



Legislation
of the
Financial Investment Services
and Capital Market Act

March 29, 2007

MINISTRY OF FINANCE AND ECONOMY
REPUBLIC OF KOREA

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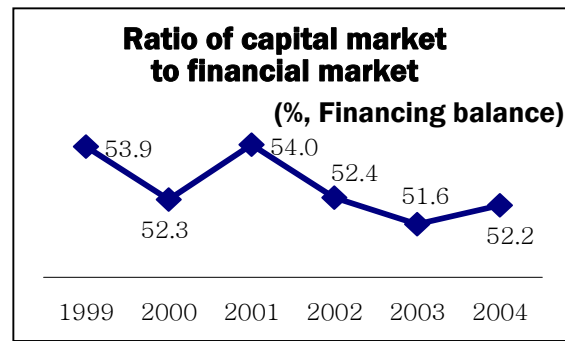
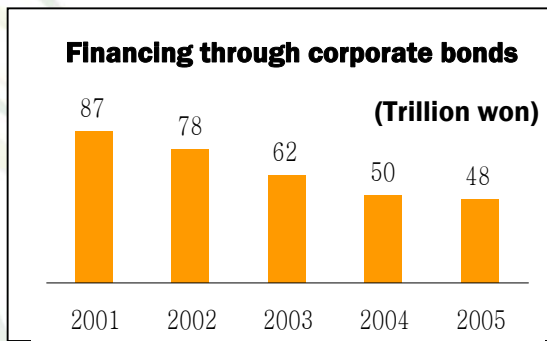
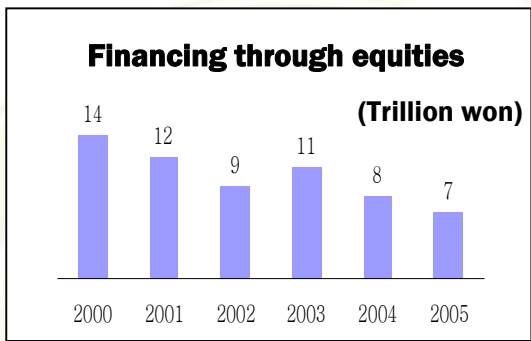
Background for legislation

1. Current Status

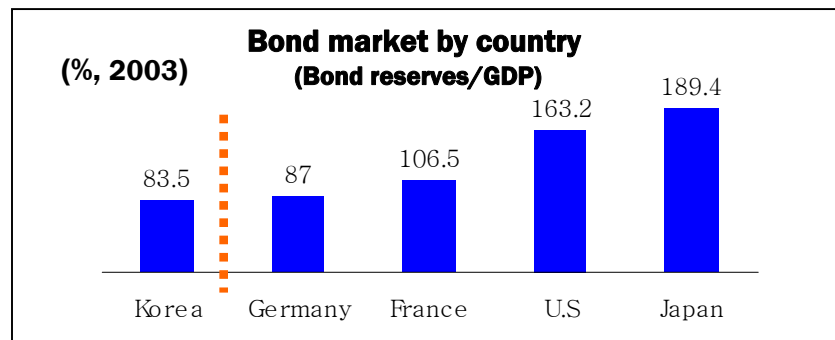
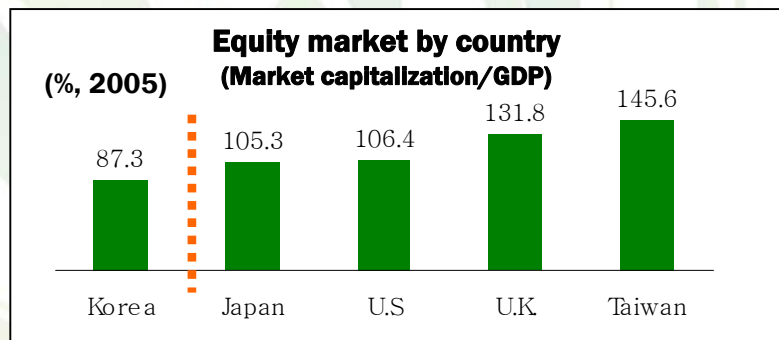
Capital market & its related financial services are yet to be fully developed

- **Current status of capital market**

- ▶ **Corporate financing through capital market continues to shrink**

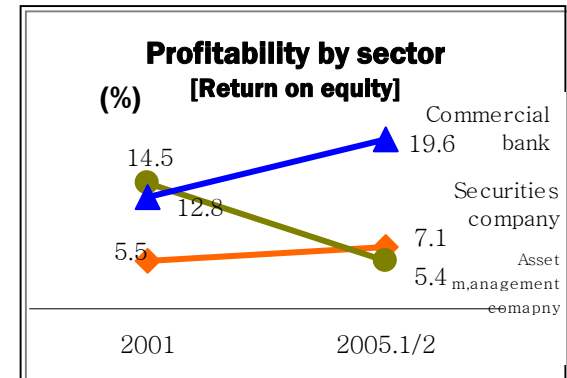
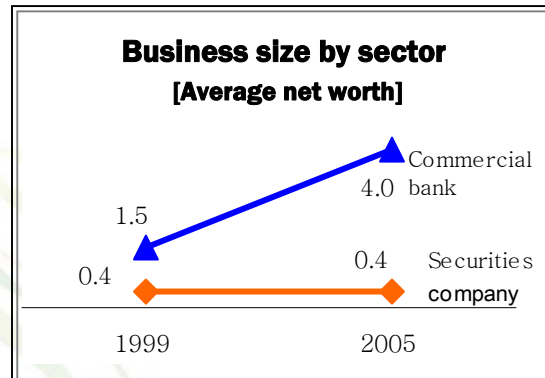
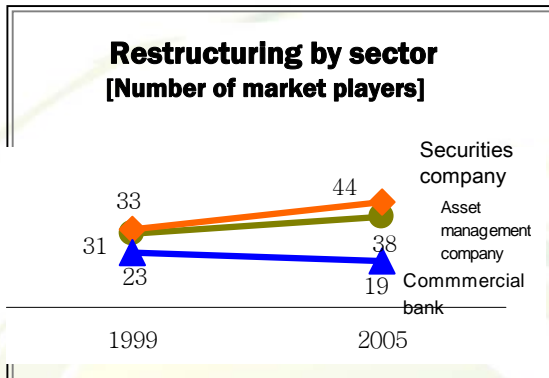


- ▶ **Capital market fails to grow commensurate with real economic growth**

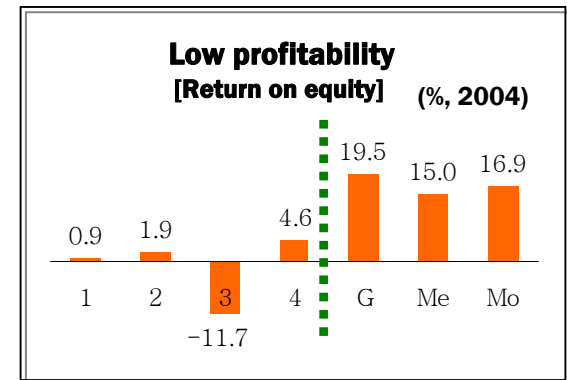
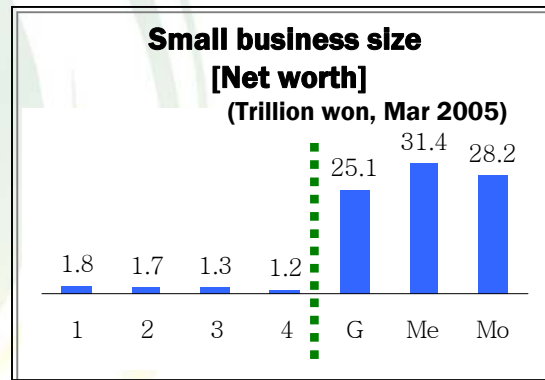
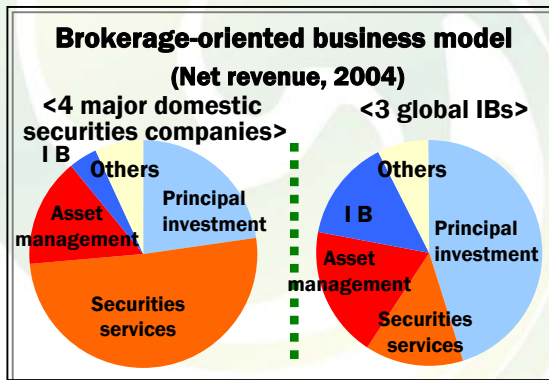


