2011
CAPITAL MARKET IN KOREA

Korea Financial Investment Association

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This book has been written by the Research and International Affairs Department of the Korea Financial Investment Association (KOFIA).

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PREFACE

CAPITAL MARKET IN KOREA 2011

The first half of 2011 saw the Korean capital market record its strongest growth in recent years – indicating that Korea has profoundly recovered from the downturn that beset the global financial markets in the autumn of 2008.

In the face of the ongoing fiscal uncertainties in the eurozone and the sluggish recoveries of the US, the UK and other major economies, the Korean capital market has surged forward, reaching post-crisis levels and beyond. The KOSPI, Korea's representative stock index, has shown a rapid pace of recovery, hitting record highs. The bond market also maintained sustained growth, recording higher levels of bond issuance and trading. Demand for Korean bonds has greatly increased due to concerns over the soundness of advanced countries resulting from Europe's fiscal crisis. With greater participation in the market by securities firms, the daily average trading volume of 3-year government bond futures and US dollar futures has significantly increased from 2009, and the trading volume of OTC derivatives has also shown an upward trend. While the fund market has suffered from a record net outflow in 2009, fund redemption has subsided since the second half of 2010.

On the regulatory front, the government continues to refine the 2009 Financial Investment and Capital Markets Act to promote greater deregulation and innovation in the financial services industry and address gaps in its coverage. Specifically, the Korean government is working to further amend the Act to foster the growth of large-scale investment banks that can compete on the global markets and to boost hedge funds and prime brokerage services in Korea. Another important area to be highlighted is the pension fund market and post-retirement planning. As we move from an aging to an aged society, the Korean economy and capital market must be ready for the challenge and adopt new strategies to ensure retirees have access to the funds necessary to live out their retirement. As such, KOFIA is working with the government and industry to explore strategies to channel Korean pension funds' vast financial resources into such areas as equity market, so that it may further fuel the growth of the Korean economy and thereby gain value as the economy develops.

In light of all the factors stated above, I am confident that the Korean capital market and financial investment industry will build upon the achievements of 2010-2011 and continue to move closer toward realizing its goal of becoming a leading international financial center. I hope that this publication will serve as a useful introduction and reference guide to better understand the abundant investment opportunities existing in the capital market in Korea.

July 2011

Kun Ho Hwang
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 the 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 the capital market in Korea has grown due to the increased significance of process manufacturing, the need for increased venture businesses and the need for corporate monitoring of the market. 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 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 habitually 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 counterparties at anytime, 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 the rapidly changing financial environment.

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 a bank compared to the market - Mostly indirect financing - Individual banks have exclusive access to corporate information - High information asymmetry - Banks as 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 these advances, the Korean government carried out policies that extensively channeled funds 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 1997 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 becoming 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 3.2 times from KRW890tn in 1998 to KRW2,811tn in 2010. During the same period, the figure for the banking sector increased about 3.3 times from KRW565tn to KRW1,841tn. For securities-related companies (securities, futures and asset management companies), their total asset value also increased 6 times from KRW34tn to KRW205tn.

Korea's banking sector makes up a large proportion of the financial market, mainly because the banking sector was protected in the past thanks to the separation between different kinds of services financial firms could offer and because banks' credit ratings were guaranteed by the government. As such, the banking sector's share of the industry increased slightly from 63.5% in 1998 to 65.5% in 2010. During the same period, the rate of securities-related companies increased from 3.9% to 7.3%. This reflects that the rate of increase in securities-related companies is surpassing that of the banking sector. In addition, the competiveness of banks was seen as higher than that of non-bank deposit-taking institutions such as merchant banks and mutual banks.

TABLE 1-2. TOTAL ASSETS OF FINANCIAL INSTITUTIONS

(Unit: billion won, %)

	Banks	Non-bank deposit-taking institutions	Etc.	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 (100.0)

	Banks	Non-bank deposit-taking institutions	Etc.	Insurance companies	Securities companies	Futures companies	Asset management companies	Total
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 (100.0)
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 (100.0)
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 (100.0)
2008	1,870,633 (71.6)	102,569 (3.9)	102,121 (3.9)	391,935 (15.0)	140,657 (5.4)	2,799 (0.1)	2,977 (0.1)	2,613,690 (100.0)
2009	1,799,880 (68.14)	123,345 (4.67)	104,074 (3.94)	444,431 (16.82)	163,956 (6.21)	2,480 (0.09)	3,355 (0.13)	2,641,521 (100.0)
2010	1,841,707 (65.5)	134,618 (4.8)	122,526 (4.4)	507,504 (18.1)	199,807 (7.1)	1,794 (0.1)	3,669 (0.1)	2,811,626 (100.0)

Source: Monthly Bulletin by Financial Supervisory Service

2. The Size of Domestic Capital Market

The domestic capital market was worth KRW2,356tn at the end of 2010, up 8.6 times from 1995. The market has grown both in quantity and quality as it performed its financing role for the corporate sector. The stock market has expanded 8.4 times from KRW148tn to KRW1,239tn. At the same time, the bond market grew 8.9 times from KRW125tn to KRW1,116tn and expanded much faster than the stock market, further accelerating the growth of Korea's capital market.

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

(Unit: billion won, %)

	1995	2000	2002	2004	2006	2008	2010
Bonds	125,998	424,683	563,179	659,308	777,903	865,388	1,116,354
	(45.9)	(66.2)	(65.5)	(59.8)	(50.0)	(58.1)	(47.4)
Stocks	148,489	217,056	296,083	443,737	776,724	623,011	1,239,857
	(54.1)	(33.8)	(34.5)	(40.2)	(50.0)	(41.9)	(52.6)
Total	274,487	641,740	859,263	1,103,046	1,554,628	1,488,400	2,356,211

Note: 1) Based on listed bonds. Government bonds include treasury bonds, national housing bonds type 1, national housing bonds type 2, grain bonds, public loan bonds of metropolitan transit corporations in local regions including Daejeon, Incheon, Gwangju and Daegu, and regional development bonds. Specific law bonds are financial debenture, bank notes, credit card receivables, leasing bonds, merchant banks finance debentures, installment finance bonds, other financial debentures, non-finance specific laws bonds and other non-finance specific law bonds including monetary stabilization bonds. Corporate bonds include guaranteed bonds, mortgage bonds, non guaranteed bonds, convertible bonds, bonds with warrants, bond with embedded options (BO) and asset backed securities (ABS).
2) Based on the market capitalization of stocks listed on the KRX and KOSDAQ

Source: KRX Information Center

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 of domestic firms accounted for 23.2% of the total capital raised in 2010, with direct financing accounting for 47% of the total. Although financing through direct financing has decreased since its peak in 1998, companies were able to successfully finance between 2004 and 2006 due to a bullish stock market. However, the amount of financing reduced somewhat in 2008 due to the global financial downturn. It then bounced back in 2009, before decreasing again in 2010. Recently, the issue of corporate debentures took up a slightly larger portion of direct financing than stock issues.

TABLE 1-4. CORPORATE FINANCING TRENDS

(Unit: billion won, %)

	1998	2000	2002	2004	2006	2008	2010
Financing	27,664	65,759	83,318	67,760	189,987	232,178	113,249
Indirect financing	-15,862 (-57.3)	11,768 (17.9)	50,102 (60.1)	2,944 (4.3)	68,055 (35.8)	118,769 (51.2)	26,319 (23.2)
Deposit-taking institutions	259	23,279	41,137	14,929	60,412	107,318	4,512
Other financial institutions	-16,550	-11,551	8,606	-11,875	7,466	11,451	21,807
Direct financing	49,496 (178.9)	17,204 (26.2)	20,009 (24.0)	29,229 (43.1)	79,905 (42.1)	60,682 (26.1)	53,226 (47.0)
CP (Commercial paper)	-11,678	-4,764	-3,777	-1,873	14,747	12,395	-4,312
Corporate debenture	45,907	-2,063	-7,857	1,765	25,464	21,165	25,551
Stock	13,515	20,751	28,720	22,218	28,768	19,988	24,362
Equity interests			-	7,302	10,121	6,232	6,868
External financing	-9,809 (-35.5)	16,820 (25.6)	2,446 (2.9)	8,695 (12.8)	5,903 (3.1)	7,421 (3.2)	8,404 (7.4)
Others[1)]	3,839 (13.9)	19,967 (30.4)	10,761 (12.9)	26,892 (39.7)	36,125 (19.0)	45,306 (19.5)	25,298 (22.3)

Note: 1) Commerce credit, government borrowing, account payables, etc.
Source: Bank of Korea, Flow of Funds Trend

2. Financing through the Capital Market

Corporate financing through the capital market has shown a downward trend since its peak in 2002, but it has slowly begun to recover with the high issuance of corporate debentures after the global financial turmoil of 2008. In particular, the amount of corporate bond issues was much higher than that of stock issues. Financing through IPOs and paid-in capital increases declined due to the prolonged economic recession and a sudden drop in the stock market during the first half of 2008. The amount of financing increased to some extent, thanks to a bullish stock market, but contracted again because of the global financial crisis.

TABLE 1-5. DIRECT FINANCING BY LISTED COMPANIES

(Unit: billion won, %)

		1999	2000	2002	2004	2006	2008	2010
Stocks	No. of financing activities	490	523	382	271	317	267	254
	Amount	41,125 (57.3)	14,369 (19.7)	9,885 (11.3)	8,364 (14.2)	6,499 (13.5)	5,068 (6.4)	10,339 (8.4)
IPO	No. of financing activities	150	269	156	82	84	64	96
	Amount	5,278 (7.4)	4,006 (5.5)	3,163 (3.6)	3,015 (5.1)	2,041 (4.2)	1,313 (1.7)	4,303 (3.5)
Paid- in capital increase	No. of financing activities	340	254	226	189	233	203	158
	Amount	35,847 (49.9)	10,364 (14.2)	6,722 (7.7)	5,349 (9.1)	4,459 (9.3)	3,754 (4.7)	6,035 (4.9)
Corporate bonds	No. of financing activities	803	886	1,580	1,501	1,250	1,631	2,193
	Amount	30,671 (42.7)	58,663 (80.3)	77,522 (88.7)	50,379 (85.8)	41,678 (86.5)	74,116 (93.6)	112,919 (91.6)
Total amount of financing	No. of financing activities	1,293	1,409	1,962	1,772	1,567	1,898	2,447
	Total amount	71,796 (100.0)	73,032 (100.0)	87,407 (100.0)	58,743 (100.0)	48,178 (100.0)	79,183 (100.0)	123,258 (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 $35.7 billion deficit due to shortages in the balance of its portfolio investment, derivatives and other investments.

After the 2008 global financial crisis, the derivatives account registered a deficit of $14.7 billion, mainly as a result of drastic swings in the won-dollar exchange rates.

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
1985	-1,513	2,664	-93	2,756	-358	1,737		1,335
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	42,644	-35,738	171	-35,909	1,182	-1,224	-654	-4,238
2000	14,803	-13,383	-615	-12,768	4,802	12,177	-179	-5,796
2002	7,542	-7,010	-1,087	-5,923	-632	346	362	5,800
2004	32,312	-35,467	-1,753	-33,714	3,595	6,599	2,020	-7,218
2006	14,083	-14,151	-3,126	-11,025	-7,588	-23,230	484	41,421
2008	3,198	-1,154	109	-1,263	-16,941	-2,406	-14,770	-23,593
2009	32,791	-34,651	290	-34,941	-14,948	49,728	-3,093	2,039
2010	28,214	-25,332	-174	-25,157	-19,380	38,552	-7	-17,228

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

Source : The Bank of Korea, Economic Statistics System

VI. RATIO OF FINANCIAL ASSETS AND THE CAPITAL MARKETS TO GDP

Both the ratio of financial assets and the size of the capital market compared to GDP grew continuously. The ratios of the value of financial assets and market capitalization to GDP were 4 times and 1.1 times higher respectively in 2010. Between 1995 and 2010, the value of financial assets and the capital market (market capitalization) increased by 5.4 times and 8.8 times respectively, while GDP grew 2.8 times. This shows that the financial industry's rate of growth was accelerating, with financial assets and the capital market outpacing GDP.

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

(Unit: billion won, number of times)

	1995	2000	2002	2004	2006	2008	2010
GDP	409,654	603,236	720,539	826,893	908,744	1,026,452	1,172,803
Financial assets	855,327	1,496,045	2,155,163	2,545,704	3,196,241	3,701,187	4,635,456
Market capitalization (MC)	141,151	217,057	296,083	443,737	776,724	623,113	1,239,857
Financial assets to GDP	2.1	2.5	3.0	3.1	3.5	3.6	4.0
Market capitalization to GDP	0.3	0.4	0.4	0.5	0.9	0.6	1.1

Note: 1) GDP valuation before 2000 is based on the criterion of 2000 and after 2000 the criterion of 2005 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
Source: Bank of Korea Economic Statistics System, KRX Information Center

VII. TRENDS IN FINANCIAL ASSETS HELD BY INVESTOR TYPE

1. Financial Institutions

Since financial institutions provide financing to companies through deposits and the issue of securities or supply capital by purchasing securities, the intermediary role of financial institutions has grown in line with the expansion of the Korean economy. As of 2010, the percentage of stocks and investment held in the financial sector was 8.4% with bonds making up 26.2% of the market.

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

(Unit: billion won, %)

	1995	2000	2002	2004	2006	2008	2010
Currency and pensions	43,395 (4.9)	83,196 (4.6)	126,812 (5.4)	141,945 (5.5)	196,702 (6.2)	334,778 (7.9)	351,161 (7.4)
Insurance and deposits	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)
Bonds	187,227 (20.9)	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)
Loans	445,956 (49.9)	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)
Stock and equity investments	54,387 (6.1)	78,922 (4.3)	120,354 (5.2)	134,814 (5.2)	250,272 (7.9)	292,508 (6.9)	396,097 (8.4)
Others	162,975 (18.2)	414,014 (22.8)	466,762 (20.1)	574,877 (22.4)	596,581 (18.9)	912,488 (21.6)	915,964 (19.4)
Total	893,939 (100.0)	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)

Source: Monthly Bulletin by the Bank of Korea

2. Corporations

When examining the financial assets held by the corporate sector, the percentage of currency and deposits amounted to 37.4% of all corporate assets in 1995, with that figure gradually falling to 25.6% by 2010. On the other hand, the share of stocks and equity investments went up from 6.1% in 1995 to 28.6% in 2010. This shows that corporate assets are held in the form of currency, deposits, stocks, equity investments and bonds, with a continuously increasing amount of stocks and equity investments.

TABLE 1-9. FINANCIAL ASSETS HELD BY CORPORATIONS

(Unit: billion won, %)

	1995	2000	2002	2004	2006	2008	2010
Currency and deposit	111,290 (37.4)	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)
Insurance and pensions	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)
Bonds	34,855 (11.7)	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)
Loans	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)
Stocks and equity investments	18,212 (6.1)	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)
Others	132,928 (44.7)	217,248 (48.6)	313,351 (44.9)	345,680 (40.9)	421,934 (39.8)	604,774 (46.4)	655,446 (40.5)
Total	297,285 (100.0)	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)

Note: The calculation was made based on the figures of companies (excluding financial companies) for the year 1995, 2000 and after 2002 the figures of non-financial corporations (public companies and private companies) were used.
Source: Monthly Bulletin by the Bank of Korea

3. Individual Investors

When looking at financial assets held by individuals, the percentages of stocks/equity investments and bonds stood at 20.1% and 9.8% respectively in 2010. Meanwhile, the percentage of investments in insurance and pension stood at 24.4%, while the amount for currency and deposits stood at 45.0%. This demonstrates that while the share of stocks/equity investments is increasing continuously, individuals are still primarily investing their assets in currency and deposits.

TABLE 1-10. FINANCIAL ASSETS HELD BY INDIVIDUAL INVESTORS

(Unit: billion won, %)

	1995	2000	2002	2004	2006	2008	2010
Currency and deposit	266,433 (57.1)	488,204 (61.1)	589,324 (54.3)	625,001 (50.1)	718,251 (46.9)	790,154 (46.9)	982,013 (45.0)
Insurance and pensions	81,629 (17.5)	144,139 (18.1)	231,746 (21.4)	281,604 (22.6)	345,772 (22.6)	422,469 (25.1)	532,902 (24.4)
Bonds	60,914 (13.0)	74,446 (9.3)	90,767 (8.4)	119,328 (9.6)	164,300 (10.7)	183,493 (10.9)	214,352 (9.8)
Loans	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)
Stocks and equity investments	45,507 (9.7)	68,456 (8.6)	155,568 (14.3)	207,055 (16.6)	290,638 (19.0)	274,446 (16.3)	440,000 (20.1)
Others	12,408 (2.7)	23,271 (2.9)	17,699 (1.6)	13,860 (1.1)	12,967 (0.8)	15,753 (0.9)	15,151 (0.7)
Total	466,891 (100.0)	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)

Source: Monthly Bulletin by the Bank of Korea

4. Foreign Investors

Domestic financial assets held by foreign investors are primarily in the form of stocks and equity investments and bonds. In 2010, the percentage of stocks and equity investments was 38.3% of all stocks and equity, while bonds stood at 21.1%. This shows that foreign investors invest mainly in stocks and bonds, rather than in financial institutions. Out of all of the stocks and equity investments in Korea, the share held by the external sector increased from 0% in 1990 to 22.1% in 2000, and then dropped to 19.1% in 2010. Among total bond assets, the percentage held by foreign investors was 4.2% in 1990 with repeated increases and decreases until 2006. In 2010, the percentage increased to 10.0%. This can be attributed to strategies implemented to increase the percentage of bonds and lower the relative percentage of stocks and equity investments due to the global financial crisis.

TABLE 1-11. FINANCIAL ASSETS HELD BY FOREIGN INVESTORS

(Unit: billion won, %)

	1995	2000	2002	2004	2006	2008	2010
Currency and deposit	410 (0.4)	2,337 (0.8)	5,517 (1.7)	6,879 (1.6)	10,226 (1.7)	36,743 (4.9)	18,941 (2.0)
Insurance and pensions	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)
Bonds	26,588 (25.9)	66,694 (23.9)	48,659 (14.6)	56,257 (13.0)	70,654 (11.7)	159,803 (21.1)	198,637 (21.1)
Loans	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)
Stocks and equity investments	11,923 (11.6)	66,136 (23.7)	90,829 (27.3)	163,268 (37.8)	256,930 (42.4)	156,763 (20.7)	360,309 (38.3)
Others	63,607 (62.0)	143,758 (51.5)	187,714 (56.4)	205,202 (47.5)	268,534 (44.3)	402,849 (53.3)	361,670 (38.5)
Total	102,527 (100.0)	278,925 (100.0)	332,718 (100.0)	431,605 (100.0)	606,345 (100.0)	756,158 (100.0)	939,558 (100.0)

Source: Monthly Bulletin by the Bank of Korea

TABLE 1-12. TRENDS IN SHARE OF BOND AND STOCK INVESTMENTS HELD BY FOREIGN INVESTORS

(Unit: %)

	1995	2000	2002	2004	2006	2008	2010
Bonds	8.4	8.6	5.0	5.1	5.1	9.6	10.0%
Stocks and equity investments	7.8	22.1	16.2	20.4	21.2	13.7	19.1%

Source: Monthly Bulletin by the Bank of Korea

Foreign stock ownership in listed domestic companies stood at 31.1% of the entire stock market in 2010, with the figure peaking at 40.1% in 2004. Nevertheless, the rate of foreign stock ownership is still quite high in the domestic stock market.

TABLE 1-13. FOREIGN STOCK OWNERSHIP IN LISTED COMPANIES

(Unit: %)

	2000	2002	2004	2006	2008	2010
Exchange	30.19	36.01	41.97	37.26	28.78	32.95
KOSDAQ	6.89	10.50	15.41	14.64	8.17	10.17
Total	26.98	32.79	40.1	35.16	27.25	31.14

Note: Based on market capitalization of stocks listed on the KRX and stocks listed in KOSDAQ
Source: KRX

CHAPTER 02

DEVELOPMENT OF THE KOREAN CAPITAL MARKET

I. INTRODUCTION

Korea's securities market has developed significantly over the past 54 years 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 turmoils as the oil shocks and the Asian financial crisis to emerge as the world's 7^{th} largest trading nation, the KSE (now the Korea Exchange - KRX) has also shown tremendous achievements, growing 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, 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 the market 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, meanwhile, were first 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 establishment of the Korea Stock Exchange (KSE) in the form of a corporation 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 designed exclusively to create capital for Japanese companies operating in Korea and were both closed in 1946. In 1949, the first Korean securities companies and the Korea Stock Dealers Association (KSDA) were established in an attempt to assist Korean companies to raise funds, but their roles were still limited to arranging over-the-counter (OTC) trading of some 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, the 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, the long-term suspension of the KSE, and the bankruptcy of certain securities firms, dampening 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

Year	Stocks		Government bonds		Total	
	Amount	Proportion	Amount	Proportion	Amount	Proportion
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: 1) hwan= 0.001 won

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

(Unit: tens of thousands hwan[1], %)

Year	Securities trades		Later settlement		Total	
	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: 1) 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 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 Korea's industrial infrastructure. As international borrowing was not 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 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
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 reliefs. At the same time, the state-owned Korea Investment Corporation (KIC) was established to take responsibility for issuing securities. Additionally, in order to boost the demand for stock investment, measures 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 them to simply register rather than receive approval. For the secondary market, the securities transaction system was improved, shifting from the later settlement system into the new 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 OFFERING OF STOCKS AND CORPORATE BONDS

(Unit: million won)

	Stocks							
	Offering		Sales		Total		Corporate bonds	
Year	Cases	Amount	Cases	Amount	Cases	Amount	Cases	Amtount
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)

				Fund size			Sales balance		
Year	No. of issues	No. of management companies	No. of beneficiaries	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 designed to improve the securities registration statement, enhance external audit system, increase capital stock of securities firms and introduce book-entry clearing.

In May 1974, a Special President 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 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)

	1972		1973		1974		1975		1976		
Year	**Savings**	**With-drawals**	**Savings**	**With-drawals**	**Savings**	**With-drawals**	**Savings**	**With-drawals**	**Savings**	**With-drawals**	**Total assets**
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 depositories 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 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, regulations on total equity investment, 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 (million won)	Market cap of listed stocks (million won)	Trading volume (million shares)	Capital mobilization (million 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 country's economic policies focusing on stable growth and surging construction stock prices thanks to the industry's performance in overseas markets. However, in 1982 the market plunged due to negative growth resulting from the second oil shock and a 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 function of 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 been utilized only by the Korea Securities Finance Co. to finance securities firms, became available to all market participants. This measure helped facilitate growth in the securities market and 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 for international investment trusts - Establishment of the Korea Fund - Issuance of beneficiary certificates for foreigners - Allow foreign securities firms to open representative offices in Korea - Nuture finanacial professionals in securities related institutions - Improve legal/institutional framework for globalization
Phase 2 (1985-1987)	- Limited permission for foreign direct investment - Gradual relaxation of limits on international investment trust
Phase 3 (1988-1989)	- Full permission on foreign investment - Allow companies to issue and list stocks in foreign securities markets - Permit foreign securities firms to establish subsidiaries in Korea, and domestic firms abroad
Phase 4 (1990-)	- Allow Korean investors to make investment in foreign securities markets - Permitt 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 more liberalized securities markets, limits on foreign ownership of stock were also prescribed.

Meanwhile, the securities trading system was 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 also established to prevent investors' deposits flowing away from the securities market, prevent any mishaps while holding securities, and to 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 from the income of capital increases, which were temporarily granted under the Regulation Law on Tax Reduction and Exemption, were restated under the Corporate Income Tax Law in 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. Since the 1980s, the market mechanisms had worked to drive the country's economic direction to focus more on the private sector, the Korean economy was beginning to open and interest rates were liberalized. In addition, the 3 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 trends. Thanks to stable growth in the real economy, KOSPI recorded 1,007 basis points on April 1, 1989, the first time it had reached above 1,000 and a dramatic climb from its 180 points at the end of 1985. In the same period, the market's trading volume also 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. This resulted in 670 companies listing on the market with additional national stocks also being 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.

At the same time financial institutions began to modernize, adopting advanced computerized business processes.

In November 1987, the SEA was revised to allow investment advisors and introduce a membership system for the KSE. The Public Corporation Inducement Law was integrated into the Law on Fostering the Capital Market, which stipulated provisions to recommend IPOs and paid-in capital increases to companies. In addition, a series of measures were 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. In addition, brokerage commissions were liberalized, and autonomy in securities companies' business 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. In June, KSE was opened to all certified securities companies; in August, brokerage commissions were further liberalized; and in September, foreign securities firms were permitted to enter the Korean market. 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 Jardine Fleming, a British securities company, established an office 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. Meanwhile the ceiling on individual investors was gradually lifted until full liberalization was reached 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 also 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 the 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
1992.1	3	10	1	8	-	-
1994.12	3	12	1	8	-	-
1995.7	3	15	1	10	-	-
1996.4	4	18	1	12	-	-
1996.10	5	20	1	15	-	-
1997.5	6	23	1	18	-	-
1997.11	7	26	1	21	-	-
1997.12	50	55	1	25	5	15
1998.4	50	55	1	25	50	55
1998.5	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)

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

The Korean securities market achieved significant progress since 1993, thanks to stable growth in the real economy and the liberalization of the capital market. 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 business 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 was 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, comprehensive measures were taken to further develop the bond market and improve the CB market, respectively, 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 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. This allowed securities firms and securities investment trust companies to share services by establishing subsidiaries, and permitted 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 over 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 investment
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 a 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. For example, the dividend distribution system was improved in January 1996, ceilings on treasury bond ownership were raised from 5% to 10% in February 1996, and based on the OTC Market Promotion Plan, the KOSDAQ market was established in July 1996 to help venture companies and SMEs better utilize direct financing. 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. KOSPI plunged from 653 points to 376 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 TRUST

Financial sector	No. of entities at the end of 1997(A)	Restructuring: Revocation of authorization	Restructuring: Merger	Restructuring: Bankruptcy/ business suspension	Restructuring: Total (B)	Restructuring: Weight (B/A)	New entities	No. of entities in Jul. 2004
MB[1)]	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

Note: 1) MB: Merchant Banks, SF: Securities Firms, IT: Investment Trusts
Source: Changes in Competitive Structure through Financial Restructuring after the Asian Financial Crisis by SERI in July, 2004.

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%. Both 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, foreigners 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 option and futures were also permitted.

The Stock Index Futures (SIF) market opened in May 1996, allowing for foreign direct investment, though with some restrictions that 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 in 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, foreigners were permitted to invest in corporate-issued money market funds (MMF) 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. The qualification for engaging in securities business was expanded from authorized banks and trust companies to authorized corporations. Additionally, the requirements for registering investment advisory services were also relaxed and only registration, not government approval, was 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 and promote the sound development of the securities industry. In this context, in January 2000, the institutional criteria for securities business were laid out in detail and reasonable grounds for nullifying approval were established, enhancing transparency in 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 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 investment.

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 being 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, it 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 combined financial statements, and companies whose assets were valued at KRW7bn 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 (2004-2010)

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.This in turn 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 other 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' 401K plans) were introduced. These pension funds were 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 authorities and securities-related organizations to promote an indirect and long-term investment culture.

A series of efforts to improve market infrastructure and financial laws was 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. In December 2007, the Bond Quotation System (BQS) was introduced to enhance transparency and liquidity in the OTC bond market.

In February 2004, information infrastructure to disclose 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&A increased. Later in July, controlling shareholders of securities companies were required to get authorization in advance from the FSC.

In August 2007, the government enacted FSCMA, with the Act coming into effect in February 2009. 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 the governor of 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 reflect 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 the second half of 2010, the government announced its intention to revise FSCMA in order to further innovate and improve the capital market by allowing the creation of advanced investment banks and the introduction of hedge funds. These revisions aimed to fulfill the original purpose of the Act – deregulation – which had not been fully satisfied at this early stage of its enforcement due to the global financial crisis.

CHAPTER 03

STOCK MARKET: PRIMARY MARKET

I. DEFINITION OF EQUITIES

Companies permitted under the Commercial Code 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 right (Right to personal economic gain)	**Public interest right** (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 KRW100 and over. In addition, when a listed company issues shares whose par values are less than KRW5,000, the value of one equity must be KRW100, KRW200, KRW500, KRW1,000, or KRW2,500.

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 stock 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 amount of the total amount of rights offerings. Public offerings accounted for 35.2% of all rights offerings in 2007 due to increases in stock prices. However, this number plummeted in 2008 due to a fall in corporations' capital demands as a result of the credit crisis and the global economic recession. The number of public offerings rose back up to 22.2% in 2009 with the recovery of the stock market, but in 2010, despite better conditions for capital-raising such as increasing stock prices and decreasing interest rates, the proportion of public offerings fell compared to 2009 as the market was driven by large corporations and companies made swift action in 2009 to expand retained earnings.

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 bond with warrants	- Bonus issues - Stock splits - Takeovers - Stock exchanges - Stock transfers

TABLE 3-3. TRENDS IN RIGHTS OFFERINGS BY METHOD

(Unit: billion won, %)

		Public offering		Allotment to third party		Offering to existing shareholders	
Year	Total	Amount	%	Amount	%	Amount	%
2000	53,227.8	-	0.0	48,755.8	91.6	4,472.1	8.4
2001	83,801.4	4,184.1	5.0	77,468.2	92.4	2,149.1	2.6
2002	82,696.4	14,023.4	17.0	64,557.9	78.4	4,115.1	5.0
2003	82,926.7	8,960.0	10.8	69,801.3	84.2	4,165.4	5.0
2004	18,314.4	220.8	1.2	13,406.2	73.2	4,687.4	25.6
2005	15,598.6	1,904.9	12.2	8,084.1	51.8	5,609.7	36.0
2006	25,957.8	5,903.9	22.7	9,921.8	38.2	10,142.1	39.1
2007	116,532	40,998	35.2	49,838	42.8	25.696	22.1
2008	74,721	1,638	2.2	59,686	79.9	13,397	17.9
2009	65,676	14,595	22.2	13,814	21.0	37,267	56.7
2010	40,981	2,848	6.9	14,051	34.3	24,082	58.8
Entire period	670,211	95,276	14.4	429,384	65.3	135,782	20.3

Note: Based on rights offerings amount
Source: Korea Exchange e-Disclosure system (2000~2006), Korea Listed Companies Association (2007~2010)

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.

Offering to existing shareholders is 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.

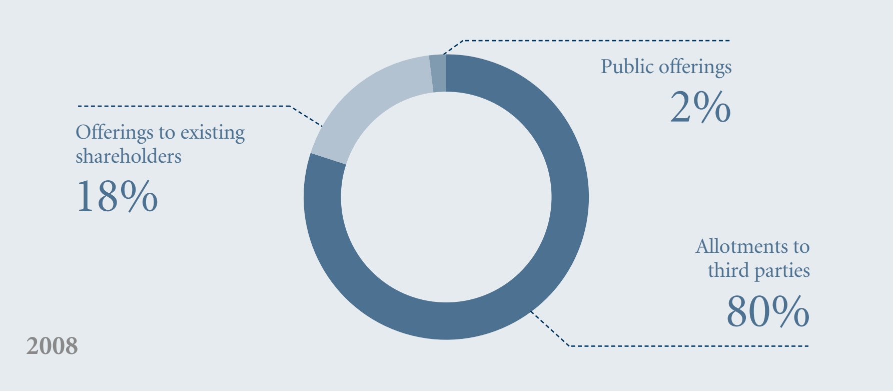
Allotment to a third party is when a certain third party is given a bond with warrant (BW) due to a special law, the company's articles of incorporation, or a special decision at the shareholders meeting. It has a critical impact on the interests of existing shareholders and the company's management 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.

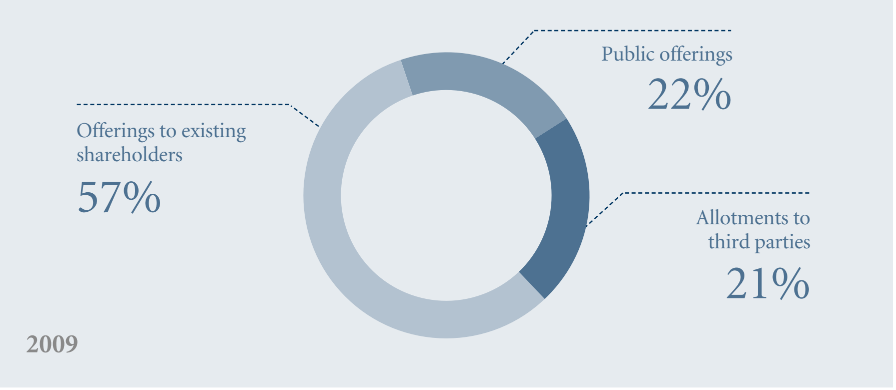
Public offerings completely rule out the right to exercise BW by shareholders, and receive applications for new shares from ordinary investors through the joint signing of the managing companies (lead manager, etc.). Given that it offers shares to the public, the administrative work is onerous and complex, 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.

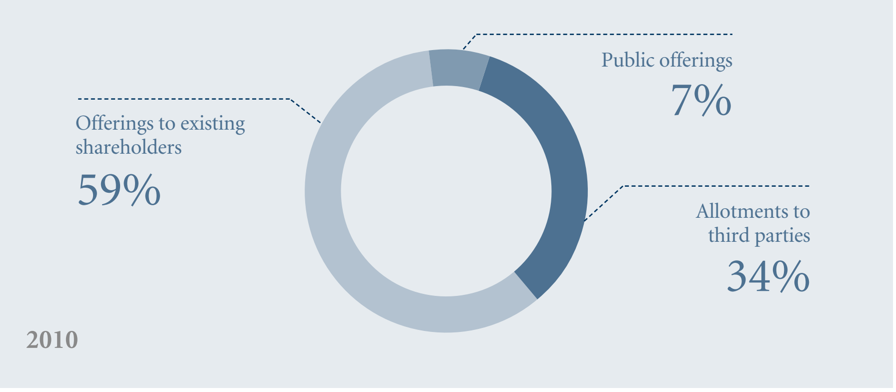
In regards to the issuing procedures, the articles of incorporation of the company state in advance the authorized shares (the total number of shares) that the company may issue. As such, issuing new stocks within that limit merely requires a decision by the BOD. However, the BOD may only decide upon 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 KRW1bn.

GRAPH 3-1. NEW STOCK ISSUANCE BY TYPE







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 KRW290bn in 1985 to KRW14,170bn 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 KRW1,101bn 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 KRW10,014.4bn. In 2007, improved corporate results and a bullish global market centering round emerging markets such as China dramatically increased financing through IPOs and rights offerings (the number of rights offerings reached 65, worth a total of KRW10,479bn, 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 KRW320bn, and rights offerings numbered a mere 38 cases worth a total of KRW1,468bn, 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 KRW4.036tn, and financing through rights offerings saw 285.6% year-on-year increase worth KRW5.66tn. In 2010, IPOs recorded KRW2.9385tn, 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. On the other hand, rights offerings witnessed a decline from the previous year as large corporations completed the capital-raising they began during the financial crisis.

TABLE 3-4. 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

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

V. EQUITY UNDERWRITING

The issuance of equities is generally categorized into public offerings (subscriptions 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 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. Most indirect issuances comprise of firm-commitment underwriting, and as this poses a heavy burden to the underwriter, it comes with the highest underwriting fee. Prior to 1974, stand-by underwriting was the most common form of issuance.

TABLE 3-5. UNDERWRITING BY DOMESTIC SECURITIES COMPANIES

(Unit: billion won)

		2004	2005	2006	2007	2008	2009	2010
Equity	IPO	1,089.9	1,239.8	755.8	1,903.2	690.5	4,054.6	5,933.9
	PO	2,935.8	1,570.3	1,547.6	3,227.3	3,429.2	3,544.4	2,572.0
	Total	4,025.7	2,810.1	2,303.4	5,130.5	4,119.7	7,599.0	8,506.0
Government and public bonds	KTB Muni	36,728.6	30,215.4	28,771.9	27,181.4	27,827.3	39,534.6	26,633.7
	Special	25,025.3	35,642.3	33,659.2	39,792.5	68,099.2	102,202.3	112,445.9
	Financial	105,442.4	94,321.3	149,216.3	113,909.3	129,618.9	113,428.6	62,492.2
	Sub-total	167,192.2	160,179.0	211,647.4	180,883.2	225,540.5	255,165.5	201,571.9
Corporate		24,459.8	33,628.7	1,950.3	23,680.6	41,098.4	56,934.8	63,357.1
DR		977.9	1,190.3	2,192.4	4,878.4	2,000.2	570.1	5,036.1
Total		196,659.5	197,808.1	236,093.5	214,572.7	271,875.8	359,918.0	327,153.2

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. FSCMA states that any company with under KRW1bn 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, 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 the investor, 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 ability to list publicly.

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 also been relaxed. The name of the OTC market was changed to the FreeBoard Market in July 2005. At the end of 2009, 70 issues of 66 venture companies were traded on the FreeBoard, an increase of 8 issues and 6 companies from July 2005, and the total trading volume reached 81.98mn shares compared to 20.55mn in 2005, thus marking a 299% increase.

CHAPTER 04

STOCK MARKET: SECONDARY MARKET

I. SECONDARY MARKET

The secondary market comprises of the KRX (established with the merger of 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 was 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) depends on certain trading policies including the principle of auction; and 3) trading is systematic and follows a fixed set of rules. 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 in the FreeBoard market (an OTC market to enable 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. THE KOREAN SECURITIES SECONDARY MARKET

	Stock market	KOSDAQ	FreeBoard
Trading hours	- Regular trading session: 09:00-15:00 - Off-hour 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. CHANGES IN THE EQUITY SECONDARY MARKET

1. Recent Changes and Features of the Equity Secondary Market

With low interest rates since the 1997 Asian financial crisis, the inflow of funds to indirect investments including mutual funds as well as stock-type funds became active. In addition, the concentration of investment stemming from positive evaluations of the Korean economy by foreign investors made a steady boom possible. KOSPI surged to 1,028.07 points at the end of 1999, up from 562.46 points at the end of 1998. In particular, large amounts of capital flowed into KOSDAQ due to the government's policy of aggressively developing the KOSDAQ market, and the impact of technological stocks including information and communication technology equities.

The Korean stock market then saw a long-term slump. The securities market, which started out at 1,028.33 points in early January 2000, sank to 504.62 points in the same year due to repercussions from the Daewoo debacle in 1999 and steady restructuring. Likewise, KOSDAQ steadily declined after peaking at 283.44 points in March 2000, dropping to a record low of 34.64 points in March 2003. Imbalances in supply and demand due to excessive numbers of IPOs and capital increases, controversy over the IT stock bubble, stock price manipulation, and the moral hazard of some business leaders resulted in the loss of investor confidence.

After 2006, increased net buying by foreign investors and the anticipation of improved corporate results continued the uptrend for KOSPI, which hit 1,467.7 points that year. In particular, the stock market remained bullish, posting record highs 51 times due to the increased inflow of capital into stock-type funds, and despite the record amounts of net selling by foreign investors. Emerging markets were also bullish and corporate results improved despite the distressed subprime mortgage loans in the U.S.

In 2008, the KOSPI dropped sharply by 41%, compared to the end of the previous year to 1,124.47 points (KOSDAQ fell 52.8% compared to the previous year to 332.1 points). This was due to increased net selling by foreign investors (increasing to KRW33.6tn in 2008 from KRW24.7tn in 2007) and the worsening global financial crisis including the Lehman Brothers bankruptcy.

In 2009, however, KOSPI recovered faster than any other markets and posted an increase of 49.7% year-on-year to reach 1,682.77 points, with KOSDAQ seeing a 54.7% rise to reach 513.57 points. Foreign investors led the market with net buying worth KRW32.4tn. In 2010, thanks to the continuing economic recovery and liquidity supplied by advanced countries, 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, 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 portion of foreign investments in the Korean stock market was an important factor. The inflow of capital from foreign investors rose dramatically, due to increased confidence in the Korean market and the notion that the Korean securities market was undervalued. As a result, foreign investors became the most influential group in the secondary market for equities. After accounting for 26.98% of market capitalization in 2000, foreign investors' capital increased gradually. But after surpassing 40% in 2003, their share has decreased steadily to about 27% until 2008 due to the global financial crisis. In 2009, the number rose back to 30% with increasing net buying by foreign investors resulting from the financial recovery. In 2010, foreign investors' share hit a record high thanks to continuous net buying, rising stock prices, etc.

TABLE 4-2. KOREAN SECONDARY MARKET SEEN IN INDICES

(Unit: billion won)

Year	No. of listed companies	Capital stock	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
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

Note: KOSDAQ statistics have been compiled from 1997.

TABLE 4-3. MAKEUP OF MARKET SHARE BY OWNER

(Unit: %)

Year	Government and Government-controlled entities	Institutional investors	Other companies	Individual	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

Note: Based on market capitalization, KRX stock market + KOSDAQ
Source: Korea Exchange

2. Changes Seen Through Major Indices

1) TRADING VALUE IN THE KRX STOCK MARKET AND KOSDAQ

As shown in the above tables, the KOSDAQ market grew dramatically, even surpassing the stock market, as a result of the government's policy of aggressive development. However, the year 2000 marked the beginning of a long-term slump and trading value drastically decreased. By 2005, KOSPI had somewhat stabilized with its trading value increasing due to an upturn in the stock market on the back of increased net buying by foreign investors and expectations of improved corporate results. In particular, KOSPI's trading value increased 60.6% year-on-year to KRW1,362,738bn in 2007. While the global financial crisis in 2008 led to another plunge, KOSPI recovered and bounced back to KRW1,466.2745tn in 2009. In 2010, the trading value of the stock market fell from the previous year despite better performances of domestic companies and increasing global liquidity, due to the fiscal crisis in Europe (January and May), the sinking of the ROK's Cheonan (May), and other externalities.

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

Source: Korea Exchange

2) KOSPI AND TRADING VALUE

There was no particular correlation between KOSPI and trading value between 2000 and 2004. However, this changed during the period of 2005-2009, when share prices steadily increased and a strong positive correlation became evident. The trading value in the second half of 2010, when KOSPI started to rise in earnest, increased KRW11tn compared to the same period of 2009.

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

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

3) MAKEUP OF MARKET SHARE BY INVESTOR

The most notable trend in shareholding by investor is that the market share of individual investors, which was previously steadily declining, surged from 2007. The proportion of shareholdings by individual investors peaked at 26.42% in 2001 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 reviving 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 represented an ever increasing percentage of investment in the stock market since 1992, when caps on investments by foreign investors were 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 represents a 9.2% decrease for the past three years, and is attributable to the diversification of investment destinations around the world and the concentration of investment 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%. Foreign investors' share increased further in 2010 to 31.17% due to their continuous net buying.

