected in pension savings funds. Also, pension holders are free to shift their pension savings account between different pension savings products without having to pay additional tax.

As of the end of December 2012, the amount of aggregate funds from all pension savings products is KRW 78.8tn, with the annual growth rate being above 10% since 2007. Of these funds, KRW 42.9tn was life insurance products (56%), KRW 16.5tn was non-life insurance products (26.0%), KRW 12tn was bank trusts (16%), and KRW 4.8tn was securities companies (6%).

TABLE 9-18. OUTSTANDING BALANCE OF PENSION SAVINGS MANAGED BY DIFFERENT FINANCIAL INSTITUTIONS

(Unit: 100 million won, %)

Institutions	Dec 2008	Dec 2009		Dec 2010		Dec 2011		Dec 2012	
	Balance	Balance	YoY Growth	Balance	YoY Growth	Balance	YoY Growth	Balance	YoY Growth
Life insurance	228,365	259,270	13.5%	298,393	15.1%	338,136	13.3%	429,950	27.2%
Non-life insurance	70,568	83,600	18.5%	102,743	22.9%	130,739	27.2%	165,162	26.3%
Bank (trust)	110,140	108,563	-1.4%	113,198	4.3%	117,645	3.9%	122,285	3.9%
Securities	22,898	29,241	27.7%	35,518	21.5%	39,234	10.5%	48,474	23.6%
Other	30,796	38,513	25.1%	46,288	20.2%	55,833	20.6%	22,246	-60.2
Total	462,767	519,186	12.2%	596,140	14.8%	681,587	14.3%	788,117	15.6%

Note: For years, pension savings managed by Nonghyup's insurance arm was counted in the "other" category, but since it was converted into a life insurance company, pension savings assets under management (KRW 4.7861tn) are now included in the "life insurance" category.
Source: The Financial Supervisory Service (FSS)

As of the end of March 2014, more than 100,000 accounts have been opened for the pension savings fund account since the launch of the product one year prior. Among these accounts, securities companies attributed for 93,482 accounts (91%), banks to 8,950 (9%), and insurance companies to 303 (0.3%).

TABLE 9-19. PENSION SAVINGS ACCOUNTS OPENED BY FINANCIAL INSTITUTIONS

Securities companies	Banks	Insurance companies	Total
93,482(91%)	8,950(8.7%)	303(0.3%)	102,735

Source: KOFIA's pension savings fund comparative disclosure (April 2014)

(c) Variable Insurance

Variable insurance is an asset management instrument run by insurance companies which invest part of the insurance premiums from insurance policy holders in stocks, government bonds, public bonds and corporate bonds, with any returns arising from the investment distributed back to the paid premiums of the policy holders. In most cases, insurance companies delegate asset management companies to manage assets held in variable insurance products. The types of variable insurance include whole life insurance, annuity insurance, universal insurance, and critical illness insurance.

In Korea, variable whole life insurance was first introduced in 2001, variable annuity in 2002, and the multi-fund investment-linked insurance policy (ILP) in 2003. During the early days of variable life insurance, sales were sluggish due to a lack of qualified sales agents and low understanding of the products. But an improvement in sales capacity and the growth of the stock market have caused a steady rise in the sales of variable insurance instruments. For FY 2012 (April 1, 2012 to March 31, 2013), the aggregate premium income from variable insurance was KRW 21.223tn, a nine-fold increase from the figure in 2004.

TABLE 9-20. PREMIUM INCOME FROM GENERAL AND VARIABLE INSURANCE PRODUCTS

(Unit: KRW 100 million, %)

Category	FY 2004	FY 2005	FY 2006	FY 2007	FY2008	FY2009	FY2010	FY2011	FY 2012
General insurance[1)]	472,342	477,807	496,100	516,858	512,324	533,591	571,478	604,389	874,693
Variable insurance	23,789	83,822	115,278	173,912	175,916	171,882	194,129	212,937	212,230
Total	496,131	561,629	611,378	690,770	688,240	705,473	765,607	817,326	1,086,923
Proportion[2)]	(4.8)	(14.9)	(18.9)	(25.2)	(25.6)	(24.4)	(25.4)	(35.2)	(19.5)

Source: Korea Life Insurance Association, Korea Insurance Development Institute

Note: 1) General insurance refers to life insurance products other than retirement insurance and variable insurance plans.

2) Proportion refers to the share of variable insurance premiums in the total premium income earned by insurance companies.

II. TRUST MARKET

1. Trust

1) DEFINITION OF TRUSTS

Just as the Korean word for trust (shin-tak) literally means to trust (shin) and entrust (tak), trust refers to a legal relationship whereby an individual or an entity is trusted, and entrusted with property. To be precise, trust is a legal term that represents a relationship in which one places confidence in a third party by making that party the nominal owner of transferred properties to be managed for a particular purpose defined by the third party or his designated representative

Article 2 of the Trust Act defines trust as the following:

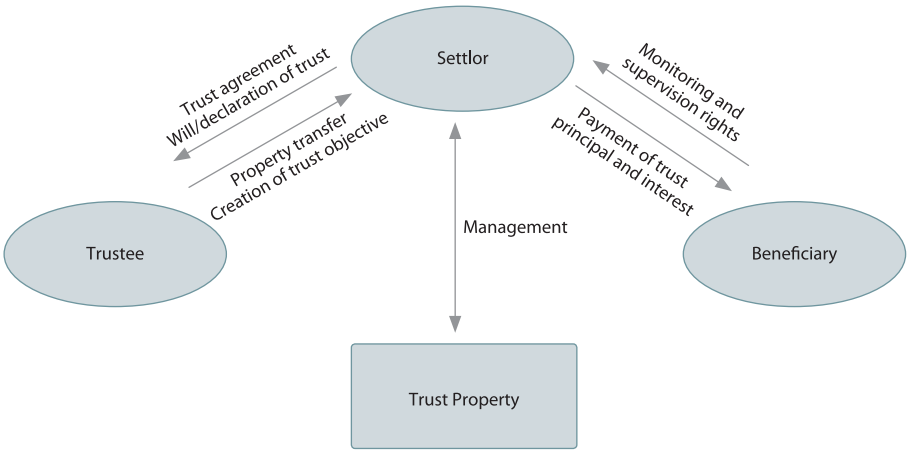
> Article 2 of Trust Act: Definition of Trust
>
> The Act defines a "trust" as a legal relationship based on the fiduciary relationship between an entity creating a trust (hereinafter referred to as "settlor") and an entity assuming a trust (hereinafter referred to as "trustee") that requires the settlor to transfer certain properties--including parts of operating rights or copyrights-to the trustee, file a lien on them, or take measures to dispose or liquidate them, and mandates the trustee to manage, dispose, invest, develop entrusted properties or carry on activities necessary to achieve the objective of the trust for the benefit of a designated person (hereinafter referred to as "beneficiary") or for certain pre-defined purposes.

2) CHARACTERISTICS OF TRUSTS

The most notable characteristic of a trust is the fact that once a trust is created upon the transfer of a property from a settlor to a trustee, the trustee becomes a nominal owner entitled with rights and duties over the entrusted property. The trustee holds the trust property under its name and formally manages the property as its own; however, the trustee holds the trust property not for its own interest but for the sake of a beneficiary, with all principal and interests relating to the property to be gathered by the beneficiary. As such, when the settlor is the sole beneficiary of the trust (self-settled trust), the primary objective of the

trust would be the management of assigned property for the benefit of the trust creator. On the other hand, when the settlor is not the designated beneficiary (non-self-settled trust), the trust would be managed in a way that benefits entities other than the settlor. Although the ownership of the trust property lies with the settlor, the benefits arising from a trust can be distributed to any third party under the Trust Act.

CHART 9-1 . STRUCTURE OF TRUSTS



As trust properties are held under the name of the trustee, there are risks that the trustee may use or sell properties for his or her own sake, instead of for the benefit of the beneficiary. To prevent such abuse of authority, the Trust Act mandates that a trustee adhere to a special duty of loyalty on top of the fiduciary duty imposed by the Civil Act. The Trust Act also mandates that trustees shall conform to the prohibition against acts of conflicting interest, the principle of fair treatment of multiple beneficiaries, the restriction of benefit distribution to trustees, the duty to earmark trust properties, and similar duties to ensure fair and responsible conduct.

In the case where a trustee violates one's duties and causes damage to the trust property, the trustee is liable for the recovery of the property or indemnification of damages. The Trust Act provides further protection for beneficiaries by stating that when the trustee's breach of a special duty of loyalty grants certain benefits to the trustee or a third party, the trustee shall return all gains from the trust property, even if no loss to the trust property has been incurred.

Another distinctive characteristic of trust properties is the duty to embark and the independence requirements for trust properties. Owing to its independent characteristic, a trust is used for various purposes, i.e. a trust to safeguard employees' retirement pensions from the risk of bankruptcy of a company, or a trust to protect buyers in real estate development projects or property sell-outs.

The last noteworthy quality of a trust is the principle of result distribution. This principle refers to the fact that the relationship present in a trust gives a trustee the rights and duties over properties for the benefit of a beneficiary, but does not guarantee principal or profits generated from it. To be more precise, all profits, and losses, generated through trust management are distributed to the beneficiary.

3) CHANGES IN LAWS ON TRUSTS

The trust market in Korea opened in earnest in 1961 with the enactment of the Trust Act and the Trust Business Act, which also permitted banks to engage in trust business activities. On April 13, 1990, real estate trusts were institutionalized following the government's special intervention in the real estate market to address housing price hikes. This gave rise to the establishment of real estate trust companies. Securities and insurance companies later joined the trust market after acquiring authorization in 2005 and 2007, respectively. Currently, four sectors—banking, securities, insurance and real estate trust companies—are engaged in trust business activities.

CHART 9-2. HISTORY OF LAWS ON TRUSTS

- 1961: Enactment of the Trust Act and the Trust Business Act
  After Hanil Bank became the first entity in the nation to be authorized to conduct trust business activities in November 1961, other commercial banks followed suit in September 1962.
  Commercial banks were no longer allowed to engage in trust business activities after the Korea Trust Bank was established in December 1968.
- 1983: Trust market re-opened to banks
  In a series of efforts to liberalize the financial industry in the 1980s, the government granted local banks (1983), commercial banks (1984), and national policy banks (1988) the right to operate a trust business.
- 1990: Introduction of real estate trust system
  To cope with the housing price surge in the late 1980s, the government introduced a real estate trust system following the announcement that it would institute special control measures over the real estate market (April 13, 1990). As of the end of 2012, there are 11 real estate trust companies operating in the market.
- 2004: Prohibition on creation of unspecified money trusts
  Since the Indirect Investment Asset Management Business Act, implemented in January 2004, defines an unspecified money trust as an indirect investment scheme; the creation of unspecified money trusts was restricted beginning in July 2004.
- 2005 and 2007: Trust market opened to securities (2005) and insurance companies (2007)
  First, nine securities firms acquired the license to carry out trust business activities in December 2005. A life insurance company would later attain the license in September 2007. As of the end of 2012, 21 securities companies and 5 insurance companies are operating trust businesses.

Source: The Financial Supervisory Service (FSS)

4) LEGAL FRAMEWORK ON TRUSTS

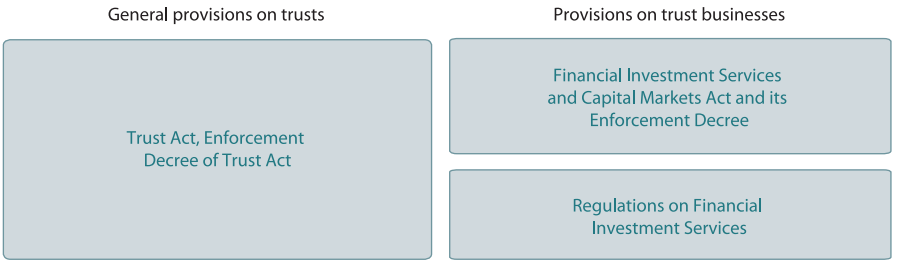
The laws governing trust relationships are the Trust Act, a set of general provisions on trusts, and the Financial Investment Services and Capital Markets Act (FSCMA), a code of regulations to guide and oversee trust companies that engage in trust business activities for profits. The Trust Business Act, which had been the applicable law for regulating trust companies, was abolished with the enforcement of the FSCMA in February 2009. Trusts are one of the six sectors of financial investment services governed by the FSCMA. In July 2011, the Trust Act underwent an extensive revision.

The Trust Act had not been updated for the fifty years following its enactment in December 1961. As the Act failed to keep pace with changes in the economic landscape over the prior decades, the Ministry of Justice initiated work on revising the Act in January 2009 and submitted a revision bill to the National Assembly in February 2010, which led to the promulgation of the new Trust Act in July 2011.

The revision mapped out a new trust system encompassing a limited liability trust, beneficiary certificate issuing trust, and trust corporate bond, securing easier financing methods through trusts. New forms of trusts were adopted as well, such as a trust for wills and a trust for beneficiary in succession, to diversify ways to inherit assets or donate to charities. The duties of trustees have also been reinforced by codifying the special duty of loyalty and recognizing their liabilities for recovery of principal and return of profits generated by the trust.

In order to ensure such revisions are covered in the FSCMA, the FSC revised the section for trusts in the FSCMA and submitted its proposal to the National Assembly in August 2012. Currently, talks are underway to pass the proposal. The FSC's revision includes the addition of collateral rights and debts to assets available for trusts, regulations on corporate bond issue limits and businesses similar to trusts, and allowing issuance of beneficiary certificates for all trust properties through refined policies. This series of efforts has led to a solid legal framework supporting the development of the trust industry in Korea.

CHART 9-3. LEGAL FRAMEWORK ON TRUSTS



2. Current Status of Trust Market

1) TRUST COMPANIES AND ASSETS IN TRUSTS

As of the end of 2013, 57 financial institutions provide trust services, with 46 companies operating a trust business in addition to their core business (21 securities companies, 20 banks and 5 insurance companies), and 11 real estate trust companies that are dedicated to trust business activities.

TABLE 9-21. NUMBERS OF COMPANIES ENGAGING IN TRUST BUSINESS ACTIVITIES

(Unit: number of companies)

Category		2009	2010	2011	2012	2013
Institutions operating other core businesses	Securities	17	20	21	21	21
	Banks	20	20	20	20	20
	Insurance	5	5	5	5	5
Sub-total		42	45	46	46	46
Real estate trust companies		11	11	11	11	11
Total		53	56	57	57	57

Source: Korea Financial Investment Association

As of the end of 2013, a breakdown of assets in trusts shows that banks have the largest market share with 49.3%, followed by securities companies (26.3%), real estate trust companies (24.0%), and insurance companies (0.5%).

Assets of financial companies that concurrently operate a trust business (securities companies, banks, insurance companies) rose by 19.0% to KRW 60.5tn, while the assets of real estate trust companies that are dedicated to a trust business decreased slightly from the previous year.

TABLE 9-22. ASSETS IN TRUSTS BY INDUSTRY

(Unit: KRW trillion)

Category		2007	2008	2009	2010	2011	2012	2013
Institutions operating other core businesses	Banks	150.6	147.0	150.9	165.0	182.0	202.1	245.2
	Securities	22.3	27.5	54.5	63.4	79.3	113.9	130.7
	Insurance	0.1	0.3	0.4	0.5	0.7	1.7	2.3
	Sub-total	173.0	174.8	205.8	228.9	262.0	317.7	378.2
Real estate trust companies		76.6	95.9	124.2	142.4	153.8	120.9	119.2
Total		249.6	270.7	330.0	371.3	415.8	438.6	497.4

Source: Financial Supervisory Service (2007-2009), Korea Financial Investment Association (2010-2013)

2) TYPES OF TRUSTS AND CURRENT STATUS OF ASSETS IN TRUSTS CLASSIFIED BY TYPES

(a) Types of Trusts

Trusts are classified in various ways—by trust property types, by management rights or by trust beneficiaries. The most common approach is to classify trusts by the type of trust property at the time of the signing of a trust agreement. When different types of properties are to be transferred in a single trust agreement, such a trust is classified as a composite property trust. In general, trust properties are divided into money trusts and property (non-money) trusts. Money trusts are further distinguished as specified money trusts and unspecified money trusts, and property trusts are identified as securities trusts, monetary bond trusts, movable trusts, real estate trusts, trusts of the rights over real estate, and trusts of intellectual property rights, each with different trust compositions and management objectives.

TABLE 9-23. CLASSIFICATION OF TRUST PRODUCTS AND THEIR OBJECTIVES

Classification	Objective of Trust
Money trust	To grow wealth through active investments
Securities trust	To preserve, manage or lend securities
Monetary bond trust	To manage and collect monetary bonds; but in general, used as a means to secure financing by transferring the entitlements to the trust to a third party
Movable trust	To manage, operate or dispose of movables by leasing or hiring out transportation vehicles or mechanical equipment, including ships, airplanes, automobiles and heavy machinery; often used as a means to secure financing by transferring the entitlements to a third party
Real estate trust	To manage, dispose of, collateralize or develop real estate
Trust of the rights over real estate	To manage and utilize surface rights, deposit-based lease rights and other rental rights
Trust of intellectual property rights	To manage or dispose of intellectual property rights including copyrights, trademarks and patents; patents held by companies and copyrights of movie productions or record companies can be put in a trust to ensure expert management, or their entitlements can be transferred to secure funding
Composite property trust	To securitize different types of properties in a single contract, or to combine different properties under a trust for the purpose of inheritance

Another way to classify trusts is by dividing them into discretionary trusts and non-discretionary trusts, depending on who—the trustee or settlor—has the power to make decisions over the management of the trust. When the trustees have the right to management decisions, it is called a discretionary trust; but when the right to make decisions is with the settlors, it is non-discretionary.

To clarify, a discretionary trust gives a professional trustee, usually a trust company, the power to determine and execute plans for investment and wealth management to effectively manage trust properties. In a non-discretionary trust, basic duties over management are fulfilled by trustees, but major investment decisions that may affect the performance of trust management are to be made by settlors on their own responsibility.

Similarly, a money trust is divided into specified and unspecified money trusts. An unspecified money trust allows a trustee to have managing rights over a trust property and make investment decisions based on the conditions provided in the trust agreement. In a specified money trust, a settlor gives instructions over the management of properties to a trustee and the trustee returns results generated from trust activities to the settlor. A specified money trust is usually in the form of a non-discretionary product, but a part of the decision-making can be delegated to the trustee in a discretionary specified money trust.

For instance, when a settlor gives a directive to a trustee to buy 100 shares of Samsung Electronics at KRW1mn per share in a non-discretionary specified money trust, the trustee should purchase the shares based on the given condition without making any decision regarding such investment, and manage those shares for the benefit of the settlor. A partial discretionary approach is possible upon the request of the settlor if the settlor gives instructions to buy listed stocks but provides no details as to the item, price or quantity of stocks to buy and delegates decision-making to the trustee.

In general, property trusts, which focus on the preservation of properties rather than proactive management, are non-discretionary, and money trusts, of which the fundamental objective is to grow wealth, are discretionary so that settlors can rely on the expertise of professional trustees.

As mentioned earlier in this chapter, trusts can be categorized based on who the beneficiaries are. A self-settled trust is an approach in which the settlor is the sole beneficiary that receives the principal and interest from a trust. A non-self-settled trust distributes the benefits of a trust to a third party designated by the settlor. The trust system was originally used as a means to entitle trustees with the rights and duties over properties in cases where settlors could not manage them by themselves; but these days, self-settled trusts have become the dominant type of trust in the market.

(b) Sub-categories of Trusts

The trust types mentioned above can be further classified into sub-categories according to the composition and quality of their products. Sub-categories of specified money trusts are fixed-rate, equities, advisory, structured product, overseas investment, money market, treasury stock, separate taxation, and pension trusts. Unspecified money trusts are largely managed by a joint or a single entity. It is advised to note that jointly managed unspecified money trusts cannot be provided through new accounts or contracts as they are deemed similar to mutual funds in the 2004 Indirect Investment Asset Management Business Act.

The subcategories for real estate trusts are—depending on the objective and scope of the trust activities—collateral, management, disposition, land (for development and management purposes), and parceling-out trusts.

TABLE 9-24. TYPES OF REAL ESTATE TRUST PRODUCTS

Category	Details
Collateral	-A settlor can get a loan secured by beneficiary certificates issued by a trustee after properties are transferred to the trustee -A trustee manages the collateral or sells the collateral to repay a loan
Management	-Overall real estate management to be performed by a trustee; activities include management of ownership, maintenance of real estate and management of lease
Disposition	-A trust company is responsible for disposition of real estate that requires complex and strict procedures until completion of disposition
Development (land for lease)	-A trust company develops transferred land with additional financing, and distributes the profits generated from parceling-out or lease contracts. This is also referred to as a land trust
Land management	-Similar with the development trust described above, a trust company is in charge of the land development project, but financing and actual managerial procedures are carried out by a settlor -Risks can be reduced on the part of trust companies in case of project failures, and projects can be continued even when settlors go bankrupt
Parceling-out	-A trust company handles the duties of the management of the construction site and funds related to parceling-out in a way to ensure transparency and stability of the parceling-out of commercial buildings

(c) Assets in Trust by Trust Type

Assets in trust can be classified according to the types of trust properties. The entire volume of trusts is rising, particularly in specified money trust products. Assets in money trusts also continue to rise thanks to the surge of specified money trusts, although the volume of unspecified money trusts is declining since the Indirect Investment Asset Management Business Act banned the opening of new accounts for such products in 2004.

Among property trust products, as of the end of 2013, real estate trusts had the largest asset value with KRW 144.8tn, followed by monetary bond trusts (KRW 95.4tn) and securities trusts (KRW 9.3tn). While the assets of monetary bond trusts and securities trusts increased by 39.9% (KRW 27.2tn) and 32.9% (KRW 2.3tn) respectively, property trusts fell by 3.5% (KRW 5.3tn).

TABLE 9-25. ASSETS IN TRUST BY TRUST TYPE

(Unit: KRW trillion)

Category		2007	2008	2009	2010	2011	2012	2013
Money trust	Specified	76.0	80.3	101.8	123.1	157.4	201.4	235.3
	Unspecified*	18.3	17.6	16.7	15.8	12.4	12.0	12.3
	Sub-total	94.3	97.7	118.6	138.9	169.8	213.4	247.7
Property trust	Real estate	109.0	128.1	156.7	176.0	185.0	150.1	144.8
	Securities	9.7	8.9	8.2	4.7	4.7	7.0	9.3
	Monetary bond	36.6	35.8	46.1	51.5	54.7	68.2	95.4
	Sub-total	155.3	172.8	210.9	232.2	244.4	225.3	249.4
Other (mortgage bond trust, etc.)		-	-	0.5	0.2	1.6	-	0.3
Total		249.6	270.7	330.0	371.3	415.8	438.6	497.4

*New openings banned after the enforcement of the Indirect Investment Asset Management Business Act in Jan. 2004
Source: Financial Supervisory Service (2007-2009), Korea Financial Investment Association (2010-2013)

3. Taxation on Trusts

Since the Trust Law defines a trust as a legal relationship that entitles a trustee the rights over transferred properties for the benefit of the trust creator, the nominal ownership of properties is with the trustee, but the actual principal and earned profits belong to the beneficiaries.

Such structure has given rise to years-long controversies over who should be taxed for the income generated in the course of a trust agreement—the legal owner or the de facto owner of the properties. Different countries have adopted different taxation methods for trusts based on a product-specific approach. Under the Korean Tax Code, beneficiaries are taxed in general based on the conduit principle. The conduit principle is a taxation doctrine that all income earned by trustees must be passed through the "conduits" to the accounts of the de facto owner, the beneficiaries, and must be reported on their tax returns. This is the underlying doctrine on which the National Tax Act, Income Tax Act, and Corporate Tax Act are based. In short, unlike typical

indirect investment products, income generated from trusts is regarded as an asset owned by beneficiaries and taxed accordingly.

Exceptions are the former unspecified money trust products under joint management, which are now out of the market, and pension trust products, which are still available. In contrast to the conduit principle, the trust entity theory acknowledges a trust as an independent entity and therefore as an entity subject to taxation.

As trusts are increasingly utilized for various purposes, the taxation of trusts is expected to grow more controversial. Thus, it is critical for Korea to adopt a more reasonable tax system to deal with modern types of trusts and trusts created for new purposes.

III. INVESTMENT ADVISORIES, DISCRETIONARY INVESTMENTS, AND WRAP ACCOUNTS

1. Investment Advisories

An investment advisory refers to advisory services offered to help investors understand the value of financial investment products and make investment decisions. As businesses can provide investment advisory services upon registration, companies that fulfill legal requirements can provide their services as soon as they register with the Financial Services Commission.

Prior to the enactment of the Financial Investment Services and Capital Markets Act (FSCMA), investment advisories encompassed a wider range of financial products, including certificates of deposit (CD) and entitlements to real estate properties. However, since the FSCMA came into effect in February 2009, investment advisors were able to offer services on only financial investment products. In August 2008, deposits in financial institutions, real estates properties and rights over them were added to the assets investment advisors can service.

As of the end of December 2012, a total of 335 registered companies operate investment advisory businesses, with 146 investment advisory companies, 94 offshore advisors, 61 asset management companies, 32 securities companies, one futures company, and one bank.

2. Discretionary Investments

Discretionary investment refers to a business conducting the acquisition, disposition, and management based on discretionary judgment, entirely or partially, over financial investment instruments for each investor. As with investment advisories, an entity has to register with the FSC to engage in discretionary investment business activities. The scope of assets serviced by discretionary investment managers is the same with investment advisories—financial investment products, deposits in financial institutions, and real estate and relevant rights.

As of the end of December 2012, there are 332 registered companies offering discretionary investment management services, with 125 investment advisory companies, 103 offshore advisors, 60 asset management companies, 38 securities companies and 6 futures companies.

3. Wrap Accounts

AA wrap account is an account in which a brokerage (securities company) manages an investor's portfolio by combining brokerage and discretionary investment management services to provide allocation strategies that meet the investor's appetite, or recommend adequate investment destinations. Wrap accounts are largely divided into discretionary wrap accounts, which allow brokerage firms to directly manage assets on their discretion, and advisory wrap accounts, in which securities companies manage investment portfolios as per the guidance offered by investment advisors.

Securities firms started to distribute discretionary wrap accounts in the market in February 2001, and advisory wrap accounts in October 2003. Currently, 29 domestic companies are offering wrap accounts.

CHART 9-4. STRUCTURE OF ADVISORY WRAP ACCOUNT

CHAPTER 10

STOCK EXCHAGE: KOSPI

I. KOSPI STOCK MARKET

1. Introduction

The KOSPI Stock Market is a market established by the Korea Exchange (KRX) for the trading of securities – debt securities; equity securities; beneficiary certificates; investment contract securities; derivatives-combined securities; and securities depository receipts (FSCMA Article 9-13). In accordance with the Korea Securities and Futures Exchange Act (herein the Exchange Act), the previously separate Korea Stock Exchange, KOSDAQ, and the Korea Futures Exchange were all integrated into the Korea Exchange in January 2005. They now operate as the three business divisions of the KRX: the Stock Market Division (also known as the KOSPI), the KOSDAQ Market Division, and the Derivatives Market Division. Among them, the Stock Market Division was initially established and operated by the Korea Stock Exchange. The Financial Investment Services and Capital Markets Act (FSCMA) has replaced the Exchange Act and continues to use the same title to refer to the division for the Stock Market.

The FSCMA defines financial investment instruments as comprising of securities and derivatives. This diverges from the Exchange Act's definition, which defined securities but not derivatives. Given that securities are also traded on the KOSDAQ, the term Stock Market Division does not accurately reflect the nature of the market. Yet, given the need to separate the stock market from the KOSDAQ Market, and to prevent confusion among market participants due to frequent changes in terminology, the former name was maintained. The FSCMA also has a separate definition for the KOSDAQ Market. This definition ensures the independence of both markets, enabling the operation of both while maintaining their own unique brand despite the integration of the exchange markets.

In the traditional sense of the word, the stock market is a physical, organized, permanent and competitive market. Physical and organized means there are physical facilities for the market, which operate with human and tangible resources. The term permanent refers to the fact that transactions of securities will be executed every day on an ongoing basis. The term competitive indicates that the public freely participates in competitive transactions.

The FSCMA denotes that the Korea Exchange was established 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 (Article 373). In addition, in order to maintain fairness in markets established by the KRX as well as to establish market order and protect investors, etc., non-KRX participants are prohibited from establishing a rival stock market, KOSDAQ Market, derivatives market, or other similar facilities. In addition, trading transactions using similar facilities is banned and the use of similar names is also forbidden.

2. Economic Functions of the KOSPI Stock Market

The object of the secondary securities market is the facilitation of smooth transactions for securities that have been supplied through the primary securities market, thereby enhancing the transferability and marketability of securities, as well as increasing their circulation. As such, the stock market, which is the key market for the secondary securities market, has the following basic functions: 1) the transfer of capital – delivery and receipt of securities and

payment, or the exchange of securities and currency, which can be conducted more efficiently and accurately than in any other market; 2) the price forming function – the price of securities is formed through competitive transactions in the exchange, so the social evaluation of their value is performed in the fairest and most reliable way; and 3) the price standardization function – wild fluctuations in share prices due to a temporary supply-demand imbalance including speculative trading, etc. are suppressed by natural supply-demand interactions.

TABLE 10-1. IPOs AND LISTINGS

(Unit: no. of shares, 100 million won)

Year	No. of IPOs	IPO amt.	No. of listed companies (Cumulative)	Year	No. of IPOs	IPO amt.	No. of listed companies (Cumulative)
1973	45	208	104	1993	7	1,812	693
1974	19	143	128	1994	25	5,795	699
1975	62	394	189	1995	36	5,801	721
1976	87	740	274	1996	40	13,914	760
1977	49	441	323	1997	23	4,793	776
1978	33	415	356	1998	3	368	748
1979	5	49	355	1999	15	17,201	725
1980	1	3	352	2000	-	-	704
1981	2	30	343	2001	3	2,178	689
1982	-	-	333	2002	11	12,274	683
1983	3	308	328	2003	10	5,603	684
1984	14	814	336	2004	10	6,413	683
1985	11	351	342	2005	11	4,517	702
1986	16	431	355	2006	9	11,167	731
1987	44	2,438	389	2007	9	15,253	745
1988	112	10,449	500	2008	5	3,204	763
1989	126	30,510	626	2009	10	4,727	770
1990	36	3,360	669	2010	21	29,386	777
1991	21	2,269	686	2011	13	13,589	791
1992	8	817	688	2012	5	2,059	784

Source: Monthly Financial Statistics Bulletin of the Financial Supervisory Service

II. LISTING ON THE KOSPI STOCK MARKET

1. Listing

Registering securities to be traded on the KRX is referred to as listing. Securities acknowledged as objects for sale are called listed securities, and companies that issue listed securities are called listed companies. Securities listed to be traded on the KRX are required to undergo listing eligibility reviews in order to facilitate smooth trading and to protect investors by forming fair prices.

Although the value of listed securities is not guaranteed by the KRX, listing raises confidence in the listed company, which has the effect of pushing up its share price, and makes raising capital easier for the company, improving collateral value and increasing the company's status.

TABLE 10-2. TYPES OF LISTING

Securities for listing		Stock certificates (foreign certificates and foreign stocks, DRs included), debt securities, beneficiary certificates, warrants and certificates for BW, ELW, ELS, etc.
Listing type	IPO	Listing securities for the first time on the KRX
	New listing	Listing stock certificates newly issued by listed companies due to rights offerings, bonus offerings, etc.
	Change listing	Change listings of listed stock certificates, including name, type, par value and quantity
	Relisting	When preliminary listing reviews have been requested within five years since the stock certificate was delisted; listing an entity that is newly established through split-up or merger of split-up companies

2. Listing Requirements

The KRX sets forth listing requirements in order to facilitate the smooth trading of stocks, form fair prices and protect investors. It also evaluates whether the securities fulfill the requirements set forth in its standards. As a result of the evaluation, when they satisfy the requirements, the KRX approves the listing of securities, notifies the FSC, and lists them. To be listed on the KRX, stocks should be traded in the securities market and must comply with various requirements on the size of the companies, financial details, ease of circulation, soundness, public interest, and investor protection.

TABLE 10-3. REQUIREMENTS FOR IPO ON THE KOSPI STOCK MARKET

Listing criteria		Ordinary companies	Holding companies
Quantitative requirements (all items must be met)	Corporate size	Shareholders equity of KRW 30bn or more as of application date	Same as for ordinary companies
	No of shares to be listed	1 million or more	
Distribution requirements (all items must be met)	No. of shares held by minority shareholders, etc.	- One of the following: ①At least 25% should be allocated to minority shareholders ②At least 25% should be publicly offered ③At least 10% of shares offered through public offerings, based on shareholders equity (market cap): - KRW50bn-100bn (KRW100bn-200bn): 1 million shares and over - KRW100bn-250bn (KRW200bn-500bn): 2 million shares and over ④At least 10% of shares publicly offered simultaneously on overseas exchanges and the KRX and at least 1 million shares publicly offered in Korea	Same as for ordinary companies
	No. of minority shareholders	No. of owners of the shares with voting rights should be at least 1,000	Same as for ordinary companies
	Offering requirement	After filing an application for a listing eligibility review, at least 5% and KRW1bn should be publicly offered	Same as for ordinary companies (Excluding financial holding companies)
	Limit on transfer	There should be no limit on transfers of issued stock certificates	Same as for ordinary companies
Financial requirements (one items must be met)	Sales and profit	Recent year's sales of at least KRW 100bn and 3-year-average for sales of at least KRW 70bn; an operating profit for the recent year, income from continuous operations before taxes, net income; and one of the following: ①ROE for the latest fiscal year should should be at least 5%, and combined ROE for the last three fiscal years should be 10% or more ②Amount of income for the latest fiscal year should be at least KRW 3bn and the sum for the last three fiscal years should be KRW 6bn or more ③If net worth is larger than KRW 100bn, ROE for the latest fiscal year should be at least 3%, or profits should be at least KRW 5bn, and the cash flow from operating activities in the latest fiscal year should be positive (+)	Same as for ordinary companies (Holding company sales+subsidiary sales×shareholding ratio) (Based on consolidated financial statements)
	Sales and market capitalization	Recent year's sales of at least KRW 200bn and market capitalization of at least KRW 400bn *Market capitalization = IPO price × no. of shares to be listed (for secondary listings or KOSDAQ-listed companies, market value)	Same as for ordinary companies (Holding company sales+subsidiary sales×shareholding ratio)
Soundness of company	No. of years since establishment	Have been operating without interruption for at least 3 years since establishment. In cases where there has been a merger, split, merger after split or business transfer, the duration of actual operating activities is considered	Same as for ordinary companies (Considering length of major subsidiaries' actual operations)
	Audit opinion	Unqualified opinion for the latest fiscal year, and unqualified or qualified (excluding qualified opinion due to limitation on scope of audit) for the previous two years	Same as for ordinary companies (Standalone and consolidated financial statements)

Listing criteria		Ordinary companies	Holding companies
Soundness of company	When there has been a merger, etc.	When there has been a merger, etc. closing financial statements for the relevant fiscal year should have been completed When the time of operation is less than 3 months from the establishment of date of merger to the end of the fiscal year, interim financial statements for the following fiscal year should have been completed	Same as for ordinary companies (Not applied in case of holding companies, shift to holding company structure, or merger to make another company wholly owned subsidiary through share exchange of subsidiaries)
	Lock-up	Shares held by the largest shareholder and shares transferred from the largest shareholder within one year before the request for preliminary review: 6 months after listing Within 1 year before preliminary review request, 1 year from the date of new stock issuance for third party allotment. However, if that date is within 6 months from the listing day, the period is for 6 months after listing	Same as for ordinary companies (For financial holding companies, excludes restrictions on selling shares held by the largest shareholder)

3. Listing Procedures

In order to meet the IPO requirements of the securities market, the issuing company should prepare and submit an application for preliminary review. The preliminary review determines whether the company fulfills the listing requirements. The KRX determines its eligibility after deliberation by the KRX listing committee.

The FSC, the relevant company and the underwriter are notified of the results of the preliminary review (including further reviews) within three days of the application date. The issuing company that has received notification of approval for the listing should submit a securities registration statement regarding the offering of stocks to the Financial Supervisory Service (FSS). The registration statement takes effect after a certain amount of time has passed from the day it was registered.

Book building and pricing are held with the participation of institutional investors and securities firms in order to decide a reasonable IPO price. The lead manager and the issuing company reflect the results in the IPO price after negotiations.

After the registration statement takes effect, subscription is conducted for two to three days and the shares are paid to the designated issuing company. After the payment, the application for a new listing is submitted to the KRX; upon its approval, trading of the stock begins on the stock exchange.

CHART 10-1. LISTING PROCEDURES

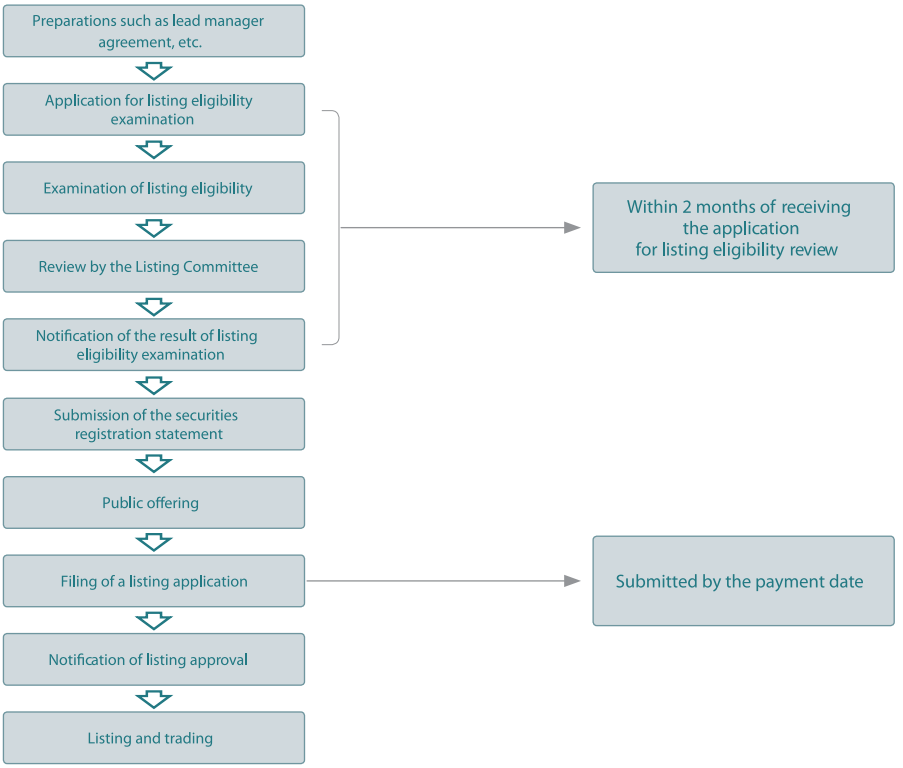


TABLE 10-4. DETAILED PROCEDURES

Steps		Descriptions
Advance preparation	Audit by an external auditor	Audit of the annual report of the latest fiscal year by an auditor approved by the Financial Supervisory Commission (FSC)
	Corporate registration	Registration of the company with the FSC
Preparation	Arrangement with a lead manager	Appoint a lead manager and make a business arrangement before filing an application
	Amendment of AI	The standard AI formulated by the Korea Listed Companies Association may be used as reference
	Entry into an arrangement for transfer agent services	Transfer agent services can be made with the Korea Securities Depository, KB or Hana Bank
	Establishment of employee stock ownership plan	
	Prior consultation with the KRX	Matters relating to listing requirements, time, etc. should be consulted
Listing eligibility review	Application for listing eligibility examination	Application for listing eligibility examination should be filed
	Examination of listing eligibility	Both qualitative and quantitative requirements are considered
	Review by the listing committee	Appropriateness of listing is reviewed and a final decision is made
	Notification of the result for listing eligibility examination	Both the concerned company and the FSC are notified
Public offering	Filing securities registration statement	The statement should be filed with the FSC (effective within 15 days)
	Estimation of the demand and pricing	After estimating the demand, price is determined in consultation with lead manager
	Subscription, allotment and payment of securities	Registration after making payment of securities
	Filing of report on record of stock issuance	Record of stock issuance is filed with the FSC
Listing	Application for listing	Listing application should be submitted by the payment date
	Listing and trading	

* For details, refer to the Examination of Stock Market Listing (www.krx.co.kr)

4. Management of Listed Shares

To ensure that: 1) the company does not fall short of the criteria it met at the time of listing, 2) its stock does not become unsuitable to be listed on the stock market, and 3) changes in its corporate information do not alter the value or rights of its shares, the stock market regulator monitors whether listed shares meet the listing criteria and whether the company meets disclosure requirements in a timely manner. Through these activities, the regulator prevents the trading of unsound securities and provides accurate investment information to investors, thereby facilitating the sound development of the stock market.

1) INDUSTRY CLASSIFICATION OF LISTED COMPANIES

The industrial classification of the shares to be listed is based on the Korea Standard Industry Code (KSIC) depending on the category of the company's operations. Disclosure of statistics for each sector increases the convenience of investment for investors.

2) CAUSES FOR TRADING SUSPENSION AND LIFTING OF SUSPENSION

TABLE 10-5. CAUSES FOR TRADING SUSPENSION AND LIFTING OF SUSPENSION

Cause of suspension	Period of trading suspension	Lifting measures
When falling under the category of administrative issues	One day from notification date (trade day)	No need for lifting measures. When the KRX acknowledges the need, trading suspension may be lifted
When securities are confirmed to have been forged/falsified	The day the relevant act was confirmed	When the cause is resolved
When submission of stock certificates is demanded for their consolidation (including overseas shares) or splitting	From the day before submission of stock certificates	Day after the receipt of new stock certificates
When the KRX acknowledges need for other public interest, investor protection and market management	Until cause for trading suspension is relieved	When cause for trading suspension is relieved

3) CRITERIA FOR DESIGNATION AS ADMINISTRATIVE ISSUES AND DELISTING

TABLE 10-6. CRITERIA FOR DESIGNATION AS ADMINISTRATIVE ISSUES AND DELISTING ON THE STOCK MARKET

Items	Administrative issue designation criteria	Delisting criteria
Failure to submit business plan, etc.	When applicable	Failure to submit within 10 days from the deadline
Failure to file semi-annual or quarterly reports	When applicable	Failure to submit following semi-annual or quarterly reports
Audit opinion of "Adverse" or "Disclaimer of opinion"	–	When applicable
Audit opinion of scope limitation	When applicable	Two consecutive years
Audit opinion of "Adverse" or "Disclaimer of opinion" on semi-annual reports	When applicable	–
Suspension of business operations	–	When applicable
Defaults on bills or checks issued by the listed corporation, freezing of bank transactions	–	When applicable
Impaired capital ratio	50% and over	Impaired capital ratio of 100% or 50% for two consecutive years
Falling short of minimum minority shareholder ownership	When applicable	-No. of ordinary shareholders less than 200 for two consecutive years -Shareholding ratio lower than 10% for two consecutive years (excluding cases where there are more than 2 million shares)
Application for commencement of rehabilitation procedures	When applied for	During application for commencement or cancellation of commencement decision
Average trading monthly volume ~~of less than 1%~~	Semi-annual period	Two consecutive semi-annual periods
Failure to meet requirements for governance structure	When applicable	Falling short of the no. of outside directors for two consecutive years or failing to establish an audit committee
Failure to satisfy disclosure requirements	Demerit points of 15 or more within 1 year	Failure to disclose material facts intentionally or due to gross negligence
Sales	Less than KRW5bn	Sales of less than KRW 5bn for two consecutive years
Share price	Under 20% of par value for 30 consecutive days	Failure to resolve the reasons for being designated with administrative issues within 90 days from the day of the decision
Market cap	Under KRW5bn for 30 consecutive days	Failure to resolve the reasons for being designated with administrative issues within 90 days from the day of the decision
Relevant cause for liquidation, restrictions on transfer of stocks, other public interest and investor protection	–	When applicable

* For details, refer to the Examination of Stock Market Listing (www.krx.co.kr).