■ Current status of capital market related financial services

- ▶ Lagging behind commercial banks in terms of restructuring, business size and profitability



- ▶ Substantially weak competitiveness in quality and quantity compared to the top 3 international investment banks



* 1, 2, 3 and 4 are the 4 major domestic companies (net worth basis)
 * G: Goldman Sachs * Me: Merrill Lynch * Mo: Morgan Stanley

2. Key Measures to upgrade Capital Market

i To expand demand basis of Market

- to strengthen the roles of Institutional Investor, including PEF, pension funds, and lead to long term investment

ii To enhance capital market transparency

- to improve internal decision-making process, to strengthen shareholders' rights and to create markets for corporate control

iii To improve capital market efficiency

- consolidated the three exchanges into KRX(2005)
- to introduce electronic securities system

iv To set up the advanced legal framework of capital market

- to enact Financial Investment Services and Capital Markets Act

Create a financial big bang in capital market

- Promote financial innovation and competition through advanced regulatory reform and stronger investor protection

Shift to functional regulation

- Re-classify financial investment services, financial investment products and investors according to their economic substance (nature)
* *Financial function = Services + Products + Investors*
- Financial function of the same nature shall be governed by the same regulation, regardless of the financial institutions engaged in the transaction

Introduce comprehensive system

- Use a broad-based definition of “financial investment products” to embrace them all into the new regime, so as to keep pace with rapidly developing financial investment products
* *Expand the scope of permissible products for financial investment companies and the coverage of investor protection regulations*

Consolidate capital market laws into a single law

Expand business scope

- Allow integration of all financial investment services
→ Dealing, arranging, asset management, discretionary & non-discretionary investment advisory services, asset custodian management
- Allow all accessory services
- Adopt an introducing-broker system
- Allow forex services in connection with financial investment services

Upgrade investor protection mechanism

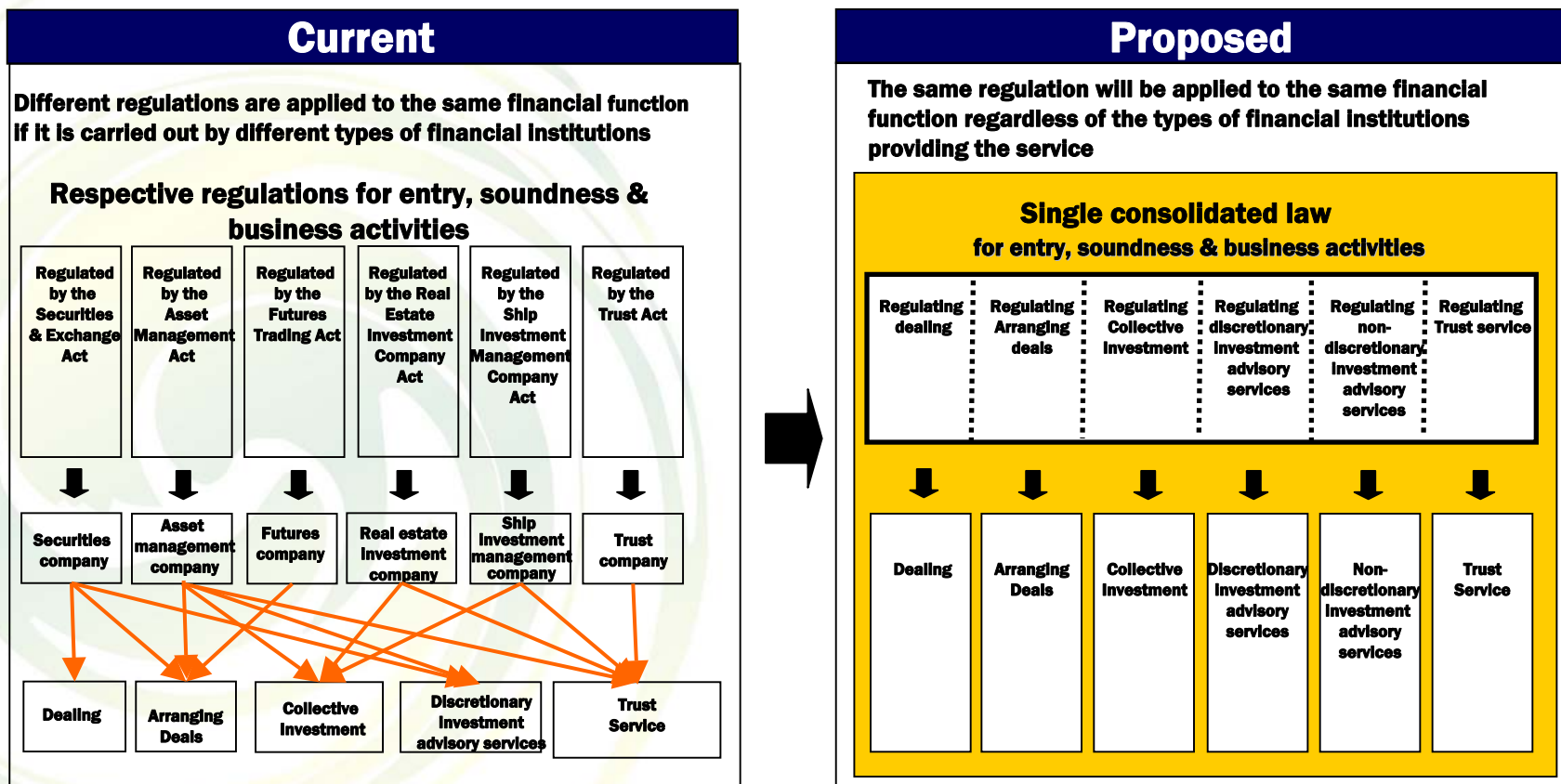
- Put in place advanced investor protection mechanism
* *Mandate product guidelines to investors*
* *Introduce the principle of suitability*
- Establish a system to prevent conflict of interests
- Expand the scope of securities subject to registration statement/regulation, including indirect investment securities and beneficiary certificates

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Major changes

1. Shift to functional regulatory regime

■ Shift from current institutional regulation to functional regulation



II. Major changes – Shift to functional regulation

[1] Classify FINANCIAL INVESTMENT SERVICES into 6 categories by economic nature

- 6 categories of financial investment services

- ▶ Dealing, arranging, asset management, discretionary & non-discretionary investment advisory services, and trust services

Current: Each law enumerates financial services permissible for each financial company