Institutional investors have also gradually increased in market share from 2002. Pension funds have led the increase in institutional investments, increasing their equity investments. Equity investment by institutional investors peaked at 20.8% in 2006, but then shrank drastically to 11.69% in 2008 due to the run on funds, before rising slightly in 2009 to reach 12.04%. Also in 2010, the share of institutional investors increased slightly, although they sold their stocks due to fund redemption requests resulting from rising stock prices.

TABLE 4-6. MAKEUP OF MARKET SHARE BY INVESTOR

(Unit: %)

Year	Government and Government-controlled entities	Institutional investors	Other companies	Individual	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

Note: Based on market capitalization
Source: Korea Exchange

4) NUMBER OF EQUITY INVESTORS

The number of equity investors increased sharply in the 1980s as a result of surges in IPOs, supplies of national stock, and increases in 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 shrank during the Asian crisis. Equity investors have increased in number since, buttressed by the venture and IT boom.

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	24,397	19.1
2010	4,787	+2.6	24,538	19.5

Source: Korea Exchange

With indirect equity investment gradually increasing after 1999, less 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 KOSDAQ became highly popular due to the venture and IT boom. This percentage later dropped and was on a gradual decline, but surged again from 2007 to reach 19.5% in 2010.

5) DIVIDEND YIELDS

Dividend yields in the stock market peaked at 2.44% in 2000 to steadily trend downwards, returning upwards of the 2.0% range in 2003 and 2004. It then dropped again continuously since 2006 before surging back to 2.58% in 2008 with the indices falling due to the global financial crisis. Dividend yields have been on the downward trend since then, with rising stock prices resulting from the economic recovery, dropping to 1.12% in 2010.

TABLE 4-8. CHANGES IN DIVIDEND YIELD

(Unit: %)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Dividend yield(%)	2.44	1.73	1.77	2.09	2.06	1.74	1.66	1.39	2.58	1.17	1.12

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, then dropped to the single digits in 2008, demonstrating that KOSPI declined relative to corporate results. However, in 2009, the ratio reached 23.68x as a rapid economic recovery led to a steep increase in the stock market. In 2010, it dropped to 17.80x due to surging net income of companies.

The P/B ratio maintained a gentle incline in 2002-2007 then dropped to 0.94x in 2008. This reflects the fact that share prices were excessively overvalued relative to the value of assets. 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.

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

(Unit: x)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
P/E Ratio (x)	15.34	29.29	15.61	15.61	10.06	10.98	11.40	16.84	8.99	23.68	17.80
P/B Ratio (x)	-	-	1.15	1.02	1.16	1.63	1.46	1.75	0.94	1.34	1.50

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 caution, alert or risk, or administrative issues, and securities that the exchange requires a 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 KRW1mn 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 4-9, the share of margin transaction volume in total equity trading volume from 2000 onwards has maintained a relatively stable trend at 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

Source: Financial Supervisory Service

CHAPTER 05

STOCK MARKET DIVISION OF KRX

I. STOCK MARKET

1. Meaning of the Stock Market

The Korea Securities Exchange is a market established for the trading of securities – debt securities; equity securities; beneficiary certificates; investment contract securities; derivatives-linked 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 (KRX) in January 2005. They now operate as the three business divisions of the KRX: the Stock Market Division (also known as the KRX), KOSDAQ Market Division, and the Derivatives Market Division. Among them, the Stock Market Division is where the Stock Exchange was established. The Financial Investment Services and Capital Markets Act (FSCMA) follows the Exchange Act and uses the same titles to refer to the various divisions of the Korea Exchange.

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 in 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 with market participants due to frequent changes in terminology, the former name was maintained. 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 after 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 operates 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.

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 stock market, KOSDAQ market, derivatives market, or any other similar facilities. In addition, trading transactions using similar facilities are banned and using similar names are also forbidden.

2. Economic Functions of the Secondary Securities 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 to increase their circulation. As such, the stock market, 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 any other market; 2) the price forming function – the price of securities is formed through competitive transactions in the exchange. Accordingly, social evaluation on their value is the most fair and reliable; 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 5-1. IPO AND LISTING

(Unit: no. of shares, billion won)

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

Source: Financial Supervisory Service Monthly Financial Statistics Bulletin

II. LISTING ON THE STOCK MARKET

1. Listing

Registering securities to be traded in 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 in the KRX are required to undergo listing eligibility reviews in order to facilitate smooth trading and to protect the investor 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 share price and makes raising capital easier for the companies, improving collateral value and increasing the company's status.

TABLE 5-2. TYPES OF LISTING

Securities for listing		Stock certificates (foreign certificates and foreign stock, DRs included), debt securities, beneficiary certificates, warrant and certificate for BW, ELW, ELS, etc.
Listing type	IPO	Listing securities for the first time on KRX
	New listing	Listing stock certificates newly issued by listed companies due to rights offerings and bonus offerings, etc.
	Change listing	Change listing of listed stock certificates, changing their name, type, par value or 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

KRX sets forth listing requirements in order to facilitate the smooth trading of stocks, form fair prices, and protect the investor. 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, KRX approves the listing of securities, notifies FSC, and lists them. To be listed on KRX, stocks should be traded in the securities market and must comply with various requirements on the size of companies, financial details, ease of circulation, soundness, public interest, and investor protection.

TABLE 5-3. REQUIREMENTS FOR IPO ON THE STOCK MARKET

Listing criteria		Ordinary companies	Holding companies
Quantitative requirement (all items must be met)	Corporate size	- One of the followings: 1) Shareholders equity of KRW10 bn or more as of application date 2) Market Capitalization* of KRW20 bn or more - When changing markets (KOSDAQ → Stock exchange) over KRW30bn * Market Cap.= offering price x no. of shares to be listed (for secondary listings or KOSDAQ-listed companies, market value)	Same as for ordinary companies
	No. of shares to be listed	1 million or more	

Listing criteria		Ordinary companies	Holding companies
Distribution requirement (all items must be met)	No. of shares held by minority shareholders, etc.	- One of the followings: 1) At least 25% should be allocated to minority shareholders 2) At least 25% should be publicly offered 3) At least 10% of shares offered through public offering, based on shareholders equity (market cap): - KRW50bn-100bn (KRW100bn-200bn): 1 million shares and over - KRW100bn-250bn (KRW200bn-500bn): 2 million shares and over 4) At least 10% of shares publicly offered simultaneously on overseas exchanges and 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 right 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 requirement (all)	Sales and profit	Recent year's sales of at least KRW30bn and 3 year average sales of at least KRW20bn and should realize recent year's operating profit, income from continuous operations before tax, net income and one of the following: - ROE for the latest fiscal year should be at least 5% and combined ROE for the last three fiscal years KRW5bn or more - Amount of income for the latest fiscal year should be at least KRW2.5bn and the sum for the latest three fiscal years should be KRW5bn - In case of net worth larger than KRW100bn, ROE for the latest fiscal year should be at least 3% or the profit at least KRW5bn 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 sales of at least KRW50bn and market capitalization of at least KRW100bn	Same as for ordinary companies (Holding company sales+subsidiary sales×shareholding ratio)
	Sales, market capitalization and operating cash flow	Recent year sales of at least KRW70bn; market capitalization of at least KRW50bn; and operating cash flow of at least KRW2bn	Same as for ordinary companies (Holding company sales+subsidiary sales×shareholding ratio) (Based on consolidated financial statements)
Soundness of company	No. of years since establishment	Have been operating without interruption for at least 3 years since establishment. In case where there has been 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 its wholly owned subsidiary through share exchange of subsidiaries)
	Restriction on change of shareholding	During the one year prior to the date of application to list, the largest shareholder should not have been changed	
	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 six months from the listing day, the period is for six 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. KRX determines 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 into the issuing company designated. After the payment, the application for a new listing is submitted to KRX; upon its approval of listing, trading of the stock begins on the stock exchange.

CHART 5-1. LISTING PROCEDURES

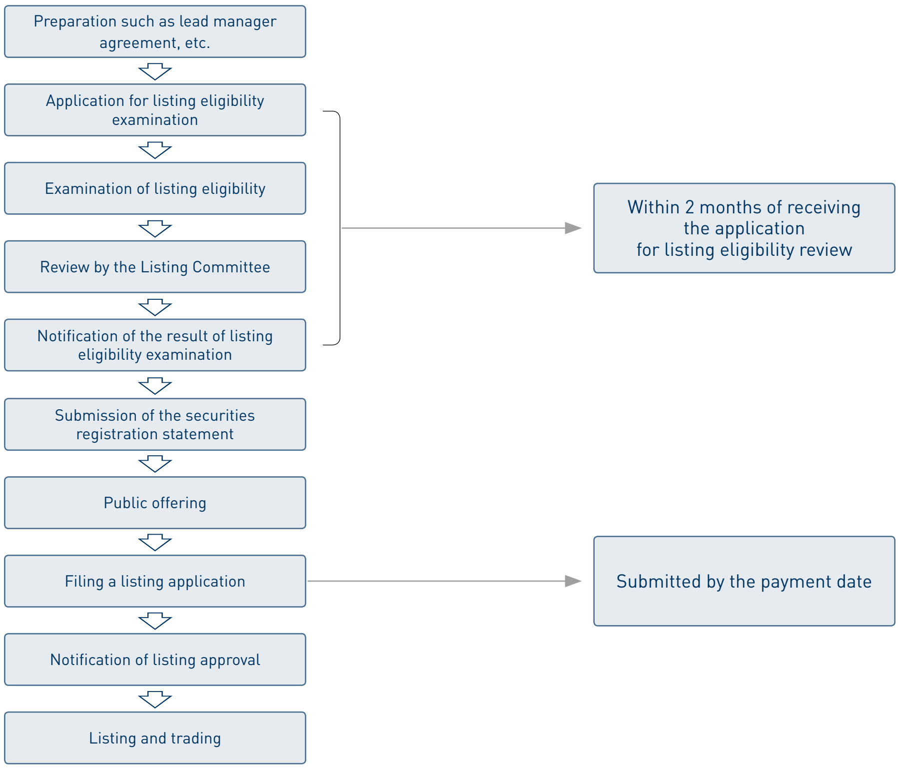


TABLE 5-4. DETAILED PROCEDURES

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 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 either the Korea Securities Depository, KB or Hana Bank
	Establishment of employee stock ownership plan	
	Prior consultation with KRX	Matters relating to listing requirements, time, etc. should be consulted

Steps		Descriptions
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 FSC are notified
Public offering	Filing securities registration statement	The statement should be filed with 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 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 doesn't fall short of the criteria it met at the time of listing, 2) its stock doesn't 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 increase the convenience of investment for investors.

2) CAUSES FOR TRADING SUSPENSION AND LIFTING OF SUSPENSION

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

Cause of suspension	Period of trading suspension	Lifting of suspension
Relevant to criteria for being named administrative issue	One day from notification date (trade day)	No need for lifting measures. When KRX acknowledges the need, trading suspension shall not 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 split	From the day before submission of stock certificate	On the day following receipt of new stock certificate
When 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 resolved

3) CRITERIA FOR DESIGNATION AS ADMINISTRATIVE ISSUES AND DELISTING

TABLE 5-6. 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	One additional time
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 [1)]	When applicable	Two consecutive years

Items	Administrative issue designation criteria	Delisting criteria
Application for commencement of rehabilitation procedures	When applied for	During application for commencement or cancellation of commencement decision
Failure to meet requirements for outside directors, etc. (failure to establish governance structure)	When applicable	Throughout one year
Average trading monthly volume of less than 1%	Semi-annual period	Two consecutive semi-annual periods
Failure to meet requirements for number of outside directors or to establish an audit committee	When applicable	One additional time
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	One more instance
Share price	Under 20% of par value for 30 consecutive days	Failure to maintain common stock price at 20/100 of par value for 10 consecutive days or for 30 days out of 90 days
Market cap	Under KRW5bn for 30 consecutive days	Failure to maintain listed market cap at KRW5 billion or more for 10 consecutive days or for 30 days out of 90 days
Relevant cause for liquidation, restrictions on transfer of stocks, other public interest and investor protection	–	When applicable

Note: 1) Falling short of minimum minority shareholder ownership: Minority shareholder ownership of less than 10% or less than 200 minority shareholders

* 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 5-7. TICK SIZE AND TYPES

Price of share	Tick size
Less than KRW5,000	KRW5
KRW5,000 to less than 10,000	KRW10
KRW10,000 to less than KRW50,000	KRW50
KRW50,000 and over	KRW100

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

TABLE 5-8. FIVE TYPES OF QUOTATION

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 that 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, or 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 to a third party at a low price, the lowest tick size, KRW5, is used to derive the base price.

TABLE 5-9. BASE PRICES

		Average price	Price range
New listings	Ordinary issues an external	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%
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% (5-200%)
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 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 of the KRX transactions.

TABLE 5-10. 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
Ordinary settlement transactions	Settlement is due on the second business day following the contract date. Generally stock transactions

TABLE 5-11. 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 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
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)

Trade is executed using the principle 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) principles. 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.

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 priority among ask prices 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 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, trade is executed using prices that become the same, according to the principles of price/time priority.

TABLE 5-12. 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
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 5-13. 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: No. ①,②, ③ and ④, etc. mean the sequences of receiving offer price.

- 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 5-14. TRADE EXECUTION IN SIMULTANEOUS ASK PRICE [2]

Category	No.③ask price (10,000 shares)	No.④ask price (5,000 shares)	No.①ask price (1,000 shares)	No.②ask price (200 shares)
① 10 times of trading unit	100	100	100	100
② 50 times of trading unit	500	500	500	100
③ 100 times of trading quantity unit	1,000	1,000	400	-
④ 200 times of 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 5-15. METHOD OF TRADING FOR CONTINUOUS AUCTION

Selling	Price	Buying	Results
	10,600		- Price: 10,300 (Price of preceding offer price) ①200-③200
	10,500		
②200	10,400		
	10,300	①200	- Quantity: 200 shares
③200	10,200		
	10,100		
	10,000		
	9,900		
	9,800		

Note: No. ①, ② and ③ refers 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 is also possible through K-BloX, an electronic network dedicated to block trading and basket trading.

TABLE 5-16. 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, and basket trading in order to handle 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 5-17. AFTER-HOURS TRADING AT CLOSING PRICE

Category	Descriptions
Objects of trading	Stock certificate, ETF, 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 Korea ECN Securities' operations shutdown.

TABLE 5-18. AFTER-HOURS TRADING FOR PERIODIC CALL AUCTION

Category	Descriptions
Objects of trading	Stock certificate, ETF, 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 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. KRX then exchanges the net balance and settlement amount between it and the members. However, the actual exchange of securities and settlement amount is conducted by the Korea Securities Depository (KSD).

The settlement deadline is determined when the member decides among settlement days agreed to by the customer and member. Between the member and KRX, the deadline is 4pm after the day's trading has closed.

The following three types of settlement are the most usual. 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 KRX; a separate settlement occurs to handle the settlement between the counter parties to trade.

Book entry clearing involves KRX deducting the securities and settlement amount and executing the transactions of the fixed amounts through KSD. In this instance, members who must settle and the financial institutions consign their securities to KSD beforehand in order to eliminate the task of transferring real certificates. When the deposited securities need to be moved, the physical securities are not 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 KRX and 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 KRX is the Central Bank. 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, Pusan 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, 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.

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)). Meanwhile the Market Oversight Commission (MOC) has been established for the self-regulation of 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).

KRX handles the self-regulation of 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.

TABLE 5-19. COMPARISON OF PUBLIC AND SELF-REGULATION

	Public regulation	Self-regulation
Regulatory basis	- Laws and decrees	- Self-regulatory codes (laws and decrees have provisions for self-regulation)
Scope	- Stipulations in laws and decrees	- Broad-ranging regulation possible on laws and decrees, and on moral, ethical aspects
Flexibility	- Flexible, rapid response to changes in market environment difficult - Concerns of rigidity and lack of variety	- Easy to make regulations flexible
Effectiveness	- Easy to secure effectiveness due to enforcement by government	- Regulations depend on self-observance - Less binding than official regulations
Regulatory expenses	- Increased public expenses due to the maintenance of regulatory agency	- Regulatory expenses minimized given the regulated pay for regulation expenses
Other	- Easy to make regulations strict and binding - Regulations are reliable	- Expertise in market operation and practices - Difficult to regulate non-members

2. Main Self-Regulation Actions

The self-regulation of 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 indeed. 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 KRX, and whether the member is engaged in abnormal trading.

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

TABLE 5-20. MARKET SURVEILLANCE AND DISPUTE SETTLEMENTS (2009-2010)

(Unit: cases)

	Market surveillance			Investigation and Inspection	Dispute settlement
	Implementation of preventative measures	Market warning[1)]	Audit and Disclosure		
2009	1,179	7,845	405	386	6,516
2010	1,827	3,106	347	475	1,566

Note: 1) Steps of investment caution → investment alert → investment risk → trading suspension

CHAPTER 06

KOSDAQ MARKET DIVISION OF KRX

I. INTRODUCTION OF THE KOSDAQ MARKET

1. Introduction and History of the 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 (KOSDAQ Committee, KOSDAQ Securities, Co.), and the Futures Exchange were integrated into one comprehensive exchange. Within this exchange, the Stock Exchange, 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 Stock Exchange 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 of the various developed economies.

Thus from the early 1980s, the Korean government pursued a new strategy to foster 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, 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 6-1. 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 Jul. 1996	Establishment of the KOSDAQ Securities market, Inc. Opening of the KOSDAQ market
Jan. 1997 Apr. 1997 Jun. 1997	Introduction of the KOSDAQ market stock index Legislation of the KOSDAQ market Establishment of operating regulations for the KOSDAQ market
Jun. 1998 Oct. 1998	Measures to revitalize the KOSDAQ market Establishment of the KOSDAQ Committee
May 1999 Dec. 1999	Measures to revitalize the KOSDAQ market Development measures to enhance soundness of the KOSDAQ market
Feb. 2000 Jun. 2000 Jul. 2000 Aug. 2000 Oct. 2000	KOSDAQ trading amount hits record high Establishment of KETRA system Introduction of electronic settlement system Market operation improvement measures for stabilization of the KOSDAQ market Introduction of the KOSDAQ 50 Index
Jun. 2001 Jul. 2001 Dec. 2001	Introduction of the electronic accounting system Introduction of KOSNET (New KOSDAQ information system) More than 700 registered companies, outnumbering companies listed on Korea Exchange
Apr. 2002 Jul. 2002 Dec. 2002	Introduction of English disclosure for KOSDAQ companies Introduction of index on scale of market capitalization Obtainment of CMM Level3 for the first time in the global securities market
Apr. 2003 Dec. 2003	Establishment of the ETF market Extension of digits in short code for stocks (Five digits → Six digits)
Jan. 2004	Adjustment of KOSDAQ base value (100 →1,000), introduction of KOSDAQ Star Index
Feb. 2005 Dec. 2005	No. of companies listed on KOSDAQ surpasses 900 Listing of Star Index-based ETF

2. Current Status of Operation

1) MARKET SIZE

The number of KOSDAQ-listed corporations jumped from 19 in 1987 to 1,036 in 2008. As of the end of May 2011, the number of KOSDAQ-listed corporations stood at 1,022 and market capitalization had reached KRW98.5tn.

TABLE 6-2. 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

Year-end	No. of listed companies	No. of issues	No. of stocks	Capital (in billion won)	Market capitalization (in trillion won)
2009	1,028	1,036	21,695	13,335	86.1
2010	1,029	1,035	23,370	13,524	97.9
May 2011	1,022	1,027	22,475	13,425	98.5

Note: Including securities investment firms (excluding ETF)
Source: Korea Exchange, 2010 Annual Securities Market Trend

2) TRADING VOLUME

The total trading volume of 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, 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 average daily trading value.

TABLE 6-3. AVERAGE DAILY TRADING OF THE KOSDAQ MARKET

(Unit: ten thousand shares, hundred million won)

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010
Trading volume	32,042	40,824	28,691	59,795	54,271	61,382	50,411	77,775	64,304
Trading value	12,053	10,785	6,253	17,927	17,308	20,305	12,422	20,986	19,247

Source: Korea Exchange, 2009 Annual Securities Market Trend

II. KOSDAQ MARKET OPERATIONS

1. Listing on KOSDAQ

1) SIGNIFICANCE OF LISTING

When a corporation wishes to trade on KOSDAQ, it has to be listed on the market through a set of listing procedures. 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 KOSDAQ, listing is limited to companies that meet certain requirements. In other words, a corporation that wishes to be listed on 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 FSCMA. The shares must also meet the basic listing requirements according to the KOSDAQ listing regulations. Listing on KOSDAQ is divided into three categories, all of which have different requirements: ordinary companies, venture companies, and growth-oriented venture companies.

TABLE 6-4. KOSDAQ LISTING REQUIREMENTS

Category		KOSDAQ listing requirements		
		Ordinary company	**Venture company**	**Growth-oriented venture company**
Years since incorporation		Three years or more	-	-
Either one	Equity capital	KRW3bn or more	KRW1.5bn or more	KRW1.5bn or more
	Market capitalization		KRW9bn or more	
Stock distribution		• Public offering (one of the following shall be met) - A company with at least 500 minority shareholders and 25% or more shares held thereof shall meet any of the following requirements: • Minority shareholders holding 25% or more → 5%(KRW1bn) or more of public offering after application for listing • Minority shareholders holding less than 25% → 10% or more of public offering after application for listing		

Category	KOSDAQ listing requirements		
	Ordinary company	**Venture company**	**Growth-oriented venture company**
	- For a corporation with KRW50bn or more of equity capital/KRW100bn or more of market capitalization: 500 or more minority shareholders and 10% or more public offering after application for listing with any of the following: • Equity capital (market capitalization) KRW50-100bn (KRW100-200bn): one million shares or more • Equity capital (market capitalization) KRW100-250bn (KRW200-500bn): two million shares or more • Equity capital (market capitalization) KRW250bn (KRW500 bn) or more: five million shares or more - Public offering of 25% or more shares and 500 minority shareholders ● Pre-distribution and direct listing (listing without public offering) ※ Subject of direct listing: At least 500 minority shareholders who hold 25% or more shares through public offering as of the application date		
Financial position		No capital impairment	
Management performance	Income from continued operation before deduction of corporate tax	Income from continued operation before deduction of corporate tax	-
ROE, sales revenue, and standard market value (One of the above)	- ROE 10% - Net income KRW2bn - Recent sales revenue KRW10bn and market capitalization KRW30bn or more	- ROE 5% - Net income KRW1bn - Recent sales revenue KRW5bn and market capitalization KRW30bn or more	-
Auditor's opinion	Auditor's opinion for the most recent business year's financial statements should be "unqualified"		

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, and the KRX makes the final decision, and notifies the FSC, the corporation in question, and the underwriter of the results of the preliminary review (including re-evaluation).

After the KRX grants approval after the preliminary review, 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, demand forecasting and pricing is conducted to set a reasonable public offering price. Demand forecasting is based on institutional investors and securities companies and the results are reflected when the lead manager and 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 KOSDAQ becomes possible.

TABLE 6-5. KOSDAQ LISTING PROCEDURES

Category	Subject	Date	Others
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.

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, the delisting measures are continuously enhanced with stronger delisting requirements and the introduction of the examination criteria for delisting.

2) DELISTING STANDARDS

Delisting standards in the KOSDAQ market can be divided into formal standards and real evaluation standards according to 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 under administrative issue. Therefore, investors should be more cautious about investing in companies designated under administrative issue as there are concerns that delisting may occur.

TABLE 6-6. REQUIREMENTS FOR DESIGNATION OF ADMINISTRATIVE ISSUES AND FORMAL DELISTING STANDARDS

Category	Administrative issue designation	Formal delisting
Sales revenue	Less than KRW3bn in the recent year	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 KRW1bn 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 after the deadline or where audit opinion is adverse, disclaimer, or qualified after (A), (B), or (C)
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.

	Administrative issue designation	Formal delisting
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 * Monthly trade volume shall be ten million shares or more, with at least 300 minority shareholders holding 20% or more	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% shares, more than one million shares.	2 consecutive years
Unfaithful disclosure	15 or more penalty points for unfaithful disclosure in two years	- 15 or more additional penalty points in two years since designated under administrative issue due to unfaithful disclosure - Re-designated under administrative issue in three years since the withdrawal of designation for administration
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	- 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
Others (immediate delisting)		- 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

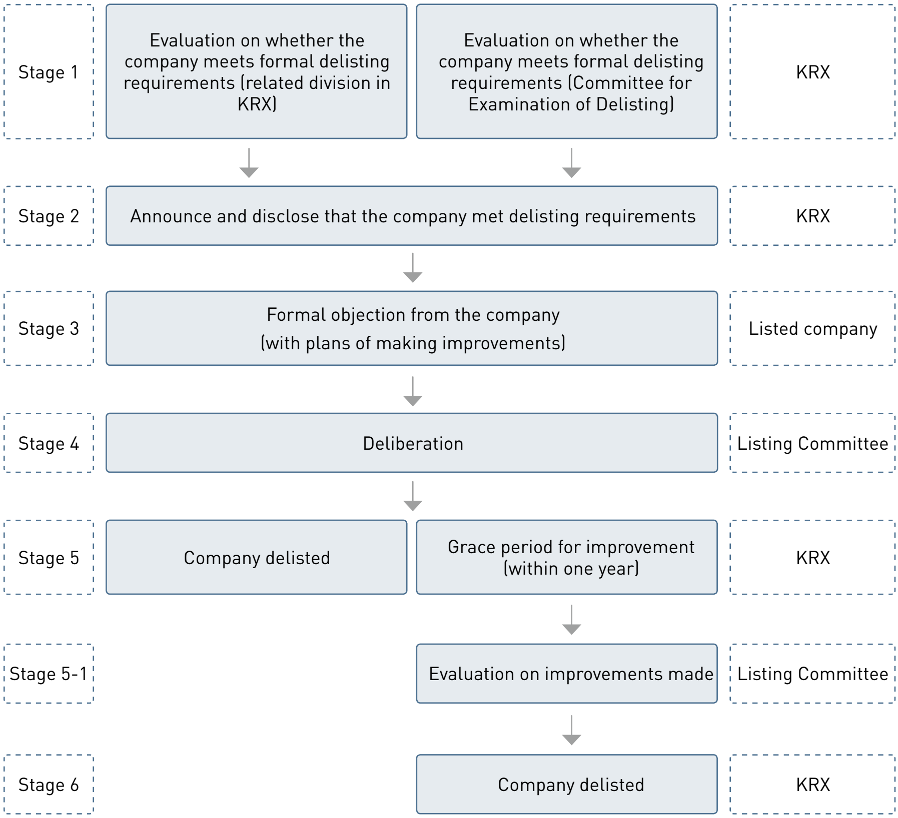
3) EXAMINATION PROCESS FOR DELISTING

When an event that has significant influence on the company's management continuity, transparency, or investor protection occurs, the company's qualifications 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 the 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 6-7. EXAMINATION CRITERIA FOR DELISTING

Category		Subject to examination
Individual approach	Suspension of main business	- A company's main production or sales business is suspended - License related to the main business is revoked or returned - Main business is transferred, or acquired through spin-off - Considered to be practically suspended due to other reasons
	Unfaithful disclosure	- Penalty of 15 points added during the two-year period since designated an administrative issue - Penalty of 15 points added during the two-year period since designated an administrative issue - Designated an administrative issue for the second time within a three-year period after the previous designation was lifted and is considered to be in the constant practice of conducting unfaithful disclosure - When a company is additionally charged with willful gross negligence after being designated an administrative issue
	Decision to enter corporate rehabilitation	- After designated an administrative issue upon application for corporate rehabilitation procedures, (A) the court rejects the application, revokes the decision to grant the rehabilitation, does not authorize the rehabilitation plan, or decides to abolish the rehabilitation program; or (B) upon regular assessment, the continuity of the company is not recognized
	False statement	- Making false statements or omitting important facts in the listing applications and related documents
Comprehensive approach	Efforts to deliberately avoid delisting requirements	- Avoiding delisting requirements through achieving management performance or financial status through fraudulent payments or over valuation of payments in cash - When delisting was avoided through submitting an additional audit report reflecting the paid-in capital increase after settlement date, but it was found that the capital funded was not used to improve financial structure - When delisting was avoided through temporarily passing the revenue related standards
	Embezzlement or malfeasance	- When a former or present executive officer was found to have conducted an act of embezzlement or malfeasance - When the embezzlement or malfeasance amount is found to be equal to or more than 5% of the equity capital
	Window dressing	- If the content of the window dressing accounting, when corrected, meets the delisting requirements - When the Financial Services Commission or Securities and Futures Commission has restricted the company's securities issues, or the company was indicted by the prosecutors office or charged with penalties due to window dressing

CHART 6-1. DELISTING PROCEDURES



Note: If the reason for delisting can be confirmed to be based on objective grounds such as the failure to meet formal listing standards (i.e. submitting regular reports, bankruptcy or suspension of bank transactions, capital impairment, sales revenue, or trade volume below the required level), the corporation will be delisted without going through the process of formal objection.

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. The minimum price variation in KOSDAQ ranges from KRW5 for stock prices under KRW5,000 to KRW100 for the stock price of KRW50,000 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, quotations placements for the purpose of market manipulation, or unfair quotations.

TABLE 6-8. VARIATIONS IN STOCK PRICE UNIT

Stock price	Minimum price variation
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 quotation in the KOSDAQ market include limit quotation, market quotation, immediately executable limit quotation, best limit quotation, and limit-to-market-on-close quotation.

TABLE 6-9. TYPES OF QUOTATION

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 6-10. BASE PRICE CALCULATION BY TYPES 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 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

Type of issue	Base price calculation
In case of ex-rights or ex-dividends	- Base price in the case of ex-rights [(closing price of cum-rights stocks × the 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 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 TRADE

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 6-11. 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	15:00 - 15:30
	Off-hours single price trading	15:30 - 18:00

CHAPTER 07

FREEBOARD

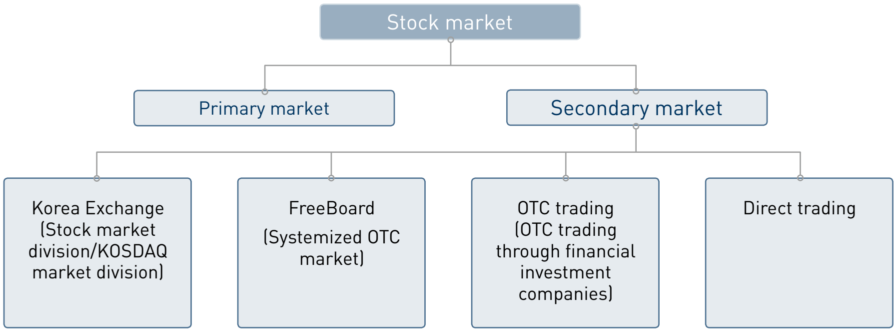
I. OVERVIEW

1. Introduction

The FreeBoard is a systemized over-the-counter (OTC) market, established and managed by the Korea Financial Investment Association (KOFIA) in accordance with the Financial Investment Services and Capital Markets Act (FSCMA). The market provides a place for companies unable to meet the listing requirements of the two national securities exchanges to trade their stocks, and acts as a financing channel, particularly for venture companies or SMEs.

Companies can finance their businesses through the FreeBoard in two ways: either by becoming a FreeBoard-listed company and trading their shares in this secondary market, or by registering as a company in the preliminary listing stage and receiving various forms of financing assistance without the trading of shares. Companies listed on the FreeBoard can be divided into three categories: venture companies, ordinary companies and Technopark-supported companies.

CHART 7-1. STOCK MARKET STRUCTURE IN KOREA



2. Function

The FreeBoard serves the following functions:

- Supports the financing of unlisted SMEs and venture firms, and enhances liquidity for these issuers
- Provides a means for investors to recover their venture-invested capital and to raise funds to make further investments
- Provides investors seeking high-risk high-return investment opportunities the chance to purchase stocks of promising companies at a stage prior to being listed on the KRX
- Protects investors from any unfair trading or scams that could occur in the OTC market
- Provides liquidity for stocks delisted from the Stock Exchange or KOSDAQ

3. Historical Background

The FreeBoard was initially set up as the Korean Over-the-Counter Bulletin Board (OTCBB) in March 2000 by KOFIA (then the Korea Securities Dealers Association) in order to invigorate the KOSDAQ market by playing a complementary role. The third market also aimed to provide a more convenient place for trading OTC shares. Along with the booming KOSDAQ market, the establishment of the third market drew much attention in its early stage as investors recognized the market as a "pre-KOSDAQ" market.

Since its launch, however, interest began to wane, leading to stagnation. Accordingly, as part of the government plan on tax benefits and financial support to invigorate venture companies, the third market was reorganized as follows: the market operation management system was improved; capital gains tax exemptions for venture companies' minority shareholders was implemented; and the third market was re-launched as the "FreeBoard" on July 13, 2005.

II. MARKET STATISTICS

1. Status of Listed Companies

The number of companies listed on the third market peaked at 183 at the end of 2002; however, that number dropped to 71 as of the end of December 2010 as the venture boom subsided. As of the end of 2010, the FreeBoard was made up of 29 venture companies, 39 ordinary companies, and 3 Technopark-supported companies.

TABLE 7-1. COMPANIES LISTED ON THE FREEBOARD

(Unit: number of companies)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total listed issuers	132	176	183	107	69	62	56	54	70	66	71
Newly- listed issuers	134	55	30	11	2	11	8	7	25	6	18
Delisted	2	11	23	87	40	18	14	9	9	14	13
Issuers waiting to be listed	-	-	-	-	-	-	-	-	8	76	116

2. Trading on the FreeBoard

The daily trading value in the third market has shown a steady decrease since it peaked at KRW674mn in 2000. With the launch of the FreeBoard, the number has again begun to rise, reaching KRW230mn as of the end of December 2010.

TABLE 7-2. TRADING ON THE FREEBOARD

(Unit: thousand shares, 100 million won)

		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
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
	Accumulative amount	1,227	841	584	172	102	187	190	420	318	155	581
Total market capitalization (Unit: trillion won)		1.03	1.29	1.37	1.08	0.38	0.44	0.42	0.46	5.74	0.74	0.81

3. Financing Status

As of 2010, the total financing volume of the companies listed on the FreeBoard was valued at KRW1.3bn, all of which was in the form of paid-in capital increase.

III. FREEBOARD LISTING AND PRELIMINARY LISTING

1. FreeBoard Listing

Companies not listed on the Stock Market Division or KOSDAQ Division can list on the FreeBoard to trade their stocks with less stringent requirements and minimum regulation. The FreeBoard consists of new listings and additional listings. To be listed on the FreeBoard, the following requirements must be met:

1) EXTERNAL AUDIT

An issuer must obtain either an “unqualified" or “qualified" opinion on its financial statements for the latest fiscal year through an external audit in accordance with the Act on External Audit of Stock Companies.

When an issuer applies to be newly listed after the semi-annual closing, a semi-annual report is required in addition to the external audit of the recent fiscal year’s financial statement. Venture companies and companies delisted from the stock market or KOSDAQ are subject to external auditing but are not required to meet a certain audit opinion.

2) ISSUANCE OF STANDARD STOCK CERTIFICATES

Issuers must use standard stock certificates such as those designated by the Korea Securities Depository. This is to prevent any forgeries and to maintain fair trading practices in the FreeBoard market.

3) TRANSFER AGENT AGREEMENT

An issuer must conclude a transfer agency service contract with a transfer agent. Transfer agents manage and keep track of changes in stock ownership, e.g. maintaining a record of the shareholder's name, address, etc. The Korea Securities Depository, KB and Hana Bank serve as transfer agents.

4) NO LIMITING CLAUSE ON THE TRANSFER OF STOCKS

An issue must be transferable without any limitations imposed by the firm's articles of association.

A company that intends to list on the FreeBoard must submit listing documents, including an application and relevant documents (two copies each), directly or through the financial investment company underwriting the issuer's equity securities (excluding collective investment securities). Upon receiving the application, KOFIA will determine its eligibility within seven business days following the date of application. Once approved, the issuer will begin trading its shares through the FreeBoard on the third business day following the date of approval, provided the issuer submits all the registration documents for stocks sales in small amounts to the Financial Services Commission (FSC), including documents describing the issuer and an audit report, three business days prior to the start of trading. If these disclosure requirements are not met, trading will be put off until three business days after disclosure is made.

2. Preliminary Listing

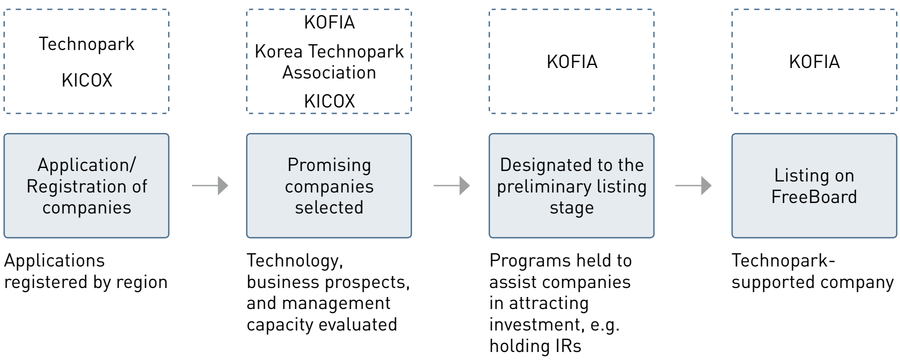
Promising SMEs and venture firms can register with the FreeBoard as a preliminary listing stage and receive assistance in attracting the investment necessary to fund their business. KOFIA and Technopark[1], a technology complex, aiming to promote the development of regional industries, launched this service in July 2008. KOFIA also established a cooperation agreement with

Note: 1) Technopark is an industrial technology complex established to promote technological innovation and development of high-tech industry in accordance with the Exemption Law on Support for Industrial Technology Complexes.(as of the end of June, 2010, there were 10 complexes in total)

Korea Industrial Complex Corp. (KICOX)[2] in December 2010, and expanded the preliminary listing system for companies located in the complex. Stocks issued by companies in the preliminary listing stage are not traded on the FreeBoard, and are therefore not subject to listing requirements for investor protection (such as external audits) or disclosure.

To apply for the preliminary stage, the applying company must be recommended by the Korea Technopark Association, a representing body of Technopark members all around the nation, or by KICOX. Once the application is made, KOFIA will determine its eligibility within seven business days after the application date.

CHART 7-2. PROCESS OF ENTERING THE PRELIMINARY LISTING STAGE



Once a company has entered the preliminary listing stage, KOFIA will provide it with diverse investment information through Techboard (www.techboard.or.kr) in an effort to help its financing activities. At the same time, KOFIA will assist it through support programs such as IR clinics, IRs, and corporate finance training programs. When the company succeeds in attracting investment, it is required to apply as a new listing on the FreeBoard and is classified as a Technopark-supported company.

Note: 2) Korea Industrial Complex Corp. (KICOX) is an industrial complex management organization established to develop and manage industrial complexes and to support production activities of companies in accordance with the Act on Industrial Cluster Development and Factory Establishment. (KICOX has established 48 industrial complexes nationwide as of the end of December 2010.)

IV. TRADING ON THE FREEBOARD

1. Overview

Stocks eligible for trading on the FreeBoard are restricted to stocks issued by FreeBoard-listed companies. Trading hours are from 9:00 to 15:00 without any distinction between the morning and afternoon sessions. The FreeBoard operates Monday through Friday, excluding national holidays, the Labor Day, and the last business day of the calendar year. The trading unit is set at one share when an order is placed and the quotation price unit is set to reflect the share price as shown in the following table.

TABLE 7-3. TICK SIZE

Share price	Tick size
Less than KRW5,000	KRW5
KRW5,000 or more to less than 10,000	KRW10
KRW10,000 or more to less than 50,000	KRW50
KRW50,000 or more to less than 100,000	KRW100
KRW100,000 or more to less than 500,000	KRW500
More than KRW500,000	KRW1,000

To prevent unfair trading practices such as unreasonable pricing or price manipulations, KOFIA refuses to receive bid/ask quotes if, at the time of its submission, the ask price is lower than the highest bid price by more than 10 quotation price units, or the bid price is higher than the lowest ask price by more than 10 quotation price units. The daily price fluctuation limit of an issue is set at 30 percent of the base price.

When a new listing is first traded on the FreeBoard, the base price for the first transaction will be calculated as follows: if there has previously been an offering or selling of the issue during the six-month period prior to the FreeBoard application date, the base price will be the equivalent of the offering or selling price per share at that time. Otherwise, the base price will be the net asset value (NAV) per share.

After the first day of trading has taken place, the base price for issues thereon will be calculated as follows: the volume weighted average price (total transaction value divided by total number of traded shares) of the previous day will be the base price. For issues that did not engage in trading the previous day, that day's base price will continue to be applied. Also, in cases where there is a stock split, stock consolidation, reverse stock split, capital increase, increase of capital stock without consideration, or stock dividend, the base price will be adjusted to balance the value of stocks before and after the event.

Using the Quotation Dissemination System (QDS), trading on the FreeBoard takes place through a bilateral matching method. Therefore, in principle, if the bid price and ask price for an issue match, trades are executed automatically for as many stocks as the quotes are matched for. If the prices do not match, however, trading does not take place. Also, in the case of two bid quotes competing for one offer quote, the time priority principle of first-come first-serve is applied.

2. Trading Procedure

An investor intending to buy/sell stocks on the FreeBoard must open a trading account at a financial investment company prior to trading. If the investor has already opened such an account for the purpose of buying/selling KRX-listed stocks, that account can also be used to trade on the FreeBoard. To make an order, the investor provides the financial investment company with an order slip containing information such as the name of issue, specification of sell or buy, and price and quantity. Investors can also trade using the telephone or home trading system (HTS).

If the financial investment company determines that the order involves an act of unfair trading such as price manipulation, the order can be deemed a case for rejection and the financial investment company must reject taking custody of the order. In such cases, the financial investment company will state the reason for refusal on the order slip and notify the investor.

As a mechanism to ensure settlement, KOFIA requires the financial investment company retain an investor deposit worth 100% of the payment. To buy an issue, the entire payment amount should be deposited, and to sell, the entire stocks amount must be deposited with the financial investment company.

The Korea Securities Depository (KSD) undertakes the settlement, which takes place on the third business day (T+2) starting with the date of execution. The FreeBoard permits trading before settlement.