III. TRANSACTIONS AND SETTLEMENT

1. Tick Size and Types

Tick size refers to the minimum allowed change of the price of a share. Tick size is set in order to standardize transactions and to ease price negotiations.

TABLE 10-7. TICK SIZE AND TYPES

Price of share	Tick size
Less than KRW 1,000	KRW 1
KRW 1000 to less than KRW 5000	KRW 5
KRW 5,000 to less than KRW 10,000	KRW 10
KRW 10,000 to less than KRW 50,000	KRW 50
KRW 50,000 to less than KRW 100,000	KRW 100
KRW 100,000 to less than KRW 500,000	KRW 500
KRW 500,000 and over	KRW 1000

The stock market currently allows five types of quotations: limit order, market order, best price order, first priority order, and conditional limit order.

TABLE 10-8. FIVE TYPES OF QUOTATIONS

Type of quotation	Details
Limit order	Executed only at a price specified by the investor or at a price better than the specified price
Market order	No price conditions are specified, and it is executed at the best available price when delivered to the market
Best price order	- Offered price: the highest offered price at the time of the relevant price reception - Bid price: the lowest bid price at the time of the relevant price reception
First priority order	- Offered: the lowest offered price - Bid: the highest bid price
Conditional limit order	- When submitted, serves as a limit order during regular sessions, but converts into a market order during the periodic call auction if the order is not executed by the time the periodic call auction to decide closing price occurs

2. Base Price

The base price serves as a standard for setting the fluctuation limits for stocks and beneficiary certificates in the stock market. It serves as a basis to determine the range of price fluctuations during the day. Generally, the closing price of the previous day is applied when calculating the base price, but when this is not possible, e.g. due to ex-rights from rights offerings or bonus offerings, ex-dividends due to payment of dividends, stock splits, and par-value consolidation, when there is a need to standardize the share value before or after the above measures (theoretical price), or when there is no closing price on the previous day (decided by the market), a new base price is applied.

Newly listed issues use the price decided by bid/ask prices within a set range during the call auction period (08:00-09:00) before trading begins. The base price of issues that have been split or consolidated is derived by multiplying the ratio of split or consolidation to the closing price of the previous day. When capital has decreased (reduced capital for minority shareholders), quotations are registered in the 50%-200% range of the appraised price, which is used as the base price. However, for issues that have had large scale capital increases in consideration of a third party at a low price, the lowest tick size, KRW 5, is used to derive the base price.

TABLE 10-9. BASE PRICES

		Average price	Price range
New listings	Ordinary issues	IPO price (issue price at IPO or public offering of outstanding issues)	90%-200%
	KOSDAQ issues	Final day closing price in the KOSDAQ market	90%-200%
	Holding company	(Market cap of listed subsidiaries+NAV of unlisted subsidiaries)/No. of shares (however, if listed companies account for an extremely small percentage, the lowest offered price is 50%)	90%-200%
	Other	NAVPS (NAV divided by issued shares on the day of application for listing)	50%-200%
Relisting	Corporate split (Normal)	Market cap per type on final trading day of company before split×ratio of NAV split/no. of shares by type after split	50%-200%
	Corporate split (Distressed)	Surviving entity: closing price of the final trading day before split New entity: NAVPS	(Within closing price before split)
	Consolidation	Sum of market cap per type of final trading day of company before consolidation/lowest offer price by type of company after consolidation is 50%	50%-200%

		Average price	Price range
Share consolidation (Capital reduction)		Consolidation ratio multiplied by previous day's closing price (large-scale capital increase with consideration to a third party due to low price)	50%-200% (KRW5-200%)
Preferred stock	Initial listing of preferred stock	Previous day's closing price of common stock (large-scale capital increase with consideration to third party due to low price)	50%-200%
	Listing of preferred stock of different types	Simple mathematical average of previous day's closing price of already-listed preferred stock	50%-200%

3. Types of Transactions

Depending on the settlement date, transactions are categorized into spot (cash) transactions that are normally settled on the day of the contract, next-day transactions and regular-way transactions, with settlement due on the second business day following the contract date (T+2). Regular-way transactions account for most KRX transactions.

TABLE 10-10. TYPES OF TRANSACTIONS

Spot transactions	Settlement is due on the day of the contract. Used for ordinary bond and small-amount bond transactions
Next-day transactions	Settlement is due on the first business day following the contract date. Used in transactions in the Inter-dealer Market
Regular-way transactions	Settlement is due on the second business day following the contract date. Generally stock transactions

TABLE 10-11. COMPARISON OF TRANSACTION AND SETTLEMENT SYSTEMS BETWEEN THE STOCK MARKET AND KOSDAQ MARKET

	Stock market	KOSDAQ market
Operator	KRX	Same as the stock market
Traded objects	Issues listed on the KRX	Same as the stock market
Trading hours	Regardless of morning/afternoon sessions, single trading session of 09:00-15:00, off-hour trading sessions 1 hour before market opens and 2 hours 50 minutes after market closes are possible	Same as the stock market
Trading unit	10 shares (1 high-priced share of over KRW50,000) However, single-share transactions are possible in off-hour trading sessions	One share
Trading method	Call auction period and post trading, off-hour trading sessions, off-hour block trading, market price order, conditional limit order, etc.	Same as the stock market
Margin deposits	Deregulated, spot transactions possible	Same as the stock market

	Stock market	KOSDAQ market
Credit transactions	Permitted	Same as the stock market
Transaction principles	Price/time priority (Simultaneous offer price: brokerage priority, quantity priority)	Same as the stock market
Brokerage fee	Unregulated	Same as the stock market
Securities transaction tax, etc.	Securities transaction tax: 0.15% of transfer price (Flexible tax rate) Special tax for rural development: 0.15% of transfer price (Tax-exempted if exempted from Securities Transaction Tax)	Securities transaction tax: 0.3% of transfer price (Flexible tax rate)
Settlement day	Second business day from transaction date (T+2)	Same as the stock market
Price fluctuation limit	Fixed rate (15% of base price)	Same as the stock market

4. Trade Execution (1)

A trade is executed using the principles of price priority (low ask price and high bid price take precedence over other orders) and time priority (price registered first takes precedence when prices are the same). They take place under two methods, individual auction for a single price in a concentrated trading method, and individual auction for multiple prices in post trading.

A periodic call auction is used when it is deemed necessary to form price balance through the concentration of demand and supply. Offers and bids are received for a certain time and then trading is concluded at a single price with ask prices receiving priority according to the principles of price and time. The priority order of ask price in periodic call auction was referred to in the past as a simultaneous ask price, and the principle of time priority was not applied. However, the principle of time priority has been applied since September 2001, with the simultaneous ask price only used as an exception. Accordingly, for ask prices that take part in periodic call auctions, the trading of whole quantities is concluded in compliance with the principle of price and time priority, and no allocation of quantities is made between those of same ask prices.

However, when the market price is in the upper or lower price limit, in the case of the upper price limit, allocation is made to those at the buying ask price of the corresponding price range. In the case of the lower limit price, allocation is made to those at the selling ask price in the corresponding price range, using the principles of brokerage priority and quantity priority, rather than using the time priority (simultaneous ask price system). In other words, for the simultaneous ask price system, stocks are allocated in the order of the

most offers to the least number of offers downwards for brokerage orders. After trading is executed for brokerage orders, the balance is traded after being allocated to prop trading orders by members. Quantity allocation has been categorized into six stages (trading units of 10x → 50x → 100x → 200x → 1/2 of balance → balance) in order to increase the opportunities for minority investors to execute orders.

In the continuous auction, when price is determined by individual competitive trading at plural prices, if the lowest ask price and the highest bid price are the same, the trade is executed at the price registered before. Accordingly, the trade is executed using prices that become the same, according to the principles of price/time priority.

TABLE 10-12. METHOD OF TRADING FOR PERIODIC CALL AUCTION

Selling quantity	Price	Buying quantity
	15,400	● 1,000
○ ○	15,350	● 300
○ ○	15,300	● 100
④○ ③○ ②◑ ①● 2,000 1,000 500 100	15,250	①● 200 ②● 300
150 ●	15,200	○ ○
150 ● 500 ●	15,150	○
500 ●	15,100	○ ○ ○
150 ●	15,050	

Note: 1) ○ un-executed offer price / ◑ partially executed price / ● wholly executed price
①, ②, ③, ④ are numbered in the order of offers received
2) The highest bid price and the lowest offer prices are matched in sequence.
For the same price of KRW15,250, trade is executed using the time priority principle

[TRADE EXECUTION IN SIMULTANEOUS ASK PRICE]

- If the opening price is determined to be KRW20,150 (the upper price limit), for instance, quantities at the ask price shall be allocated according to the order of priority in quantity between buying offers at the upper price limit (assuming they are all brokerage orders).

- Price situation (before market price is decided): 13,100 shares for sale are required to be allocated among four prices (total 16,200 shares) that have been registered as upper price limit.

TABLE 10-13. TRADE EXECUTION IN SIMULTANEOUS ASK PRICE [1]

Selling order (Q'ty)		Price	Buying order (Q'ty)	
4,000 1,500 600	(6,100)	20,150	(16,200)	①1,000 ②200 ③10,000 ④5,000
1,700 1,500	(3,200)	20,100		500 700
1,300 1,000	(2,300)	20,050		400
800	(800)	20,000		
700	(700)	19,950		
	13,100	Total	16,200	

Note: ①, ②, ③ and ④, etc. refer to the sequence of receiving offer prices.

- Trade execution results (when decided by market price): Upon allocating quantities in six steps from the ask price ③, which has the largest offer quantity following the quantity priority principle, allocation is completed for offers ① and ②, while unallocated ask prices (2,400 shares for ③, 700 shares for ④) will be executed in priority during the trading hours on the same day.

TABLE 10-14. TRADE EXECUTION OF SIMULTANEOUS ASK PRICE [2]

Category	No. ③ ask price (10,000shares)	No. ④ ask price (5,000 shares)	No. ① ask price (1,000 shares)	No. ② ask price (200 shares)
① 10 times trading unit	100	100	100	100
② 50 times trading unit	500	500	500	100
③ 100 times trading quantity unit	1,000	1,000	400	-
④ 200 times trading quantity unit	2,000	2,000	-	-
⑤ Half of balance	3,200	700	-	-
⑥ Remainder	800	-	-	-
Executed quantity (13,100 shares)	7,600	4,300	1,000	200

TABLE 10-15. METHOD OF TRADING FOR CONTINUOUS AUCTION

Selling	Price	Buying	Results
	10,600		- Price: 10,300
	10,500		(Price of preceding
②200	10,400		offer price)
	10,300	①200	①200- ③200
③200	10,200		- Quantity: 200 shares
	10,100		

TABLE 10-15. METHOD OF TRADING FOR CONTINUOUS AUCTION

Selling	Price	Buying	Results
	10,000		
	9,900		
	9,800		

Note: No. ①, ② and ③ refer to the sequences of receiving ask price.

5. Trade Execution (2)

1) BLOCK/BASKET TRADING

When members offer a price for both bid/ask prices to individual issuers or to groups of stocks that satisfy certain requirements during off-hour trading or regular trading hours, block/basket trading enables the execution of trades among quotations. Trading takes place through mutual agreement on trading terms including issues, price and quantity between investors who desire to execute block/basket trading. Although the decision regarding the counterparty and negotiating transactions generally takes place in the OTC market, it can also be done through K-BloX, an electronic network dedicated to block trading and basket trading.

TABLE 10-16. TRADING SCHEDULE

	Off-hour trading		Regular trading	
	Block	Basket	Block	Basket
Trading hours and offer price	07:30 - 08:30 (before market opens) 15:10 - 18:00 (after market closes)		09:00 - 15:00	
Executed price	Within the highest/lowest price formed prior to receipt of corresponding offer price		Within the highest/lowest price formed prior to receipt of corresponding offer price	
Quantity requirements	500x of trading unit or over KRW100mn	Five issues and over and more than KRW1bn	(Same as off-hour trading)	
Quantity of trading	One share			
Execution of trading	Executed as corresponding order price from both parties' ask prices (coupled order)			
Revision, withdrawal	Possible to revise or cancel prior to execution of trading			

2) OFF-HOUR SINGLE/CLOSING PRICE TRADING

Off-hour trading refers to trading that takes place after trading in the regular market has closed, by taking orders for a certain amount of time before or after regular trading hours. It is categorized into off-hour closing-price trading, which trades using the same-day closing prices, off-hour block/basket trading, which is for handling block orders by institutional investors using the private sale method, and off-hour single price trading that uses the market functions of the former ECN securities market.

(a) Off-hour Trading at Closing Price

This is a system to provide investors with additional trading opportunities after-hours and prior to opening time at the closing price of the day, subject to application of the time priority principle.

TABLE 10-17. AFTER-HOURS TRADING AT CLOSING PRICE

Category	Descriptions
Objects of trading	Stock certificates, ETFs, KDRs (excluding unexecuted issues of the day)
Trading hours	80 minutes (07:30-08:30, 15:10-15:30)
Receiving time of offer price	90 minutes (07:30-08:30, 15:00-15:30)
Executed price	Closing price of the day (after market closing), closing price of previous day (before market opening)
Type of order	Order at closing price
Trading unit	One share
Execution of trading	Application of time priority rule
Revision, withdrawal	Possible to revise quantity or cancel prior to execution of trading

(b) Off-hour Trading for Periodic Call Auction

Periodic call auction after-hours is a system, where periodic call auctions take place every 30 minutes. It was established in May 2005 in order to handle trading functions of the ECN market, following the shutdown of Korea ECN Securities' operations.

TABLE 10-18. AFTER-HOURS TRADING FOR PERIODIC CALL AUCTION

Category	Descriptions
Objects of trading	Stock certificates, ETFs, KDRs (excluding un-executed issues of the day)
Trading hours	150 minutes (15:30-18:00)
Method of trading	Periodic call auction trading regularly per 30 minutes
Range of fluctuation	±5% of closing price of the day (subject to within upper limit/lower limit price of the day)
Type of order	Limit order
Trading unit	One share

6. Settlement

Settlement takes place when the KRX takes on the obligation to pay for trades its members (securities firms) need to handle with immunity from responsibility. It fixes the securities and the amount to be settled through deduction by the type and member of the executed transaction. The KRX then exchanges the net balance and settlement amount between itself and the members. However, the actual exchange of securities and settlement amount is conducted by the Korea Securities Depository (KSD).

The settlement deadline between a member and its customer is a certain time during the settlement day as decided by the member. Between the member and the KRX, the deadline is 4pm after the day's trading has closed.

The following three types of settlement are most general. Among them, Korean participants use book entry clearing, net balance delivery and central clearing.

- Cash or book entry clearing: cash involves settlement in cash when settling trades; book entry clearing involves settlement of spot trades using book keeping entries.
- Full settlement or net balance delivery: Full settlement uses the method where one member delivers the entire amount by currency or securities to be settled by bid/offer; net balance delivery uses the method where each member settles using the balance after bid/offer has been deducted by member.
- Central clearing or separate settlement: Central clearing handles the settlement of trading in a central clearing organization at the KRX; a separate settlement occurs to handle the settlement between the counter parties to trade.

Book entry clearing involves the KRX deducting the securities and settlement amount and executing the transactions of the fixed amounts through the KSD. In this instance, members who are required to settle and the financial institutions consign their securities to the KSD beforehand in order to eliminate the task of transferring real certificates. The physical securities are not moved when the deposited securities need to be moved. Instead, the trades and netting transactions are matched so that only the net difference is "settled" in a cash settlement or securities settlement. This is called book entry clearing. The settled securities are transferred without physical exchange between the KRX and the settling members through accounts established in the securities clearing system at KSD. The settled amount is remitted among accounts set up by the liquidating institution and the members of the settling bank (central bank/commercial banks). Currently, the settlement bank for the government bond market at the KRX is The Bank of Korea. For the stock market, the settlement banks are Shinhan Bank and Woori Bank. For derivatives, they are Shinhan Bank, Woori Bank, Korea Exchange Bank, KB, Busan Bank, and the National Agricultural Cooperative Federation (NACF).

Book-entry clearing through KSD saves human resources and the time required for the physical exchange of securities and can prevent accidental loss or theft in the transportation process. Moreover, it has the added advantage of securing speed and accuracy in settlement.

IV. SELF-REGULATION OF THE KRX

1. Summary

The stock market aims to be a perfect competitive market where multiple participants compete to form a fair price (stock price). Therefore, the KRX is given self-regulatory functions in order to prevent damage to the intrinsic function of the stock market due to insufficient information sharing among market participants or an imbalance of supply and demand.

The FSCMA sets forth that the Korea Exchange will fix and stabilize fair prices in transactions of securities and exchange-traded derivatives as well as facilitate the stability and efficiency of other transactions (Article 373). It also stipulates the surveillance of abnormalities in trading and the investigation

of members (Article 377 (8)). The Market Oversight Commission (MOC) has been established to ensure the self-regulation of the KRX, and it handles self-regulatory activities including market surveillance, investigation into abnormal trading activities, member inspection, and self-resolution of trade-related disputes in the stock market (Article 402).

The KRX performs self-regulation over its members. Self-regulation, unlike public regulation, has the advantage of being wider in scope and is more flexible. However, the regulations also have the disadvantage of being less binding.

2. Main Self-Regulation Actions

T The self-regulation of the KRX is broadly categorized into market surveillance, investigation into abnormal trading activities, member inspection and mediation of disputes. The KRX works to prevent unfair trading practices before they may occur. Accordingly, it requests members who have made transactions that have the potential to be unfair to take preventive actions.

The term market surveillance means monitoring, investigating and analyzing the status of the buying and selling of securities and exchange-traded derivative products in the securities and derivatives markets, disclosures, rumors, news, etc. The term investigation into abnormal trading activities refers to the task of determining if a trade has the potential for abnormal trading, including the violation of the prohibition against insider trading, price manipulation, failure to disclose profits from short-selling and engagement in illegal trading. If the price or trading volume of securities changes rapidly, or there are disclosures, rumors, news, etc., or concerns of unfair trading in the stock market, the relevant trading-related situations are assessed in order to confirm whether there have been unfair trades. Member inspection means the in-depth examination of business reports, financial status, account books and other documents and materials of the members in order to ascertain that the member complies with the regulations governing the business of the KRX, and whether the member is engaged in abnormal trading.

In addition, the KRX performs dispute resolution in order to rapidly and efficiently resolve complex and difficult securities-related disputes. The KRX

conducts the mediation of agreements when there are requests by participants in the stock market or derivatives market, regarding trading in those markets.

Meanwhile, when it is necessary to investigate or inspect abnormal trading, the KRX may request document submissions, pay a visit or give testimony in the course of investigations. If results show that the relevant member violated the market surveillance regulations, the Market Oversight Commission (MOC) may decide on punitive measures, and if the member officers and employees are involved, the relevant member's punishment might be requested.

CHAPTER 11

STOCK EXCHANGE: KOSDAQ

I. KOSDAQ MARKET

1. Introduction

The Korea Exchange was founded to advance the capital market by operating the securities market more efficiently with reduced dealing costs, providing consistent services for spot and futures transactions, enhancing fairness by linking the supervision for spot and futures transactions, and upgrading the status and international competitiveness of the exchange.

Thus, the Stock Exchange, KOSDAQ Market (formerly the KOSDAQ Committee or KOSDAQ Securities, Co.), and the Futures Exchange were integrated into one comprehensive exchange. Within this exchange, the KOSPI Stock Market, KOSDAQ Market, and Futures Market operate independently as different business divisions.

The Korea Exchange was established to pursue balanced development among each market with enhanced efficiency through increased competition. After integration, each market developed unique characteristics and roles to provide

differentiated services. The KOSPI Stock Market has become a large-scale, blue chip market with relatively stable investment opportunities. On the other hand, the KOSDAQ Market has become a vibrant securities market with high-risk, high-yield investments focused on SMEs.

The KOSDAQ Market is completing its vision as the "new competitive market for technology stocks" with the establishment of the integrated exchange.

2. Historical Background

Until the end of the 1970s, Korea pushed for high-growth strategies that focused on the development of large companies. This strategy led Korea to overcome its lagging economic status in a relatively short period of time, but not without some side effects. Internally, Korea faced a large imbalance between industries and regions. Externally, limits were seen in Korea's export strategy due to the heightened protectionism in developed economies.

Thus from the early 1980s, the Korean government pursued a new strategy to foster the growth of SMEs. It increased financial support and reduced taxes for such companies and streamlined the procedures for establishing such companies.

In line with these government policies, the capital market was also reformed so that SMEs excluded from the stock exchange could finance themselves through the securities market. Thus, in December 1986, the Ministry of Finance announced it was undertaking market restructuring measures to revitalize the securities transactions of SMEs. Accordingly, in April 1987, an over-the-counter stock market was established within the Korea Securities Dealers Association (KSDA).

In May 1996, the KSDA founded KOSDAQ Securities, Inc., which specialized in brokering transactions. From July 1996 to the present, there have been auctions ongoing in the KOSDAQ Market. In April 1997, the Securities and Exchange Act was reformed to create legal grounds for the operation of the KOSDAQ Market. Through these reforms, investor protection was strengthened with the introduction of regulations on unfair trading including insider trading and market manipulation, etc., and the obligatory submission of periodic reports (annual reports, semi-annual reports and quarterly reports).

In January 2005, pursuant to the Korean Securities and Futures Exchange Act, the KOSDAQ Market was reopened as an independent division in the Korea Exchange.

TABLE 11-1. CHRONOLOGY OF KOSDAQ MARKET

Apr. 1987	Organization of over-the-counter stock market
Oct. 1991	Establishment of brokerage for over-the-counter stock trading
May 1996	Establishment of the KOSDAQ Securities market, Inc.
Jul. 1996	Opening of the KOSDAQ market
Jan. 1997	Introduction of the KOSDAQ market stock index
Apr. 1997	Legislation of the KOSDAQ market
Jun. 1997	Establishment of operating regulations for the KOSDAQ market
Jun. 1998	Measures to revitalize the KOSDAQ market
Oct. 1998	Establishment of the KOSDAQ Committee
May 1999	Measures to revitalize the KOSDAQ market
Dec. 1999	Development measures to enhance soundness of the KOSDAQ market
Feb. 2000	KOSDAQ trading amount hits record high
Jun. 2000	Establishment of KETRA system
Jul. 2000	Introduction of electronic settlement system
Aug. 2000	Market operation improvement measures for stabilization of the KOSDAQ market
Oct. 2000	Introduction of the KOSDAQ 50 Index
Jun. 2001	Introduction of the electronic accounting system
Jul. 2001	Introduction of KOSNET (New KOSDAQ information system)
Dec. 2001	More than 700 registered companies, outnumbering companies listed on Korea Exchange
Apr. 2002	Introduction of English disclosure for KOSDAQ companies
Jul. 2002	Introduction of index on scale of market capitalization
Dec. 2002	Obtainment of CMM Level3 for the first time in the global securities market
Apr. 2003	Establishment of the ETF market
Dec. 2003	Extension of digits in short code for stocks (5 digits → 6 digits)
Jan. 2004	Adjustment of KOSDAQ base value (100→1,000), introduction of KOSDAQ Star Index
Feb. 2005	No. of companies listed on KOSDAQ surpasses 900
Dec. 2005	Listing of Star Index-based ETF
Aug. 2007	First listing of a foreign company (3NOD Digital)
Feb. 2009	Introduction of deliberation system for delisting companies
Mar. 2010	First listing of a special purpose acquisition company (Mirae Asset SPAC)
May 2011	Revision of company categories and designation of investment alert issues

3. Current Status of Operations

1) MARKET SCALE

TABLE 11-2. KOSDAQ-LISTED CORPORATIONS

(Unit: companies, issues, million shares)

Year-end	No. of listed companies	No. of issues	No. of stocks	Capital (in billion won)	Market capitalization (in trillion won)
2004	889	906	12,172	12,304	31
2005	917	930	14,045	12,874	70.8
2006	963	975	16,602	13,029	72.1
2007	1,022	1,033	19,515	14,290	99.8
2008	1,036	1,047	22,303	13,217	46.1
2009	1,028	1,036	21,695	13,335	86.1
2010	1,029	1,035	23,370	13,524	97.9
2011	1,031	1,036	21,440	12,973	105.9
2012	1,004	1,009	20,991	12,695	109
2013	1,009	1,014	21,335	12,848	119

Source: Korea Exchange
Note: Including securities investment firms (excluding ETFs)

2) TRADING VOLUME

The total trading volume of the KOSDAQ reached KRW100tn in 1999 and continued to grow, taking up 92.3% of the total trading volume in the securities market (approximately KRW627tn) in 2000. However, the KOSDAQ's trading volume later declined with the downturn of the IT industry. The KOSDAQ market has shown strong signs of recovery in 2010 amid Korea's rapid recovery from the global financial crisis, recording approximately 640 million shares in daily trading volume, and KRW1.9tn in average daily trading value.

TABLE 11-3. AVERAGE DAILY TRADING ON THE KOSDAQ MARKET

(Unit: 10 thousand shares, 100 million won)

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Trading volume	32,042	40,824	28,691	59,795	54,271	61,382	50,411	77,775	64,304	54,341	59,064	39,510
Trading value	12,053	10,785	6,253	17,927	17,308	20,305	12,422	20,986	19,247	22,500	21,291	18,233

Source: Korea Exchange

II. KOSDAQ MARKET OPERATIONS

1. Listing on KOSDAQ

1) SIGNIFICANCE OF LISTING

When a corporation wishes to trade on the KOSDAQ, it has to go through a set of listing procedures to be listed on the market. The issuing company must be listed on the exchange through a securities company and should list all of its issues according to set principles.

Since numerous investors buy and sell listed shares on the KOSDAQ, listing is limited to companies that meet certain requirements. In other words, a corporation that wishes to be listed on the KOSDAQ needs to meet the basic requirements regarding stability, growth potential, business characteristics, distribution capability, etc.

2) LISTING REQUIREMENTS

The shares to be listed shall be issued from a corporation registered with the Financial Services Commission (FSC) pursuant to the FSCMA. The shares must also meet basic listing requirements according to the KOSDAQ listing regulations. Listings on the KOSDAQ are divided into three categories, all of which have different requirements: general companies, venture companies, and growth technical companies.

TABLE 11-4. KOSDAQ LISTING REQUIREMENTS

Category		KOSDAQ listing requirements		
		General company	Venture company	Growth technical company
Years since incorporation		Three years or more	n/a	n/a
Either one	Equity capital	KRW3bn or more	KRW1.5bn or more	KRW1.5bn or more
	Market capitalization	KRW9bn or more	n/a	n/a

Category	KOSDAQ listing requirements		
	General company	Venture company	Growth technical company
Stock distribution	• Must meet any one of the following requirements: 1. At least 500 minority shareholders; at least 25% of shares held by minority shareholders; at least 5% of shares to be publicly offered after submission of application for listing eligibility review (if minority shareholders hold less than 25% of shares, at least 10% of shares to be publicly offered) 2. At least KRW50 billion in equity capital; at least 500 minority shareholders; at least 10% of shares to be publicly offered after submission of application for listing eligibility review and higher than a certain number of shares by size of capital or market capitalization 3. At least 25% shares to be publicly offered and at least 500 minority shareholders		
Financial status	No capital impairment		
Audit opinions	Unqualified opinion on the financial statements from the most recent fiscal years (Including an audit opinion on the consolidated financial statement, if the company is subject to the preparation of a consolidated financial statement)		
Earnings	Positive income from ongoing business activities (*Not applicable to large-sized companies) (If the company is subject to the preparation of a consolidated financial statement, it shall be based on the consolidated financial statement)		n/a
Profit size, sales amount & total market capitalization	Must meet any one of the following: 1) ROE: Higher than 10% 2) Net Income: Higher than KRW2bn 3) Total Sales: Higher than KRW10bn & Total market capitalization: Higher than KRW30bn 4) Sales Growth: Higher than 20% (& Sales Amount: Higher than KRW5bn)	Must meet any one of the following: 1) ROE*: Higher than 5% 2) Net Income: Higher than KRW1bn 3) Total Sales: Higher than KRW5bn & Total market capitalization Higher than KRW30bn 4) Sales Growth: Higher than 20% (& Sales amount: Higher than KRW5bn)	n/a
Restriction on disposal of shares held by largest shareholder, etc.	One-year-period after listing (Six months for large-sized company)		Two-year-period after listing
Other qualitative requirements	No restrictions placed on transfers of shares		

Notes: 1) ROE (Return on Equity) = Net Income / Equity Capital × 100
2) Growth Technical Company: A company that has received above an A-rating in an assessment of its technological capability by a professional appraisal agency.
3) Large-sized company: A company with equity capital over KRW100billion or a base market capitalization of at least KRW200billion (as of the submission date of the application for a listing eligibility review).

Source: Korea Exchange

3) LISTING PROCEDURES

First, the issuer has to file a preliminary review to confirm that it has met all of the listing requirements. The KOSDAQ Listing Committee then reviews to see whether the requirements are met. The KRX makes a final decision, and approval of the preliminary review (including re-evaluation) is granted after 63 days from when it was initially filed. The decision is announced within 45 days from the day the issuer applied for a review.

After the KRX grants approval, the issuer has to file a Registration Statement with the FSS for a public offering or secondary distribution, which takes effect after a certain period of time from the date of submission. Then, book-building and pricing is conducted to set a reasonable public offering price. Book-building is based on institutional investors and securities companies, and the results are reflected when the lead manager and the issuer deliberate on a public offering price. Subscription is done two to three days after the Registration Statement takes effect and payments regarding the shares are transferred to an account designated by the issuer. After the payments are made, a listing application shall be filed with the KRX and once listing is approved, trading on the KOSDAQ becomes possible.

TABLE 11-5. KOSDAQ LISTING PROCEDURES

Category	Subject	Date	Other
Outside auditor under the Act on External Audit of Stock Companies (Appointed auditor)	Issuer, Financial Supervisory Service (FSS), Accounting firm		FSS Accounting Review Division
Contract closed with lead manager	Issuer, Securities company		Submission of contract, etc. to KOFIA Self-regulation Planning Dept.
Reform in articles of incorporation and other preparations	Issuer, Securities company		Amendment of Articles of Incorporation to fit standards
Preparation of analytical data for due diligence and issue value	Issuer, Securities company		
Selection of transfer agency	Issuer		Kookmin, Hana, Korea Securities Depository
Contract for printing stock details	Issuer, Print shop		
Submission of preliminary review	Issuer, Securities company	D	
Examination of preliminary review	KOSDAQ Headquarters Listing Review Team		
Evaluation of applicant company	KOSDAQ Listing Committee	D+60	Review by the Listing Committee
Approval of preliminary review	KOSDAQ Headquarters	D+63	
Submission of registration statement	Issuer, FSS	D+65	
Decision of issuing price	Issuer, Securities company	D+75	
Registration statement takes effect	-	D+81	15 days after submission
Subscription	Securities company	D+82-84	
Distribution	Securities company	D+91	
Application of IPO	Issuer, Securities company	D+92	
Registration of capital increase	Issuer	D+93	
Approval of KOSDAQ listing	KOSDAQ Headquarters	D+94	
Start trading on KOSDAQ	KOSDAQ Headquarters	D+96	

2. Delisting

1) SIGNIFICANCE OF DELISTING MEASURES

Delisting occurs when a listed corporation applies for delisting, fails to submit annual reports, goes bankrupt, or meets other delisting standards. In such cases, the shares of the corporation are disqualified and can no longer be traded on the market.

The KOSDAQ takes an active stance when it comes to delisting insolvent companies in order to enhance market soundness and promote sustainable market development. In this regard, delisting measures are continuously enhanced with stronger delisting requirements and the introduction of the examination criteria for delisting.

2) DELISTING STANDARDS

Delisting standards on the KOSDAQ Market can be divided into formal standards and real evaluation standards depending on whether there is a need to review facts. Formal delisting standards do not require any special judgment or review; when the standards are met, delisting will be disclosed for three days and then proceed through a seven-day period of settlement trading.

In order to minimize investor confusion resulting from sudden delisting and to warn investors of investment risks in advance (excluding cases that are subject to immediate delisting), KOSDAQ first designates corporations with poor management as "administrative issues". Therefore, investors should be more cautious about investing in companies marked as an administrative issue as there are concerns that delisting may occur.

TABLE 11-6. REQUIREMENTS FOR DESIGNATION OF ADMINISTRATIVE ISSUES AND FORMAL DELISTING STANDARDS

Category	Administrative issue designation	Delisting
Sales revenue	Less than KRW3bn in the recent year	Less than KRW3bn in 2 consecutive years
Business losses before deduction of corporate tax	Loss recorded two or more times before deduction of corporate tax that exceeds 50% of shareholder's equity (and KRW1bn or more) during the latest three business years	Continued loss posted before deduction of corporate tax that exceeds 50% of shareholder's equity (and KRW1bn or more) after designation of administrative issue
Capital impairment/ equity capital	(A) 50% or more of capital impairment as of the end of the business year (half year) (B) Less than KRW1billion of equity capital as of the end of the business year (half year) (C) Failure to submit semi-annual reports ten days after the deadline or where audit opinion is adverse, disclaimer, or qualified	Complete capital impairment at the end of the latest year - 50% or more of capital impairment as of the end of the business year (half year) after (A) or (C) - Less than KRW1bn of equity capital as of the end of the business year (half year) after (B) or (C) - Failure to submit semi-annual reports no later than 10 days after the deadline or where audit opinion is adverse, disclaimer, or qualified after (A), (B), or (C)
Prolonged operating loss	Operating loss for 4 consecutive business years (based on consolidation for holding companies)	Operating loss for 5 consecutive years
Audit opinion		Adverse, disclaimer, or qualified audit report * In the case of going concern uncertainty, delisting shall be postponed until the end of the half-year if the delisting cause is confirmed as resolved.
Market capitalization	Less than KRW4bn for more than thirty days	Failure to keep market capitalization "KRW4bn or more for ten consecutive days and thirty accumulated days" during the ninety days after being designated an administrative issue
Trade volume	Average monthly trade volume shall be less than 1% of floating stocks in the latest quarter * Not to apply to cases where the monthly trading volume is 10,000 shares or more and 300 or more minority shareholders hold 20% or more of shares	2 consecutive quarters
Share distribution	Less than 200 minority shareholders or less than 20% of shares held thereof * The same shall not apply when 300 or more minority shareholders hold more than 10% of shares, more than one million shares.	2 consecutive years
Unfaithful disclosure	15 or more penalty points for unfaithful disclosure in two years	- Subject to qualitative delisting examination
Disclosure documents	(A) Failure to submit quarterly or semi-annual business reports (B) Failure to gain approval of financial statements at the regular general meeting of shareholders or the general meeting of shareholders was not held	- Failure to submit quarterly or semi-annual business reports three times in two years - Failure to submit business reports within 10 days after the deadline - Re-occurrence of (A) or (B) in the term after the occurrence of (A) (failure of submission) or (B)
Outside directors, etc.	Failure to satisfy requirements from outside directors / audit committee	2 consecutive years
Application for rehabilitation/ bankruptcy	- When a request for commencement of rehabilitation procedure is filed -When an application for bankruptcy is filed	(Subject to qualitative delisting examination) When application for commencement of rehabilitation procedures is turned down, decision of commencement of rehabilitation procedures is cancelled, or rehabilitation plan is disapproved

Category	Administrative issue designation	Delisting
(Growth technical company)	Failure to disclose business progress every semi-annual period or failure to organize the investor relations meeting at least once every semi-annual period (for 3 years after listing)	Failure to disclose business progress or organize the investor relations conference in the next semi-annual period
Others (Immediate delisting)	When other causes for delisting occur	- Final bankruptcy or suspension of bank transactions - When acquired by another corporation - When placing restrictions on stock transfers in statutes, etc. - When listing on the stock market - In the case of back-door listing, violation of back-door listing standards

3) EXAMINATION PROCESS FOR DELISTING

When an event occurs which has significant influence on a company's management continuity, transparency, or investor protection, the company's eligibility to continue its status as a KOSDAQ-listed company will be assessed considering the event and its implications. If needed, a grace period will be granted for the company to make necessary improvements and recovery. The examination criteria can be divided into an individual or comprehensive approach. In the individual approach, examination on delisting is restricted to individual factors such as the suspension of business, unfaithful disclosure and making false statements. A comprehensive approach focuses on the overall eligibility of a corporation as a KOSDAQ-listed company and considers factors such as the company's avoidance of formal delisting requirements, embezzlement or malfeasance, or window dressing.

TABLE 11-7. EXAMINATION CRITERIA FOR DELISTING

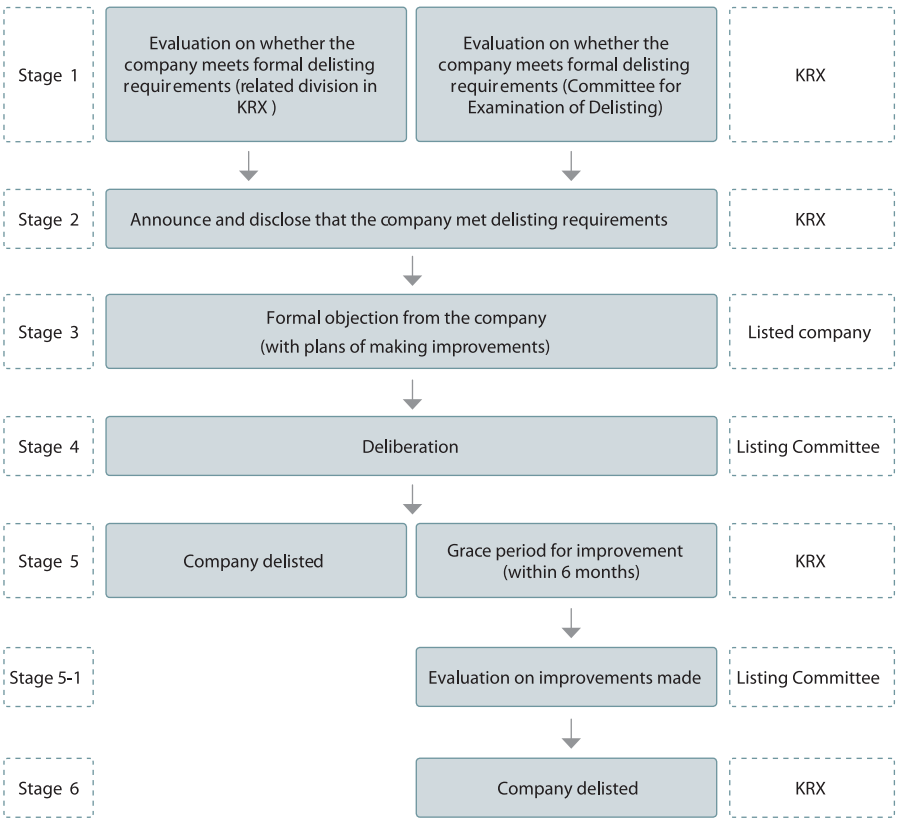
Category		Examination Criteria
Individual approach	Unfaithful disclosure	- Impact of the disclosure violation on the market and investors - Significance of the impact on corporate management - Whether it was willful misconduct, gross negligence on the part of the company - Whether the company is in the constant practice of conducting unfaithful disclosure
	Decision to enter corporate rehabilitation	- Whether the rehabilitation plan, such as the repayment plan, is properly implemented - Comprehensive consideration of operating profits pursuant to the business plan of the rehabilitation plan or the court's decision on granting authorization of the rehabilitation plan, etc.
	Submission of falsified documents	- Significance of the false report in the listing examination - Impact of the false report on investment decisions - Whether it was willful misconduct, gross negligence, etc., on the part of the company concerned

Category		Subject to examination	
Comprehensive approach	(1) Operation, financial status and other matters regarding a going concern	A. Business continuity	
		Sustainability of sales	- Whether sales continuity is viable amid continuous deterioration of business - Probability of sales recovering from business improvement plans - Whether a company that falls short in amount of sales and is designated as an administrative issue continuously avoided delisting with temporary sales
		Probability of profitability recovery	- Amount of losses incurred by steeply deteriorating business over the last 3 years and whether losses may continue -The amount that non-operating losses, including goodwill amortization and asset impairment losses, account for net loss, and whether additional depreciation may occur - Whether delisting for falling below the profitability requirement was avoided by reducing ongoing business losses with a suspended business or by generating non-recurring profit
		B. Soundness of financial status	
		Weak financial status	- Probability of a default or bankruptcy, taking into consideration the size of debt, maturity structure, repayment plan, etc. - In case of capital impairment, probability of overcoming capital impairment, taking into consideration the degree of impairment and trends -Whether repeated self-financing, such as paid-in capital increases, has occurred for overcoming capital impairment -The nature of the self-financed capital and whether it was used for business management such as facilities investment and operation capital
		Financial status deterioration due to management engaging in illegal activities	- Impact of embezzlement and malfeasance on financial status - Probability of exercising right to indemnity and retrieving money from embezzlement and malfeasance - Impact of window dressing on the financial status of the recent business year
		Whether the financial status deteriorated due to contingent liabilities	- Impact on financial status due to contingent liabilities such as illegal guarantees and provision of collateral to the largest shareholder and management - Impact on financial status due to lawsuits or illegal actions that have a material impact on corporate management such as disputes about managerial rights
	(2) Management transparency such as governance, internal control systems, disclosure systems	A. Material damage on governance structure	
		Engagement in illegal activities by the largest shareholder and management	- Whether the largest shareholder and management were involved in embezzlement and malfeasance, and the amount concerned - Whether the largest shareholder and management were involved in organized window dressing
		Threat to management stability	- Whether there was material damage to the internal control system due to embezzlement and malfeasance by the largest shareholder and management - Whether management stability was threatened due to the frequent change of the largest shareholder and disputes among management
		B. Review of whether material damage occurred to the internal control system	- Whether the internal control system has been undermined due to embezzlement and malfeasance of the largest shareholder and management - Whether an internal control system has been established and operated to prevent in advance the embezzlement and malfeasance of the largest shareholder and management
		C. Whether there has been material damage to the disclosure system	

Category		Subject to examination	
		Non-transparency of accounting process	- Whether the act of violation is material when considering the window dressing year, continuity, amount, and impact on current financial status - Whether an internal account management system has been established to prevent the reoccurrence of window dressing - Changes to the audit opinion due to the reissuing of the audit report
		Whether the disclosure violation was intentional or habitual	- Whether the disclosure violation was related to management, such as through change of the largest shareholder - Whether it is related to financing, such as capital increase by allocation to third parties - Whether the disclosure concerned may lead to additional embezzlement through fund outflows such as investments in other companies
	(3) Other	A. Undermining investor protection and sound development of securities market	- When there is a reason that matches the continuity of corporate management and transparency that is found to be ineligible to be listed, as it undermines investor protection and the sound development of the securities market

*KOSDAQ Market Listing Regulations as of February 22, 2013

CHART 11-1. DELISTING PROCEDURES



3. Trading on KOSDAQ

1) TRADING UNIT

The trading unit is in multiples of one share or one certificate and the minimum price variation depends on the stock price range. There are five minimum price variations on the KOSDAQ, ranging from KRW 1 for stock prices under KRW 1,000 to KRW 100 for a stock price of KRW 50,000 or more. Quotations exceeding 5/100 of the number of listed stocks cannot be submitted to prevent any errors in placing orders, and also protect the market from any shocks, quotation placements for the purpose of market manipulation, or unfair quotations.