Law	Futures Trading Act	Securities Trading Act	Merchant Bank Act	Trust Act	Asset Management Act				Corporate Restructuring Vehicle Act		Real Estate Investment Act		Ship Investment Management Act		Industry Development Act Special Act on Venture Startups Support for SME Establishment Act	
					Asset mngmt co.	Discretionary advisory co.	Non-discretionary Inv. advisory	Custodian, trust co.	Asset mngmt	Asset custodian	Asset mngmt	Asset custodian	Ship investment mngmt	Asset custodian	Corporate restructuring vehicle	Investment corporation
Company type	Futures co	Securities co.	Merchant bank	Trust	Asset mngmt co.	Discretionary advisory co.	Non-discretionary Inv. advisory	Custodian, trust co.	Asset mngmt	Asset custodian	Asset mngmt	Asset custodian	Ship investment mngmt	Asset custodian	Corporate restructuring vehicle	Investment corporation
Permitted Financial services		Dealing Underwriting Sales	Dealing Underwriting Discounting		Indirect investment securities sales											
		Futures trading	Brokerage arrangement, agency	Arranging					Asset management	Asset management	Asset management	Asset management			Business of partner	
						Investment advisory										
					Trust		Discretionary		Custodian Trust-tee	Custodian	Custodian	Custodian	Custodian			

Revised: 6 streamlined categories by economic substance

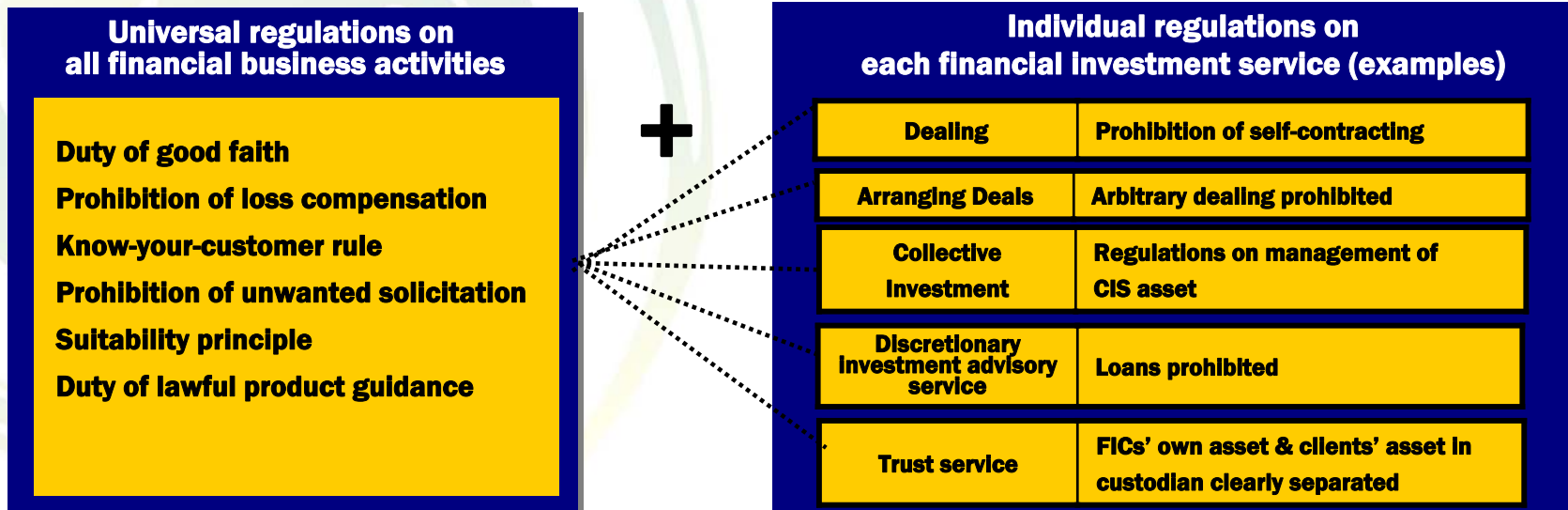
Law	Financial Investment Services & Capital Market Act
Company type	Financial Investment company ("FIC")
Financial services	Dealing
	Arranging Deals
	Collective Investment
	Discretionary investment advisory services
	Non-discretionary investment advisory services
	Trust service

[2] Streamline prudential regulations

- The same financial function will be subject to the same prudential regulation
- Followings are the prudential regulation mechanisms applied to all FICs:
 - ▶ Capital adequacy ratio (to ensure adequate equity capital against the underlying risk)
 - ▶ Restriction on transactions with major shareholders
 - ▶ Disclosure of financial and management status

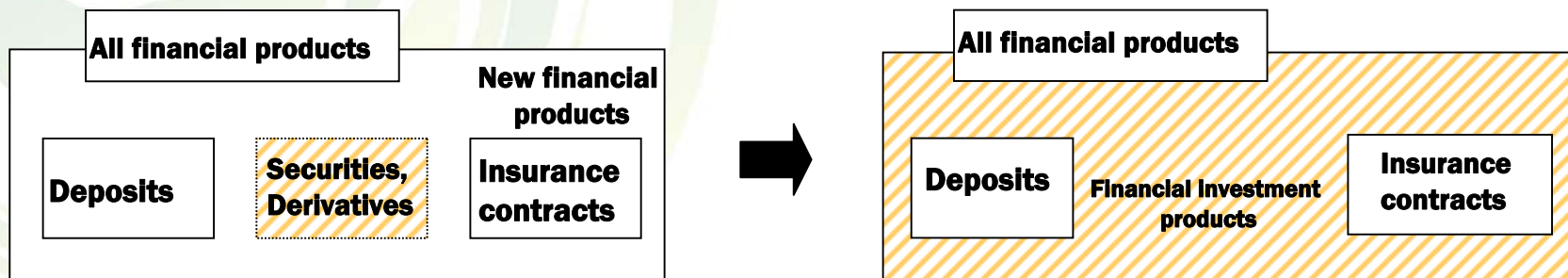
[3] Revise regulation on business activities

- The same regulations govern business activities of the same financial function
 (Universal regulations for all financial investment services
 + individual regulations for each financial investment service)