TABLE 7-4. COMPARISON BETWEEN THE FREEBOARD AND KRX

Category		FreeBoard	Stock Market/KOSDAQ
Trading method		Bilateral matching	Competitive auction trading
Trading hours	Regular trading	Same as the KRX Exchanges	9:00-15:00
	After-hours	N/A	7:30-8:30 15:10-18:00
Quotation unit		1 share	10 shares/1 share
Price fluctuation limit		±30%	±15%
Margins		100% of cash or securities	At the discretion of financial investment company
Trading before settlement		Same as the KRX Exchanges	Permitted
Settlement		Same as the KRX Exchanges	On the third day starting with the date of execution (T+2)
Settlement entity		Same as the KRX Exchanges	KSD
Commission rate		Same as the KRX Exchanges	At the discretion of financial investment company

3. FreeBoard Stock Price Index

KOFIA introduced a capitalization-weighted stock price index on the FreeBoard on December 4, 2006. The base date for the index is the market's closing hour on December 1, 2006, and the base value is 1,000p. In addition to the composite stock price index, other stock market indices, including the venture index and industry indices (manufacturing, computer and related activities) are calculated on a minute-by-minute basis.

4. Trading Costs

Trading on the FreeBoard market involves the cost of paying commissions to the financial investment company as well as securities transaction tax and capital gains tax when selling stocks.

Commissions are paid to the financial investment company at a rate set by the company for undertaking the sell/order transactions and related services for the investor.

Securities transaction tax is charged on financial assets of taxable stock certificate or equity share transfers. When an investor sells stocks of a FreeBoard-listed company, 5/10,000 of the payment has to be paid as securities transaction tax, which will be collected at the point of settlement by KSD.

Capital gains tax is charged on any income occurring from the transfer of assets. If the transferred stocks are shares of SMEs, a 10% tax rate is applied. For shares of large corporations, a 20% tax rate is applied. And for stocks owned by a major shareholder of a large corporation for a period less than one year, a 30% tax rate is applied. Capital gains tax is exempted if a minority shareholder of a FreeBoard-listed venture company transfers the company's stocks through the FreeBoard.

TABLE 7-5. COMPARISON OF SECURITIES TRANSACTION TAX AND CAPITAL GAINS TAX

Category	Stock Market	KOSDAQ	FreeBoard
Securities transaction tax	0.3% of sell price (Including 0.15% special tax for rural development)	0.3% of sell price (No special tax for rural development)	0.5% of sell price (No special tax for rural development)
Capital gains tax	Minority shareholders (Exchange-traded): Tax exempted Minority shareholders (OTC-traded): Tax levied		Minority shareholder of venture company (Transferred on the FreeBoard): Tax exempted Minority shareholder of venture company (Transferred outside of the FreeBoard): Tax levied
	Tax rate: 10% for SME shares, 20% for large corporation shares, 30% for shares owned by major shareholder of large corporations for a period less than one year		

Note: Minority shareholders refer to shareholders meeting the following conditions:
- In cases of a stock exchange-listed company, owning shares of less than 3% and the total market capitalization of less than KRW10bn.
- In cases of a KOSDAQ-listed company or a FreeBoard venture company, owning shares less than 5% and total capital market capitalization of less than KRW5bn.

V. DISCLOSURE

1. Corporate Disclosure

Issuers are required to disclose any managerial decision or change that may affect its stock price so that investors are able to make investment decisions based on an accurate picture of the issuer's status. Disclosure is especially important in the FreeBoard market in order to protect investors, since many companies listed on the FreeBoard are smaller in scale and less-known due to the low entry barrier.

2. Primary Market Disclosure

When a FreeBoard-applying or FreeBoard-listed corporation wishes to make a public offering or sell its stocks, it must report and make disclosure to the FSC. If the amount of the total offering or the sales of stocks is equal to or more than KRW10bn, a registration statement must be filed with the FSC. If the amount is less than KRW10bn, the public offering disclosure documents for a capital increase in small amounts must be submitted to the FSC. There are, however, special disclosure exemptions for small investors selling stocks on the FreeBoard.

When applying to be listed on the FreeBoard, if the applicant had submitted documents, describing the issuer (disclosure documents for small sales on the Quote Brokerage System)[3], and an audit report (or semi-annual report in cases after the semi-annual closing) to the FSC or KOFIA three days prior to the sales of stocks, it will be regarded as having already complied with the duty to submit the public offering disclosure documents for capital increase in small amounts.

If the FreeBoard applicant or FreeBoard-listed corporation subject to such obligations has already filed its business report and made its disclosure to the FSC (in cases of FreeBoard applicants, submitted three days prior to the small investor's sales of stocks), then the company is exempted from the duty to submit the audit report and sales registration documents for small amounts.

3. Secondary Market Disclosure

Corporations listed on the FreeBoard are required to make disclosure through periodic, ad-hoc, or inquired disclosure.

1) PERIODIC DISCLOSURE

Listed corporations are required to submit two copies of their audit report (including semi-annual reports) and documents containing information on the issuer to the FSC and KOFIA within 90 days after the fiscal year-end and within 45 days after the half-year end.

Note: 3) “Document describing the issuer” refers to a simplified documentation to the second part of the registration statement dealing with issues. The form is the same as the registration document of stocks sales in small amounts (submitted when applying for the listing on FreeBoard), and the registration document on changes in the stocks sales in small amounts.

2) AD-HOC DISCLOSURE

If there are any facts or decisions regarding the management of an issuer that can affect the decision-making of investors, disclosure must be made immediately. The listed corporation can make the disclosure through documents or fax. KOFIA discloses the information through the QDS or Internet. The following cases are deemed as reasons for ad-hoc disclosure.

Subject to disclosure on the date of event:

- Issued checks or bills are dishonored, transactions with banks are suspended or banned, or transactions with banks are resumed
- Main business activities of the listed corporation have been suspended
- An application is submitted for commencement, conclusion, or cancellation of corporate reorganization procedures, or a court decision thereon has been notified in accordance with the Debtor Rehabilitation and Bankruptcy Act
- A decision or a Board's resolution is made on a merger with another corporation, transfer or acquisition by transfer of a major business, or a corporate spin-off or consolidation
- Any cause for dissolution pursuant to the relevant laws and regulations occur
- A decision is made on a capital increase or decrease

Subject to disclosure on the next day from the date of event:

- Location of the main office, CEO, name of the corporation, or business purpose has been changed
- A decision is made on a stock split or consolidation
- A decision is made on the issue of corporate bonds, including convertible bonds and bonds with warrants
- A decision is made on acquisition, transfer, or acquisition by transfer of a patent on new material or technology, which may have a material impact on the management and asset of the designated corporation
- A decision is made to apply for delisting
- A board resolution is made on stock dividend distribution
- A board resolution is made on interim dividend distribution
- A board resolution is made on the opening of a shareholders meeting and such meeting is concluded
- The largest shareholder (in accordance with Article 9 of FSCMA) has changed

In addition, other matters incidental to the cases above, which may have a material impact on investors' investment decisions can be subject to disclosure.

3) INQUIRED DISCLOSURE

When there are rumors or press releases regarding a certain FreeBoard-listed corporation, the corporation should make a disclosure. KOFIA can require the disclosure officer of the corporation to confirm the validity of the matter regarding the disclosure. The issuer is required to document the contents of the disclosure within one day of the request and submit it to KOFIA through fax, etc.

4. Failure of Disclosure Obligations

KOFIA will urge corporations to promptly make disclosures public and will impose sanctions on unfaithful issuers. When a corporation is designated as unfaithful for the first time, the fact will be made public through the QDS and the corporation will be banned from trading on the FreeBoard for a set period of time. If the issuer is designated as unfaithful four times within 2 years, then KOFIA can warn investors of the corporation's acts by making them known to the public. If the number increases to six times in two years, it can be delisted from the FreeBoard. Such measures contribute to enhancing the effectiveness of the disclosure system.

5. Investment Alerts to Investors

When a corporation is suspected of falling under any of the following categories that could lead to delisting or possible insolvency, KOFIA will disclose the facts to investors as a way of investment alert.

- Monthly trading volume has been less than 5/10,000 (in cases of common stocks) of the total designated stocks for four months or longer
- A FreeBoard-listed corporation has been designated as unfaithful in complying with disclosure standards four times or more within the recent two-year period
- The auditor's audit opinion on the listed corporation is "adverse" or "disclaimer of opinion," or the corporation's capital is impaired

VI. DELISTING

In cases where the issuer loses its qualification as a listed company, it is delisted from the FreeBoard and will no longer be able to trade on the FreeBoard. Reasons for being delisted include:

1. Insolvency

- In cases where the trading bank dishonors issued checks or bills, or transactions with the bank are suspended. However, if the issue had gone bankrupt before the stock market or KOSDAQ's delisting date, and had applied for the FreeBoard listing within a three month period prior to the decision of delisting, then, it will not be delisted for one year from the date of the FreeBoard listing
- When an application to commence rehabilitation proceedings has been rejected, a decision of corporate reorganization commencement has been withdrawn, or a disapproval of a rehabilitation plan or a repeal of rehabilitation procedures has been decided in accordance with the Debtor Rehabilitation and Bankruptcy Act
- If the corporation is no longer able to meet the qualifications as a newly listed corporation

2. Unable to Meet Obligations as a FreeBoard-listed Corporation

- In cases where any material facts considered important for investor protection are misstated or omitted in the application or other accompanying documents
- When regular disclosures are not made within 30 days starting from the next business day of the deadline, which is within 90 days from the closing of the business year
- When monthly trading volume of all FreeBoard-listed stocks has remained at less than 5/10,000 for more than six months
- When designated as a corporation of unfaithful disclosure and such designation has taken place six times or more during a two-year period preceding the date of designation

3. Changes in Corporate Structure or Management Policy

- When merged with another corporation
- When listed on the Stock Exchange or KOSDAQ market
- If any reason for legal dissolution occurs
- In cases where KOFIA deems it is necessary to delist the corporation because its existence is severely threatened due to the violation of disclosure duties or laws and regulations, etc., intentionally or due to negligence

4. Application for Delisting

- In case the corporation applies for delisting

VII. INCENTIVES FOR LISTING ON KOSDAQ

As part of the effort to improve the FreeBoard system, KOFIA provides incentives to stable, well-performing venture corporations that meet the following description when applying to be listed on KOSDAQ.

- Corporations listed on the FreeBoard for a period of one year or longer
- Corporations that have not been designated unfaithful disclosures during the recent year
- Corporations with yearly turnover rate of 5% or more

This system, which is regulated by the KOSDAQ listing regulations of the KRX, was introduced to strengthen the FreeBoard's function as a pre-KOSDAQ market and to assist SMEs and venture companies in their financing through the capital market.

Incentives given to FreeBoard-listed corporations are as follows:

- When FreeBoard-listed companies apply for preliminary reviews for KOSDAQ listing, within the 10% range of all corporations subject to the review, KRX will review FreeBoard-listed corporations first
- When estimating the total issues to be offered or sold on KOSDAQ after the preliminary review date, up to 5% of the offered or sold stocks on the FreeBoard (excluding the sale of minority shareholders shares) will be acknowledged and reflected in the estimation
- Listing review fees (KRW1mn) and listing fees (only in cases of new listings) are exempted
- If a FreeBoard-listed corporation is a new growth engine venture firm, it will be exempt from the restrictions placed on KOSDAQ-listed issuers, regarding refraining from selling stocks to venture capitals or professional investors for a period of one month, after listing on KOSDAQ

CHAPTER 08

BOND MARKET: 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.

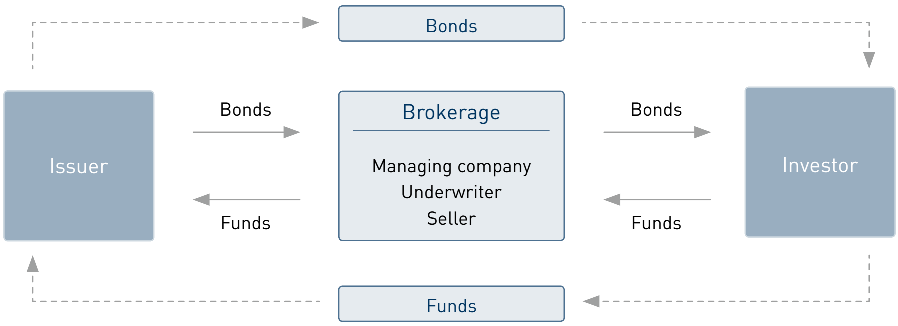
Accordingly, the primary bond market in the Korean capital market lately has been connected to the vitalization of the secondary market, and has demonstrated pronounced changes stemming from the wider variety and amounts of bonds issued.

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 the issuer to the investor. 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 8-1. STRUCTURE OF THE PRIMARY BOND MARKET



2. Participants in the Primary Market

1) ISSUER

The issuer raises capital by issuing bonds. They include the government, local governments, companies established by a special law and stock companies.

2) INVESTORS

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 processes 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 the issued bonds in collaboration with the managing companies. They sell the purchased bonds to the ordinary investors and sellers.

(c) Seller

The sellers directly sell issued bonds to the ordinary investors, the demand side of bonds.

II. THE CURRENT STATUS OF THE PRIMARY BOND MARKET

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

A quick look at bond issuance trends shows the value of bonds issued has increased 358.8% from KRW470.2tn in 2000 to KRW1216.8tn in 2010. The amount of bonds issued as proportion of GDP was 78.0% in 2000, increasing 25.8%p to 103.8% at the end of 2010.

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 2010, KTBs accounted for the largest share (29.6%), followed by financial bonds (20.3%), special bonds (19.6%), and monetary stabilization bonds (13.4%). In 2010, the amount of KTBs and financial bonds had doubled from its 2000 number, while the percentage of corporate bonds decreased by a large amount.

TABLE 8-1. TYPES OF BONDS OUTSTANDING

(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	603.2	78.0
2001	83.0	10.0	136.4	79.1	86.0	95.8	67.4	557.7	651.4	85.6
2002	99.0	9.1	136.4	83.9	122.3	90.1	67.6	608.3	720.5	84.4
2003	136.7	9.7	120.1	105.5	125.2	86.4	63.9	647.5	767.1	84.4
2004	178.6	10.1	116.8	142.7	134.4	75.5	48.3	706.4	826.9	85.4
2005	223.7	10.8	119.1	155.2	142.4	76.6	39.6	767.4	865.2	88.7
2006	258.0	11.6	107.3	158.4	184.9	76.5	34.8	831.5	908.7	91.5
2007	274.3	12.3	120.9	150.2	232.9	80.6	27.4	898.6	975.0	92.2
2008	284.5	13.1	142.1	126.9	270.4	98.2	20.7	955.9	1,026.4	93.1
2009	330.6	15.3	198.1	149.2	273.5	131.8	31.2	1,129.7	1,063.1	106.3
2010	359.6	16.0	238.0	162.8	246.5	164.6	29.4	1,216.8	1,172.8	103.8
Percentage (2000)	15.2	2.2	21.6	14.2	15.7	21.6	9.5	100.0	-	-
Percentage (2010)	29.6	1.3	19.6	13.4	20.3	13.5	2.4	100.0	-	-

Source: Korea Securities Computer Corporation, The Bank of Korea

The share of equity and corporate bonds issued when a company raises capital shifted from 19.7% and 80.3%, respectively, in 2000 to 6.2% and 93.8% in 2010, indicating that financing through corporate bonds has surged.

TABLE 8-2. PROPORTION OF CAPITAL RAISED THROUGH PUBLIC OFFERINGS OF EQUITY/BOND

(Unit: 100 million won, %)

	Equity		Corporate bonds		
Year	Issued balance	Percentage	Outstanding balance	Percentage	Total
2000	143,694	19.7	586,629	80.3	730,322
2001	121,713	12.2	871,949	87.8	993,662
2002	98,849	11.3	775,220	88.7	874,069
2003	112,534	15.4	617,575	84.6	730,110

Year	Equity		Corporate bonds		Total
	Issued balance	Percentage	Outstanding balance	Percentage	
2004	83,642	14.2	503,790	85.8	587,432
2005	67,633	12.3	481,031	87.7	548,664
2006	64,993	13.5	416,782	86.5	481,775
2007	172,576	27.6	451,598	72.4	624,174
2008	50,801	6.4	741,155	93.6	781,956
2009	116,157	9.2	1,149,400	91.8	1,265,557
2010	75,012	6.2	1,129,191	93.8	1,204,203

Source: Financial Supervisory Service, Monthly Financial Statistics Bulletin

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)). In other words, this means soliciting 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.

As such, FSCMA refers to recommendations for application for public offering and sale to the public during the previous six months. Here, "public" refers to the parties that are subject to the offer and sale, and consists of 50 or more investors.

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 since bonds of the Fund for Management of Government Bonds (changed to KTB in 1998) were issued in 1994. Currently, government bonds issued include KTBs, National Housing Bonds (NHB) Type 1 and 2, 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 four types of KTBs issued by maturity: 3-year, 5-year, 10-year, and 20-year, and they fall into fixed interest-type bonds (3-year, 5-year, 10-year and 20-year) and inflation-linked bonds (10-year maturity) depending on the interest rates.

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, 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 8-3. OUTSTANDING AMOUNTS BY GOVERNMENT BOND TYPE

(Unit: billion won)

KTB	NHB type 1	NHB type 2	TIPS	Total
310,076	44,170	4,712	2,536	359,554

Note: As of December 31, 2010

2) SCALE OF KTB ISSUANCE

The scale of KTB issuance has steadily increased with the outstanding issues, which were a mere KRW50.9tn in 2001, increasing six-fold to KRW281.9tn at the end of 2009. The portion out of the total amount of outstanding bond issues increased 2.8 times from 9.1% in 2001 to 25.5% at the end of 2010.

TABLE 8-4. PERCENTAGE OF KTBS OUTSTANDING AMONG TOTAL BONDS

(Unit: trillion won)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
KTB (Percentage)	50.9 (9.1)	55.6 (9.1)	81.5 (12.6)	123.1 (17.4)	170.5 (22.2)	206.8 (24.9)	227.4 (25.3)	284.5 (29.8)	281.9 (25.0)	310.1 (25.5)
Total	557.7	608.3	647.5	706.4	767.4	831.5	898.6	955.9	1,129.7	1,216.8

3) ISSUING PROCEDURES FOR KTB

TABLE 8-5. ISSUING PROCEDURES FOR KTB

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 - Establish 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 KTB: Every first Monday · 5-yr KTB: Every second Monday · 10-yr KTB: Every third Monday (Wednesday for inflation-linked KTB) · 20-yr KTB: Every fourth Monday - Bidding time: 10:40am - 11:00am - Bidding type and method of selecting successful bid · 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 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 and results	- The Minister of Strategy and Finance announces the details of bidding and the accepted bids when they are complete
5. Issuance of KTB and settlement of 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 the 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 are issued on March 10 and September 10; 10-year KTBs are issued on June 10; and 20-year KTBs are issued on December 10 each 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 made to be multiples of 0.25% by rounding up or rounding down the successful interest rate for each KTB issuance. The name of the issue is listed as "KTB Coupon Rate-Maturity Date." For example, 3-year KTBs with a coupon rate of 4.00% that were issued in June 2009 are listed as KTB0400-1206.

5) REDEMPTION OF KTBS

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 working 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 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 KRW1bn (par value), and increases in whole number multiples of KRW1bn. 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's Security Depository's (KSD) current deposit account, and KSD transfers the principal and interest to the bank that handles the transactions for the institution that holds KTBs.

3. Issuing Corporate Bonds

1) TYPES OF CORPORATE BONDS

Corporate bond issuances are divided into direct and indirect depending on who issues the bonds. Indirect issuance comprises of firm commitments, stand-by agreements, and best effort basis, depending on who handles the risk related to the underwriting. In addition, bonds comprise of par value, discount issue, and issues at a premium. The types of corporate bonds can be categorized into bonds with guarantees or collateral, ways of paying interest, and the rights given to holders of corporate bonds.

Depending on the existence of guarantees or collaterals, bonds are categorized 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 of the bonds are required to undergo credit assessment of the debentures from two or more different credit rating agencies.

Bonds are categorized by their 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.

Depending on the redemption periods, bonds can be divided into short-term bonds, mid-term and long-term bonds. Generally, short-term bonds have redemption periods under one year; mid-term bonds have redemption periods between one year and five years; long-term bonds have redemption periods over five years. Of note, long-term bonds refer to bonds that mature in 10 or 20 years in the U.S.

In addition, there are fixed-income bonds and floating rate notes (FRN) depending on how interest is paid. Fixed-income bonds involve the payment of fixed periodic returns. FRN has a variable interest rate that is linked to the benchmark interest rate.

Bonds categorized by the holder of the bonds are convertible bonds, bonds with warrant, exchangeable bonds, participating bonds and bonds with embedded option. 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) CORPORATE BOND ISSUANCE PROCEDURES

CHART 8-2. CORPORATE BOND ISSUANCE

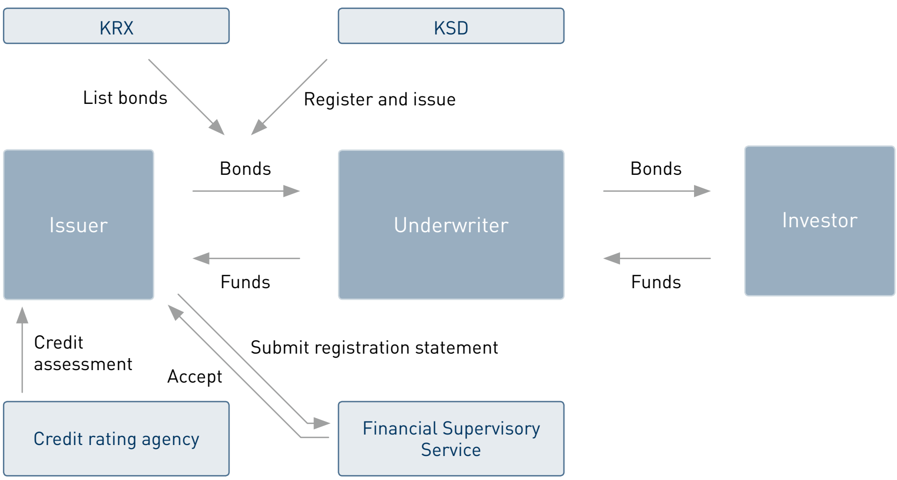


TABLE 8-6. CORPORATE BOND ISSUING PROCEDURES

1. Company registration	- Register with 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 (determine issuing amount, issuing interest rate, managing company, etc.)
4. Sign agreement to pay principal and interest as agent	- Decide where to pay corporate bond 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 trustee	- Select managing company that will underwrite and manage corporate bonds and a 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. Due diligence	- Lead manager, etc. checks for risk factors through due diligence of companies
7. Submit securities report	- Submit securities report and attached documents (subscription agreement, trustee agreement, principal and interest payment agency agreement, etc.) to FSS
8. Take effect	- Unsecured corporate bonds: Seven days after registration statement submission - Secured bonds, collateral bonds, ABS: Five days after registration statement submission - Shelf registration: Five days after registration statement submission
9. Submit prospectus	- When the bond takes effect after the submission of the registration statement, the issuer distributes and discloses the prospectus at its branches, FSS, and firms that will accept applications
10. Issuance and payment	- Issuance, payment and listing take place simultaneously
11. Issuance reporting	- After issuance is complete, issuance report is submitted to the FSS
12. Report underwriting by managers	- Report underwriting performance by managing companies to KOFIA five days from issuance day

CHAPTER 09

BOND MARKET: 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 KRX).

Unlike equities, bonds come in a large number of types (there are approximately 15,400 different types as of the end of 2010), 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

The OTC market accounts for 90% of the 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 KTB market (in October 2002), the OTC market accounted for 98-99% of all bond trading. After the measure, PDs increasingly began to trade in the exchange market, establishing a ratio of approximately 9:1 for the OTC to exchange market.

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 the point of view of the retail investor, 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 investor.

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 KRW10bn.

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-T+30, but mostly occurs at T+1. When foreign investors trade Korean bonds, the time differences result in T+3-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) in collaboration with the Financial Services Commission (FSC). 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

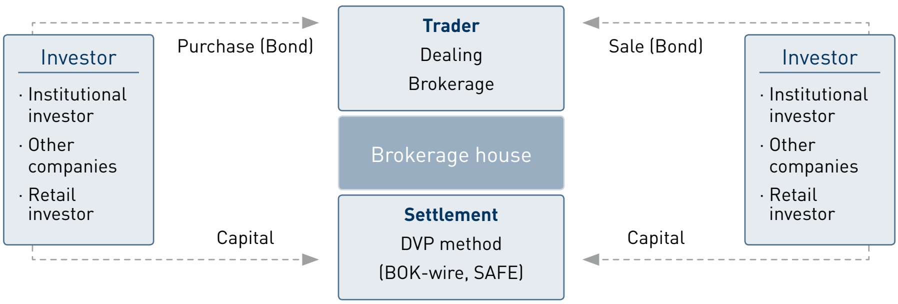
KRW5bn that are formed in the Korean OTC market. Then the collected bid/ask prices are disclosed to all market participants through KOFIA's BQS (www.bqs.or.kr) and through information terminals (CHECK, INFOMAX, etc.). Before the introduction of BQS, transactions in the Korean market primarily took place through the exchange of bid/ask prices through Yahoo messenger. This method of using instant messenger 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.

In the bond markets of developed nations and Korea, negotiated sale methods have traditionally served as the center of the OTC market. The private sale method mainly comprised of voice trading through the telephone. With the high penetration rate of the Internet in Korea, and with instant messenger becoming widespread after 2000, delivering the bid/ask price via instant messenger established itself as an important trading method in the OTC bond market as the convenience and speed became widely known.

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 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 of Bonds", which focuses on the bond trading system. Based on this, KOFIA has established and is operating FreeBond, an exclusive bond trading system. FreeBond, which consists of a 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 2011, 176 institutions and 1,463 individuals were registered with FreeBond, with 115 institutions and 685 individuals actually logging on to the system to use it. In the future, a complete bond ATS (alternative trading system) will be introduced, equipped with a settlement function. The introduction of a bond ATS will introduce 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 9-1. 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 IDM. Before the Asian financial crisis in the late 1990s, the Korean bond market 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 IDM was launched in the KRX.

Participants in 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 KRW1 and uses the limit order method. The order quantity consists of whole number multiples of KRW1bn. The market opens from 9am to 3pm 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 issue. 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 KRW1,000, while equity-related corporate bonds and ordinary bonds are traded in units of KRW100,000. 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 9-1. 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	PD
Trading broker	Securities companies	IDB	KRX	KRX
Main trading instrument	All bonds	All bonds	Small-amount government and public bonds, equity-linked corporate bonds	KTB
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, BW, 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 amount bonds: KRW1,000 Others: KRW100,000	KRW1bn

Source: Korea Financial Investment Association, Korea Stock Exchange

II. 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 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 KRW2,808tn. By 2004 it had reached KRW3,363tn, demonstrating a sharp increase. And while the trading volume decreased in 2007 to KRW3,078tn, it has increased on average by KRW3,000tn per year since 2004. In 2010, the trading volume surpassed KRW6,000tn.

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 KRW15tn in 2000, increased to KRW34.5tn in 2003, KRW56tn in 2004, and KRW62.6tn in 2005. 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, municipal 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 9-2. ANNUAL TRADING VOLUME BY BOND TYPE

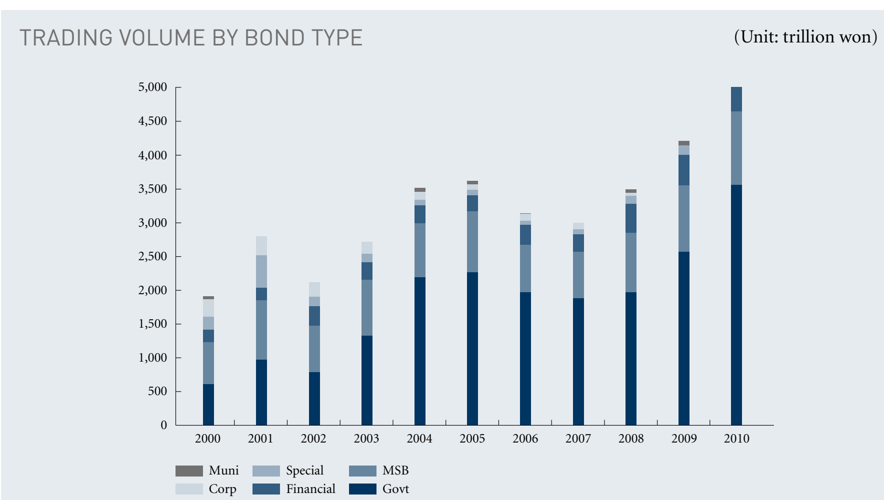
(Unit: trillion won, %)

		2001		2002		2003		2004		2005	
		Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age
Govt. and Public bonds	Govt. bonds	988.8	35.1	774.0	35.1	1,200.0	44.8	1,898.9	58.3	2,031.3	58.9
	Muni	9.2	0.3	8.4	0.4	8.8	0.3	11.5	0.4	10.3	0.3
	Special	503.3	17.9	130.1	5.9	124.1	4.6	96.6	3.0	78.8	2.3
	MSB	864.1	30.7	760.4	34.5	883.7	33.0	842.3	25.9	966.4	28.0
Financial		188.8	6.7	310.7	14.1	300.0	11.2	266.7	8.2	243.9	7.1
Corporate		262.2	9.3	223.2	10.1	163.1	6.1	139.2	4.3	116.6	3.4
Total		2,816.4	100.0	2,206.8	100.0	2,679.7	100.0	3,252.2	100.0	3,447.3	100.0

		2006		2007		2008		2009		2010	
		Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age
Govt. and Public bonds	Govt. bonds	1,677.5	56.3	1,519.4	55.8	1,614.2	50.6	2,658.0	57.1	3,703.4	60.2
	Muni	10.7	0.4	11.5	0.4	14.9	0.5	18.2	0.4	28.1	0.5
	Special	62.4	2.1	61.2	2.2	124.2	3.9	203.9	4.4	231.7	3.8
	MSB	833.7	28.0	766.5	28.2	895.8	28.1	1,071.9	23.0	1,403.7	22.8
Financial		301.8	10.1	293.0	10.8	468.4	14.7	548.8	11.8	628.0	10.2
Corporate		92.2	3.1	70.3	2.6	73.4	2.3	150.8	3.2	156.2	2.5
Total		2,978.3	100.0	2,721.9	100.0	3,190.9	100.0	4,651.6	100.0	6,151.1	100.0

Note: Sum of OTC and exchange trading (both sides), figures are as of June 2010. (same below)
Source: Korea Financial Investment Association, Korea Stock Exchange

GRAPH 9-1. ANNUAL TRADING VOLUME BY BOND TYPE



Source: Korea Financial Investment Association, Korea Exchange

TRADING PERCENTAGE BY BOND TYPE

Source: Korea Financial Investment Association, Korea Stock 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 abolished in July 2008 in order to increase transparency in the OTC market following the introduction of BQS for OTC traded bonds in December 2007. As a result, the proportion of exchange-based trading has continuously decreased since 2007. In 2010, exchange trading accounted for a mere 9.5% of the total trading volume.

Although the ratio of OTC to the exchange traded market is approximately 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 trading market. Government bonds, which account for an absolute share in the exchange traded market, have remained at approximately 20% 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 9-3. PROPORTION OF OTC/EXCHANGE TRANSACTIONS

(Unit: %)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
OTC	99.5	97.8	92.1	88.4	89.4	90.1	86.9	88.3	89.2	90.5
Exchange	0.5	2.2	7.9	11.6	10.6	9.9	13.1	11.7	10.8	9.5

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

TABLE 9-4. BREAKDOWN OF OTC/EXCHANGE TRANSACTIONS BY BOND TYPE

(Unit: trillion won, %)

			2001		2002		2003		2004		2005	
			Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age
Govt. and Public bonds	Govt.	OTC	978.4	98.9	730.7	94.4	991.3	82.6	1,529.7	80.6	1,672.0	82.3
		Exch-ange	10.4	1.1	43.3	5.6	208.7	17.4	369.2	19.4	359.3	17.7
	Muni	OTC	7.9	85.9	6.0	71.4	6.2	70.5	5.7	49.6	6.7	65.0
		Exch-ange	1.3	14.1	2.4	28.6	2.6	29.5	5.8	50.4	3.6	35.0
	Special	OTC	503.2	100.0	129.9	99.8	123.8	99.8	95.5	958.9	78.5	99.6
		Exch-ange	0.1	0.0	0.2	0.2	0.3	0.2	1.1	1.1	0.3	0.4
	MSB	OTC	864.1	100.0	760.3	100.0	883.6	100.0	842.1	100.0	966.3	100.0
		Exch-ange	0.0	0.0	0.1	0.0	0.1	0.0	0.1	0.0	0.1	0.0
Financial		OTC	188.8	100.0	310.6	100.0	299.0	100.0	266.6	100.0	243.7	99.9
		Exch-ange	0.0	0.0	0.1	0.0	0.1	0.0	0.1	0.0	0.2	0.1
Corporate		OTC	260.1	99.2	221.3	99.1	162.1	99.4	138.1	99.2	114.8	98.5
		Exch-ange	2.1	0.8	1.9	0.9	1.0	0.6	1.1	0.8	1.8	1.5
Total		OTC	2,802.5	99.5	2,158.8	97.8	2,466.9	92.1	3,082.0	89.4	3,082.2	89.4
		Exch-ange	13.9	0.5	48.0	2.2	212.8	7.9	365.3	10.6	365.3	10.6

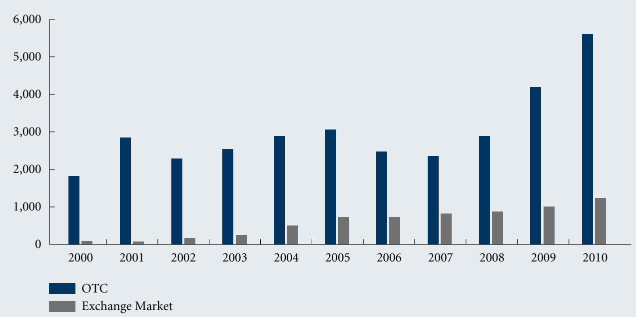
			2006		2007		2008		2009		2010	
			Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age	Trading volume	Percent-age
Govt. and Public bonds	Govt.	OTC	1,388.2	82.8	1,173.2	77.2	1,251.8	77.5	2,166.1	81.5	3,149.6	85.0
		Exch-ange	289.3	17.2	346.2	22.8	362.4	22.5	491.9	18.5	553.8	15.0
	Muni	OTC	6.9	64.5	7.1	61.7	9.4	63.1	13.6	74.7	14.4	51.2
		Exch-ange	3.8	35.5	4.4	38.3	5.5	36.9	4.6	25.3	13.7	48.8
	Special	OTC	62.3	99.8	61.0	99.7	123.9	99.8	203.2	99.7	230.9	99.7
		Exch-ange	0.1	0.2	0.2	0.3	0.3	0.2	0.7	0.3	0.8	0.3
	MSB	OTC	833.1	99.9	765.0	99.8	894.1	99.8	1,069.8	99.8	1,392.6	99.2
		Exch-ange	0.6	0.1	1.5	0.2	1.7	0.2	2.1	0.2	11.1	0.8
Financial		OTC	301.1	99.9	291.3	99.4	465.8	99.4	547.7	99.8	627.0	99.8
		Exch-ange	0.4	0.1	1.7	0.6	2.6	0.6	1.1	0.2	1.0	0.2
Corporate		OTC	90.9	98.6	68.4	97.3	71.7	97.7	146.9	97.4	152.2	97.4
		Exch-ange	1.3	1.4	1.9	2.7	1.7	2.3	3.9	2.6	4.0	2.6
Total		OTC	2,682.8	86.9	2,366.0	86.9	2,816.7	88.3	4,147.3	89.2	5,566.7	92.5
		Exch-ange	295.5	13.1	255.9	13.1	374.2	11.7	504.3	10.8	584.4	9.5

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

GRAPH 9-2. COMPARISON OF OTC/EXCHANGE MARKETS

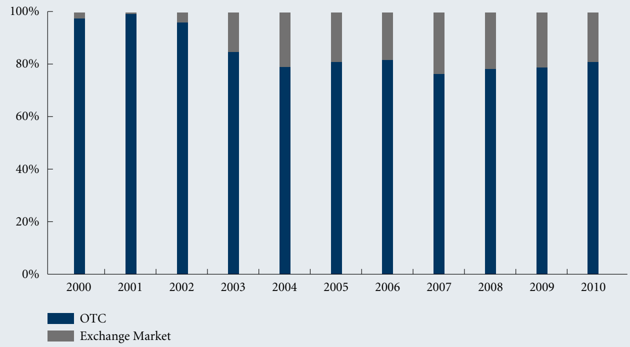
OTC/EXCHANGE MARKET TRANSACTIONS

(Unit: trillion won)



Source: Korea Financial Investment Association, Korea Stock Exchange

OTC/EXCHANGE MARKET PROPORTIONS

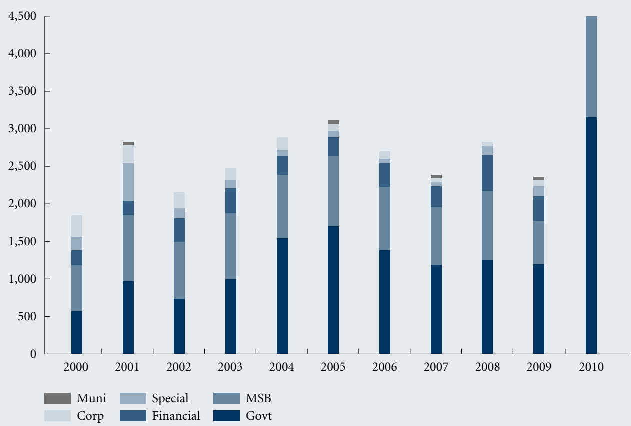


Source: Korea Financial Investment Association, Korea Stock Exchange

GRAPH 9-3. OTC/EXCHANGE MARKET TRADING BY BOND TYPE

OTC MARKET TRADING VOLUME

(Unit: trillion won)



Source: Korea Financial Investment Association, Korea Stock Exchange

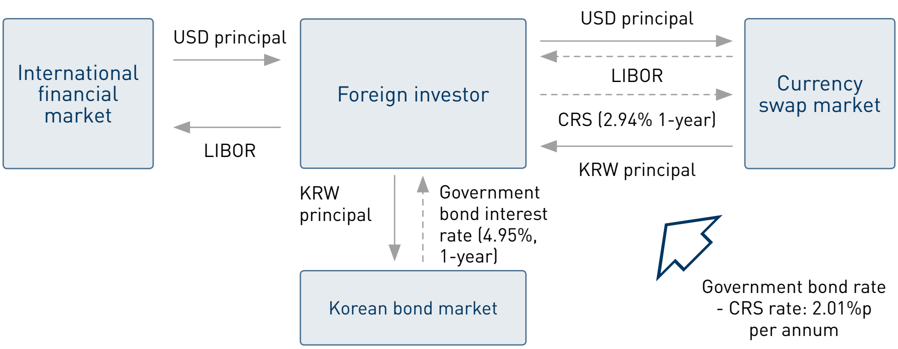
Source: Korea Financial Investment Association, Korea Stock Exchange

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. Until the first half of 2007, foreign investment in Korean bonds had been insignificant and little noted. Then, in the second half, forward exchange sales volume to hedge against foreign exchange fluctuations increased due to a boom in shipbuilding sales. Overseas investments by funds rapidly expanded, leading to an increase in forward exchange sales, which resulted in dramatically lower interest rates for currency swaps (CRS), widened the swap basis, and substantially increased opportunities 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 US 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 9-2. PROCEDURES FOR FOREIGN INVESTMENT IN KOREAN BONDS (E.G.)



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 gradually increasing 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 increase foreign investment in Korean bonds by announcing tax exemptions for withholding corporate and income tax on interest income from the purchases of government and monetary stabilization bonds. The relevant law passed 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, and an increase in investment in Korean bonds began to occur. Through this policy, the Korean government hopes Korean government bonds will be included in global government bond indices including the Citi Group's WGBI (World Government Bond Index). As of 2010, foreign investments in domestic bonds are steadily increasing, backed by rapid economic recovery and the strong won.

