



Growing Asia's Markets



Korea Capital Markets 2022 and Beyond *Opportunities and Challenges*

November 2022

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Executive Summary

Amidst the backdrop of fundamental changes brought by Covid-19 and a shifting geopolitical landscape, Korea has adopted smart, expansionary macroeconomic policy through its supplementary budgets, while the undergirding liquidity and stability of Korea's financial markets has helped Korea weather the storm. As it continues to navigate uncharted waters, Korea seeks to continue growing its markets and expand its sizeable market cap as one of Asia's leading financial centres.

Data from the World Federation of Exchanges ranks the Korea Exchange ("KRX") as 15th in the world in terms of market capitalization, at USD 1.74 trillion as of July 2022.¹ With a total of 2,519 listed companies split across main index KOSPI, secondary bourse KOSDAQ and SME-exclusive KONEX, KRX sees over 1.34 million transactions every day.² As such, the Korean market does not only enjoy a significant role within Asia, but has within recent decades stepped up to become a major global player. In fact, the advancement of Korea's real economy over the past two decades has been nothing short of phenomenal, firmly establishing Korea as a leading exporter of technology as well as of culture to markets all over the world. The widespread international recognition and appreciation of Korean K-Pop, films and food have only contributed to Korea's well-established presence on the world stage.

In order to maintain its strong economic position and stay on its positive trajectory, Korea's market needs to continue to evolve with the changing times. The tumultuous period we live in presents Korea and other emerging markets in Asia with an outsized opportunity to emerge from this crisis with greater strength and vitality. The Regional Comprehensive Economic Partnership (RCEP), the world's largest FTA encompassing one third of global GDP and one third of the world's population, eliminates tariffs on more than 90% of goods over the next 10 to 15 years and introduces rules on investment and intellectual property to advance free trade, per Thomson Reuters.³ Encouraging further investment into Asia-based supply chains to grow Asian economies and trade, the RCEP is a trade deal in Asia, by Asia, for Asia.

South Korea's exports to RCEP participants accounted for half of the country's exports in 2020, and is the first trade agreement which includes both South Korea and Japan, per article in The Korea Herald.⁴ According to the Ministry of Trade, Industry and Energy, "The agreement is expected to help our companies' advance into overseas markets, as it expands the market for our key export items including steel and cars, as well as service sectors such as online game, animation, film, and records". To support its ever-expanding export engine for both hard and soft goods, and to nourish and sustain its growing economy, Korea needs to attract more global capital.

¹ World Federation of Exchanges, Jul 2022. <https://statistics.world-exchanges.org/>

² Korea Exchange, Aug 2022. <http://data.krx.co.kr/contents/MDC/MDI/mdiLoader/index.cmd?menuId=MDC0201>

³ "RCEP is transforming trade in Asia Pacific and creating advantages for companies", *Thomson Reuters*, 4 Apr 2022. <https://www.thomsonreuters.com/en-us/posts/international-trade-and-supply-chain/rcep-asia-pacific-advantages/>

⁴ "RCEP pact to take effect for S. Korea next month", *The Korea Herald*, 27 Jan 2022. <https://www.koreaherald.com/view.php?ud=20220127000715>



Since opening up the market to foreign direct portfolio investment in January 1992, KRX's main board KOSPI has enjoyed sizable participation from global investors, ranging between 30% and 40% of market activity over the past two decades. However, foreign investors have contributed significant net outflow since March 2020, including USD 10 billion from KOSPI and KOSDAQ during the first quarter of 2022 alone.⁵ Foreign ownership in the KOSPI is now down to 30%, the lowest rate since the global financial crisis.⁶ In consultation with ASIFMA members, who collectively represent USD 58 trillion in AUM, we believe one of the drivers behind this trend beyond fundamental factors may be related to a number of addressable market structure issues. An unusually protracted short sales ban since early 2020, the limited access to information of global investors with respect to acceptable trading activities (including for market making), the limited accessibility of the Korean Won ("KRW"), increasing barriers to entry including sizable minimum capital requirements, stringent labour laws, and challenges obtaining the required Investment Registration Certificate ("IRC") are all contributing factors.