TABLE 11-8. VARIATIONS IN STOCK PRICE UNITS

Stock price	Minimum price variation
Less than KRW1,000	KRW1
KRW1,000 or more to less than KRW5,000	KRW5
KRW5,000 or more to less than KRW10,000	KRW10
KRW10,000 or more to less than KRW50,000	KRW50
KRW50,000 or more	KRW100

Types of quotations on the KOSDAQ Market include limit quotations, market quotations, immediately executable limit quotations, best limit quotations, and limit-to-market-on-close quotations.

TABLE 11-9. TYPES OF QUOTATIONS

Type	Definition
Limit quotation	Investor sets a price and trade is to be concluded at the price or higher.
Market quotation	Specific price is not set, and trading takes place at market price.
Immediately executable limit quotation	- Offer quotation: on the basis of highest bid price at the time of receiving the quotation - Bid quotation: on the basis of lowest offer price at the time of receiving the quotation
Best limit quotation	- Offer quotation: on the basis of lowest offer price - Bid quotation: on the basis of highest bid price
Limit-to-market-on-close quotation	The limit quotation with such conditions that it may change into a market quotation at the time when the price at market closing is determined by individual auction at a single price.

2) BASE PRICE

The base price is the benchmark price in the trading of securities. Generally, the closing price for the previous trading day acts as the base price. When changes occur in the rights of a stock issue, such as ex-rights due to capital increase or increase of capital stock without consideration, or changes in the par value due to changes in listing, a separate base price will be applied. The daily price limit is set at 15% above or below the base price. Adding or decreasing the daily price limit to the base price calculates the upper limit or lower limit. The amount that is less than the quotation price unit applicable shall be dropped.

TABLE 11-10. BASE PRICE CALCULATION BY TYPE OF ISSUE

Type of issue		Base price calculation
Ordinary issues	When trade was executed the previous day	Closing price of previous day
	When trade was not executed the previous day	- When there was a bid/offer quotation: lowest offer price among the offer quotations lower than the previous day's base price; or the highest bid price among the bid quotations higher than the previous day's base price - When there was no bid/offer quotation: previous day's base price
In case of par value split or reverse par value split		Closing price (previous day) × split ratio
In case of ex-rights or ex-dividends		- Base price in the case of ex-rights [(closing price of cum-rights stocks × number of stocks before rights offering) + (issuing price for stocks × number of shares allotted to shareholders)] / number of stocks after rights offering • In case of capital increase, the issuing price will be the most recent price from among the prices calculated and disclosed before ex-rights In case of capital increase without consideration, the issuing price will be "zero" - Base price for ex-dividends (Closing price of cum dividend stocks × number of stocks before the dividend) / number of stocks after the dividend *Applied only to issues where dividend was announced

3) PROCEDURE FOR EXECUTING TRADES

When determining the opening price or closing price of ordinary issues, the opening price for newly-listed issues or re-listing issues, or price by issue when trading is resumed after the market was temporarily closed, etc., the method of individual auction at a single price is applied. In such cases, among the received quotations, the one with the highest bid price and the lowest offer price are matched and trading is executed consecutively. During the regular session, the trading method is switched to multi-price auction, in which trade is executed through the competitive bidding of bid/offer quotations according to price priority and time priority.

4) MARKET OPERATION AND TRADING HOURS

TABLE 11-11. TRADING HOURS

Category		Hours
Pre-hours session (before regular session)	Quotation receiving hours	07:30 - 08:30
	Trading hours	07:30 - 08:30
Regular trading session	Quotation receiving hours	08:00 - 15:00
	Trading hours	09:00 - 15:00
Off-hours trading (after regular session)	Quotation receiving hours	15:00 - 18:00
	Trading hours	15:10 - 18:00
	Off-hours closing price trading	15:10 - 15:30
	Off-hours single price trading	15:30 - 18:00

CHAPTER 12

FINANCIAL INVESTMENT INDUSTRY

I. OVERVIEW OF FINANCIAL INVESTMENT COMPANIES

When the Financial Investment Services and Capital Markets Act (FSCMA) came into effect in February 2009, financial investment business entities were, for the first time, permitted to offer a comprehensive range of financial investment services such as investment dealing, investment brokerage, collective investment, investment advisory, discretionary investment and trust services. According to the FSCMA, a financial company that conducts one or more of the six types of financial investment businesses mentioned above is referred to as a financial investment company. Existing companies in the areas of securities, futures, asset management, trusts, investment advisory services and discretionary investment services are all defined as financial investment companies.

Currently, the main business for securities firms which have not changed their names to reflect their status as financial investment companies involves brokerage, underwriting, and the dealing of securities, while additional businesses in trusts, investment advisory services, and discretionary investment services may be allowed only upon licensing or registration. Brokerage and

dealing of derivatives products is handled by futures companies, and asset management companies provide investment advisory and discretionary investment services in addition to their main business of asset management.

However, the FSCMA has opened a door for financial companies to run multiple financial investment services concurrently by obtaining a license from, or registering with, the Financial Supervisory Service. In other words, by obtaining the required license, a securities company can now engage in the businesses of futures or collective investment, services previously only permitted for a futures company or an asset management company. Additionally, with the FSCMA broadening the definition for financial products, financial investment companies will be spurred to engage in more fiercer competition by offering wider ranges of products as well as broadening their services.

Established to advance the Korean capital markets, the Korea Financial Investment Association has 165 regular members, 120 associate members, and 24 special members as of May 2014. All licensed financial investment business entities, such as securities, asset management, futures and trust companies, are qualified for full membership, while associate membership is granted to entities running a financial investment business concurrently with other businesses, such as banks, insurance companies and merchant banks, and to registered financial investment business entities such as discretionary investment and investment advisory companies.

II. FINANCIAL INVESTMENT BUSINESS

The investment dealing business refers to the business of buying and selling financial investment instruments, issuing, underwriting and inviting offers for securities, and offering and accepting offers for securities on the company's own account regardless of whose name they are in. Securities firms' underwriting and proprietary trading, and futures companies' proprietary trading all belong to this category of business.

The brokerage business refers to the business of buying and selling financial investment instruments, issuing, underwriting and inducing offers for securities, and offering and accepting offers for such instruments on another person's account regardless of whose name they are in. Securities and derivative instruments brokerage by securities or futures companies fit into this business.

The collective investment business refers to the business of collecting money from a group of investors, managing it and distributing the benefits to the investors. Collective investment firms have a fiduciary duty of due care to their investors when managing collective investment properties and carrying out their business in good faith to protect investors' interests. The asset management services division of an asset management company can be cited as an example.

The investment advisory business provides customers with advice on the value of a financial investment product or an investment judgment of a financial investment product. The discretionary investment business is the business of acquiring, disposing of, or managing in other ways, financial investment products for customers after obtaining authorization for discretionary judgment, entire or partial, over their financial investment instruments. Both services, which generate commission revenues, are handled by investment advisory firms, securities companies, and asset management companies.

The trust business engages in managing, developing, and disposing of specific entitlements to a property transferred from a trust settlor for the benefit of specified beneficiaries. Entities conducting trust activities are trust companies whose sole business is trusts, i.e. real estate trust companies, and institutions that provide other financial services, i.e. banks and securities and insurance companies.

Among the 6 types of financial investment businesses, Article 11 of the FSCMA defines investment dealing, investment brokerage, collective investment and trust services as licensed businesses given their likelihood of posing higher risks to customers. On the contrary, Article 17 of the FSCMA defines the investment advisory business and discretionary investment business as registered businesses due to the relatively lower level of risk associated.

1. Licensing

Pursuant to Article 12 (1) of the FSCMA, an entity that wishes to run a licensed financial investment business shall select all or a part of its business units for licensing from the FSC. A single business unit can be defined through a combination of factors such as the type of financial investment business, the scope of financial investment products, and classes of investors. More

specifically, the constituents of a financial investment business are the six types of investment businesses mentioned above, and the product scope consists of securities, exchange-traded derivatives, and over-the-counter derivatives. Investors are divided into ordinary and professional investors.

In addition, in accordance with Article 18 (1) of the FSCMA, an entity that wishes to operate a registered financial investment business shall create a single business unit by combining the aforementioned three factors and selecting all or part of the business units for registration with the FSC as a financial investment business.

The Enforcement Decree of the FSCMA sets forth the minimum level of net assets required to run each licensed or registered business unit based on the associated risk and the required level of investor protection for each service. For example, a higher level of minimum net assets is required for dealing and trust services, compared to brokerage and collective investment services, respectively. Likewise, as the registration of a business unit is a relaxed means of entry, it requires a lower level of minimum net assets than a licensed business unit.

With regards to the financial investment instrument, over-the-counter derivatives require the highest level of net assets. Between securities and exchange-traded derivatives, securities require a higher minimum level of net assets due to the more frequent release of new products on the market. In addition, the minimum net asset requirement is reduced by half if a financial investment service only targets professional investors who are generally more experienced and have the capacity to bear risk.

The minimum level of net assets required is set forth in the Enforcement Decree of the FSCMA. The Decree also requires that any increase in the licensed business unit should be accompanied by an increase in the net asset amount set for the corresponding business unit. This measure is intended to encourage financial investment firms to add more services, grow in size, and enhance their expertise.

Based on the Enforcement Decree, if a financial investment company launches an investment dealing service that handles debt securities, equity securities, beneficiary securities, derivatives-combined securities and securities depository receipts, the company should hold a minimum amount of net assets of KRW 50bn. But in the case of only managing debt securities, the net asset

requirement is KRW 20bn, while the equity securities business (excluding collective investment securities) alone requires minimum net assets of KRW 25bn.

TABLE 12-1. MINIMUM NET ASSET REQUIREMENTS FOR DEALING BUSINESS

(Unit: billion won)

Business area	Financial investment product	Minimum net assets (ordinary/ professional)
Dealing	Securities[1)]	50 / 25
Dealing	Debt securities[2)]	20 / 10
Dealing	State, local government and special bonds	7.5 / 3.75
Dealing	Equity securities (excluding collective investment securities)	25 / 12.5
Dealing	Collective investment securities	5 / 2.5
Dealing	Exchange-traded derivatives	10 / 5
Dealing	Exchange-traded derivatives (securities for underlying assets)	5 / 2.5
Dealing	OTC derivatives	90 / 45
Dealing	OTC derivatives (securities for underlying assets)	45 / 22.5
Dealing	OTC derivatives (non-securities for underlying assets)	45 / 22.5
Dealing	OTC derivatives (currency/interest rates for underlying assets)	18 / 9
Dealing (Excluding underwriting)	Securities[1)]	20 / 10
Dealing (Excluding underwriting)	Debt securities[2)]	8 / 4
Dealing (Excluding underwriting)	State, local government and special bonds	3 / 1.5
Dealing (Excluding underwriting)	Corporate bonds	4 / 2
Dealing (Excluding underwriting)	Equity securities (excluding collective investment securities)	10 / 5
Dealing (Excluding underwriting)	Collective investment securities	2 / 1
Dealing (Excluding underwriting)	Repurchase agreements (RP)[3)]	6 (Professional)
Dealing (Underwriting bonds only)		6 / 3

Note: 1) Securities means financial investment instruments that comprehensively cover debt securities, equity securities, beneficiary certificates, derivatives-combined securities and securities depository receipts (Article 4 of FSCMA).
2) Debt securities include state bonds, local government bonds, special bonds, corporate bonds and corporate commercial papers.
3) Financial instruments for RPs include government bonds, public offering bonds issued by listed companies and state-owned companies, guaranteed bonds, ABS and MBS for public offering and beneficiary certificates.

For the brokerage business, the minimum net asset requirement is KRW 1bn, with the amount halved to KRW 500mn if the company only targets professional investors who require relatively lower levels of protection. Based on this formula, a company that wants to carry out both brokerage and dealing will require total net assets of KRW 11bn, which is broken down to KRW 1bn for brokerage and KRW 10bn for dealing.

TABLE 12-2. MINIMUM NET ASSET REQUIREMENTS FOR BROKERAGE BUSINESS

(Unit: billion won)

Business area	Financial investment product	Minimum net assets (ordinary/ professional)
Brokerage	Securities[1)]	3 / 1.5
Brokerage	Debt securities[2)]	1 / 0.5
Brokerage	Equity securities (excluding collective investment securities)	1 / 0.5
Brokerage	Collective investment securities	1 / 0.5
Brokerage	Repurchase agreements (RP)[3)]	0.5 (Professional)
Brokerage	Exchange-traded derivatives	2 / 1
Brokerage	Exchange-traded derivatives (securities for underlying assets)	1 / 0.5
Brokerage	OTC derivatives	10 / 5
Brokerage	OTC derivatives (securities for underlying assets)	5 / 2.5
Brokerage	OTC derivatives (non-securities for underlying assets)	5 / 2.5
Brokerage	OTC derivatives (currency /interest rates for underlying asset)	2 / 1
Brokerage (ECNs)	Listed securities	15 / 7.5
Brokerage (OTC bond transactions)	Securities; debt securities	3 (Professional)

Note: 1) Securities means financial investment instruments that comprehensively cover debt securities, equity securities, beneficiary certificates, derivatives-combined securities and securities depository receipts (Article 4 of FSCMA).
2) Debt securities include state bonds, local government bonds, special bonds, corporate bonds and corporate commercial papers.
3) Financial instruments for RPs include government bonds, public offering bonds issued by listed companies and state-owned companies, guaranteed bonds, ABS and MBS for public offering and beneficiary certificates.

For the collective investment business, a company must have minimum net assets of KRW 8bn to run all types of funds, including equity funds (inclusive of MMFs), real estate funds, special assets funds, and mixed assets funds.

However, only KRW 2bn is required to run a single type of fund, such as real estate funds or special assets funds.

Licenses for trust businesses are granted depending on the type of trust properties entities intend to deal with. If a licensed trust company wishes to diversify its portfolio, it has to seek an additional license after fulfilling the minimum capital requirements and attain the professional managers necessary to service the intended trust products.

TABLE 12-3. MINIMUM NET ASSET REQUIREMENTS FOR COLLECTIVE INVESTMENT /TRUST/INVESTMENT ADVISORY /DISCRETIONARY INVESTMENT BUSINESSES

(Unit: billion won)

Business area	Financial investment product	Minimum net assets (ordinary/ professional)
Collective investment	Securities collective investment schemes (CIS) Real estate CIS Special asset CIS Mixed asset CIS Short-term finance CIS	8 / 4
Collective investment	Securities CIS Short-term finance CIS	4 / 2
Collective investment	Real estate CIS	2 / 1
Collective investment	Special asset CIS	2 / 1
Collective investment	Compound asset CIS	6
Trust	Money, securities, monetary claims, movables, real estate, rights related with real estate, intangible property rights	25 / 12.5
Trust	Money	13 / 6.5
Trust	Securities, monetary claims, movables, real estate, rights related with real estate, intangible property rights	12 / 6
Trust	Movables, real estate, rights related with real estate	10 / 5
Investment advisory	Securities, exchange-traded derivatives, OTC derivatives	0.5 / 0.25
Discretionary investment	Securities, exchange-traded derivatives, OTC derivatives	1.5 / 0.75

In addition, if a bank or an insurance company wishes to offer financial investment services concurrently, the minimum net asset requirement for the services should be examined based on an amount with the capital requirements for banking or insurance businesses (as prescribed in the banking act or the insurance act) deducted.

2. Restriction on Financial Soundness

As a measure to ensure the financial soundness of financial investment businesses, Article 30 (1) of the FSCMA sets forth that a financial investment business entity shall maintain the level of net capital to a level equivalent to or higher than the gross risk amount.

$$\text{Net capital ratio} = \frac{\text{Net capital}}{\text{Gross risk}} \times 100\%$$

Net capital refers to the amount calculated by subtracting the sum of the fixed assets and other assets difficult to be converted into cash in the short term from the sum of capital and reserves, as prescribed by the ordinance of the Prime Minister. The gross risk amount refers to the aggregated monetary value of risks that are inherent in the assets and liabilities accompanying the business undertaking.

Any financial investment entities that fail to maintain a certain level of net capital ratio (NCR) will be subject to prompt corrective action by the financial supervisory authorities. The FSC makes recommendations for management improvement of securities companies with NCR figures of less than 150%, and demands and orders management improvement in the event of an NCR lower than 120% and 100%, respectively.

In addition, a financial investment business entity shall strive to maintain soundness in its business management by complying with the standards prescribed and announced by the FSC. These standards define matters related to capital adequacy, soundness and liquidity of assets and other matters necessary for financial soundness as prescribed by the relevant Presidential Decree.

III. FINANCIAL STATUS AND PROFITABILITY OF FINANCIAL INVESTMENT COMPANIES

1. Broker-Dealer (Securities Companies)

The main business of securities companies is brokerage, issuing and underwriting, and dealing of securities and bonds. They also sell fund products and structured securities and provide asset management services centered on cash management accounts (CMAs).

The securities industry in Korea has gone through sweeping changes, such as the introduction of online trading at the end of the 1990s, followed by the opening and deregulation of the securities industry and the recent implementation of the FSCMA. Over the course of the years, the industry has achieved significant growth in volume.

Examples of these changes include the introduction of the online trading system HTS (Home Trading System) in April 1997, and the liberalization of brokerage commissions in September of that year. These measures increased the proportion of online trading in total transactions from an average of 2.8% in 1998 to 42.79% (KOSPI) and 79.30% (KOSDAQ) at the end of 2010, and have lowered brokerage commissions down to around 15bp from over 40bp in the late 1990s.

Securities companies' cash management accounts (CMAs), which were introduced in 2004, also saw a sharp increase in their balances since 2006. Further growth of CMAs is expected as securities companies are now allowed to offer payment and settlement services. With the FSCMA opening the door for securities companies to conduct other services such as futures or asset management, further expansion of their business boundaries is expected.

1) BALANCE SHEETS OF SECURITIES COMPANIES

As of 2010, the aggregate shareholders' equity of securities companies stood at KRW 38tn, an increase of 2.5 times from KRW 15tn in 2003. The size of the asset pool has also seen a sharp increase to KRW 200tn from KRW 49tn in 2003. Among asset items, the proportion of securities has risen dramatically

since 2006, which is largely attributable to the growth of CMAs. In 2011, aggregate shareholders' equity climbed to KRW 42tn, since many securities companies focused on increasing their equities for the adoption of home-grown hedge funds.

TABLE 12-4. AGGREGATE BALANCE SHEETS OF SECURITIES COMPANIES

(Unit: billion won)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY2011	FY2012	FY 2013
Total shareholders' equity	15,839	19,645	22,122	29,723	31,763	35,315	37,557	42,095	41,846	40,809
Total liabilities	36,137	48,582	73,702	101,143	117,044	141,667	162,239	195,002	226,440	229,801
Deposits by customers	15,371	17,510	16,694	18,312	22,113	24,002	25,900	27,205	27,424	23,350
Total assets	51,976	68,227	95,824	130,867	148,807	176,982	199,796	237,097	268,286	270,610
Cash and deposits	16,395	19,226	18,118	24,406	33,555	41,142	44,200	50,812	50,306	45,310
Loans	4,953	7,469	10,827	17,008	13,500	16,589	22,600	20,371	20,065	20,616
Marketable securities	21,172	30,932	53,930	75,279	84,415	103,461	115,600	134,569	168,038	174,607

Source: Korea Financial Investment Association

It should be noted that the aggregated net capital ratio (NCR) of securities companies has been maintained at above 300% since 2003. Considering that an NCR figure of less than 150% is subject to an FSC recommendation for management improvement, it would be fair to say that securities companies are maintaining sound financial performance. Recently, the NCR is showing an upward trend since securities companies are reinforcing risk management amid external uncertainties.

TABLE 12-5. AGGREGATE NET CAPITAL RATIO OF SECURITIES COMPANIES

(Unit: billion won)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Net capital	9,232	13,824	15,305	19,909	24,208	27,778	30,039	31,556	31,687	30,334
Gross risks	1,866	2,009	2,526	3,370	3,847	4,793	5,407	5,214	6,233	6,351
NCR (%)	494.7	688.2	605.9	590.7	629.3	579.5	555.6	605.2	508.3	477.56

Source: Korea Financial Investment Association

2) INCOME STATEMENTS OF SECURITIES COMPANIES

In 2013, the aggregate net income of securities companies fell to KRW -186.8bn in a significant drop from the previous year's record. Return on earnings (ROE) also dropped to -0.6%.

TABLE 12-6. AGGREGATE REVENUE AND ROE OF SECURITIES COMPANIES

(Unit: billion won)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013 (Mar-Dec)
Operating revenue	10,897	16,521	24,381	43,327	47,728	51,890	58,825	62,446	47,789	34,829
Operating expenses	9,995	12,941	21,470	38,087	45,190	48,248	55,735	59,431	46,043	34,433
Pretax income	693	4,242	3,289	5,630	2,736	3,820	3,787	3,014	1,745	47
Net income	305	3,715	2,602	4,410	2,020	2,948	2,808	2,212	1,233	-186
ROE (%)	1.9	18.9	11.8	14.8	6.4	8.8	7.8	5.6	2.9	-0.6

Source: Korea Financial Investment Association

Since 2000, brokerage services have been the biggest source of commission revenue for securities companies, followed by dealing, fund distribution and wealth management, and investment banking. The aggregate fees and commissions collected by securities companies stood at KRW 4.419tn as of 2013 (From March to December), with the income from brokerage services and wealth management accounting for 59% and 11% of the total, respectively. Investment banking (managing securities underwriting and advisory services) made up approximately 8% of the total commissions.

TABLE 12-7. SECURITIES COMPANIES' COMMISSION REVENUE

(Unit: billion won)

	Net operating revenue	Brokerage		Investment banking		Fund distribution and wealth management	
FY 2003	4,941	3,742	76%	217	4%	712	14%
FY 2004	4,472	3,248	73%	281	6%	586	13%
FY 2005	6,851	5,174	76%	351	5%	665	10%
FY 2006	6,132	4,168	68%	412	7%	827	13%
FY 2007	9,307	6,641	71%	632	7%	1,186	13%
FY 2008	6,728	4,615	69%	596	9%	791	12%
FY 2009	8,003	5,536	69%	782	10%	782	10%

	Net operating revenue	Brokerage		Investment banking		Fund distribution and wealth management	
FY 2010	8,212	5,361	65%	838	10%	930	11%
FY 2011	7,930	5,456	69%	886	11%	800	10%
FY 2012	6,094	3,700	61%	846	14%	626	10%
FY 2013 (Mar-Dec)	4,419	2,623	59%	353	8%	469	11%

Source: Korea Financial Investment Association

2. Futures Trading Companies

Futures Trading Companies (FTCs) mainly deal with futures trading and brokerage of exchange-traded derivatives, including overseas futures. They feature derivatives such as KOSPI 200 futures and options, interest rate futures (3-yr, 5-yr, 10-yr KTB futures), currency futures (dollar, yen, euro) and other commodity products such as gold, mini gold and hog futures. Overseas products include futures related with the Dow Jones, S&P 500, T-Note, T-Bond, FX Margin trading, and the Euro FX. As of 2011, there are seven domestic FTCs. A total of seven domestic futures companies provide dealing and brokerage services for futures as per the FSCMA as of the end of July 2013.

After the enactment of the FTA in 1995, KOSPI200 futures and KOSPI200 options were launched on the Korea Stock Exchange in 1996 and 1997, respectively. Emboldened by the successful launch, 3-year KTB futures and US dollar futures began trading on the Korea Futures Exchange (KFE) in 1999. After 2000, 5-year and 10-year KTB futures, euro futures and yen futures were all launched on the KFE and the Korea Exchange, and FX margin trading was also launched.

1) BALANCE SHEETS OF FUTURES TRADING COMPANIES

The total assets of futures trading companies posted KRW 224.7bn as of the end of 2013.

TABLE 12-8. AGGREGATE BALANCE SHEETS OF FTCS

(Unit: billion won)

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Total shareholders' equity	334	453	539	459	470	449	435	423
Total liabilities	1,169	1,697	2,146	1,693	1,656	1,904	2,464	1,824
Total assets	1,504	2,150	2,685	2,152	2,127	2,353	2,899	2,247

Source: Korea Financial Investment Association

The net capital ratio (NCR) of futures trading companies stood at 735.7% in 2013.

TABLE 12-9. AGGREGATE NET CAPITAL RATIO OF FTCS

(Unit: billion won)

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Net capital	266	337	504	428	422	376	390	382
Gross risks	104	63	77	58	57	50	55	52
Net capital ratio (%)	256.8	533.7	655.5	733.1	731.0	754.9	703.1	735.7

Source: Korea Financial Investment Association

2) INCOME STATEMENTS OF FUTURES TRADING COMPANIES

In fiscal year 2013, the aggregate net income of futures trading companies was KRW 3.4bn, marking a 75% decline on a year-on-year basis. The ROE, which rose above 10% starting in 2005, has been on the decline since 2009, and dropped to 0.8% in 2013.

TABLE 12-10. AGGREGATE REVENUE AND ROE OF FTCS

(Unit: billion won)

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Operating revenue	260	379	771	377	374	372	256	205
Operating expenses	209	280	635	289	306	316	230	200
Operating profit	52	100	135	88	68	55	19	5
Net income	40	72	102	64	48	40	14	3
ROE (%)	12.0	15.9	19.0	13.9	10.7	8.9	3.2	0.8

Source: Korea Financial Investment Association

The number of FTCs has been declining since 2008 in the aftermath of the global financial crisis and intensifying competition in the market. Consequently, the total revenue of FTCs has also decreased, with commission income from derivatives brokerage dropping by KRW 37.6bn from the previous year. And while the balance of payment for derivatives accounts has seen an increase of KRW 2.4bn, that of financial accounts declined by KRW 12.3bn.

TABLE 12-11. MAJOR PROFITS/LOSSES OF FTCS

(Unit: 100 million won)

	FY 2012 (B)	FY 2013 (B)	Differences (B-A)	Variation
Commission income	1,245	869	△376	△30.2%
Derivatives-related accounts	17	41	24	141.2%
Financial accounts	308	185	△123	△39.9%
Selling general & administrative expenses	947	716	△231	△24.4%
Net income	137	34	△103	△75.2%

Source: Financial Supervisory Service

3. Asset Management Companies

As of the end of 2013, a total of 84 asset management companies (AMCs) were registered for operation in Korea, consisting of 62 domestic companies and 22 foreign companies (defined as having over 50% of shares held by foreign investors). After the launch of Fidelity International in 2004, other foreign AMCs such as JP Morgan, Lazard and BlackRock began operations in the Korean market. In addition, the number of independent AMCs is on the rise as an increasing number of asset management companies are investing

in single, specialized assets such as real estate, commodities, natural resource development, and social overhead capital.

TABLE 12-12. NUMBER OF ASSET MANAGEMENT COMPANIES

(Unit: number of AMCs)

Category	2006	2007	2008	2009	2010	2011	2012	2013
Total number of AMCs	49	51	63	69	80	82	84	84
Domestic AMCs	35	36	43	46	57	60	62	62
Foreign AMCs[1)]	14	15	20	23	23	22	22	22

Source: Financial Supervisory Service, Korea Financial Investment Association
Note: A foreign AMC has 50% or more of its shares held by foreign investors.

1) TOTAL AUM AND NET ASSETS OF ASSET MANAGEMENT COMPANIES

The total AUM of AMCs stood at KRW 328tn as of the end of 2013. The number of large AMCs with an AUM value over KRW 10tn stood at nine, while seven AMCs held an AUM of between KRW 5tn to KRW 10tn, and 36 AMCs managed KRW 1tn or below in assets. In terms of the total net assets of AMCs, the top five AMCs made up 38.2% of the share of the market, or KRW 125tn, and the top ten AMCs accounted for 58.1%, or KRW 190tn, of the aggregate total net assets of AMCs.

TABLE 12-13. AVERAGE AUM OF AMCS

(Unit: 100 million won)

Category	2006	2007	2008	2009	2010	2011	2012	2013
AVERAGE AUM	49,476	62,435	45,795	46,162	39,852	33,822	36,618	39,101

Source: Korea Financial Investment Association

The overall balance sheet of AMCs indicates that assets continue to grow as new companies enter the market. The portion of capital stock and deposits is decreasing, while that of securities is on the rise. This is attributable to the deregulation of capital requirements for AMCs. Securities now account for 35.7% of total assets held by AMCs as of the end of 2013.

TABLE 12-14. AGGREGATE BALANCE SHEET OF AMCS

(Unit: billion won)

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Total shareholders' equity	1,850	2,297	2,623	2,976	3,130	3,281	3,486	3,635
Total liabilities	232	417	531	431	502	524	440	550
Deposits received	32	96	220	90	116	51	101	190
Debts and other liabilities	-	321	310	341	387	473	338	359
Total assets	2,083	2,713	3,154	3,407	3,633	3,805	3,927	4,185
Capital stock/deposits	1,388	1,841	2,170	1,917	1,870	1,818	1,911	1,999
Securities	-	246	341	802	1,086	1,274	1,305	1,494
Bonds and other assets	8	26	31	588	580	628	649	626

Source: Korea Financial Investment Association

The net capital ratio of the entire asset management industry was 531.3% in 2013, considerably higher than the minimum standard of 150% set out by regulators.

TABLE 12-15. AGGREGATE NET CAPITAL RATIO OF AMCS

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Liquid assets	1,672	2,060	2,230	2,338	2,330	2,183	2,284	2,351
Indebtedness	436	418	420	463	473	423	429	442
Net capital ratio (%)	383.4	493.0	531.0	504.5	492.6	516.8	532.4	531.3

Source: Korea Financial Investment Association

2) BALANCE SHEETS OF ASSET MANAGEMENT COMPANIES

With the rising flow of capital to the funds market and the increasing popularity of equity funds, which usually charge higher fees than other types of funds, the performance of AMCs has improved significantly since 2005. Boosted by the steep growth of the funds market, the industry's net income soared from KRW 26bn in fiscal year 2004 to more than KRW 500bn in fiscal year 2007.

However, the asset management industry is experiencing sluggish growth in its profits as AUM remains stagnant and the scale of equity funds, a key source of revenue from sales charges, has contracted. The net profit of domestic AMCs in fiscal year 2013 (the accounting period changed, and statistics from April 1,

2013 to December 31, 2013 were used) was KRW 325.1bn, a steep decline of 37.2% compared to the record high of 2007.

Since 2007, the AUM of mutual funds has remained stagnant, which led to a slowdown of the growth of management fee income. Fixed expenses, such as sales administrative costs, rose in general across the industry as new AMCs joined the market

TABLE 12-16. AGGREGATE REVENUE AND ROE OF AMCS

(Unit: billion won)

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Operating revenue	879	1,556	1,537	1,662	1,638	1,519	1,535	1,202
Operating expenses	514	905	952	1,048	1,113	1,068	1,090	809
Operating profit	358	682	580	624	541	418	448	416
Net income	263	517	404	453	391	304	328	325
ROE (%)	15.1	25.0	16.4	16.2	12.8	9.5	9.7	9.1

Source: Korea Financial Investment Association

4. Trust Companies

1) NUMBER OF TRUST COMPANIES AND ASSETS UNDER MANAGEMENT

As of the end of 2013, 57 financial institutions provide trust services, of which 46 provide other financial business services, and 11 are real estate trust companies whose sole business is limited to trusts.

TABLE 12-17. NUMBER OF TRUST COMPANIES

(Unit: no. of companies)

Category		2009	2010	2011	2012	2013
Institutions operating other core businesses	Securities	17	20	21	21	21
	Banks	20	20	20	20	20
	Insurance	5	5	5	5	5
	Sub-total	42	45	46	46	46
Real estate trust companies		11	11	11	11	11
Total		53	56	57	57	57

Source: Korea Financial Investment Association

As of the end of 2013, the total AUM of trust companies stood at KRW 497.4tn, a 13.4% or KRW 58.8tn jump from a year earlier.

TABLE 12-18. AUM OF TRUST COMPANIES

(Unit: trillion won, %, percentage points)

Category		2012(A)	Market share(a)	2013(B)	Market share(b)	Growth: AUM(B-A)	Growth: Market share(b-a)	Growth: Growth rate (B-A)/A
Institutions operating other core businesses	Banks	202.1	46.1	245.2	49.3	43.1	3.2	21.3
	Securities	113.9	26.0	130.7	26.3	16.8	0.3	14.7
	Insurance	1.7	0.4	2.3	0.5	0.6	0,1	35.3
	Sub-total	317.7	72.4	378.2	76.1	60.5	4.5	19.0
Real estate trust companies		120.9	27.6	119.2	24.0	△1.7	△3.6	△1.4
	Total	438.6	100.0	497.4	100.0	58.8	-	13.4

Source: Korea Financial Investment Association

The growth of specified money trusts by 16.8% (KRW 33.9tn) and monetary bond trusts by 39.9% (KRW 27.2tn) contributed to driving the AUM of money trusts and property trusts up by 16.1%, or KRW 34.3tn, and 10.7%, or KRW 24.2tn, respectively, compared to the end of the previous year.

TABLE 12-19. AUM BY TYPE OF TRUST PROPERTY

(Unit: trillion won, %)

Category		2012 (A)	2013 (B)	2013 (B): Proportion	Growth (B-A)	Growth rate (B-A)/A
Monetary trusts	Unspecified*	12.0	12.3	2.5	0.3	2.5
	Specified	201.4	235.3	47.3	33.9	16.8
	Sub-total	213.4	247.7	49.8	34.3	16.1
Property trusts	Monetary bond	68.2	95.4	19.2	27.2	39.9
	Securities	7.0	9.3	1.9	2.3	32.9
	Real estate	150.1	144.8	29.1	△5.3	△3.5
	Sub-total	225.2	249.4	50.1	24.2	10.7
	Other	-	0.3	0.1	0.3	-
	Total	438.6	497.4	100.0	58.8	13.4

Source: Korea Financial Investment Association

* New openings banned after the enforcement of the Indirect Investment Asset Management Business Act in Jan. 2004

2) BALANCE SHEET OF REAL ESTATE TRUST COMPANIES[2)]

The balance sheet of the 11 real estate trust companies shows that the assets witnessed growth of 2.3% (KRW 35.4bn) on a year-on-year basis to reach KRW 1.58tn at the end of 2013. The strong balance sheet shows that real estate trust companies are on sound financial footing as liabilities dropped by 16.9%, or KRW 85.7bn, from the previous year to record KRW 421.8bn.

TABLE 12-20. BALANCE SHEET OF REAL ESTATE TRUST COMPANIES

(Unit: 100 million won)

Category	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012 (A)	FY 2013 (B)	Growth (B-A)
Assets	18,306	17,015	17,482	17,132	14,870	15,453	15,807	354
Liabilities	10,893	9,207	8,717	8,605	5,585	5,075	4,218	△857
Capital	7,413	7,808	8,764	8,528	9,286	10,378	11,589	1,211

Source: Financial Supervisory Service (FY 2007 - FY 2008), Korea Financial Investment Association (FY 2009 - FY 2013)

3) INCOME STATEMENT OF REAL ESTATE TRUST COMPANIES[3)]

A closer look at the income statements of the real estate trust companies shows that their net income for 2013 jumped by KRW 9.0bn, or 8.0%, on a year-on-year basis to reach KRW 122.2bn.

TABLE 12-21. INCOME STATEMENT OF REAL ESTATE TRUST COMPANIES

(Unit: 100 million won)

Category	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	Growth
Operating revenue	4,369	3,806	3,616	3,269	3,832	3,926	4,491	565
Operating expenses	2,867	2,738	2,428	3,511	2,975	2,426	2,841	415
Operating profit	1,502	1,068	1,187	△242	857	1,500	1,651	151
Net income	1,237	942	909	△154	574	1,132	1,222	90

Source: Financial Supervisory Service (FY 2007 - FY 2008), Korea Financial Investment Association (FY 2009 - FY 2013)

5. Investment Advisory Companies

As of the end of March 2014, a total of 154 investment advisory companies[1)] were registered for operation in Korea, which is an increase of 63 companies compared to 91 registered in 2008.
The total number of investment advisory companies showed a continued growth trend from 2005 to early 2012. Most notably, the number surged between 2009 and 2011 with the increase in advisory wrap accounts and the implementation of the FSCMA. Recently, however, the number has fallen slightly due to some top investment advisory companies switching to become asset management companies, and corrections in the stock market.

TABLE 12-22. NUMBER OF INVESTMENT ADVISORY COMPANIES

(Unit: no. of companies)

Category	March 2006	March 2007	March 2008	March 2009	March 2010	March 2011	March 2012	March 2013	March 2014
Total number of investment advisory companies	57	74	84	91	116	141	159	157	154

Source: Financial Supervisory Service

1) TOTAL ASSETS AND AUM OF INVESTMENT ADVISORY COMPANIES

At the end of March 2014, the total assets of investment advisory companies marked KRW 655.5bn, a KRW 6.6bn increase from the previous year, and shareholders' equity increased by KRW 11.5bn to reach KRW 581.3bn.

TABLE 12-23. FINANCIAL STATUS OF INVESTMENT ADVISORY COMPANIES

(unit: 100 million won)

Type		End of March 2013 (A)	End of March 2014 (B)	Growth (B-A)
Total assets		6,489	6,555	66
	Securities	3,260	3,177	△83
	Capital stock/deposits	2,150	2,454	304

Note: 1) Considering the difficulties in obtaining balance sheet and income statement information on trust business activities for institutions operating other core businesses, i.e. banks, securities and insurance companies, analysis is provided for only real estate trust companies.

Type		End of March 2013 (A)	End of March 2014 (B)	Growth (B-A)
Total liabilities		791	743	△48
	Borrowings	311	235	△76
Total capital		5,698	5,813	115

The AUM of investment advisory companies for advisory and discretionary investment services recorded KRW 22.9tn as of the end of March 2014, a KRW 3.1tn (15.1%) increase compared to the year before.

TABLE 12-24. TOTAL AUM OF INVESTMENT ADVISORY COMPANIES

(unit: trillion won)

Category		FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
AUM		14.8	25.8	22.8	19.8	22.9
	Discretionary	10.4	13.5	123	12.1	13.8
	investment	4.4	12.3	10.5	7.7	9.1

Source: Financial Supervisory Service

2) BALANCE SHEET OF INVESTMENT ADVISORY COMPANIES

As of 2013, investment advisory companies posted KRW 272.4bn in operating revenue. They showed improved performance and posted a record-high net income in 2007 on the back of continued growth in the AUM of investment advisory and discretionary investment services as the stock market thrived from 2005 until mid-2007. The sector, however, suffered massive losses in 2008 when the stock market tumbled due to the global financial crisis. After the crisis, there were signs of gradual recovery, but recently, operating revenues have begun to decline again due to the conversion of several top investment advisory companies into asset management companies, and market corrections.

TABLE 12-25. AGGREGATE REVENUE OF INVESTMENT ADVISORY COMPANIES

(Unit: billion won)

	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Operating revenue	1,596	1,615	3,126	1,503	2,544	3,558	3,513	2,524	2,724
Operating expenses	1,008	1,133	1,939	1,763	2,051	2,413	2,956	2,289	2,306
Operating profit	588	482	1,187	△296	493	1145	557	235	418
Net income	477	403	849	△303	338	877	355	140	307

Source: Financial Supervisory Service

CHAPTER 13

FOREIGN INVESTMENT IN THE KOREAN CAPITAL MARKET

I. FOREIGN INVESTOR REGISTRATION

Foreign investors who wish to acquire or dispose of securities listed on the securities market, or securities offered or sold for listing, must register with the Financial Supervisory Service (FSS). The documents required by the FSS should be submitted in person or through a local agent and an investment registration certificate (IRC) will be issued. After submitting an IRC, a licensed local investment dealer or investment broker may open an account for securities trading on behalf of foreign investors.

Under the respective laws, including the Financial Investment Services and Capital Markets Act (FSCMA), foreign investors are permitted to acquire securities within certain investment ceilings. As of the end of April 1, 2014, 33 stock issues from 33 companies have restrictions for foreign investors. Foreign investor registration aims to manage the matters pertaining to foreign investment limits and other related issues. Through the system, statistics on foreign investment including foreign holdings will also be managed. Furthermore, the IRC is used to authenticate the real name of an investor when

opening an account, easing the burden placed on the investor of submitting other ID documents to individual financial companies.

II. INVESTORS SUBJECT TO REGISTRATION

Generally, an individual of foreign nationality who has not maintained residence in Korea for more than six months will be subject to registration if he or she intends to invest in listed securities. The same applies to corporations. Any corporation that does not have an office in Korea and was established according to foreign laws must register in order to invest in listed securities in Korea. This means that a Korean citizen residing outside Korea need not register for an IRC because of his or her Korean nationality. However, foreign corporations (local subsidiaries) established by Korean nationals are viewed as foreign entities; therefore they must register with the FSS for an IRC.

In addition, the main office and branch offices (except branch offices established within Korea) of a foreign corporation are viewed as a single foreign entity and are only required to have one IRC issued.

In the case of funds, however, a master fund and sub-fund cannot be registered together according to Article 6-10(2) of the Regulations on Financial Investment Business, in order to ensure the effectiveness of investment registration. If they are registered together, a single beneficiary owner may eventually have more than two certificates. However, when a master fund is not registered, each sub-fund is able to register individually since these sub-funds are considered separate beneficiary owners.

III. EXEMPTION FROM REGISTRATION

Foreign nationals, foreign-incorporated entities, or local branches of a foreign corporation engaging in business activities in Korea that qualify for "foreigner under national treatment" status, shall be exempt from registration upon submitting documents verifying their status. Registration will also be exempted in the case of acquiring or disposing of stocks on the OTC market for the purpose of "direct investment", but the details of the relevant transactions must be reported promptly to the FSS.