TABLE 9-5. FOREIGN INVESTORS' NET BUYING BY BOND TYPE (BASED ON OTC)

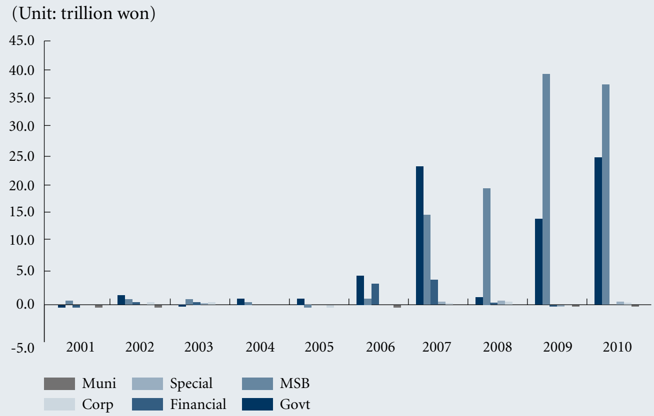
(Unit: trillion won)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Government	△0.1	1.5		1.0	1.4	2.2	21.1	1.4	13.3	24.8
Municipal							0.1			
Special	0.1	0.1	0.2	0.1		0.1		0.6		
MSB	0.4	1.3	1.5	0.5		2.7	9.8	18.7	39.3	38.8
Financial		0.3	0.4	0.1	0.1	1.4	0.6	0.1	△0.1	0.7
Corporation	0.1	0.2	0.6	0.1	△0.3	0.1	0.1	0.4		
Total	0.6	3.5	2.6	1.8	1.2	6.5	31.7	21.2	52.5	64.3

Source: Korea Financial Investment Association

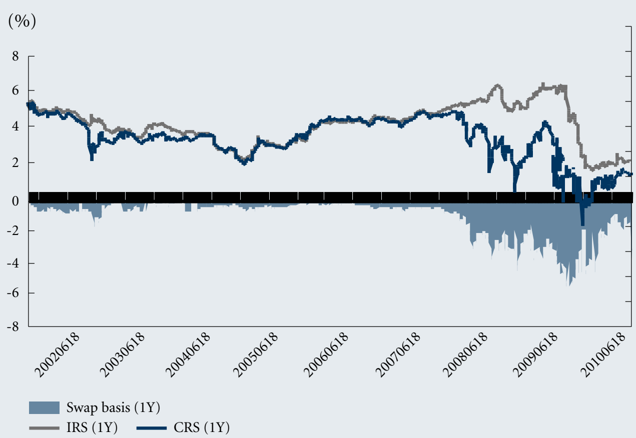
GRAPH 9-4. CHANGES IN FOREIGN INVESTMENT IN KOREAN BONDS

FOREIGN INVESTORS' NET BUYING OF KOREAN BONDS



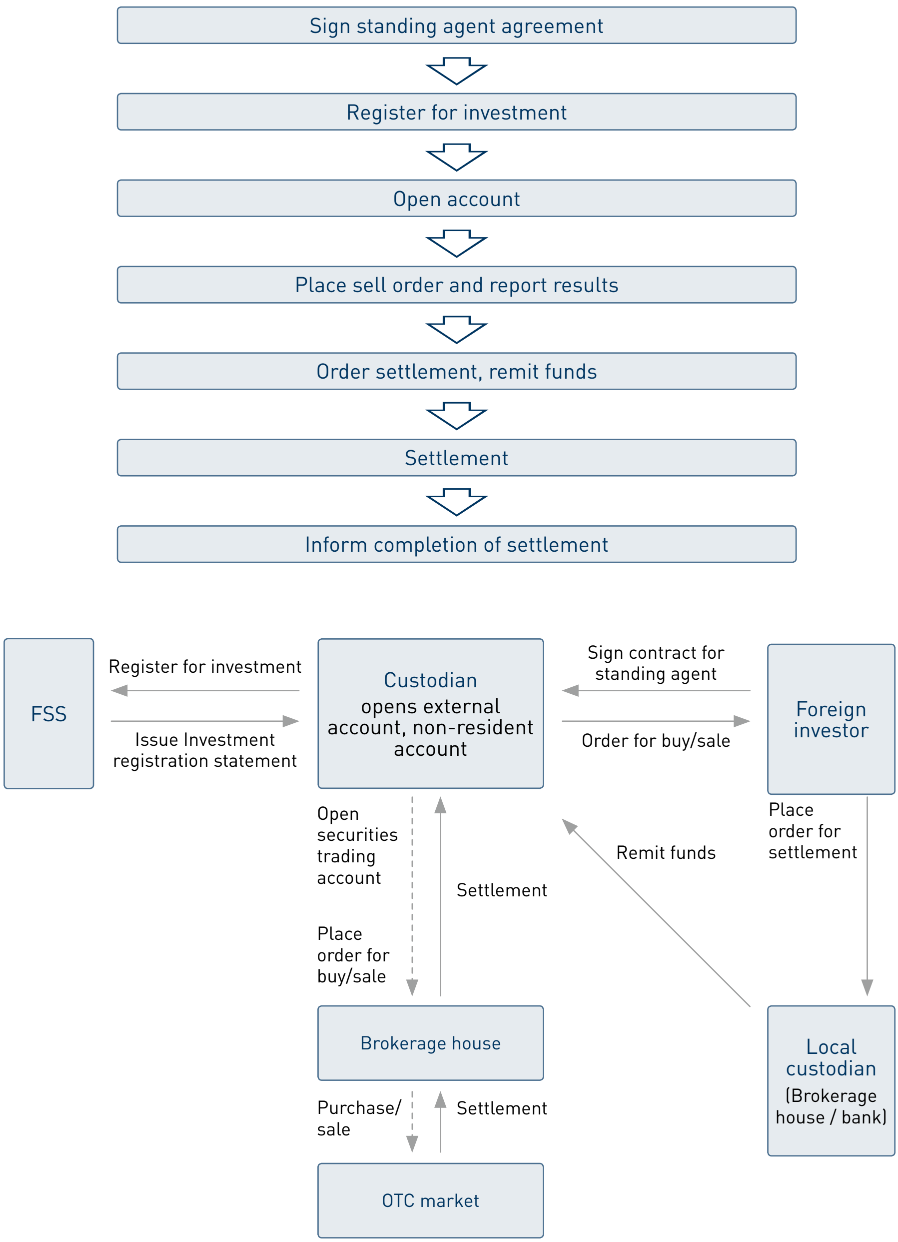
Source: Korea Financial Investment Association, Prebon

SWAP BASIS (1-YEAR)



Source: Korea Financial Investment Association, Prebon

CHART 9-3. PROCEDURES FOR FOREIGN INVESTMENT IN THE KOREAN BOND MARKET



- 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 custodian.
  - The custodian and standing agent may be separate institutions while they may be one institution that handles both activities.
- Investment registration: Standing agent
  - The standing agent receives a proxy from a foreign investor and 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 transaction 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 Apr. 2010)

1) BACKGROUND

Similar to developed nations, the bond market in Korea has traditionally used telephone voice trading as negotiated sale method. With the advances in IT technology after the Asian financial crisis, instant messenger 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 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[1)] that October, which aims to establish a specialized bond trading system. Based upon the measure, KOFIA established the online bond trading system, FreeBond.

Since the late 1990s, major developed nations have successfully introduced electronic bond trading systems using advances in IT technology. However, in the case of Korea, legal restrictions[2)] have hindered the introduction of ATS.

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 the 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 Exchange shall not establish the markets or any other similar facility and shall not trade securities or exchange-traded derivatives through any other similar facility.

2) MAIN CONTENTS

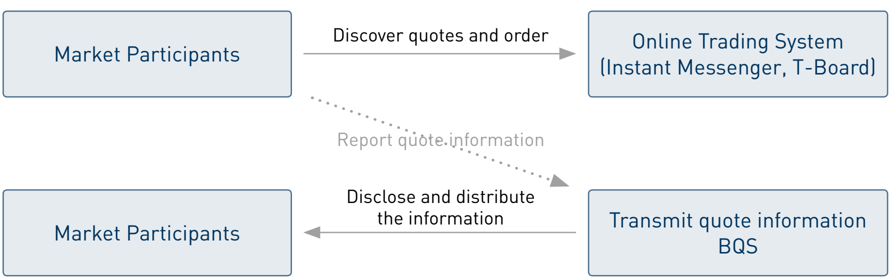
(a) Definition and Composition of FreeBond

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 9-4. OPERATION OF FREEBOND



① Market participants discover bid/ask price on FreeBond and excute 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.

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

T-Board offers trading functions such as bid/ask prices discovery, orders, negotiation and trade confirmation, and analyses and reference. Instant messenger, a replacement of the current private messenger, provides functions specialized for bond trading including 1 to n chatting and automatic storage of chatting records, on top of the general functions of private messenger.

(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 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 messenger which anyone can access. In addition, T-Board enables market participants to find quotes in real-time, issues of interest, information on bond issuance, and it offers a bulletin board for trading.

Unlike private messenger, 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

The success of FreeBond in the market with its wider use by market participants is expected to become a turning point in the advancement of the OTC bond market in Korea for the following reasons.

It will significantly improve the bond trading infrastructure. The formalized and safer FreeBond will not only boost the security of bond trading but it will also integrate the market which had been divided by different messenger groups.

In addition, transparency in bond prices will be enhanced as the search of 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. Information asymmetry will be reduced, and price discovery and the search of trading counterparts will be easier.

FreeBond was designed by and for bond traders, which makes it especially "market-friendly" and thus convenient for users. The system reflects all the requirements needed for trading, such as a variety of trading methods and analyses.

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

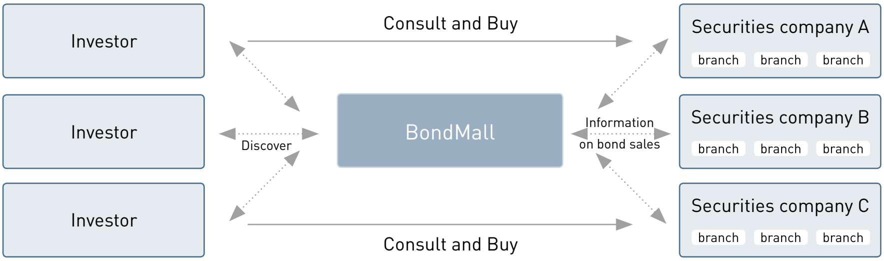
With Korea's aging population and low interest rates, high interest bonds such as corporate bonds are becoming popular with individuals and small investors. However, the retail bond market in Korea is dominated by small bond markets centered on securities firms and categorized according to the types 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. through visits, telephone, internet usage), 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 over 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 conducted by securities firm)

CHART 9-5. 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 investment. 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) OPERATION RESULTS

As of April 2011, fifteen months after BondMall was launched, approximately 18 securities companies have posted 741 issues per day - indicating that securities firms are using BondMall actively as a major bond 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 higher than A to protect investors.

V. BOND MARKET INFRASTRUCTURE

1. Credit Assessment

1) CORPORATE BOND ASSESSMENT

When a company issues corporate bonds in order to raise long term capital from the direct financing market, it is required to obtain a credit rating from a specialized credit rating agency for all non-guaranteed bonds in order to protect small-cap investors that lack professional knowledge on the issuer, and in order to ensure a reasonable price in the bond market.

Excluding government bonds, bonds for which the government gurantees the payment of principal and interest, municipal bonds, and monetary stabilization bonds issued by the Bank of Korea, all non-guaranteed corporate bonds must receive a credit rating in order to be included in the trusted assets of banks and investment trust companies. In other words, bonds issued without a guarantee, including those by ordinary companies, specialized lenders, financial investment firms, commercial banks, the Korea Development Bank, government-funded agencies, and pension funds, must first receive a credit assessment from a specialized credit rating agency. Corporate bond credit ratings are used as criteria for deciding upon investment when issuing and trading non-guaranteed bonds. They are also used as criteria for the mark-to-market value for funds that are subject to mark-to-market.

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 the changes in the investment environment.

TABLE 9-6. 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

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.
Source: Korea Investors Service (KIS)

2) COMMERCIAL NOTE ASSESSMENT

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 assessment 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 by issuing unsecured debentures or notes 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 (unsecured commercial paper and merchant bank intermediary notes) 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 9-7. GRADE HIERARCHY AND DEFINITION

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 specculative 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

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

3) ASSET-BACKED SECURITIES ASSESSMENT

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 9-8. KOREAN CREDIT RATING AGENCIES[1)]

	Korea Ratings	KIS	NICE	SCI
Capital	KRW24.45bn	KRW5bn	KRW5bn	KRW17.75bn
No.of emplyoees	170	109	121	220
Web site	www.korearatings.com	www.kisrating.com	www.nicerating.com	www.sci.co.kr
M/S(%)[2)]	33.2	32.4	34.0	0.4
Largest shareholder	Fitch(73.55%)	Moody's(50%+1 share),KIS(50%-1)	NICE(100%)	SP Partner(20.5%)
CEO	Insub Yoon	Wang Ha Cho	Yong Hi Lee, Sang Kwon Lee	Jung Sang Lee
Initiation of operations	Nov. 1987	Sep. 1985	Jun. 1987	Established Apr. 1992 Began credit assessment from Jan. 2000
Bonds for evaluation	Corporate bonds, CP, ABS	Corporate bonds, CP, ABS	Corporate bonds, CP, ABS	CP, ABS
Partner companies in credit assessment	Fitch	Moody's	Japan R&I, China Dagong Rating	Japan JCR

Note: 1) As of April 2011
2) Market share source: Financial Supervisory Service press release (Credit Information Service Providers' Operating Results: 2010)

2. Mark-to-Market Valuation of Bonds

1) SUMMARY

In November 1998, after the Asian financial crisis, the government introduced the mark-to-market policy 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 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'. As of March 2011, KOFIA monitors approximately 11,000 issues per month by various rating agencies. The results are reported to each company and to the FSS. These results are posted at KOFIA 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- KBP, NICE Pricing Services, 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 from November 2000.

TABLE 9-9. KOREAN BOND RATING AGENCIES

Name	KBP	KIS Pricing	Nice pricing services
Capital	KRW5.32bn	KRW3bn	KRW7.55bn
Largest shareholder	Korea Ratings	KIS	NICE
CEO	Hak-Kyoon Lee	Sun Dae Kim	Jong Hyun Kim

3) EFFECTS OF 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 are 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) ENHANCEMENT OF 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 investment 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 current 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 included bond transactions may be settled the same day.

Settlement of bonds in the OTC market is done by the Delivery versus Payment (DVP) 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, 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 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 facilitate bond circulation. Thus, the costs required for handling, shipping and storing bond certificates are cut, saving massive amounts of social overhead cost.

According to the Enforcement Decree of the Registration of Bonds and Debentures Act, 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 or 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 leaser, 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. KOFIA's Roles

KOFIA, based on FSCMA, FSC Regulations under FSCMA, and FSC Enforcement Rules under 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 transaction. KOFIA then discloses this information. The disclosure mandate was introduced in 2000 to enhance market transparency and increasing credibility in trade price.

Behind the introduction of the 15-minute rule were aspirations towards enhancing market transparency and encouraging more bond derivatives into the market. Previously, the details of a transaction were reported to KOFIA after 15:00 when the market was closed. Under such 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 2011, an average of 4,000 trade executions were reported daily. 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 messenger services, such as Yahoo and MSN, as a negotiating method. Compared to telephone negotiation, private messenger contributed, in part, to a reduction in bid/ask spreads and increased liquidity. However, it 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 messenger 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 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 price 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 YIELDS, ETC.

When the market closes, KOFIA posts the yield of each bond that represents 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). The final quotation yield disclosed by KOFIA comprises of final quotation yields for particular yields to maturity (8 types, 15 yields) and final quotation yields by yield to maturity (5 types, 47 yields).

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 government bonds (3-yr, 5-yr, 10-yr), and market-making quotation yields for bond-specialized dealers. KOFIA also discloses CP issuance information management, yields and indices, CD yields and transaction status, customer RP transaction status, and intermediary transactions of RP among institutions. Moreover, since December 1999, KOFIA has announced on a daily basis the 'KOFIA-Bloomberg Bond Index', an indicator of changes in the bond value of certain groups over time.

From 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 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 comprising mainly of bond market insiders who are surveyed on their market forecasts. The results of these analyses are quantified for BMSI. It is 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 Web site, it gives easy access to Korean bond-related information to foreign investors.

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 to 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.

CHAPTER 10

DERIVATIVES MARKET

I. 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, 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 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 FSCMA to cover new products such as derivatives. Fourth, FSCMA states that a financial investment instrument is a right acquired by an agreement. As a result, risk arising from mattersoccurring outside of the agreement such as credit risk cannot be included as an element constituting a financial investment product.

II. DEFINITION OF DERIVATIVES

A derivative is a financial instrument that is derived from other assets, which are referred to as underlying asset. 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 or before 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 the financial futures. In October 1975, the Chicago Board of Trade (CBOT) began trading interest rate futures with the 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 receiving 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.

TABLE 10-1. TYPES OF DERIVATIVES

Types / **Underlying assets**	**Futures/ Forwards**	**Option**	**Swap**
Interest rates	Interest rate future / FRA	Interest rate options	Interest swaps
Foreign currency (spots)	Currency futures / Forward exchanges	Currency options	Currency swaps / FX swap
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 10-2. 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 months for trading on an exchange	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 upon contract
Guarantee of transactions	Clearing houses	Counterparty
Market participants	Available for the general public	Not available for 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 the counterparty with insufficient credit ratings
Physical delivery	Most contracts are closed before a contract expiration date through cash settlements, and only some of the contracts are held to the expiration for physical delivery	Most of the 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

III. STATUS OF THE KOREAN DERIVATIVES MARKET

After recording continued increases in transactions, the turnover of derivatives handled by financial companies in Korea stood at KRW66,731tn in 2010, an increase of 36.2% from the KRW48,986tn recorded in the previous year. This dramatic increase occurred because equity-related derivatives such as equity-linked securities (ELS), equity-linked warrants (ELW), stock options, and stock futures have increased by 20.3% from last year's KRW5,663tn to KRW6,813tn. Securities companies, which mainly deal with these equity related derivatives, have also increased their turnover by 86.8% from the KRW15,451tn last year to KRW28,859tn this year. Despite its continuing growth, the OTC derivatives market still lags behind the exchange-traded derivatives market in terms of turnover growth. OTC derivatives make up around 0.78% of the total turnover in the domestic derivatives market.

TABLE 10-3. TURNOVER OF THE KOREAN DERIVATIVES MARKET

(Unit: billion won, %)

Category		2006	2007	2008	2009	2010
Underlying assets	Stock/Stock index	2,528,112	3,835,410	4,588,108	5,663,355	6,813,811
	Interest rate	2,948,124	4,712,286	5,958,961	6,575,227	7,912,962
	Currency	3,830,831	6,743,897	10,024,923	11,485,628	11,186,553
	Commodity	1,548	10,334	24,573	12,987	33,096
	Credit	2,294	2,943	6,429	5,377	6,073
Transaction venue	Exchange-traded	35,082,350	50,380,203	33,954,856	24,902,224	40,252,098
	Over-the-counter	435,175	615,874	676,091	341,221	526,834
Total		44,828,434	66,300,948	55,233,941	48,986,021	66,731,427

In 2010, the value of open interest handled by Korean financial companies amounted to KRW7,022tn, over two times the amount recorded in 2006 and 12.2% more than the same period of the previous year (KRW6,254tn). OTC derivatives accounted for 98.7% of the total value of open interest. An analysis of the turnover and open interest value of derivatives shows that exchange-traded derivatives center on short-term transactions, while OTC derivatives are usually held until the contract expires.

TABLE 10-4. VALUE OF OPEN INTEREST ON THE KOREAN DERIVATIVES MARKET

(Unit: billion won, %)

Category		2006	2007	2008	2009	2010
Underlying assets	Stock/Stock index	89,717	108,666	65,831	98,675	145,953
	Interest rate	1,397,516	2,561,138	3,415,807	3,920,002	4,693,829
	Currency	1,138,361	212,401	2,586,471	2,223,657	2,170,772
	Commodity	2,164	6,073	6,946	3,925	3,506
	Credit	2,709	3,895	6,406	8,373	8,055
Transaction venue	Exchange-traded	78,949	118,240	71,702	78,101	89,430
	Over-the-counter	2,551,518	4,663,933	6,009,759	6,176,531	6,932,685
Total		2,630,467	4,782,173	6,081,461	6,254,632	7,022,115

1. Recent Status of the Korean Exchange-Traded Derivatives Market

Rising demand for diverse derivatives, growth in equity-linked derivatives market (such as ELS), and increasing uncertainty in the global markets driven by the European financial crisis have all combined to boost the Korean exchange-traded derivatives market in 2010. This brought the daily average trading volume to 14,944,038 contracts in that period, an increase of 21.8% from the previous year.

Compared with the previous year, the daily average trading volume of the futures market decreased by 0.1%, recording 718,427 contracts in 2010. Compared with the same period of the previous year, the KOSPI200 options market experienced a rise in the daily average trading volume of 21.8%, amounting to 14,047,404 contracts in 2010.

TABLE 10-5. COMPARISON ON THE DAILY AVERAGE TRADING VOLUME OF MAJOR DERIVATIVES

(Unit: number of contracts, %)

Category		2009		2010		Variance rate (year-on-year comparison)
			First half of 2009		First half of 2010	
KOSPI200 futures	Weekly	328,437	354,125	341,893	362,384	4.1
	Global	705	-	3,792	2,921	437.9
Stock futures		146,132	182,853	178,159	177,953	21.9
3-year KTB futures		79,252	78,120	111,011	102,225	40.1
US dollar futures		162,695 (212,912)	105,952 (208,411)	261,727	250,097	60.9
Futures market total		718,972 (769,189)	722,587 (825,046)	718,427	899,343	-0.1
KOSPI200 option		11,545,418	11,089,241	14,047,404	13,589,161	21.7
Total		12,264,390 (12,314,607)	11,811,828 (11,914,287)	14,944,038	14,488,504	21.8

Note: ( ) is as of April 27, 2009 unit contraction from US 5mn to US 1mn in order to compare the trading volume.

The trading value of institutional investors in KOSPI200 futures, KOSPI200 options, and stock futures increased by 2.8%p, -2.3%p, and 8.6%p respectively from the previous year. However, looking at individual investors, the trading value of KOSPI200 futures and stock futures declined by 7.2%p and 8.9%p respectively. With regard to foreign investors, KOSPI200 options and stock futures saw a rise of 1.7%p and 0.3%p respectively during the same period.

TABLE 10-6. COMPARISON OF THE TRADING DISTRIBUTION OF MAJOR DERIVATIVES BY INVESTOR TYPE

(Unit: %)

Types	Period	Institution	Individual	Foreign
KOSPI200 futures	2009 2010	40.6 43.4	34.3 27.1	25.1 29.5
KOSPI200 options	2009 2010	34.8 32.5	31.9 32.5	33.3 35.0
Stock futures	2009 2010	15.0 23.6	79.0 70.1	6.0 6.3
3-year KTB futures	2009 2010	84.3 83.4	7.4 8.8	8.3 7.8
US dollar futures	2009 2010	80.2 73.0	13.3 15.8	6.5 11.2

Overall, derivatives trading enjoyed higher popularity in Korea in 2010. Once again, the source of such popularity can be traced back to the expansion of risk due to the European financial crisis, the growth in equity-linked derivatives market (ELS and ELW) and the expansion of the investor base brought about by securities companies' increased participation in the market after FSCMA's introduction.

2. Recent Status of the Korean OTC Derivatives Market

The OTC derivatives market in Korea has continued its robust recovery after the global financial crisis in 2008. Trading value increased by 5.0% in 2009 from the previous year to KRW13,133tn and again by 7.0% to KRW14,058tn in 2010. By investor type, banks made up 93.8% of the trading, followed by securities firms (3.5%), trusts (2%), insurance (0.1%), and others (0.5%). The higher creditworthiness of banks contributed to their dominance in the market because such credibility matters in a market where transactions are directly entered between counterparties.

TABLE 10-7. OTC DERIVATIVES TRADING BY KOREAN FINANCIAL INSTITUTIONS

(Unit: billion won, %)

Underlying	2008	2009	2010					
				Banks	Securities companies	Insurance companies	Trusts	Others
Equity <Korean won-related>	215,328 <144,822>	181,823 <108,143>	379,294 <296,014>	38,455 <38,453>	275,582 <252,156>	5,407 <5,403>	346 <2>	59,504 <>
Interest rate <Korean won-related>	2,671,720 <2,160,114>	2,857,511 <2,451,958>	3,484,733 <3,221,454>	3,327,686 <3,066,433>	149,551 <149,122>	1,931 <1,931>	3,768 <3,768>	1,797 <200>
Foreign currency <Korean won vs. Foreign currency>	9,594,889 <8,931,591>	10,082,007 <9,529,089>	10,180,328 <9485759>	9,812,102 <9,140,167>	64,431 <62,789>	10,910 <10,343>	276,962 <258,911>	15,923 <13,548>
Commodity <Korean won vs. Foreign currency>	23,723 <2,621>	6,363 <610>	8,205 <661>	7,190 <70>	672 <590>	1 <1>	342 <>	- <>
Credit <Denominated in Korea won>	6,429 <2,499>	5,377 <2,428>	6,073 <4,191>	3,793 <2,628>	2,270 <1,553>	- <>	10 <10>	- <>
Total <Korean won-related>	12,512,088 <1,241,647>	13,133,080 <12,092,227>	14,058,633 <13008078>	13,189,227 <12,247,752>	492,506 <657,340>	18,248 <17,678>	281,428 <262,691>	77,224 <13,748>

A break-down of derivatives indicates equity-related derivatives such as equity options and ELWs saw the highest rate of increase with their trading volume and balance in 2010 up year-on-year by 108.6% and 108.5%, respectively.

The trading volume of interest rate derivatives also increased by 21.9% over the previous year, spurred by a rise in the trading volume of interest rate swaps. However, the contraction of short-term spreads and declining volatility of interest rates led to a drop in the trading volume of interest rate forwards and options.

As for foreign currency derivatives, options saw their trading volume increase 28% year-on-year in 2010, a notable recovery from the KIKO crisis of 2008. The total trading volume increased 0.9% from the previous year.

Credit derivatives also witnessed a 12.9% increase in trading volume; although there was a drop in the issue of credit derivatives-linked-securities (DLS) resulting from the tightening of credit spreads that had expanded during the global financial crisis.

Judging by the trading volume ratio of derivatives, interest rate and foreign currency derivatives represent 97.2% of the total, with each taking up 24.7% and 72.4% respectively.

3. Expansion of Financial Derivatives

The spread of globalization and cooperation across the global economy has introduced diversification and higher risks to economic entities. As the volatility of F/X rates and interest rates increases amid wider fluctuations in the prices of underlying assets such as commodities and stocks, demand for financial derivatives is also increasing due to the unique nature of their trading risks. This, in turn, significantly expands the scope and trading volume of financial derivatives.

The trading of financial derivatives will increase further thanks to lower transactions costs, enabled by technological advances and higher efficiency in the integrated global market. Additionally, more accurate pricing of derivatives and easier evaluation and control of their risks have been made possible through the emergence of sophisticated pricing models and advances in financial engineering. All these factors have contributed to facilitating the creation and use of financial derivatives in the market.

Financial derivatives are traded based on different levels of risk appetite among market participants. In the arrangement, risk is traded between the investors willing to take risk and those wishing to avert risk for the exchange of premiums. In this process, the capital gains generated from risk trading are spread not only to the counterparties in the transaction, but to the society as a whole.

Another function of financial derivatives is their ability to absorb uncertainties in the market, thereby stimulating economic activity. For example, companies or financial institutions may use derivatives to reduce uncertainties in the spot market. As a result, they can plan for future investments or financing more safely, reduce fund raising costs, and achieve higher returns on asset management.

In addition, as financial derivatives separate risk from the reference asset, the asset market receives a higher flow of liquidity. The availability of capital gains through derivatives trading also contributes to raising liquidity and flexibility in cash flows. The other benefit of financial derivatives is enhanced market efficiency in allocating resources, as derivatives prices reflect all the information available in the market.

4. Status of the Global Derivatives Market

In 2010, the trading volume of global derivatives increased, fueled by ongoing fiscal uncertainty in Europe and concerns over a potential double-dip recession to reach 22.295 billion contracts – a growth of 25.9% compared to 2009. To this end, the Korean derivatives market has shown steady growth in major derivatives products and has increased by 20.8% from the second half of 2009. The Korean market now makes up 18.7% of all derivatives traded globally.

China achieved a remarkable growth rate of 33.1%, moving from 7th to 5th place in the world. India also recorded a high growth rate of 198.7% and remained the 3rd largest market, mainly due to the increase of currency futures (USD/INR). Brazil maintained 6th place, boosted by a growth rate of 54.6% while Russia moved from 8th to 7th place, with its trading volume increasing 32.6% compared to 2009.

The United States and Germany, renowned for their strong performance in traditional derivatives trading in the past, recovered from the poor results they showed in 2009. Active trading in short-term interest rate, bond-related products, and stock/stock index products contributed to an increase of 12.8% and 12.4% for each country, respectively.

TABLE 10-8. TRADING VOLUME OF DERIVATIVES BY COUNTRY

(Unit: number of contracts in million, %)

Rank	Country	2006	2007	2008	2009	2010	
							Proportion
1	U.S.A	4,597 (29.8)	6,091 (32.5)	6,954 (14.2)	6,315 (-9.2)	7,121 (12.8)	35.5
2	South Korea	2,475 (-4.6)	2,776 (12.2)	2,867 (3.3)	3,103 (8.2)	3,748 (20.8)	18.7
3	India	290 (43.3)	484 (66.6)	709 (46.5)	1,333 (85.0)	2,737 (105.3)	13.6
4	Germany	1,527 (23.3)	1,900 (24.4)	2,165 (13.9)	1,687 (-22.1)	1,896 (12.4)	9.4
5	China	695 (43.2)	927 (69.0)	1,076 (72.8)	1,246 (50.7)	1,566 (33.1)	7.8
6	Brazil	571 (22.0)	794 (39.0)	742 (-6.5)	920 (24.1)	1,422 (54.6)	7.1
7	Russia	-	229	371 (62.0)	494 (33.0)	655 (32.6)	3.3
8	Japan	218 (13.0)	258 (18.4)	316 (22.5)	312 (-1.4)	375 (20.2)	1.9
9	U.K.	695 (29.9)	927 (33.4)	1,076 (16.1)	1,246 (15.8)	369 (70.4)	1.8
10	South Africa	105 (104.7)	330 (213.8)	514 (55.8)	175 (-66.0)	169 (3.4)	0.9
Total		11,882 (18.9)	15,483 (30.3)	17,668 (14.1)	17,709 (0.2))	22,295 (25.9)	100

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

CHAPTER 11

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 social 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 ratings thanks to the liquidity premium as well as its structural premium.

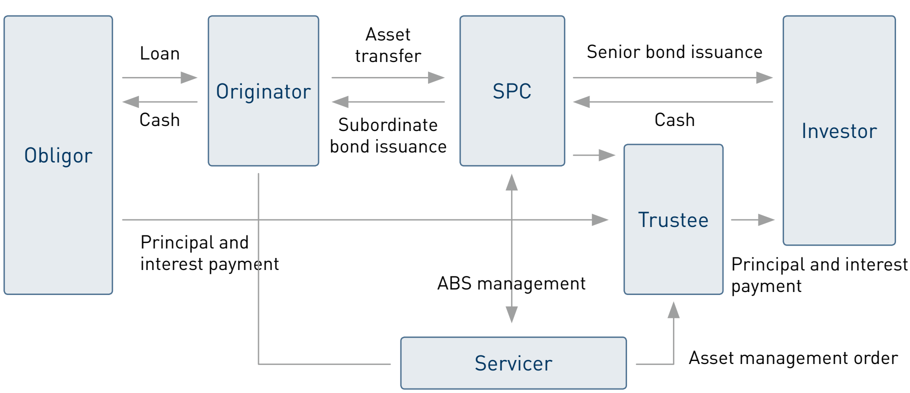
Asset-backed securities contribute to the development of the overall financial market in that they encourage securities firms to analyze various assets and build knowledge regarding the issuance of new types of securities, thereby providing the new sources of profits for a wide range of interested parties.

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 through wire transfer and utilized to be repaid at the time of maturity.

CHART 11-1. BASIC STRUCTURE OF ABS



2) MAJOR PARTICIPANTS

Entities that are involved in ABS issuance include originators, 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.

The 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 the claims, redemption and debt collection, and collects and provides relevant information and prepares reports.

The 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.

The 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 to carry out the ABS redemption as a proxy.

3) ABS STRUCTURE

The features of the underlying assets and the cash flows are critical factors in creating the structure of asset-backed securities. The 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 11-1. 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.

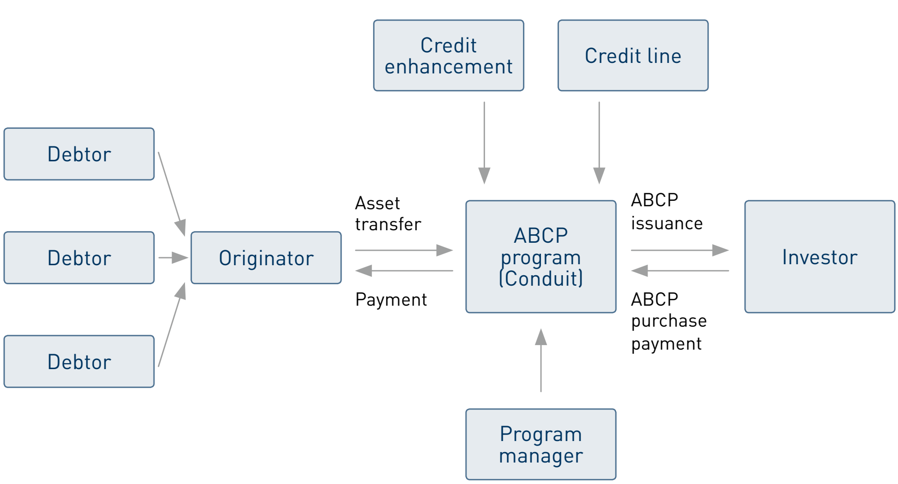
Credit enhancements refer to what increases the credit ratings of asset-backed securities over and above the certainty of the underlying cash flow. The credit rating agency determines the credit quality of an asset-backed security by considering its cash flow and its ability to withstand financial stress 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 the 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 underlying 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 expenditure. Since commercial paper is easy to issue through a simple process compared to corporate bonds, many companies rely on CPs for short-term financing. Unlike a conventional CP that is issued with credit, not 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 SPCs, 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 the approval and supervision matters. Credit enhancement agencies provide credit guarantees and take other measures to enhance the credit ratings for ABCPs.

CHART 11-2. 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 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 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 institution, 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 matters of asset-backed securitization. In reality, however, securitized assets are property rights that can be transferred and registered, since securitized assets shall 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 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; 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 KRW25bn 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 promulgated 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 in 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 insufficient, the government shall cover any loses.

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 the 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 ABS 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 (NPL).

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.

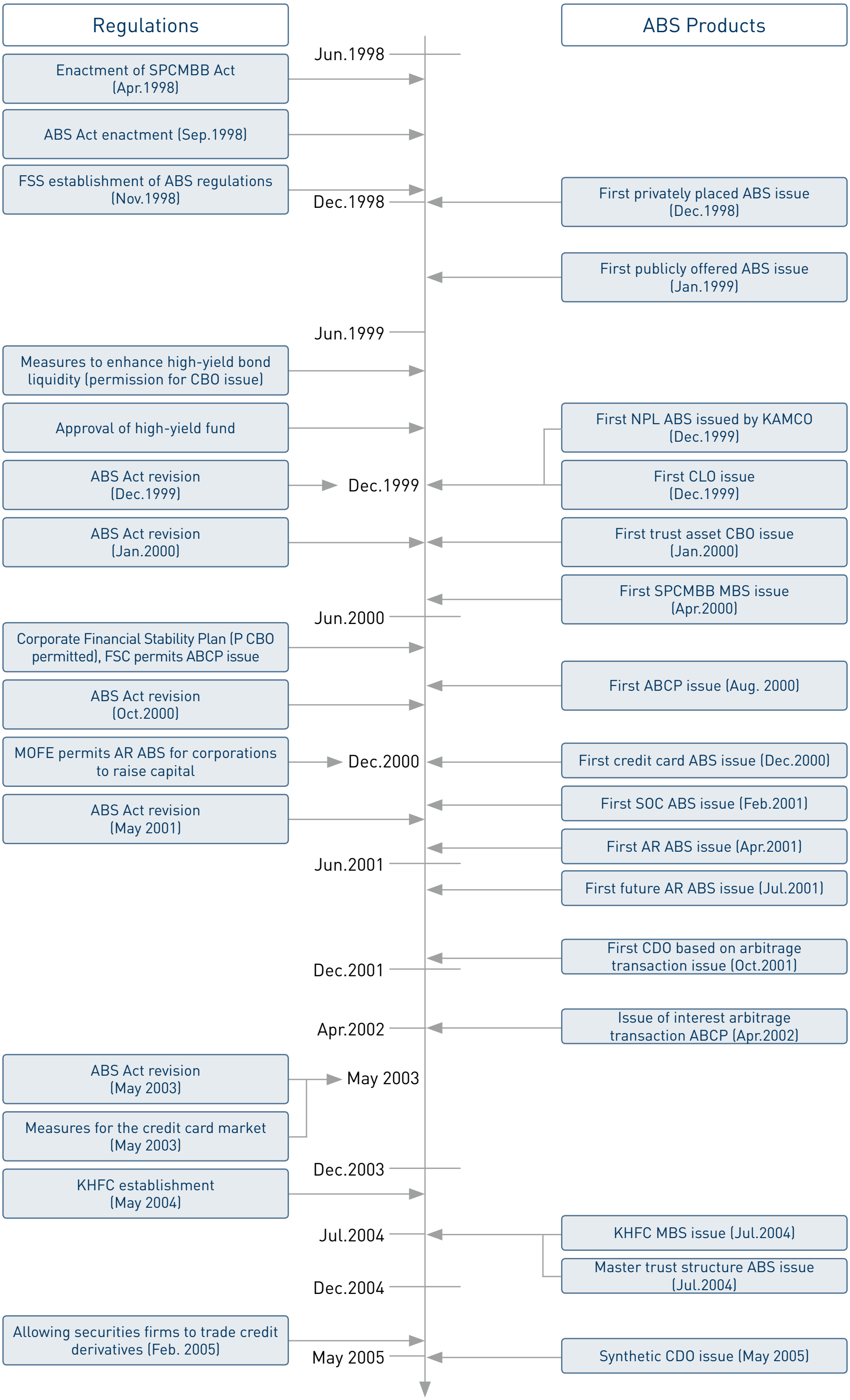
At the end of 2000, the government introduced yet another supportive measure, the revolving structure of asset-backed securities that issues long-term bonds based on short-term assets in order to help corporations finance funds. Many corporations were attracted to the securitization of account receivables 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 asset performance of credit card companies deteriorated, which resulted in the introduction of provisions for repayment by credit card asset-backed securities issued in 2003. In 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 "L Card", 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 that are 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.

In 2005, securities firms were allowed to deal in credit derivatives and began to issue synthetic CDOs utilizing such products.

CHART 11-3. DEVELOPMENT OF ABS REGULATIONS AND PRODUCTS



3. Disclosure on ABS

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 issues ABS, it must register the asset-backed securitization plan and the transfer of assets, and then submit the registration certificate of the securities to issue asset-backed securities. After the issuance, the SPC shall submit the issuance the 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 the detailed matters that shall 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 of ABS business, and the relevant best practices.

In March 2000, the Data Analysis, Retrieval and Transfer (DART) System, a comprehensive online disclosure system for the ABS business, 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 TREND

Asset-backed securities were first issued in Korea in 1999 and grew rapidly, recording issuance amounts as high as KRW50.9tn in 2001. However, in 2002, issuance declined sharply to KRW39.8tn due to a significant drop in the NPL volume of financial institutions. In addition, increasing credit card delinquency in 2003 caused another plunge in the 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 KRW27tn. Since 2005, the size of ABS market has further reduced with the issuance of existing types of ABS declining to KRW20.6tn in 2008. However, because the impact of the global financial crisis was relatively small, the increased issuance of primary CBOs supported by government led to a sharp increase in ABS issuance, totaling KRW36tn in 2009. Issuance declined by KRW8tn in 2010 compared to the previous year, but this cannot be interpreted as a recession in the ABS market since the decrease was largely affected by the suspension of P-CBO issuance for bond market stabilization funds.

TABLE 11-2. ABS ISSUANCE

(Unit: trillion won, case)

Type	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Amt.	49.4	50.9	39.8	39.9	27	28.6	23.2	19.8	20.6	36.0	28.0
No. of Issuance	154	194	181	191	170	236	183	106	81	138	133

Source: Financial Supervisory Service

2) ABS ISSUANCE BY ORIGINATORS

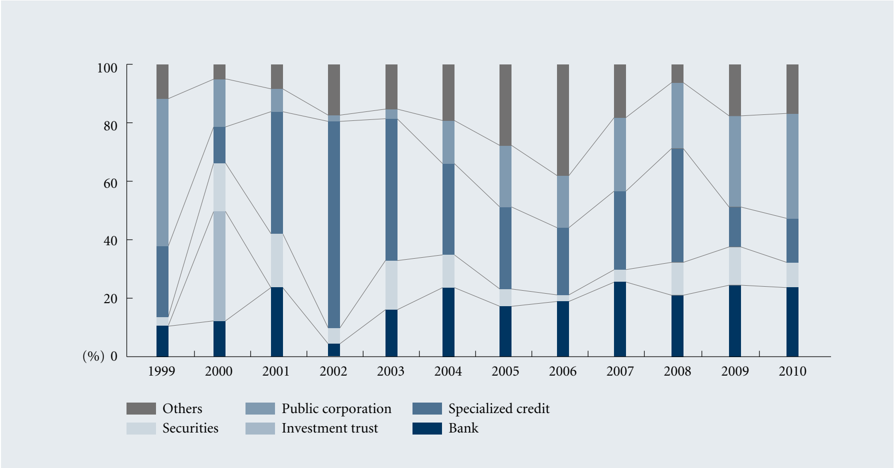
Originators of asset securitization have changed dramatically with the development of the ABS market. In the initial stage, KAMCO was the principal originator to securitize assets based on NPLs that are segregated from financial institutions. The core objective of introducing asset-backed securities 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 11-1. ABS ISSUANCE BY ORIGINATORS



Source: Financial Supervisory Service

3) ASSET-BACKED SECURITES 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.

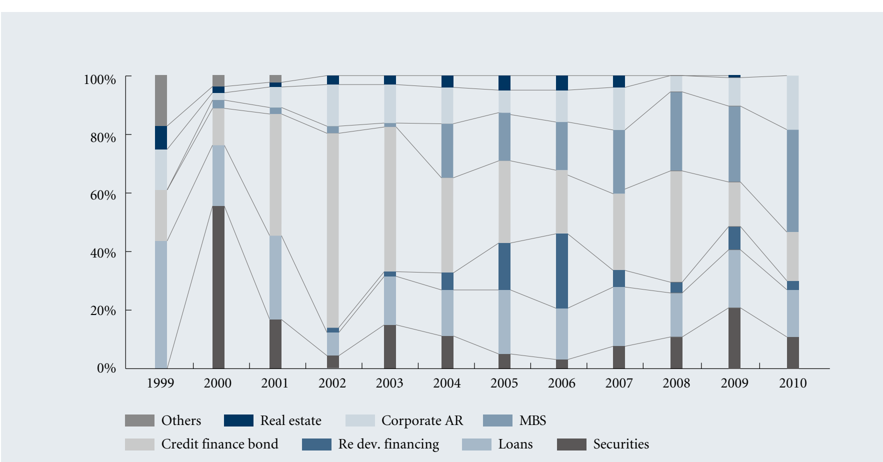
Since 2001, specialized credit financial institutions have utilized asset-backed securities as a means of raising funds, which has led to an increasing volume of ABS issuance underlying the assets of credit card companies and consumer financing. However, in the wake of the credit card liquidity crisis 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 the securitization utilizing project financing 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. 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 11-2. ABS ISSUANCE BY UNDERLYING ASSETS



Source: Financial Supervisory Service (FSS)

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 KRW14.7tn, increasing to KRW21tn in 2007. In 2008, it decreased to KRW15.2bn, while 2009 marked a small increase, reaching KRW16.1tn. In particular, ABCP issued pursuant to the Commercial Code comprised 89.4% of ABCP market in 2009, equal to KRW14.4tn. Most of the ABCP issued are related to project financing. For instance, in 2009, 59.0% of the ABCP issued were based on project financing, amounting to KRW9.5tn. In 2010, the issuance of ABCP increased sharply from the previous year to KRW19.2. As such, the share of ABCP trading in the ABS market climbed to 50.6%. While 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.