A string of welcome developments in the Korean market of late look promising, and we hope that this positive trend will continue and bolster the growth of the Korean market. ASIFMA members welcome the partial lift of the short sales ban, as well as recent measures to improve regulatory oversight of securities lending to win back the public's trust. With the new controls in place to better manage market volatility and to minimize abusive practices, a full lift of the ban will hopefully follow. Active fund managers who employ market-neutral long-short strategies continue to remain on the side lines until a broader range of securities eligible for securities lending become available to support their trading strategies. Further, uncertainty over what constitutes legitimate trading activity has led many global firms to suspend market-making businesses in Korea which have historically helped to provide liquidity to the market.

The industry applauds the decision of Financial Services Commission ("FSC") in July 2022 to lift the proposed fine by Financial Supervisory Service ("FSS") of KRW 48 billion on nine local and foreign securities firms for allegedly 'disturbing market order'. Although the FSC decision represents a significant, positive step in the right direction, market participants remain confused about the basis for the initial issuance of the fine by FSS. The industry would appreciate more rigorously defined trading guidelines and specifications and seek to resolve future misunderstandings by appealing for more information upfront.

The industry hopes the new Administration will leverage the opportunity to pivot its policies to become more market friendly and to attract the global capital needed to support its rapidly growing economy. Through this updated white paper ("Paper"), now broadened in scope beyond an equities focus, ASIFMA and our members wish to highlight in detail some of the challenges faced by global institutional investors when seeking to invest in South Korea's capital markets and to offer

⁵ "Foreign ownership of Korean shares hits lowest level since 2010", *The Korea Economic Daily*, 26 Apr 2022.
<https://www.kedglobal.com/korean-stock-market/newsView/ked202204260021>

⁶ "Foreign ownership of S. Korean stocks at 13-year low", *The Korea Economic Daily*, 21 Jun 2022.
<https://www.kedglobal.com/korean-stock-market/newsView/ked202206210010>



constructive recommendations. In doing so, we hope to help empower the Korean market to fulfil its vast potential.

Path to MSCI Developed Market (“DM”) Status & Korean Treasury Bond (“KTB”) Inclusion in FTSE Russell World Global Bond Index (“WGBI”)

The industry supports South Korea’s longstanding aspiration to become upgraded to Developed Market (DM) status by MSCI (of which many ASIFMA members are key stakeholders). As forecasted by KCMI, this may attract an increase in foreign capital inflows of up to USD 36 billion,⁷ and would promote the long-term growth and sustainability of the Korean market. As such, a major aim of this Paper is to offer concrete suggestions that will help Korea achieve this status.

The 2022 MSCI report identified several hurdles that Korea still needs to clear in relation to the FX market, short sales, and information disclosure in English among other matters.⁸ Before the MSCI report, our members had also shared their views in March 2022 through an ASIFMA press release.⁹ The press release, widely covered by both the local and global media, featured additional matters such as regulatory transparency and the labour law. While the recommendations in this Paper should offer helpful advice for Korea in its pursuit of the DM status from MSCI, we want to particularly highlight our recommendations on the top four equities issues as prioritized by our members: A) information flow and regulatory guidelines, B) top broker leaderboard and investor protection, C) foreign exchange, and D) short sales. We believe there are significant growth opportunities for South Korea’s capital markets along its journey towards attaining the MSCI DM status, and that the recommendations outlined in this Paper can help in achieving this goal.

The development and size of the Korean economy should also naturally lead to the inclusion of KTBs in the WGBI. There are nevertheless some market practices and regulatory requirements that should be changed/eased to support the index-led increased volumes and holdings which are highlighted by our members: A) iCSD linkage, B) exemption from withholding tax and capital gains tax and C) account structure for holding Korean securities by foreign investors. These recommendations are not exhaustive but considered to be critical to facilitate the inclusion process and increase foreign investors’ appetite to invest in the Korean government bond market.