Exemption from registration will also apply to cases where government bonds and market stabilization bonds are acquired and sold using an omnibus account at the International Central Securities Depository (ICSD).

IV. SPECIAL CASES FOR FOREIGN REGISTRATION

When registering as an investor, one IRC is issued per beneficiary owner. There are certain exceptions however to make investing more convenient for foreign investors.

Overseas branches or business offices of a domestic investment dealer or investment broker can register separately under the name of the financial institution concerned, when it is necessary to arrange the outsourcing of transactions in the securities market. And a foreign financial institution can register separately under its own company name when it needs to manage its own assets and customers' assets separately.

An investment dealer or an investment broker can also separately file for registration of an investment under its own name when it is necessary to process entire orders for an investor group and distribute them. A foreign investor group can make orders by using the same IRC. Here, foreign investors eligible for making orders are those where the investment manager of the investor group has reported to the relevant investment dealer or investment broker before engaging in trading. Investment dealers and brokers have an obligation to make and keep a record of orders, order execution and order distribution.

V. REGISTRATION APPLICATION PROCEDURE

1. Summary

A foreign investor who wishes to register with the FSS in person or through a local agent may do so by submitting the completed registration application form (Form No. 34 of Supplementary Volume 1 of Detailed Rules of the Regulations on Financial Investment Business) to the FSS, along with the

official documents that authenticate the lawful identity of the investor. After confirming all the documents, the FSS will issue the foreign investor IRC directly or through a local agent.

TABLE 13-1. OFFICIAL DOCUMENTS THAT AUTHENTICATE THE LAWFUL IDENTITY OF THE INVESTOR

For an individual investor	For a legal entity
A passport or any other equivalent document issued by a foreign government stating name, date of birth, and other personal information of the applicant may suffice. Notarization is required when submitting a copy. (Notarized letter of authorization is required when registering through a local agent.)	A certificate of incorporation (COI) and other similar documents issued by a central government, local governments, or a public regulatory authority of a foreign nation stating the name of the entity, the date of incorporation, the name of the issuing authority, and the date of the issuance may suffice. Notarization is required when submitting a copy. (Notarized letter of authorization is required when registering through a local agent.)

The FSS has developed an electronic registration system for foreign investors to shorten the time required for investment registration, which has been in operation since June 1, 2007. Under the system, financial institutions (local agents of foreign investors) file investment registration applications and submit relevant documents through the Financial Information Exchange System (http://fines.fss.or.kr) to the FSS, and receive registration certificates electronically.

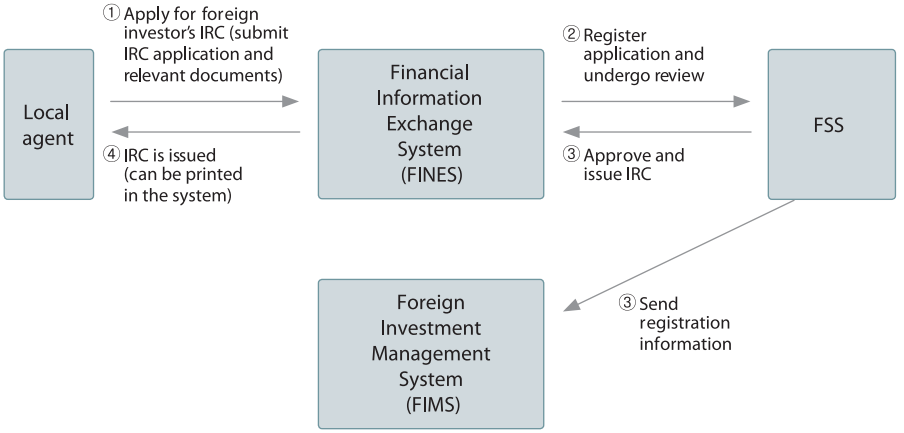
Previously, it took approximately 4 days to issue an IRC, inconveniencing investors and causing delays in investment opportunities. With the introduction of the online investment registration system, the IRC issuance period was reduced to less than 4 hours, enabling foreign investors to promptly open accounts and engage in transactions.

2. Detailed Procedures

1) DESIGNATING A LOCAL AGENT AND REGISTERING THROUGH THE AGENT

The local agent applies for the foreign investor's IRC by electronically submitting the IRC application and the relevant documents to the FSS through the Financial Information Exchange System (http://fines.fss.or.kr/), and the FSS then reviews the documents. When approved, an IRC will be issued electronically.

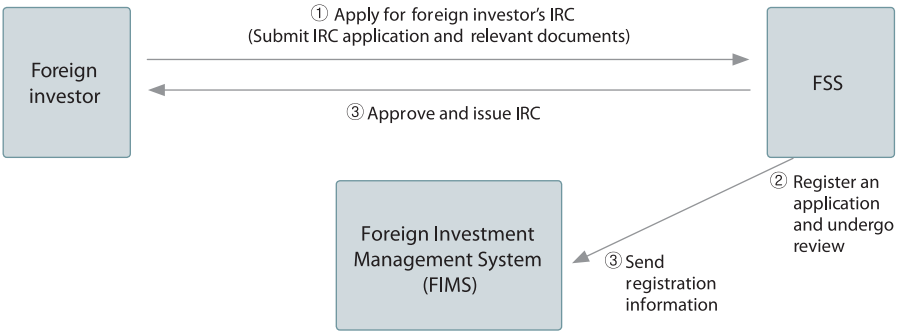
CHART 13-1. DESIGNATING A LOCAL AGENT AND REGISTERING THROUGH THE AGENT



2) REGISTERING IN PERSON

A foreign investor can submit in person the IRC application and all official documents authenticating his or her identity. The FSS issues an IRC after reviewing the documents.

CHART 13-2. REGISTERING IN PERSON



VI. RESTRICTIONS ON OTC TRANSACTIONS AND EXCEPTIONS

1. Concentration Rule (Floor Trading)

A foreign investor or a foreign corporation must trade listed securities on the exchange under the Enforcement Decree of the Financial Investment Services and Capital Markets Act. Since over-the-counter (OTC) transactions take place based on the agreement between the relevant contract parties, changes in securities holdings of foreign investors are not immediately reflected, thereby causing considerable trouble for the management of the statistics on foreign investors' acquisition limits as well as investments. Accordingly, the so-called "concentration rule" is imposed to ensure the smooth and stable management of foreign investment.

2. Exceptions

However, OTC transactions are allowed in exceptional cases. For example, OTC transactions are allowed in cases where government bonds or monetary stabilization bonds are traded between foreign investors who hold a settlement account with an international central securities depository (ICSD), use the account in the same ICSD and make the payment through the ICSD.

Also, investment managers for collective investment schemes are allowed to trade securities in block orders through a representative account or an account which has been opened by a dealer or a broker for handling transactions for an investor group (broker/dealer account), and distribute them to foreign investors who belong to the investor group no later than the day after the day of the trade. Another exception is when securities are traded at a fair price (market closing price on the day when the OTC transaction was made) between foreign investors who belong to an investor group managed by the same manager.

Foreign investors' securities that are registered under different names but essentially belong to a single owner are allowed to be transferred in the OTC market. In such a case, a foreign investor who takes over the securities must

submit an application for transfer, as well as documents that can verify that both the transferee and the transferor are the same person, to the Governor of the FSS.

VII. FOREIGN STOCK OWNERSHIP RESTRICTIONS

1. Ceiling on Foreign Ownership

A ceiling on foreign ownership may be imposed on listed companies that are designated public-purpose companies or otherwise restricted under other Acts. As of the end of April, 2014, Korea Electric Power Corporation (KEPCO) was the only designated public-purpose company under the FSCMA. There are 34 stock issues of 33 other listed companies (including KEPCO) that are restricted under other acts, such as the Broadcasting Act and the Aviation Act.

According to the Enforcement Decree of the FSCMA, the ceiling on a public-purpose company (KEPCO) for foreign investors is 40% of the total shares. The ceiling on a single foreign investor in a public-purpose company is subject to restriction as provided for in the company's articles of incorporation. For other restricted companies, the ceiling is set by the applicable acts.

TABLE 13-2. LIST OF COMPANIES WITH FOREIGN OWNERSHIP RESTRICTIONS

(Unit: %)

Applicable laws and regulations		Limit by law		Limit by articles of incorporation			
	Total	Single investor	Total	Single investor	Companies listed on KRX stock market	Listed on KOSDAQ market
FSCMA	40	-	-	3	KEPCO	-
Telecommunications Business Act	49	-	-	-	KT, SK Telecom, LG Uplus	SK Broadband Eyesvision Onse Telecom KRTnet Innocell
Act on Privatization of Public Enterprises	-	15	30	-	Korea Gas	-
Broadcasting Act	0	-	-	-	Seoul Broadcasting-System	KNN, TBC, YTN
	49	-	-	-	Hwasung Industrial Hyundai Home Shopping Hyundai HCN	Korea Business News CJ O Shopping InfoBank SBS Contents Hub

Applicable laws and regulations	Total	Limit by law		Limit by articles of incorporation		Listed on KOSDAQ market
		Single investor	Total	Single investor	Companies listed on KRX stock market	
					Skylife	Digital Chosun KTH CCS CJ E&M GS Home Shopping KMH CJ Hellovision
Newspaper Act	30	-	-	-	-	Sports Seoul Jcontentree
Aviation Act	49.99	-	-	-	Korean Air (including preferred stock) Asiana Airlines	-
Total number of companies	(34)				12 (13)	21

Note: As of April 30, 2014

2. Changes in Foreign Ownership Restrictions

As part of the government's effort to establish an open economy and capital market, foreign investors have been permitted to invest in domestically listed stocks since 1992. Following this, the Foreign Investment Management System (FIMS) was introduced to set a total acquisition limit for foreign investors per issue as well as acquisition limits per single investor, and to electronically manage foreign investor registrations and acquisition limits on investments. Since then, the acquisition limit has been continuously raised to pursue market liberalization, and the acquisition limit for listed companies, excepting public-purpose corporations, was abolished in May 1998.

TABLE 13-3. LIFTING OF CEILINGS ON FOREIGN INVESTMENT

Effective date		Jan. 1992	Dec. 1994 (Stage 1)	Jul. 1995 (Stage 2)	Apr. 1996 (Stage 3)	Oct. 1996 (Stage 4)	May. 1997 (Stage 5)	Nov. 1997 (Stage 6)	Dec. 1997 (Stage 7)	Dec. 1997 (Stage 8)	May. 1998 (Stage 9)	Nov. 2000
Total limit	General corporation	10%	12%	15%	18%	20%	23%	26%	50%	55%	abo-lished	-
Total limit	Public corporation	8%	8%	10%	12%	15%	18%	21%	25%	25%	30%	40%
Per investor limit	General corporation	3%	3%	3%	4%	5%	6%	7%	50%	50%	abo-lished	-
Per investor limit	Public corporation	1%	1%	1%	1%	1%	1%	1%	1%	1%	3%	3%

Source: Korea Financial Investment Association, Financial Statistics Information System

3. Reporting on Stock Ownership

In accordance with the Detailed Rules of the Regulations on Financial Investment Business, corporations and institutions that are engaged in handling the securities transactions by foreign investors, have reporting requirements. Specifically, in cases where a corporation with foreign ownership is newly listed, or a listed corporation merges with another corporation, the corporation should directly report the foreign ownership of its shares to the FSS.

CHAPTER 14

TAXATION ON FINANCIAL INVESTMENT

I. RESIDENTS AND TAXATION ON FINANCIAL INCOME

Issues of taxation arise at every step of purchasing, retaining and redeeming or selling financial instruments. Korean taxation laws dictate no tax on the acquisition of financial investment instruments. However, dividends or interest accrued from possession of financial investment instruments are subject to the income taxation under Korean taxation laws. In the case of the disposition/transfer of financial investment instruments to other persons, capital gains accrued are exempt from taxation. Instead, transaction taxes are levied on the selling of securities.

Korean tax laws classify taxpayers into residents, domestic corporations, non-residents and foreign corporations, applying different tax laws to each. Tax laws applied to residents and non-residents are stipulated in the Income Tax Act (ITA), and taxation on domestic and foreign corporations are prescribed in the Corporate Tax Act (CTA). Although non-residents and foreign corporations ("non-residents and foreign corporations" hereinafter referred to as "foreigners") are separately governed by the ITA and CTA, the specifics of the taxation rules described in both Acts are almost identical.

The CTA states that the taxable income of corporations be calculated in a way that sums up every possible gain and loss that could cause increases or decreases in the net asset value of the corporation. When an investor is a domestic corporation, there is no need to confirm whether the gain or loss accrued from an individual stock is taxable or not, as every gain and loss that could bring changes in the corporate net asset amount is taxable. However, in this case, the issue could be whether to impose a withholding tax on imputed income of the corporation. In principle, the withholding tax is only imposed on the interest income and proceeds generated by collective investment schemes (for investment trusts).

1. Overview of the Income Tax Act

1) MAIN FEATURES

(a) Taxation based on Quellentheorie - Income Source Theory

Currently, the ITA enumerates eight types of taxable income – interest income, dividend income, business income, earned income, annuity income, miscellaneous income, retirement income, and transfer income. Income that is not stipulated in the Act is exempt from taxation, with the exception of income similar to the interest, dividends, and annuity income – they are liable for taxation even though they are not specified in the Act.

The ITA uses a positive definition, classifying income based on the types of income sources, and only imposing taxes on the income accrued on a continuous and repeated basis. The reason for such a selective taxation is that the current income tax system is based on Quellentheorie, in other words, income source theory.

(b) Global, Schedular and Separate Taxations

Global taxation imposes tax on the total amount of income accrued during a certain period of time, regardless of its type. The current income tax system applies global taxation to interest, dividends, business, earned annuity and miscellaneous income on a personal basis. Along with global taxation, the ITA also uses schedular and separate taxations as well. Schedular taxation

separately levies a tax on retirement income and transfer income without adding them to the other eight types of income. The reason for such an approach is that retirement and transfer incomes are usually realized all at once, based on incomes accrued during a relatively long period of time. Therefore, in most of the cases, the amount of income realized is very large. If global taxation is applied to such cases, this could lead to a heavy tax rate, increasing the tax burden of ordinary taxpayers. Considering this fact, the ITA uses a schedular system which classifies and taxes based on type of income to ease the public's tax burden. In addition, when it comes to regular income, such as interest income, separate taxation is applied. Without the periodic summing up of regular income, separate taxation closes its taxation process with tax withholdings whenever the income is paid to an individual.

(c) Voluntary Tax Payment based on Individual Progressive Tax Rate

In the global taxation system, units subject to taxation can be an individual, a married couple or a household. In principle, Korea imposes an income tax, based on the individual unit. Unlike corporate tax, income tax is directly levied on a natural person. Therefore, one of the important functional values enshrined in income tax is that it should be a tax that considers each individual's different financial abilities, facilitating a fair redistribution of income among the general public. Based on such an understanding, the ITA applies different income tax tariffs - ranging from 6% to 38% - to each income bracket. Plus, a personal deduction is also applied considering the number of the taxpayer's dependents. Given the different tax paying ability of each individual, different amounts of taxes are levied on each person depending on the type of income they earn, even if the amounts earned are the same.

Meanwhile, from the tax amount collected since 1995, the ITA has applied amended taxation rules, abandoning its original government-led tax assessment and taxation system in which the government notifies the amount of income tax that should be paid by taxpayers. To replace the old system, a voluntary, self-assessment taxation system was introduced in which taxpayers assess themselves and declare the amount of taxes they should pay to settle their tax claim. Under this system, taxpayers have to file their final return on tax base between the 1st and 30th day of May of the year following the taxable period to determine the amount of income tax due.

2) TAX WITHHOLDING

Any person who pays income to a resident or non-resident in Korea should collect income tax from them, and pay the withheld income tax to the government by no later than the 10th of the month following that to which the withheld tax belongs.

Tax withholding is a taxation system in which an individual that pays income to another person is liable to pay tax. The individual, therefore, gives an amount of money that excludes the amount of tax payable, and pays the government the tax collected through withholding. The purpose of withholding, which is widely used under the current income tax system, is to minimize the omission of taxation sources and enhance convenience for taxpayers. There are two types of tax withholdings: full payment and prepayment. The former, full payment withholding, is a separate taxation system in which related tax payments are cleared off all at once only by withholding taxes. In this case a taxpayer does not carry the obligation of a final return for settlement. Examples of full payment withholding are described in Table 14-1.

Prepayment also withholds tax at the point of payment, but requires the taxpayers to file an income tax return and calculate their income accrued during the current year when they submit their final return for income taxes. In the process, the amount of tax withheld shall be deducted as a prepaid amount. Tax withholding by a corporation is an example of prepayment tax withholding.

TABLE 14-1. EXAMPLES OF FULL PAYMENT TAX WITHHOLDING

Residents	① Separate taxation on interest income ② Separate taxation on dividend income ③ Separate taxation on earned income (wages of daily-paid workers) ④ Separate taxation on annuity income (optional separate taxation for persons with an annual income of less than KRW 12mn) ⑤ Separate taxation on miscellaneous income (optional separate taxation for persons with an annual income of less that KRW 3mn)
Non-residents	Income liable for withholding (excluding transfer income)

3) TAXABLE PERIOD AND TAX CALCULATION

The taxable period is from January 1 to December 31 of a calendar year, and when a resident becomes deceased the period shall be from January 1st to the day the resident passed away. If a resident emigrates from Korea, the period

shall be from January 1st to the day of departure. As such, unlike the corporate tax, the taxable period of income tax is not affected by commencement or discontinuation of a business. An arbitrary designation of the taxable period is not allowed for income taxation.

TABLE 14-2. INCOME CLASSIFICATION AND TAX CALCULATION FOR AGGREGATE INCOME

Classification	Definition
Total amount of aggregate income	(=∑ Income amount: Total amount of income (excluding tax free, and separate taxation) - Interest, dividend, business, earned, annuity, miscellaneous income * positive definition in principle but negative definition for interest, dividend and annuity income - Aggregate taxation on financial income
(--) aggregate income deduction*	- Special exceptions for calculation of income (deduction of summing up taxation on a joint business, deficits and deficits carried over)
	- Personal + special + other deductions
Base of taxation	- (Below KRW 12mn: 6%, KRW 12mn to KRW 46mn: 15%, KRW 46mn to KRW 88mn: 24%, KRW 88mn to KRW 300mn: 35%, above KRW 300mn: 38%)
(x) tax rate**	- 6%-38% of progressive tax rate
Calculated tax	- Special exceptions for tax calculation of financial income
(--) tax credit and exemption	- Tax credit for foreign taxes paid, tax credit for dividends, tax credit for earned income, tax credit for losses due to disaster, tax credit for bookkeeping, tax credit based on RSTA*
Determined tax (+) penalty tax (+) additional tax to pay	Amount of additional interest assessment
Total amount of determined tax	Resident tax = total amount of determined tax × 10%
(--) Prepaid tax	Interim tax payment, occasional assessment tax payment, withholding tax payment, tax amount collected by tax association
Voluntary tax payment	

Note: RSTA - Restriction of Special Taxation Act
* (Revised in 2014) The existing special deduction was converted into a special tax credit.
- aggregate income deduction: personal exemption + other exemptions
- tax credit: tax credit for foreign taxes paid, tax credit for dividends, tax credit for earned income, tax credit for losses due to disaster, tax credit for bookkeeping, tax credit based on RSTA, special tax credit, pension income tax credit

** (Tax Rate in 2014) Below KRW 12mn: 6%, KRW 12mn to KRW 46mn: 15%, KRW 46mn to KRW 88mn: 24%, KRW 88mn to KRW 150mm: 35%, above KRW 150mn: 38%

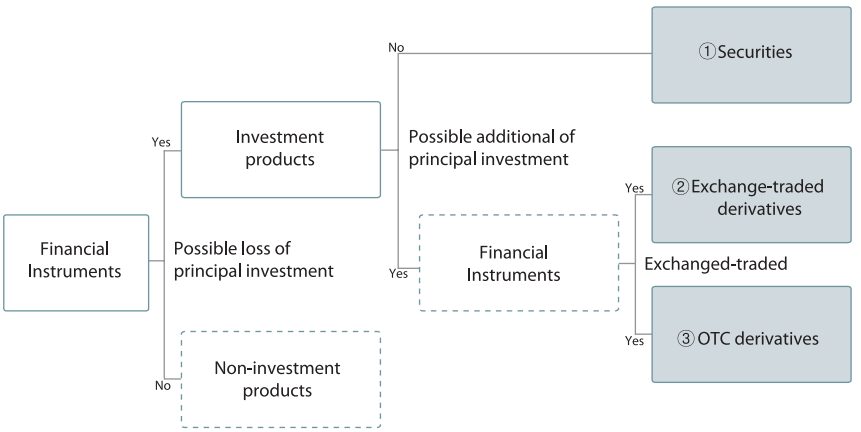
II. FINANCIAL INVESTMENT INSTRUMENTS AND TAX

Korea classifies financial business as banking, insurance and financial investments. A financial instrument means a product that is handled by a financial business. The types of financial instruments are classified as loan products offered by the banking industry, insurance products offered by insurance businesses, and financial investment instruments offered by financial investment businesses. In general, income accrued from financial instruments is referred to as financial income.

The FSCMA defines financial investment instruments by classifying them into securities and derivatives. The difference between financial investment instruments and financial instruments in terms of taxation is that the former take the form of securities, which are transferable. As financial investment instruments take the form of securities, in principle, a person who owns the securities can transfer them to another person. In this case, the taxation laws have to decide whether to impose tax on the accrued capital gains, with the current taxation laws not imposing any tax liability on any kinds of capital gains accrued from the transfer of securities other than certain derivatives-linked securities and equity securities.

Among the many types of financial investment instruments, there is one type that invests money into a variety of financial investment securities or simultaneously invests in different types of property rights. The financial investment instruments that fall into this category are derivatives-linked securities, beneficiary securities issued by certain monetary trusts, and collective investment securities, all of which invest money or other valuables into more than two types of financial instruments, or make diversified investment portfolios that include not only financial instruments but also real goods.
The following section explains more about the classification of financial investment instruments, based on the definitions in the FSCMA and specific information on the Korea taxation system applied to each product in the order of derivatives, debt securities, equity securities, derivative-combined securities, and collective investment securities.

CHART 14-1. CLASSIFICATION OF FINANCIAL INSTRUMENTS BASED ON THEIR ECONOMIC CHARACTERISTICS



1. Derivatives

In general, derivatives are referred to as financial instruments derived from underlying assets. If we further develop this concept using financial terms, derivatives could be defined as newly contracted transactions that reflect the characteristics of variables such as interest rates, FX rates and prices embedded in bonds, securities (in this context they refer to underlying assets), and other kinds of assets owned by a corporation or a financial company. Through the transaction of derivatives, a corporation or financial company that owns assets can avoid risks from the variables, and the opposite party of the transaction can utilize them as a high-risk, high-return investment tool.

According to the FSCMA, "derivatives" refers to a contractual right that has a possibility of loss that is larger than the value of the principal, and is a financial instrument that falls under the category of forwards, futures and options.

The ITA does not impose a tax liability on profits accrued from forwards, futures or options. For financial investment instruments mixed with derivatives, the Act separately collects taxes based on separate regulations. The term "derivative mixed financial investment instruments" means derivatives-linked securities and collective investment securities.

However, for derivatives products that are linked to interest- and dividend-paying products, the interest and dividend income that accrues from the derivatives product will be taxed.

2. Debt Securities

1) DEFINITION OF DEBT SECURITIES

According to the FSCMA, debt securities means government bonds, municipal bonds, special bonds, corporate bonds, corporate commercial papers, and other similar instruments that bear the indication of a right to claim a payment. The ITA explains debt securities as "debentures, etc." and enumerates the kinds of "debentures, etc." according to the following table. (Article 16 (1) of the ITA and Article 102 (1) of the Enforcement Decree of the ITA. (EDITA))

TABLE 14-3. DEFINITION OF DEBT SECURITIES AS PER THE INCOME TAX ACT

- Bonds or securities issued by the Government or a municipal government
- Bonds or securities issued by a domestic corporation
- Bonds or securities issued by a domestic branch or business office of a foreign corporation
- Bonds or securities issued by a foreign corporation
- Certificates of deposit or similar forms of certificates issued by financial institutions, etc.
- Bills (including bills issued, sold, or mediated by financial institutions, and excluding commercial bills)

2) TAXABLE INCOME

According to ITA, "interest and discount amounts" are considered taxable interest income. Bonds, etc. are usually issued at par or at discount. Bonds issued at par pay interest on a quarterly or yearly basis to bondholders based on the coupon rate, considering the market interest rate at the point of issuance. Bonds issued at discount pay the principal and amount of interest simultaneously at the point of maturity.

The term "discount amount" in this context means an amount of interest paid at the point of maturity of the bonds issued at discount. That amount shall be the difference between the amount of redemption at maturity and the value of bonds discounted by the market interest rate at the point of issuance. The taxable discount amount stipulated in the ITA only refers to the issuance discount (the amount according to the market interest rate at the point of bond issuance), not the market discount (the amount according to the market interest rate at the point of early bond redemption).

If a person redeems their bonds before maturity, they have to pay tax on the amount of interest accrued during possession of the bonds. For instance, if an investor who has bought 3-year discount bonds with a KRW 3mn amount of discount wants to sell the bonds after only a year of possession, out of the total discount amount of KRW 3mn, KRW 1mn – the discount amount allocated for one year of possession – is the interest income liable for taxation. (This is referred to as the holding period tax system for bonds.)

Usually, both the interest and discount amount of bonds are taxable, except when they are: 1) government bonds; 2) industrial financial bonds and policy financial bonds; 3) deposit protection fund bonds and compensation fund bonds for deposit protection fund bonds; and 4) monetary stabilization bonds

issued by the Bank of Korea on the open market. When these bonds are issued with uniform conditions (meaning issuing additional bonds with the same maturity and coupon rates for a defined period of time), only the amount of interest accrued by the coupon rate except the discount amount is considered to be taxable interest income according to Subparagraph 2 of Article 22-2 of the EDITA. This is an effort to help promote and develop the secondary market for government bonds. As for bonds issued by the government in which the principal is linked to inflation, the increased amount of principal over time will be liable to taxation as income interest.

Furthermore, if a person transfers one's bonds to another person before maturity, they can accrue capital gains due to the interest rate difference between the interest rate at the point of bond issuance and at the point of the transfer. Korea's tax code levies tax on capital gains from such transfers as the following:

TABLE 14-4. TAXATION FOR BOND TRANSFER GAINS ACCORDING TO CTA AND ITA

Seller		Taxability
Korean Nationals	Domestic corporations	Taxable
	Residents	Non-taxable
Foreigners	Foreign corporations and non-residents with domestic operation	Taxable
	Foreign corporations and non-residents without domestic operation	Taxable when foreigners transfer bonds to domestic corporations and residents, or domestic branch of foreign corporations and non-residents

When calculating taxable income, the amount of interest and dividend income shall be included in the total gross income accrued during the corresponding year according to Article 16 (2) and Article 17 (3) of the ITA. Therefore, necessary expenses are not recognized as expenses.

3) RECEIPT DATE OF INCOME

The date of receipt of income from bond interest shall be the agreed date of receipt of such payments for interest and discount amounts for bearer public bonds, and the payment date under the agreement in the case of non-bearer public bonds, according to Subparagraph 2 and 3 of Article 45 of the EDITA.

The receipt income accrued from coupon interest shall be the date of the coupon, which is the receipt date of such payment. As for the discount amount, the receipt date of income shall be the date of maturity, which is the receipt date of such payment.

In the case of the sale of bonds before maturity, the receipt date of income from interest shall be the sale date of the relevant bonds. Therefore, when discount bonds are sold before maturity, the receipt date of income from the sale of the relevant bonds shall be the sale date, and if the bonds were redeemed at maturity, the date of redemption at maturity shall be the date of income from such payment according to Subparagraph 10 of Article 45 of the EDITA.

Meanwhile, in the case of commercial notes or cover notes with short maturity terms traded by the passbook in custody, the receipt date of income shall be the date of discount sale if the owner of the notes decides to pay withholding tax on the same day. (Such bonds are referred to as prepaid interest bonds.)

3. Equity Securities

1) DEFINITION OF EQUITY SECURITIES

The FSCMA defines equity securities as stock certificates; instruments representing a preemptive right; investment securities issued by a legal entity established by direct operation of an Act; equity shares in contribution to a limited partnership, limited liability company, private company, limited liability partnership or undisclosed association under the Commercial Act; equity shares in contribution to an association under the Civil Act; and other similar instruments that bear the indication of equity shares in contribution.

The ITA defines dividend income as dividends or shares received from an organization or a corporation that have the nature of profit distribution. Equity securities are issued by a corporation or an organization and profits are distributed based on the equity securities, so the income from the equity securities is considered dividend income and is liable for taxation. Meanwhile, when the ITA defines transfer income, it refers to "stocks or investment shares" as "stocks, etc." in Subparagraph 1 of Article 94. Based on the definition of the FSCMA, equity securities fall under the definition of the term "stocks, etc."

2) TAXABLE INCOME AND RECEIPT DATE OF INCOME

Dividends from equity securities issued by a domestic or a foreign corporation are considered dividend income and are liable for taxation according to the ITA. Dividends include not only cash dividends but also stock dividends. In such cases, only those whose revenue sources are earned surpluses are taxable. If the revenue source is a capital reserve, it is not liable for taxation according to Subparagraph 2 of Paragraph 2 of Article 17 of the ITA. As for dividends gained by exercising the appraisal rights of dissenting shareholders of a corporation that issued the relevant stocks, only the amount that exceeds the stock acquisition price is considered a taxable dividend income according to Subparagraph 1 of Paragraph 2 of Article 17 of the ITA.

TABLE 14-5. SCOPE OF EQUITY SECURITIES RELATED DIVIDEND INCOME ACCORDING TO ITA

- Dividends or distribution of any profits or surplus received from a domestic corporation, and dividends of the interest during construction as prescribed in Article 463 of the Commercial Act;
- Dividends or distribution received from an organization considered as corporation
- Dividends or distribution of any profits or surplus received from a foreign corporation, and dividends of the interest during construction as prescribed by the laws and regulations of the relevant foreign country, and dividends of the similar nature
- Other income which bears a nature of profit distribution

When income tax is imposed on dividend income accrued from equity securities, it is a de-facto double taxation as an income tax is imposed on the dividends distributed by a corporation. To address such a situation, the ITA uses the imputation tax system. (Please refer to part III on "Aggregate Taxation on Financial Income" for more information about the imputation tax system.)

When a person transfers their equity securities to another person, the capital gain accrued from the transfer shall be considered transfer income, and is subject to taxation according to Article 94, Paragraph 1, Subparagraph 3 of the ITA. However, in the case where investors other than major shareholders trade listed stocks on the securities market, capital gains accrued from such trade are free from taxation.

TABLE 14-6. TAXATION AND TAX RATES ON CAPITAL GAINS FROM EQUITY SECURITIES

Classification		Taxability		Applied tax rate
		O	X	
Stocks from listed companies	KRX-traded	Major	Minor	- Stocks issued by SMEs: 10% - Other stocks: 20% - Retained less than a year by major shareholders: 30%
	OTC-traded	All shareholders	-	
Stocks from non-listed companies		All shareholders	-	

When a resident transfers equity securities issued by a foreign corporation through foreign stock exchanges, etc., the capital gains accrued from the transfer is liable for taxation. In such cases, the scope of residents is limited to those with a domicile or temporary domicile in Korea for not less than five consecutive years until the day of the transfer of the securities, according to Subparagraph 3 of Article 118-2 of the ITA.

The receipt date of the income accrued from dividends is the receipt date of such payment according to Subparagraph 3-3 of Article 46 of the EDITA. Additionally, Subparagraph 2 of Article 46 of the EDITA stipulates that the receipt date of dividends derived from the disposal of surplus funds is the resolution date for the disposal of surplus funds at the relevant corporation, and the receipt date of the dividends accrued by exercising the appraisal rights of dissenting shareholders is the day on which the retirement of securities, decrease of capital, or capitalization is decided according to Subparagraph 4 of the same article of the EDITA.

3) SECURITIES TRANSACTION TAX

When equity securities are transferred, a securities transaction tax is imposed. This tax falls into the category of indirect tax as it is imposed on the transfer of equity securities, according to Article 1 of Securities Transaction Tax Act (STTA). Based on Article 2 of the STTA, the term “transfer” in this context means the ownership is transferred onerously by contract or legal causes. Therefore, when securities are transferred as an inheritance or a gift, such cases are exempt from the securities transaction tax. Additionally, only equity securities are taxable while other types of securities, including debt securities, are exempt from the securities transaction tax. As the securities transaction tax is an indirect tax, even though stock brokers have to pay the securities transaction tax according to Article 3 of the STTA, the person who actually

bears the tax obligation is the one who transferred the relevant securities. The securities transaction tax applies a 0.5% tax rate to the income accrued from a transfer of non-listed stocks, 0.3% to equity securities transferred on the securities market (including a 0.15% special tax for rural development) and 0.3% to equity securities transferred on the KOSDAQ market, respectively.

4. Derivatives-Linked Securities

1) DEFINITION OF DERIVATIVES-LINKED SECURITIES

Derivatives-linked securities are structured securities consisting of securities, such as bonds, embedded with derivatives that have stocks or similar as their underlying asset. According to the definition stipulated in Subparagraph 7, Article 4 of the FSCMA, derivatives-linked securities are instruments bearing the indication of a right under which the amount payable or recoverable shall be determined according to a predetermined formula tied to fluctuations in the price of any underlying assets, an interest rate, an indicator, a unit, an index, or any other similar factor. Derivatives-linked securities are similar to collective investment securities as both instruments invest money in securities such as bonds and derivatives products simultaneously. However, derivatives-linked securities are different from collective investment securities in that the profit of derivatives-linked securities is wholly decided by external factors, while collective investment securities require another person's effort to ensure their profit. Derivatives-linked securities are classified as in the following table, depending on their product type and possible risks coming from underlying assets.

TABLE 14-7. TYPES OF DERIVATIVES-LINKED SECURITIES

Product Classification / Underlying Asset		Derivatives			Types of Derivatives-linked Securities
		Option	Forward	Swap	
Interest rate		Interest rate derivatives			Interest-rate-linked securities
Stocks	Individual stocks	Equity derivatives			Equity-linked securities
	Basket				
	Index				
Currency		Currency derivatives			Currency-linked securities
Credit risk		Credit derivatives			Credit-linked securities
Spot		Spot derivatives			Spot-linked securities

2) TAXABLE INCOME AND RECEIPT DATE OF INCOME

The ITA enumerates the types of derivatives-linked securities and classifies them based on taxation on their dividend income. Currently, among derivatives-linked securities, distribution of profits from equity linked securities (ELS) and other derivatives-linked securities is liable for taxation as dividend income. Meanwhile, among derivatives-linked securities, equity-linked warrants (ELW) are exempt from taxation (Article 26-3 of the EDITA) as the ITA considers it an option – a derivatives product.

The receipt date of income accrued from derivatives-linked securities is "the date on which the earnings of securities are distributed." Therefore anyone who has invested money into derivatives-linked securities pays dividend income taxes when they receive earnings from the issuer of the securities at maturity or the early redemption of the relevant securities. When derivatives-linked securities are transferred, the ITA does not impose a tax on the capital gains accrued from the transfer.

TABLE 14-8. TAXATION ON DERIVATIVES-LINKED SECURITIES

Classification	Income subject to taxation
Equity-linked securities (ELS)	Dividend income
Other derivatives-linked securities	Dividend income
Equity-linked warrants (ELW)	No taxation

5. Collective Investment Securities

1) DEFINITION OF COLLECTIVE INVESTMENT SECURITIES AND COLLECTIVE INVESTMENT SCHEMES

In Article 21 (9), THE FSCMA defines "collective investment securities" as instruments by which equity shares in a collective investment scheme (referring to the beneficial interest in the case of an investment trust) are indicated. The Act stipulates that a "collective investment scheme" is any scheme established for carrying on collective investments, with "collective investments" being defined as the activities of acquiring, disposing of, and managing assets.

TABLE 14-9. CLASSIFICATION OF COLLECTIVE INVESTMENT SCHEMES BASED ON FSCMA

Type of organization	Collective investment scheme	Legal form
Trust-based	Investment trust	Trust
Company-based	Investment company	Stock company under the Commercial Act
	Private equity fund	Limited partnership company under the Commercial Act
	Investment limited liability company	Limited liability company under the Commercial Act
	Investment limited partnership company	Limited partnership company under the Commercial Act
Association-based	Investment association	Association under the Civial Act
	Undisclosed investment association	Undisclosed association under the Commercial Act

According to the FSCMA, Korea's taxation laws impose taxes on each type of organization described in the table above in a similar way. However, private equity funds are governed by the partnership tax system under the current taxation laws[1]. The FSCMA classifies collective investment schemes into various forms, such as trusts, companies, and associations, but the most dominant form in the Korean fund market is the investment trust.

2) SEPARATION FROM CERTAIN MONEY TRUSTS

According to the ITA, earnings from collective investment schemes are taxable as dividend income. Additionally, based on Article 4 (2), when it comes to the income derived from trusts other than collective investment schemes, the ITA imposes a tax on income by classifying the content of the income accrued from the property rights. The term "trusts other than collective investment schemes" means certain money trusts[2], property trusts[3] based on the FSCMA, and other trusts based on the Trust Act. Therefore, the property rights of such trusts are considered to be possessed by the investors of the trusts, and taxes imposed on the accrued income are decided according to the contents of the income.

When we calculate the earnings accrued from certain money trusts, the trustee's fee and other commissions are deducted in the same method used for collective investment schemes, according to Article 26-2 of the EDITA. Plus, the receipt date of the earnings from certain money trusts, etc. is the day on which the income is accrued from property rights that are included in trusted

Note: 1) As seen from the existence of general partners, private equity funds, unlike other collective investment schemes, are subject to the partnership tax
2) Subparagraph 1 of Article 103 of Enforcement Decree of FSCMA
3) Subparagraph 3 of Article 103 of FSCMA

properties and are defined as belonging to the trusted properties. Article 155-2 of the ITA prescribes that income declaration and tax withholding on the accrued income shall be made within three months from the date on which the accrued income became a part of the trusted properties to avoid inconveniences entailed from tax withholding, which would otherwise have to be done whenever the accrued income is added to investors' properties.

Investments through discretionary investment contracts[4)] have similar aspects to those of investment trusts, as investors give investment professionals discretion over their money that is invested in diverse assets. However, a discretionary investment is nothing but a contract which gives investment professionals discretion over investment decisions, etc., therefore the ownership over the invested assets is still retained by the investors. Thus, just like in the case of trusts, income tax is imposed on the accrued income according to the contents of the income.

Meanwhile, variable insurance sold by insurance companies is classified not only as savings insurance but also as an investment trust according to Article 251 of the FSCMA. Therefore, if there is no legal consideration, the capital gains accrued from variable insurance could be taxed not only as interest income – as it could be considered a gain on an insurance claim for the savings insurance – but also as dividend income, accrued from the relevant collective investment scheme. With such an understanding, Article 4 (2) of the ITA clearly states that any income accrued from savings insurance is taxed as a gain on an insurance claim.

3) TAXABLE INCOME

One way investors realize profits accrued from assets invested in collective investment securities is through redemption or profit distribution at the closing of their accounts. Another way to realize this is through transferring the securities to another person, winning the capital gain from the transaction. In general, the former is the preference among Korean investors. In the case of collective investment schemes that lack legal personality (hereinafter referred to as "investment trusts"), redemption and transfer of such securities are all taxable under the current ITA system. For collective investment schemes with legal personality (hereinafter referred to as "investment companies"), however, securities redemptions and securities transfers are subject to a dividend income tax and transfer income tax, respectively.

Note: 4) Subparagraph 7 of article 6 of FSCMA : "discretionary investment business" in this Act means a business carrying on the acquisition, disposition, and management in any way of financial investment instruments, earmarking them for investors, with authorization from investors for discretionary judgment, entirely or partially, over financial investment instruments.

TABLE 14-10. INCOME CLASSIFICATION IN THE CASES OF REDEMPTION AND TRANSFER OF COLLECTIVE INVESTMENT SECURITIES

Classification	Investment trust Investment association Undisclosed investment association	Investment company Private equity fund Investment limited liability company Investment limited partnership company
Redemption	Dividend income	Dividend income
Transfer	Dividend income	Transfer income

(a) Legal Requirements for Collective Investment Schemes Based on ITA

Based on Article 26-2, Subparagraphs 1 and 8 of the EDITA, dividend income accrued from a collective investment scheme is taxed accordingly when the scheme meets the following requirements:

(1) It shall be a collective investment scheme under the FSCMA;
(2) Account settlements shall be made once or more each year and the accrued profit should be distributed;
(3) Investments should be made in money or any other assets that are assessed in monetary terms;
(4) The management of collective investment schemes should be performed by a collective investment business entity.

Collective investment schemes that fail to meet every requirement described above are liable for taxation as tax items other than a collective investment scheme as they are considered as (1) corporations in the case of investment companies or (2) accruing profits from trusts other than collective investment schemes in the case of investment trusts, according to Subparagraph 3 of Article 26-2 of the EDITA.

Therefore, investment trusts, etc. are taxed according to the contents of their income, and investment companies, etc. are liable for corporate tax and dividend income tax at both the corporate and investor levels.

(B) Deduction of Commissions, Etc., and Tax Exemptions on Capital Gain & Loss

When calculating the profit of collective investment schemes that meet the aforementioned requirements, capital gains and losses accrued from transactions or appraisal of exchange-traded derivatives defined by the FSCMA, or securities that fall under the categories below and are acquired directly by collective investment schemes, the following are exempt from taxation based on Subparagraph 4 of Article 26-2 of the EDITA.

① Securities listed on the securities market (excluding those in the following items):
(a) Bonds, etc. under Article 46 (1) of the ITA; and
(b) Stocks or beneficiary certificates of a foreign collective investment scheme established under foreign acts and subordinate statutes
② Stocks or investment shares of a venture business under the "Act on Special Measures for the Promotion of Venture Businesses"
③Exchange-traded derivatives targeting securities mentioned in No. ①

The above mentioned regulatory conditions are introduced for taxation equity. In regards to direct investment, the accrued capital gains and losses of listed stocks, etc. are exempt from taxation. As such, in the case of indirect investment through a collective investment scheme, the accrued capital gains and losses from listed stocks, etc. are also exempt from taxation based on the conditions above.

Article 26-2 (6) of the EDITA defines profits given to an investor from a collective investment scheme as the amount, excluding various remunerations, commissions, fees, etc. defined in the FSCMA. Therefore, based on the FSCMA, the various commissions – remunerations, redemption commissions, sales commissions, etc. – given to collective investment business entities, trust business entities, investment traders and investment brokers are deducted when calculating the taxable income of an investor. The calculation of taxable income from a collective investment scheme is different from other financial instruments in that it recognizes necessary expenses.