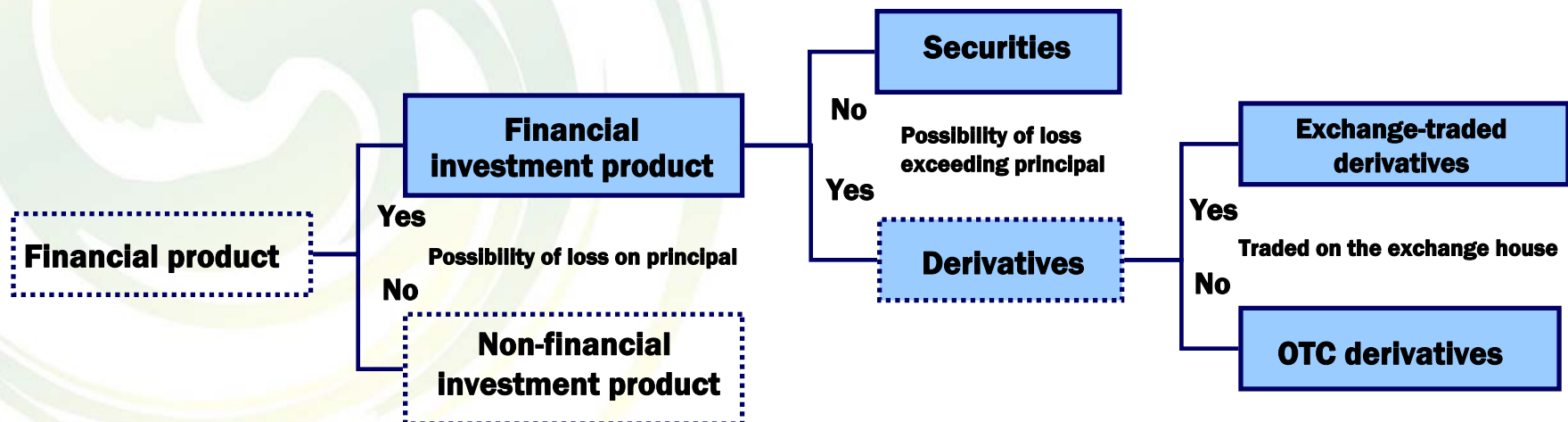


2. Introduce a comprehensive system

- **Permissible securities and derivatives for transaction are specified by law**
 - ➔ **FICs may deal with financial investment products specified by law, and only to which investor protection is applied**
- **Introduce a broad-based definition to encompass all financial investment products with investment value**
 - ➔ **Allow FICs to structure and deal with all financial investment products and apply regulations on investor protection to all of these products**



- The possibility of loss on the principal differentiates financial investment products from non-financial products, such as deposits
- The degree of underlying risks divides financial investment products into two: securities (general financial products) and derivatives (risky financial products)
- ▶ Derivatives are subdivided into exchange-traded and OTC derivatives by trading channel



- Introduce a broad-based definition for each of the 3 categories of financial investment products—securities, OTC derivatives & exchange-traded derivatives

Securities	Type		Definition	Example
	Con-ventional securities	Debt securities	Representing debt liability	Government bond, municipal bond, corporate bond, commercial paper, etc.
		Equity securities	Representing equity contribution share	Stocks, subscription right, subscription certificate, contribution quota, etc.
		Beneficiary certificate	Representing beneficial interests	Trust beneficiary certificates, investment trust beneficiary certificates, etc.
		Depository Receipt (DR)	Securities of issuers that have received the deposit of equity securities	KDR, GDR, ADR
	Investment contract		- Investments made in a common public business with expectation of profits -Compensations depend upon a 3 rd party's efforts	Indirect investment securities, unregulated indirect investment securities, stocks, contribution quota, etc.
Securitized derivatives		Rights under contract for the purpose of gaining profits or avoiding losses linked to fluctuations of underlying asset prices	ELS, ELW, FX-linked securities, reverse FRN, etc.	

OTC derivatives

Introduce a broad-based definition for forward, swap, and option

Exchange-traded derivatives

Derivatives traded in exchanges

- Maximize the scope of underlying assets of securitized derivatives and derivatives

Current

Securities, Currencies, Commodities, and Credit risk



Proposed

Financial investment products, Currencies, Commodities, Credit risk, and other natural, environmental and economic risks

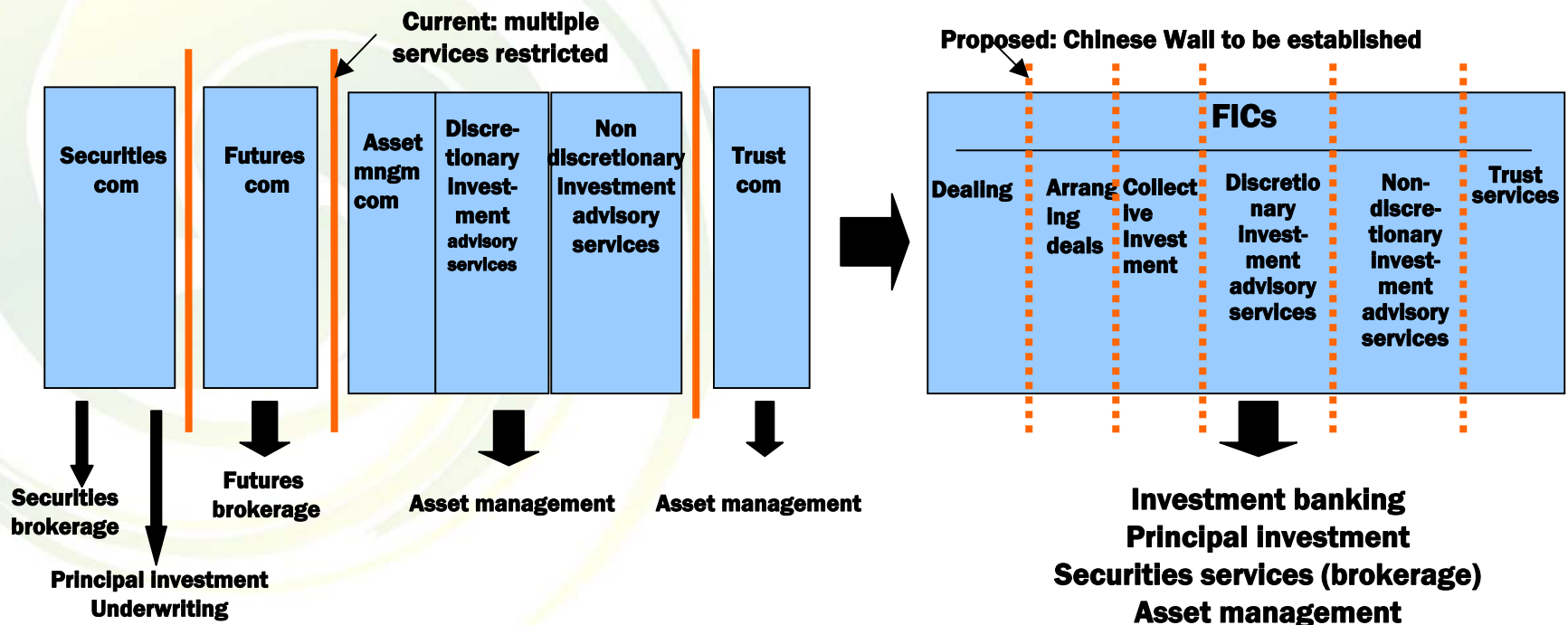
3. Expand business scope

[1] Remove the boundaries among different financial investment services

- Currently, financial investment services are comprised of securities services, futures services, asset management, trust, and discretionary & non-discretionary investment advisory services. Their business territories are strictly separated.

➔ Allow FICs to conduct businesses encompassing 6 financial investment services (dealing, arranging deals, collective investment, discretionary & non-discretionary investment advisory services, trust service)

- Establish a Chinese Wall to prevent the conflict of interests caused by rendering multiple services



Application for Authorization & Registration

Financial services	Financial products	Investors
<input type="checkbox"/> Dealing <input checked="" type="checkbox"/> Underwriting	<input type="checkbox"/> Securitles <input type="checkbox"/> Bonds <input checked="" type="checkbox"/> Stocks <input type="checkbox"/> Indirect investment securities <input type="checkbox"/> Exchange-traded derivatives <input type="checkbox"/> OTC derivatives	<input checked="" type="checkbox"/> Non-professional investor <input type="checkbox"/> Professional investor
<input checked="" type="checkbox"/> Arranging deals	<input type="checkbox"/> Securitles <input checked="" type="checkbox"/> Bonds <input type="checkbox"/> Stocks <input type="checkbox"/> Indirect investment securities <input checked="" type="checkbox"/> Exchange-traded derivatives <input checked="" type="checkbox"/> OTC derivatives	<input checked="" type="checkbox"/> Non-professional investor <input checked="" type="checkbox"/> Professional investor
<input checked="" type="checkbox"/> Asset management	<input checked="" type="checkbox"/> Securitles <input type="checkbox"/> Real estate <input type="checkbox"/> Special Assets <input type="checkbox"/> Mixed Assets <input type="checkbox"/> Money market products	<input checked="" type="checkbox"/> Non-professional investor <input checked="" type="checkbox"/> Professional investor
<input checked="" type="checkbox"/> Discretionary investment advisory services	<input checked="" type="checkbox"/> Securitles <input checked="" type="checkbox"/> Bonds <input checked="" type="checkbox"/> Stocks <input checked="" type="checkbox"/> Indirect investment securities <input checked="" type="checkbox"/> Exchange-traded derivatives <input checked="" type="checkbox"/> OTC derivatives	<input checked="" type="checkbox"/> Non-professional investor <input type="checkbox"/> Professional investor