A. Information Flow and Regulatory Guidelines

The country comparison of MSCI’s Global Market Accessibility Review, released in June 2022, spotlights the information flow of the Korean market as a relative weak point both compared to other

⁷ ‘Korea’s Inclusion in MSCI Developed Markets Index: Impacts, Challenges, and Implications’, *KCMI*, 11 May 2022. https://www.kcmi.re.kr/en/report/report_view?report_no=1488

⁸ ‘MSCI Global Market Accessibility Review’, p32, *MSCI*, June 2022. <https://www.msci.com/documents/1296102/8ae816b1-fa03-bae3-0bb4-1a3b2bf387bf?t=1654804221837>

⁹ ‘Leading Global Association of Investors and Financial Institutions Highlights Key Areas of Focus for New Presidential Administration as Korea Seeks Developed Market Classification ...’, *ASIFMA*, 7 March 2022. <https://www.asifma.org/wp-content/uploads/2022/03/press-release-asifma-korea-white-paper.pdf>



Emerging Markets and Korea's other market elements.¹⁰ The report suggests that information disclosure, especially to foreign market participants, could be improved.

Changes to policies and market structure are often not accompanied by a public consultation or an official announcement in English. More generally, information in English is not always available in as much depth as in Korean. The additional efforts needed by global firms for translation and coordination with affiliates therefore require sufficient lead time to test and implement the necessary changes and to ensure smooth operation in the market.

Policies related to the identification of prohibited trading activities which the KRX considers "abnormal" are somewhat unclear and only available to KRX members, who are advised not to share them with their clients. Without this information, ASIFMA members and their clients employing algorithms with genuine trading intentions may inadvertently breach unknown thresholds and generate formal warnings from the KRX. The adjudication process upon a KRX surveillance system triggered alert would also benefit from more transparency, as the information provided by the KRX to brokers in connection with requests to issue warnings to their client does not always provide enough context to identify abnormal behaviour. The engagement in such discussion from the outset triggers significant compliance concerns within foreign institutions.

ASIFMA Recommendation: It would be helpful for policies (and policy changes) to be clear, formally published, and made available in both Korean and English for all investors. Given the sophistication of today's trading activities and technologies, global investors would appreciate if the KRX can adopt an adjudication process whereby it proactively engages with market participants to understand the context, background, and mitigating factors of any apparent abnormal behaviour that is not expressly prohibited in the KRX's guidance before issuing a warning for such behaviour. Public consultations should precede market structure changes and should be accompanied by sufficient timeframe for response and implementation.

B. Top Broker Leaderboard and Investor Protection

The real-time disclosure of the top five brokers for the day per stock can be subject to different interpretations to a variety of investors who may be inclined to trade based on the perceived directional activity of foreign brokers. There seems to be insufficient appreciation that a broker's aggregated flow includes principal, as well as client orders (each with their own varying directional views) and may therefore not be correlated to a firm's research recommendations and internal views. The net overall direction may be misinterpreted as well, should there be futures activities in the opposite direction. A forensic analysis of historical trading activity would likely reveal that retail investor interests are harmed in practice by misinterpreted trading information. In fact, a 2022 KCMI report revealed that behavioural biases in retail investors become exacerbated when they are provided an abundance of information without appropriate means to interpret the information.¹¹ As such, although well intentioned, the real-time disclosure of the top broker leaderboard harms the interests of retail investors.

¹⁰ 'MSCI Global Market Accessibility Review – Country Comparison', MSCI, June 2022.

<https://www.msci.com/documents/1296102/2cfed30d-daff-2155-91cc-3476882b057c?t=1656973074509>

¹¹ "Behavioral biases and the trading of individual investors in the Korean stock markets", KCMI, 3 February 2022.
https://www.kcmi.re.kr/en/report/report_view?report_no=1481&s_report_subject=&s_report_type=&pg=3



Per KRX study from 2004, and recently validated by ASIFMA members, there are no other exchanges in the world offering such real-time disclosure of broker activity at an individual stock level. This is a practice unique to Korea, which global investors find troubling, and without any seeming tangible benefit to domestic retail investors.

ASIFMA Recommendation: Although market transparency is strongly supported by all market participants, given the risks associated with the real-time nature of these disclosures, ASIFMA recommends delaying the Top Broker Leaderboard's disclosure of trading data to the end of the day or publishing the data on an aggregated weekly basis, complemented by enhanced investor education.