4) RECEIPT DATE OF INCOME

When an investor receives their invested principal and earnings from their investment through redemption of collective investment securities, or receives their earnings on the date of account settlement of the collective investment securities, or transfers their securities in the collective investment scheme, the date of receipt of the income shall be the date on which earnings were distributed or the date on which securities were transferred, based on Article 46 of the EDITA. In other words, the day when profits are received from the collective investment scheme or the day when accrued profits in cash are received shall be the date of the receipt of income. Even though there is no distributed income received in cash, if the distributed amount is transferred to the principal in cases where there is a special agreement to do so, it is considered the same as receiving cash, so the date on which the distributed

amount is transferred to the principal is defined as the date of the receipt of income.

TABLE 14-11. SYNTHETIC CLASSIFICATION OF INCOME BASED ON THE TYPES OF FINANCIAL INVESTMENT INSTRUMENT TYPE

Instrument type \ Income Classification		Interest/Dividend	Transfer	Remarks
Derivatives		N/A	N/A	
Debt securities		Interest income	N/A[1)]	
Equity securities		Dividend income	△	Taxation on non-listed stocks
Derivatives-linked	ELS, DLS	Dividend income	N/A	
	ELW	N/A	N/A	
Collective investment securities (beneficiary certificates)		Dividend income	Dividend income[2)]	
Beneficiary certificates from certain money trusts or discretionery investment (wrap accounts)		N/A	N/A	Taxation based on type of income

Note: 1) When transferring debt securities, interest income taxation based on amount of interest accrued during possession of relevant bonds
2) When transferring collective investment securities (beneficiary securities), dividend income taxation based on amount of capital gains

III. AGGREGATE TAXATION ON FINANCIAL INCOME

Based on the ITA, financial income is defined as income that can be classified as interest or dividend income among what is accrued from the above mentioned financial instruments, i.e. loans, insurances and financial investment instruments.

Any person who pays financial income to a resident (in most cases, financial companies), should withhold tax equaling 14% of the income at the point of such payment (which is the receipt date of the financial income) and remit the amount withheld to the competent tax office no later than the 10th day of the following month.

In cases where a resident's yearly financial income is less than KRW 20mn, his or her tax liability finishes with tax withholding, but for a resident whose yearly financial income is more than KRW 20mn, global taxation shall be imposed. The reason for only applying global taxation to people whose annual

financial income is more than KRW 20mn is to reduce administrative burdens in taxation which would otherwise be too large for the universal application of global taxation on every financial income. Financial income accrued from financial instruments that are subject to separate taxation with a lower tax rate based on the RSTA is not included when determining whether the yearly financial income exceeds the KRW 20mn limit. In the case of financial income that was accrued from foreign countries and is not subject to a withholding tax, it is subject to global taxation. However, if the total amount of such income is less than KRW 20mn, the 14% taxation rate is applied.

Furthermore, when the total amount of annual financial income is over the KRW 20mn limit and liable for global taxation, the aggregate amount up to the KRW 20mn limit is taxed at the 14% taxation rate and only the remaining amount, which is above KRW 20mn, is subject to the progressive tax rate.

TABLE 14-12. AGGREGATE TAXATION AND TAX RATES ON FINANCIAL INCOME

Classification	Financial income liable for aggregate taxation		Applied tax rate
Subject amount > KRW20mn	Income liable for conditional aggregate taxation + income liable for unconditional aggregate taxation	Amount above KRW 20mn	Basic tax rates applied after combining with other income
		Up to KRW 20mn	14%
Subject amount ≤ KRW 20mn	Income liable for unconditional aggregate taxation (Separate taxation on income liable or conditional aggregate taxation)		

Note: Subject amount = Income amount liable for conditional aggregate taxation + Income amount liable for unconditional global taxation

In the case of financial income amounting to more than KRW 20mn, including dividend income accrued from equity securities, the amount of dividend income shall be the amount of imputed corporate tax plus the dividend income. The amount of imputed corporate tax in this case is calculated by multiplying the target dividend income by 11% of the gross rate, provided that a 10% corporate tax was already imposed at the corporate level. The reason for adding up the amount of imputed corporate tax is to prevent double taxation on the dividend income accrued from equity securities. Therefore, to eliminate possible elements of double taxation, the Korean tax system calculates the amount of aggregate income first by grossing the amount of imputed corporate tax, and then, when calculating financial income, the imputed corporate tax is deducted from the amount of tax payable.

In this case, among the dividend income, the scope of double taxation adjustment targets is limited to income accrued from equity securities. Dividend income from derivatives-linked securities or collective investment securities is not the target of double taxation adjustment because, for the collective investment schemes, etc., tax is only imposed on the income of investors.

IV. FINANCIAL INCOME TAXATION FOR FOREIGNERS

When it comes to financial income taxation on foreigners, international tax treaties, conventions and agreements prevail over domestic tax laws to prevent double taxation. But in cases where domestic laws are more advantageous than their international counterparts, the domestic laws shall apply to foreigners. In other words, rather than the general concepts of foreigner, income classification, or tax rates, the concepts of the above-mentioned items defined in bilateral or international tax treaties, conventions or agreements precede over foreign investors. Meanwhile, foreigners from countries without any tax treaty with Korea shall be governed by domestic tax laws.

Domestic tax laws classify foreigners into non-residents and foreign corporations, with the former governed by the ITA and the latter by the CTA. Under the current tax acts, the ITA and CTA cover and define all identical taxation targets and issues.

1. Definition of Foreigners

Based on Subparagraph 2 of Paragraph 1 of Article 1of the ITA, a person who holds an address in Korea or has held a temporary domicile in Korea for one or more years is referred to as a resident. Any foreign investor not meeting that definition is defined as a non-resident. Therefore, according to this definition, a person who does not have an address or temporary domicile in Korea for one or more years is defined as a non-resident. The address in this context is determined by the objective facts of a living relationship, such as the existence of a family living together in Korea and of property located in Korea. The term domicile in this context means the place where a person has resided for a significant period of time, besides their address, and in which there is no general living relationship, according to Paragraph 1 and 2 of Article 1 of the EDITA.

2. Taxable Income and Tax Rates according to the Types of Instruments

The type of income accrued from the financial instruments of foreign investors is classified using the same criteria applied to residents. Hence, as was explained in Section II, income earned from loan products and insurance products is classified as interest income. According to Paragraph 1 of Article 119 of the ITA, income from debt securities is considered interest income, and income from equity securities, derivatives-linked securities, and collective investment securities is classified as dividend income according to Paragraph 2 of the same article.

However, different taxation criteria are applied to non-residents' capital gains. Under the FSCMA, capital gains from all kinds of securities, including equity securities, are considered transfer income, and are liable for taxation. However, equity securities traded on the securities market by a person who owns less than 25% of equity shares of a corporation are not subject to taxation according to Article 179 (11) 1 of the EDITA. Therefore, in the case of debt securities, if a non-resident transfers the securities, the capital gains and interest accrued during the possession of the securities will be subjected to taxation. Also, the equity securities (beneficiary certificates) of collective investment institutions that do not have legal personality and the capital gains from derivatives-linked securities such as ELS are subject to taxation.

For derivatives, the income acquired through the trading of derivatives on the exchange market by a non-resident who does not have a domestic place of business is liable for taxation, according to Article 179 (12) of the EDITA. Therefore, in the case of OTC derivatives, only income with domestic income sources is subjected to taxation.

When it comes to the interest income and dividend income, a tax rate of 20% is applied, based on Article 156 (1) 3 of the ITA. However, in cases where the tax rates (when the taxable income for local income tax is subjected to tax treaties, conventions or agreements, the rate shall be 22%) designated by international or bilateral tax treaties on interest and dividend income are lower than 20%, the rates designated by the treaties prevail under Paragraph 1 of Article 29 of the Adjustment of International Taxes Act.

When it comes to transfer income, a tax rate of 20% is applied. However, in cases where the acquisition value cannot be verified, a tax rate of 20% is applied to the transfer value, based on Article 156 (1) 4 of the ITA.

3. Preferential Taxation on Debt Securities

In principle, a 20% tax rate is applied to the interest income accrued from debt securities. However, if the debt is issued by the government, municipal governments, or domestic corporations, a 14% tax rate is applied as per Article 156 (1) of the ITA. In addition, interest and transfer income accrued from foreign currency denominated bonds (public or government bonds issued abroad) and distributed to non-residents is exempt from taxes according to Article 21 (1) of the RSTA. Korean tax laws offer non-taxation benefits to foreigners to increase the investment value of government bonds and ensure foreign currency liquidity.

4. Tax Treaties

Taxes on non-residents may be reduced or exempted by applicable tax treaties, conventions or agreements signed between Korea and other jurisdictions. Tax rates on interest, dividends and capital gains vary according to the relevant tax treaties.

If the tax treaties are in conflict with the domestic tax laws of the concerned country (as given below), the tax treaties take precedence over the latter.

TABLE 14-13. INCOME TAX WITHHOLDING RATES FOR COUNTRIES WITH TAX TREATIES

(Unit: %)

Country	Dividends	Interest	Royalties	Country	Dividends	Interest	Royalties
Albania	5 or 10	10	10	Algeria	5 or 15	10	2 or 10
Australia	15	15	15	Austria	5 or 15	10	2 or 10
Bangladesh	10 or 15	10	10	Belarus	5 or 15	10	5
Belgium	15	10	10	Brazil	10	10 or 15	10 or 25
Bulgaria	5 or 10	10	5	Canada	5 or 15	10	10
Chile	5 or 10	5 or 15	5 or 10	China	5 or 10	10	10
Croatia	5 or 10	5	0	Czech Republic	5 or 10	10	10
Denmark	15	15	10 or 15	Egypt	10 or 15	10 or 15	15
Fiji	10 or 15	10	10	Finland	10 or 15	10	10
France	10 or 15	10	10	Germany	5 or 15	10	2 or 10
Greece	5 or 15	8	10	Hungary	5 or 10	0	0
India	15 or 20	10 or 15	15	Indonesia	10 or 15	10	15
Ireland	10 or 15	0	0	Israel	10 or 15	7.5 or 10	2 or 5
Italy	10 or 15	10	10	Japan	5 or 15	10	10
Jordan	10	10	10	Kazakhstan	5 or 15	10	2 or 10
Kuwait	5	5	15	Laos	5 or 10	10	5
Luxembourg	10 or 15	10	10 or 15	Malaysia	10 or 15	15	10 or 15
Malta	5 or 15	10	0	Mexico	0 or 15	5 or 10 or 15	10
Mongolia	5	5	10	Morocco	5 or 10	10	5 or 10
Myanmar	10	10	10 or 15	Nepal	5 or 10	10	15
Netherlands	10 or 15	10 or 15	10 or 15	New Zealand	15	10	10
Norway	15	15	10 or 15	Oman	5 or 10	5	8
Pakistan	10 or 12.5	12.5	10	Papua New Guinea	15	10	10
Philippines	10 or 25	10 or 15	10 or 15	Poland	5 or 10	10	10
Portugal	10 or 15	15	10	Romania	7 or 10	10	7 or 10
Russia	5 or 10	0 5		Singapore	10 or 15	10	15
Slovakia	5 or 10	10	10	Slovenia	5 or 15	5	5
South Africa	5 or 15	10	10	Spain	10 or 15	10	10
Sri Lanka	10 or 15	10	10	Sweden	10 or 15	10 or 15	10 or 15
Switzerland	10 or 15	10	10	Thailand	10	10 or 15	5 or 10 or 15
Tunisia	15	12	15	Turkey	15 or 20	10 or 15	10
Ukraine	5 or 15	5	5	United Arab Emirates	5 or 10	10	0
United Kingdom	5 or 15	10	2 or 10	United States	10 or 15	12	10 or 15
Uzbekistan	5 or 15	5	2 or 5	Venezuela	5 or 10	5 or 10	5 or 10
Vietnam	10	10	5 or 15				

Source: National Tax Service (as of Dec. 2012)

CHAPTER 15

CAPITAL MARKET REGULATION

I. HISTORY OF CAPITAL MARKET REGULATORY ACTS

Since the establishment of the Korea Exchange in 1956, Korea has introduced a series of financial market related Acts – the Securities and Exchange Act, Futures Trading Act, Indirect Investment Asset Management Business Act, etc. – at every step of its financial development, with each Act pivotal for creating a regulatory framework that is fair and transparent.

The 1964 Securities and Exchange Act defined the scope of securities issued and circulated in the Korean securities market. It contained a series of measures against unfair securities trading including the duty for listed companies to report and disclose on the issuance and circulation of securities. This duty required companies to disclose registration statements and annual business reports. The Act also prohibited unfair trading practices such as market manipulation and the use of nonpublic information. The Act defined "securities business" as any business that buys and sells securities or buys and sells securities on consignment, stipulating the terms and procedures for licensing and standards for corporate governance and financial soundness to ensure the sufficient operation of securities companies.

The 1995 Futures Trading Act provided a legal basis for the establishment of the Futures Exchange and introduced measures that prohibited unfair trading practices such as futures market manipulation and price manipulation by connecting spots and futures, which abuses the unique trading characteristics of futures. The law defined "futures business" as any business in which a company executes futures trading for its own account or for its client's account, drawing a distinctive line between the securities business and the futures business. The Act also introduced regulatory requirements for the establishment of a futures business, such as the terms and procedures for licenses and the scope of business activities. Based on the Act, the Futures Exchange was established in 1998 but was later merged with the Korea Stock Exchange – creating the Korea Securities and Futures Exchange, a stock company based on the 2005 Korea Securities and Futures Exchange Act.

The 2004 Indirect Investment Asset Management Act defined "indirect investment" as a business that collects funds from investors to manage assets and distribute profits accrued from the management of assets to investors. It clearly limited the scope of the "asset management business" by defining an asset management company as a financial firm operating in the business of managing indirect investment property. The Act was created through consolidation of the Securities Investment Trust Act and Securities Investment Companies Act to coherently manage the securities investment trust system and the securities investment companies system. The Act dealt with discretionary investment businesses and investment advisory businesses that were previously governed by the Securities and Exchange Act, improving the regulatory system for the asset management business as a whole.

In February 2009, Korea's financial regulatory structure witnessed a fundamental change in its landscape with the enforcement of the Financial Investment Services and Capital Markets Act (FSCMA). Enacted in 2007 to promote fair market competition, financial innovation and stricter investor protection, the FSCMA drastically revamped the regulatory framework of the Korean capital market. With its implementation, the previous major capital market laws such as the Securities and Exchange Act, Futures Trading Act, Korea Securities and Futures Exchange Act, Indirect Investment Asset Management Act, Trust Business Act and Merchant Banks Act were abolished and replaced by the FSCMA.

II. FINANCIAL INVESTMENT SERVICES AND CAPITAL MARKETS ACT

1. Legislative Background and Process

The FSCMA is the result of Korea's previous financial reforms, and aims to enhance investors' confidence in the Korean capital market while boosting the vigor and competitiveness of the capital market and market-related financial industries. At the time of enactment, the Korean capital market displayed a lopsided structure with an anemic financial brokerage function and a strong indirect financial market. The capital market itself was also still very nascent compared to the highly developed real economy. Worse still, the lack of sound growth and improvement of capital market-related financial industries served to further aggravate the imbalance between the banking and indirect financial investment industries. In addition, the different regulatory systems that separately governed the securities, futures and asset management businesses added additional impediments to the pursuit of product and service innovation in the capital market. Restoring investors' confidence was another urgent issue to ensure the sustainable development of the Korean capital market.

Therefore, after thorough reviews and analyses of overseas examples of financial legislative integration including the UK, Australia and Japan, the Korean government finally decided to integrate capital market-related laws with some necessary modifications, considering the unique features of the Korean legal system and structure. In February 2006, the Korean government announced its plan for the integrated capital market law, drafting a bill in close consultation with the industry and academia. The bill was promulgated in August 2007 after passage through the National Assembly in July 2007. Given that the Act would bring a seismic change in the Korean capital market by integrating various laws and regulations all at once, the government decided upon a one and a half year phase-in period, with the law becoming effective on February 4, 2009.

[Legislative Process of FSCMA]

- *Feb. 17, 2006* *Announcement of the enactment plan for the Financial Investment Services and Capital Markets Act (tentative) (Government)*

- *Dec. 29, 2006 Submission of proposed bill to the National Assembly (Government)*
- *Jul. 2, 2007 Alternative bill from the Finance and Economy Committee (FEC) of the National Assembly (National Assembly)*
- *Jul. 3, 2007 Passage of the alternative bill by FEC of the National Assembly at the plenary session of the National Assembly (National Assembly)*
- *Aug. 3, 2007 Promulgation of FSCMA*
- *Jul. 29, 2008 Enactment and promulgation of the Enforcement Decree of FSCMA*
- *Aug. 4, 2008 Enactment and promulgation of the Enforcement Rule of FSCMA*
- *Feb. 4, 2009 Effectuation*

2. Main Features

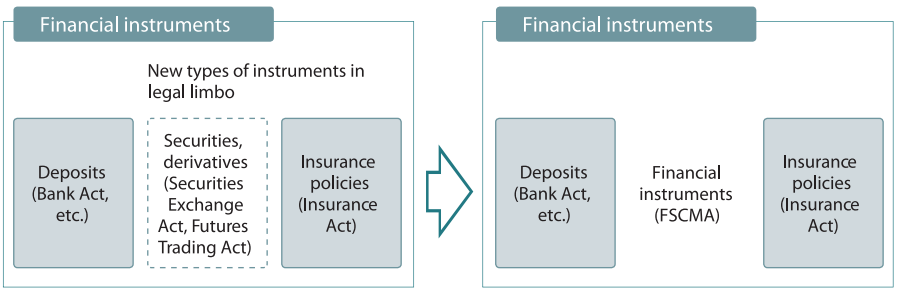
1) NEGATIVE DEFINITION OF FINANCIAL PRODUCTS

The FSCMA has a comprehensive definition of "financial investment instrument," significantly broadening the scope of financial instruments dealt by financial firms. A financial investment instrument is a right, acquired by an arrangement to pay money or any other asset at a specific time in the present or in the future with an intention to earn profit or avoid loss, where there is a risk that the total amount of such money or assets, paid or payable for the purpose of acquiring such a right, may exceed the total amount of money or assets already recovered or recoverable from the right (in this context, this means "investment risk"). Any financial product with investment risks is considered a financial investment instrument regardless of its form or type. For instance, if your bank account or insurance policy has investment risks, they are considered to be financial investment instruments. However, if there is any loss of principal because the opposite trading partner is unable to pay the pre-contracted money or any other asset due to bankruptcy, debt restructuring etc., the Act postulates that a non-investment risk exists, encouraging the market to consider risks from the structure of financial instruments and the market itself, rather than from credit, when identifying investment risks of financial instruments.

With the introduction of the FSCMA, the Korean financial market divides the types of every financial instrument developed and sold on the financial market into those with investment risks and those without investment risks (bank

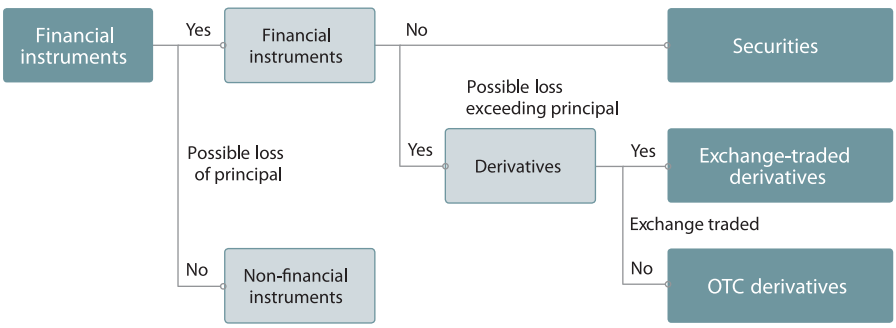
deposits and insurance policies that guarantee the principal). This has significant meaning for the Korean financial market as it implies that certain financial investment instruments – investment contracts, atypical indirect investment, etc. that previously were not governed by any law and thus contained no investor protection measures – now fall under the financial regulatory framework and are controlled by the FSCMA.

CHART 15-1. CLASSIFICATION OF FINANCIAL INVESTMENT PRODUCTS UNDER FSCMA



Under the FSCMA, financial investment instruments are classified into securities and derivatives, over-the-counter derivatives and exchange-traded derivatives, based on their characteristics - the possibility of the loss being larger than the value of the principal and the obligation of overpayment. Securities are defined as financial investment instruments for which investors do not owe any obligation to pay anything further in addition to the money the investors had already paid at the time of acquiring the security. Financial instruments that have the possibility of a loss of principal, which is larger than the value of the principal due to the obligation of overpayment, are classified as derivatives.

CHART 15-2. CLASSIFICATION OF FINANCIAL INVESTMENT INSTRUMENTS



The FSCMA uses a comprehensive definition for the concept of securities and derivatives. According to the FSCMA, securities are defined as financial investment instruments for which investors do not owe any obligation to pay anything in addition to the money or asset paid at the time of acquiring such instruments (excluding obligations to pay where an investor assumes such an obligation by exercising a right to effectuate the purchase and sale of an underlying asset). Along with this comprehensive definition of securities, the Act also stipulates the types and concepts of equity securities and debt securities, and clearly states the inclusion of new types of securities such as investment contract securities, derivative-combined securities, etc. into the category of securities. Derivatives are contractual rights falling under the categories of forwards, options and swaps, and the scope of the underlying assets are financial investment instruments, currencies (including any foreign currency), ordinary commodities, credit risks, and other risk that is of natural, environmental or economic phenomena, which can be computed or assessed by price, interest, indicator, or unit in a reasonable and appropriate way.

TABLE 15-1. TYPES AND DEFINITIONS OF SECURITIES

Type	Definition
Debt securities	Government bonds, municipal bonds, special bonds (referring to bonds issued by a legal entity established by direct operation of an Act), corporate bonds (for a corporate bond of which the payment amount is determined through previously agreed methods, generally in line with the price of securities or currency, or other types of assets and indicators prescribed by Presidential Decree, its interest payment on the amount paid by investors at the time of bond issuance, and other types of proceeds shall correspond to the price, interest rate, indicator, and unit of underlying asset, or any index based on any of the aforementioned. commercial papers (commercial paper refers to promissory notes issued by a company to finance its projects that meet the requirements put forth by Presidential Decree.), and other similar instruments that bear the indication of a right to claim the payment
Equity securities	Stock certificates, instruments representing a preemptive right, investment securities issued by a legal entity established by direct operation of an Act, equity shares in contribution to a limited partnership company, limited liability company, private company, limited association or undisclosed association under the Commercial Law, and other similar instruments that bear the indication of equity shares or the right to obtain equity shares in contribution
Beneficiary certificates	Beneficiary certificates of a monetary trust, beneficiary certificates of a collective investment trust and other similar instruments that bear the indication of a beneficial interest in a trust
Investment contract securities	Instruments bearing the indication of a contractual right under which a specific investor is entitled to the profits earned or liable for losses sustained, depending upon the results of a joint venture in which the investor makes an investment jointly with another person and which is to be run mainly by the other person
Derivatives-linked securities	Instruments bearing the indication of a right under which the amount payable or recoverable shall be determined based on fluctuation in the price, interest rate, indicator, or unit of an underlying asset or any index based upon any of the aforementioned or any other similar factors
Securities depository receipts	Instruments issued by a person with whom any of the five types of securities stated above are deposited in a country other than the country where such underlying securities were issued, which bear the indication of the relevant right on the deposited underlying securities

2) FUNCTIONAL REGULATION OF THE FINANCIAL INVESTMENT BUSINESS

The FSCMA integrated the previously separate financial investment business areas, the securities business, futures business, asset management business, trust business, etc., under a single set of regulations. The financial investment business is now classified into six areas – the dealing business, brokerage business, investment advisory business, discretionary investment business, trust business and collective investment business – depending on their economic functions and based on the transactions of the financial investment instruments. Dealing and brokerage offer financial investment instruments trading and trading brokerage functions. Investment advisory provides investors with financial advice on the value of financial investment instruments and investment decisions, while discretionary investment has discretion over financial instrument investments. A trust, which is in charge of the custody, disposition and management of trusted assets as a trustee, and collective investment, which manages collected money or assets from investors and distributes the outcome of their management to the investors, mainly invest trusted and collective investment assets into financial investment instruments.

Meanwhile, dealers and brokers who have been authorized by the Financial Services Commission to engage in investment banking provide a prime brokerage service, which is a comprehensive set of services that includes securities lending, financing, custodial, dealing, settlement, clearing, and investor reporting.

CHART 15-3. REGULATORY FRAMEWORK OF FINANCIAL INVESTMENT BUSINESS

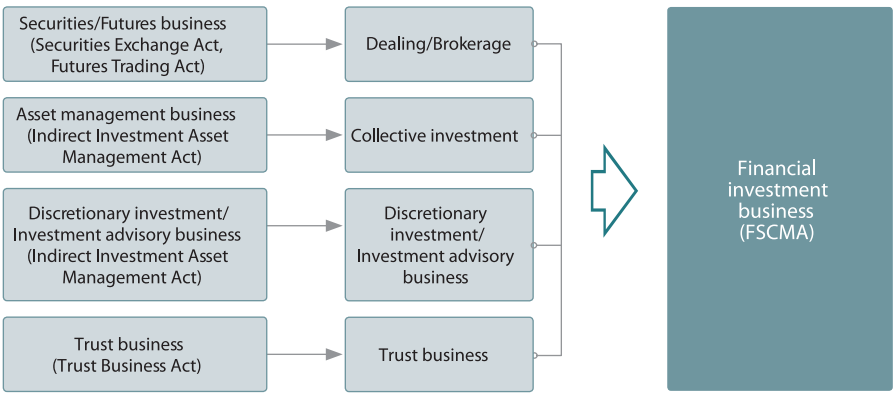


TABLE 15-2. TYPES AND CONCEPTS OF FINANCIAL INVESTMENT BUSINESS

Type	Concept	Classification
Dealing	A business making transactions in financial investment instruments, issuing and underwriting securities, inviting offers, offering, and accepting offers for securities on one's own account regardless of the name of the accountholder	- Securities companies - Futures companies
Brokerage	A business making transactions in financial investment instruments, issuing and underwriting securities, inviting offers, offering, and accepting offers for securities on another person's account regardless of the name of the accountholder	- Securities companies - Futures companies
Collective investment	A business engaging in the activities of managing valuable assets for investment purposes, through acquisition, disposition or other means, with money pooled by inviting two or more persons, without being bound by regular instructions given by investors or by a fund management entity, and sharing the costs and benefits of doing so with investors or a fund management entity	-Asset management companies
Trust	A business carrying on trusts	- Trust companies - Securities companies
Investment advisory	A business providing advice on the value of financial investment instruments or related judgments	- Investment advisory companies - Securities companies Asset management companies - Banks
Discretionary investment	A business making conducting the acquisition, disposition, and management in any of financial investment instruments, based on discretionary judgment, entirely or partially, over financial investment instruments for each investor, considering the current status of investor's assets and purpose of investment	- Discretionary investment companies - Securities companies - Asset management companies - Futures companies

The FSCMA defines financial functions considering financial investment instruments, financial investment business and investors as major components of the financial functions. Based on such an understanding, the Act differentiates the market entry requirements (authorization, registration), corporate soundness standards, and business activity regulations applied to each type of financial investment firm, given the level of the risks and by their financial functions. Currently, Korea classifies 48 types of financial functions and each function is considered the basic authorization and registration unit of a financial investment business. Depending on the functional regulation of a financial investment business, financial firms willing to carry out financial investment business can apply for authorization or registration by selecting the entire or partial set of authorization or registration units. Financial investment firms that are already on the market can apply for additional authorization or registration by selecting the necessary authorization or registration units. Dealing, brokerage, trust, and collective investment businesses need authorization from the FSC, while investment advisory and discretionary investment businesses need to register with the FSC.

The amendments to the FSCMA in 2013 contain information about the adoption of the Alternative Trading System (ATS) and define it as an authorization unit. The minimum capital requirement was set at KRW 20bn, but is set at KRW 50bn if floor trading is involved.

The FSCMA significantly empowered investor protection measures to bolster investor confidence in the Korean capital market. In particular, the Act takes different approaches to professional and ordinary investors given their different risk-taking abilities, based on such factors as their financial proficiency and the size of their assets. As such, the Act focuses on delivering effective investor protection to ordinary investors, who are much more vulnerable to investment risks.

The Act defines professional investors as those who have the ability to take the risks accompanying their investment in light of the expertise they possesses in connection with the financial investment instruments, the scale of their assets, etc., and who fall within the categories set forth in the FSCMA, such as the government, The Bank of Korea, financial institutions, etc. However, the Act also states that if a professional investor notifies a financial investment business entity in writing of its willingness to be treated as an ordinary investor, then such investor should be treated as an ordinary investor.

Meanwhile, if ordinary investors wish to be treated as professional investors, the Act requires that financial investment institutions treat them as professional investors only if they possess a minimum balance in financial investment instruments (KRW 10bn for corporations, KRW 5bn for individuals). This ensures financial investment institutions cannot shirk their responsibility for investor protection.

Investors who are not professional investors are defined as ordinary investors and when financial investment companies offer investment recommendations to such investors, stricter regulations on investment recommendation are applied. Based on the FSCMA, investment recommendation means recommending financial investment services, such as the trading of financial investment instruments, or making contracts for investment advisory services, discretionary investments, and trust services for specific investors. The FSCMA demands that financial investment firms give enough product information (product guidance) to investors to recommend fitting investment instruments that suit their objectives (suitability) and to understand the needs and purpose

of the investment ("Know Your Customer Rule"), so that investors can make wise and informed investment decisions. Additionally, when financial investment firms sell high-risk investment instruments such as derivatives, derivatives linked securities and derivatives funds to ordinary investors, they should conduct a thorough analysis of the investors' investment purpose, financial status and previous investment records through interviews and other methods. If the instruments recommended are deemed inappropriate, the financial investment firm should report that fact to the investor and make a record of the notification and investor's confirmation in the form of the investor's seal, signature, etc.

3. Structure of FSCMA

1) OVERVIEW

The FSCMA is comprised of 43 Chapters in 10 Parts with many subordinate regulations. The Enforcement Decree of the FSCMA, which is a Presidential Decree, enumerates matters entrusted by the FSCMA and the required regulations to implement the entrusted obligations. The Enforcement Rules of the FSCMA (Ordinance of the Prime Minister) stipulate the authorities entrusted by the Decree and the required regulations to implement the entrusted obligations. Regulations made by the FSC contain articles that explain the duties entrusted by the Decree and the required regulations to implement the entrusted obligations.

TABLE 15-3. STRUCTURE OF FSCMA

Part	Chapter	Contents	Details
Part 1. General provisions	-	General provisions	- Purposes and definitions
Part 2. Financial investment business	Chapter 1	License and registration	- Conditions and procedures for license and registration
	Chapter 2	Governance	- Approval on change of major shareholders - Outside directors, standing auditors - Internal Control Guidelines and Compliance Officer - Minority shareholder rights
	Chapter 3	Maintenance of sound business management	- Maintenance of financial soundness - Restriction on trading with major shareholders - Accounting - Business report and disclosure

Part	Chapter	Contents	Details
	Chapter 4	Business conduct rules	- Common rules of business conduct • Rules on investment recommendations (principles of suitability, duty to explain) • Prohibition on compensation for loss, liability for damages - Rules on business conduct by financial investment business entities
Part 3. Issuance and circulation of securities	Chapter 1	Disclosure of issuance	- Registration statement
	Chapter 2	Systems related to corporate acquisitions and mergers	- Public tender offer, 5% rule, etc.
	Chapter 3	Listed corporations business reports	- Submission of annual business and other major reports
	Section 2 of Chapter 3	Special cases for stock listed companies	- Acquisition of stocks, financial management standards
	Chapter 4	Over-the-counter trading, etc.	- OTC trading, restrictions on OTC trading by foreigners
Part 4. Regulation on unfair trading	Chapter 1	Insider trading	- Return of insider's short-swing profit, insider trading, etc.
	Chapter 2	Market price manipulation	- Prohibition on market price manipulation
	Chapter 3	Restriction of short sales and unfair trading	- Comprehensive restriction on unfair trading activities, restriction on short sales
Part 5. Collective investment scheme	Chapter 1-11	Collective investment schemes	- Definition and composition of collective investment schemes - Collective investment securities and related companies of collective investment schemes
Part 6. Financial service-related institutions	Chapter 1-8	Financial service-related institutions	- Korea Financial Investment Association, Korea Securities Depository, securities finance companies, merchant banks, central counterparty clearing houses, credit rating agencies, etc.
Part 7. Stock exchanges	Chapter 1-8	Stock exchanges	- Approval of stock exchanges - Organization, establishment of markets - Market supervision and dispute resolution
Part 8. Supervision and disciplinary action	Chapter 1-4	Financial Services Commission's authority	- Order and approval, inspection and disposition - Investigation, penalty surcharges
Part 9. Supplementary provisions	-	-	- Reporting on violations, reporting by an electronic document
Part 10. Penal provisions	-	Penal provisions	- Penal provisions, fines, sentencing rules.

The FSC Regulations contain the Regulation on Financial Investment Business, Regulation on Issuance and Disclosure of Securities, Regulation on the Return of Short-Swing Profits and the Investigation and Reporting of Unfair Trading Practices, Regulation on Capital Market Survey, Regulations on Inspection and Sanction of Financial Institutions, etc. In its regulatory enforcement rules, the FSS defines the authority entrusted to its Governor by the FSCMA, its decrees and enforcement rules, FSC Regulations, and the other relevant

laws and regulations along with requirements and documents needed for the concrete implementation of the above mentioned laws and regulations.

2) REGULATION ON FINANCIAL INVESTMENT BUSINESS

The Regulation on Financial Investment Business (RFIB) is an FSC regulation, enacted in August 2008, to improve and integrate the existing regulations on the Supervision of the Securities Business, Indirect Investment Asset Management Business, Trust Business, Merchant Bank Industry, and Guidelines for the Licensing of the Trust Business, Merchant Banks and Financial Brokerage Companies.

The RFIB defines matters that are required for the regulation and supervision of governance, soundness, and business activities of licensed or registered financial investment firms. However, among the various financial investment business areas, concurrently-run financial investment business entities such as banks and insurance companies, which are partially licensed or registered, are not subject to the regulations on the governance, accounting, financial soundness, and restriction on trading with major shareholders.

The RFIB also stipulates supervisory issues regarding the over-the-counter (OTC) trading of non-listed stocks, bonds, commercial notes and fractional shares, OTC trading through bond brokerage firms and professional bond dealers, RP trading, securities lending transactions, OTC trading of derivatives, trading on the overseas securities markets and exchange-traded derivatives along with matters such as investment registration, account opening, trading and deposit of securities and derivatives held by foreigners.

3) REGULATION ON SECURITIES ISSUANCE AND DISCLOSURE

The Regulation on Securities Issuance and Disclosure (RSID), enacted in February 2009, is an FSC regulation that overhauled the former "Regulation on the Issuance and Disclosure of the Securities" by adding regulatory improvements and additional authorities entrusted by the FSCMA.

To ensure the fairness of securities issuance and investor protection, the RSID specifically defines items which investors should be notified of in the form of descriptions on the registration statement and investment prospectus, along with the forms and other documents that should accompany them. In particular, when it comes to the registration statements of collective investment

securities and asset-backed securities, and the registration statement on mergers, business transfers and split-offs, split-and-mergers, comprehensive exchanges or transfer of stocks, the RSID defines different specifics and required documents.

The RSID defines matters that are needed for the concrete implementation of the registration of tender offers, reports on the holding of stocks in bulk, and restrictions on the solicitation to exercise voting right by proxy. Plus, it also contains specifics regarding the types of corporations that should submit regular reports such as business reports, and the information that should be stated in those reports; acquisition and disposition of treasury stocks of stock-listed corporations; decisions on the issue value of capital increase with consideration; and issuance of convertible bonds and bonds with warrants.

III. INVESTOR PROTECTION

Article 1 of the 2009 Financial Investment Services and Capital Markets Act (FSCMA) stipulates that "the purpose of the Act is to contribute to the development of the national economy by facilitating financial innovation and fair competition in the capital market, protecting investors, enhancing the development of the financial investment business and heightening the fairness, reliability, and efficiency of the capital market."

When the financial assets of an ordinary investor are unfairly treated by a financial investment business entity or such an entity recommends financial investment instruments by providing misleading or false information that is not adequate for an ordinary investor considering their investment purpose, the investor will lose confidence in the capital market. As such, investor protection is crucial not only to protect the rights of investors as the consumers of the market, but also to promote the sound development of the capital market.

Since many of the articles in the FSCMA include investor protection, it is hard to detail all the relevant provisions governing investor protection; however, this chapter will discuss the major provisions of the FSCMA relating to investor protection. Section I covers investment recommendation restrictions, a newly introduced measure for investor protection with the enactment of the FSCMA. Section II focuses on disclosure, and while this is not directly related to investor protection, investors should refer to this section in order to

better utilize the information disclosed in the market, thereby enhancing their decision-making capabilities. It is desirable for investors to identify what kind of information they need and how to get access to such information so they can make financial investment instrument decisions.

Section III covers unfair trading in the securities market including insider trading, market price manipulation, and liabilities for damages caused by unfair trading, while Section IV discusses dispute resolution. A financial dispute can be resolved by filing a lawsuit if the parties concerned cannot reach an agreement. However, in order to minimize the time and cost of a civil suit, an organization for financial dispute resolution mediates the interests of both parties and proposes a resolution. The final section covers efforts to promote international cooperation with overseas supervisory organizations.

1. Restrictions on Investment Recommendation

The FSCMA distinguishes between an ordinary investor and a professional investor based on the expertise of their professional knowledge and experience as well as the amount of assets invested. A professional investor is an investor that does not need strong investor protection measures considering their own expertise and experience. Examples of this type of investor include a nation, a local municipality, a central bank, or a financial institution. Most individual investors fall under the classification of an ordinary investor with the exception of an investor whose financial investments exceed 5 billion won. These classifications aim to protect ordinary investors from taking large risks when making investments due to a lack of understanding of financial investment instruments.

1) PRINCIPLE OF SUITABILITY

A financial investment business entity is required to comply with the "Know Your Customer Rule" before recommending any investment instruments to an ordinary investor in order to identify the customer's level of knowledge and experience, and thereby suggest investment instruments that are suitable for the investor. Pursuant to Article 50 of the FSCMA, KOFIA established the standard procedures on investment recommendations, providing a set of specific guidelines as to how financial investment businesses should make investment recommendations to their customers.

2) PRINCIPLE OF ADEQUACY

Regarding derivatives or other high-risk financial products, the FSCMA requires financial investment companies to evaluate the adequacy of the product, and when the product is deemed inadequate for investment, inform individual investors of the risk, even in the case when investors made a discretionary judgement without being influenced by recommendations from the company.

Financial investment companies must collect information about individual investors' investments including their investment goal, status of wealth, and past investment experiences through consultations or questioning, without offering recommendations about specific products. If the company decides that a certain product is inadequate for the investor based on this information, it must inform the investor and receive confirmation through signature, seal, or recording.

3) DUTY TO EXPLAIN

A financial investment business entity must, whenever it makes an investment recommendation to an ordinary investor (client), explain the details of the financial investment instrument, risks contingent upon the investment, structure and nature of the investment risks of the financial investment instrument, matters concerning direct and indirect fees, matters concerning the term and conditions of early repayment, matters concerning the cancellation and termination of contracts, etc. (hereinafter "investment considerations") with such sufficiency as to allow the ordinary investor to understand them, and must obtain a signed confirmation from each ordinary investor stating that they have understood the details.

Notably, investor protection requirements are strengthened in that a financial investment business entity must provide sufficient explanation for an investor to understand the financial investment instrument, not just simply notify the investor of the investment considerations.

In addition, a financial investment business entity shall provide investors with investment prospectuses, except in cases where an investor refuses to receive one, or where the prospectus of securities for which the registration statement has taken effect is provided before its sale. The investor confirms that he or she has received the investment prospectus by providing a signature.

When explaining investment products, the executives and employees of a financial investment business entity should not provide false information or omit an explanation of any of the material facts that may have a significant impact on the investor's judgment for a financial investment instrument.

4) LIABILITY FOR DAMAGES

A financial investment business entity shall be liable for the damages inflicted upon an ordinary investor if the financial investment business entity did not explain the details of the financial investment instrument, provided false or distorted information or omitted an explanation of any of the material facts that may have had a significant impact on the investor's reasonable judgment. The amount shall be calculated by subtracting the total amount of money recovered or recoverable by an ordinary investor through the disposal of the financial investment instrument, or through any other means, from the total amount of money paid or payable by the ordinary investor for the acquisition of a financial investment instrument.

2. Disclosure

The term disclosure refers to the provision of information to the general public so that anyone may have access to such information. Unlike institutional investors or other professional investors, ordinary investors are highly likely to be excluded from material information that may have a significant impact on the value of stocks and other financial investment vehicles. Therefore, such material information shall be disclosed to ensure fair trading in the financial market. The FSCMA stipulates a series of provisions concerning the matter. The provisions of disclosure are related to investor protection in that the purpose of these provisions is to prevent damages being inflicted upon ordinary investors due to information asymmetry. Investors shall be able to make reasonable and informed decisions based on such publicly disclosed information.

1) DISCLOSURE OF FINANCIAL INVESTMENT BUSINESS

Information on financial investment instruments and financial investment business entities is disclosed on the KOFIA website (http://www.kofia.or.kr). KOFIA's electronic disclosure system posts information on financial investment instruments, financial investment business entities, and professional investors.

Matters that a securities company must disclose include commission rates, management disclosure, timely disclosure and net capital ratio. Commission rates are provided by the amount of trading and the methods of transaction (online or offline). Management disclosure includes information on any cases of litigation or restrictions relevant to the securities company. The disclosed information can be utilized to assess the compliance of the company to the internal controlling policies for investor protection.

A collective investment business discloses information on asset management companies and funds. An asset management company provides periodic disclosures including closing accounts reports, periodic reports, and periodic management disclosure, as well as timely disclosures. A collective asset management entity shall submit an asset management report of funds at least once every three months, including the operating performance of funds, total amount of assets and liabilities of funds, the assessed value of each type of asset that belongs to the funds, the total number of stocks traded, total trading amount, turnover rate during the pertinent management period, matters concerning professional investment managers, and the fees for each investment broker.

An asset management company shall immediately provide timely disclosure when there is: an occurrence of a significant financial scandal or loss; an issuance of a recommendation or requirement from the FSC to improve management; or an occurrence of a non-performing loan that exceeds 10% of the amount of equity capital as of the end of the previous quarter. Such information is material to assess the soundness of the company since any significant financial scandal or loss represents inadequate risk management or internal control systems within the company. Meanwhile, the timely disclosure of funds provides information such as changes in fund managers, decisions on deferment or resumption of redemption and the reasons thereof, details of resolutions of the general meeting of collective investors, and details of a change in the base price.