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

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

TABLE 11-3. ABCP ISSUANCE

(Unit: trillion won)

	2006	2007	2008	2009	2010
ABCP issuance	14.7	21.0	15.2	16.1	19.2
ABCP issuance based on the Commercial Code	11.5	18.0	13.5	14.4	18.7
PF ABCP issuance	9.2	9.6	8.3	9.5	13.9

Source: Korea Ratings

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) CLEAR DEFINITION OF TRUE SALE

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 ABS Act[1)] also prescribes that in the event of bankruptcy of the caretaker, the securitized assets administered in a trust shall not become a part of the caretaker'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 ABS

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 the 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) THE SUBPRIME MARKET TURMOIL

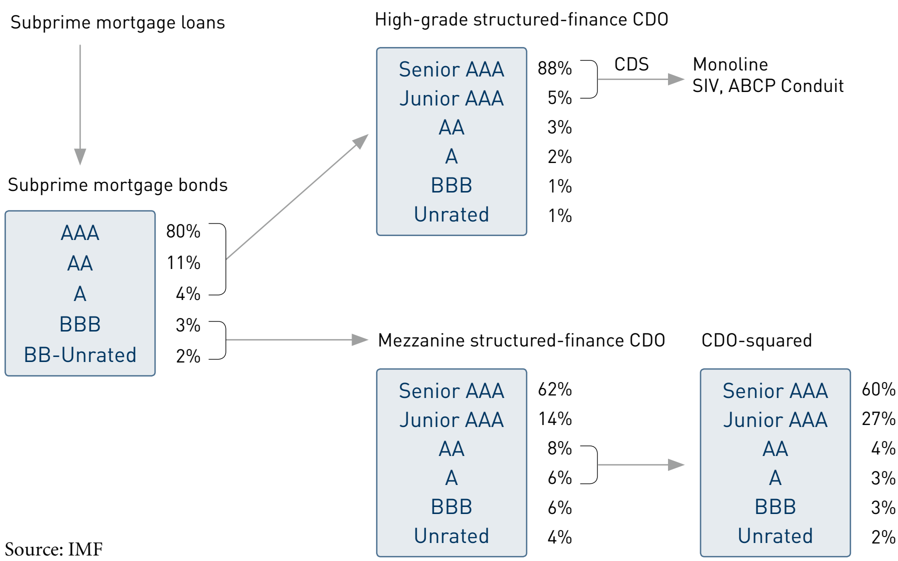
The U.S. subprime mortgage crisis has rapidly changed the structure of the ABS markets across the world. Since subprime mortgages were securitized and used throughout each financial sector, when the underlying assets became insolvent, the losses passed through into the financial sectors that made investment 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 (SIV). 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 didn't 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, the monoline insurance 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 11-4. 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 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 strengthening the subprime mortgage crisis. Credit rating agencies established assessment models based on the data collected in the past, but as things had 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 be 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 CDOs, 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 SECURITES

After 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 the 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 that 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, etc.

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 that is 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 the 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 the 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, plans 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 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 the 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 was promulgated in order to properly regulate 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 during 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 effect of asset securitization, while maximizing its proper functions in the financial market.

CHAPTER 12

FINANCIAL INVESTMENT SERVICES (1)

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 trading, investment brokerage, collective investment, investment advisory, discretionary investment and trust services. According to 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, or investment advisory services are all defined as financial investment companies.

The division of services between these companies was very strict. The main business of securities firms involved brokerage, underwriting, and the dealing of securities, while additional businesses in trusts, investment advisory or discretionary investment could be allowed only upon licensing or registration. Brokerage and dealing of derivative products was handled by futures companies, and asset management companies provided investment advisory and discretionary investment services in addition to their main business of asset management.

However, 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 and changing its name to a financial investment firm, 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 FSCMA broadening the definition for financial products, financial investment companies will be spurred to engage in 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 161 regular members, 108 associate members, and 17 special members. 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 financial investment business concurrently with other business 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

Investment trading 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 another person's account regardless of whose name is given on it. Securities firms' dealing, the area of investment banking, and futures trading all belong to this category of business.

Investment brokerage business refers to the business of buying and selling financial investment instruments, issuing, underwriting and inducing offers for securities, offering and accepting offers for such instruments on another person's account regardless of whose name is given on it. Securities and derivative instruments brokerage by securities or futures companies fit into this business.

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 service of an asset management company can be cited as an example.

Investment advisory business provides customers with advice on the value of a financial investment product or an investment judgment of a financial investment product. 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, entirely or partially, over their financial investment instruments. Both services, which generate commission revenues, are handled by investment advisory firms, securities companies, and asset management companies.

Trust business, which is governed by the Trust Act, engages in managing and disposing of specific titles to property entrusted by an investor in order to generate profitability for specified beneficiaries.

Among the 6 types of financial investment businesses, Article 11 of FSCMA defines investment trading, investment brokerage, collective investment and trust services as licensed businesses given their likelihood of higher risks to customers. On the contrary, Article 17 of FSCMA defines 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 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 the combination of factors such as the types of financial investment business, the scope of financial investment products, and classes of investors. More specifically, the constituents of financial investment business are the six types of investment business 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 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 select all or part of the business units for registration with the FSC as a financial investment business.

The Enforcement Decree of 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 investment trading and trust services, compared to investment brokerage and collective investment services, respectively. Likewise, as the registration of a business unit is a relaxed means of an 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 in 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 asset requirement is set forth in the Enforcement Decree of 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 through lowered entry barriers.

Based on the Enforcement Decree, if a financial investment company launches an investment trading 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 KRW50bn. But in the case of only managing debt securities, the net asset requirement is KRW20bn, while equity securities business (excluding collective investment securities) alone requires minimum net assets of KRW25bn.

TABLE 12-1. MINIMUM NET ASSET REQUIREMENTS FOR INVESTMENT TRADING BUSINESS

(Unit: billion won)

Business area	Financial investment product	Minimum net assets (ordinary /professional)
Trading	Securities [1]	50 / 25
Trading	Debt securities [2]	20 / 10
Trading	State, local government and special bonds	7.5 / 3.75
Trading	Equity securities (excluding collective investment securities)	25 / 12.5
Trading	Collective investment securities	5 / 2.5
Trading	Exchange-traded derivatives	10 / 5
Trading	Exchange-traded derivatives (securities for underlying asset)	5 / 2.5
Trading	OTC derivatives	90 / 45
Trading	OTC derivatives (securities for underlying asset)	45 / 22.5
Trading	OTC derivatives (non-securities for underlying asset)	45 / 22.5
Trading	OTC derivatives (currency/interest rates for underlying asset)	18 / 9
Trading (Excluding underwriting)	Securities [1]	20 / 10
Trading (Excluding underwriting)	Debt securities [2]	8 / 4
Trading (Excluding underwriting)	State, local government and special bonds	3 / 1.5
Trading (Excluding underwriting)	Corporate bonds	4 / 2
Trading (Excluding underwriting)	Equity securities (excluding collective investment securities)	10 / 5
Trading (Excluding underwriting)	Collective investment securities	2 / 1
Trading (Excluding underwriting)	Repurchase agreement (RP) [3]	6 (Professional)
Trading (Underwriting Bonds only)		6 / 3

Note: 1) Securities mean financial investment instruments that comprehensively cover debt securities, equity securities, beneficiary certificates, derivatives-linked securities and securities depository receipts (Article 3 of FSCMA).
2) Debt securities include state bonds, local government bonds, special bonds, corporate bonds and corporate commercial papers.
3) Financial instruments for RP 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 KRW1bn with the amount halved to KRW500mn 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 KRW11bn, which is broken down to KRW1bn for brokerage and KRW10bn for dealing.

TABLE 12-2. MINIMUM NET ASSET REQUIREMENTS FOR INVESTMENT 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 agreement (RP) [3]	0.5 (Professional)
Brokerage	Exchange-traded derivatives	2 / 1
Brokerage	Exchange-traded derivatives (securities for underlying asset)	1 / 0.5
Brokerage	OTC derivatives	10 / 5
Brokerage	OTC derivatives (securities for underlying asset)	5 / 2.5
Brokerage	OTC derivatives (non-securities for underlying asset)	5 / 2.5
Brokerage	OTC derivatives (currency /interest rates for underlying asset)	2 / 1
Brokerage (ECN)	Listed securities	15 / 7.5
Brokerage (OTC bond transaction)	Securities; debt securities	3 (Professional)

Note: 1) Securities mean financial investment instruments that comprehensively cover debt securities, equity securities, beneficiary certificates, derivatives-linked securities and securities depository receipts (Article 3 of FSCMA).
2) Debt securities include state bonds, local government bonds, special bonds, corporate bonds and corporate commercial papers.
3) Financial instruments for RP 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 KRW8bn to run all types of funds such as equity funds (including MMF), real estate funds, special assets funds, and mixed assets funds. However, only KRW2bn is required to run a single type of fund, such as real estate funds or special assets funds.

In the trust business, net assets of KRW25bn are required if a financial investment company is to manage all types of trust properties, while monetary trust alone requires only a minimum of KRW13bn in net assets. For registered businesses such as investment advisory and discretionary investment services, minimum net assets of KRW500mn and KRW1.5bn are required, respectively.

TABLE 12-3. MINIMUM NET ASSET REQUIREMENTS FOR COLLECTIVE INVESTMENT BUSINESS/TRUST BUSINESS/INVESTMENT ADVISORY ·DISCRETIONARY INVESTMENT BUSINESSES

(Unit: billion won)

Business area	**Financial investment product**	**Minimum net assets** (ordinary /professional)
Collective investment	Securities collective investment scheme (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
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 requirements for the services should be examined based on an amount with the capital requirements for banking or insurance business (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 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.

$$\text{Net capital ratio} = \frac{\text{Net capital}}{\text{Gross risk}} \text{ x } 100\%$$

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 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 with 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. 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 (CMA).

The securities industry in Korea went 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 FSCMA. Over the course of the years, the industry has achieved significant growth in its 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 portion 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.

In addition, relaxed regulations on the trading of derivatives have increased the popularity of structured or derivatives combined securities such as ELS (equity linked securities), DLS (derivatives linked securities) and ELW (equity linked warrants). 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 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 KRW38tn, an increase of 2.5 times from KRW15tn in 2003. The size of the asset pool has also seen a sharp increase to KRW200tn from KRW49tn in 2003. Among asset items, the portion of securities has risen dramatically since 2006, which is largely attributable to the growth of CMAs.

TABLE 12-4. AGGREGATE BALANCE SHEETS OF SECURITIES COMPANIES

(Unit: billion won)

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Total shareholders' equity	14,876	15,839	19,645	22,122	29,723	31,763	35,315	37,557
Total liabilities	33,493	36,137	48,582	73,702	101,143	117,044	141,667	162,239
Deposits by customers	13,663	15,371	17,510	16,694	18,312	22,113	24,002	25,900
Total assets	48,369	51,976	68,227	95,824	130,867	148,807	176,982	199,796
Cash and deposits	15,153	16,395	19,226	18,118	24,406	33,555	41,142	44,200
Loans	4,129	4,953	7,469	10,827	17,008	13,500	16,589	22,600
Marketable securities	19,225	21,172	30,932	53,930	75,279	84,415	103,461	115,600

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.

TABLE 12-5. AGGREGATE NET CAPITAL RATIO OF SECURITIES COMPANIES

(Unit: billion won)

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Net capital	8,693	9,232	13,824	15,305	19,909	24,208	27,778	30,039
Gross risks	2,355	1,866	2,009	2,526	3,370	3,847	4,793	5,407
NCR (%)	369.2	494.7	688.2	605.9	590.7	629.3	579.5	555.6

Source: Financial Supervisory Service, Financial Statistics Information System

2) INCOME STATEMENTS OF SECURITIES COMPANIES

In 2010, the aggregate net income of securities companies decreased slightly to KRW2.808tn from KRW2.948tn in 2009. ROE stood at 7.8%, a 1%p decrease from the previous year.

TABLE 12-6. AGGREGATE REVENUE AND ROE OF SECURITIES COMPANIES

(Unit: billion won)

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Operating revenue	11,721	10,897	16,521	24,381	43,327	47,728	51,890	58,825
Operating expense	9,650	9,995	12,941	21,470	38,087	45,190	48,248	55,735
Pretax income	1,566	693	4,242	3,289	5,630	2,736	3,820	3,787
Net income	1,248	305	3,715	2,602	4,410	2,020	2,948	2,808
ROE(%)	8.4	1.9	18.9	11.8	14.8	6.4	8.8	7.8

Source: Financial Supervisory Service, Financial Statistics Information System

The net income of Korean securities companies stood at KRW2.4tn in 2010, showing a decrease of KRW19bn from the same period of the previous year. The net income of foreign companies also declined by KRW50bn to KRW0.4tn. This was due to the fact that stocks were more actively traded through Korean securities companies than through foreign companies after the global financial crisis. The number of domestic and foreign securities firms operating in Korea stood at 42 and 20 respectively, the same as the previous year.

TABLE 12-7. COMPARISON OF PROFITABILITY BETWEEN DOMESTIC AND FOREIGN SECURITIES COMPANIES

(Unit: billion won)

		FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Domestic companies	Net income	975	36	3,174	2,113	3,585	1,455	2,594	2,402
	ROE(%)	7.2	0.3	18.0	10.5	13.4	5.0	8.0	7.5
	No. of securities companies	39	37	34	34	34	41	42	42
Foreign companies	Net income	272	269	541	489	825	565	354	407
	ROE(%)	22.0	15.0	26.8	24.5	28.4	19.6	12.0	8.8
	No. of securities companies	19	19	19	19	19	18	20	20

Source: Financial Supervisory Service, Financial Statistics Information System

Since 2000, brokerage services have been the biggest source of revenue for securities companies, followed by dealing, fund sales and asset management and investment banking. The aggregate net operating revenue of securities companies stood at KRW11.147tn as of 2010, with the revenues from brokerage and dealing services accounting for 50% and 24% of the total, respectively. Investment banking, and fund sales and asset management contributed 8% and around 10% of the net operating revenue, respectively.

TABLE 12-8. SECURITIES COMPANIES' NET OPERATING REVENUE BY BUSINESS

(Unit: billion won)

	Net operating revenue	Brokerage		Investment banking		Fund sales and asset management		Dealing	
FY 2003	6,697	3,620	54%	275	4%	1,162	17%	1,263	19%
FY 2004	5,199	3,205	62%	326	6%	333	6%	884	17%
FY 2005	8,314	5,076	61%	376	5%	797	10%	1,293	16%
FY 2006	7,846	4,407	56%	442	6%	995	13%	1,181	15%
FY 2007	11,616	7,187	62%	649	6%	1,280	11%	1,520	13%
FY 2008	8,848	5,281	60%	615	7%	738	8%	2,086	24%
FY 2009	11,091	5,578	50%	809	7%	930	8%	3,346	30%
FY 2010	11,147	5,532	50%	854	8%	1,102	10%	2,665	24%

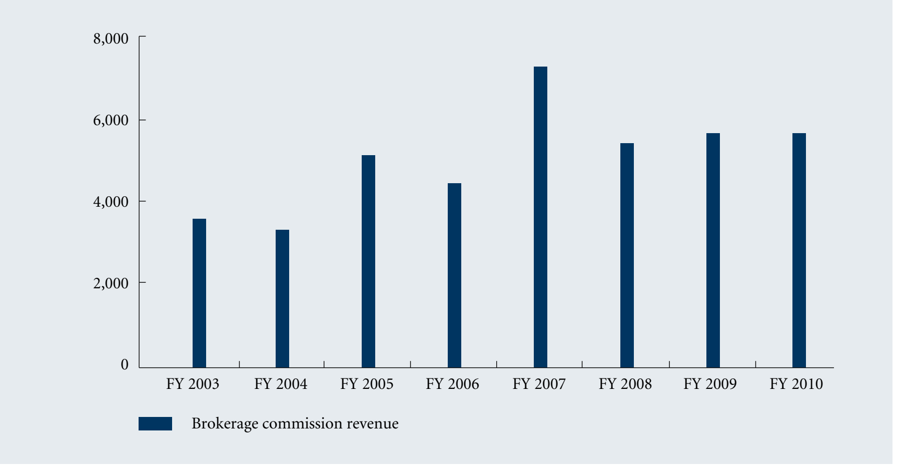
Source: Korea Financial Investment Association

3) BROKERAGE

During the nine-year period from 2000 to 2009, securities companies posted higher revenues from brokerage commissions in the latter half of the period. Affected by the global financial crisis, revenue through commissions was KRW5.28tn in 2008. This increased by a meager 6% to KRW5.5322tn in 2010.

GRAPH 12-1. BROKERAGE COMMISSION REVENUE BY SECURITIES COMPANIES

(Unit: billion won)



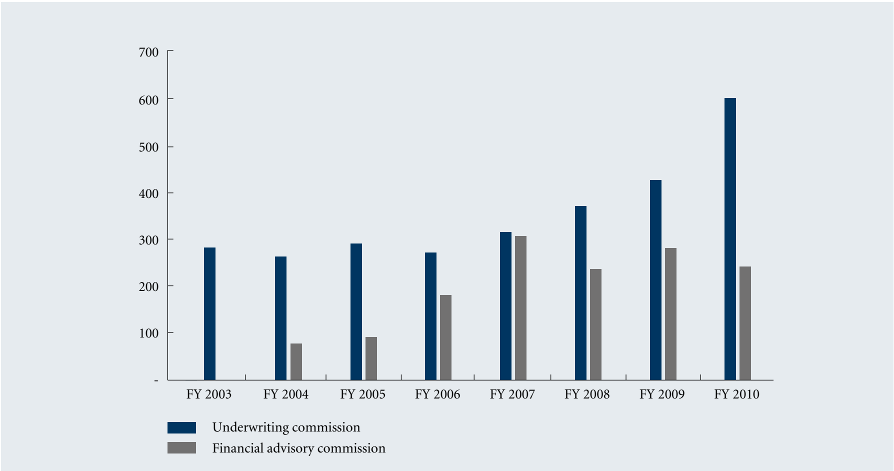
Source: Korea Financial Investment Association

4) INVESTMENT BANKING

Throughout the period from 2000, combined underwriting fees earned by securities companies hovered between KRW200bn to KRW400bn. Aggregate revenue for securities companies in 2009 consisted of KRW537bn from underwriting and KRW272bn from financial advisory.

GRAPH 12-2. INVESTMENT BANKING REVENUE BY SECURITIES COMPANIES

(Unit: billion won)



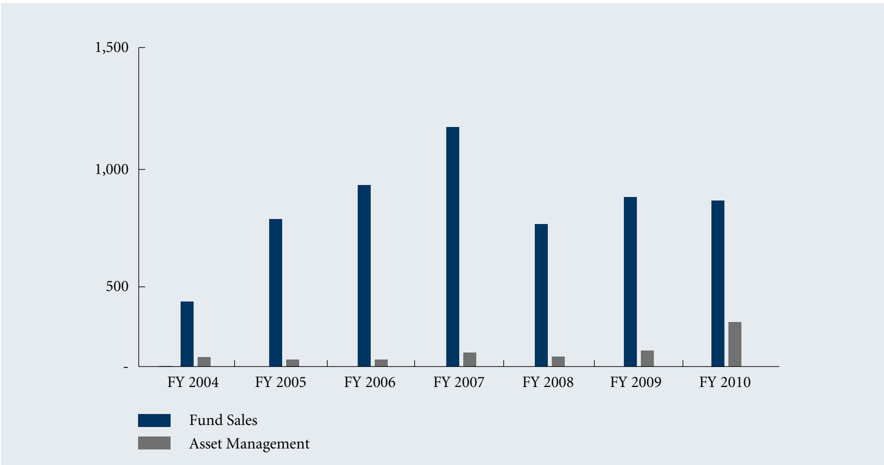
Note: Statistics on the financial advisory commission revenues started from 2004
Source: Korea Financial Investment Association

5) FUNDS SALES AND ASSET MANAGEMENT

With the increase of fund investors since 2004, commission revenues from fund sales have dramatically increased to KRW1.28tn as of 2007. Though revenues slightly declined in 2008, they recovered considerably in 2009, and recorded KRW839.9bn in 2010.

GRAPH 12-3. COMMISSION REVENUE FROM THE SALES OF FUNDS AND ASSET MANAGEMENT BY SECURITIES COMPANIES

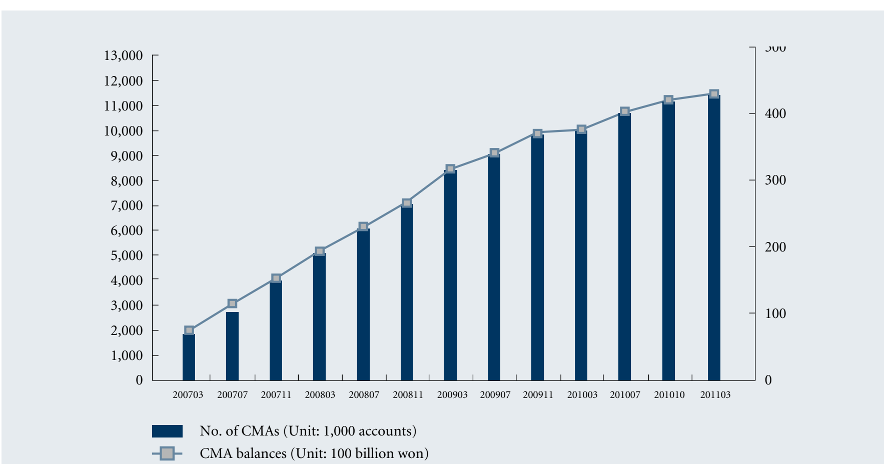
(Unit: billion won)



Source: Korea Financial Investment Association

In addition, the number and balance of cash management account (CMA) holders saw an enormous increase since 2007, with the number of accounts reaching over 11.68 million and the combined value of CMA balances reaching over KRW44tn as of March 2011.

GRAPH 12-4. NUMBER OF CMA AND THE BALANCES

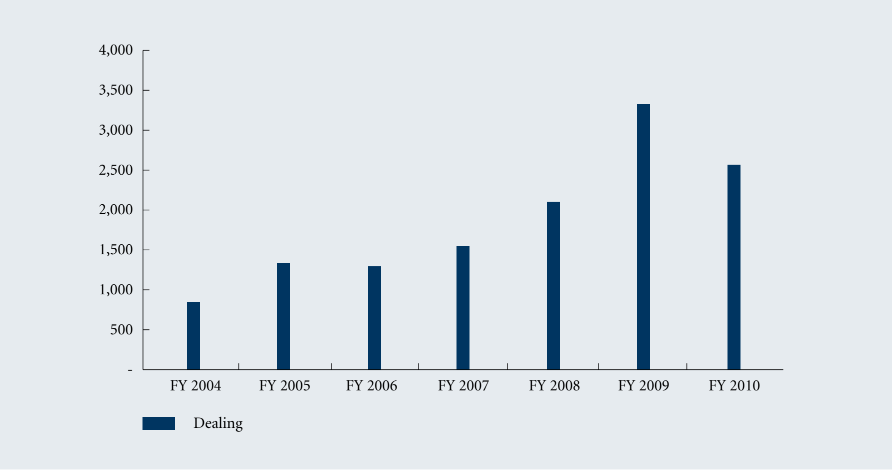


6) DEALING

The dealing business involves transaction of stocks, bonds, and derivatives. Interest gains from the management of other types of funds are also categorized as dealing revenue. In particular, the dealing of bonds yielded net revenue worth KRW2.04tn in 2008. This is due to interest rate cuts at the end of 2008 and early 2009, which led to a large increase in the gains from valuation and sales of bonds. Overall, the dealing business has seen a steady rise in its net revenue.

GRAPH 12-5. DEALING REVENUE BY SECURITIES COMPANIES

(Unit: billion won)



Source: Korea Financial Investment Association

2. Futures Trading Companies

Futures Trading Companies (FTCs) mainly deal with futures trading and brokerage of overseas futures. They feature securities products such as KOSPI200 futures and KOSPI200 options, interest rate futures (3-year KTB futures), currency futures (Dollar, Yen) and other commodity products such as 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 2010, a total of 8 domestic FTCs and 1 foreign FTC engaged in the trading of futures and the brokerage of overseas futures in accordance with the Futures Trading Act (FTA).

After the enactment of 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 Dollar futures began trading on the Korea Futures Exchange (KFE) in 1999. After 2000, 5-year KTB futures, Euro futures and Yen futures were all launched on KFE and the Korea Exchange, and FX margin trading was also launched.

1) BALANCE SHEETS OF FUTURES TRADING COMPANIES

Since 2004, the assets of FTCs have increased steadily, but have begun to show a downward trend since 2009. In 2010, the size of FTCs again decreased compared to the previous year. On the other hand, the total value of shareholder equity rose 1.7 times from KRW275bn in 2004 to KRW470bn in 2010.

TABLE 12-9. AGGREGATE BALANCE SHEETS OF FUTURES TRADING COMPANIES

(Unit: billion won)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Total shareholders' equity	275	308	334	453	539	459	470
Total liabilities	719	965	1,169	1,697	2,146	1,693	1,656
Deposits by customers	696	940	1,144	1,637	2,066	1,657	1,619
Borrowings and other liabilities	23	25	26	60	80	36	37
Total assets	994	1,273	1,504	2,150	2,685	2,152	2,127
Cash and due from banks	782	1,047	1,211	1,728	2,190	1,808	1,767
Marketable securities	49	102	130	284	337	216	274
Loans and other assets	164	124	162	138	158	128	86

Source: Financial Supervisory Service, Financial Statistics Information System

The net capital ratio (NCR) of futures trading companies combined stood at 741% in 2010, indicating a sound financial performance. The NCR figures improved notably since 2005, thanks to a continuous increase in the net capitals of the FTCs.

TABLE 12-10. AGGREGATE NET CAPITAL RATIO OF FUTURES TRADING COMPANIES

(Unit: billion won)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Net capital	212	246	266	337	504	429	380
Gross risks	86	56	104	63	77	58	51
Net capital ratio (%)	246.9	437.5	256.8	533.7	655.5	734.4	740.9

Source: Financial Supervisory Service, Financial Statistics Information System

2) INCOME STATEMENTS OF FUTURES TRADING COMPANIES

In 2010, the aggregate net income of futures trading companies reached KRW48bn, marking a dramatic increase from the KRW6.8bn in 2004. However, compared year-on-year, 2010 had a 30% decline in the aggregate net income. ROE, which has continuously been recorded at over 10% since 2005, declined in the past two years, showing a 3.2%p decrease in 2010 from the previous year.

TABLE 12-11. AGGREGATE REVENUE AND ROE OF FUTURES TRADING COMPANIES

(Unit: billion won)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Operating revenue	142	200	283	260	379	771	374
Operating expense	128	174	240	209	280	635	306
Pretax income	14	26	43	52	100	135	68
Net income	9	19	35	40	72	102	48
ROE (%)	3.3	6.8	11.3	12.0	15.9	19.0	10.7

Source: Financial Supervisory Service, Financial Statistics Information System

The number of FTCs has been declining since 2008. Consequently, the total revenues of FTCs have also decreased, with commission income from derivatives brokerage decreasing by KRW37.9bn, derivatives-related accounts by KRW5bn, and financial accounts by KRW8.7bn from the previous year.

TABLE 12-12. MAJOR PROFITS/LOSSES OF FUTURES TRADING COMPANIES

(Unit: 100 million won)

	FY 09(A)	FY 10(B)	Gap (B-A)	Variation
Commission income	1,945	1,566	↑ 379	↑ 19.5%
Derivatives-related accounts	114	64	↑ 50	↑ 43.7%
Financial accounts	422	335	↑ 87	↑ 20.7%
Selling general & administrative customers	1,177	1,026	↑ 151	↑ 12.8%
Net income	643	475	↑ 168	↑ 26.2%

Source: Financial Supervisory Service, Financial Statistics System

CHAPTER 13

FINANCIAL INVESTMENT SERVICES (2)

I. INTRODUCTION OF 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 investment in indirect investment products, rather than participation 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 and Asset Management Business Act (IIAMBA – 2004). Now, 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 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 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 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 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 IIAMBA, FSCMA has widened the definition to include any asset that holds monetary value. FSCMA has also eased restrictions on the types of assets allowed for investment by each collective investment scheme.

In addition, with 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. 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 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, FSCMA also sets forth measures to prevent conflicts of interest that might arise among various parties involved in investments.

II. STATUS OF THE FUNDS MARKET

1. Aggregate AUM and Total Net Assets of Funds

As of the end of 2010, the aggregate assets under management (AUM) of funds stood at around KRW315tn, an increase of 1.68 times from the 2004 figure of KRW187tn. The aggregate total net assets of funds were KRW319tn by the end of 2010, up 1.68 times from 2004's KRW190tn. This growth has led to a 3.02 percentage point rise in the funds' ratio to total capitalization on the KOSPI market, up from 3.25% in 2004 to 6.27% at the end of 2010.

TABLE 13-1. AGGREGATE AUM AND TOTAL NET ASSETS OF FUNDS

(Unit: billion won, %)

			Funds' share of the KOSPI market capitalization	
	Aggregate AUM	Aggregate total net assets	Stocks [1]	Bonds [2]
2004	186,993	190,119	(3.25)	(16.78)
2005	204,346	216,809	(5.67)	(12.26)
2006	234,615	242,433	(6.59)	(11.47)
2007	296,460	318,420	(8.18)	(7.68)
2008	359,487	288,507	(9.63)	(7.58)
2009	331,834	318,467	(8.49)	(8.84)
2010	315,183	318,812	(6.27)	(9.15)

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.
Source: Korea Financial Investment Association

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 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 13-2. 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	331.8 (25.2)	812.2 (61.8)	68.1 (5.2)	58.4 (4.4)	43.9 (3.3)	1,314.4 (100)
2010	315.2 (22.7)	874.2 (62.9)	85.1 (6.1)	68.8 (5.0)	46.3 (3.3)	1,390.2 (100)

Source: Korea Financial Investment Association, the Bank of Korea

2. Classification of Funds and AUM by Fund Type

1) 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 trade their shares 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 investors, not exceeding 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 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, FSCMA focuses more on the characteristics of a fund's portfolio. In addition, 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.

However, the investment assets of money market funds (MMFs) are still restricted to securities. 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 13-3. 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 is 50% or more
	Hybrid bond type	Maximum equity portion of total assets is 50% or less
	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
Type		**Investment assets**
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 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

2) AUM STATUS BY FUND

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 an investment 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 a 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 2010, the aggregate assets under management (AUM) of contractual-type funds stood at KRW302.7814tn, marking an increase of 67.9% from the 2004 figure of KRW180.3049tn. The aggregate AUM of mutual funds has also seen an increase of 85.4%, from KRW6.6878tn at the end of 2004 to KRW12.4014tn as of the end of September 2010. Contractual-type funds account for over 95% of the total AUM in the domestic asset management market.

TABLE 13-4. AUM BY CONTRACTUAL TYPE FUNDS AND MUTUAL FUNDS

(Unit: billion won, %)

	Contractual type funds		Mutual funds		Total AUM	
2004	180,305	(96.4)	6,688	(3.6)	186,993	(100)
2005	193,264	(94.6)	11,081	(5.4)	204,346	(100)
2006	222,149	(94.7)	12,466	(5.3)	234,615	(100)
2007	283,146	(95.5)	13,315	(4.5)	296,460	(100)
2008	346,300	(96.3)	13,187	(3.7)	359,487	(100)
2009	319,078	(96.1)	12,802	(3.9)	331,880	(100)
2010	302,781	(96.1)	12,401	(3.9)	315,183	(100)

Source: Korea Financial Investment Association

As of the end of 2010, the aggregate AUM held by funds for public offering was KRW197.501tn, an increase of 83.1% from the 2004 figure of KRW107.88tn. The aggregate AUM held by private equity funds also got a boost of 48.8% from the 2004 figure of KRW79.10tn to stand at KRW117.6817tn. The portion of private equity funds in the total AUM still stands at around 37%, though it is on a decline. Most private equity funds are assumed to be purchased by institutional investors, such as pension funds and large companies.

TABLE 13-5. AUM BY PUBLIC OFFERING FUNDS AND PRIVATE EQUITY FUNDS

(Unit: billion won, %)

	Public offering funds		Private equity funds		Aggregate AUM	
2004	107,888	(57.7)	79,105	(42.3)	186,993	(100)
2005	123,769	(60.6)	80,577	(39.4)	204,346	(100)
2006	143,299	(61.1)	91,316	(38.9)	234,615	(100)
2007	203,250	(68.6)	93,210	(31.4)	296,460	(100)
2008	232,931	(64.8)	126,556	(35.2)	359,487	(100)
2009	224,640	(67.7)	107,240	(32.3)	331,880	(100)
2010	197,501	(62.7)	117,682	(37.3)	315,183	(100)

Source: Korea Financial Investment Association

When it comes to AUM by different types of funds based on investment assets, the aggregate AUM held by equity-type funds recorded a huge increase from about KRW9tn at the end of 2004 to a whopping KRW140tn by the end of September 2008, before dropping to KRW101tn at the end of 2010. This decline came about due to increased redemptions by investors who suffered losses in the 2008 global financial crisis and were seeking to recoup those losses in the market recovery. In the same period, the figure for bond-type funds declined from KRW76tn to KRW53tn. This clearly shows that the growth of equity-type funds has driven the rise of the total assets managed by funds. But since 2009, bond-type funds have gradually recovered. MMFs account for 21% of the fund market, although their AUM decreased KRW5tn from KRW72tn at the end of 2009 to KRW67tn by the end of 2010. This shows that a considerable amount of capital in the market is invested in bond-type funds and MMFs.

TABLE 13-6. AUM BY FUND'S INVESTMENT ASSET TYPE

(Unit: billion won)

	Securities					MMF	Derivatives	Others[1]	Total AUM
	Equity type	Hybrid		Bond type	Sub total				
		Equity type	Bond type						
2004	8,580	8,160	26,502	75,749	118,991	59,801	4,727	3,473	186,993
2005	26,185	8,353	34,106	51,336	119,981	64,846	12,201	7,317	204,346
2006	46,491	8,891	39,121	50,417	144,921	57,154	16,845	15,695	234,615
2007	116,353	12,878	31,786	40,862	201,880	46,739	22,393	25,449	296,460
2008	140,214	13,592	25,658	30,342	209,806	88,903	27,880	32,898	359,487
2009	126,232	13,436	18,003	46,108	210,778	71,691	19,335	37,077	331,880
2010	100,992	12,272	20,493	52,569	186,325	66,918	18,249	43,691	315,183

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

Funds for overseas investment 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 growth of about eleven times from KRW5.6tn at the end of 2004 to KRW63.7848tn as of the end of 2010. As a result, their share of the total AUM of funds jumped from 3.0% to 20.2%, an increase of about six times. However, after a dramatic growth in 2006, on-shore funds have experienced a decrease in net assets due to the global financial crisis and the end of tax exemption benefits at the end of 2009.

TABLE 13-7. AUM AND TOTAL NET ASSETS OF DOMESTIC INVESTMENT FUNDS AND OVERSEAS INVESTMENT FUNDS[1)]

(Unit: billion won, %)

	AUM			Total net assets		
	Domestic investment funds	**Overseas investment funds[1)]**	**Total**	**Domestic investment funds**	**Overseas investment funds[1)]**	**Total**
2004	181,310 (97.0)	5,683 (3.0)	186,993 (100)	184,460 (97.0)	5,659 (3.0)	190,119 (100)
2005	195,535 (95.7)	8,810 (4.3)	204,346 (100)	207,665 (95.8)	9,144 (4.2)	216,809 (100)
2006	214,925 (91.6)	19,690 (8.4)	234,615 (100)	220,529 (91.0)	21,904 (9.0)	262,633 (100)
2007	224,656 (75.5)	73,040 (24.5)	297,698 (100)	233,687 (73.4)	84,734 (26.6)	318,420 (100)
2008	283,831 (78.7)	76,958 (21.3)	360,789 (100)	245,354 (85.0)	43,153 (15.0)	288,507 (100)
2009	258,640 (77.9)	73,240 (22.1)	331,880 (100)	257,682 (80.9)	60,834 (19.1)	318,515 (100)
2010	251,398 (79.8)	63,785 (20.2)	315,183 (100)	261,505 (82.0)	57,307 (18.0)	318,812 (100)

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.
Source: Financial Supervisory Service, Korea Financial Investment Association

TABLE 13-8. TOTAL NET ASSETS OF OFF-SHORE FUNDS[1]

(Unit: billion won)

Category	2005	2006	2007	2008	2009	2010
Net assets	6,125	12,891	8,927	1,939	1,721	1,311

Note: 1) Off-shore funds are established in overseas regions for investment in overseas assets and distribution to Korean investors.
Source: Financial Supervisory Service, Korea Financial Investment Association

3) PORTFOLIO STATUS BY FUNDS

Out of the total asset holdings of funds, bonds amounted to 57.8% at the end of 2004. Since then, bonds' portion has steadily decreased while equities' share has increased significantly. As of 2010, the ratio of equities was higher than that of bonds in the funds' aggregate portfolio, standing at 34.7% and 31.7%, respectively, of the total.

In terms of the assets of specific types of funds, equity-type 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. Regarding hybrid funds, the AUM of equities has risen while that of bonds has decreased out of the total portfolio, causing the share of hybrid equity funds to rise and hybrid bond funds, CPs, and deposits to fall. When it comes to bond-type funds, even though most of their net assets were lost from bonds, the funds' asset percentage remains the same.

TABLE 13-9. AGGREGATE PORTFOLIOS OF FUNDS

(Unit: billion won, %)

	Total assets	Equity	Bond	CP	Deposit	Call loan	Others
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)

Source: Korea Financial Investment Association

TABLE 13-10. PORTFOLIOS OF EQUITY-TYPE FUNDS

(Unit: billion won, %)

	Total assets	Equity	Bond	CP	Deposit	Call loan	Others
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)

Source: Korea Financial Investment Association

TABLE 13-11. PORTFOLIOS OF HYBRID-TYPE FUNDS

(Unit: billion won, %)

	Total assets	Equity	Bond	CP	Deposit	Call loan	Others
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)	10,603 (29.6)	18,646 (52.1)	784 (2.2)	1,129 (3.2)	2,375 (6.6)	2,261 (6.3)

Source: Korea Financial Investment Association

TABLE 13-12. PORTFOLIOS OF BOND-TYPE FUNDS

(Unit: billion won, %)

	Total assets	Equity	Bond	CP	Deposit	Call loan	Others
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)

Source: Korea Financial Investment Association

TABLE 13-13. PORTFOLIOS OF MMFS

(Unit: billion won, %)

	Total assets	Equity	Bond	CP	Deposit	Call loan	Others
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)

Source: Korea Financial Investment Association

III. CURRENT STATUS OF ASSET MANAGEMENT BUSINESS

Asset management business refers to financial arrangements that invest money pooled from investors in assets such as investment securities, exchange-traded/OTC derivatives and real estate, and distribute the result of the asset management to investors. Asset management companies, or collective investment business entities, owe investors a fiduciary duty of care when managing collective investment assets and must carry out the business in good faith to protect investors' interests. In addition to the main business of asset management, asset management companies also provide investment advisory and discretionary investment services.

1. Requirements for Asset Management Business

Pursuant to Article 12 (1) of FSCMA, an entity that wishes to offer asset management services shall define a licensed business unit by combining factors such as the types of financial investment business, scope of financial investment products and classes of investors, and selecting all or part of the business units to be licensed by the FSC.

Based on the minimum net asset requirements for a licensed business unit prescribed in the Enforcement Decree of FSCMA, a minimum of net assets worth KRW8bn is required to run collective investment services that cover all types of funds. But the minimum amount of net assets required drops to KRW2bn if only a single type of fund such as real estate or special assets funds is to be managed by the asset management company.

TABLE 13-14. LICENSING REQUIREMENTS FOR ASSET MANAGEMENT COMPANY

Licensed by	Requirements
Financial Services Commission	- Legal entity: Financial institution as prescribed by the Presidential Decree or a stock company under the Commercial Code - Type of financial investment business: Collective investment business - Minimum net assets requirement based on investment instrument types and investor classes - All types of funds including mixed assets funds: KRW8bn for ordinary investors, KRW4bn for professional investors - Securities funds including MMFs: KRW4bn for ordinary investors, KRW2bn for professional investors - Real estate funds:KRW2bn for ordinary investors, KRW1bn for professional investors - Special assets funds: KRW2bn for ordinary investors, KRW1bn for professional investors - Others: Requirements on necessary human resources, physical facilities and feasibility of the business plan

Source: Financial Services Commission

2. Current Status of Asset Management Companies

1) NUMBER OF ASSET MANAGEMENT COMPANIES

As of the end of 2010, a total of 80 asset management companies (AMCs) were registered for operation in Korea, consisting of 58 domestic companies and 22 foreign companies (defined as having over 50% of shares held by foreign investors). The total number has increased 70.2% from 2004, largely due to the entry of 23 new asset management companies after 2007.

Foreign asset management companies accounted for 27.5% of the market as of the end of 2010, and are expected to increase further with the expansion of the domestic asset management market. 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 13-15. NUMBER OF ASSET MANAGEMENT COMPANIES

(Unit: Number of AMCs)

Category	2003	2004	2005	2006	2007	2008	2009	2010
Total number of AMCs	45	47	46	49	51	64	69	80
Domestic AMCs	36	36	34	35	36	44	46	52
Foreign AMCs [1]	9	11	12	14	15	20	23	28

Note: 1) A foreign AMC has 50% or more of its shares held by foreigners.
Source: Financial Supervisory Service, Korea Financial Investment Association

2) STATUS OF AUM AND TOTAL NET ASSETS BY ASSET MANAGEMENT COMPANIES

The total AUM by AMCs stood at KRW315.1828tn as of the end of 2010. The number of large AMCs with AUMs over KRW10tn was ten, while ten AMCs held AUMs of between KRW5tn to KRW10tn, and 31 AMCs managed assets of KRW1tn or below. In terms of the size of AUM, the top five AMCs accounted for 40%, or KRW126.87tn, of the total AUM in the market, and the top ten AMCs managed KRW190.3581tn in assets, making up over 60% of the market. When it comes to total net assets of AMCs, the share of the top five AMCs made up 40.2% of the market, or KRW127.9899tn, and the top ten AMCs accounted for 60.7%, or KRW193.3492tn, of the aggregate total net assets of AMCs.

The average AUM and total net assets of all AMCs received a large boost with the growth of the Korean asset management market. The average AUM of AMCs has risen slightly from KRW3.8tn at the end of 2004 to KRW3.968tn at the end of 2010. The average total net assets of all AMCs also climbed to KRW6.2tn at the end of 2007, but then dropped sharply due to the global financial crisis. In addition, 22 AMCs recorded AUMs higher than the market average, and 23 AMCs topped the market average in their total net assets as of September 2010.