C. Foreign Exchange ("FX")

Global investors need the ability to transact in KRW in the local market to support their securities transactions. However, as the onshore FX window closes at the same time as the end of the KRX trading day at 3:30pm, global investors are forced to bear a significant amount of overnight risk, which makes Korea a difficult and expensive market to transact in. We are glad to see that the FX window extension is under discussion. It is also important to make it easier for foreign investors to conduct third party onshore forward to hedge currency risks without any prior report or approval requirement other than purely relying on the NDF market which can be expensive and subject to basis risk.

ASIFMA Recommendation: The onshore FX window should be extended to allow for an appropriate window between the close of the equities market and the FX market (e.g., 5pm) to allow sufficient time for FX transactions and to avoid overnight and funding risks.

D. Short Sales

The partial lift of the short sales ban in May 2021 was an encouraging development. Yet, the 2022 MSCI report continues to regard the restriction on short sales as a potential friction on Korea's path towards DM status. The ban has also hindered foreign investors from fully participating in the market, including market neutral long/short active fund managers who would otherwise add liquidity to the market. In July 2022, there was discussion about Korea's potential return to a complete ban on short sales in response to an upturn in market volatility, but the context was for such ban to be activated in accordance with volatility thresholds defined in advance with full transparency. Volatility control mechanisms which temporarily suspend trading are normal features for stock exchanges and would align Korea with other markets. We welcome adoption of international practice to help manage abnormal price moves but hope that the restrictions on short sales be eased after the adoption of such features, given the role of short selling in maintaining the efficiency of the financial markets, which supports fair price discovery.

Although we understand the new reporting regulations announced by the FSC in July 2022 is intended to prevent illegal short sales activities and protect retail investors, it can further create unexpected operational burdens for market participants. We believe the existing reporting regime is sufficiently rigorous and that the new regulations could disrupt and deter foreign investment.

Another issue concerning short sales is the strict reporting threshold, at 0.01% of outstanding shares, which can be burdensome for market participants. A higher threshold would promote more active



investment, while useful and accurate market data can still be provided. Additionally, the FSS reporting page for short sales currently seems to be in Korean only, which remains an obstacle for foreign investors.

ASIFMA Recommendation: We recommend further lift of the short sales ban for more efficient pricing and liquidity for the market, as well as continuing to attract foreign investment. We also suggest that ASIFMA and the Pan Asia Securities Lending Association (“PASLA”) members be given the opportunity to provide feedback on behalf of foreign investors before new rules are implemented. As for the reporting threshold, we believe it can be increased, to 0.2% for instance, in order to ease the burden on market participants. We hope that FSS can provide an English option for the short sales reporting page.

E. KTB Inclusion in FTSE Russell WGBI

1) iCSD Linkage

Although not deemed as a pre-requisite for index inclusion, the eligibility of Korean government bonds on international central securities depository (“iCSD”) platforms is nevertheless a strong advantage. It would also facilitate the use of KTB and Monetary Stabilization Bonds (“MSBs”) as collateral offshore especially in the context of the full implementation of the Uncleared Margin Rules further discussed in F.2.(a). iCSDs such as Clearstream and Euroclear had set up iCSD connectivity with the Korean market for KTBs and MSBs but following the 2010 reversal of the tax exemption granted to foreigners on withholding tax on interest income and capital gains tax relating to KTBs and MSBs, the change in tax policy together with the IRC registration requirements have been key impediments to iCSD linkage as it complicates the interoperability of iCSD with the Korean bond market. We further discuss these points below and in detail in the main section of this Paper.

2) Exemption from Withholding Tax and Capital Gains Tax

From a tax perspective, the existing member jurisdictions included in the WGBI have offered foreign investors exemption from withholding tax on interest income and capital gains tax. The industry welcomes the Ministry of Economy and Finance (“MOEF”)’s proposed changes to the tax law (and also the temporary application thereof) whereby foreign investors will be exempted from withholding tax on interest income and capital gains tax for KTBs and MSBs, which is critical to the industry for the process of WGBI inclusion and broader iCSD connectivity. At the time of publication of this Paper, the proposed regulatory changes have yet to be officially adopted by the National Assembly, which would be required for the tax exemption to become permanent once the current temporary application expires at the end of 2022. We look forward to the final adoption of the tax law amendments and also the continued policy application thereafter, as it would allow foreign investors to trade in KTBs and MSBs without concerns over the applicability of the tax exemption that unfortunately remain given the reversal in policy by the Korean tax authorities back in 2010.