[2] Allow incidental services

- Shift to a system that permits, in principle, all incidental services* with some exceptions

* *Non-financial services incidental to financial investment services*

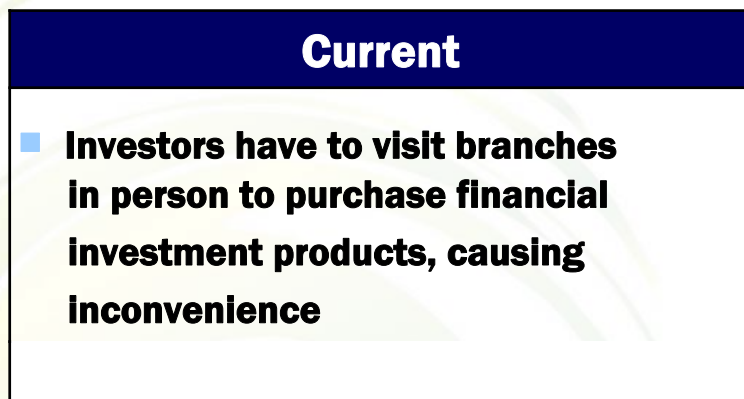
Current	
Method	Positive-list system
Services scope	[In case of securities company] 22 services including securities evaluation, M&A brokerage/arrangement/ agency services, consulting service on corporate management and restructuring, securities safeguarding, etc.



Proposed	
Method	Comprehensive system
Services scope	(Principle) Allow all non-financial incidental services (Exceptions) Services that may have negative effect on the soundness of FICs or investor protection

[3] Expand sales network through introducing-broker system

- **Apply introducing-broker system to offer various channels of access to financial investment products to investors**



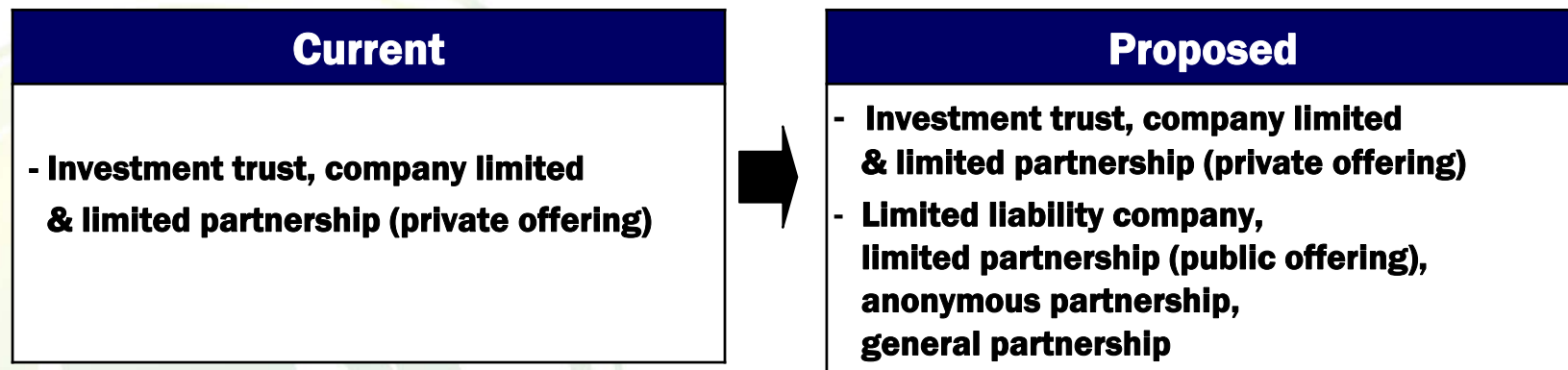
- **Make investor protection mechanism**

- ▶ **Employ the same ‘investment solicitation’ regulation applied to FICs in order to prevent sales of risky products by deceiving, misleading or not fully explaining the extent of underlying risks**
- ▶ **Currently consider requesting a relevant certificate to guarantee the introducing-broker’s basic qualifications such as securities investment consultant license**
- ▶ **FICs to take responsibility for registering introducing-brokers with the FSC and supervising them**
 - **FICs shall be liable for any losses of investors incurred by illegal activities of introducing-brokers entrusted by them**

[4] Expand the scope of asset management services

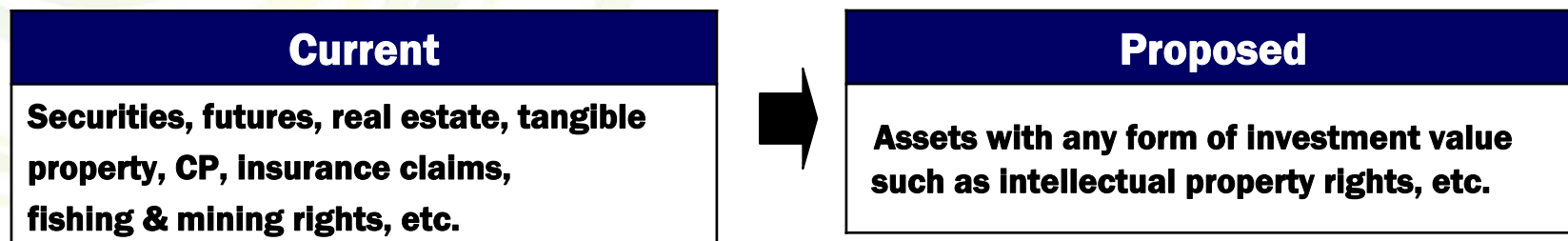
A. Expand vehicles for collective investment scheme (CIS)

- Expand CIS vehicles to the extent permissible under the Korean Civil or Commercial Codes



B. Expand the scope of CIS-managed assets

- Redefine CIS-managed assets in a comprehensive manner and thus expand the scope of CIS-managed assets that are currently enumerated for permission



[5] Allow “Mixed Asset Funds”

- Remove restrictions on the scope/type of assets to be managed by funds to enhance autonomy of the asset management industry and satisfy diverse demands of investors

Current

- Funds are classified based on the investment assets
 - Securities fund, derivatives fund, real estate fund, tangible asset fund, MMF, fund of funds, special asset fund
- Assets for investment determine the scope of each fund’s operation

	Secu-rities fund	Deriva-tives fund	Real Estate fund	Tangible assets fund	MMF	Fund of funds	Special assets funds
Secu-rities	○	○	○	○	○	○	○
Deriva-tives	○	○	○	○	×	○	○
Real estate	×	×	○	×	×	×	×
Tangible assets	×	×	×	○	×	×	×
Special assets	×	×	×	×	×	×	○