The KOFIA website also posts information on professional managers including securities investment advisors, derivatives investment advisors, and fund investment advisors with their company names and business areas.

2) DISCLOSURE IN THE SECONDARY MARKET

A listed company shall make periodic disclosures as well as timely disclosures when it is deemed necessary. The information on a listed company is easily accessible on the KRX website.

(a) Periodic Disclosure

Periodic disclosure includes annual, semi-annual and quarterly reports. Anyone can have access to the information via the electronic disclosure system on the websites of the KRX or FSS.

A listed corporation shall submit an annual report to the FSC and KRX within ninety days of the end of the business year. An annual report shall include an overview of the company, the trade name, details of its business, the remuneration of executives, matters concerning finance (financial statements), the accounting auditor's audit opinion, the organization of the company including the board of directors, shareholders, executives and employees, details of transactions with major shareholders, executives or employees of the company, and matters concerning investor protection. Such information is material to the selling or purchasing of stocks of the company and assessing the value of securities.

A semi-annual report is a six-monthly business report and a quarterly report is a three-monthly report calculated from the commencement date of the pertinent business year. A listed company shall submit the reports to the FSC and KRX within 45 days of the closing of each term.

If any of the following events that may have a significant impact on the management of a company occur, the company shall submit a report on the details of the events to the FSC by the following day from when such events occurred. The events include: a bill or check issued by the corporation is returned or its check account transactions in a bank are suspended or banned; its business activities are completely or partially suspended; or, there is an application filed for commencement of proceedings for rehabilitation under the Debtor Rehabilitation and Bankruptcy Act.

A person who has acquired or disposed of securities issued by a corporation has the right to make a claim for damages caused by a false description or an omission of a material fact in a business report. The claim for damages can

be made against the directors of the corporation, the person in charge of the business report, or the auditor. In addition, when a business report has not been submitted, or a false description or an omission of a material fact exists, the FSC may suspend any securities issuance by the company for up to one year, file criminal complaints, or recommend the dismissal of executives.

(b) Timely Disclosure

Timely disclosure refers to reports that listed companies shall prepare without delay in order to immediately notify the KRX of any material changes related to their business operations. The KRX provides the respective disclosure requirements for the Stock Exchange and KOSDAQ. Since the timely disclosure typically contains material information that may have a significant impact on the value of the company and the stocks, anyone may access such information through the KRX website. Although the timely disclosure includes a massive amount of information, it can be classified into three categories, and the KRX shall be notified of the following information by the following day from which such events have occurred.

First, matters that may have an impact on the operation or production of a listed company, such as a full or partial suspension of business operations that takes up 10% or more of the sales volume or any administrative measures thereof; a suspension of transactions that makes up 10% or more of sales; or the conclusion of contracts for product supply or sales.

Second, events that may change the financial structure of a listed company, for example, the increase or reduction of capital, retirement of stocks, disposal of treasury stocks and stock splits that may have an impact on securities issued by a listed company; new facility investments that take up 10% or more of the equity that may have an impact on production; short-term borrowings that take up 10% or more of the equity that could have an impact on the credit or liability of the company; natural disasters that could have an impact on the profit and loss of a listed company by 5% or more at the year's end; and any decisions made on stock dividends.

Third, matters that may have an impact on the management of a listed company such as any changes in corporate governance due to changes in the largest shareholders; or litigation related to the company is brought to court; or a judgment on litigation is made.

Article 392 of the FSCMA prescribes that, in order to secure the effectiveness of disclosure, banks shall notify the KRX of material information that is likely to affect investors' decisions without delay, for example, where any issued bill or check defaults; or where any current account transaction with the bank is suspended or prohibited.

(c) Fair Disclosure

Korea's securities market introduced the fair disclosure rule in November 2002. The rule requires that, if a company deliberately discloses certain information to selective investors, the same information should also be disclosed to the general public in the market before the information is provided to the selective investors. If the information is disclosed to selective investors by accident or error, the company should also provide such information to ordinary investors on the same day. In the case that the executives of the listed company were not aware of the disclosure, the company must disclose the information on the day it came to their attention.

The purpose of fair disclosure is to prevent insider trading and information asymmetry, and to allow more investors to receive the material information in a timely manner. The rule also aims to make the market fairer and more transparent and thereby enhances investor confidence. Fair disclosure is to supplement the timely disclosure system and is implemented by the KRX, a self-regulatory exchange. Detailed disclosure information is accessible on the KRX website.

The information released in fair disclosure is different from that of periodic or timely disclosures in that it pertains to expected data, such as business projections, management projections, projections of sales, operating income or loss, net income or loss before tax from continuing. Such information is material since it has a direct impact on stock prices, and if it were selectively disclosed only to institutional investors or analysts, individual investors would be disadvantaged when making investment decisions. In this regard, fair disclosure is a regulation to protect ordinary investors.

3. Unfair Trading

1) INSIDER TRADING

Given that corporate information related to the value of the company such as profits, growth potential and future plans may have a direct impact on the stock price, such material information shall be disclosed to the general public in the market. If any trader monopolizes such information and sells or purchases stocks utilizing it, those investors who were not informed would be disadvantaged – the prime example of unfair trading.

Although stock trading by insiders itself is not recognized as unfair trading, if an insider takes advantage of nonpublic information it falls under "unfair trading". One such case occurred when President A of Company D sold 30,000 shares of his company after being informed that a fire had occurred in a subsidiary of Company D, causing KRW 2bn in damage, and the subsidiary suffered a KRW 3.5bn trade deficit due to declining exports. Considering that the fire could impact the profits of Company D, such information should be disclosed in the market. However, President A sold his shares without providing that information to the general public. In this case, the FSC found President A guilty of insider trading and he was sentenced to 8 months imprisonment, with one year's probation. The FSCMA stipulates provisions concerning insider trading.

When we refer to insider trading, the insider encompasses corporate insiders, quasi-insiders and tippees. Corporate insider refers to the corporation, including its affiliated companies, its executives, significant shareholders or employees who become aware of material nonpublic information that may have a significant impact on investors' investment judgments in the course of the performance of their business. For example, an employee who conducts business related to finance, accounting, planning or R&D falls under the definition of a corporate insider.

Quasi-insider refers to a person who has the legal authority or power to access material nonpublic information about the company. It includes a government official or employee of a supervisory organization for banks, securities companies and insurance companies, who has the authority to grant permission or authorization, or supervise the company; or an accountant, corporation-designated banks, or legal advisor who has concluded a contract

with the corporation or is under contract negotiation, who becomes aware of material nonpublic information in the course of performing such a contract.

Tippee refers to a person who deliberately receives material nonpublic information from an insider or quasi-insider and understands the importance of such information. For example, if an insider or quasi-insider gives material nonpublic information to relatives, journalists or fund managers, those who receive such information fall under the definition of a tippee. However, a third party that receives information from a tippee and then trades using that information is not regarded as an insider.

An executive or significant shareholder of a listed corporation shall report to the Securities and Futures Commission (SFC) and KRX the status of specific securities held in their own account within 5 days from the day they became an executive or a significant shareholder respectively, or within 5 days from the day any change occurred. The SFC and KRX shall then disclose this information on their websites. This allows market participants to identify the trading of insiders of a company and inspect whether an executive or a significant shareholder of a company is conducting insider trading using nonpublic information.

Under the FSCMA, if an executive, employee, or significant shareholder of a listed corporation derives profits by purchasing financial investment instruments and then sells them or vice versa within six months, the corporation may require the executive, employee, or the significant shareholder to return the profits to the corporation. A shareholder may demand that the corporation make a claim against the insider concerned, or the shareholder may make such a claim on behalf of the corporation if the corporation does not make such claim itself within two months of receiving the demand. However, if the purchase or sale is permitted under a relevant Act, for example where the appraisal rights of dissenting shareholders are considered, the corporation or shareholder cannot require the return of short-swing profits since the insider is deemed to have had no intention to conduct insider trading. Even if an insider commits insider trading utilizing material nonpublic information, it is difficult to prove. Therefore, the regulations on the return of insiders' short-swing profits are a preventive measure against insider trading.

Material nonpublic information refers to any information that has not yet been disclosed to the general public and may have a significant impact on investors' investment decisions. Article 174 (1) of the FSCMA prescribes that "no

person shall use any material nonpublic information in trading or any other transaction involving specific securities, etc., nor allow any another person to use it." Whether the material information is nonpublic or not depends on the time of disclosure of such information to the general public. The Enforcement Decree of the FSCMA defines the disclosure time of information as follows:

① Information reported to the FSC or the KRX or described in a document reported: One day after the document containing such information is made available for inspection as decided by the FSC or the KRX;
② Information disclosed through an electronic communication medium established and run by the FSC or the KRX: 3 hours after disclosure;
③ Information published through two or more newspapers circulated nationwide among ordinary daily newspapers and daily newspapers specializing in the economy: 6 hours after 0:00 of the day after publishing;
④ Information broadcast through television or radio with nationwide coverage: 6 hours after broadcast; and
⑤ Information provided through Yonhap News: 6 hours after provision.

Therefore, any person who uses the material information before the disclosure deadline is in violation of the prohibition on the use of material nonpublic information.

2) MARKET PRICE MANIPULATION

Market price manipulation is the act of artificially changing market prices or trading volume in order to mislead any person about the price of listed securities or exchange-traded derivatives for the purpose of making a profit from it. Market price manipulation is prohibited as unfair trading since it interferes with the fair and transparent pricing of financial investment instruments in the market. Since market manipulation is a type of fraud, it is regulated by both criminal and civil law. However, Article 176 of the FSCMA also regulates market manipulation in order to properly prohibit such an act.

Listed securities and exchange-traded derivatives are subject to price manipulation and the act of manipulation, and entrusting or being entrusted with such an act is regulated by the FSCMA. The types of market manipulation prohibited by the Act are detailed below; not only do they cover the process of artificially changing market prices through actual trading, but also acting with the purpose to cause any person to misunderstand that the trading of listed securities or exchange-traded derivatives is booming, or to mislead any person

into making an incorrect assessment, for example:

- Selling (purchasing) securities or exchange-traded derivatives in a conspiracy with another person to sell the securities or exchange-traded derivatives at the same price as theirs, or at an agreed value at the same time as they sell (purchase) them;
- Appearing to trade securities or exchange-traded derivatives without the intention of transferring the interest or rights therein; and,
- Entrusting or being entrusted with an act set forth below.

Selling or purchasing with an intention to fix or stabilize the market price is also prohibited, with the exception of cases when an investment trader, who has entered into an underwriting contract with the issuer, trades such securities with an intention of making the public offering or the sale of the securities smoother by stabilizing the price of the securities during a specified period of time not exceeding 30 days prior to the end of the subscription period, or not exceeding six months from the day on which the securities were listed. The investment trader shall prepare a report on manipulation for stabilization describing the trading name of the investment trader, the issue of securities subject to manipulation, trading price, details of trades, day, time and the period of manipulation for stabilization to the FSC and KRX.

TABLE 15-4. PROHIBITED ACTS OF MARKET PRICE MANIPULATION

Act of manipulation	Detail
False trading	Committing acts resulting in any person misunderstanding that the trading of listed securities is booming; or misleading any person into making a poor judgment
Actual trading	Selling, purchasing, entrusting or being entrusted with the sale or purchase of such securities or derivatives to cause fluctuation in the market price in order to attract any person
False or misleading representation	Disseminating a rumor that fluctuations in the market price for such securities or derivatives are being caused by his/her or another person's market manipulation; and making a false or misleading representation concerning a material fact in trading such securities or exchange-traded derivatives
Fixing or stabilizing market prices	Selling or purchasing listed securities or exchange-traded derivatives with an intention to fix or stabilize the market price; entrusting or being entrusted with such an act

3) UNFAIR TRADING

Unfair trading refers to committing an act using unfair means while trading financial investment instruments. It includes utilizing an unfair means, scheme, or tricks; attempting to earn money or any interest in property by using a document containing a false description or false representation of a material fact, or an omission of a description or representation of a material fact, necessary for preventing others from being misled; using inaccurate market prices with the intention to attract others to trade or make any other transactions in financial investment instruments; or disseminating a rumor, using a deceptive scheme, or making a threat with the intention to trade or make any other transaction in financial investment securities or attempt to cause a fluctuation in the market price.

For example, if a listed company submits an annual report with false information on its financial statements, claims uncertain business projections are certain or ready to begin, publicizes such information on newspapers and leaflets to mislead investors and raise stock prices, and then later sells the stocks that are owned by the CEO of the company to realize a profit, the case falls under the definition of unfair trading.

4) LIABILITY FOR DAMAGES CAUSED BY UNFAIR TRADING

A person who incurs damages inflicted by unfair trading has the right to a claim for damages. The right to a claim for damages ceases by prescription if the claimant does not exercise the right within one year from the time he or she becomes aware of the fact, or within three years from the time such an act was committed.

A person who committed unfair trading is subject to punishment by imprisonment for up to 10 years, or a fine of up to KRW 500mn. However, when three times the amount of the profit or loss derived from unfair trading exceeds KRW 500mn, the fine is three times the amount of the profit or loss derived from such unfair trading.

5) DISCRETIONARY TRADING AND EXCESSIVE TRADING

Discretionary trading and excessive trading are prime examples of unfair trading in the securities business. Discretionary trading is prohibited in Article 70 of the FSCMA, which prescribes that, "No investment trader or investment

broker shall trade financial investment instruments with property deposited by an investor in the absence of an order for the trading of such financial investment instruments from the investor or his or her agent." Excessive trading is a practice when a broker purchases and sells securities excessively, in size or frequency in view of the financial resources of a customer, in order to generate more commissions, and not with the best interests of the customer in mind.

Discretionary trading and excessive trading are the most commonly disputed securities issues between investors and brokers. Discretionary trading is unlawful in that an employee of a securities firm is highly likely to trade the accounts of customers, putting his or her or the company's interests before the interests of the customer. For a broker, frequent trading means more commissions; therefore, excessive unauthorized trading or excessive discretionary trading is commonly practiced. When such a dispute arises, it is not easy to determine whether a broker committed such discretionary trading with the investor's consent or not, making it hard for the investor to file a claim for damages. Even when an investor has entered into a discretionary investment contract with a broker, if the broker practices excessive trading in view of the scope and purpose of the investment, it is deemed as excessive trading and regulated by the FSCMA.

4. Dispute Resolution

A financial dispute can be resolved by filing a lawsuit if the parties concerned cannot reach a mutual agreement. However, in order to minimize the time and cost of a civil suit, the dispute resolution system mediates the interests of both parties and proposes a resolution.

1) FINANCIAL SUPERVISORY SERVICE (FSS)

A financial dispute refers to a dispute related to financial issues arising among financial institutions and financial consumers or investors and other interested persons. Pursuant to Article 51 of the Act on the Establishment, etc., of the Financial Services Commission, the FSS has established the Financial Disputes Mediation Committee (FDMC) to deliberate and resolve matters concerning the mediation of financially related disputes.

The FDMC is comprised of a maximum of 30 commissioners, including the Chair of the FDMC, who is nominated by the FSS Governor from among the deputy governors of the FSS. The FDMC may include persons nominated or appointed by the Governor from among: deputy governors of the FSS; judges, public prosecutors, or attorneys-at-law; executives or ex-executives of the Korea Consumer Agency and other consumer organizations; persons who have served in financial institutions, or finance-related institutions or organizations for 15 years or longer; persons who have knowledge and experience in finance; and any other persons that the Governor deems qualified and needed to be included in dispute resolutions.

An investor, a financial institution, or other interested parties may request that the FSS mediate a financial dispute. The person who requests the mediation of a dispute should submit an application form to the Governor of the FSS. It must include the name and address of the person requesting mediation and of the other party concerned, the name and address of the proxy, if applicable, and the purpose and reasons for requesting mediation. There should also be attached documents proving the facts and reasons for requesting mediation, a letter from an attorney, if applicable, and other necessary materials.

The Governor will, upon receipt of the request to mediate a dispute, notify the details thereof to the parties concerned and may recommend they reach an agreement. If an agreement is not reached within 30 days from the date of receiving the request to mediate the dispute, the Governor will refer the case to the FDMC without delay, and the FDMC will deliberate upon the case and devise a draft mediation within 60 days from the date referred. When the parties concerned accept the mediation plan, it will have the same effect as a judicial compromise. If either party brings a lawsuit against the other party during the mediation procedure, the Governor will cease the mediation procedure and notify the parties concerned.

2) KOREA FINANCIAL INVESTMENT ASSOCIATION (KOFIA)

KOFIA performs dispute resolution for disputes arising from the conduct of business of its members pursuant to the FSCMA.

The Dispute Resolution Committee (DRC) in KOFIA consists of a maximum of 15 commissioners, including the Chair, who is the person in charge of dispute resolution duties in the association. The commissioners are appointed by the chair of the Self-Regulation Committee (SRC) from among: judges,

public prosecutors, or attorneys-at-law; persons currently holding the position of assistant professor or higher with a major in law, business administration, or studies related to securities and derivatives; executives or ex-executives of corporations related to the financial investment business; employees or ex-employees who have acquired expert knowledge and experience after working for corporations related to the financial investment business for more than 10 years; persons with sufficient professional expertise and experience in the field of securities, derivatives, accounting, or computer systems; executives or ex-executives of the Korea Consumer Agency and other consumer organizations; and any other persons that the chairperson of the SRC deems qualified and needed to be included in dispute resolutions.

Dispute resolution policies are not legally binding since the purpose of dispute settlement, as mentioned earlier, is to simply mediate the interests of both parties and propose a resolution in order to minimize the time and cost of a civil suit. When both parties concerned accept the mediation plan proposed by the DRC, the resolution shall have the same effect as a judicial compromise.

The process for KOFIA's dispute resolution is as follows: when a person submits a request for the mediation of a dispute to KOFIA, it identifies the authenticity of the descriptions of the request and the attached documents by inquiring into the records and visiting the parties concerned or other interested persons. KOFIA may then recommend a resolution plan in order for the parties to reach an agreement. The mediation procedure will cease when the person who requested the mediation accepts the proposal of KOFIA and withdraws the case, when the requested case comes under investigation by the authorities, when the case is brought to court by either party, or when the case proves to be false.

If mediation is necessary, the case shall be referred to the DRC within 30 days from the date of receiving the request. The DRC will then deliberate on the case within 30 days from the date referred. However, the deadline can be delayed by up to 15 days if necessary. When the persons concerned accept the mediation plan, they shall submit a signed acceptance letter to KOFIA within 20 days upon the receipt of the dispute resolution notice, and the case will be settled. The member firm shall submit the follow-up measures to KOFIA without delay within 20 days from the dispute settlement.

3) KOREA EXCHANGE (KRX)

The KRX is a stock market approved by the FSC under the FSCMA and takes responsibility for the resolution of financial disputes over the rights and obligations or conflicts of interest derived from investment trading. The Market Monitoring Committee (MMC) of the KRX has established the Disputes Settlement Deliberation Committee (DSDC) which is composed of experts in related sectors, such as the legal department, academia, securities and futures businesses and consumer groups. The DSDC deliberates disputed cases submitted to the Committee; then the MMC makes a final resolution in consideration of the result of the deliberation. The detailed procedure of dispute settlement is similar to that of KOFIA's.

5. International Cooperation with Overseas Supervisory Organizations

The FSC can share and exchange information with foreign financial investment supervisory institutions. When a foreign financial investment supervisory institution requests an inspection or investigation in a manner stipulated by the FSCMA, regarding a breach of the Act or overseas laws and regulations equivalent to the Act by identifying the purpose and scope of the case, the FSC can provide the foreign institution with needed cooperation. In cases of investigating violations involving the return of short-swing profits gained by insiders of a company, use of nonpublic information, market manipulation, unfair trading and restrictions of short-selling, the Securities and Futures Commission (SFC) can offer needed cooperation as well. In such a case, the FSC or SFC can provide or be provided with investigative or inspection documents to or from relevant foreign institutions based on the principle of reciprocity. Plus, in the case of providing inspection or investigative documents to foreign counterparts based on the above principle, the provided documents should only be used for the purpose of the request and the confidentiality of the documents, and all the related facts regarding the transfer of the documents should be maintained.

The FSC and FSS are active members of the International Organization of Securities Commissions (IOSCO) in order to foster an organic cooperation system with foreign securities supervisory institutions for effective information-sharing on unfair trading cases and inspection information on financial

companies operating in each other's jurisdictions. The FSC and FSS became members of Appendix A of the Multilateral Memorandum of Understanding of IOSCO in 2009.

IV. CAPITAL MARKET SUPERVISORY BODIES

1. History

The financial supervision system of Korea was diversified for a long time, during which licensing and authorization rights, and supervision and inspection rights were scattered across institutions such as the Ministry of Finance and Economy (MOFE), Bank Inspection Board, Securities Supervisory Board, Insurance Supervisory Board and the Korea Non-Bank Deposit Insurance Corporation. In the case of the capital market, the MOFE had licensing and authorization rights for securities companies, while the FSC and Securities Supervisory Board were the authorities for approval, consent, order and inspection.

However, the Asian financial crisis in 1997 caused the Korean government to reorganize its financial supervisory institutions. Right after the outbreak of the crisis, the Korean government and the International Monetary Fund (IMF) agreed to create an integrated financial supervisory body, enacting the Act on the Establishment, Etc. of Financial Supervisory Organizations (AEFSO) in December 1997. AEFSO reshuffled Korea's existing sectional supervision structure and offered a legal basis for the establishment of the Financial Supervisory Commission and Financial Supervisory Service as an integrated financial supervisory institution. Based on AEFSO, the Commission was launched in April 1998 and the Bank Inspection Board, Securities Supervisory Board, Insurance Supervisory Board and Korea Non-Bank Deposit Insurance Corporation were incorporated into the FSS in January 1999. However, given the specific aspects of the capital market, the Securities and Futures Commission was established separately under the Financial Supervisory Commission.

In 2008, a new regulatory system reorganized the Financial Supervisory Commission into the Financial Services Commission (FSC) to maintain

operational coherence between financial policy and supervision. The FSC took over the function of financial policy formulation from the MOFE, conducting financial supervision, policy formulation and implementation. To support the financial policy function of the FSC, a secretariat was created. To ensure the independence of the financial supervision, directorship of the FSS, which was simultaneously held by the Chairman of the FSC, was appointed separately.

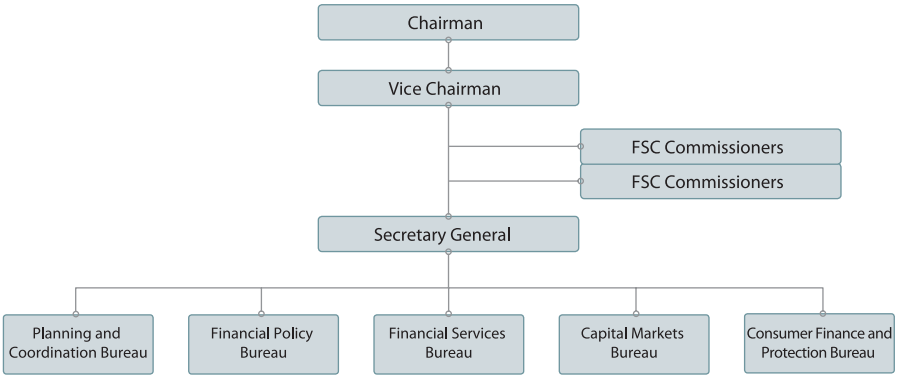
2. Financial Services Commission and Securities and Futures Commission

As a government organization, the FSC is a board-style administrative organization under the Prime Minister's Office. But unlike other governmental organizations whose authorities are designated by the Government Organization Act, the FSC's authority is designated by AEFSO, the Presidential Decree of the Financial Services Commission and affiliated institutions' organizations, and other Acts on financial supervision.

The FSC conducts matters regarding the financial policies and institutions, including inspections and placing restrictions on financial organizations, licensing and authorizing the establishment of financial organizations, the management, supervision and surveillance of the capital market, and legal and regulatory enactment and revision of financial policies and systems. The Commission also manages the business activities, operation and management of the FSS, and reviews and determines the FSS's budget and account settlement, along with the revision of the FSS rules and regulations.

The Securities and Futures Commission (SFC) is responsible for the investigation of unfair business activities in the capital market, establishment and implementation of corporate accounting standards and accounting audits, and pre-deliberation of major issues related to capital market management, surveillance, and inspection, as well as other matters entrusted by the FSC for management, surveillance, and inspection of the Korean capital market.

CHART 15-4. ORGANIZATION OF THE FSC (As of April 2014)

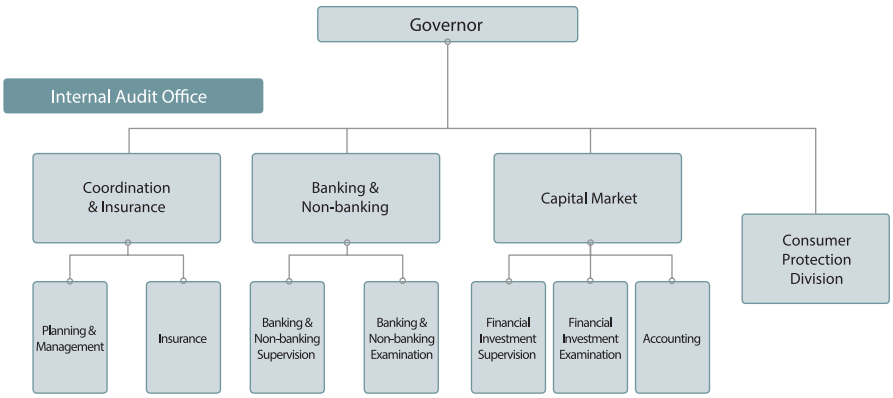


3. Financial Supervisory Service

The Financial Supervisory Service (FSS) is a special legal entity that has no capital base. It is independent from the central and local governments, conducting public affairs as a public corporation. By law, the FSS is not a government institution, but an independent public corporation, as it aims to carry out politically neutral and financially specialized supervisory functions over the Korean financial market, free from any political or administrative pressure.

Under guidance from the FSC and SFC, the FSS is responsible for inspections and supervision over financial institutions. It reports the results to the FSC, as well as any follow-up recommendations of the inspections. The FSC and SFC can require the FSS to make necessary changes to ensure effective monitoring and guidance over the FSS, and the FSC can also enact general or partial suspension orders to actions taken by the FSS or SFC when those actions are deemed to be legally inappropriate or to go against the public benefit, such as investor or depositor protection.

CHART 15-5. ORGANIZATION OF THE FSS (As of April 2014)



4. Self-Regulatory Organizations

1) KOREA FINANCIAL INVESTMENT ASSOCIATION

The Korea Financial Investment Association (KOFIA) is an incorporated membership organization with the purpose of maintaining business order between members, assuring fair trade, protecting investors, and promoting the sound development of financial investment services. Association members consist of financial investment firms, general administration companies, collective investment scheme assessment companies, bond assessment companies and members under the conditions prescribed by the articles of the Association.

KOFIA aims to promote fair business practices among member companies, create a fair business culture in the securities trading market, and maximize the function of investor protection. As such, KOFIA undertakes such activities as the: self-regulation to protect investors and maintain market order among member companies; dispute mediation between members regarding their business activities; registration and management of investment advisers and managers; OTC trading management for non-listed stocks; and establishment of dispute mediation rules for the industry's self-mediation of conflicts.

2) KOREA EXCHANGE

The Korea Exchange operates the Stock Market, the KOSDAQ Market, the Derivatives Market, and the KONEX Market, which was launched in July 2013. Under the FSCMA, the Stock Market is a market established for the trading of securities, such as debt securities, equity securities, beneficiary securities, investment contract securities, derivative-combined securities and depositary receipts. The KOSDAQ Market was established for the trading of specific securities, designated by the FSCMA, such as corporate bonds and stocks. Therefore, the Stock Market and KOSDAQ Market have clear differences in terms of the kinds of stocks they deal in. The Derivatives Market is a market established by the Korea Exchange for the trading of exchange-traded derivatives. The KONEX Market was established to promote the growth of technologically competitive small- and medium-sized enterprises (SMEs) in the early stages of their development. Although the market limits the participants to professional investors, requirements for entry were scaled down, pressure on corporate governance was eased, and companies were exempted from submitting quarterly and semi-annual reports in order to better support SMEs.

The responsibilities of the Korea Exchange include: the establishment and operation of various markets; conducting of transactions of securities and exchange-traded derivatives; transaction confirmation; debt acquisition; deductions; confirmation of settlement securities, settlement items, and settlement amounts; settlement execution guarantees; follow-up measures on settlement failure and settlement instruction as a result of transactions on the securities market and the derivatives market; reporting and disclosure of listed corporations; and self-resolution of disputes arising from transactions on the Stock Market, the KOSDAQ Market and the Derivatives Market.

CHAPTER 16

KOREA FINANCIAL INVESTMENT ASSOCIATION

I. OVERVIEW

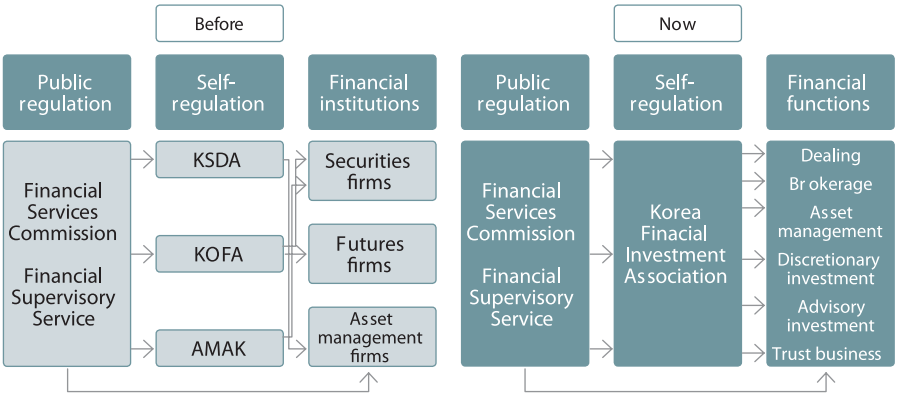
The Korea Financial Investment Association (KOFIA) is the self-regulatory body that manages the Korean financial services industry, and it plays a significant role in developing the Korean financial investment industry and capital market.

The most notable achievement of the association is the promotion of small and medium-sized enterprises by creating and utilizing reliable market data and effective technical support for these enterprises through the successful launch of the KOSDAQ market in July 1996 (merged into the Korea Exchange in January 2005).

KOFIA, the self-regulatory watchdog overseeing the Korean capital market, was created through the merger of the Korea Securities Dealers Association (KSDA), the Korea Futures Association (KOFA), and the Asset Management Association of Korea (AMAK) in February 2009, as set forth by the Financial Investment Services and Capital Markets Act (FSCMA). The KSDA, AMAK and KOFA successfully laid the foundation for the Korean capital market and

financial investment industry to become globally competitive by boosting demand in the capital market, creating a sound investment culture, establishing fair business practices, and nurturing quality financial professionals.

CHART 16-1. SELF-REGULATION SYSTEM



As a non-profit membership-based organization, KOFIA aims to promote fair business practices among its member companies, create a fair business culture in the financial investment industry, and maximize the function of investor protection to thereby ensure the healthy development of the Korean capital market.

To achieve that goal, KOFIA performs the following roles:

- Self-regulation to protect investors and maintain sound market order among member companies;
- Dispute mediation between members and their customers regarding their business activities;
- Registration and management of investment advisers and managers;
- Management of OTC trading for non-listed stocks;
- Management of the OTC bond market;
- Research and studies on the financial investment services industry;
- Investor education, and the establishment and operation of a foundation for investor education;
- Training and education programs for financial professionals;
- Promotion of public awareness and understanding about the financial investment industry;

- Disciplinary measures on member companies and supervision of their regulatory compliance; and
- Establishment of dispute mediation rules for the self-mediation of industry conflicts.

1. Role of the Korea Financial Investment Association

1) ESTABLISHMENT AND ENFORCEMENT OF SELF-REGULATORY MEASURES

KOFIA has introduced and implemented self-regulatory measures to create a culture of investor protection and fair business practices in financial trading, while enhancing the public's confidence in the financial investment industry.

The revision of the Securities and Exchange Act in 2002 created the legal basis for enhancing the association's self-regulatory function, and the passage of the FSCMA in 2009 broadened the association's role as the self-regulatory body of the Korean capital market, by granting KOFIA the authority to supervise the financial investment industry. The FSCMA clearly sets forth KOFIA's authority as a self-regulatory organization, and stipulates the prevention of conflicts of interests between the association's key roles – its membership services and self-regulatory functions. The FSCMA also legally defines KOFIA's powers of investigation and sanction as well as its obligation to submit documentation to the relevant authorities and report on the status of its member firms' legal and regulatory compliance, including to KOFIA's rules.

To ensure the transparency and credibility of the Korean financial market, the financial supervisory authority entrusts KOFIA with the duties of monitoring financial investment firms, introducing brokers, and contract businesses, as well as the supervision and investigation of financial investment firms.

The FSCMA legally guarantees KOFIA's regulatory power and allows for the revision of the association's regulations, as well as its authority to impose sanctions over its member companies. Based on these legal grounds, KOFIA can maintain fair business practices and a sound trading culture among its members, while introducing and implementing rules and regulations for self-regulation to ensure investor protection.

Among the many rules and regulations of the FSCMA, the section on the business and activities of financial investment firms enumerates several regulations that financial investment companies must comply with. For example, the regulations on sales and other common business activities define a company's permitted business activities, such as investment recommendations. There are also regulations based around the type of financial investment business, such as investment trading business or investment brokerage business. This section includes regulations governing other business activities as well as advertising investment schemes and instruments. The regulations on the management of agreements made by financial investment companies deal with the establishment and creation of a standard agreement for the business operation of the financial investment firms.

The establishment of KOFIA's Self-regulation Committee is a mandatory requirement to prevent any possible conflicts of interest between its member service function and the self-regulation process. The FSCMA changed the clause establishing the Self-regulation Committee from being optional into being a mandatory requirement. By doing so, the Act opened the way to strengthen the institutional independence of the self-regulatory function of KOFIA. The role of the committee is to protect investors while conducting self-regulation activities – such as enactment and deliberation of self-regulatory regulations, enactments and revisions of regulations regarding the business conduct of member companies, and administering disciplinary measures on member companies, corporate executives and employees failing to comply with the regulations.

TABLE 16-1. KOFIA'S MAJOR REGULATIONS AND BEST PRACTICES

Regulations	Codes of best practices
Regulations on the business conduct of financial investment companies	Standard rules on investment recommendations
Regulations on the management of agreements by financial investment companies	Codes of best practices for CMA businesses
Regulations on dispute resolution	
Regulations on the securities underwriting business	Standard internal control criteria for financial investment companies
Regulations on the management and sanctions of the Self-regulatory Committee	Codes of best practices for risk management of financial investment companies
Regulations on financial investment professionals and certification	Codes of best practices for the appointment of outside directors and audit committees for financial investment companies
Regulations on the quotation intermediation of OTC stocks	Codes of best practices for special asset fund transactions
Regulations on the assessment of credit rating agencies	Codes of best practices for the prevention of financial crimes in financial investment services
Deliberation criteria on the exclusive right to use new products	
Regulations on the trading system for qualified institutional investors	Core prospectus system (FX margin trading, margin loan)
Guidelines on the registration and management of applicants for retirement pension plans	
	Standard code of ethics for financial investment companies
	Standard contract on the operation of non-guaranteed bond trusts
	Codes of best practices for the prevention of unfair trading
	Codes of best practices for cross-trading in purchases with buy-back agreements
	Codes of best practices for using research/analysis services of collective investment managers
	Criteria on the management of risk limits of derivatives products
	Criteria on the integrated disclosure of financial instruments
	Compliance manual for financial investment companies
	Standard criteria on investment recommendation brokerage
	Codes of best practices for specified money trust businesses
	Codes of best practices for advisory wrap accounts
	Codes of best practices for green fund investments
	Codes of best practices for the issuance and management of derivatives-linked securities or derivatives-linked bonds
	Criteria on lead management businesses
	Codes of best practices for the management of provisional of fices of financial investment companies
	Codes of best practices for private collective investment schemes and brokers involving qualified institutional investors
	Codes of best practices for the management of electronic documents for trading financial investment products and opening accounts

2) POLICY RECOMMENDATIONS FOR THE CAPITAL MARKET AND INDUSTRY

KOFIA maintains ongoing communication with various government authorities and proposes important recommendations to bodies such as government ministries and the National Assembly. These recommendations include constructive opinions and ideas relating to government policies aimed at enhancing the regulation and development of the Korean capital market. Thanks to KOFIA's previous policy recommendations, the Korean securities market was able to make significant advances, for example, by encouraging pension funds to invest more in the stock market. In particular, in 2007, KOFIA pushed for the enactment of the FSCMA so that the six previously separate financial market laws, including the Securities Transaction Act and the Futures Transaction Act, could be combined, contributing to the successful implementation of the Act on February 4, 2009. Working in close cooperation with the Korean government and financial industry, KOFIA played a pivotal role in drawing up the content and structure of the bill, and made meaningful contributions by providing theoretical as well as practical support for the birth of the FSCMA.

3) STRENGTHENING INVESTOR PROTECTION AND EDUCATION

Investor education is a proactive means to protect investors and help them make informed financial decisions by enhancing their financial understanding and literacy. KOFIA consistently strives to protect the rights and benefits of investors through education, while at the same time fulfilling its self-regulatory functions, including the improvement of the current financial system and developing policy recommendations.

KOFIA led the establishment of the Korea Council for Investor Education (KCIE) in 2005, to better facilitate investor education initiatives. It currently serves as the secretariat of the KCIE. The KCIE is a non-profit organization specializing in financial education, established by a consortium of five capital market institutions – the Korea Financial Investment Association, Korea Exchange, Korea Securities Depository, Korea Securities Finance Corporation, and Koscom Corporation. The Financial Services Commission and the Financial Supervisory Service are special members of the KCIE.

The KCIE provides life-long education to the general public by offering a practical curriculum to support Koreans' financial well-being. The course covers a wide range of individuals; teenagers, university students, employees, housewives, the elderly, and people with special vocations, including certified

labour attorneys and tax office workers. Its investor education programs come in various forms: collective classes, online courses, mobile education, and publications such as books and leaflets. In 2013, the Council released a U-Learning application named "Master of Wealth Management," which allows the general public to access financial education courses through widely used mobile devices such as smartphones and tablet PCs.

As Korea becomes an aging society with a low birth rate, the KCIE now offers a wide range of investor education programs for after retirement in order to help individuals make more reasonable and informed investment decisions, and create "asset-based welfare" through long-term asset management plans.

With the FSCMA coming into effect, financial investment instruments have become ever more complex and diversified. In response, the KCIE offers and distributes free of cost a wide range of books on financial investment, such as guidebooks on saving on taxes through financial investment, and financial product guidebooks that aim to help investors better utilize such financial instruments and protect themselves in the market. It also provides a comprehensive online wealth management education program named Academy Series, guidelines for becoming a smart investor, easy-to-understand information on financial investment, special courses starring popular lecturers, online professional training classes for teachers, and a variety of e-Learning programs on its website (www.kcie.or.kr).

In addition, the KCIE has strengthened investor education programs to ensure proactive investor protection. One example is its online and offline mandatory education courses for ELW investors, which was implemented from February 2011 to February 2013 as a response to financial authorities' efforts to promote the sound growth of the ELW market. These courses provided information on ELW products, trading structure, risks, etc.

Furthermore, the Council has offered its ongoing support for the legislation of financial education laws designed to foster a national framework for systemic financial education. A case in point is the Council's co-hosting of the "Policy Debate for Building Adolescent Financial Capacities" with the Sustainable Economic Forum of the National Assembly in April 2013.

Meanwhile, the KCIE is actively involved in strengthening financial education in schools to facilitate financial education at an early age. It has been working to develop financial education for young students in cooperation with the Seoul Metropolitan Office of Education, Busan Metropolitan City Office of

Education, and Daegu Metropolitan Office of Education, designating 100 schools as providers of financial courses. The Council has signed MOUs with 10 high schools specializing in finance to provide financial education as well as vocational training. Moreover, it offers general and special in-depth programs to teachers so they may better educate their students.

An online professional training course for teachers was launched in 2013, in order to cut the costs of the teacher training program and to attract more people. The online course received a lot of attention right from the beginning, as it did not pose time or place constraints, and approximately 3,500 people signed up for the class in 2013.

In line with these efforts, a range of practical classroom content, including a standard financial education curriculum, is developed and distributed to elementary, middle and high schools. A variety of alternative hands-on programs, such as weekend finance classes, bus tours of financial institutions in Yeouido, and finance camps for teens, complement this educational program. These programs aim to facilitate financial education for children and teens in order for them to better understand finance and the economy, thereby growing up to be informed and responsible investors.

In December 2011, the KCIE opened the state-of-the-art Financial Village, where the general public can learn about finance in fun, easy and effective ways. It is the world's first financial education facility featuring hands-on education programs customized to all ages, from teenagers to general investors, which are delivered through various types of high-tech devices, such as tablet PCs, large multi-touch screens and media tables. Visitors from both domestic and foreign securities-related organizations and the press have shown great interest in this new facility, praising the innovative approach being taken. In 2012, over 10,000 visitors enjoyed the programs offered at the Financial Village. Introduced and widely praised at the Annual General Meeting of the Asia Forum for Investor Education (AFIE) in New Delhi, India, in March 2013, the Village has received great attention from the securities industry and the media, both home and abroad. The Village cemented its position as the best hands-on financial education facility in Korea, as it attracted 11,000 people during the year 2013.

Lastly, KOFIA actively participates in promoting international exchange and cooperation as a full member of the International Forum for Investor Education (IFIE). It expanded its global role in the investor education field

by leading various initiatives, including the establishment of the Asia Forum for Investor Education (AFIE) in February 2010, which aims to facilitate the exchange of investor education knowledge and information concerning capital markets in Asian countries.

The education system offered by the KCIE has been praised and benchmarked by countries across the globe. Consequently, each year, many countries request an opportunity to visit the facility or seek consultation. For example, in May 2014, the Turkish Capital Markets Association, the chair of the AFIE, suggested the implementation of advanced investor education systems such as the KCIE's Financial Village in emerging markets, while the Stock Exchange of Thailand expressed a desire to learn more about the KCIE's expert knowledge that has gone into the Village.

TABLE 16-2. NUMBER OF EDUCATIONAL PROGRAM PARTICIPANTS BY YEAR

Year	Investor education	Youth education	Total
2005	1,994	18,991	20,985
2006	5,065	9,843	14,908
2007	13,379	17,743	31,122
2008	13,969	18,752	32,721
2009	22,097	19,214	41,311
2010	10,728	24,350	35,078
2011	18,045	45,843	63,888
2012	20,871	57,858	78,729
2013	37,349	55,795	93,144
Total	143,497	268,389	411,886

Note: Online program participants not included.