TABLE 13-16. AVERAGE AUM AND AVERAGE TOTAL NET ASSETS OF AMCS

(Unit: 100 billion won)

Category	2004	2005	2006	2007	2008	2009	2010
AUM	38,880	43,392	47,781	58,265	60,085	48,099	39,680
Total net assets	39,564	46,082	49,415	62,361	48,060	46,162	39,828

TABLE 13-17. TOP 20 ASSET MANAGEMENT COMPANIES IN TERM OF AUM AND NAV

(Unit: KRW100mn, %)

	TOP 20 AMC - AUM				TOP 20 AMC - NAV		
	AMC	AUM	Share		AMC	NAV	Share
1	Mirae Asset Global Investments	382,133	(12.0)	1	Mirae Asset Global Investments	381,427	(12.0)
2	Samsung Asset Management	305,388	(9.6)	2	Samsung Asset Management	312,636	(9.8)
3	Shinhan BNP Paribas Asset Management	212,837	(6.7)	3	Shinhan BNP Paribas Asset Management	207,309	(6.5)
4	Korea Investment Management	188,405	(5.9)	4	Korea Investment Management	195,617	(6.1)
5	KB Asset Management	179,937	(5.7)	5	KB Asset Management	182,910	(5.7)
6	UBS Hana Asset Management	165,035	(5.2)	6	UBS Hana Asset Management	170,628	(5.4)
7	Woori Asset Management	133,199	(4.2)	7	KDB Asset Management	133,158	(4.2)
8	KDB Asset Management	124,644	(3.9)	8	Woori Asset Management	130,757	(4.1)
9	Tong Yang Asset Management	111,109	(3.5)	9	Tong Yang Asset Management	115,092	(3.6)
10	Hanhwa Investment Trust Management	100,894	(3.2)	10	Hanhwa Investment Trust Management	103,958	(3.3)
11	NH-CA Asset Management	90,811	(2.9)	11	NH-CA Asset Management	93,505	(2.9)
12	KTB Asset Management	72,813	(2.3)	12	KTB Asset Management	77,446	(2.4)
13	Schroders Korea	71,973	(2.3)	13	Schroders Korea	67,892	(2.1)
14	Mirae Asset MAPS Global Investments	70,879	(2.2)	14	Dongbu Management	67,287	(2.1)
15	Dongbu Management	66,047	(2.1)	15	IBK SG Asset Management	67,028	(2.1)
16	IBK SG Asset Management	65,234	(2.1)	16	Hi Asset Management	63,895	(2.0)
17	Prudential Asset Management	64,339	(2.0)	17	Prudential Asset Management	62,529	(2.0)
18	Hi Asset Management	63,889	(2.0)	18	Mirae Asset MAPS Global Investments	58,972	(1.9)
19	Heungkuk Asset Management	56,822	(1.8)	19	Heungkuk Asset Management	57,933	(1.8)
20	KYOBO AXA Investment Managers	50,274	(1.6)	20	KYOBO AXA Investment Managers	55,252	(1.7)

Note: As of the end of 2010
Source: Korea Financial Investment Association

3) INCOME STATEMENT OF ASSET MANAGEMENT COMPANIES

With the rising flow of capital to the funds market and the increasing popularity of equity-type funds that usually charge higher fees than other types of funds, the performance of asset management companies (AMCs) has improved significantly since 2005. Driven largely by the revenue increase from management fees, the industry's net income has grown from KRW87.4bn in 2004 to KRW500bn in 2007.

In the wake of the global financial crisis, the rise in funds' AUM has stalled and capital inflow to equity-type funds has declined. As a result, AMCs experienced a decline in revenue after several years of growth. For the fiscal year 2010, spanning April 1, 2010 to March 31, 2011, the industry's net income fell 11.7% year-on-year from KRW454.1bn to KRW401.1bn. Operating revenue decreased 1.5% year-on-year to KRW1.6384tn, and operating expenses increased 6.4% from a year earlier to KRW1.1142tn.

While the flat growth of assets in funds since the middle of 2008 has led to little increase of revenue from fund management fees, fixed expenses associated with fund distribution have increased overall with the advance of new asset management companies into the market. ROE of AMCs has stood over 10% since 2005 as seen in the following table.

TABLE 13-18. VARIANCE IN THE PROFITABILITY OF AMCS

(Unit: 100million won, %)

Year	Operating revenue		Operating expense		Net income		ROE	
FY 2005	7,253	(68.3)	3,979	(25.9)	3,375	(286.2)	15.7	(10.3)
FY 2006	8,806	(21.4)	5,137	(29.1)	2,632	(-22.0)	15.1	(-0.6)
FY 2007	15,551	(76.6)	9,004	(75.3)	5,038	(91.4)	24.4	(9.3)
FY 2008	15,371	(-1.2)	9,516	(5.7)	4,025	(-20.1)	16.4	(-8.0)
FY 2009	16,627	(8.2)	10,467	(10.0)	4,541	(12.8)	15.2	(-7.3)
FY 2010	16,384	(-1.5)	11,142	(6.4)	4,011	(-11.7)	13.1	(-2.1)

Source: Financial Supervisory Service

4) SALES BALANCES BY DISTRIBUTION CHANNEL

Securities companies and banks are the most representative channels of fund distribution in Korea. As of the end of 2010, 60% of funds were distributed by securities companies, 31.7% by banks, 4.2% by insurance companies and 4.1% 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 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 and MMFs make up a high share of the sales by banks.

TABLE 13-19. FUND SALES BALANCES AND SALES RATIO BY DISTRIBUTION CHANNEL

(Unit: trillion won, %)

	FY 2006		FY 2007		FY 2008		FY 2009		FY 2010	
Securities companies	134.1	(58.1)	151.9	(51.9)	164.5	(46.6)	176.0	(54.0)	182.8	(60.0)
Banks	87.7	(38.0)	126.7	(43.3)	136.7	(38.7)	121.2	(37.2)	96.6	(31.7)
Insurance companies	5.2	(2.3)	9.0	(3.1)	12.7	(3.6)	13.7	(4.2)	12.7	(4.2)
Others	3.7	(1.6)	4.9	(1.7)	39.1	(11.1)	14.8	(4.5)	12.6	(4.1)
Total	230.7	(100.0)	292.4	(100.0)	352.9	(100.0)	325.7	(100.0)	304.8	(100.0)

Source: Korea Financial Investment Association

IV. OTHER MATTERS ON FUNDS

1. 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 advisory on funds and the sale of a fund, 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 is measured in the total expense ratio (TER). These costs cover management fees, sales fees, custodian fees, administration fees, and other transactions fees that are paid out from a fund's assets. The average TER of all funds stood at around 1.18% as of the end of 2010. Equity-type and hybrid equity-type funds recorded the highest TER of 1.81% and 2.08% while MMF and bond-type funds posted the lowest ratio of 0.29% and 0.4%, respectively.

Despite a dramatic rise in the assets managed by AMCs in Korea, fee ratios have stood at almost the same level. Fee ratios of equity-type funds, which have risen every year, decreased 0.23%p to 1.78% in 2010, due to impacts of the policy for reducing the sales fee ratio (May 2010, 1.5%/year → 1%/year or below). In most funds, the portion of sales fees outnumbers management fees by a ratio of six to four. Overall, the TER of funds has remained flat, except for bond-type funds that continue to show a lower TER.

TABLE 13-20. TOTAL EXPENSE RATIO BY FUND (END OF 2010)

(Unit: %)

	Fees					Commision				
Fund type	Management fees	Distribution fees	Custody fees	Administration fees	Total fees	Pre-pay	Post-pay	Brokerage commision ratio	Other Expense	Total expense ratio [1]
Equity	0.74	1.01	0.04	0.02	1.78	1.00	1.00	0.29	0.03	1.81
Hybrid equity	0.96	1.06	0.05	0.02	2.05	0.96	0.53	0.31	0.03	2.08
Hybrid bond	0.36	0.80	0.03	0.02	1.21	1.18	1.00	0.12	0.02	1.23
Bond	0.17	0.29	0.02	0.02	0.39	0.38	2.85	0.01	0.01	0.40
MMF	0.08	0.18	0.02	0.01	0.28	0.26	0.00	0.00	0.00	0.29
Derivative	0.36	0.53	0.03	0.01	0.73	0.54	1.82	0.20	0.02	0.75
Real estate	0.83	0.49	0.05	0.04	1.38	1.49	0.00	0.04	0.08	1.45
Real asset	3.00	0.80	0.06	0.03	3.89	1.00	0.00	0.10	0.01	3.90
Fund of funds	0.37	0.91	0.05	0.02	1.34	1.95	1.00	0.13	0.02	1.36
Special assets	0.83	0.19	0.02	0.02	1.03	1.00	0.00	0.00	0.12	1.08
Total	0.47	0.67	0.03	0.02	1.16	0.99	1.04	0.17	0.02	1.18

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.
2) All numbers are as of August 2010.
Source: Korea Financial Investment Association

2. 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 KRW40mn, 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 KRW40mn is combined with other types of income for the taxation under the global income tax.

TABLE 13-21. CHARACTERISTICS OF INCOME FROM FUND INVESTMENT

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

Source: Korea Institute of Public Finance

3. Status on Fund Investment by Retirement Pension Plan and Variable Annuity

1) FUND INVESTMENT BY RETIREMENT PENSION PLAN

In 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 benefit 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 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 account (IRA). As of the end of 2010, DB plans accounted for 72%, DC plans 17.7% and IRAs 10.3% 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 with 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, while up to 30% of the total assets may be invested in overseas bonds with an investment grade rating or those issued by OECD member nations, other risky assets permitted in DB plans cannot be held as assets. In general, DC plans are more strictly regulated than the DB plan when it comes to the make-up of assets.

As of the end of 2010, the aggregate balance of retirement pension plans in Korea stood at KRW29.1472tn, out of which KRW25.7867tn (88.5%) was invested in principal-protected products, KRW1.9tn (6.5%) in investment products, and KRW1.4605tn (5.0%) in other areas. These figures show that 88.5% of assets are invested in deposits, installment savings, and insurance products that guarantee the principals, and only 6.5% in dividend products. This indicates a conservative investment approach taken by the pension plans.

Between DB and DC plans, DB plans' investments in principal-protected instruments are higher at 93.4% with DC plans at 70.4% of total assets. In terms of financial institutions managing pension plans, banks and insurance companies have 91.9% and 96.7% of their pension balances invested in principal-protected instruments, respectively, indicating a conservative approach in managing pension plans. Securities companies have a higher ratio of investment in dividend products than banks and insurance companies.

Within dividend products, fund investment has concentrated on bond funds with the share of bond funds standing at 5.6%, equity funds at 0.2% and hybrid funds at 0.1% of the total.

TABLE 13-22. STATUS OF PENSION PLAN INVESTMENT BY PENSION TYPE AND FINANCIAL INSTITUTION (END OF 2010)

(Unit: 100million won, %)

	Pension plans			Financial institutions			
Category	**DB Plan**	**DC Plan**	**IRA**	**Banks**	**Insurance companies**	**Securities companies**	**Total**
Principal-protected products	196,062 (93.4)	36,272 (70.4)	25,534 (84.8)	132,881 (91.9)	96,154 (96.7)	28,832 (60.9)	257,867 (88.5)
Dividend products	3,605 (1.7)	13,217 (25.6)	2,178 (7.2)	9,112 (6.3)	2,666 (2.7)	7,223 (15.3)	19,000 (6.5)
Others [1)]	10,159 (4.8)	2,042 (4.0)	2,404 (8.0)	2,640 (1.8)	663 (0.7)	11,301 (23.9)	14,605 (5.0)
Total	209,826 (100)	51,530 (100)	30,115 (100)	144,633 (100)	99,483 (100)	47,357 (100)	291,472 (100)

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

2) FUND INVESTMENT BY VARIABLE ANNUITY

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 insurance in 2002, and variable universal insurance in 2003. During the early days of variable life insurance, sales were sluggish due to a lack of qualified sales agents and low understanding on 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 the fiscal year ending March 31, 2010, the aggregate premium income from variable insurance was KRW17.1882tn, an increase of about 7 times from the figure in 2004.

TABLE 13-23. PREMIUM INCOME FROM GENERAL AND VARIABLE INSURANCE PRODUCTS

(Unit: 100million won, %)

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

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

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

Source: Korea Life Insurance Association, Korea Insurance Development Institute

CHAPTER 14

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[1)] 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 August 21, 2009, only 24 stock issues of 22 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.

Note: 1) This is based on Article 6-22 of the Regulations on Financial Investment Business. A foreign investor may designate his/her local agent to represent him/her in exercising his/her rights on the securities acquired and in handling other related matters. Any one of the entities listed below may be designated as a local agent for a foreign investor: Korea Securities Depository, foreign exchange banks, investment dealers, investment brokers, collective investment managers, and internationally recognized securities depository institutions. No other person or entity may be appointed a local agent by a foreign investor. A designated agent shall fulfill its fiduciary duty.

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 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.

[Laws regarding Investors Subject to Registration]

- *Financial Investment Services and Capital Markets Act*

Article 9 (Definition of Other Terms)
The term "foreign corporation, etc." in this Act shall mean a person falling under any of the following subparagraphs:

1. *Foreign government;*
2. *Foreign municipal government;*
3. *Foreign public organization;*
4. *Foreign company established under foreign Acts and subordinate statutes;*
5. *International institution designated by the Presidential Decree; or*
6. *Other corporations located in a foreign country as designated by the Presidential Decree.*

■ *Enforcement Decree of the Financial Investment Services and Capital Markets Act*

Article 13 (Scope of Foreign Corporation)
(1) The term "international institution designated by the Presidential Decree" under Article 9(16)(v) of the Act shall mean an international institution established in accordance with a treaty.
(2) The term "corporations located in a foreign country as designated by the Presidential Decree" under Article 9(16)(vi) of the Act shall mean those falling under any of the following subparagraphs:
1. A fund or association established, supervised or managed in accordance with foreign Acts and subordinate statutes;
2. A fund or association established, supervised or managed by a foreign government, foreign municipal government or foreign public organization; or
3. A fund or association established, supervised or managed by an international organization established in accordance with a treaty.

■ *Regulations on Financial Investment Business*

Article 6-1. (Definitions)
1. The term "foreign national" refers to a private individual of foreign nationality without his/her domicile or abode in Korea for six months or longer or a foreign legal entity as defined in Article 9(16) of the Act.

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 stocks on the OTC market for the purpose of "direct investment"[2)], 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 International Central Securities Depository (ICSD) omnibus accounts[3)].

[Definition of Omnibus Account regarding Foreign Investment in Bonds]

When foreign investors intend to engage in bond trading activities, they entrust the International Central Securities Depository (ICSD) with custodial and settlement services. ICSD then opens an account with the country of the investment destination under its own name to carry out investment services, such as managing customers' accounts and making orders. Such an integrated account is referred to as an omnibus account. Though the account is opened under ICSD's own name, the beneficiary owners of the investment capital are those customers (foreign investors), involved in transactions with ICSD. Therefore, ICSD carries out securities investment on behalf of its customers, and the profits will be returned to the customers.

With the amendment to the old Regulations on Supervision of Securities Business, the exemption of registration has been made applicable to individual investors if they engage in the trading of government treasury bonds and monetary stabilization bonds through Euroclear or Clearstream omnibus accounts. Also, the trading of treasury bonds and monetary stabilization bonds among foreign investors is possible when they use ICSD accounts. Additionally, with the amendment to the Detailed Rules of the Regulations on Financial Investment Business, institutional improvements have been made to support foreign investment in bonds. Such improvements include easing the reporting obligation for foreign investors when they engage in bond transactions through an omnibus account.

Note: 2) This is based on Article 2(1)(iv)(a) of the Foreign Investment Promotion Act. In general, with the amount of the foreign investment being 50 million won or more, the term "foreign investment" shall refer to where a foreigner purchases 10% or more of holdings of a Korean corporation or where a foreign investor purchases holdings after signing such contracts as a management participation contract and a research and development contract with a Korean corporation.

3) This is based on Article 5-1(1)(i) of the Detailed Rules of the Regulations on Financial Investment Business. This shall refer to Euroclear as well as Clearstream.

[Regulations regarding the Exemption from Registration]

- *Regulations on Financial Investment Business*

Article 6-1. (Definitions)

2. The term "foreigner treated as a citizen" refers to any of the following foreigners: provided, that excluded herein are non-residents as defined in Article 10(2)(i),(ii), and(vi) of the Enforcement Decree of the Foreign Exchange Transaction Act:

(a) A person who works in a business office or any other office in Korea or who engages in any business activity in Korea; and

(b) A foreign legal entity that has its principal place of business in Korea or a domestic branch office, liaison office, or any other office of a foreign legal entity;

Article 6-10. (Application for Registration of Investment)

(3) Notwithstanding paragraph (1), the registration of investment is not required in any of the following cases:

1. Where it is intended to dispose of stocks acquired by exercising a right to overseas securities within three months from the date of acquisition;

2. Where it is intended to acquire or dispose of stocks in connection with direct investment: provided, that the cases where stocks are acquired from the securities market are excluded herein; and

3. Where it is intended to acquire or dispose of state bonds or monetary stabilization bonds through an account opened in the Korea Depository in the name of an international depository and clearing organization that has completed the registration of investment; provided, that excluded herein are cases where the obligation to report is waived, in the manner prescribed by the Governor of the Financial Supervisory Service, the details of bonds traded by a foreigner through an international depository and clearing organization that has completed the registration of investment in its name.

Article 6-26. (Special Exceptions to Application)

(3) As to cases where a foreigner intends to acquire bonds issued in Korean won in Korea by a foreign corporation and sold overseas (including cases where a foreigner acquires the bonds in Korean won sold in Korea by such foreign corporation for retiring them after purchasing), Articles 6-10, 6-14, 6-15, and 6-21 shall not apply.

(4) As to foreign exchange stabilization bonds issued in foreign currency in Korea by the Government, Articles 6-7, 6-10, 6-14, 6-15, and 6-21 shall not apply.

IV. SPECIAL CASES FOR FOREIGNER REGISTRATION

When registering an investment, one IRC is issued per beneficiary owner. There are certain exceptions however to make investment 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[4)] 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.

[Regulations on Special Cases for Foreigner Investment Registration]

- *Regulations on Financial Investment Business*

  (1) Notwithstanding Article 6-10 (2), the registration of investment may be done additionally in the name of the relevant financial institution or similar in any of the following cases, provided, that a statement be added to indicate that the registration is for the separate management of customers' assets in cases under subparagraph 2, or that the registration is for processing orders from an investor group in cases under subparagraph 3:

  1. Where it is necessary for an overseas branch office or an overseas business office of a domestic investment trader or broker or an investment trader or broker in Japan, specified by subparagraph 1 of the notification with regard to the remittance of Japanese investors' fund for securities, to make an arrangement for the entrustment of transactions in the securities market;

Note: 4) An investor group refers to a large number of foreign investors (foreign corporations only) whose investment management activities are managed by one and the same person under relevant laws or agreements.

2. Where it is necessary for a foreign financial institution or similar to manage assets for management separately by segregating its own assets from customers' assets; and

3. Where it is necessary for an investment trader or broker to process orders from an investor group by consolidating the orders in accordance with Article 6-7 (3).

(2) Any overseas depository that intends to acquire underlying stocks in order to issue depository receipts or secondary depository receipts shall file for registration of the investment for each underlying stock of the depository receipts in addition to the registration of investment filed for the investment of its own assets, and in such cases the registered name shall include the class of the depository receipts and the name of the underlying stocks in addition to the name of the overseas depository.

(3) Any foreigner who intends to acquire securities in accordance with Article 6-7 (1) (viii) or (ix) may file for the registration of investment for each issue of the securities, and in such cases the registered name shall include the name in which the securities were issued in addition to the name of the foreign depository.

V. REGISTRATION APPLICATION PROCEDURE

1. Overview

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 14-1. 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.

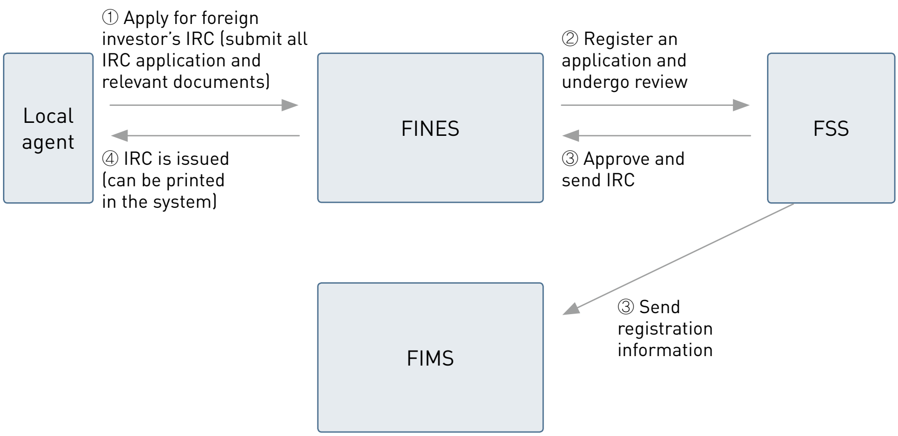
Previously, it took approximately 4 days to issue an IRC, inconveniencing the investors and causing delays in investment opportunities. With the introduction of the online investment registration system, the IRC issuance period was reduced to 4 hours, enabling foreign investors to promptly open accounts and engage in transactions.

2. Detailed Procedures

1) DESIGNATING A LOCAL AGENT AND REGISTERING THROUGH THE AGENT

The local agent applies for foreign investor's IRC by electronically submitting the IRC application and the relevant documents to the FSS through FINES (http://fines.fss.or.kr/), the FSS then reviews the documents. When approved, an IRC will be issued electronically.

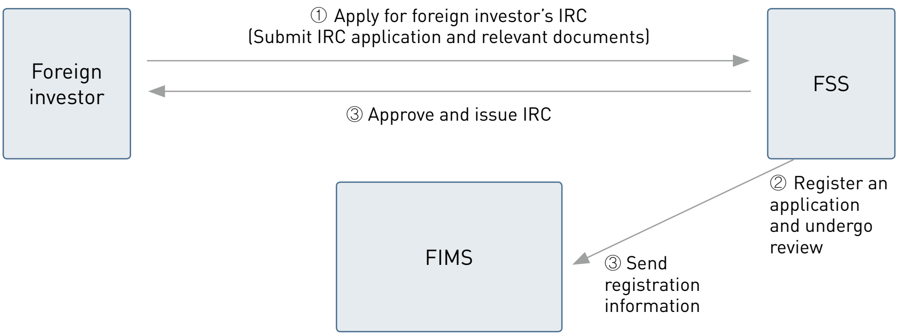
CHART 14-1. DESIGNATING A LOCAL AGENT AND REGISTERING THROUGH THE AGENT



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 confirming the documents.

CHART 14-2. REGISTERING IN PERSON



VI. RESTRICTIONS ON OTC TRANSACTIONS AND EXCEPTIONS

1. Concentration Rule (Floor Trading) and Exceptions

A foreign investor or a foreign corporation must trade listed securities on the exchange under Article 188 (2) of 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 limit as well as investment. Accordingly, the so called "concentration rule" is imposed to ensure the smooth and stable management of foreign investment.

However, OTC transactions are allowed in exceptional cases, subject to Article 6-7 of the Regulations on Financial Investment Business as well as Article 5-4 of Detailed Rules of the Regulations on Financial Investment Business. For example, OTC transactions are allowed in cases where state bonds or monetary stabilization bonds are traded between foreign investors who hold a payment account with an international central securities depository (ICSD), use the account in the same ICSD and make the payment through the ICSD, or in cases where 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 individual.

2. Transferring Securities between Foreign Investors with No Change in the Beneficiary Owner

In principle, an investment must be registered under the name of the accounting entity. However, foreign investors' securities that are registered under different names are allowed to be transferred in the OTC market so long as there is no change in the beneficiary owner. In such a case, a foreign investor who takes over the securities must submit the reporting document, 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 December 31, 2010, Korea Electric Power Corporation (KEPCO) was the only designated public-purpose company under FSCMA. There are 24 stock issues of 22 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 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 14-2. LIST OF COMPANIES WITH FOREIGN OWNERSHIP RESTRICTIONS

(Unit: %)

Applicable laws and regulations	Limit by law: Total	Limit by law: Single investor	Limit by articles of incorporation: Total	Limit by articles of incorporation: Single investor	Companies listed on KRX stock market	Listed on KOSDAQ market
FSCMA (Article 168)	40	-	-	3	KEPCO	-
Telecommunications Business Act (Article 6)	49	-	-	-	KT, LG Dacom, LG Telecom, SK Telecom, LG Powercom	SK Broadband, EYESVISION, Onse telecom, KRTnet, Asia Pacific Systems, INNOCELL
Act on Privatization of Public Enterprises (Article 18, 19)	-	15	30	-	Korea Gas	-
Broadcasting Act (Article 14)	0	-	-	-	Seoul Broadcasting System	-
	10	-	-	-		YTN
	49	-	-	-	On Media, Hwasung Industrial	KOREA CABLE T.V., CHUNG-BUK SYSTEM, Qrix Communications, Korea Business News, TBROAD HANVIT BROADCASTING, CJ O SHOPPING, GS Home Shopping, CJ Internet, Mnet Media, InfoBank, DONGYANG TELECOM, Daum Communications, SBS Contents Hub, Digital Chosun, Yedang Entertainment, KTHitel
Newspaper Act (Article 13)	30	-	-	-	-	ISPLUS, AnC Bio Holdings
Aviation Act (Article 6)	49.99	-	-	-	Korean Airlines, Asiana Airlines	-
Total number of companies	36				12	24

Note: As of December 31, 2010

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, except public purpose corporations, was abolished in May 1998.

TABLE 14-3. 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%	Abolished	-
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%	Abolished	-
Per investor limit	Public corporation	1%	1%	1%	1%	1%	1%	1%	1%	1%	3%	3%

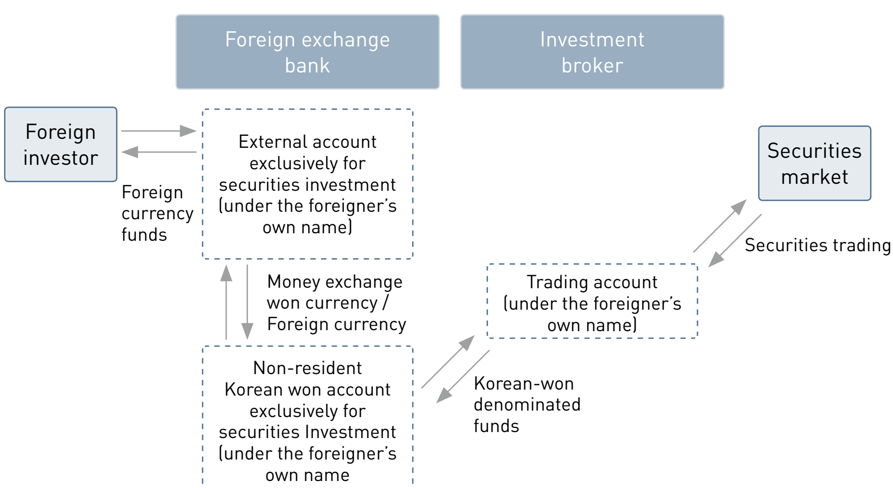
3. Reporting on Stock Ownership

In accordance with the Detailed Rules of the Regulations on Financial Investment Business, corporations and institutions that are engaged in securities transactions of foreign investors, as well as the foreign investors themselves, have reporting duties. 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.

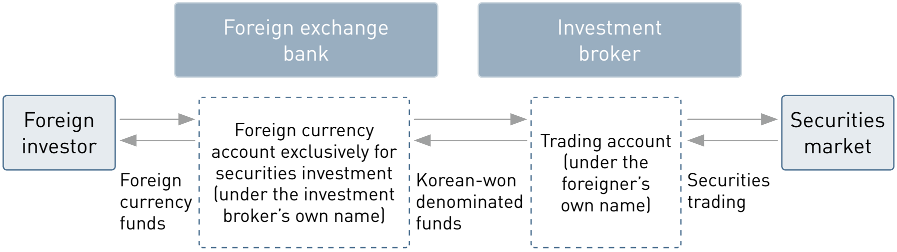
Appendix 1. Capital Flow regarding Securities Investment by Foreigners

When a foreigner invests in won-denominated securities, sends money generated from selling securities overseas or makes a payment regarding securities lending transactions which were legally allowed for foreigners, the foreigner can deposit or dispose of them by opening an external account exclusively for securities investment and a non-resident Korean won account exclusively for securities investment under his or her own name. For cases when ICSD is entrusted with the trading of treasury bonds or monetary stabilization bonds by a foreigner, ICSD can deposit or dispose of the relevant funds by opening an account for investment under its own name.

When a foreigner trades securities in won by directly opening an account under his or her own name with a foreign-exchange bank, the foreigner shall first send foreign currency funds through an external account exclusively for securities investment (under the real name of the foreigner), exchange the funds into Korean won and then deposit them into a non-resident Korean won account exclusively for securities investment (under the real name of the foreigner). This deposited currency in won may then be again transferred to a trading account under the name of the foreigner, in the form of an account opened with an investment broker. Now securities trading for foreigners can take place based on this.



On the other hand, an investment broker may open a foreign currency account for investment under its own name with a foreign exchange bank to acquire or dispose of foreigners' securities in won or to engage in legally allowed securities lending transactions for foreigners. When a foreigner trades securities through this foreign currency account exclusively for securities investment, an account that is used for a similar purpose to the external account exclusively for securities investment under the real name of the foreigner, the foreigner has an advantage that he or she does not necessarily need to open a separate account under his or her own name with a foreign exchange bank. In other words, a foreigner sends foreign currency funds to a foreign currency account exclusively for securities investment (under the real name of an investment broker), and an investment broker exchanges that foreign currency and transfers it to a trading account under the name of that foreigner. These transferred funds in won are then used for securities trading for the foreigner.



Appendix 2. Trends of Foreign Investment in Domestically Listed Securities

(Unit: 100 million won, %)

By year	Trends in net buying			Status of foreign ownership					
	Stocks[1]	KOSDAQ	Bonds	Stock		KOSDAQ		Bonds	
1992	15,083	-	-	41,451	(4.9)	-	-	-	-
1993	43,294	-	-	110,478	(9.8)	-	-	-	-
1994	9,304	-	386	153,658	(10.2)	-	-	386	(0.0)
1995	13,612	-	229	167,229	(11.9)	-	-	615	(0.1)
1996	31,613	-	200	152,220	(13.0)	-	-	747	(0.0)
1997	5,609	50	1,989	103,580	(14.6)	3,185	(4.5)	2,094	(0.1)
1998	59,206	1,950	29,727	256,334	(18.6)	2,693	(3.4)	9,683	(0.3)
1999	22,759	2,402	7,818	765,905	(21.9)	79,642	(7.5)	11,567	(0.3)
2000	115,110	16,234	△4,157	565,585	(30.1)	20,335	(7.0)	6,921	(0.2)
2001	76,317	12,765	1,537	936,982	(36.6)	53,713	(10.4)	4,293	(0.1)
2002	△25,529	2,021	4,564	931,607	(36.0)	39,291	(10.5)	6,466	(0.1)
2003	137,671	8,374	11,512	1,425,341	(40.1)	53,922	(14.4)	17,676	(0.3)
2004	109,794	16,446	20,289	1,731,577	(42.0)	47,995	(15.4)	31,753	(0.5)
2005	△29,559	6,701	13,646	2,602,626	(39.7)	95,752	(13.5)	33,457	(0.5)
2006	△113,067	△4,648	17,761	2,625,335	(37.3)	105,589	(14.6)	46,178	(0.6)
2007	△305,908	300	350,057	3,080,470	(32.4)	173,520	(17.4)	384,484	(4.6)
2008	△432,241	△23,217	223,130	1,669,327	(28.9)	37,839	(8.2)	374,577	(4.3)
2009	415,690	△1,463	535,820	2,892,793	(32.6)	67,094	(7.8)	564,864	(5.6)
2010	245,288	3,805	568,162	3,277,618	(31.5)	80,787	(8.8)	746,229	(6.7)

Note : 1) Based on foreigners' trading of listed securities including ETF, ELW and others in the securities market
2) The ratio of foreign shareholding to the total market capitalization of listed securities as of the end of the period is shown inside the parenthesis.(listed amount for bonds)
3) Based on the settlement date

CHAPTER 15

TAXATION ON FINANCIAL INVESTMENT

I. 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, nonresidents and foreign corporations, applying different tax laws to each. Tax laws applied to residents and nonresidents are stipulated in the Income Tax Act (ITA), and taxation on domestic and foreign corporations are prescribed in the Corporate Tax Act (CTA). Although nonresidents and foreign corporations are separately governed by ITA and CTA, the specifics of taxation rules described in both Acts are almost identical.

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 that 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 withholding tax on imputed income of the corporation. In principle, withholding tax is only imposed on the interest income.

1. Overview of the Income Tax Act

1) MAIN FEATURES

(a) Taxation based on Quellentheorie - Income Source Theory

Currently, ITA enumerates nine types of taxable income – interest income, dividend income, real estate rental 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, dividend, and annuity income – they are liable for taxation even though they are not specified in the Act.

ITA uses a positive definition, classifying income based on the types of income sources, and only imposing taxes on the income accrued in a constant and regular basis. The reason for such a selective taxation is that 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 types. The current income tax system applies global taxation to interest, dividend, business, earned annuity and miscellaneous income on a personal basis.

Along with global taxation, ITA also uses schedular and separate taxations as well. Schedular taxation separately levies 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, ITA uses a schedular system which classifies and taxes based on types 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 withholding whenever the income is paid to an individual.

(c) Voluntary Tax Payment based on Individual Progressive Tax Rate

In the global taxation system, the taxation unit could be on an individual, a household or a couple, in other words; on a consumption basis. In principle, Korea imposes income tax, based on the individual unit.

Unlike corporate tax, income tax is a kind that 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 ability, facilitating a fair redistribution of income among the general public. Based on such an understanding, ITA applies different income tax tariffs - ranging from 6% to 33% - 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 tax are levied on each person depending on the type of income they earn, even if the amounts earned are same.

Meanwhile from the tax amount collected since 1995, ITA has applied amended taxation rules, abandoning its original government-led tax assessment and taxation 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 themselves assess and declare the amount of tax they should pay to settle their tax claim. Under the 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 nonresident 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 following month 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 taxpayers' convenience. There are two types of tax withholding: 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 are described in Table 15-1.

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 tax. In the process, the amount of tax withheld shall be deducted as prepaid amount. Tax withholding by a corporation is an example of prepayment tax withholding.

TABLE 15-1. 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 a daily-paid worker) ④ Separate taxation on annuity income (Optional for a person with less than KRW6mn of annual income) ⑤ Separate taxation on miscellaneous income (Optional for a person with less than KRW3mn of annual income)
Non-residents	Income liable for withholding

3) TAXABLE PERIOD AND TAX CALCULATION

The taxable period is from January 1st to December 31st of that 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 15-2. INCOME CLASSIFICATION AND TAX CALCULATION FOR AGGREGATE INCOME

Classification	Contents
Total amount of aggregate income	(=Σ Income amount: Total amount of income(excluding tax free, and separate taxation) necessary expense) - Interest, dividend, real-estate lease, business, earned, annuity, miscellaneous income amount · Positive definition in principle but negative definition for interest and dividend income - Aggregate taxation on financial income - Special exceptions for calculation of income amount (deduction of summing up taxation on a joint business, deficit and deficit carried over)
(−)Aggregate income deduction	- Personal + special + other deductions
Base of taxation (x) tax rate	- (Below KRW12mn: 6%, KRW12mn-46mn: 15%, KRW46mn-88mn: 24%, above KRW88mn: 33%) - 6~33% of progressive tax rate
Calculated tax amount	- Special exceptions for tax calculation of financial income
(−)Tax credit and exemption	- Tax credit for foreign taxes paid, tax credit for dividend, tax credit for earned income, tax credit for losses due to disaster, tax credit for bookkeeping, tax credit based on RSTA*
Amount of determined tax (+)penalty tax (+)additional tax amount to pay	Amount of additional interest assessment
Total amount of determined tax	Resident tax = total amount of determined tax x 10%
(−)Prepaid tax	Interim tax payment, occasional assessment tax payment, withholding tax payment, Tax amount collected by a tax association
Voluntary tax payment	

* RSTA: Restriction of Special Taxation Act

II. FINANCIAL INVESTMENT INSTRUMENTS AND TAX

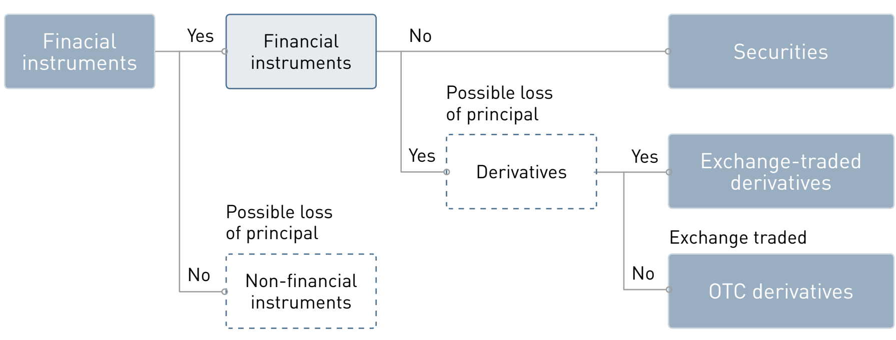
Korea classifies the financial business into banking, insurance and financial investment. A financial instrument means a product that is dealt by a financial business. The types of financial instruments are classified as loan products offered by the banking industry, insurance products offered by the insurance business, and financial investment instruments offered by the financial investment business. In general, income accrued from financial instruments is referred to as financial income.

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 kinds of financial investment instruments, there is a kind that invests money into a variety of financial investment securities or simultaneously invests in different types of property rights. 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 physical delivery.

The following section explains more about the classification of financial investment instruments, based on the definitions in 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 15-1. CLASSIFICATION OF FINANCIAL INSTRUMENTS BASED ON THEIR ECONOMIC CHARACTERISTICS



1. Derivatives

In general, derivatives are referred to as financial instruments derived from underlying assets[1]. 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 monetary 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 FSCMA, derivatives refer 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.

ITA does not impose 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 derivative-combined securities and collective investment securities.

2. Debt Securities

1) DEFINITION OF DEBT SECURITIES

According to FSCMA, debt securities mean government bonds, municipal bonds, special bonds, corporate bonds, corporate commercial papers, and other similar instruments that bear the indication of a right to claim the payment.

ITA explains debt securities as "debentures, etc." and enumerates the kinds of "debentures, etc." according to the following table (Article 16 (1) of ITA and Article 102 (1) of the Enforcement Decree of ITA (EDITA)).

TABLE 15-3. ITA'S DEFINITION OF DEBT SECURITIES

- Bonds or securities issued by the Government or the 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 issued by financial institutions or similar certificates;
- Bills (including bills issued, sold, or mediated by financial institutions, and excluding commercial bills)

Note: 1) Page 537 of "Securities and Exchange Act," 3rd edition by Kun-sik Kim (Doosung Books, 2004)

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 ITA only refers to 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 KRW3mn amount of discount wants to sell the bonds after only a year of possession, out of the total discount amount of KRW3mn, KRW1mn – 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 finance 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. In these cases, to help promote and develop the government bond market, only the amount of interest accrued by the coupon rate exclusive of the discount amount is considered to be taxable interest income according to Article 22-2 (2) of EDITA.

Furthermore, if a person transfers his/her bonds to another person before maturity, they could 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. But Korea’s taxation laws do not levy tax on capital gains accrued from the transfer of bonds, etc.

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 ITA. Therefore necessary expenses are not recognized as expenses.

3) DATE OF INCOME EARNING

The date of receipt of income from bond interest shall be the date of receipt of such payments for interest and discount amounts for bearer public bonds, and the payment date under the agreement for interest and discount amount in the case of non-bearer public bonds, according to Subparagraph 2 and 3 of Article 45 of EDITA.

The receipt income accrued from coupon interest shall be the date of 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 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

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 company, limited liability company, 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.

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 ITA defines transfer income, it refers to "stocks or investment shares" as "stocks, etc." in Subparagraph 3 of Article 94. Based on the definition of 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 ITA. Dividends include not only cash dividends but also stock dividends. In such cases, only those whose revenue source are earned surpluses are taxable. If the revenue source is a capital reserve, it is not liable for taxation according to Subparagraph 2 of Article 17 (2) of 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 Article 17 (2) of ITA.

TABLE 15-4. SCOPE OF EQUITY SECURITIES RELATED DIVIDEND INCOME ACCORDING TO ITA

- Dividends or shares 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 shares received from an organization considered as corporation
- Dividends or shares 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 bear a nature of profit distribution

Dividend income accrued from long-held stocks falls under the category of special cases of the non-taxation of income tax and withholding tax. For instance, in cases where a resident holds listed-stocks for more than three years, no income tax or only 5% of withholding tax rate shall be imposed on the dividend income according to Article 91 (1) of the Restriction of Special Taxation Act (RSTA) – though this sunset clause will expire at the end of 2010.

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 dividend distributed by a corporation. To address such a situation, 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 (1), Subparagraph 3 of 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 15-5. TAXATION AND TAX RATES ON CAPITAL GAINS FROM EQUITY SECURITIES

Classification		Taxability o	Taxability x	Applied tax rate
Stocks from stock-listed corporations	Exchange-traded	Major shareholders	Minor shareholders	· Stocks issued by SMEs : 10% · Other stocks: 20% · Major shareholder's stocks retained less than one year: 30%
	Over-the-counter traded	Every shareholder	-	
Stocks from non-listed corporations		Every shareholder	-	

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 2 of Article 118-2 of 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 EDITA. Additionally, Subparagraph 2 of Article 46 of 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 3 of the same article of 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 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 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 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 0.15% of special tax for rural development) and 0.3% to equity securities transferred on KOSDAQ market respectively.