Proposed

- Re-classify the current fund categories into four based on investment assets, while lifting restrictions on their operation
- Establish “mixed asset funds” which can be operated freely without being limited to specific assets

Classifi-cation	Secu-rities	Real estate	Special assets	MMF	Mixed asset fund
Secu-rities	○	○	○	○	○
Deriva-tives	○	○	○	×	○
Real estate	○	○	○	×	○
Tangible assets	○	○	○	×	○
Special assets	○	○	○	×	○

4. Upgrade investor protection mechanism

[1] Remove loopholes in investor protection

- **En bloc application of regulations for investor protection in the ‘Financial Services and Capital Market Act’ shall be made, covering all, including OTC derivatives trading currently in absence of investor protection mechanism.**

➡ **Eliminate loopholes in investor protection**

[2] Introduce regulation on investment solicitation

- **Institutionalize investor protection mechanism in line with global standards**

A. Introduce the duty of product guidance in full scale

- **Obligate FICs to provide investors with detailed explanation on the contents and underlying risks of the products when soliciting investment**
- **Expand special liability rule to all financial products under which FICs are held liable for losses and damages incurred to investors from FICs’ incomplete product guidance**
- ▶ **Under review is a plan to enhance investor protection by estimating the loss on principal as the amount of damage in case of any loss on principal**

B. Introduce the know-your-customer rule

- **Prior to solicitation, grasp investor profiles such as wealth status, investment purpose, experience, etc., through interviews with potential investors**

C. Adopt the principle of suitability: Applicable to non-professional investors

- **The principle of suitability shall be introduced for investment solicitation tailored to investor profiles**
 - ✧ *Applicable only to non-professional investors who are relatively weak in risk taking and hedging*

D. Make a new regulation on unsolicited calls

- **Unsolicited calls via unwanted phone calls and other methods may infringe on privacy and peaceful life of potential investors**
- ▶ **Therefore, investment solicitation through real-time methods like visiting and calling shall be permitted only at the investor's invitation**

[3] Establish a system to prevent conflict of interests

■ Definition of conflict of interests

- ▶ Act of pursuing the interests of FICs or other investors at the expense of the interest of certain investors

■ Measures to prevent conflict of interests

- ① Prohibit conflict of interests by law and enforce it with sanctions
- ② Oblige FICs to set up an internal control system
- ③ Make FICs disclose any conflict of interests to investors
- ④ Make organizational separation and/or prohibition of employees holding more than one position mandatory if serious conflict of interests is deemed to exist

[4] Expand the scope of disclosure and registration requirements

■ Seek ways to apply the current disclosure and registration requirements (registration statement) to all securities that need investor protection

- ▶ Proposed regulation confines exemption from registration obligation only to bonds issued by government and quasi-government entities

■ Seek ways to lower expense ratio on securities issuance (stock at 1.8bp, bond at 5~9bp at present) in order to prevent a sharp rise in issuance cost from the expanded application of disclosure and registration requirements.

Comparison with other countries' legislations

- Regulations of the Korean FISCMA are comparable to the those of advanced markets' laws such as England, USA, Australia, etc., and somewhat excel Japan's recent legislation
- ▶ Based on the England's FSA 1986/FSMA 2000 and Australia's FSRA 2001, and
- ▶ also referred to the USA's Securities Regulations

1) Comprehensive system : referred to the Financial products' definitions of England, Australia, USA, Singapore, etc., and introduced comprehensive system of securities and depravities => advanced than the new legislation of Japan

England	Australia	USA	Singapore	Japan	Korea (FISCMA)
comprehensive	comprehensive	comprehensive	comprehensive	Positive list system	comprehensive

2) Functional regulation : Comparable to England, Australia, USA, Singapore, etc.

England	Australia	USA	Singapore	Japan	Korea (FISCMA)
Functional regulation (no reserve)	Functional regulation (no reserve)	Functional regulation (no reserve)	Functional regulation (no reserve)	Cross sectional regulation (where special articles exist)	Functional regulation (no reserve)

3) level of Investor protection : Comparable to England, Australia, USA, Japan, etc.

4) Scope of businesses of financial institutions : Same with England, Australia, USA, Japan, etc.

England	Australia	USA	Singapore	Japan	Korea (FISCMA)
All financial Investment Services allowed	All financial Investment Services allowed	All financial Investment Services allowed	All financial Investment Services allowed	All financial Investment Services allowed	All financial Investment Services allowed

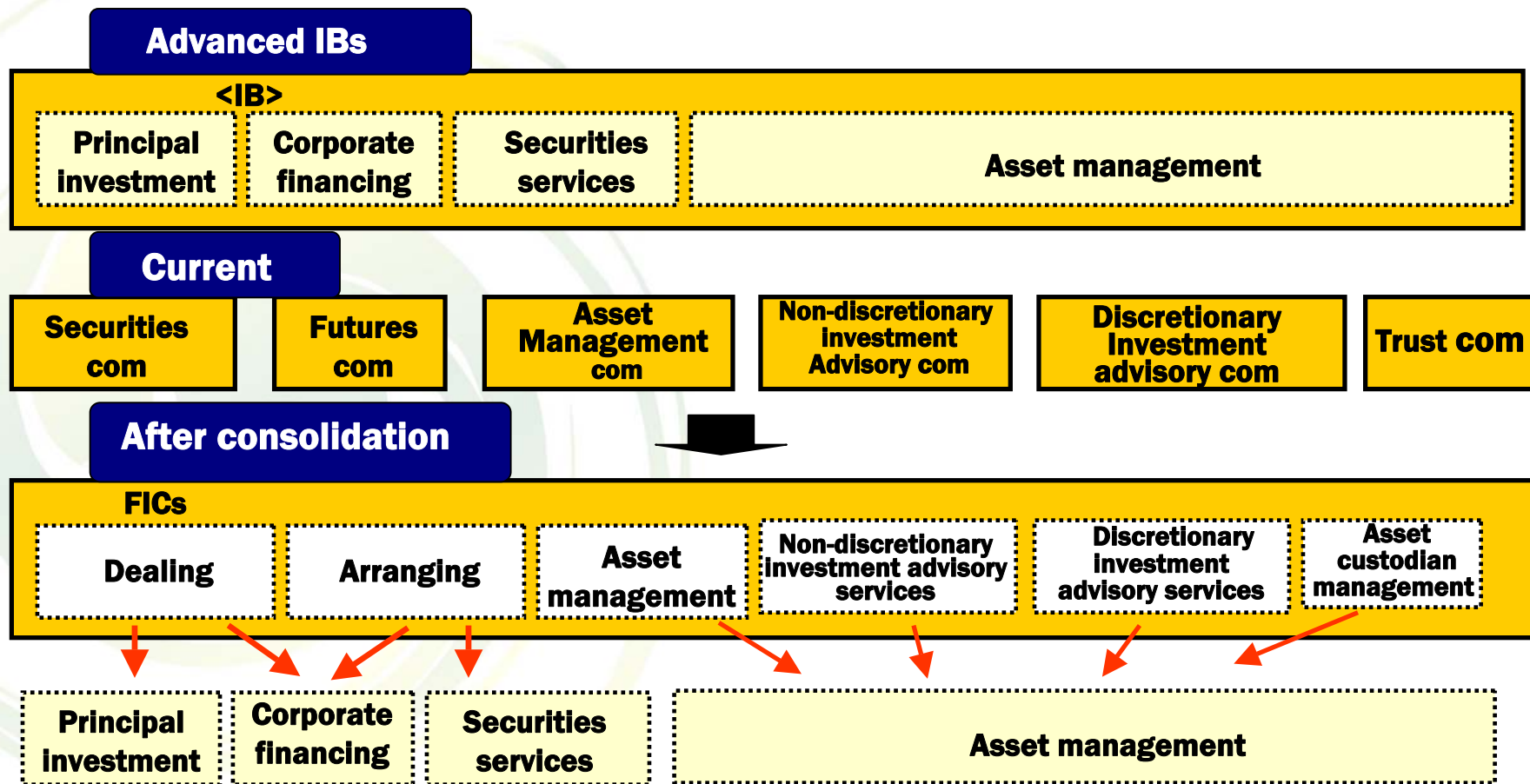
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Expected effects