KOFIA has also encouraged and supported securities companies seeking to launch their own investor education campaigns in order to enhance local investors' overall understanding of securities transactions. The association has continuously worked towards raising the public's awareness of financial investment through various education programs and the distribution of educational materials and brochures. Additionally, to provide greater investment information to the public, KOFIA operates its Securities Library, contributing to the establishment of a sound financial investment culture in Korea.

The securities savings campaign is a good example of KOFIA's efforts to create a long-term financial investment culture in Korea, and to raise investors' confidence in the capital market. The campaign aims to make the public view the securities market as a stable and reliable channel for asset accumulation and management for their household income. KOFIA is taking a multidirectional approach to this campaign, running media advertisements and holding investor education programs.

KOFIA also operates a Consumer Protection Office to protect the rights and interests of consumers. It offers investors information and services to help consumers make rational decisions and provides support to members' consumer protection activities, including education on dispute prevention. Additionally, the office mediates financial disputes between financial consumers and financial investment companies, and offers a financial transaction inquiry service for bereaved heirs as well.

4) OPERATION OF THE OVER-THE-COUNTER MARKETS

KOFIA manages and operates FreeBoard, an over-the-counter market that was created in 2005. Stocks not listed on the KRX market are eligible to be listed on FreeBoard, and KOFIA is responsible for listing and delisting such stocks. In addition, the association holds the authority to propose or revise the rules and regulations governing the market's operation and disclosure requirements.

KOFIA also manages and administers the OTC bond market in Korea. Since most bonds in Korea are traded on the OTC market, KOFIA plays an important role in this secondary market. To enhance the transparency of OTC bond trading, KOFIA provides market participants with essential information such as the details of bond trading, mark-to-market yields, representative bond yields, and final quotation yields for different bond types on its website (www.kofia.or.kr). To further enhance investor protection, the ATS system was introduced in 2010 to facilitate greater transparency and more transactions in OTC bond trading.

In addition, KOFIA has managed and operated the OTC market for securities which are not listed on the KRX or KOSDAQ since 2000. In 2005, this market changed its name to FreeBoard.
The number of companies listed on FreeBoard peaked at 183 at the end of 2002. However, as the venture boom subsided, that number had dropped to 52 as of the end of December 2013, consisting of 34 ordinary companies, 17 venture companies, and 1 Technopark-supported company.

TABLE 16-3. COMPANIES LISTED ON FREEBOARD

(Unit: number of companies)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Total listed issuers	132	176	183	107	69	62	56	54	70	66	71	63	52	52
Newly listed issuers	134	55	30	11	2	11	8	7	25	6	18	11	6	4
Delisted	2	11	23	87	40	18	14	9	9	14	13	19	17	4
Pre-listed issuers	-	-	-	-	-	-	-	-	8	76	116	110	57	0

The daily trading value on FreeBoard has shown a steady decrease after it peaked at KRW 674mn in 2000. It reached KRW 100mn as of the end of December 2013.

TABLE 16-4. TRADING ON THE FREEBOARD

(Unit: thousand shares, 100 million won)

		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Trading value	Daily average	6.74	3.41	2.41	0.70	0.41	0.75	0.77	1.71	1.28	0.61	2.31	2.0	1.0	1.0
	Accumulative amount	1,227	841	584	172	102	187	190	420	318	155	581	498	259	246
Total market capitalization		1.03	1.29	1.37	1.08	0.38	0.44	0.42	0.46	5.74	0.74	0.81	0.86	0.59	0.62

5) MANAGEMENT OF GLOBALLY COMPETITIVE FINANCIAL INVESTMENT PROFESSIONALS

Under the FSCMA, KOFIA is responsible for the registration and management of financial investment professionals, including certified investment advisors, certified research analysts, and certified investment managers. KOFIA established the Regulations on Investment Professionals and Qualifying Examinations, which consists of provisions on the registration and management of financial investment professionals, administration of qualification exams, and operation of classes and continuing education. Also, a comprehensive infrastructure was built across the industry to streamline the business activities of professionals.

Certified investment advisors, who make up the largest category of financial investment professionals, are responsible for providing investment recommendations or advice about a financial product to consumers. According to the kind of financial product they primarily deal with, these advisors can be

classified as a certified fund investment advisor, certified securities investment advisor, and certified derivatives investment advisor. Certified investment managers, generally known as fund managers, manage collective investment property, trust property, or discretionary investment property. They can be classified into five groups depending on the type of investment they specialize in: financial investment products, real estate, Social Overhead Capital (SOC), hedge funds, or investment management of overseas resource development projects. Certified research analysts create, evaluate, or rate analysis reports that provide useful information to investors, containing predictions or recommendations about the value of certain financial products.

In addition, KOFIA handles the registration and management of many other professionals: certified investment advisory officers, who are in charge of monitoring and supervising the activities of investment advisors and brokers in each branch or office; certified financial risk managers, who manage various financial risks as a member of a risk-management team in an organization; and credit rating agents, who set, evaluate, and approve credit ratings in a credit rating agency.

As of the end of December 2013, the number of financial investment professionals registered with KOFIA was 310,380.

TABLE 16-5. REGISTRATION STATUS OF FINANCIAL INVESTMENT PROFESSIONALS

(Unit: # of people)

Types of certification		Number of people
Financial investment professionals	Certified Fund Investment Advisor	132,186
	Certified Securities Investment Advisor	99,583
	Certified Derivatives Investment Advisor	49,803
	Certified Investment Advisory Officer	14,811
	Certified Investment Manager	11,840
	Certified Research Analyst	1,335
	Certified Financial Risk Manager	227
	Credit Rating Agent	205
Professionals in fund-related companies	Fund Administrative Service Professional	223
	Bond Pricing Agent	51
	Fund Pricing Agent	116
	Total	310,380

6) TRAINING AND CONTINUING EDUCATION FOR FINANCIAL INVESTMENT PROFESSIONALS

The Korea Institute of Financial Investment (KIFIN), a subsidiary of KOFIA, offers an array of learning courses on financial investment instruments to meet the needs of the financial investment industry. The principal objective of KIFIN is to provide the industry with continued education and training in order to foster high-quality professionals. The courses are broadly classified into professional education on specialty building for practitioners, and mandatory education for certification or skill maintenance purposes. Currently, KIFIN runs 124 classes in 9 different spheres, categorized into three groups. KIFIN also offers advanced courses, each tailored to the needs of its member companies. KIFIN started running its website in July 2000, with the total number of individuals that have signed up online reaching 408,955.

TABLE 16-6. NUMBER OF TRAINEES ENROLLED IN KIFIN COURSES

(Unit: # of people)

Year	Professional Education		Mandatory Education*		Total
	In-class	E-Learning	In-class	E-Learning	
2010	2,804	3,057	744	39,464	46,069
2011	2,823	3,655	1,398	59,100	66,976
2012	3,597	8,680	1,130	63,269	76,676
2013	3,453	11,625	544	59,145	74,767

Note: *Refresher, skill-building and preliminary education courses offered to help financial investment professionals acquire and maintain their certification and specialties.

7) GLOBAL ACTIVITIES

KOFIA researches and analyzes domestic and international financial markets, and makes policy recommendations to the Korean government. The association also publishes the annual guide "Capital Market in Korea," a publication which contains market survey reports and useful information about the Korean capital market. The Capital Market in Korea report is also available on the KOFIA website.

KOFIA is also actively involved in international activities and is a member of several international organizations: the International Council of Securities Associations (ICSA), the Asia Securities Forum (ASF), the International Forum

for Investor Education (IFIE), the International Organization of Securities Commissions (IOSCO), the International Investment Funds Association (IIFA), etc. Through international conferences and events, KOFIA exchanges information, maintains positive international relations and cooperates with respective members on policy issues that have implications for Korea.

II. SELF-REGULATORY FUNCTION OF KOFIA

1. Importance of Self-Regulation

1) MEANING OF SELF-REGULATION

Self-regulation generally means regulation of the behaviour and activities of the members of an organization using a set of rules established by the organization. In other words, self-regulation is a type of discretionary supervision of an industry, which voluntarily establishes rules and organizations with the purpose of regulating the activities of the industry, supervises its members' compliance with the regulations, and imposes sanctions on a member that breaches the regulations.

2) NECESSITY AND USEFULNESS OF SELF-REGULATION

As it is almost impossible for official regulation exercised by the government or government authorities to regulate all business activities due to limited resources, self-regulation is considered necessary as a complement to official regulation. On top of that, official regulation is currently facing multi-faceted challenges: both the number of entities to regulate and the scope of regulation expanded, raising the overall cost of regulation, including budgets; the capacity to respond to the changes in the financial environment in a timely and flexible manner is limited; and overly strict measures can restrict the creativity and autonomy for financial investment companies to develop new business models, etc., which can decrease the sales activity and weaken the global competitiveness of the companies. In addition, some ethical issues lie out of the scope of laws and regulations.

On the contrary, self-regulation is based on the expertise of the industry itself, and its flexible operational processes and rules can enable the industry to

promptly respond to changes in the financial environment. It also can help improve the efficiency of official regulation at a low supervision cost and offset the shortcomings of official regulation. Lastly, it can impose ethical regulations of a higher level than required by laws and official regulations, which can strengthen the preventive effect of laws and regulations.

Self-regulation plays an important role in the perspective of deregulation as well, because in most cases, "deregulation" does not mean the "end of regulation," but rather the "privatization of regulation" or "internalization of regulation." Therefore, as the financial industry develops, self-regulation should play a bigger role, as seen in the cases of many developed countries.

Assuming that the total number of regulations is fixed, there should be an appropriate balance and allocation of roles between official regulation and self-regulation to improve the overall effectiveness of regulations. For example, self-regulation is more effective in regulating business practices than official regulation.

2. Self-Regulation by KOFIA

KOFIA is a unique organization, as its role combines self-regulatory and member support functions. As such, it is committed to minimizing potential conflicts of interest while maximizing the synergy effect of the two functions.

Since the merger of its three parent associations, KOFIA has overseen a wide spectrum of areas in the Korean financial investment industry. It conducts its role and function as a Self-Regulatory Organization (SRO) not only in individual financial sectors, such as securities, derivatives, collective investment schemes, investment advisory services, discretionary services, and trusts, but also in the overall capital market. For this purpose, KOFIA has worked on the proper division of roles and coordination among sectors.

In addition, to ensure its ability to effectively function as an SRO, KOFIA maintains the Self-Regulation Committee (SRC) which is independent from its Board of Directors. At the same time, it strives to maximize the synergy effect of its member support function and self-regulatory function by continuing to have a close relationship with the financial investment industry and implementing market-friendly self-regulatory activities.

1) ORGANIZATIONAL STRUCTURE

(a) Self-Regulation Committee (SRC)

Pursuant to KOFIA's Articles of Association, the SRC consists of one full-time Chairman with a three-year term and six outside officers (three financial experts, one legal expert, one accounting or financial expert, and one CEO from a regular member), who are part-time committee members with a two-year term. The SRC resolves matters related to the enactment, amendment, and abolishment of business regulations concerning the self-regulation of the members, matters related to the enactment, amendment, and abolishment of regulations concerning dispute resolution for self-regulation, and matters related to the investigation and sanctions of members and the recommendation of sanctions for executives or employees of members. It also makes decisions on matters related to the businesses designated by the General Meeting, and matters recognized to be necessary by the Committee, including other duties of self-regulation to maintain sound business practices among members and protect investors.

(b) Self-Regulation Advisory Committee

The Self-Regulation Advisory Committee may submit its opinions to the Committee or the Chairman. It consists of less than 18 persons, including the CEOs of regular members and financial/legal experts, with a one-year term.

(c) Self-Regulation Division

The Self-Regulation Division performs secretariat functions for the SRC, including the execution of the SRC's resolutions, and conducts self-regulatory activities such as regulation planning, registration of financial professionals, internal control support, member investigations, agreement terms and advertising evaluations, and dispute resolutions.

2) MAIN RESPONSIBILITIES

(a) Major Self-Regulatory Activities Pursuant to Laws

KOFIA performs "self-regulation to maintain sound trade practices among members and to protect the interests of investors," pursuant to §286 (1) 1 of

the FSCMA. It is notable that KOFIA's self-regulatory function is specifically mentioned in the FSCMA.

Details regarding KOFIA's self-regulatory activities pursuant to the laws are described below:

① Registration and management of professional investor designation (FSCMA Enforcement Decree §387 (2) 2 (b); Regulations on Financial Investment Business §1-8)
- Corporations and individuals who are ordinary investors must submit relevant materials to prove the fulfillment of all requirements in order to be designated as professional investors.

② Establishment of internal control standards (Regulations on Financial Investment Business §2-34)
- Financial investment companies must establish internal control standards related to compliance with laws, sound asset management, investor protection, etc., which are to be followed by executives and employees.
- KOFIA may create a template for internal control standards and recommend its use.

③ Establishment of standard working rules on investment solicitation (FSCMA §50 (3))
- Financial investment companies must establish working rules governing investment solicitation which are to be followed by executives and employees, and KOFIA may establish standard working rules governing investment solicitation that are commonly available to financial investment companies.

④ Content of a prospectus (Regulations on Financial Investment Business §4-20 (1) 9)
- Financial investment companies are required to provide prospectuses to investors. Detailed information to be included in a prospectus is specified by KOFIA.

⑤ Registration and qualifications of introducing brokers
- (Registration) The FSC delegates the registration of introducing brokers to KOFIA through a delegation contract. (FSCMA §51 (3); FSCMA Enforcement Decree §57)

- (Qualifications) A person who wishes to be an introducing broker shall complete training as required by KOFIA and recognized by the FSC. (FSCMA Enforcement Decree §56)

⑥ Establishment of a standard agreement and evaluation of individual agreements

- (Standard agreement) KOFIA may establish a standard agreement for financial investment in order to prevent the circulation of unfair agreements. (FSCMA §56 (3))
- (Evaluation of individual agreements) The FSC shall entrust to KOFIA the authority to receive reports and notifications concerning individual agreements, and to review whether an agreement violates any law or investors' interests. (FSCMA §56 (1) & §438 (3); FSCMA Enforcement Decree §387 (2) 2 (a))

⑦ Establishment of advertising standards and preliminary review of advertising plans

- KOFIA conducts self-reviews of investment advertising plans (FSCMA Enforcement Decree §307 (2) 5). Financial investment companies submit an advertising plan to KOFIA in advance, and KOFIA evaluates the appropriateness of the plan. (Regulations on Financial Investment Business §4-12 (1) 3, 4, 5)
- KOFIA may determine additional information to be included with the advertising plan submitted by financial investment companies. (Regulations on Financial Investment Business §4-11 (1) 6)

⑧ Comparative disclosure of commissions of financial investment companies (FSCMA §58 (3) & (4))

- KOFIA shall be notified of commission standards and charging procedures by financial investment companies, and disclose such information for each company.

⑨ Establishment of standards on providing and receiving property interest (Regulations on Financial Investment Business §4-18 (2) & (4), §4-61 (2) & (4), §4-62 (2) & (4), §4-76 (2) & (4), §4-92 (2) & (4))

- KOFIA may establish standards on the provision of direct and indirect property interest related to business activities of investment companies to financial investment companies, the receipt of such interest by the companies from investors or counterparties, and their limits.

⑩ The scope of property interest related to research and analysis materials, and the content and method of notification of property interest (Regulations on Financial Investment Business §4-20 (1) 5 (g))

- Persons preparing research and analysis materials must report property interest, in the case that they have property interest in financial instruments they recommend. KOFIA determines the scope of property interest, and the content and method of notification of such interest.

⑪ Credit extension

- Regarding loans collateralized with deposited securities issued by investment dealers or brokers, KOFIA may establish detailed standards on securities that should not be posted as collateral. (Regulations on Financial Investment Business §4-24 (3))
- Regarding credit extension by investment dealers or brokers, KOFIA determines the appraisal values of collateral securities which are not specified in the Regulations on Financial Investment Business. (Regulations on Financial Investment Business §4-26 (1))

⑫ Dispute resolution (FSCMA §286 (1) 2; §288)

- KOFIA performs dispute resolutions related to the business activities of financial investment companies, for issues arising between clients and financial investment companies.
- KOFIA operates the Dispute Resolution Committee to ensure fair mediation.

⑬ Registration and management of experts (FSCMA §286 (1) 3)

- KOFIA is responsible for registering and managing various types of financial experts, including investment advisors, analysts and fund managers, as well as administering qualification exams for 5 types of professionals.
- KOFIA imposes disciplinary sanctions on professionals for engaging in illegal or unfair practices.

⑭ Maintenance and management of disciplinary records of executives and employees of financial investment companies (FSCMA Enforcement Decree §307 (2) 1)

- Financial investment companies must report to KOFIA those employees of financial investment companies who have received disciplinary sanctions consisting of a reprimand or higher. KOFIA creates and maintains a blacklist of such employees.

⑮ Job training and ethics education for executives and employees of financial investment companies (FSCMA Enforcement Decree §307 (2) 4)
- KOFIA provides training and education to enhance professional capacity, and ethicality of executives and employees of financial investment companies.

⑯ Inspection authority (FSCMA Enforcement Decree §372 (1))
- The Governor of the FSS may delegate inspection authorities to KOFIA regarding (1) matters on the conduct of business of experts (professionals) and introducing brokers; (2) securities underwriting; and (3) compliance with agreement terms (through delegation contracts).

* Regarding illegal or unfair practices discovered during inspections, penalties for the violation of laws will be applied by the FSS, while those for the violation of KOFIA regulations will be applied by KOFIA.

(b) Independent Self-Regulatory Activities

① Regulation of securities underwriting
- Setting a standard for allocation of public offering shares according to subscriber types in initial public offerings (IPOs)
  (Employee Stock Ownership Association – 20%, institutional investors – 60%, ordinary investors – 20%)
- Restricting the holdings of lead managers and limit on over-allotment options(Corporations holding stakes of 5% or more are not allowed to be a lead manager; over-allotment is limited to an amount up to 15% of the initial issuance.)

② Restriction on hiring
- Restricting financial investment companies from hiring unqualified employees
  (A financial investment company must not recruit a person who was punished with disciplinary dismissal if five years have not lapsed since the date of the disciplinary action.)

③ Inquiry system on notification of punishment details
- Providing a list of employees of financial investment companies who have received disciplinary sanctions and details of their punishment

④ Research and analysis services
- Securing independence of research and analysis materials; restrictions on trading
- Restricting the release of research and analysis materials; compulsory disclosure of a financial investment analyst's proprietary interest

⑤ Foreign exchange margin trading
- Setting guidelines for matters necessary when a client entrusts foreign exchange margin trading to a financial investment company (e.g. trading procedures, quotation provision methods, duty to explain, disclosure of financial status, etc.)

⑥ Funds sales guidelines
- Setting guidelines to be followed by financial investment companies when selling funds to ensure investor protection

⑦ Deliberation of new products and imposition of exclusive rights for new products
- Protecting exclusive rights to use new products to promote the development of new financial products by financial investment companies (Evaluation of the appropriateness of the exclusive right to use new products through a deliberation committee)

⑧ Account management and payment of compensation, etc.
- Setting guidelines to be followed for merging or closing investors' accounts
- Regulating investor deposits to which financial investment companies should pay compensation

⑨ Standard Rules and Best Practices
- Provision of various Standard Rules and Best Practices to facilitate the internal control of financial investment companies

3) SANCTIONS OF THE SELF-REGULATORY COMMITTEE

(a) Cases where the relevant statutes of the FSCMA or finance-related laws have been violated or neglected;

(b) Cases where the regulations, orders or punishments of the supervisory authorities have been violated, or cases where the supervisory authorities

impose such measures as the cancellation of approval/registration for financial service businesses, business suspensions, the request for the dismissal of an executive or employee, etc.

(c) Cases where the relevant regulations of KOFIA, including the Articles of Association or duties, have been violated or neglected;

(d) Cases where matters of resolution for the General Meeting, the Board or the Committee have not been abided; and

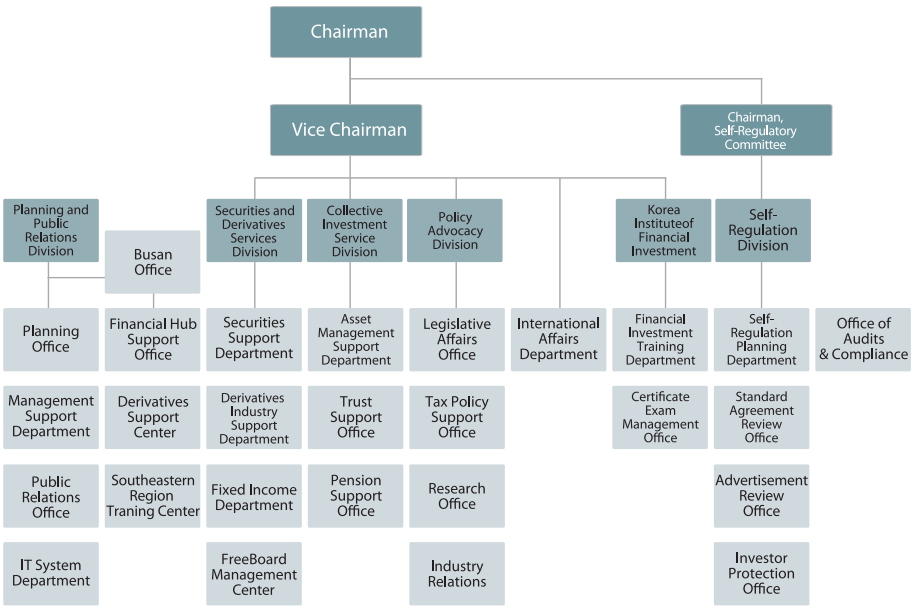
(e) Other cases that fall under any of Items (a) through (d) where unfair or unsound business practices have disturbed the fair trading order of the capital market, or go against investors' interests.

In addition, the SRC may impose against a member of KOFIA any of the following disciplinary sanctions: a request for the member to be barred from the General Meeting; suspension of membership; suspension of all or part of the duties provided to the member by KOFIA; imposition of fines (may be imposed with other sanctions); a warning; and a caution. Against the executives of the member company, the SRC may recommend dismissal, suspension of business practices for up to six months, a warning, a caution, etc. Against the employees of the member company, the SRC may recommend disciplinary dismissal, suspension, a salary reduction, a reprimand, a caution, etc. Furthermore, the SRC may issue a request for improvement, adjustment or the submission of a confirmation letter on its corrective actions, in the case where the illegal and unfair practices of the member company are due to a lack of internal regulations or internal control, or it is deemed necessary to restore them to normal status.

III. ORGANIZATIONAL STRUCTURE

KOFIA operates one subsidiary institution in Busan, eight departments, and 14 offices under five divisions.

CHART 16-2. ORGANIZATIONAL STRUCTURE



IV. MEMBERSHIP

KOFIA offers three different types of memberships: regular, associate and special. Regular members consist of licensed financial investment services companies. Associate members are registered financial investment firms and concurrently-run financial investment business entities. Special members include financial investment-related institutions, general administrative service companies, fund and bond pricing companies, and credit rating agencies. As of May 2014, KOFIA has 165 regular members, 120 associate members, and 24 special members.

TABLE 16-7. TYPES OF MEMBERSHIP

Regular members	Authorized financial investment firms (dealing, brokerage, collective investment, trust businesses) Securities firms, asset management firms, and futures firms
Associate members	Registered financial investment firms (discretionary investment businesses, investment advisory businesses), concurrently-run financial investment business entities
Special members	General administration companies, collective investment scheme assessment companies, bond assessment companies, credit rating agencies, Korea Listed Companies Association, KOSDAQ Listed Companies Association, and Korea Securities Depository.

FACTBOOK

I. FINANCIAL INVESTMENT INDUSTRY

Securities Companies

1) CURRENT STATUS

Year	Total asset (100mn. won)	Total liability (100mn. won)	Total equity (100mn. won)	Operating profit (100mn. won)	Net profit (100mn. won)	ROA (%)	ROE (%)	No. of companies	No. of units
2000	435,388	318,513	116,875	2,565	-1,584	-0.3	-1.3	64	1,795
2001	587,896	457,635	130,261	16,204	9,228	1.8	7.5	61	1,829
2002	504,761	392,188	112,573	-81	-6,001	-1.1	-4.9	60	1,779
2003	483,688	334,928	148,760	20,706	12,476	2.5	9.5	59	1,674
2004	519,757	361,369	158,388	9,018	3,049	0.6	2.0	57	1,531
2005	682,271	485,819	196,452	35,804	37,148	6.2	20.9	54	1,542
2006	958,240	737,018	221,222	29,110	26,017	3.2	12.5	54	1,585
2007	1,308,669	1,011,435	297,234	52,407	44,098	3.9	17.0	54	1,782
2008	1,488,068	1,170,436	317,632	25,382	20,202	1.4	6.6	60	1,861
2009	1,769,781	1,416,729	353,052	36,410	29,473	1.8	8.8	62	1,852
2010	1,997,898	1,622,404	375,494	30,902	28,051	1.5	7.7	62	1,905
2011	2,370,976	1,950,020	420,956	30,145	22,126	1.0	5.6	62	1,827
2012	2,682,984	2,264,433	418,551	17,443	12,420	0.5	3.0	62	1,623
2013	2,704,128	2,296,693	407,434	4,080	-1,687	-0.1	-0.6	z 62	1,534

(Financial Supervisory Service) / (No. units=Domestic branches+Domestic operational sub-branches)

Note: In December 2013, 52 out of 62 securities companies transformed into corporations whose settlement of account takes place in December.

Performance indices for FY2013 were calculated as of the end of December 2013, based on the aggregation of data between April and December (three quarters). The data was converged into annual rates for items written as a percentage. (the same applies for other tables)

2) PROFIT AND LOSS

Type	FY'11 (Apr. 2011 ~ Mar. 2012)	FY`12 (Apr. 2012 ~ Mar. 2013)	FY`12 (Apr. ~ Dec. 2012, A)	FY`13 (Mar. ~ Dec. 2013, B)
Commission profit	79,306	60,942	45,544	44,288
Custody commission	54,563	37,002	27,834	26,237
Underwriting, management, etc.	5,569	5,403	4,213	3,705
Fund sales	5,250	4,290	3,153	3,204
Asset management	2,757	2,010	1,501	1,499
Valuation and dealing of securities	140	525	-1,071	-8,554
Interest income	73,321	77,701	58,355	57,270

Asset Management Companies

1) CURRENT STATUS

Year	Total asset (100mn. won)	Total liability (100mn. won)	Total equity (100mn. won)	Operating profit (100mn. won)	Net profit (100mn. won)	ROA (%)	ROE (%)	No. of companies
2004	16,292	1,248	15,044	1,132	260	1.6	1.7	45
2005	17,999	1,623	16,376	3,281	2,522	14.7	16.1	44
2006	20,829	2,324	18,505	3,650	2,629	13.5	15.1	49
2007	27,134	4,167	22,967	6,510	5,174	21.6	25.0	49
2008	31,536	5,306	26,231	5,855	4,037	13.8	16.4	62
2009	34,066	4,310	29,756	6,148	4,528	13.8	16.2	69
2010	36,325	5,025	31,300	5,248	3,909	11.1	12.8	80
2011	38,050	5,241	32,809	4,518	3,036	8.2	9.5	82
2012	39,268	4,403	34,865	4,456	3,280	8.5	9.7	84
2013	41,904	5,483	36,420	3,936	3,251	8.0	9.1	84

2) PROFIT AND LOSS

Type	FY'11 (Apr. 2011 ~ Mar. 2012)	FY`12 (Apr. 2012 ~ Mar. 2013)	FY`12 (Apr. ~ Dec. 2012)	FY`13 (Mar. ~ Dec. 2013)
Asset management commission	7,043	7,143	4,227	4,779
Management fee of collective investment vehicles	27,899	26,554	15,836	16,292

Futures Companies

1) CURRENT STATUS

Year	Total asset (100mn. won)	Total liability (100mn. won)	Total equity (100mn. won)	Operating profit (100mn. won)	Net profit (100mn. won)	ROE (%)	No. of companies
2008	25,604	20,489	5,116	1,309	992	19.0	13
2009	21,511	16,914	4,597	885	643	13.0	10
2010	21,267	16,561	4,706	691	513	11.0	9
2011	23,529	19,043	4,486	561	403	9.0	7
2012	28,994	24,641	4,353	256	137	3.1	7
2013	22,468	18,240	4,228	54	34	0.8	7

*Calculated as of the end of the fiscal year (March). However for 2013, aggregation of data at the end of December was used as all seven futures companies changed the fiscal year.

2) PROFIT AND LOSS

(Unit: 100mn. won)

Type	FY'11 (Apr. 2011 ~ Mar. 2013)	FY`12 (Apr. 2012 ~ Mar. 2013)	FY`13 (Apr. ~ Dec. 2013)
Commission profit	1,426.8	1,244.8	869.2
Valuation and dealing profit of derivative instruments	1,610.8	799.1	880.4
Other profit	695.5	516.3	307.8

Real Estate Trust Companies

Year	Total asset (100mn. won)	Total liability (100mn. won)	Total equity (100mn. won)	Operating profit (100mn. won)	Net profit (100mn. won)	ROA (%)	ROE (%)	No. of companies	No. of executives and employees
2009	17,482	8,717	8,764	1,187	909	5.2	10.4	11	990
2010	17,132	8,605	8,528	-242	-154	-0.9	-1.8	11	1,089
2011	14,870	5,585	9,286	857	574	3.9	6.2	11	1,131
2012	15,453	5,075	10,378	1,500	1,132	7.3	10.9	11	1,177
2013	15,807	4,218	11,589	1,651	1,222	9.4	13.4	11	1,185

Investment Advisory Companies

Year	Total asset (100mn. won)	Total liability (100mn. won)	Total equity (100mn. won)	Operating profit (100mn. won)	Net profit (100mn. won)	ROA (%)	ROE (%)	No. of companies	No. of executives and employees
2007	5,053	674	4,379	1,181	846	19.4	22.2	84	-
2008	4,324	400	3,924	-296	-303	-6.5	-7.3	91	-
2009	5,546	573	4,973	493	338	6.9	7.6	116	1,040
2010	7,292	1,071	6,221	1,145	877	13.7	15.7	141	1,258
2011	7,050	871	6,179	557	355	5.0	5.7	159	1,444
2012	6,473	765	5,708	213	146	2.2	2.5	157	1,361
2013	6,716	861	5,855	305	193	3.8	4.4	156	1,316

Source: Financial Supervisory Service, Korea Financial Investment Associate

II. CAPITAL MARKET

Stock Market

1) CURRENT STATUS

Year	Index (pt)	Trading volume (million shares)	Trading value (trillion won)	Market capitalization (trillion won)	No. of issues
1990	696.11	1,431	21	79	1,115
1991	610.92	4,094	63	73	1,013
1992	678.44	7,064	91	85	1,014
1993	866.18	10,398	170	113	1,045
1994	1,027.37	10,910	230	151	1,089
1995	882.94	7,656	143	141	1,122
1996	651.22	7,785	143	117	1,143
1997	376.31	12,125	162	71	958
1998	562.46	28,533	193	138	925
1999	1,028.07	69,359	867	350	916
2000	504.62	73,785	627	186	902
2001	693.70	116,417	491	256	884
2002	627.55	209,168	742	259	861
2003	810.71	133,876	548	355	856
2004	895.92	92,851	556	413	844
2005	1,379.37	116,440	786	655	858
2006	1,434.46	68,937	848	705	885
2007	1,897.13	89,506	1,363	952	907
2008	1,124.47	88,149	1,287	577	928
2009	1,682.77	122,871	1,466	888	925
2010	2,051.00	95,596	1,411	1,142	927
2011	1,825.74	87,732	1,702	1,042	938
2012	1,997.05	120,647	1,196	1,154	930
2013	2,011.34	81,096	986	1,185	918

Source: Korea Exchange

2) AMOUNT OF STOCK HELD IN THE STOCK MARKET BY INVESTOR TYPE

(unit : trillion won)

Year	Individual	Foreign	Institutional	Others	Total
2003	70	143	59	83	355
2004	74	173	73	92	413
2005	121	260	128	146	655
2006	126	263	155	161	705
2007	207	308	202	235	952
2008	156	166	71	183	576
2009	275	290	111	211	887
2010	241	375	160	362	1,139
2011	215	342	141	341	1,039
2012	234	401	193	326	1,154

Source: Korea Exchange

3) PROPORTION OF STOCK HELD IN THE STOCK MARKET BY INVESTOR TYPE

(unit : %)

Year	Individual	Foreign	Institutional	Others
2003	19.7	40.1	16.7	23.5
2004	18.0	42.0	17.6	22.4
2005	18.4	39.7	19.6	22.3
2006	17.9	37.3	22.0	22.8
2007	21.8	32.4	21.2	24.7
2008	27.1	28.8	12.4	31.8
2009	31.0	32.7	12.5	23.8
2010	21.2	33.0	14.0	31.8
2011	20.7	32.9	13.6	32.8
2012	20.6	34.7	16.7	28.0

Source: Korea Exchange

4) AVERAGE TRADING VALUE IN THE STOCK MARKET BY INVESTOR TYPE

(unit : trillion won)

Year	Individual	Foreign	Institutional	Others	Total
2003	357	85	105	1	548
2004	321	125	109	1	556
2005	478	161	145	1	786
2006	435	219	193	1	848
2007	724	333	302	3	1,363
2008	638	327	321	2	1,287
2009	856	249	336	25	1,466
2010	770	285	329	27	1,411
2011	944	312	415	31	1,702
2012	608	275	294	19	1,196
2013	458	281	232	12	986

Source: Korea Exchange

5) PROPORTION OF TRADING VALUE IN THE STOCK MARKET BY INVESTOR TYPE

(unit : %)

Year	Individual	Foreign	Institutional	Total
2003	65.3	15.5	19.2	0.0
2004	57.8	22.5	19.6	0.1
2005	60.9	20.5	18.5	0.2
2006	51.2	25.9	22.8	0.1
2007	53.2	24.5	22.2	0.2
2008	49.5	25.4	24.9	0.1
2009	58.4	17.0	22.9	1.7
2010	54.6	20.2	23.3	1.9
2011	55.5	18.3	24.4	1.8
2012	50.8	23.0	24.6	1.6
2013	46.5	28.7	23.5	1.2

Source: Korea Exchange

KOSDAQ Market

1) CURRENT STATUS

Year	Index (pt)	Trading volume (million shares)	Trading value (trillion won)	Market capitalization (trillion won)	No. of issues
1997	972.50	47	1	7	408
1998	751.80	206	2	8	350
1999	2561.40	8,673	107	99	474
2000	525.80	51,050	578	29	615
2001	722.10	94,393	425	52	732
2002	443.60	78,182	294	37	856
2003	448.70	100,835	266	37	894
2004	380.33	71,441	156	31	907
2005	701.79	148,890	446	71	931
2006	606.15	134,050	428	72	975
2007	704.23	151,252	501	100	1,034
2008	332.05	125,464	309	46	1,049
2009	513.57	196,771	531	86	1,036
2010	510.69	161,403	483	98	1,035
2011	500.18	134,765	558	106	1,036
2012	496.32	146,478	528	109	1,010
2013	499.99	97,591	450	119	1,014

Source: Korea Exchange

2) AMOUNT OF STOCK HELD IN THE KOSDAQ MARKET BY INVESTOR TYPE

(unit : trillion won)

Year	Individual	Foreign	Institutional	Others	Total
2003	21	5	2	8	37
2004	18	5	3	6	31
2005	43	10	6	12	71
2006	44	11	7	10	72
2007	58	17	9	16	100
2008	31	4	2	10	46
2009	61	6	6	12	85
2010	56	10	7	24	98
2011	65	8	7	26	106
2012	69	9	7	24	109

Source: Korea Exchange

3) PROPORTION OF STOCK HELD IN THE KOSDAQ MARKET BY INVESTOR TYPE

(unit : %)

Year	Individual	Foreign	Institutional	Others
2003	57.4	14.4	6.2	21.9
2004	57.9	15.4	8.7	18.0
2005	61.1	13.5	9.0	16.5
2006	61.4	14.6	9.4	14.5
2007	58.2	17.3	8.5	16.0
2008	66.2	8.2	3.4	22.2
2009	71.5	7.4	7.1	14.1
2010	57.9	10.2	6.9	25.0
2011	61.3	7.9	6.6	24.3
2012	63.5	8.2	6.3	22.0

Source: Korea Exchange

4) AVERAGE TRADING VALUE IN THE KOSDAQ MARKET BY INVESTOR TYPE

(unit : trillion won)

Year	Individual	Foreign	Institutional	Others	Total
2003	247	7	13	0.1	266.38
2004	140	7	8	0.1	155.70
2005	418	10	18	0.3	446.38
2006	396	13	18	0.3	427.51
2007	459	19	22	0.4	500.75
2008	278	15	15	0.8	308.98
2009	497	11	19	4	530.96
2010	446	13	19	5	483.09
2011	514	18	21	5	558.01
2012	484	17	22	6	528.03
2013	400	22	23	4	450.37

Source: Korea Exchange

5) PROPORTION OF AVERAGE TRADING VALUE IN THE KOSDAQ MARKET BY INVESTOR TYPE

(unit : %)

Year	Individual	Foreign	Institutional	Others
2003	92.6	2.7	4.7	0.0
2004	89.8	4.8	5.4	0.0
2005	93.6	2.2	4.1	0.1
2006	92.6	3.1	4.2	0.1
2007	91.6	3.9	4.4	0.1
2008	90.0	5.0	4.7	0.3
2009	93.5	2.0	3.6	0.8
2010	92.3	2.6	4.0	1.1
2011	92.1	3.2	3.8	1.0
2012	91.6	3.2	4.2	1.1
2013	88.9	4.8	5.1	1.0

Source: Korea Exchange

Market Related Funds

1) MARKET FUNDS

(unit : %)

Year	Investor's deposit	Deposits for exchange-traded derivatives	Sales balance of securities under RP to consumers	Receivables for brokerage	Amount of offset trading against receivables for brokerage	Proportion of offset trading against receivables for brokerage
1998	37,773	4,327	25,247	2,195	0	0
1999	69,919	10,159	13,149	4,383	0	0
2000	60,576	9,367	24,204	1,740	0	0
2001	95,579	15,358	29,459	5,029	0	0
2002	81,406	25,273	31,446	5,648	0	0
2003	95,437	29,568	49,765	5,260	0	0
2004	81,309	36,374	51,198	4,945	0	0
2005	118,956	45,551	79,139	20,454	0	0
2006	84,489	46,810	194,193	8,871	163	0.8
2007	95,087	64,670	323,136	1,799	0	0
2008	92,406	72,036	384,144	1,425	0	0
2009	117,865	84,121	465,916	2,409	0	0
2010	137,024	80,307	551,377	1,882	74	3.1
2011	174,270	81,314	588,740	1,859	0	0
2012	170,749	77,421	623,391	1,209	21	1.1
2013.3	172,475	78,900	700,346	1,168	53	3.9
2013	139,004	73,435	695,656	933	20	2

2) AMOUNT OF STOCK HELD IN THE KOSDAQ MARKET BY INVESTOR TYPE

(unit : 100million won)

Year	RP-type	MMF-type	Merchant bank-type	Others	Total
2006	51,047	7,038	28,546	0	86,631
2007	185,257	23,677	45,822	17,024	271,780
2008	201,628	30,339	52,925	22,258	307,151
2009	251,086	37,821	62,313	31,118	382,337
2010	276,650	35,827	68,303	58,766	439,545
2011	262,304	29,478	15,063	78,980	385,825
2012	261,368	29,156	18,627	96,113	405,264
2013.3	269,959	29,643	18,974	104,990	423,567
2013	277,127	29,048	23,756	87,919	417,850

Source: Korea Exchange

FreeBoard Market

Year	Index (pt)	Trading volume (1000 shares)	Trading value (million won)	Market capitalization (100mn won)	No. of designated companies
2000	-	104,062	122,660	10,289	129
2001	-	208,922	84,068	12,915	175
2002	-	190,442	58,479	13,753	182
2003	-	62,737	17,186	10,803	107
2004	-	13,649	10,224	3,848	69
2005	-	20,553	18,738	4,406	62
2006	1,179.24	28,837	19,003	4,180	56
2007	905.61	35,081	42,009	4,574	54
2008	8,534.58	29,075	31,833	57,355	70
2009	13,079.86	81,976	15,463	7,408	66
2010	13,001.28	87,481	58,054	8,147	71
2011	12,918.62	64,037	49,806	8,586	63
2012	12,378.03	36,069	25,907	5,894	52
2013	13,632.19	31,730	24,625	6,201	52

*The Freeboard index has been calculated since 2006.