4. Derivatives-Linked Securities

1) DEFINITION OF DERIVATIVES-LINKED SECURITIES

Derivatives-linked securities are structured securities in which derivatives that take stocks, etc. as their underlying assets are embedded in securities such as bonds[2]. According to the definition stipulated in Article 4 (7) of 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 the 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 15-6. TYPES OF DERIVATIVES-LINKED SECURITIES[3]

Underlying asset	Product Classification	Derivatives: Option	Derivatives: Forwards	Derivatives: Swap	Types of derivatives-linked securities
Interest rate			Interest rate derivatives		Interest rate-linked securities
Stock	Individual stock		Securities derivatives		Equity-linked securities
	Basket				
	Index				

Note: 2) Page 1 of "Analysis on Current Status of ELS and Promotion Strategies" by Hyoung-tea Kim, Jung-hun Seun (May 2003)
3) Page 6 of "Analysis on Current Status of ELS and Promotion Strategies" by Hyoung-tea Kim, Jung-hun Seun (May 2003)

Underlying asset \ Product Classification	Derivatives: Option	Derivatives: Forwards	Derivatives: Swap	Types of derivatives-linked securities
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

ITA enumerates the types of derivatives-linked securities and classifies them based on taxation on their dividend income. Currently, among derivatives-linked securities, dividend income from equity linked securities (ELS) and other derivatives-linked securities is liable for taxation. Meanwhile, among derivatives-linked securities, equity linked warrants (ELW) are exempt from taxation (Article 26-3 of EDITA) as 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 tax 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, ITA does not impose tax on the capital gains accrued from the transfer.

TABLE 15-7. TAXATION ON DERIVATIVES-LINKED SECURITIES

Classification	Taxation subject
• ELS: Equity linked securities	Dividend income
• Other derivatives-linked securities	Dividend income
• ELW : Equity linked warrant	No tax applied

5. Collective Investment Securities

1) DEFINITION OF COLLECTIVE INVESTMENT SECURITIES AND COLLECTIVE INVESTMENT SCHEMES

In Article 21 (9), 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 15-8. CLASSIFICATION OF COLLECTIVE INVESTMENT SCHEMES BASED ON FSCMA

Type of organization	Collective investment scheme	Legal form
Trust type	Investment trust	Trust
Company type	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 type	Investment association	Association under the Civil Act
	Undisclosed investment association	Undisclosed association under the Commercial Act

According to FSCMA, Korea's taxations 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[4]. FSCMA classifies collective investment schemes into various forms such as trust, company, and association, but the most dominant form in the Korean fund market is the investment trust.

2) SEPARATION FROM SPECIFIED MONEY TRUSTS

According to ITA, earnings from collective investment schemes are taxable as a dividend income. Additionally, based on Article 4 (2), when it comes to the income derived from trusts other than collective investment schemes, ITA imposes a tax on income by classifying the content of the income accrued from the property rights. The term "trusts other than the collective investment schemes" means specified money trusts[5], property trusts[6] based on 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 specified money trusts, the trustee's fee and other commissions are deducted in the same method used for the collective investment schemes, according to Article 26-2 of EDITA. Plus, the receipt date of the earnings from specified money trusts, etc. is the day on

Note: 4) Shown by the existence of general partners, private equity funds, unlike the collective investment scheme, are subject to the partnership tax system as they lack the collectiveness and indirectness, which are the biggest characteristics of the collective investment scheme.
5) Subparagraph 1 of Article 103 of Enforcement Decree of FSCMA
6) Subparagraph 3 of Article 103 of FSCMA

which the income is accrued from property rights that are included in trusted properties and are defined as belonging to the trusted properties. Article 155-2 of 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 inconvenience entailed from tax withholding, which would otherwise have to be done whenever accrued income is added to investors' properties.

Investments through discretionary investment contracts[7] 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 cases of trusts, income tax is imposed on the accrued income according to the contents of the income.

Meanwhile, variable insurance sold by insurance companies are classified not only as savings insurance but also as an investment trust according to Article 251 of FSCMA. Therefore, if there is no legal consideration, the capital gains accrued from variable insurance could be taxed not only as an interest income – as it could be considered a gain on an insurance claim for the savings insurance – but also as a dividend income, accrued from the relevant collective investment scheme. With such an understanding, Article 4 (2) of ITA clearly states that any income accrued from savings insurance is taxed as a gain on insurance claim.

3) TAXABLE INCOME

One way investors realize the profit accrued from assets invested in collective investment securities is through redemption or profit distribution at the closing of their account. 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 weapon of choice among the 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 redemption and securities transfers are subjects to dividend income tax and transfer income tax respectively.

Note: 7) Subparagraph 7 of article 6 of FSCMA : "discretionary investment business" in this Act means a business carrying on 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 15-9. 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 EDITA, dividend income accrued from a collective investment scheme is taxable when the scheme meets the following requirements.

① It shall be a collective investment scheme under FSCMA.

② Account settlement shall be made once or more each year and the accrued profit should be distributed.

③ Investment 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 tax as they are considered as ① corporations in the case of investment companies or ② profits accrued from trusts other than collective investment schemes in the case of investment trusts, according to Subparagraph 3 of Article 26-2 of 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 both at 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 FSCMA, or securities that are falling under the categories below and acquired directly by collective investment schemes, are exempt from taxation based on Subparagraph 4 of Article 26-2 of EDITA.

① Securities listed on the securities market (excluding those in the following items):

(a) Bonds, etc. under Article 46 (1) of 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”

③ Exchange-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 EDITA defines profits given to an investor from a collective investment scheme as the amount, excluding various remunerations, commissions, fees, etc. defined in FSCMA. Therefore, based on FSCMA, the various commissions – remunerations, redemption commission, sales commission, etc. – given to the 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) DATE OF INCOME EARNING

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 of 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 (7) of 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 15-10. CLASSIFICATION OF INCOME BY FINANCIAL INVESTMENT INSTRUMENT

Instrument type \ Income classification		Interest Dividend income	Transfer income	Specifics
Derivatives		x	x	
Debt securities		Interest income	x (Note 1)	
Equity securities		Dividend income	△	Taxation on non-listed stocks, etc.
Derivative-combined securities	ELS, DLS	Dividend income	x	
	ELW	x	x	
Collective investment securities (beneficiary securities)		Dividend income	x (Note 2)	
Beneficiary securities from specified money trusts or discretionary investment (wrap account)		-	-	Taxation based on the content of income

Note: 1) When transferring debt securities, interest income taxation on the amount of interest accrued during the possession of the relevant bonds.
2) When transferring collective investment securities (beneficiary securities), dividend income taxation on the amount if capital gains accrued during the period of possession.

III. AGGREGATE TAXATION ON FINANCIAL INCOME

Based on 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 of the cases, financial companies), should withhold tax equaling 14%[8] of the income at the point of such payment (which is 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 whose when a resident's yearly financial income amount is less than KRW40mn, his or her tax liability finishes with tax withholding, but for a resident whose yearly financial income amount is more than KRW40mn, global taxation shall be imposed. The reason for only applying global taxation to people whose annual financial income amount is more than KRW40mn 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 RSTA is not included when summing up the yearly financial income amount for the KRW40mn limit. In the case of financial income that was accrued from foreign countries and is not a subject to withholding tax, it is subject to global taxation. However, if the total amount of such income is less than KRW40mn, the 14% taxation rate is applied.

Furthermore, when the total amount of annual financial income is over the KRW40mn limit and liable for global taxation, the aggregate amount up to the KRW40mn limit is taxed at the 14% taxation rate and only the remaining amount, which is above KRW40mn, is a subject to the progressive tax rate.

TABLE 15-11. GLOBAL TAXATION AND TAX RATES ON FINANCIAL INCOME

<table>
<tr><th>Classification</th><th colspan="2">Financial income liable for aggregate taxation</th><th>Applied tax rate</th></tr>
<tr><td rowspan="2">Subject amount > KRW40mn</td><td rowspan="2">Income liable for conditional aggregate taxation
+ Income liable for unconditional aggregate taxation</td><td>Amount above the KRW40mn limit</td><td>Apply the basic tax rate by summing up with other income</td></tr>
<tr><td>KRW40mn</td><td rowspan="2">Apply 14% of tax rate</td></tr>
<tr><td>Subject amount ≤ KRW40mn</td><td colspan="2">Income liable for unconditional aggregate taxation
*Separate taxation on income liable for conditional aggregate taxation</td></tr>
</table>

Note: Subject amount = Income amount liable for conditional aggregate taxation + Income amount liable for unconditional global taxation

Note: 8) 15.4%, inclusive of the local income tax

In the case of financial income amounting to more than KRW40mn 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 10% of 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 or agreements prevail over domestic tax laws to prevent double taxation. But in the cases where domestic laws are more advantageous than the 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 nonresidents and foreign corporations, with the former governed by ITA and the latter by CTA. Under the current tax Acts, 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 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 nonresident. 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 nonresident. 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 long time, besides their address, and in which there is no general living relationship, according to Article 1 (1) and (2) of EDITA.

2. Taxable Income and Tax Rates according to the Types of Instrument

The type of income accrued from the financial instruments of a foreign investor is classified using the same criteria applied to a resident. Hence, as was explained in part II, income earned from loan products and insurance products is classified as an interest income. According to Subparagraph 1 of Article 119 of ITA, income from debt securities is considered interest income, and income from equity securities, derivative combined securities, and collective investment securities is classified as dividend income according to Subparagraph 2 of the same article.

However, different taxation criteria are applied to nonresidents' capital gains. Under 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 is not a subjected to taxation according to Article 179 (11) 1 of EDITA. Therefore, in the case of debt securities, if a nonresident 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 subjects to taxation.

For derivatives, the income acquired through the trading of derivatives on the exchange market by a nonresident who does not have a domestic place of business is liable for tax, according to Article 179 (12) of 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 ITA. However, in the cases where the tax rates (when the taxable income for local income tax is subjected to tax treaties, conventions or agreement, 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 the transfer income, a tax rate of 20% is applied. However, in the 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 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 based on the Proviso to Article 156 (2) 3 of ITA. And if the debt securities are government bonds or currency stabilization bonds (hereinafter referred to as governments bonds), interest and transfer income accrued from them are exempt from taxation, according to Article 119-2 (1) 1 and 2 of ITA. Plus, the acquisition, retention, and transfer of government bonds through financial institutions approved by the Commissioner of the National Tax Service are not subjected to taxation, based on Article 119-2 (2) of ITA. In addition, interest and transfer income that are accrued from foreign currency bonds issued by the government, municipal governments, or corporations and given to nonresidents and foreign corporations, are also free from tax, according to Article 21 (1) and (3) of RSTA. Korean tax laws offer non-taxation benefits to foreigners to increase the investment value of government bonds and ensure foreign currency liquidity[9).

Note: 9) Refer to the Act No. 9673, May. 21, 2009

CHAPTER 16

INVESTOR PROTECTION

I. OVERVIEW

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 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 FSCMA relating to investor protection. 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 make financial investment instruments 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, the organization for financial dispute resolution mediates the interest of both parties and proposes a resolution. The final section covers investment recommendation, a newly introduced measure for investor protection with the enactment of FSCMA.

II. DISCLOSURE

The term disclosure refers to the provision of information to general public so that anyone may have access to such information. Unlike institutional investors or other professional investors, ordinary investors are highly like 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. 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 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, ad hoc 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 ad hoc 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 asset 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.

Ad hoc disclosure for a fund and an asset management company includes the details described below. An asset management company shall immediately disclose the occurrence of any massive financial scandal or non-performing claims. Such information is material to assess the soundness of the company since any massive financial scandal or non-performing claim represents inadequate risk management or internal control systems within the company. Meanwhile, the ad hoc 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.

TABLE 16-1. AD HOC DISCLOSURE FOR FUNDS AND ASSET MANAGEMENT COMPANIES

Disclosure for funds	Disclosure for AMCs
Any changes in fund managers	Occurrence of any massive financial scandals or non-performing claims
Revisions made to a trust deed or an investment prospectus	Matters concerning investments or contributions
Decisions on deferment or resumption of redemption and the reasons thereof	Matters concerning significant changes in financial structure
Details of non-performing assets and the depreciation rates thereof	Matters concerning significant changes in assets
Details of resolutions of the general meeting of collective investors	Any recommendation or requirement from the FSC to improve management
Name change of a collective investment business entity	Violation of liquidity ratio in KRW

Disclosure of funds	Disclosure of AMCs
Merger, division, merger after division, or transfer of business of a collective investment business entity	Matters concerning significant changes in management environment of financial investment business entities
Details of a change in the base price	Any changes in profit-loss structure
Cases in which the amount of principal is less than 5 billion won on the date when one year has passed, or when one month after one year has passed since the establishment of the collective investment scheme (excluding privately placed funds), and the fact that in those cases, the investment can be terminated	Occurrence of non-performing assets that exceed 10% of the equity capital as of the end of the previous quarter (except when the amount is no more than 4 billion won)

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 ad hoc disclosures when it is deemed necessary. The information on a listed company is easily accessible on the website of the KRX.

1) 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.

TABLE 16-2. DETAILS OF ANNUAL REPORT

Contents	Details
Overview of the company	Company's purpose, history, capital change, the number of stocks, the status of stocks with voting rights and dividends
Details of business	Scope of business, main products and source materials, sales and production, facilities, major contracts for management and R&D
Matters concerning finance	Balance sheets, sales during the pertinent time period, income statements and cash flow statements
Audit opinion	External audit opinion on financial statements and matters that may have an impact on financial statements
Organization of company, including board of directors	Rights of the board of directors (BOD) and other important aspects of the company's organization; personal information of directors, the resolution of meetings of BOD and other committees under BOD and executives remuneration
Matters concerning shareholders	The stock ownership status of largest shareholders and shareholders holding 5% or more of the stocks, minority shareholders at the year end, a shareholders distribution chart showing the proportion of major shareholders

Contents	Details
Matters concerning executives and employees	The personal information and job description of executives, the number of employees, the total amount of annual remuneration paid for executives and employees and the status of the labor union
Transactions with interested parties	Matters concerning transactions of cash, securities, selling or purchasing of real estate or operation
Matters with investor protection	Matters concerning ongoing litigation related to the company, contingent liabilities incurred by a court case at home or abroad, other matters that have a direct impact on the profit and loss of the company and matters concerning administrative restrictions

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. Details of what is included in an annual report are listed in Table 16-2.

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; and 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.

2) AD HOC DISCLOSURE

Ad hoc 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 disclosure requirements for the Stock Exchange and KOSDAQ respectively. Since the ad hoc disclosure typically contains the 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 ad hoc 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; the 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 and 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 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' decision without delay, for example, where any issued bill or check defaults; or where any current account transaction with the bank is suspended or prohibited.

3) FAIR DISCLOSURE

Korea's securities market introduced the fair disclosure rule in November 2002. The rule requires that if a company discloses information to selective investors and it is deliberate, the company shall also provide such information to ordinary investors at the same time. When the disclosure is accidental, the company shall disclose such information to ordinary investors on the same day without delay. 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 ad hoc disclosure system and is implemented by the KRX, a self-regulatory exchange. Detailed disclosure information is accessible on the website of the KRX website.

The information released in fair disclosure is different from that of periodic or ad hoc disclosures in that it pertains to expected data, such as business projection, management projection, projections of sales, operating income or loss, net income or loss before tax from continuing operations and net income or loss. 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.

III. 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 non-public information it falls under "unfair trading". For example, President A of Company D sold about 30,000 shares of his company after being informed that a fire had occurred in a subsidiary of Company D, causing 2 billion won of damage and the subsidiary to suffer a 3.5 billion won 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. FSCMA stipulates provisions concerning the 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 judgment 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 of the company. That is a government official or an 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, main bank, 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 contract.

The 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.

1) DISCLOSURE OF STATUS OF SECURITIES OWNED BY EXECUTIVES, ETC.

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.

2) RETURN OF INSIDERS' SHORT-SWING PROFIT

Under FSCMA, if an executive, employee, or a 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 insider's short-swing profit are a preventive measure against insider trading. For example, an Executive K of a Company D was suspected and accused of realizing short-swing profits by trading 5,000 shares of Company D in a short period of time, using an account owned under his name. Company D then requested the FSS conduct an additional inspection on Executive K, and the FSS demanded he repay the profits to Company D.

3) PROHIBITION ON THE USE OF MATERIAL NONPUBLIC INFORMATION

Material nonpublic information refers to any information that has not been yet disclosed to the general public and may have a significant impact on investors' investment decision. Article 174 (1) of 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 FSCMA defines the disclosure time of information as follows:

- 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;
- Information disclosed through an electronic communication medium established and run by the FSC or the KRX: 3 hours after disclosure;
- 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;
- Information broadcast through television or radio with nationwide Coverage: 6 hours after broadcast; and
- 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 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 the civil law. However, Article 176 of FSCMA also regulates market manipulation in order to properly prohibit such an act.

Listed securities and exchange-traded derivatives are subjects to price manipulation and the act of manipulation, and entrusting or being entrusted with such an act is regulated by 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 16-3. 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 to mislead any person into making a wrong 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 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 for up to KRW500mn. However, when three times the amount of the profit or loss derived from unfair trading exceeds KRW500mn, 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 securities business. Discretionary trading is prohibited in Article 70 of 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 its size or frequency in view of the financial resources of such customer in order to generate more commissions and not with the best interest 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 interest before the interest of the customer. For a broker, frequent trading means more commissions; therefore, excessive unauthorized trading or excessive discretionary trading is commonly practiced. When such 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 FSCMA.

IV. 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, financial dispute resolution organizations mediate the interest of both parties and propose a resolution.

1. Financial Supervisory Service (FSS)

A financial dispute refers to a dispute arising among financial institutions and financial consumers or investors and other interested persons, concerning the rights and obligations or conflicts of interests between those parties in respect to the business of financial institutions. 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 financial related disputes.

The FDMC comprises of commissioners appointed by the Governor, with the Chairperson of FDMC nominated by the FSS Governor from among the deputy governors of the FSS. FDMC may include persons commissioned by the Governor from among 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 and persons who have knowledge and experience in finance.

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 shall submit an application form to the Governor of the FSS. It shall 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. It shall also attach documents proving the facts and reasons for requesting mediation, a letter from an attorney, if applicable, and other necessary materials.

The Governor shall, 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 shall refer the case to FDMC without delay and FDMC shall deliberate upon the case and devise a mediation plan within 60 days from the date referred. When the parties concerned accept the mediation plan, it shall have the same effect as a judicial compromise. If either party brings a lawsuit against the other party during the mediation procedure, the Governor shall 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 FSCMA. KOFIA resolves disputes between members of the Association and disputes related to the operation of financial investment business entities such as investment trading, investment brokerage, collective investment business, investment advisory business, discretionary investment business, and trust business.

The composition of the Dispute Resolution Committee (DRC) in KOFIA is similar to that of FDMC of the FSS. When the persons concerned accept the mediation plan, proposed by DRC, the resolution shall have the same effect as a judicial compromise. Such resolutions, however, 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.

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 an agreement is not reached within 30 days from the date of receiving the request to mediate the dispute, the case shall be referred to DRC without delay. DRC shall then deliberate upon the case and devise a mediation plan or withdraw the case within 30 days from the date referred. However, the deadline can be delayed within 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 persons shall submit the follow-up measures to KOFIA without delay within 20 days from the dispute settlement. If the other party refuses to accept the mediation plan of KOFIA without any justifiable reason, and the party that requested the mediation brings the case to the court, KOFIA may provide support for the latter party by appointing an attorney as a proxy for the case, if it is deemed necessary for investor protection and fair trading.

3. Korea Exchange (KRX)

The KRX takes responsibility for the resolution of financial disputes over the rights and obligations or conflicts of interest derived from investment trading in the Stock Exchange, the KOSDAQ market, and the Futures Exchange. The Market Monitoring Committee (MMC) of the KRX establishes the Disputes Settlement Deliberation Committee (DSDC) that is composed of experts in related sectors, such as the legal department, academia, securities and futures business and consumer groups. DSDC deliberates disputed cases submitted to the Committee; then MMC makes a final resolution considering the result of the deliberation. The detailed procedure of disputes settlement is similar to that of KOFIA's.

V. FSCMA AND ENHANCED INVESTOR PROTECTION

1. Ordinary Investor vs. Professional Investor

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.

2. Restrictions on Investment Recommendation

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 FSCMA, KOFIA established the standard working rules on investment recommendations, which can be enforced by financial investment business entities in common.

Each financial investment business entity shall have a new investor fill out an investment information form to identify the investment preferences of the customer before recommending any investment instruments. The form shall include relevant information such as investment experience, expected period of investment, age, asset, current income, level of knowledge of financial investment instruments, risk tolerance, etc. Based on such information, an investor can be classified into one of the following types: Conservative, Moderately Conservative, Risk Neutral, Moderately Aggressive, and Aggressive.

Conservative investors are typically those who are seeking a level of return equal to interest rate deposits or installment savings, and aspire to preserve their principal balance. Moderately conservative investors are those who want to take little risk to preserve the principal balance, and typically receive income from dividends or interest from their investments. However, a moderately conservative portfolio is willing to take short-term risks and invests part of his or her assets into more volatile investment instruments to realize higher profit. Risk neutral investors understand that higher profit comes with investment risks and expect higher return rates than deposits or installment savings by taking a certain level of risks. Moderately aggressive investors are more open to risk, realizing higher returns on investment and tending to concentrate on equity investment such as stocks, equity funds and derivatives. Aggressive investors aim at high rates of return on investments in the market, often above what the long-term market performance has shown and are willing to risk the fluctuating value of their assets. They tend to concentrate most of their investment on risky instruments such as stocks, equity funds and derivatives.

Financial investment business entities shall categorize their investment instruments into five groups, based on investment risk, to selectively recommend instruments that are suitable to investors' preferences. Table 16-4 shows the investment risk by each financial investment instrument.

TABLE 16-4. INVESTMENT RISK BY EACH FINANCIAL INVESTMENT INSTRUMENT

Investment instrument		Speculative risk	High risk	Intermediate risk	Low risk	Ultra low risk
Bonds		Speculative grade bonds (BB or lower)		Corporate bonds (BBB+~BBB-)	-Financial bonds -Corporate bonds (A-or higher)	-Government bonds -Monetary stabilization bonds -Municipal bonds -Guaranteed bonds -Specific law bonds
DLS	(ELS, DLS)	Non principal-protected		Partially principal-protected	Principal - protected	
	ELW	ELW				
Stocks		-Margin transactions -Alert issues -Risk issues -Administ-rative issues	Stocks			
Future options		Future options				

Table 16-4 shows recommendable financial investment instruments by the type of investors. For example, financial investment business entities may recommend stock related instruments only to those who fall under the category of, at least, a moderately aggressive investor. The futures option is classified as a speculative risk instrument and is only recommendable to an aggressive investor. If an investor falls under the category of a conservative investor, no investment instrument except an instrument with ultra low risk shall be recommended, according to the standard rules on investment recommendations.

In cases where a financial investment business entity determines that the relevant derivatives are not adequate for an ordinary investor, taking into consideration the investment purpose, status of property, experience in investment, etc. of the ordinary investor, the financial investment business entity shall notify the ordinary investor of this fact and shall obtain confirmation from the ordinary investor by obtaining their signature or agreement.

If an investor refuses to provide information about their investment purpose, status of property, experience in investment, etc. and wants to make an investment in financial instruments, financial investment entities shall obtain signed confirmation of this fact from the ordinary investor. The investor should be very cautious in providing such confirmation since it states that the investor agrees to make an investment in the financial investment instrument under their own liability, and that the financial investment business entity is no longer obliged to take responsibility for the investment.

Other regulations on investment recommendation were also enhanced. In particular for those investors who are aged 65 or over and have investment experience in derivatives of less than one year, financial investment business entities are only allowed to recommend principal protected DLS or collective investment securities.

TABLE 16-5. RECOMMENDABLE INVESTMENT INSTRUMENT BY INVESTOR TYPE

Investor type	Speculative risk	High risk	Intermediate risk	Low risk	Ultra low risk
Conservative	Not recommendable	Not recommendable	Not recommendable	Not recommendable	
Moderately conservative	Not recommendable	Not recommendable	Not recommendable		
Risk neutral	Not recommendable	Not recommendable			
Moderately aggressive	Not recommendable				
Aggressive					

2) DUTY TO EXPLAIN

A financial investment business entity shall, whenever it makes an investment recommendation to an ordinary investor, 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 with such sufficiency as to allow the ordinary investor to understand them, and shall obtain signed confirmation from each ordinary investor stating that they have understood the details.

No financial investment business entity shall 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, such as the type, issue, the acquisition or disposition of the investment instrument, the method of acquisition and disposition, the amount of trading, and price. Notably, investor protection requirements are strengthened in that a financial investment business entity shall 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 the investment prospectus, except in the cases where an investor refuses to confirm that they received the investment prospectus by providing their signature.

3) 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 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.

VI. INVESTOR EDUCATION

1. Establishment and Role of the KCIE

In July 2004, KOSPI had shown a continuous increase for 3 consecutive years, and investors flocked toward speculative investments, blindly following fund investments or becoming involved in unfair trading. In response, it was argued that adequate measures were required to create culture of sound investment, build investor confidence and minimize damages likely to be inflicted on investors in the case of a stock price plunge. Therefore, KOFIA, in cooperation with the government and financial investment businesses, established the Korea Council for Investor Education (KCIE) in June 2006, to provide adequate investor education in order to prevent future credit crises from occurring. The establishment of KCIE also aimed to raise investor awareness regarding asset management and financial investment products, thereby promoting long-term, stable growth of the capital market.

KCIE is an integrated central organization offering investor education, which was previously conducted by various organizations such as regulators, securities related organizations or securities firms, in a more systematic and effective manner. In an attempt to enhance education in rural areas where such programs had rarely been offered, KCIE established regional associations, providing high quality investor education programs for rural communities.

2. Provision of Education

The KCIE provides a life-long education for the general public by offering practical curriculum to support the financial well-being of Koreans. The course covers a wide range of individuals; teenagers, university students, employees, housewives, the elderly, people with special vocations, and socially marginalized people. Its investor education programs come in various forms; collective classes, online courses, broadcasting programs via IPTV and DMB, and the publication of books and leaflets.

1) FINANCIAL EDUCATION FOR TEENAGERS

The KCIE has been working to develop financial education for school students in cooperation with the Seoul Metropolitan Office of Education, Busan Metropolitan City Office of Education, and Daegu Metropolitan Office of Education, designating 95 schools to provide financial courses and offering general and special in-depth programs to teachers so they may better educate their students. In addition, it has operated programs to visit social welfare centers, lifelong-learning centers, and shelters to provide education to young people, with the aim of promoting financial education.

Diverse practical content that can be used in the classroom is developed and distributed to high schools and elementary schools, including a standard financial education curriculum. In addition, the KCIE is currently in discussions to publish financial textbooks for elementary school, high school, and college students. Complementing these programs are a variety of alternative hands-on programs such as weekend finance classes, bus-tours to financial institutions in Yeouido, and teenage finance camps. Other educational events are also available, including national securities contests for high school students, securities/derivatives contests for college students, financial investment camps for college students, field trips to the finance museum, exhibitions for investor education, etc. All of these programs aim to facilitate financial education for young children and teenagers in order for them to better understand finance and economy, and thereby grow into informed and responsible investors.

2) INVESTOR EDUCATION FOR GENERAL PUBLIC

As Korea becomes an aging society with a low birthrate, the KCIE provides a wide range of investor education programs for post-retirement in order to help individuals make more reasonable and informed investment decisions, and create 'asset-backed welfare' through long-term asset management plans.

With FSCMA coming into effect, financial investment instruments have become ever more complex and diversified. In response, the KCIE offers "All Guide" courses that introduce guidelines for investors to better utilize such financial instruments and to protect themselves in the market. An example is the "Smart Investor Program," which aims to provide enhanced investor protection and deals with the most popular financial instruments of today's market by providing the practical information needed by investors. In response to the financial authorities' efforts to promote the sound growth of the ELW market, the KCIE is operating mandatory education courses for ELW investors, which provide information on ELW products, trading structure, risks, etc.

The KCIE also works to boost demand for investor education and seeks to provide education to as many people as possible. Furthermore, it takes its social responsibility seriously by supporting community services and welfare facilities and distributes guidebooks for investment education by each financial sector to the general public free of charge.

CHAPTER 17

CAPITAL MARKET REGULATORY AND SUPERVISORY SYSTEM

I. HISTORY OF CAPITAL MARKET REGULATORY ACTS

Since the establishment of the Korea Exchange in 1956, Korea has introduced series of financial market related Acts – 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 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 business and investment advisory business 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 a fair market competition, financial innovation and stricter investor protection, 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 FSCMA.

II. FINANCIAL INVESTMENT SERVICES AND CAPITAL MARKETS ACT

1. Legislative Background and Process

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「Enforcement Decree of FSCMA」*
- *Aug. 4, 2008* *Enactment and promulgation of「Enforcement Rule of FSCMA」*
- *Feb. 4, 2009* *Effectuation*

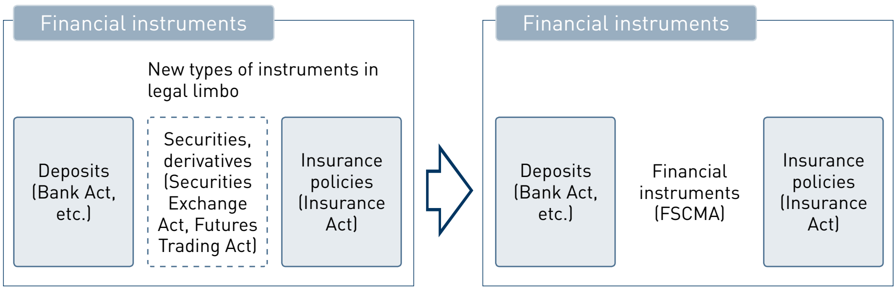
2. Main Features

1) NEGATIVE DEFINITION OF FINANCIAL PRODUCTS

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 structure of financial instruments and the market itself, rather than from credit, when identifying investment risks of financial instruments.

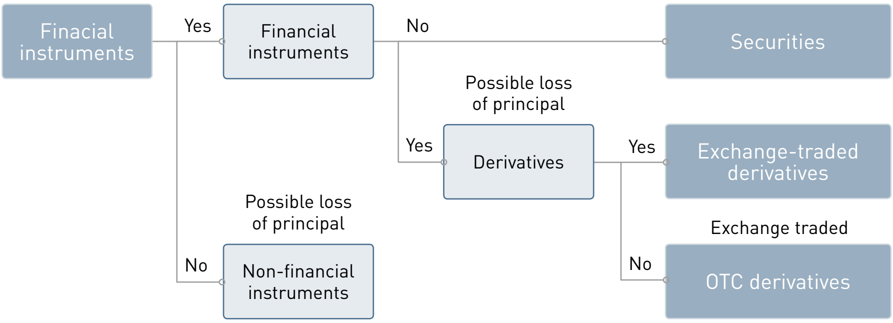
With the introduction of FSCMA, the Korean financial market divides the types of every financial instrument developed and sold on the financial market into those with investment risks and those without investment risks (bank deposits and insurance policies that guarantee the principal). This has significant 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 controlled by FSCMA.

CHART 17-1. CLASSIFICATION OF FINANCIAL INVESTMENT PRODUCTS UNDER FSCMA



Under 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 17-2. CLASSIFICATION OF FINANCIAL INVESTMENT INSTRUMENTS



FSCMA uses a comprehensive definition for the concept of securities and derivatives. According to 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 the 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 17-1. 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, corporate commercial papers 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 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
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-combined securities	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 based upon any of the aforementioned or any other similar factor
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

FSCMA integrated the previously separate financial investment business areas, securities business, futures business, asset management business, trust business, etc. into a single regulation. Financial investment business is now classified into six areas – investment trading business, investment 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. Investment trading and investment brokerage offer financial investment instruments trading and trading brokerage functions. Investment advisory provides investors with financial advice on the values of financial investment instruments and investment decisions, while discretionary investment has discretion over financial instrument investment. 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 the management to the investors, mainly invest trusted and collective investment assets into financial investment instruments.

CHART 17-3. REGULATORY FRAMEWORK OF FINANCIAL INVESTMENT BUSINESS

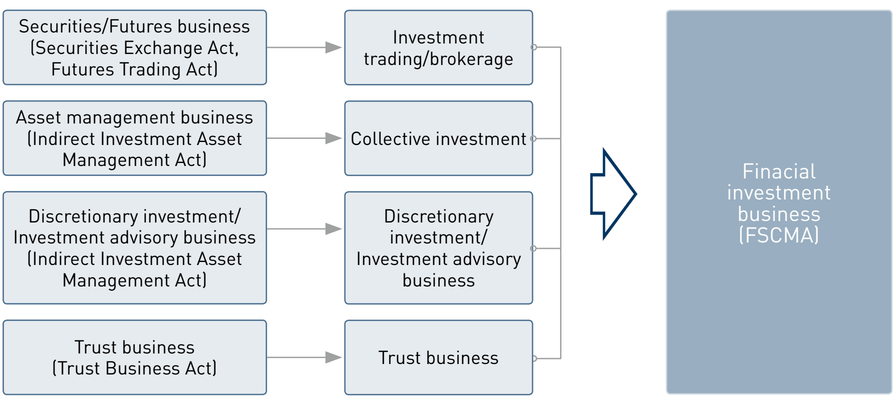


TABLE 17-2. TYPES AND CONCEPTS OF FINANCIAL INVESTMENT BUSINESS

Type	Concept	Classification
Investment trading	A business carrying on trade in financial investment instruments, issuing and underwriting securities, inviting offers, offering, and accepting offers for securities on another person's account regardless of whose name is given on it	- Securities companies - Futures companies
Investment brokerage	A business carrying on trade in financial investment instruments, inducing offers, offering, and accepting offers for such instruments, or inducing offers, offering, and accepting offers for the issuance and acceptance of securities on another person's account regardless of whose name is given on it	- Securities companies - Futures companies

Type	Concept	Classification
Collective investment	A business acquiring, disposing, and managing assets for investment with money by inviting two or more persons for such investment without being bound by management instructions given by investors and distributing the yields therefrom to investors	- Asset management companies
Trust	A business carrying on trusts based on the Trust Act	- Trust companies - Securities companies - Asset management 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
Discretionary investment	A business carrying on acquisition, disposition, and management in any way of financial investment instruments with authorization from investors for discretionary judgment, entirely or partially, over financial investment instruments	- Discretionary investment companies - Securities companies - Asset management companies

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 activities regulations applied to each type of financial investment firm, given the level of the risks and by their financial functions. Currently, Korea classifies 42 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 needed authorization or registration units. Investment trading business, investment brokerage business, trust business and collective investment business need authorization from the FSC, while investment advisory and discretionary investment businesses need to register with the FSC.

TABLE 17-3. UNITS OF AUTHORIZATION - REGISTRATION OF THE FINANCIAL INVESTMENT BUSINESS

Investment trading business	Including underwriting	Securities		
			Debt securities	
				State and public bonds
			Equity (except collective)	
			Collective investment securities	
	Except underwriting	Securities		
			Debt securities	
				State and public bonds
				Corporate bonds
			Equity (except collective)	
			Collective investment securities	
			RP Securities	
	Underwriting only	Securities	Debt securities	Corporate bonds
		Exchange-traded derivatives		
			Underlying equity	
		OTC derivatives		
			Underlying equity	
			Underlyings other than equity	
				Underlying currency and interest
Investment brokerage business	(RP brokerage)	Securities		
			Debt securities	
			Equity (except collective)	
			Collective investment securities	
		Exchange-traded derivatives		
			Underlying equity	
		OTC derivatives		
			Underlying equity	
			Underlyings other than equity	
				Underlying currency and interest
Investment brokerage business	(ECN)	Securities	Equity (except collective)	Listed stock (right)
Investment brokerage business	(Brokerage of OTC bond)	Securities	Debt securities	
Collective investment business		All funds (Mixed funds)		
			Securities fund (including MMF)	
			Real estate fund	
			Special asset fund	
Trust business		All trusted properties		
			Monetary trust only	
			Trust except money	
				Real estate trust
Investment advisory business/discretionary investment business		All financial investment instruments		

3) REGULATORY ADVANCEMENT FOR INVESTOR PROTECTION

FSCMA significantly empowered investor protection measures to bolster investor confidence in the Korean capital market. In particular, the Act takes different approaches to the 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 the 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 FSCMA, such as the State, 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 minimum amounts of balance in financial investment instruments (KRW10bn for corporations, KRW5bn 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 FSCMA, investment recommendation means recommending financial investment services such as the trading of financial investment instruments, or making contracts for investment advisory service, discretionary investment, and trust service for specific investors. FSCMA demands financial investment firms give enough product information (product guidance) to investors to recommend fitting investment instruments that suit the 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 combined 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 firms 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

FSCMA is comprised of 41 Chapters in 10 Parts with many subordinate regulations. The Enforcement Decree of FSCMA, which is a Presidential Decree, enumerates matters entrusted by FSCMA and the required regulations to implement the entrusted obligations. The Enforcement Rules of 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 17-4. 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
	Chapter 4	Business conduct rules	- Common rules of business conduct · Rules on investment recommendations · Prohibition on compensation for loss, liability for damages - Rules on business conduct by financial investment business entities

Part	Chapter	Contents	Details
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 report	- 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 and etc.
	Chapter 2	Market price manipulation	- Prohibition on market price manipulation
	Chapter 3	Restriction of short sale and unfair trading	- Comprehensive restriction on unfair trading activities, restriction on short sale
Part 5. Collective investment scheme	Chapter 1-11	Collective investment scheme	- 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, etc.
Part 7. Korea Exchange	Chapter 1-8	Korea Exchange	- 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 surcharge
Part 9. Supplementary provisions	-	-	- Reporting on violation, reporting by an electronic document
Part 10. Penal provisions	-	Penal provisions	- Penal provisions, fine, sentencing rules.

The FSC Regulations contain the Regulation on Financial Investment Business, Regulation on Issuance and Disclosure of Securities, Regulation on Capital Market Survey, Regulations on Inspection and Sanction on Financial Institutions, etc. In its regulatory enforcement rules, FSS defines the authority entrusted to its Governor by 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.

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.

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 transaction, OTC trading of derivatives, trading on the overseas securities markets and derivatives transactions on exchange along with matters such as investment registration, account opening, trading and deposit of securities and derivatives of 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 FSCMA.

To ensure the fairness of securities issuance and investor protection, 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 they should accompany. 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, RSID defines different specifics and required documents.

RSID defines matters that are needed for the concrete implementation of the registration of tender offers, report on stocks, held 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 a business report, and the information that should be stated in those reports; acquisition and disposition of treasury stocks of stock-listed corporations; decision on the issue value of capital increase with consideration; and issuance of convertible bonds and bonds with warrant.

III. 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, 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 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.

The new regulatory system, launched in 2008, 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/Securities and Futures Commission

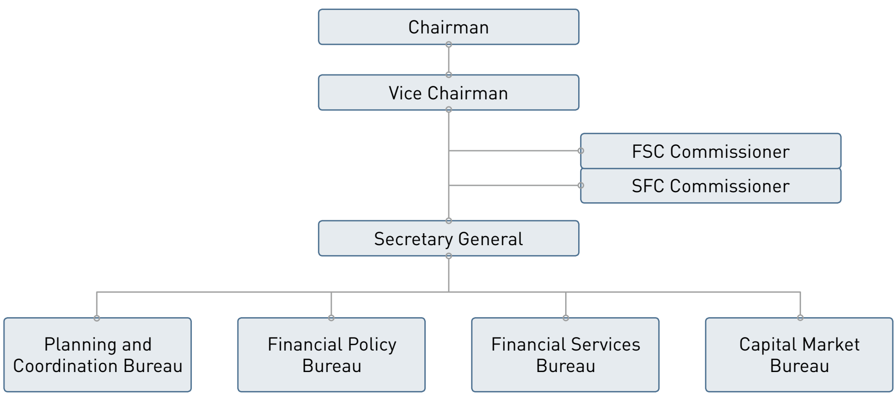
As a government organization, the FSC is a board-style administrative organization under the Prime Minister's Office. But unlike other governmental organizations whose authorities are designated by the Government Organization Act, the FSC's authority is designated by AEFSO, the Presidential Decree of Financial Services Commission and affiliated institutions' organization, and other Acts on financial supervision.

The FSC conducts matters regarding the financial policies and institutions, inspection and restriction on the financial organizations, licensing and authorization of the establishment of financial organizations, management, supervision and surveillance of the capital market and legal and regulatory enactment and revision of financial policies and system. The Commission also manages the business, 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 nine commissioners of the FSC include the Chairman and Vice Chairman of the FSC, Vice Minister of Finance and Planning, Senior Deputy Governor of Bank of Korea, President of Korea Deposit Insurance Corporation, Governor of the FSS, two persons nominated by the Chairman of the FSC and a person nominated by the Chairman of the Korea Chamber of Commerce. The Chairman of the FSC is nominated by the Prime Minister and appointed by the President of Korea, and the Vice Chair is nominated by the Chair of the FSC and appointed by the President of Korea. The Chair and Vice Chair each has a three-year tenure with a limit of two terms.

The Securities and Futures Commission (SFC) is responsible for 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. The commissioners of SFC consist of five people, including a Chairman who is nominated by the Vice Chairman of the FSC, and four financial experts nominated by the Chair of the FSC.

CHART 17-4. ORGANIZATION OF FSC



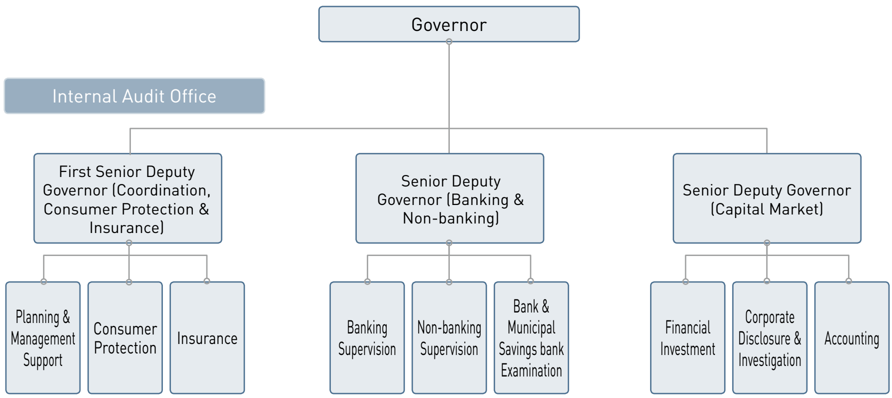
3. Financial Supervisory Service

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 the guidance from the FSC and SFC, the FSS conducts inspection 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.

The executive body of the FSS consists of the Governor, a maximum of four Senior Deputy Governors among a maximum of nine Deputy Governors and one auditor. The Governor is nominated by the Chairman of the FSC and appointed by the President of Korea, and the Senior Deputy Governors are nominated by the Governor of the FSS and appointed by the FSC. Deputy Governors are appointed by the Governor of the FSS.