Emergence of advanced investment banks (IBs) with global competitiveness is expected through convergence and consolidation in the financial industry

[1] Set up a business model in line with advanced IBs

- Business scope: The same business scope as that of advanced IBs will be realized



■ Financial investment products

Securities	Design securities that adopt all kinds of derivative techniques (Securitized derivatives)	ex) Inverse floater Dual indexed notes (CMT, etc.) Range accrual notes CPPI based notes Digital option embedded notes Credit-linked notes Fund-linked notes CAT bonds
	Structure collective investment scheme by using various CIS vehicles	ex) Publicly offered indirect investment securities using joint stock company under the Commercial Law, anonymous partnership typed funds, etc.
	Establish funds not restricted by the target investment asset	ex) Mixed assets funds that can change investment vehicles freely among stocks, bonds, real estate, currencies, etc.
OTC derivatives	Structure derivatives based on diverse risks measurable	ex) Derivatives whose underlying assets are catastrophe, crime rate, weather such as precipitation, snowfall, sunlight, etc.
Exchange-traded derivatives	Any derivatives can be traded on the exchange house if properly structured	ex) Futures and options related to environment and energy (carbon emission credits, electric power)

➔ Select a business model in line with advanced IBs

Changes in the business model of FICs after the enactment of the new Act

	Principal Investment		Corporate financing		Securities service	Asset management			
	Dealing	Investing	Under-writing	Advisory	Arranging	Discretionary	Non-discretionary	Asset managing	Trust
Existing securities	Merchant bank					Asset management co.			Trust Co.
Existing derivatives	Securities co.				Futures co.	Asset management co.			Trust Co.
New type of securities									
New type of derivatives									



	Principal Investment		Corporate financing		Securities service	Asset management			
	Dealing	Investing	Under-writing	Advisor	Arranging	Discretionary	Non-discretionary	Asset managing	Trust
Existing securities	FICs								
Existing derivatives									
New type of securities									
New type of derivatives									

[2] Create synergy effect from service integration

- **Create synergy effect by enabling a single FIC to conduct all IB businesses**

- ① **Synergy effect from securities and futures businesses combined**

- ➡ **Provide comprehensive services to investors as the FIC can trade and arrange all financial investment products**

- ② **Synergy effect from corporate financing, asset management and principal investment combined**

- ➡ **Corporate financing business such as M&A arrangement will require less cost and time for the deal and generate higher profits through direct investment of FIC's own assets from sales of financial products and funds raised from asset management**

- ③ **Synergy effect from integration of various asset management businesses**

- ➡ **Full-scale asset management service will be available by directly structuring and offering a variety of financial investment products such as structured securities (i.e., securitized derivatives), all kinds of indirect investment products, wrap accounts, and specialized trust products**

[3] Strengthen competitiveness by structuring and offering a multitude of new financial products

- **Competitiveness of the FICs will be raised on the back of their ability to structure and manage all financial investment products such as corporate financing, principal investment and asset management, as and when deemed necessary.**

① IB's Corporate Financing business

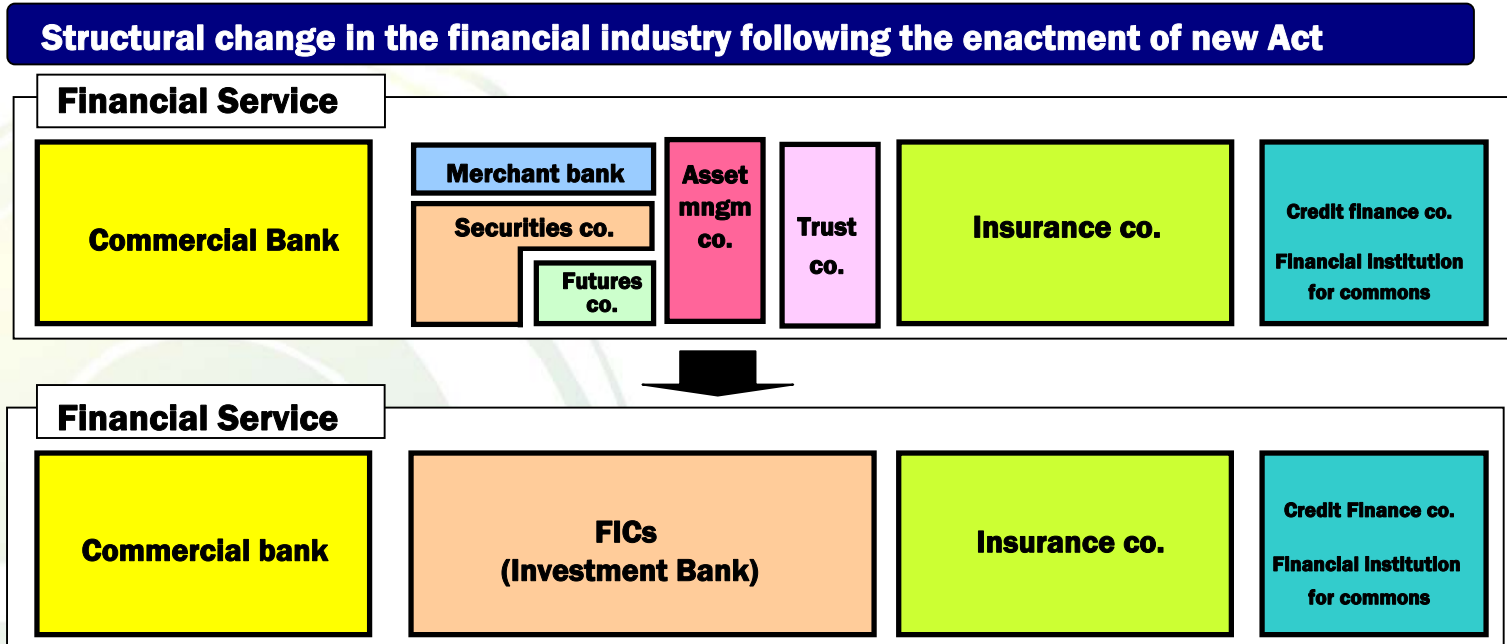
- ➡ **Expanded business scope allows IBs to support the structuring of and underwrite new securities on top of the conventional stocks and bonds, boosting fundraising capacity of corporations.**

② Asset Management business

- ➡ **It will be possible to structure and offer a variety of custom-made securitized derivatives, indirect investment products and derivatives.**

[4] Achieve economy of scale after consolidation

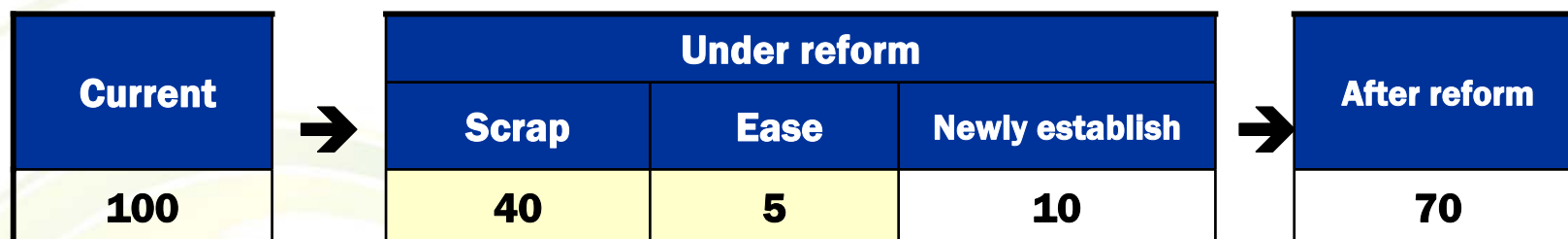
- Competitiveness of investment banks is expected to strengthen on the back of the realization of economy of scale as a result of expanded business scope as large as commercial banks or insurance companies.