Bond Market

1) INTEREST RATE OF MAJOR BONDS

(unit : %)

Year	3-yr KTB		5-yr KTB		10-yr KTB	
	Year end	Year average	Year end	Year average	Year end	Year average
2001	5.910	5.676	6.730	6.202	7.020	6.854
2002	5.110	5.812	5.340	6.299	5.610	6.624
2003	4.820	4.551	5.060	4.765	5.380	5.053
2004	3.280	4.092	3.390	4.328	3.810	4.708
2005	5.080	4.270	5.360	4.530	5.620	4.956
2006	4.920	4.830	5.000	4.960	5.060	5.152
2007	5.740	5.230	5.780	5.277	5.700	5.347
2008	3.410	5.266	3.770	5.365	4.220	5.569
2009	4.410	4.053	4.920	4.641	5.390	5.172
2010	3.380	3.711	4.080	4.300	4.520	4.766
2011	3.340	3.616	3.460	3.885	3.790	4.195
2012	2.820	3.132	2.970	3.242	3.160	3.444
2013	2.858	2.793	3.228	2.999	3.583	3.277

Year	3-yr corporate bond(AA-)		3-yr corporate bond(BBB-)		91-day CD	
	Year end	Year average	Year end	Year average	Year end	Year average
2001	7.040	7.043	11.200	11.370	4.86	5.31
2002	5.680	6.594	9.080	10.484	4.90	4.80
2003	5.580	5.434	9.890	8.882	4.36	4.31
2004	3.720	4.709	8.130	9.134	3.43	3.78
2005	5.520	4.688	9.240	8.709	4.09	3.65
2006	5.290	5.171	8.080	8.187	4.86	4.48
2007	6.770	5.697	9.120	8.404	5.82	5.16
2008	7.720	7.040	12.020	9.894	3.93	5.49
2009	5.530	5.794	11.580	11.757	2.86	2.62
2010	4.270	4.654	10.260	10.675	2.80	2.67
2011	4.210	4.407	10.010	10.378	3.55	3.44
2012	3.290	3.764	8.800	9.334	2.89	3.30
2013	3.286	3.191	8.981	8.836	2.66	2.72

2) ISSUANCE VOLUME OF MAJOR BONDS

(unit : trillion won)

Year	Treasury bond		Municipal bond		Special bond	
	Issued	Outstanding	Issued	Outstanding	Issued	Outstanding
2003	56.4	137.0	2.0	9.7	13.5	119.8
2004	73.8	178.9	1.9	10.1	21.0	115.9
2005	87.0	224.0	2.2	10.8	24.6	117.6
2006	76.1	258.3	2.4	11.6	24.0	104.3
2007	56.9	274.7	2.6	12.3	25.5	116.8
2008	60.5	285.0	2.6	13.1	48.5	135.8
2009	94.6	330.1	4.7	15.3	67.0	177.7
2010	86.7	360.1	4.2	16.0	76.5	225.8
2011	103.0	389.9	3.5	16.9	71.7	256.7
2012	111.8	413.4	3.8	17.1	110.0	318.3
2013	135.6	452.9	4.5	18.3	88.6	355.6

Year	MSB		Financial bond		Corporate bond		Total	
	Issued	Outstanding	Issued	Outstanding	Issued	Outstanding	Issued	Outstanding
2003	91.7	105.5	66.6	126.0	52.1	150.3	282.3	648.4
2004	134.7	142.7	79.5	137.7	44.0	123.8	354.8	709.1
2005	165.1	155.2	89.1	148.9	43.1	116.1	411.1	772.7
2006	149.6	158.4	117.1	191.3	35.1	109.5	404.2	833.3
2007	156.7	150.2	131.5	237.7	37.5	107.9	410.7	899.5
2008	151.4	126.9	139.3	271.6	46.9	117.8	449.3	950.3
2009	375.5	149.2	116.5	272.8	85.7	171.0	744.0	1,116.1
2010	248.2	163.5	111.7	245.7	69.3	191.4	596.4	1,202.5
2011	197.1	159.8	109.5	244.2	85.4	218.9	570.2	1,286.4
2012	167.2	163.1	96.6	242.2	96.1	249.2	585.5	1,403.2
2013	175.0	161.2	105.3	261.2	88.5	270.3	597.5	1,519.5

Source: KOSCOM CHECK

3) OTC BOND TRADING PERFORMANCE

Year end	Treasury bond		Municipal bond		Special bond	
	Outstanding amount	Trading value	Outstanding amount	Trading value	Outstanding amount	Trading value
2001	833	10,044	100	82	1,364	5,076
2002	993	7,617	91	58	1,363	1,379
2003	1,370	10,533	97	64	1,198	1,315
2004	1,789	16,411	101	59	1,159	1,001
2005	2,240	18,809	108	70	1,176	852
2006	2,583	16,564	116	70	1,043	702
2007	2,747	11,693	123	65	1,168	608
2008	2,850	12,619	131	86	1,358	1,234
2009	3,301	22,217	153	125	1,777	2,057
2010	3,601	32,413	160	136	2,258	2,285
2011	3,899	32,201	169	112	2,567	2,440
2012	4,134	34,199	171	142	3,183	3,725
2013	4,529	36,970	183	148	3,556	3,398

Year end	MSB		Financial bond		Corporate bond		Total	
	Outstanding amount	Trading value	Outstanding amount	Trading value	Outstanding amount	Trading value	Outstanding amount	Trading value
2001	791	8,552	858	1,935	1,630	2,643	5,576	28,332
2002	839	7,724	1,229	3,161	1,574	2,269	6,089	22,209
2003	1,055	9,118	1,260	3,039	1,503	1,690	6,484	25,760
2004	1,427	8,567	1,377	2,680	1,238	1,450	7,091	30,169
2005	1,552	10,186	1,489	2,528	1,161	1,252	7,727	33,697
2006	1,584	9,089	1,913	3,182	1,095	1,005	8,333	30,611
2007	1,502	7,652	2,377	2,891	1,079	694	8,995	23,602
2008	1,269	8,939	2,716	4,627	1,178	720	9,503	28,225
2009	1,492	10,779	2,728	5,517	1,710	1,484	11,161	42,178
2010	1,635	14,033	2,457	6,336	1,914	1,581	12,025	56,784
2011	1,598	16,023	2,442	5,807	2,189	2,049	12,864	58,631
2012	1,631	14,765	2,422	5,136	2,492	2,214	14,032	60,181
2013	1,612	13,905	2,612	5,356	2,703	2,100	15,195	61,877

4) TRADING VALUE IN THE OTC BOND MARKET BY INVESTOR TYPE

(unit : trillion won)

Year	Securities	Banks	Asset Management	Insurance	Funds·Credit Union	Foreign investors	Government Municipalities	Individual investors	Others	Total
2003	923.8	539.6	664.2	122.8	44.9	27.8	156.1	57.9	38.8	2,576.0
2004	1,252.4	558.2	701.3	138.2	58.6	13.2	163.5	59.9	71.7	3,016.9
2005	1,630.2	470.9	756.3	138.9	74.1	12.5	180.9	32.7	73.1	3,369.7
2006	1,558.2	376.3	620.7	141.9	82.1	26.2	169.7	11.5	74.5	3,061.1
2007	967.2	416.0	506.5	128.1	82.4	45.4	130.7	14.8	69.2	2,360.2
2008	1,280.1	496.0	493.4	157.6	110.1	93.8	140.1	11.7	39.7	2,822.5
2009	2,125.0	704.4	711.8	243.8	110.0	97.5	104.0	13.9	107.4	4,217.8
2010	3,089.7	1,057.6	758.8	296.1	112.7	145.2	78.9	12.3	127.2	5,678.4
2011	3,464.8	1,000.7	684.8	298.8	116.8	93.4	76.4	10.3	117.0	5,863.1
2012	3,739.0	926.3	631.3	326.7	112.9	94.5	65.3	13.9	108.2	6,018.1
2013	3,898.6	781.0	742.0	324.6	131.8	113.5	63.9	7.3	124.9	6,187.7

5) PROPORTION OF TRADED AMOUNT IN THE OTC BOND MARKET BY INVESTOR TYPE

(unit : %)

Year	Securities	Banks	Asset Management	Insurance	Funds·Credit Union	Foreign investors	Government Municipalities	Individual investors	Others
2003	35.9	20.9	25.8	4.8	1.7	1.1	6.1	2.2	1.5
2004	41.5	18.5	23.2	4.6	1.9	0.4	5.4	2.0	2.4
2005	48.4	14.0	22.4	4.1	2.2	0.4	5.4	1.0	2.2
2006	50.9	12.3	20.3	4.6	2.7	0.9	5.5	0.4	2.4
2007	41.0	17.6	21.5	5.4	3.5	1.9	5.5	0.6	2.9
2008	45.4	17.6	17.5	5.6	3.9	3.3	5.0	0.4	1.4
2009	50.4	16.7	16.9	5.8	2.6	2.3	2.5	0.3	2.5
2010	54.4	18.6	13.4	5.2	2.0	2.6	1.4	0.2	2.2
2011	59.1	17.1	11.7	5.1	2.0	1.6	1.3	0.2	2.0
2012	62.1	15.4	10.5	5.4	1.9	1.6	1.1	0.2	1.8
2013	63.0	12.6	12.0	5.2	2.1	1.8	1.0	0.1	2.0

6) TREND OF NET-BUYING OF FOREIGN INVESTORS IN THE OTC BOND MARKET

(unit : trillion won)

Year	Treasury bond	MSB	Others	Total
2003	-0.1	1.5	1.2	2.6
2004	1.0	0.5	0.3	1.8
2005	1.4	0.0	-0.2	1.2
2006	2.1	2.7	1.6	6.5
2007	21.1	9.8	0.8	31.7
2008	1.3	18.6	1.2	21.2
2009	13.2	39.6	-0.1	52.7
2010	24.7	38.8	0.8	64.3
2011	19.5	19.3	2.5	41.3
2012	6.9	31.2	1.2	39.3
2013	12.4	28.3	-0.1	40.5

7) ANNUAL DEFAULT RATE

(unit : %)

Type	AAA	AA	A	BBB	BB	Lower than B	Investment grade	Speculative grade	Total
1999	0	0	8.18	5.26	2.48	21.43	6.16	7.36	6.5
2000	0	0	0	0.63	3.63	9.52	0.36	4.48	1.77
2001	0	0	0	1.54	5.98	16.67	0.86	7.12	2.91
2002	0	0	0	0	2.96	21.15	0	5.9	2.15
2003	0	0	1.3	0	3.95	5.26	0.36	4.31	1.45
2004	0	0	0	0	13.58	17.86	0	15.33	3.01
2005	0	0	0	0	0	12.68	0	6.87	1.21
2006	0	0	0	2.4	2.13	1.82	0.91	1.96	1.05
2007	0	0	0	0	0	0	0	0	0
2008	0	0	0	0.93	13.33	9.68	0.29	10.87	2.49
2009	0	0	0	7.36	19.4	8	1.65	11.98	3.8
2010	0	0	0	8.87	7.14	14.29	1.36	12.14	2.95
2011	0	0	0.61	1.69	2.5	8.16	0.45	5.62	0.93
2012	0	0	0.57	1.57	5.41	27.03	0.41	16.22	1.54
2013	0	0	0	4.93	15.38	7.41	0.7	13.33	1.9
Average	0	0	0.55	1.91	5.78	11.21	0.78	7.78	2.16

*Default companies not only include bankrupt companies, but also those subject to the Corporate Restructuring Promotion Act and workout, in which rights of debtors are restrained.

*Annaual default rate: Calculated the weighted average of companies evaluated by three domestic credit rating agencies, using individual annual default rates as an evaluation parameter.

III. FINANCIAL INVESTMENT PRODUCT

Funds

1) CURRENT STATUS

Year	AUM of funds (billion won)	Total net asset of funds (billion won)	No. of funds	No. of accounts	Year	AUM of funds (billion won)	Total net asset of funds (billion won)	No. of funds	No. of accounts
1970	1	-	-	-	1999	1,937,367	-	13,606	-
1975	190	-	-	-	2000	1,382,946	-	8,173	-
1980	6,659	-	-	-	2001	1,557,370	1,578,964	6,740	-
1985	58,238	-	128	-	2002	1,748,738	1,730,490	5,616	-
1986	82,544	-	137	-	2003	1,450,368	1,483,021	8,771	3,607,658
1987	97,008	-	140	-	2004	1,869,928	1,901,192	6,492	4,671,102
1988	123,589	-	161	-	2005	2,043,458	2,168,093	7,319	9,872,201
1989	166,191	-	184	-	2006	2,346,150	2,424,331	8,137	12,391,469
1990	232,490	-	363	-	2007	2,964,601	3,184,204	8,907	23,534,523
1991	267,376	-	511	-	2008	3,594,872	2,885,071	9,678	23,329,682
1992	347,483	-	705	-	2009	3,318,799	3,185,154	9,005	20,252,103
1993	485,075	-	1,149	-	2010	3,151,828	3,188,123	9,159	16,963,169
1994	584,581	-	1,404	-	2011	2,984,802	2,773,409	9,735	16,987,817
1995	654,463	-	1,943	-	2012	3,172,727	3,075,923	9,864	15,561,093
1996	708,687	-	2,869	-	2013.3	3,355,965	3,274,618	9,992	15,211,047
1997	901,367	-	5,436	-	2013	3,348,959	3,284,454	10,807	14,642,678
1998	1,948,799	-	13,442	-					

2) AUM OF FUNDS BY FUND TYPE

(unit : 100 million won)

Year	Equity	Hybrid-equity	Hybrid-bond	Bond	MMF	Deri-vatives	Real estate	Real asset	Fund of fund	Special asset	Total
2000	40,750	250,156	261,590	562,395	268,055	-	-	-	-	-	1,382,946
2001	69,191	187,432	305,051	641,676	354,019	-	-	-	-	-	1,557,370
2002	104,831	168,962	364,210	615,913	494,822	-	-	-	-	-	1,748,738
2003	94,007	120,643	271,259	543,938	420,522	-	-	-	-	-	1,450,368
2004	85,796	81,602	265,020	757,495	598,014	47,271	8,610	-	22,227	3,893	1,869,928
2005	261,853	83,533	341,058	513,363	648,463	122,012	25,609	-	34,467	13,099	2,043,458
2006	464,906	88,913	391,214	504,174	571,538	168,455	40,979	-	76,627	39,345	2,346,150
2007	1,163,531	128,783	317,859	408,623	467,390	223,925	68,178	46	93,482	92,785	2,964,601
2008	1,402,143	135,918	256,585	303,417	889,033	278,799	83,980	367	124,435	20,196	3,594,872
2009	1,262,317	134,358	180,025	461,076	716,905	193,347	112,550	367	119,784	38,069	3,318,799
2010	1,009,916	122,722	204,925	525,688	669,182	182,488	140,225	367	130,278	66,037	2,964,601
2011	1,042,009	119,742	182,255	448,436	531,267	229,277	163,701	-	75,271	92,843	2,984,802
2012	945,508	100,450	191,839	468,848	631,380	314,679	199,051	-	87,495	33,478	3,172,727
2013	854,785	98,915	227,147	560,704	664,009	324,493	242,937	-	104,267	71,701	3,348,959

3) TOTAL NET ASSETS OF FUNDS BY MANAGEMENT PERIOD

(unit : 100 million won)

Year	Less than 1 year	1 year ~ 3 years	3 years~5 years	5 years or more	Total
2003	810,416	438,956	192,511	41,094	1,482,976
2004	671,126	946,951	197,482	85,632	1,901,192
2005	876,405	853,828	274,237	163,623	2,168,093
2006	889,231	744,122	457,627	333,350	2,424,331
2007	1,103,038	1,109,973	591,342	379,851	3,184,204
2008	520,210	882,489	515,980	966,392	2,885,071
2009	604,037	900,902	812,712	867,503	3,185,154
2010	767,051	736,038	800,711	884,323	3,188,123
2011	585,685	754,803	501,639	931,282	2,773,409
2012	540,091	824,782	499,808	1,211,243	3,075,923
2013	734,039	798,084	553,507	1,198,824	3,284,454

4) AUM OF SPECIFIED FUNDS

(unit : 100 million won)

Year	CBO	ELS investment fund	ETF	Government and public bonds for short-term financing	Separate taxation	Tax free	Tax free, high-return	Tax free, high-return, high-risk
2003	40,582	37,366	5,367	156,302	29,431	7,628	51	23,956
2004	34,677	64,403	3,617	239,176	14,451	4,310	16	12,451
2005	11,743	86,990	4,045	297,655	5,839	2,056	11	4,149
2006	9,814	105,608	7,673	265,210	4,261	1,378	0	1
2007	5,307	128,876	12,499	208,157	1,943	459	0	804
2008	2,757	162,173	33,994	256,434	607	365	0	510
2009	1,449	95,171	37,899	253,716	598	266	0	378
2010	132	55,933	60,578	243,990	283	1	0	315
2011	6	73,129	99,065	167,010	138	0	0	189
2012	5	75,242	147,177	176,107	42	-	0	128
2013	6	73,742	194,217	212,537	0	28	0	88

Year	Tax free funds for employees	Principal protected	Long term saving for housing	Long-term securities	Index -linked	Credit card bond	High yield
2003	707	8,481	537	15,452	21,460	4,007	53,462
2004	176	10,149	1,149	4,273	18,445	1,019	43,481
2005	0	14,974	2,037	1,312	118,204	0	20,125
2006	0	14,854	3,491	327	29,844	0	13,469
2007	0	7,617	7,128	274	32,071	0	7,071
2008	0	4,853	11,288	240	46,824	0	2,953
2009	0	2,471	14,110	189	96,269	0	1,990
2010	0	813	16,205	155	80,398	0	407
2011	0	694	18,928	258	93,792	0	502
2012	0	701	18,483	264	98,797	0	5,830
2013	0	3,234	14,362	109	95,322	0	8,118

5) SALES VOLUME OF FUNDS BY SALES CHANNEL

Year	Securities companies		Banks		Insurance companies		Others		Total
	Amount (100mn. won)	Proportion (%)	Amount (100mn. won)	Proportion (%)	Amount (100mn. won)	Proportion (%)	Amount (100mn. won)	Proportion (%)	
2003	1,109,285	82.5	233,020	17.3	-	0	2,943	0.2	1,345,248
2004	1,295,531	72.6	486,204	27.3	-	0	1,562	0.1	1,783,297
2005	1,304,957	65.6	639,652	32.2	36,256	1.8	7,379	0.4	1,988,244
2006	1,340,583	58.1	877,177	38.0	51,618	2.2	37,320	1.6	2,306,698
2007	1,518,701	51.9	1,266,839	43.3	89,773	3.1	49,158	1.7	2,924,471
2008	1,644,681	46.6	1,366,974	38.7	126,977	3.6	390,840	11.1	3,529,472
2009	1,759,661	54.1	1,210,441	37.2	136,718	4.2	148,239	4.6	3,255,059
2010	1,827,574	60.0	966,446	31.7	127,396	4.2	126,313	4.1	3,047,729
2011	1,642,707	58.0	915,852	32.3	113,550	4.0	161,041	5.7	2,833,150
2012	1,831,371	61.4	862,918	28.9	129,495	4.3	158,846	5.3	2,982,630
2013	1,962,195	63.2	859,948	27.7	116,239	3.7	165,745	5.3	3,104,127

6) NUMBER OF FUND ACCOUNTS BY SALES CHANNEL

Year	Securities companies		Banks		Insurance companies		Others		Total
	Number (1,000)	Proportion (%)	Number (1,000)	Proportion (%)	Number (1,000)	Proportion (%)	Number (1,000)	Proportion (%)	
2003	3,232	89.6	374	10.4	-	0	1	0	3,607
2004	3,104	66.5	1,566	33.5	-	0	1	0	4,671
2005	3,751	38.0	6,118	62.0	2	0	1	0	9,872
2006	3,825	30.9	8,503	68.6	62	0.5	2	0	12,392
2007	7,082	30.1	15,885	67.5	565	2.4	2	0	23,534
2008	7,242	31.0	15,467	66.3	617	2.6	4	0	23,330
2009	6,484	32.0	13,228	65.3	535	2.6	5	0	20,252
2010	5,601	33.0	10,916	64.4	435	2.6	11	0.1	16,963
2011	5,016	29.5	11,531	67.9	428	2.5	13	0.1	16,988
2012	4,471	28.7	10,692	68.7	386	2.5	12	0.1	15,561
2013	3,867	26.4	10,415	71.1	348	2.4	12	0.1	14,643

7) SALES VOLUME OF INSTALLMENT FUNDS BY FINANCIAL INSTITUTION

Year	Securities companies		Banks		Insurance companies		Others		Total
	Amount (100mn. won)	Proportion (%)	Amount (100mn. won)	Proportion (%)	Amount (100mn. won)	Proportion (%)	Amount (100mn. won)	Proportion (%)	
2005	51,256	36.5	88,977	63.4	14	0	49	0	140,296
2006	78,979	28.1	201,113	71.6	742	0.3	59	0	280,893
2007	130,098	22.3	449,161	76.9	4,639	0.8	100	0	583,998
2008	182,840	23.9	573,042	74.8	9,794	1.3	105	0	765,781
2009	179,433	25.6	511,578	73.0	9,679	1.4	130	0	700,820
2010	161,817	29.8	372,991	68.8	7,269	1.3	284	0.1	542,361
2011	178,534	31.2	384,920	67.3	8,037	1.4	507	0.1	571,998
2012	174,179	32.3	357,660	66.3	7,356	1.4	583	0.1	539,778
2013	155,707	32.3	319,839	66.3	6,193	1.3	503	0.1	482,242

8) NUMBER OF INSTALLMENT FUNDS BY FINANCIAL INSTITUTION

Year	Securities companies		Banks		Insurance companies		Others		Total
	Number	Proportion (%)	Number	Proportion (%)	Number	Proportion (%)	Number	Proportion (%)	
2005	968,178	17.2	4,654,460	82.8	994	0	362	0	5,623,994
2006	1,337,264	17.7	6,160,733	81.8	36,981	0.5	423	0	7,535,401
2007	3,166,955	21.3	11,401,242	76.8	267,931	1.8	503	0	14,836,631
2008	3,429,477	24.0	10,595,039	74.0	283,814	2.0	1,628	0	14,309,958
2009	3,081,597	25.9	8,575,138	72.1	226,337	1.9	2,161	0	11,885,233
2010	2,563,666	27.2	6,684,695	71.0	166,080	1.8	6,116	0.1	9,420,557
2011	2,588,750	28.1	6,453,050	70.0	166,360	1.8	7,992	0.1	9,216,152
2012	2,260,950	28.3	5,590,083	69.9	139,299	1.7	7,126	0.1	7,997,458
2013	1,840,632	26.9	4,889,430	71.4	111,245	1.6	6,988	0.1	6,848,295

9) SALES VOLUME BY INVESTOR TYPE

Year	Securities companies		Banks		Insurance companies		Total
	Amount (100mn. won)	Proportion (%)	Amount (100mn. won)	Proportion (%)	Amount (100mn. won)	Proportion (%)	
2003	410,666	30.5	357,107	26.5	577,474	42.9	1,345,247
2004	601,751	33.7	499,196	28.0	682,350	38.3	1,783,297
2005	778,487	39.2	503,099	25.3	706,658	35.5	1,988,244
2006	1,103,520	47.8	446,762	19.4	756,415	32.8	2,306,697
2007	1,678,076	57.4	437,912	15.0	808,483	27.6	2,924,471
2008	1,823,541	51.7	419,662	11.9	1,286,269	36.4	3,529,472
2009	1,645,395	50.5	422,190	13.0	1,189,227	36.5	3,256,812
2010	1,316,015	43.2	428,790	14.1	1,302,924	42.8	3,047,729
2011	1,239,288	43.7	431,331	15.2	1,162,531	41.0	2,833,150
2012	1,135,868	38.1	464,743	15.6	1,382,019	46.3	2,982,630
2013	1,059,968	34.2	523,589	16.9	1,520,571	49.0	3,104,127

10) NUMBER OF ACCOUNTS BY INVESTOR TYPE

Year	Securities companies		Banks		Insurance companies		Total
	Number	Proportion (%)	Number	Proportion (%)	Number	Proportion (%)	
2003	3,526,042	97.7	40,393	1.1	41,223	1.1	3,607,658
2004	4,582,619	98.1	51,692	1.1	36,791	0.8	4,671,102
2005	9,730,027	98.6	104,495	1.1	37,679	0.4	9,872,201
2006	12,207,095	98.5	97,046	0.8	87,328	0.7	12,391,469
2007	23,173,145	98.5	174,529	0.7	186,849	0.8	23,534,523
2008	22,774,158	97.6	189,181	0.8	366,343	1.6	23,329,682
2009	19,571,574	96.5	178,009	0.9	522,636	2.6	20,272,219
2010	16,076,351	94.8	189,253	1.1	697,565	4.1	16,963,169
2011	15,026,491	88.5	197,033	1.2	1,764,296	10.4	16,987,820
2012	13,356,459	85.8	404,564	2.6	1,800,070	11.6	15,561,093
2013	11,898,410	81.3	451,689	3.1	2,292,579	15.7	14,642,678

11) AMOUNT AND PROPORTION OF FUND INVESTMENT ASSETS BY TYPE

Year	Equity		Bond		CP	
	Amount (100mn. won)	Proportion (%)	Amount (100mn. won)	Proportion (%)	Amount (100mn. won)	Proportion (%)
2003	190,462	12.7	803,435	53.5	75,583	5.0
2004	155,553	8.0	1,118,245	57.8	88,649	4.6
2005	439,616	19.7	893,751	40.1	96,526	4.3
2006	598,970	24.5	904,137	36.9	128,930	5.3
2007	1,475,078	44.0	650,923	19.4	181,109	5.4
2008	878,782	29.9	666,351	22.7	227,716	7.7
2009	1,259,544	38.0	931,575	28.1	206,814	6.2
2010	1,165,510	34.7	1,064,891	31.7	204,635	6.1
2011	1,008,735	34.5	894,253	30.6	178,019	6.1
2012	1,036,225	31.8	944,149	28.9	271,462	8.3
2013	1,033,712	29.6	1,165,014	33.3	231,764	6.6

Year	Deposits		Call-loan		Others		Total
	Amount (100mn. won)	Proportion (%)	Amount (100mn. won)	Proportion (%)	Amount (100mn. won)	Proportion (%)	
2003	109,082	7.3	111,112	7.4	211,321	14.1	1,500,995
2004	121,204	6.3	143,350	7.4	308,419	15.9	1,935,420
2005	172,064	7.7	205,853	9.2	422,994	19.0	2,230,805
2006	190,108	7.8	177,071	7.2	448,279	18.3	2,447,495
2007	228,814	6.8	171,341	5.1	645,696	19.3	3,352,961
2008	477,907	16.3	112,908	3.8	577,686	19.6	2,941,351
2009	266,758	8.0	99,939	3.0	552,291	16.7	3,316,920
2010	242,904	7.2	113,406	3.4	569,178	16.9	3,360,523
2011	206,124	7.1	80,121	2.7	557,720	19.1	2,924,973
2012	190,662	5.8	120,046	3.7	699,775	21.5	3,262,318
2013	155,651	4.5	95,718	2.7	813,883	23.3	3,495,742

12) AUM OF OVERSEAS INVESTMENT FUNDS

Year	Beneficiary certificates reserved for foreign investors			Overseas investment funds			Mixed investment to domestic and foreign markets		
	No. of funds	AUM (100mn. won)	Total net assets (100mn. won)	No. of funds	AUM (100mn. won)	Total net assets (100mn. won)	No. of funds	AUM (100mn. won)	Total net assets (100mn. won)
2003	0.254	0.593	0.034	0.025	0.854	0.000	0.854	0.840	0.600
2004	0.200	0.538	0.032	0.017	0.762	0.000	0.762	0.910	0.430
2005	0.301	0.706	0.033	0.019	1.023	0.000	1.023	0.940	0.710
2006	0.407	0.836	0.037	0.021	1.262	0.140	1.402	0.930	0.930
2007	0.582	0.965	0.041	0.022	1.566	0.180	1.746	1.000	0.960
2008	0.469	0.816	0.035	0.020	1.289	0.040	1.329	0.960	0.700
2009	0.502	0.823	0.035	0.020	1.336	0.040	1.376	0.950	0.500
2010	0.471	0.673	0.034	0.019	1.162	0.020	1.182	0.990	1.040
2011	0.447	0.627	0.031	0.018	1.085	0.020	1.105	0.930	0.960
2012	0.395	0.546	0.029	0.017	0.952	0.020	0.972	0.900	1.080
2013	0.355	0.479	0.027	0.016	0.848	0.020	0.868	0.910	1.080

13) OVERSEAS INVESTMENT VOLUME BY TYPE (PRINCIPAL)

(unit : 100 million won)

Year	Equity	Hybrid-equity	Hybrid-bond	Bond	Deri-vatives	Real estate	Real asset	Fund of fund	Special asset	Total
2004	935	902	18,085	12,295	2,634	-	-	21,940	35	56,826
2005	11,999	991	12,235	10,118	20,284	-	-	32,442	35	88,104
2006	64,087	7,645	15,407	9,643	24,039	2,900	-	72,776	405	196,903
2007	498,856	63,786	12,076	17,422	27,078	11,863	46	90,396	8,877	730,399
2008	543,973	64,812	6,875	15,350	35,161	17,550	367	71,919	13,572	769,579
2009	507,836	62,100	8,055	25,353	23,155	20,531	367	65,620	19,388	732,404
2010	398,692	50,203	8,775	26,298	25,451	28,367	367	72,042	27,654	637,848
2011	315,155	37,203	6,221	32,351	40,768	31,196	-	66,319	37,161	566,374
2012	260,771	31,783	4,982	53,815	54,764	40,790	-	75,744	56,219	578,866
2013	197,180	27,689	7,652	58,171	71,772	59,818	0	90,410	68,776	581,468

14) OVERSEAS INVESTMENT VOLUME BY REGION

(unit : 100 million won)

	Asia					
Year	China (incl. Hong Kong)	Japan	India	Vietnam	Others	Sub-total
2007	322,120	28,130	55,840	9,160	30,040	445,290
2008	150,730	11,470	23,790	4,190	12,100	202,280
2009	199,250	8,160	3,886	6,350	16,770	269,390
2010	155,260	7,650	32,370	5,530	15,660	216,470
2011	106,690	4,280	15,380	3,360	13,110	142,820
2012	110,130	4,270	14,830	4,740	13,430	147,400
2013	90,913	5,189	10,848	6,550	10,120	123,620

	Europe				
Year	UK	Russia	Eastern Europe	Others	Sub-total
2007	8,260	11,500	4,770	40,060	64,590
2008	3,750	3,850	1,910	12,970	22,480
2009	6,090	15,420	1,400	18,870	41,780
2010	6,450	21,980	1,800	22,750	52,980
2011	5,390	10,870	1,350	34,600	52,210
2012	6,110	9,840	3,140	57,880	76,970
2013	18,453	6,945	1,961	61,862	89,221

	Other major economies			Others	Total
Year	US	Australia	Brazil		
2007	106,000	20,250	40,130	31,610	707,870
2008	39,290	7,690	18,660	20,920	311,320
2009	51,690	9,760	41,530	52,880	467,030
2010	50,410	7,710	42,370	56,540	426,480
2011	46,340	7,410	21,720	38,010	308,510
2012	72,470	6,980	22,370	44,170	370,360
2013	105,520	7,090	11,168	38,837	375,456

15) MMF

(unit : 100 million won)

Year	Individuals		Corporations		Under old laws		Total	
	Principal	Net asset value	Principal	Net asset value	Principal	Net asset value	Principal	Net asset value
2006	404,456	413,678	164,861	167,580	2,221	2,749	571,538	584,007
2007	310,738	318,921	154,952	157,468	1,700	2,281	467,390	478,670
2008	279,822	288,021	608,783	617,771	428	435	889,033	906,226
2009	264,183	267,457	452,466	456,547	256	251	716,905	724,256
2010	231,954	234,843	431,040	435,615	6,189	6,233	669,182	676,691
2011	174,822	177,734	356,398	361,055	48	43	531,267	538,832
2012	184,723	187,558	446,645	452,296	6	6	631,375	639,860
2013	212,685	215,293	451,317	455,926	6	6	664,009	671,225

* Old laws: The amount identified before investors were categorized into individuals and corporations pursuant to the Indirect Investment Asset Management Business Act.

Advisory and Discretionary Management

1) DISCRETIONARY WRAP ACCOUNTS OF SECURITIES COMPANIES

Year	No. of consumers	No. of contracts	Contract asset (100mn won)
2007	243,712	260,024	95,295
2008	468,465	519,196	118,447
2009	483,584	531,438	199,840
2010	697,951	781,085	356,478
2011	951,165	1,088,595	444,607
2012	780,189	896,465	536,897
2013	829,481	962,063	679,952

Trusts

1) MONEY TRUSTS

Year	No. of investors	No. of contracts	AUM (100mn. won)
2010	-	-	1,388,675
2011	3,008,370	2,672,552	1,697,969
2012	3,716,930	3,358,873	2,133,633
2013	4,278,451	3,840,675	2,476,547

* No. of investors and contracts were compiled from 2011.

2) PROPERTY TRUSTS

Year	No. of investors	No. of contracts	AUM (100mn. won)
2010	-	-	2,322,274
2011	12,233	8,791	2,443,950
2012	15,927	9,307	2,252,429
2013	24,805	11,326	2,494,353

* No. of investors and contracts were compiled from 2011.

3) REAL ESTATE TRUSTS

	Year	Management trust	Collateral trust	Deposition trust	Land trust	Sale management trust	Total
No. of investors	2010	-	-	-	-	-	-
	2011	716	7,997	1,850	734	423	11,720
	2012	737	10,520	2,563	931	541	15,292
	2013	752	18,077	2,864	1,073	1,280	24,046
No. of contracts	2010	-	-	-	-	-	-
	2011	556	5,718	1,016	578	279	8,157
	2012	558	6,047	942	704	314	8,565
	2013	582	7,818	914	794	352	10,460
AUM (100mn. won)	2010	127,143	1,163,811	234,513	193,099	41,230	1,759,796
	2011	119,794	1,270,177	189,666	233,741	35,779	1,849,159
	2012	92,538	1,008,897	95,397	259,167	44,537	1,500,536
	2013	88,326	944,983	92,831	277,661	44,780	1,448,582

* No. of investors and contracts were compiled from 2011. Includes statistics of companies only engaging in real estate trust business and trust companies operating other core businesses.

Derivatives-Linked Securities

1) ELS ISSUANCE

Year	Principal protected		Non-principal protected		Total	
	Amount (100mn. won)	No. of issuance	Amount (100mn. won)	No. of issuance	Amount (100mn. won)	No. of issuance
2003	19,392	146	15,263	73	34,655	219
2004	12,219	119	43,736	596	55,955	715
2005	8,782	140	133,513	1,935	142,295	2,075
2006	21,213	313	201,608	2,739	222,821	3,052
2007	43,273	812	212,730	3,611	256,002	4,423
2008	24,636	797	179,523	4,165	204,160	4,962
2009	33,147	1,249	86,493	3,885	119,639	5,134
2010	57,587	2,531	195,123	8,385	252,711	10,916
2011	98,850	3,457	244,853	11,158	343,703	14,615
2012	142,415	3,365	319,483	14,091	461,898	17,456
2013	141,021	3,706	286,070	12,645	427,091	16,351

2) PUBLICLY OFFERED AND PRIVATELY PLACED ELS

Year	Publicly offered		Privately placed		Total	
	No. of issuance	Amount	No. of issuance	Amount	No. of issuance	Amount
2003	120	24,672	99	9,983	219	34,655
2004	205	23,722	510	32,233	715	55,955
2005	401	35,684	1,674	106,611	2,075	142,295
2006	913	65,583	2,139	157,238	3,052	222,821
2007	1,326	71,179	3,097	184,823	4,423	256,002
2008	1,514	53,387	3,448	150,773	4,962	204,160
2009	2,057	55,558	3,077	64,081	5,134	119,639
2010	4,008	108,735	6,908	143,976	10,916	252,711
2011	6,222	151,149	8,393	192,554	14,615	343,703
2012	6,781	180,637	10,675	281,261	17,456	461,898
2013	6,830	196,800	9,521	230,290	16,351	427,091

3) ELS ISSUANCE BY TYPE OF UNDERLYING ASSET

(unit : 100 million won)

Year	Domestic index-type	Domestic securities-type	Overseas index-type	Overseas securities-type	Hybrid-type	Total
2010	74,114	79,685	79,087	398	19,427	252,711
2011	121,428	83,987	129,081	75	9,132	343,703
2012	200,831	61,111	187,109	1,182	11,666	461,898
2013	148,356	39,473	222,464	2,635	14,165	427,091

4) DLS ISSUANCE

	Principal protected		Non-principal protected		Total	
Year	Amount (100mn. won)	No. of issuance	Amount (100mn. won)	No. of issuance	Amount (100mn. won)	No. of issuance
2011	69,871	1,003	39,765	464	109,620	1,466
2012	140,135	1,480	98,145	1,336	238,280	2,816
2013	109,371	1,774	94,831	2,127	204,202	3,901

5) DLS ISSUANCE BY TYPE OF UDERLYING ASSET

(unit : 100 million won)

Year	Product-linked	Interest rate-linked	Credit-linked	Others	Total
2011	6,274	59,456	32,650	11,240	109,620
2012	21,151	123,944	69,543	23,642	238,280
2013	34,823	78,602	43,451	47,326	204,202

Retirement Pension

1) RESERVES

Year	Reserves (100mn. won)	Subscription rate (%)
2007	27,550	5.8
2008	66,122	10.4
2009	140,248	15.8
2010	291,472	25.1
2011	499,168	34.5
2012	673,459	46.0
2013	842,996	46.3

Source: Financial Supervisory Service

2) RESERVES BY PENSION TYPE

(unit : 100 million won)

Type	DB	DC	Corporate IRP	Individual IRP	Total
2007	18,276	7,033	1,315	926	27,550
2008	45,818	16,141	2,688	1,474	66,122
2009	100,519	29,833	3,762	6,134	140,248
2010	209,826	51,530	5,395	24,720	291,472
2011	375,394	81,070	6,093	36,610	499,168
2012	496,987	119,555	6,641	50,277	673,459
2013	606,573	169,114	6,940	60,368	842,996

Source: Financial Supervisory Service

3) RESERVES BY FINANCIAL INSTITUTIONS

(unit : 100 million won)

	Securities		Banks		Life insurance		Non-life insurance		Korea Workers Compensation and Welfare Service		
Year	Amount (100mn. won)	Proportion (%)	Amount (100mn. won)	Proportion (%)	Amount (100mn. won)	Proportion (%)	Amount (100mn. won)	Proportion (%)	Amount (100mn. won)	Proportion (%)	Total
2007	2,614	9.5	11,171	40.5	11,788	42.8	1,976	7.2	-	-	27,550
2008	7,805	11.8	31,629	47.8	22,440	33.9	4,248	6.4	-	-	66,122
2009	16,620	11.9	68,077	48.5	46,842	33.4	8,709	6.2	-	-	140,248
2010	47,356	16.2	144,633	49.6	75,959	26.1	23,524	8.1	0	0.0	291,472
2011	89,749	18.0	242,544	48.6	127,824	25.6	38,919	7.8	131	0.0	499,168
2012	124,963	18.6	335,168	49.8	161,298	24.0	51,127	7.6	904	0.1	673,459
2013	141,138	16.7	429,294	50.9	207,995	24.7	61,662	7.3	2,906	0.3	842,996

Source: Financial Supervisory Service

4) PROPORTION OF FINANCIAL INSITUTIONS BY PENSION TYPE

(unit : 100 million won)

	DB				
Year	Securities	Banks	Life insurance	Non-life insurance	Korea Workers' Compensation and Welfare Service
2007	5.6	32.6	52.7	9.1	N/A
2008	9.2	41.6	41.5	7.7	N/A
2009	9.1	42.9	40.9	7.1	N/A
2010	14.6	44.3	31.3	9.7	0.0
2011	18.5	42.7	29.6	9.2	0.0
2012	19.6	43.4	27.8	9.1	0.0
2013	17.6	44.2	29.1	9.0	0.0

	DC				
Year	Securities	Banks	Life insurance	Non-life insurance	Korea Workers' Compensation and Welfare Service
2007	22.5	53.7	19.4	4.4	N/A
2008	21.9	56.8	17.1	4.3	N/A
2009	22.4	58.7	14.3	4.6	N/A
2010	20.9	60.8	14.2	4.0	0.0
2011	18.6	63.2	14.4	3.6	0.2
2012	16.8	65.3	13.7	3.4	0.7
2013	15.3	66.5	13.4	3.0	1.7

	Corporate IRP				
Year	Securities	Banks	Life insurance	Non-life insurance	Korea Workers' Compensation and Welfare Service
2007	0.1	97.4	2.0	0.4	N/A
2008	0.3	97.5	1.9	0.3	N/A
2009	0.3	97.7	1.8	0.2	N/A
2010	0.3	97.9	1.6	0.2	0.0
2011	0.2	97.8	1.8	0.1	0.1
2012	0.3	97.2	2.3	0.1	0.2
2013	0.3	96.4	2.8	0.2	0.2

	Individual IRP				
Year	Securities	Banks	Life insurance	Non-life insurance	Korea Workers' Compensation and Welfare Service
2007	1.0	16.1	82.5	0.4	N/A
2008	3.1	53.7	42.9	0.3	N/A
2009	12.6	61.8	22.8	2.8	N/A
2010	23.6	60.8	11.4	4.2	0.0
2011	14.1	68	13.8	4.2	0.0
2012	14.4	69.0	13.2	3.4	0.0
2013	13.5	69.4	13.7	3.3	0.0

	Total				
Year	Securities	Banks	Life insurance	Non-life insurance	Korea Workers' Compensation and Welfare Service
2007	9.5	40.5	42.8	7.2	N/A
2008	11.8	47.8	33.9	6.4	N/A
2009	11.9	48.5	33.4	6.2	N/A
2010	16.2	49.6	26.1	8.1	0.0
2011	18	48.6	25.6	7.8	0.0
2012	18.6	49.8	24.0	7.6	0.1
2013	16.7	50.9	24.7	7.3	0.3

Source: Financial Supervisory Service
*Based on the balance of management contracts at the end of the term.

5) RESERVES BY MANAGEMENT METHOD

(unit : 100 million won)

Year	Principal protected			Dividend product		Others	Total
	Installment deposits	Government and public bonds	Interest rate-type (Insurance)	Dividend product-type (insurance)	Financial investment product		
2007	8,705	30	10,545	897	3,668	3,705	27,550
2008	31,437	46	22,741	897	6,691	4,309	66,122
2009	68,780	53	50,804	1,198	11,292	8,120	140,248
2010	163,462	361	94,044	1,486	17,514	14,605	291,472
2011	287,442	1,548	172,180	1,835	25,031	11,130	499,168
2012	388,314	17,988	220,724	2,066	32,313	12,054	673,459
2013	443,154	65,423	272,294	2,065	44,359	15,701	842,996

Source: Financial Supervisory Service

6) PROPORTION OF RESERVES BY MANAGEMENT METHOD

(unit : %)

Year	Principal protected			Dividend product		Others
	Installment deposits	Government and public bonds	Interest rate-type (Insurance)	Dividend product-type (insurance)	Financial investment product	
2007	31.6	0.1	38.3	3.3	13.3	13.4
2008	47.5	0.1	34.4	1.4	10.1	6.5
2009	49.0	0.0	36.2	0.9	8.1	5.8
2010	56.1	0.1	32.3	0.5	6.0	5.0
2011	57.6	0.3	34.5	0.4	5.0	2.2
2012	57.7	2.7	32.8	0.3	4.8	1.8
2013	52.6%	7.8%	32.3%	0.2%	5.3%	1.9%

Source: Financial Supervisory Service

Household Financial Assets of Korea

1) PERCENTAGE OF NON-FINANCIAL ASSETS AND FINANCIAL ASSETS

(unit : %)

Year	Non-financial asset	Financial asset
2006	79.6	20.4
2010	78.6	21.4
2011	76.8	23.2
2012	75.1	24.9

Source: Statistics Korea

2) PROPORTION OF FINANCIAL ASSETS BY TYPE

(unit : %)

Year	Cash deposits	Financial investment product	(Equity)	(Bond)	(Fund)	Pension ·Insurance	Others
2002	54.3	22.7	14.1	3.7	4.9	21.4	1.6
2003	52.8	24.2	16.3	4.3	3.6	21.6	1.4
2004	50.1	26.2	16.4	4.6	5.1	22.6	1.1
2005	47.5	29.7	20.3	3.6	5.8	21.7	1.1
2006	46.8	29.9	19.0	3.7	7.2	22.5	0.8
2007	42.5	34.1	21.4	3.0	9.7	22.7	0.7
2008	46.6	27.5	16.1	4.1	7.2	25.0	0.9
2009	45.0	29.9	18.7	4.6	6.7	24.3	0.8
2010	45.1	29.8	20.1	5.2	4.5	24.4	0.7
2011	46.5	27.1	18.2	5.3	3.7	25.7	0.7
2012	45.4	26.5	17.2	5.8	3.5	27.4	0.7

Source: Bank of Korea

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