CHART 17-5. ORGANIZATION OF THE FSS



4. Self-Regulatory Organizations

1) KOREA FINANCIAL INVESTMENT ASSOCIATION

The Korea Financial Investment Association (KOFIA) is an incorporated membership organization for the purpose of maintaining business order between members, assuring fair trade, protecting investors, and promoting the sound development of financial investment services. Members of the Association are 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 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 industry's self-mediation of conflicts.

2) KOREA EXCHANGE

The Korea Exchange is a stock company, which aims to fix and stabilize fair prices in the transactions of securities and exchange-traded derivatives, and facilitate the stability and efficiency of other transactions. It established and operates the Stock Market, the KOSDAQ Market, and the Futures Market. Under 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 securities depositary receipts. The KOSDAQ Market was established for the trading of specific securities, designated by 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 Futures Market is a market established by the Korea Exchange for the trading of exchange-traded derivatives.

The responsibilities of the Korea Exchange, include the establishment and operation of the Stock Market, the KOSDAQ Market, and the Future Market; transactions of securities and exchange-traded derivatives; transaction confirmation; debt acquisition; deduction; confirmation of settlement securities, settlement item, and settlement amount; 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; report and disclosure of a listed corporation; and self-resolution of disputes arising from transactions in the Stock Market, the KOSDAQ Market and the Futures Market.

5. International Cooperation with Overseas Supervisory Institutions

The FSC can share and exchange information with foreign financial investment supervisory institutions. When a foreign financial investment supervisory institution requests inspections or investigations, in a manner stipulated by FSCMA, on a breach of the Act or overseas laws and regulations equivalent to the Act by identifying the purpose and scope of the case, FSC can provide the foreign institution with needed cooperation. In cases of investigating violations involving the return of short-swing profit gained by insiders of a company, use of nonpublic information, market manipulation, unfair trading and restrictions of short selling, SFC can offer needed cooperation as well. In such a case, 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) to create 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 jurisdiction. The FSC and FSS became members of Appendix A of the Multilateral Memorandum of Understanding of IOSCO in 2009.

6. Financial Services Related Institutions

1) KOREA SECURITIES DEPOSITORY

Korea Securities Depository was established in order to promote a centralized depository for securities, transfer of securities between accounts, settlement, subsequent to transactions and smooth circulation. The Depository conducts business such as centralized deposits of securities, etc.; transfer of securities, etc. between accounts; and the delivery and payment of securities, subsequent to transactions on the securities market.

It also retains depositor account books, and depositors (in this context "financial investment firms") who re-deposit securities, etc. deposited by investors in the Depository should prepare and retain an investor's account book. Any person stated in the investor's account book and the depositor's account book is considered to hold the respective securities. Where a transfer between accounts is stated in an investor's account book or depositor's account book for the purpose of a transfer of securities, etc. or where the securities, etc. are stated to be pledged in such account books for the purpose of creating a pledge, the securities, etc. are considered to have been delivered. Furthermore, depositors and investors shall be presumed to have a co-ownership share on the deposited securities, etc. according to the type, item, and quantity of the securities, etc. indicated respectively in the investor's account book and the depositor's account book.

2) SECURITIES FINANCE COMPANY

Korea has institutions that only conduct securities financing business, and any person who intends to carry out that business has to obtain authorization from the FSC. Currently, the Korea Securities Finance Corporation is Korea's only securities financing organization carrying out securities financing including primary market financing, securities distribution finance, and securities collateral loan, as well as maintaining custody and management of investors' deposit and corporations' own stocks acquired by members of Employee Stock Ownership Unions.

3) MERCHANT BANK

Merchant banks deal with various businesses. They issue, discount, trade, arrange, underwrite and guarantee bills whose maturities come within a period of up to one year; make investments and loans for equipment or operating capital; underwrite securities and make public offerings for outstanding securities or intermediate or arrange public offerings for new or outstanding securities, or act by proxy for that purpose; induce foreign capital and make overseas investments, arrange international financing, or borrowing and sublease foreign capital; issue bonds; and guarantee payment. Moreover, they conduct the business of bill management accounts, factoring and brokerage or dealing of exchange-traded derivatives, traded in the derivatives market whose the underlying assets are stock indices.

4) FUND BROKERAGE COMPANY

Fund brokerage companies participate in brokering fund transactions between financial institutions, and those that intend to do such business, have to obtain authorization from the FSC. The main businesses of the fund brokerage companies are brokerage of transaction of funds in KRW such as call money, CD and RP, foreign currency brokerage and other businesses, licensed or approved by the FSC. Currently, the Korea Money Brokerage Corporation and Seoul Money Brokerage Service Ltd. are conducting fund brokerage business.

5) SHORT-TERM FINANCE COMPANY

Short-term finance companies conduct the business of issuing, discounting, trading, arranging and underwriting bills whose maturities come within a period of one year, as well as the business of guarantees and of lending money in return for taking securities as collateral. Units that can conduct such business include banks and qualified financial institutions, and anyone who intends to do the business has to be authorized by the FSC.

6) TRANSFER AGENT

Transfer agents are companies that conduct the business of making changes of entries in a register. They should be registered with the FSC and should either be a depository or a bank with branches nationwide, and equipped with certain physical facilities such as data-processing equipment. Currently three transfer agents – the Korea Securities Depository, Kookmin Bank, and Hana bank – conduct this business in Korea.

7) FINANCIAL SERVICES-RELATED ORGANIZATION

For the protection of investors and sound trade practice, any person can establish an organization comprised of investors, stock-listed corporations and investment solicitors. However, the individual must obtain permission from the FSC. Currently, the Korea Listed Companies Association and the KOSDAQ Listed companies Association, both of which aim to protect the benefits of stock-listed companies and strengthen their business bond, has received permission from the FSC.

CHAPTER 18

KOREA FINANCIAL INVESTMENT ASSOCIATION

I. OVERVIEW

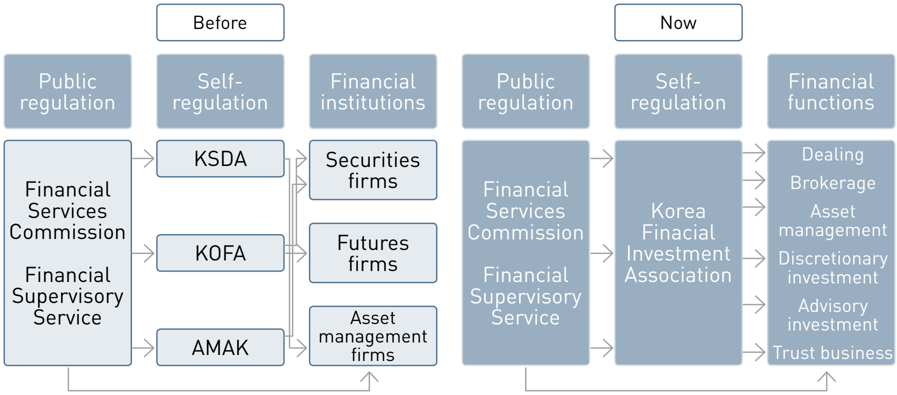
The Korea Financial Investment Association (KOFIA) is the self-regulatory body that manages the Korean financial services industry, and it plays a significant role in developing the Korean financial investment industry and capital market.

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).

To nurture and promote small innovative companies, in July 2005, KOFIA reorganized and relaunched Korea's third market under the name FreeBoard, by expanding and revamping the existing role of the third market – the conventional venue for the Over-the-Counter (OTC) trading.

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). 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 18-1. SELF-REGULATION SYSTEM

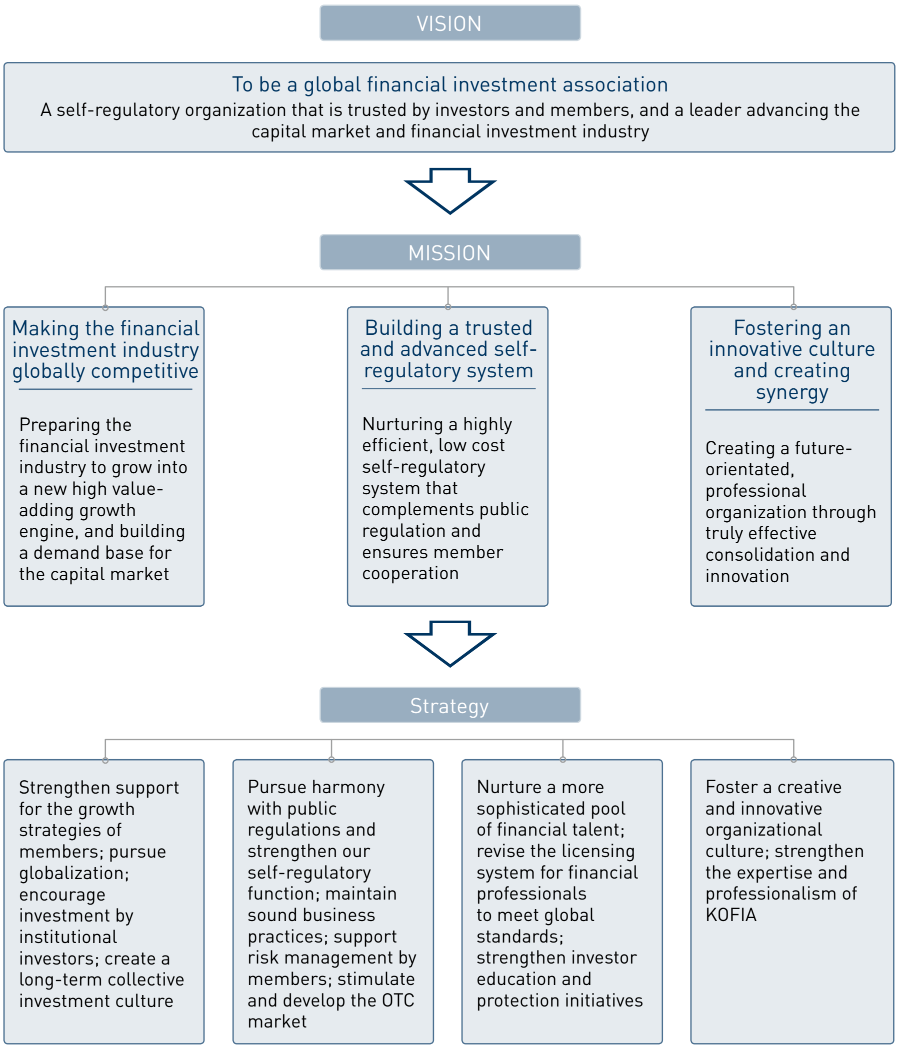


As a non-profit membership-based organization, KOFIA aims to promote fair business practices among its member companies, create a fair business culture in the financial investment industry, and maximize the function of investor protection to thereby ensure the healthy development of the Korean capital 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.

CHART 18-2. VISION OF KOFIA



1. Role of the Korea Financial Investment Association

1) ESTABLISHMENT AND ENFORCEMENT OF SELF-REGULATORY CODES

KOFIA has introduced and implemented self-regulatory measures to create a culture of investor protection and fair business practice 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 FSCMA in 2009 made the association the sole self-regulatory body of the

Korean capital market, endowing KOFIA with the authority to supervise the financial investment industry. 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. 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 Service (FSS) entrusts KOFIA with the duties of monitoring financial investment firms, introducing brokers, insurance and contract businesses, as well as the supervision and investigation of financial investment firms.

FSCMA legally guarantees KOFIA's regulatory power and allows for the revision of the association's regulations, as well as regulatory enforcement authority over its member companies. For instance, FSCMA stipulates a financial investment company's legal requirements for corporate establishment, including its duty of compliance to the KOFIA's regulations as a prerequisite. 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 the purpose of investor protection.

Among the many rules and regulations of 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 types of financial investment business such as investment trading business or investment brokerage business. This section includes regulations governing other business activities as well 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 interests between its member service function and the self-regulation process. FSCMA changed the clause establishing the Self-regulation Committee from being optional into 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 activities of member companies, surveillance and supervision of unfair and unlawful trading activities by its members, and disciplinary measures on member companies, corporate executives and employees failing to comply with the regulations.

TABLE 18-1. MAJOR BUSINESS REGULATIONS OF KOFIA AND CODES OF 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	Code of best practices on CMA business
Regulations on dispute resolution	Instruction on quasi-overseas currency futures trading
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	Quick guide
Regulations on financial investment professionals and certification	Codes of best practices for the appointment of outside directors for financial investment companies
Regulations on the quotation intermediation of OTC stocks	Codes of best practices on special asset fund transactions
Regulations on the assessment of credit rating agencies	Action plans for voice phishing protection
Deliberation criteria on the exclusive right to use new products	Codes of best practices for the prevention of misplaced orders
Rules and regulations concerning self-regulation	Codes of best practices on green fund investment
Regulations on the operation and review of OTC Derivatives Review Committee	Valuation guideline
	Codes of best practices on the prevention of CMS-related financial crime and false identity
	Analyst code of ethics
	Codes of best practices on liquidity risk management for financial investment companies
	Codes of best practices on risk management for dealing on credit
	Standard contract on non-guaranteed bond trusts
	Codes of best practices on the prevention of unfair trading
	Codes of best practices on cross trading in purchase with buy-back agreement
	Codes of best practices on using research/analysis services of collective investment managers
	Criteria on the management of risk limits of derivatives
	Codes of best practices on the management of risk limits of derivatives for qualified institutional buyers
	Criteria on the integrated disclosure of financial investment products
	Compliance manual for financial investment companies - I, II
	Standard criteria on investment recommendation brokerage
	Instruction on margin loans

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 active investment in the stock market by pension funds. In particular, in 2007, KOFIA, pushed for the enactment of FSCMA so that the six previously separate financial market laws 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 FSCMA.

3) STRENGTHEN INVESTOR PROTECTION AND EDUCATION

It is safe to say that KOFIA's raison d'être is protecting the rights and benefits of investors.

To improve the financial literacy of Korean investors and to promote and enhance investor education, KOFIA led the establishment of the Korea Council for Investor Education (KCIE) in 2006, to better facilitate investor education initiatives. KCIE is a non-profit organization established by a consortium of eight securities industry institutions – the Financial Services Commission, Financial Supervisory Service, Korea Securities Dealers Association, Asset Management Association of Korea, Korea Futures Association, Korea Exchange, Korea Securities Finance Corporation and Korea Securities Depository – to create a sophisticated capital market through the promotion of a wise financial investment culture with an advanced market environment for investor protection. KOFIA serves as the secretariat and chair of KCIE.

The purpose of KCIE is to provide investors with quality education on issues relating to securities, futures and asset management, plus other major financial issues in and out of the country so that it can nurture financially savvy investors who are able to make informed financial decisions. KOFIA is a founding member of the International Forum for Investor Education (IFIE), and actively participates in the various events and programs the IFIE offers. IFIE aims to create a global standard in investor education while providing people with useful tips and information on investment opportunities that they can gain from various investment activities, along with the financial risks hidden in the market. In November 2010, KOFIA Chairman Kun Ho Hwang was elected chair of IFIE for 2011-12.

KOFIA has also encouraged and supported securities companies launching their own investor education campaigns in order to enhance local investors' overall understanding of securities transactions. The association has constantly worked towards raising the public's awareness of financial investment through various education programs and 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 Dispute Resolution Office that offers investors information and advice about the laws and regulations governing financial investment products. The office provides advisory service to help investors address every possible issue they may confront. The latest topics and information are available on the KOFIA website (www.kofia.or.kr). Also, to be able to act promptly with disputes among member companies while also strengthening investor protection, the association implemented the Regulation on Conciliation of Securities Disputes in 2004.

Financial transaction inquiry service is another program prepared by KOFIA to enhance investor convenience. Being aware of the inconvenience investors face while checking financial investment product accounts that are inappropriate, incomplete or suspended, KOFIA offers a financial transaction inquiry service in collaboration with its member companies, and verifies the existence of problem accounts on behalf of investors, thereby enhancing investor friendliness.

TABLE 18-2. NUMBER OF EDUCATIONAL PROGRAM PARTICIPANTS BY YEAR

		Youth education programs		Investors education	
Year	Total	Off-line programs	On-line programs	Off-line programs	On-line programs
2005	35,096	18,451	-	8,226	8,419
2006	112,807	34,455	-	41,130	37,222
2007	153,297	53,530	11,224	45,285	43,258
2008	237,307	70,397	7,000	34,910	125,000
2009	280,711	97,341	10,009	42,679	130,682
2010	330,500	91,600	180,000	40,900	180,000
2011 (scheduled)	445,400	97,700	51,000	46,700	250,000

Note: This data does not include the number of viewers of financial education broadcasting programs via cable TV and digital mobile broadcasting networks which started in 2008. (About 1.5mn viewers a year)

4) OPERATION OF THE OVER-THE-COUNTER MARKETS

KOFIA manages and operates the FreeBoard, the over-the-counter market that was created in 2005. Stocks not listed on KRX market are eligible to be listed on the 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.

5) MANAGEMENT OF GLOBALLY COMPETITIVE FINANCIAL INVESTMENT PROFESSIONALS

Under FSCMA, KOFIA is responsible for the management and supervision of financial investment professionals including certified investment advisors, financial planners, financial risk managers and certified research analysts. Based on its Regulation on the Financial Investment Professionals and Certificate, KOFIA certificates all financial professionals. For instance, Certified Derivative Investment Advisors can handle all types of financial instruments, including stocks, bonds, mutual funds, futures, options and OTC derivatives. On the other hand, certified securities investment advisors are limited to handling stocks, bonds, mutual funds, beneficiary certificates and equity-linked warrants (ELW).

As of November 2010, the number of certified securities investment advisors and certified derivatives investment advisors registered with KOFIA was 111,214 and 81,686 respectively.

KOFIA also certifies investment managers who provide comprehensive asset management strategies to clients, based on their analysis of the client's personal financial planning, investment scope and preferences. They provide clients with consultations or discretionary asset management services. As of November 2010, 11,493 certified investment managers were registered with KOFIA.

KOFIA is also responsible for the examination and registration of certified financial risk managers and certified research analysts. Certified financial risk managers systematically manage a company's financial risks with operations involving stocks, bonds, futures, options, and other OTC derivatives through method-measurement, evaluation, and control. Certified research analysts produce, review and approve corporate evaluation and business outlook reports on financial investment firms, providing useful financial instruments-related investment information.

TABLE 18-3. REGISTRATION STATUS OF FINANCIAL INVESTMENT PROFESSIONALS

(Unit: person)

Types of certificate	Number of people
Certified Fund Investment Advisor	133,273
Certified Securities Investment Advisor	111,214
Certified Derivatives Investment Advisor	81,686
Certified Investment Advisors Manager	15,340
Certified Investment Managers	11,493
Certified Research Analyst	1,576
Certified Financial Risk Manager	206
Certified Collective Investment Property Calculator	119
Certified Collective Investment Property Appraiser	31
Certified Collective Investment Scheme Appraiser	65
Certified Fund Introducing Broker	35,330
Certified Securities Introducing Broker	2,456
Certified Financial Investment Introducing Broker	430
Total	**393,219**

Note: Number of certified professionals as of November 2010

6) TRAINING AND CONTINUING EDUCATION FOR FINANCIAL INVESTMENT PROFESSIONALS

The Korea Institute of Financial Investment (KIFIN), a subsidiary of KOFIA, offers an array of training 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 continuing education and training in order to foster high-quality professionals. To this end, KIFIN provides various programs based on the needs of the industry. These courses are classified into general, professional, qualification, and various cyber training categories. Currently, KIFIN runs three general courses, thirty one professional courses, and fifty six online courses. KIFIN also offers advanced courses for executives and securities professionals of member firms. KIFIN started its on-line education programs in July 2000, with the number of individuals enrolled reaching 368,030 at the end of May, 2011.

TABLE 18-4. NUMBER OF COURSES OFFERED BY KIFIN

(Unit: course, person)

Classification		2005	2006	2007	2008	2009	2010	2011 (Scheduled)
No. of courses		82	86	88	136	139	121	157
No. of trainees	Group courses	4,553	3,772	5,162	4,157	4,387	3,959	5,725
	On-line courses	33,698	29,402	27,931	67,590	72,256	42,413	127,430
Total		38,251	33,174	33,093	71,747	76,643	46,372	133,155

7) GLOBAL ACTIVITIES

KOFIA researches and analyses domestic and international financial markets, and makes policy recommendations to the Korean government. The association also publishes the annual "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 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. ORGANIZATIONAL STRUCTURE

The organizational structure of KOIFA consists of the General Meeting, Board of Directors, Self-regulation Committee, and the Secretariat to prevent conflicts of interest between the member service and self-regulatory functions, and to enhance the independence of the self-regulatory process. These four main bodies serve as the principal governing institutions of the organization, through which all regular members are represented.

The General Meeting decides policies and strategies on:

- Revision of the association's statute (except revisions due to enactment, revision or abolition of governing acts or enforcement decrees)
- Appointment and dismissal of executives
- Appointment and dismissal of members of the Self-regulation Committee
- Annual report and settlement of account
- Dismissal of membership
- Dissolution of the association

Each regular member holds voting rights at the General Meeting. This is decided upon by the total sum of proportional voting rights, which is proportionally distributed to members based on the combination of the amount of paid membership dues and equally distributed voting rights. The Board of Directors handles general operations, overseeing the admission of new members along with amending, abolishing and enacting KOFIA regulations. It is also responsible for KOFIA's budget-related business such as producing financial statements. The Board of Directors consists of 14 directors including Chairman, Vice Chairman, Chairman of Self-regulation Committee and outside directors.

Self-regulation Committee is responsible for:

- Self-regulatory work to promote investor protection and fair business practices among member companies;
- Self-arbitration works to resolve business disputes among member companies;

- Enactment, revision and abolition of the rules on self-regulation of member companies; and
- Investigation and sanctions of members for regulatory violation and the recommendation of sanctions or disciplinary actions to member companies for their employees' regulatory violation.

The Self-regulation Committee consists of seven members, including the Chairman and directors. The six directors consist of three financial experts, one legal expert, or one accounting expert, one business finance expert and one representative among the members. To support and assist the Chairman and the General Meeting, KOIFA operates a Secretariat, consisting of one subsidiary institution, seven offices and sixteen departments under six divisions.

III. MEMBERSHIP

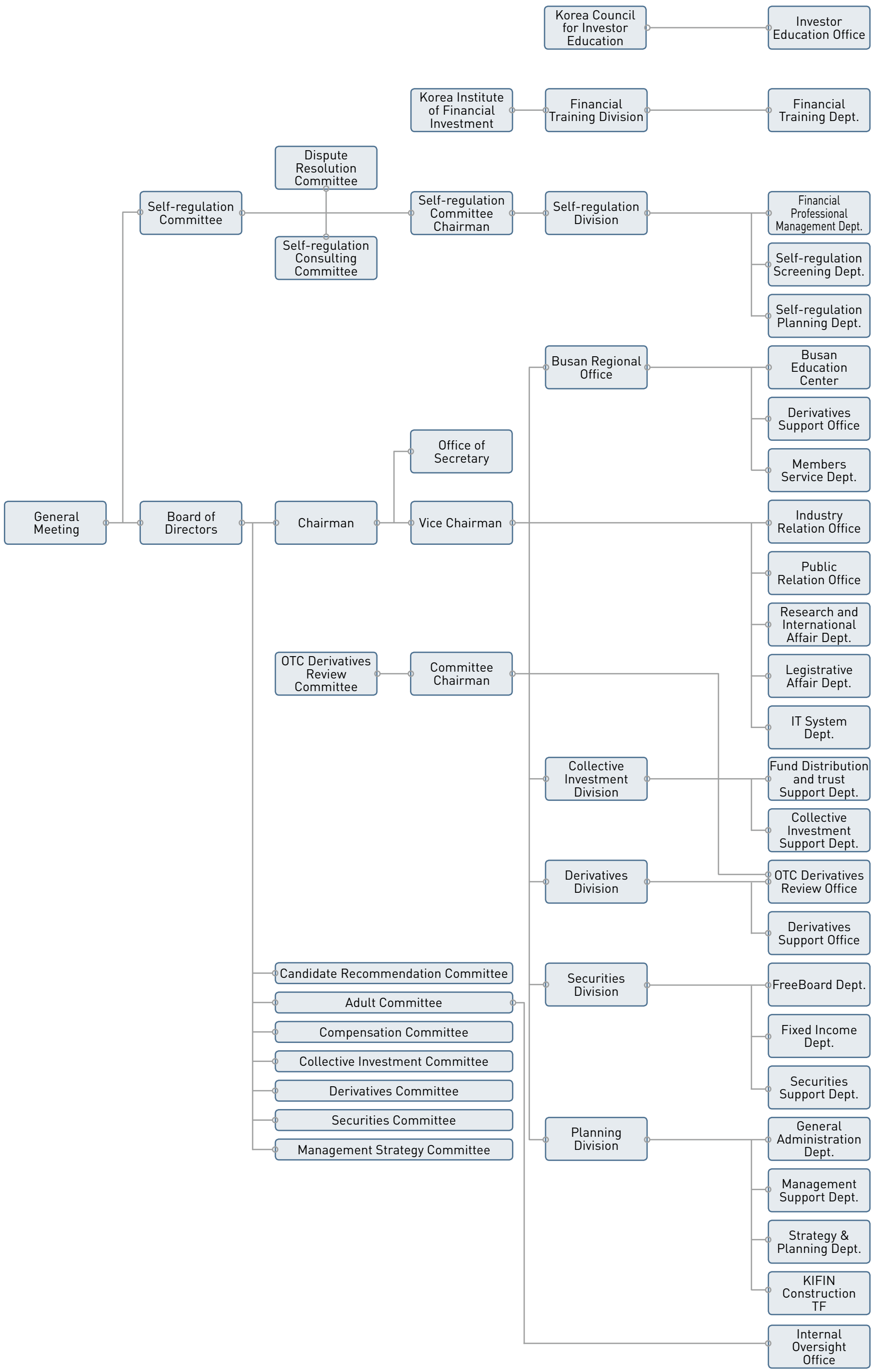
KOFIA offers three different types of membership: regular, associate and special. Regular members are given voting rights at the General Meetings. Associate and special members have a voice at the General Meeting – for the special members, the issues they can discuss are limited to those related to their business – however neither has voting rights.

Regular members consist of authorized financial investment firms. Associate members are registered financial investment firms and concurrently-run financial investment business entities. Special members are financial investment - related firms that are not eligible to be regular or associate members. At the end of November 2010, KOFIA has 161 regular members, 108 associate members and 17 special members.

TABLE 18-5. TYPES OF MEMBERSHIP

Regular members	Authorized financial investment firms (dealing, brokerage, collective investment, trust business) 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, Korea Listed Companies Association, KOSDAQ Listed Companies Association, Korea Securities Depository, and financial business entities willing to become members of the association, approved by the Board of Directors.

CHART 18-3. ORGANIZATION STRUCTURE



Appendix I. Regular Members of KOFIA

As of May 2011

	Member	Homepage
Securities	Apple Investment & Securities	www.applefn.com
	Barclays Capital	www.barcap.com
	Baro Securities	www.barofn.com
	BNG Securities	www.bngsec.com
	BNP Paribas Securities Korea	www.bnpparibas.com
	Bookook Securities	www.bookook.co.kr
	BOS Securties Korea	-
	BS Securities	www.bsfn.co.kr
	Citigroup Global Markets Korea Securities	www.citigroup.com
	CLSA	www.clsa.com
	Credit Suisse	www.credit-suisse.com
	Daewoo Securities	www.bestez.com
	Daishin Securities	www.daishin.com
	Daiwa Securities SMBC	www.daiwa.co.jp
	Deutsche Securities Korea	www.db.com
	Dongbu Securities	www.dongbuhappy.com
	E*Trade Securities	www.etrade.co.kr
	Eugene Securities	www.eugenefn.com
	Golden Bridge Investment & Securities	www.bridgefn.com
	Goldman Sachs	www.gs.com
	Good Morning Shinhan Securities	www.goodi.com
	Hana Daetoo Securities	www.hanaw.com
	Hanmag Securities	www.hanmag.com
	Hanwha Securities	www.koreastock.co.kr
	Hanyang Securities	www.hygood.co.kr
	Heungkuk Securities	www.heungkuksec.co.kr
	Hi Investment & Securities	www.hi-ib.com
	HMC Investment Securities	www.hmcib.com
	HSBC Limited Seoul Securities Branch	-
	Hyundai Securities	www.youfirst.co.kr
	IBK Securities	www.ibks.com
	Jp Morgan	www.jpmorgan.com
	KB Investment & Securities	www.kbsec.co.kr
	Kiwoom Securities	www.kiwoom.com
	Korea Inter Dealer Brokerage Co., Ltd.	www.kidb.net
	Korea Investment & Securities	www.truefriend.com
	Korea RB Securities	www.korearb.com
	KTB Securities	www.ktb.co.kr
	Kyobo Securities	www.iprovest.com
	Leading Investment & Securities	www.leading.co.kr
	LIG Investment & Securities	www.ligstock.com

	Member	Homepage
	Macquarie	www.macquarie.com
	Meritz Securities	www.imeritz.com
	Merrill Lynch International	www.ml.com
	Mirae Asset Securities	www.miraeasset.com
	Morgan Stanley	www.morganstanley.com
	Newedge Financial	www.newedgegroup.com
	NH Investment & Securities	www.nhis.co.kr
	Nomura Securities	www.nomura.com
	Prudential Investment & Securities	www.pru.co.kr
	RBS Asia Limited (Seoul) Branch	www.rbs.com
	Samsung Securities	www.samsungfn.com
	Societe Generale Corporate & Investment Banking	www.sgcib.com
	Shinyoung Securities	www.shinyoung.com
	SK Securities	www.priden.com
	Solomon Investment & Securities	www.solomonib.com
	Standard Chartered Securities Korea	www.standardchartered-securities.co.kr
	Taurus Investment & Securities	www.taurus.co.kr
	Tong Yang Securities	www.tys.co.kr
	UBS Securities	www.ubs.com
	Woori Investment & Securities	www.wooriwm.com
	Yuhwa Securities	www.yhs.co.kr
Asset Management	Aju Asset Management	-
	AllianceBernstein	www.alliancebernstein.com
	Allianz Global Investors	www.allianzglobalinvestors.co.kr
	Alpha Asset Management	www.alphaasset.com
	Ascendas Asset Management	www.ascendas.com
	Asia Asset Management	www.asiaasset.kr
	Askveritas Asset Management	www. askveritas.co.kr
	Assetplus Investment Management	www.assetplus.co.kr
	BlackRock	www.blackrock.co.kr
	Capstone Asset Management	-
	Consus Asset Management	www.consus.co.kr
	Daishin Investment Trust Management	www.ditm.co.kr
	Daol Fund	www.daolfund.com
	Darby Hana Infra Fund Asset Management	www.darbyoverseas.com
	Deutsche Asset Management	www.deam-korea.com
	Dongbu Asset Management	www.dongbuam.com
	Dream Asset	www.dream-asset.com
	Eugene Asset Management	www.eugenefn.com
	Fidelity International	www.fidelity.co.kr
	Franklin Templeton Investments	www.franklintempleton.co.kr

Member	Homepage
Golden Bridge Asset Management	www.gbam.co.kr
GG Invest Management	www.ggfund.co.kr
Goldman Sachs Asset Management	www.goldman-sachs.co.kr
GS Asset	www.gsasset.co.kr
UBS Hana Asset Management	www.ubs-hana.com
Hanhwa Investment Trust Management	www.Koreatrust.co.kr
Hanjoo Asset Management	-
Heungkuk Asset Management	www.hkfund.co.kr
Hi Asset Management	www.hi-am.com
Hyundai Asset Management	www.hyundaiam.com
Hyundai Investments	www.hdfund.co.kr
Hyundai Swiss Asset Management	www.hsasset.co.kr
I Investment Trust Management	www.iinvest21.com
IBK SG Asset Management	www.ibksgam.com
ING Investment Management	www.ingim.co.kr
ING Real Estate Investment Management	www.ingrealestate.com
JP Asset Management	www.jpasset.net
J.P. Morgan Asset Management	www.jpmorganam.co.kr
KB Asset Management	www.kbam.co.kr
KDB Asset Management	www.kdbasset.co.kr
KERR Asset Management	www.kerrasset.com
Kiwoom Asset Management	www.kiwoomasset.com
Koramco Asset Management	www.koramcofund.co.kr
Korea Infrastructure Investments Asset Management	www.kinfra.co.kr
Korea Investment Trust Management	www.kitmc.com
Korea Investment Value Asset Management	www.koreavalueasset.com
KTB Asset Management	www.i-ktb.com
Kyobo AXA Investment Managers	www.kyoboaxa-im.kr
Lazard Korea Asset Management	www.lkam.co.kr
LS Asset Management	www.lsasset.com
Mplus Asset Management	www.mplusasset.co.kr
Macquarie Samchully Asset Management	-
Macquarie Shinhan Infrastructure Asset Management	www.mkif.co.kr
Maia Asset Management	www.maiaasset.com
Meritz Asset Management	www.meritzam.com
Midas International Asset Management	www.midasasset.co.kr
Mirae Asset Global Investments	www.investments.miraeasset.com
Mirae Asset Maps Global Investments	www.mapsim.miraeasset.com
My Asset	www.mai.co.kr
NH-CA Asset Management	www.nh-ca.com
Nomurarifa Asset Management	www.nomurarifa.com

	Member	Homepage
	PCA Asset	www.pcaasset.co.kr
	Pheonix Asset	www.passet.co.kr
	Pinebridge Investments	www.pinebridge.co.kr
	Pinetree Investment & Management	-
	Plus Asset Management	www.plusasset.com
	PS Asset Management	-
	Prudential Asset Management	www.prudentialfund.com
	PS Asset Management	www. psamc.co.kr
	RAK Investment Management	www.rak.co.kr
	RG Energy Resources Asset Management	www.rgasset.co.kr
	Samsung Investments	www.samsungfund.com
	Schroders Korea	www.schroders.co.kr
	SEI Asset Korea	www.seiak.com
	Shinhan BNP Paribas Asset Management	www.shinvest.co.kr
	Shinyoung Asset Management	www.syfund.co.kr
	Tong Yang Investment Trust Management	www.tongyangfund.com
	Truston Asset Management	www.trustonasset.com
	Vestas Investment Management	www.vestasinvest.com
	WiseAsset	www.wiseasset.co.kr
	Woori Asset Management	www.wcsam.com
	Yurie Asset Management	www.yurieasset.co.kr
Futures	Eugine Investment & Futures	www.egfutures.com
	Hyundai Futures	www.hyundaifutures.com
	KEB Futures	www.kebf.com
	KR Futures	www.krfutures.co.kr
	NH Investment & Futures	www.nhfutures.co.kr
	Samsung Futures	www.ssfutures.com
	Woori Futures	www.futures.co.kr
Real Estate Trust	Asia Trust	www.asiatrust.co.kr
	Daehan Real Estate Trust	www.reitpia.com
	Hana Daol Trust	www.hanatrust.com
	KB Real Estate Trust	www.kbret.co.kr
	Koramco Reits Management and Trust	www.koramco.co.kr
	Korea Asset In Trust	www.kait.com
	Korea Real Estate Investment & Trust	www.koreit.co.kr
	Korea Trust	www.ktrust.co.kr
	Kukje Trust	www.kukjetrust.com
	Mugunghwa Trust	www.mghat.com
	Saengbo Real Estate Trust	www.sbnet.co.kr

Appendix II. Associate Members of KOFIA

As of May 2011

	Member	Homepage
Investment Advisory	AddMon Investment Management	www.addmon.co.kr
	Ace Investment Management	www.acefn.com
	AK partners	www.akpart.com
	Albatross Asset Management	www.atros.co.kr
	Aldebaran Asset Management	www.aldebaranasset.co.kr
	ARK Investment Advisors	www.arkinvest.co.kr
	ASAM Investment Advisory	www.asam4u.com
	Aseed Investment Management	www.assedcapital.com
	Bankers & Traders Investment Advisory	www.btprivate.com
	Basic Investment	-
	Baro Asset Management	-
	Brain Investment Management	-
	Brix Funding Solutions	-
	BNY Mellon AM Korea	www.bnymellon.com/assetmanagement
	Compass Asset Investment	www.compassasset.co.kr
	Cosmo Investment Management	www.cosmoasset.com
	Daesung Invest Advisors	www.actscapital.com
	DS Investment Management	-
	Eastar Investment Advisory	www.eastarib.com
	Ein Asset Investment Advisory	-
	Fides Investment Management	www.fides.co.kr
	Findvalue Investment Management	www.findvalue.co.kr
	Focus Investment	-
	Friend Asset Management	www.friendasset.com
	FRM Investment Advisory Korea	www.frmhedge.com
	Gaul Investment Management	www.gaulasset.com
	Global Leaders Advisors	www.gladvisors.co.kr
	Glenwood Investment Management	-
	Goodwealth Investment	-
	Grovesner Investment	-
	Hangaram Investment	www.himc.co.kr
	Hansset Global Advisors	www.hansset.com
	HR Investment Advisory	www.hrinvest.co.kr
	Honesty Investment	-
	Infinity Asset Advisory	www.infinityasset.com
	INJ Investment Management	-
	Invex Investment Management	www.invex.co.kr
	J&J Investment Management	www.jnjasset.com
	Korea Creative Investment	-

Member	Homepage
Korea International Portfolio Management	www.ipm-korea.com
K-ONE Investment Advisors	-
Korean Reinsurance Company	www.koreanre.co.kr
Lake Investment Advisors	-
Leadstone Investment Management	-
Leo Investment Advisory	-
LIG Capital Management	-
Lotus Investment Management	www.lotusfn.com
MAC Investment Advisory	www.macfn.com
Morningstar Associates Korea	www. associates.morningstar.co.kr
Naeway Asset Investment Management	www.naewayasset.co.kr
Oakwood Investment Advisors	www.oakwoodfg.com
Pareto Investment Management	-
Park & Partners Investment Advisory	www.parknpartners.com
PK Investment Advisory	www.pkinvest.co.kr
Quad Investment Management	-
Robust Investment Advisors	www.robustia.com
Saturn Investment Management	-
Safe Asset Management	www.safeasset.co.kr
Samho SH Investment	-
Saturn Investment Management	-
Sector Discretionary Investment	www.sectorinvest.co.kr
Sinah Investment Advisor	www.shinahfn.co.kr
Sisun Investment Advisory	-
SKY Investment Advisors	www.skyib.com
Sky Investech	-
Stallion Asset	-
STIC Investment Management	www.sticfn.com
Supreme Investment Management	-
Summit Investment Management	www.bestsummit.co.kr
Taurus Investment Management	www.timco.co.kr
Tempis Capital Management	www.tempis.co.kr
Tomato Investment	www.tomatoasset.com
TSI Investment Management	www.tsinvestment.co.kr
Tube Asset Investment Advisory	www.tubeasset.com
URich Investment	www.urichm.co.kr
Value Investment Advisors	www.value-i.co.kr
VIP Research & Management	www.viptooza.com
VOM Investment & Consulting	-
Winvest Asset Management	www.윈베스트.kr
Woongjin Lucas Investment Advisory	www.wjlucas.com

	Member	Homepage
Bank	BNP Paribas	www.bnpparibas.co.kr
	Busan Bank	www.busanbank.co.kr
	Citibank Korea	www.citibank.co.kr
	Credit Agricole CIB	-
	Daegu Bank	www.daegubank.co.kr
	Deutsche Bank	www.db.com
	Hana Bank	www.hanabank.com
	HSBC Korea	www.hsbc.co.kr
	Industrial Bank of Korea	www.ibk.co.kr
	Jeju Bank	www.e-jejubank.com
	Jeonbuk Bank	www.jbbank.co.kr
	Kookmin Bank	www.kbstar.com
	Korea Development Bank	www.kdb.co.kr
	Korea Exchange Bank	www.keb.co.kr
	Kwang Ju Bank	www.kjbank.com
	Kyongnam Bank	www.kyongnambank.co.kr
	National Federation of Fisheries Cooperatives	www.suhyup.co.kr
	NH Bank	www.nonghyup.com
	Shinhan Bank	www.shinhan.com
	Standard Chartered First Bank Korea	www.scfirstbank.com
	Sumitomo Mitsui Banking Corporation	www.smbc.co.jp
	Woori Bank	www.wooribank.com
Insurance	Heungkuk Life Insurance	www.heungkuklife.co.kr
	Kyobo Life Insurance	www.kyobo.co.kr
	Mirae Asset Life Insurance	www.miraeassetlife.com
	Samsung Fire & Marine Insurance	www.samsungfire.com
	Samsung Life Insurance	www.samsunglife.com
Merchant Bank	Kumho Investment Bank	www.ekumhobank.com
Others	Korea Securities Finance Corporation	www.ksfc.co.kr

Appendix III. Special Members of KOFIA

As of May 2011

	Member	Homepage
Fund Services	Exchange Bank Fund Services	-
	HSBC Fund Services Korea	www.hsbc.co.kr/1/2/about-kr/about-us-company/hsbc-fund
	Mirae Asset Fund Services	www.miraeassetfs.com
	SC First Fund Services	www.scfirstfundservices.co.kr
	Shinhan Aitas	www.shinhanaitas.com
Fund Valuation	FNGuide	www.fnguide.com
	KBP Fund Ratings	www.kbpfund.com
	Morningstar Korea	www.morningstar.co.kr
	Zeroin	www.zeroin.co.kr
Bond Valuation	KIS Pricing	www.bond.co.kr
	KAP & KR	www.koreabp.com
	NICE Pricing Services	www.nicepricing.co.kr
Others	CME Group	www.cmegroup.com
	Korea Investment Corporation	www.kic.kr
	Korea Listed Companies Association	www.klca.or.kr
	Korea Securities Depository	www.ksd.or.kr
	Kosdaq Listed Companies Association	www.kosdaqca.or.kr

Appendix IV. Financial Investment Organizations and Companies

As of May 2011

Name	Homepage
Ministry of Strategy and Finance	www.mosf.go.kr
Financial Services Commission	www.fsc.go.kr
Financial Supervisory Service	www.fss.or.kr
Korea Exchange	www.krx.co.kr
Korea Securities Finance Corp.	www.ksfc.co.kr
Korea Securities Depository	www.ksd.or.kr
Koscom	www.koscom.co.kr
Korea Listed Companies Association	www.klca.or.kr
KOSDAQ Listed Companies Association	www.kosdaqca.or.kr
Korea Capital Market Institute	www.kcmi.re.kr
Korea Investment Corporation	www.kic.go.kr
Korea Financial Investment Association	www.kofia.or.kr

Appendix V. List of Tables

Appendix VI. List of Charts

Appendix VII. List of Graphs

Korea Financial Investment Association

45-2 YOUIDO-DONG, YOUNGDEUNGPO-GU,
SEOUL 150-974, KOREA