- Secure FICs' own assets needed for principal investment, essential to investment banking services
- Expand business opportunities by sharing customer information from each respective business area such as asset management and securities services
- Reduce costs borne from asset management following the enlargement of managed asset pool
- Improve management efficacy through sharing electronic equipments and back offices

[5] Bring regulatory reform

- About 40% of 100 regulations concerning capital market to be scrapped or mitigated



- Major regulations to be scrapped are on the following:
 - ▶ Prohibition of concurrent engagement in securities, futures and asset management services
 - ▶ Restriction on financial investment products
 - ▶ Restriction on types of vehicles for collective investment scheme and classes of indirect investment securities
 - ▶ Restriction on management of proprietary assets owned by asset management company, trust company and merchant bank
 - ▶ Obligatory registration with the Financial Supervisory Commission by securities issuers

[6] Transparency in penalties

- **Specification of regulations for the basis of penalties**

- ▶ **Previous laws contained clauses* that did not clearly state the exact violation for which specific penalties were given, but rather listed the types of possible penalties resulting from violations**

* “Where any officer of a financial institution intentionally violates this Act or any regulations, orders, or instructions under this Act ~”

- ➔ **The reasons for penalty (violation) and the type of penalty (sanction) are listed in detail thus leading to transparency & enabling advance knowledge of the exact penalty resulting from a specific violation**

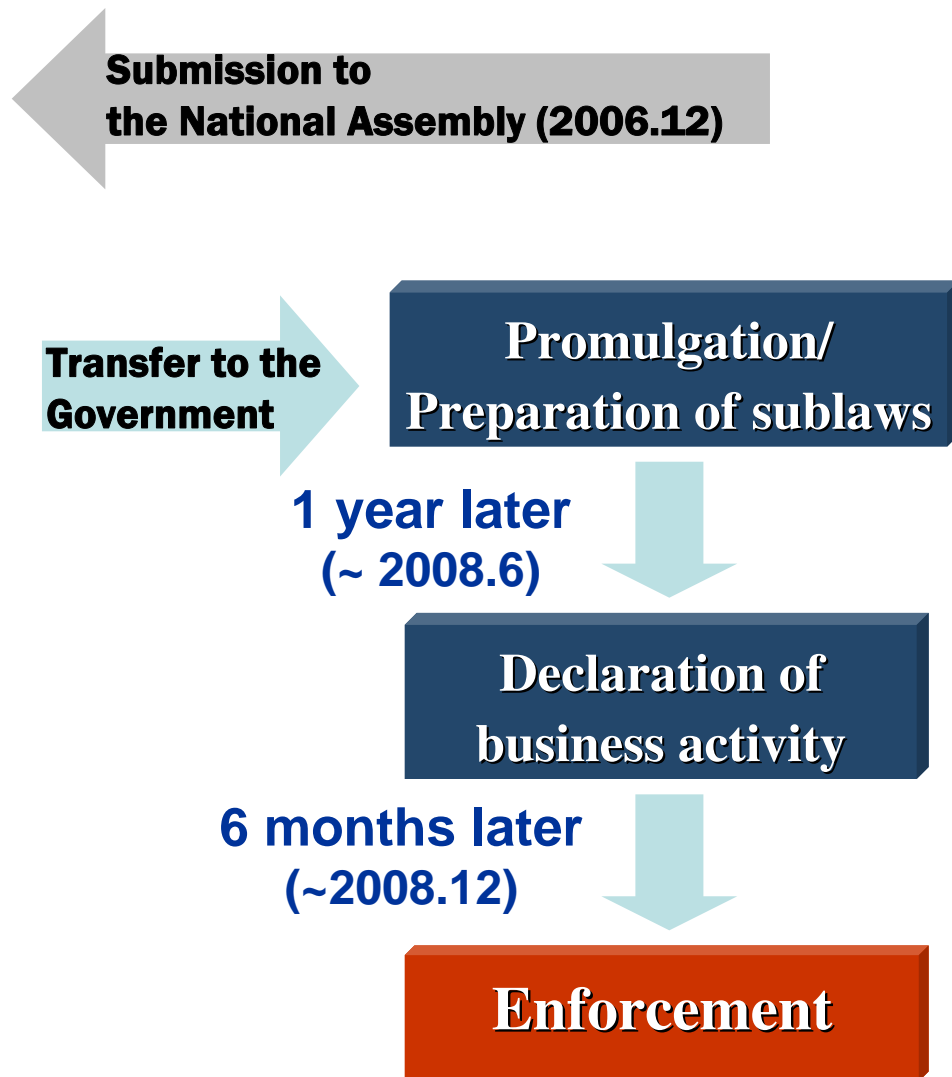


Timeline

[1] Expected Timeline



(~ 2007.6)



[2] Previous Developments

- **Proposed legislation submitted to the National Assembly year-end of 2006**
 - ▶ **Feb : Announcement of plan for proposed bill on FISCMA**
 - ▶ **Mar ~ May : 7 Financial sector-level Information Sessions and 4 Public hearings**
 - ▶ **Jun : Consultation with other concerned ministries / Public Notice concerning legislation**
 - ▶ **Aug ~ Dec : Screening by Regulatory Reform Committee and the Ministry of Legislation**
 - ▶ **Dec : After deliberation by the State council, bill submitted to the National Assembly**

[3] Future Developments

- **Efforts will be made to receive approval within the first half of 2007**
 - ▶ **Extraordinary sessions of the National Assembly are planned for April and June during the first half of this year**
 - ▶ **After public hearing, review by the Standing committee and the Legislation & Judiciary Committee, the bill will receive a resolution at the plenary session**
 - ▶ **Being the product of the convergence of numerous opinions collected on the proposed enactment, utmost efforts will be made to pass the law within the first half of this year**

- **Following enactment, sublaws will also be consolidated**
 - ▶ **Enforcement decrees, ministerial ordinances, announcements, supervisory regulations and other laws will be consolidated into sublaws by functions**
 - ▶ **The current financial supervision system divided by industry type will also be changed into a functional regulatory system**

[4] Proposed date of enforcement

- **A grace period of 18 months until enforcement following promulgation of the new law**
 - ▶ **Sufficient grace period will be granted until enforcement date to allow market participants and the supervisory authorities to make preparations**
 - ▶ **For a smooth implementation of the new regime, declaration of business activities of the existing financial investment services companies will be required during a 6-month period prior to enforcement**



Thank you

MINISTRY OF FINANCE AND ECONOMY

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