3) Account Structure

Although the 2017 adoption of omnibus structure for trading at the local broker level was well received by the industry, it did not solve the post-trade hurdles faced by iCSDs and Global Custodians. To allow iCSDs, Global Custodians and Triparty agents to offer internal settlement of positions, fully



fledged omnibus structure at the local custodian and KSD will have to be implemented. That would mean removing the IRC registration requirements for Korean securities holding by foreign investors. At a minimum, the IRC requirement for foreign investors should be removed for KTBs and MSBs settling through iCSDs. Please see section F.3 for a more detailed explanation of Internal Settlement and iCSD linkage. To comply with the regulators' transparency requirements, Global Custodians are open to developing disclosure reporting processes at the beneficial owner or IRC level. ASIFMA and its members would welcome the opportunity to discuss and share ideas with the Korean regulators on ways to align the regime for holding and settling of transactions in Korean securities by foreign investors to the international securities settlement infrastructure, which would make the Korean market more accessible for investment. We believe this change would also be a positive element in inclusion of KTBs in WGBI.

Executive Summary Conclusion

The recommendations above summarize some of the key concerns of global investors that have discouraged more active investment into Korea's capital markets and impeded Korea's upgrade to MSCI developed market status and inclusion of KTBs in FTSE Russell's WGBI. The rest of this Paper expands upon these topics in greater detail and highlights additional opportunities for market reform to further reduce investment frictions, including recommendations for improvements to regulatory reporting and penalties, streamlining the account structure issues, and upgrading KRX systems and market data infrastructure. The strict labour laws limiting overtime hours and unusually high minimum capital requirements for new business activities have also impaired global banks and fund managers from growing their onshore business in Korea.

ASIFMA welcomes the opportunity to work with Korean self-regulatory organizations ("SROs") to prioritize and to address this Paper's list of opportunities and challenges raised by our members representing the global investment community, and to support growing global investment into Korea. We have been in discussion with both the KRX and the Korea Financial Investment Association ("KOFIA") in the drafting of this Paper and understand that we are much aligned on finding solutions to improve the market. We have been working with regulators and exchanges throughout the Asia Pacific region, as well as with MSCI and FTSE, and believe we have recommended practical solutions which can be implemented to improve market access efficiently, whilst enhancing the control environment. APAC markets have been changing at an increasingly faster pace whilst growing competition for capital increases amidst a changing landscape. ASIFMA stands ready to partner with stakeholders in the development of the Korean financial market to embrace the future with confidence and continued success.

A. Information Flow and Regulatory Guidelines

1. Abnormal Trading Guidelines

To maintain orderly trading in the market and protect the legitimate rights and interests of market participants, market surveillance teams typically work to identify trading activities they deem to have “abnormal trading” patterns and require trading members to issue formal warnings to clients as soon as these patterns have been detected. However, we note that warnings can be issued by the KRX without any advance indication, and a certain number of warnings accumulated over a designated time period can result in a trading suspension. Although the KRX does provide exchange participants with published parameters and heuristics for brokers’ compliance staff to perform daily self-audits against prescribed patterns and thresholds, these abnormal trading guidelines are not publicly available and KRX member firms are not allowed to share these parameters with clients, nor even with offshore affiliated entities.

Many of our members have received warning letters for issues such as “false trading” (e.g., excessive numbers of cancel/corrects) or relating to adverse impact to market price. Lacking clear guidance, ASIFMA members and their clients employing algorithms with genuine trading intentions may inadvertently breach unknown thresholds and generate formal warnings. Market participants would also appreciate more information from the KRX on what is considered a large price move in the closing auction. Our membership believes the process could be improved by publicly providing additional guidance, examples or case studies regarding trading behaviours that surveillance is intended to prevent.

Additional public guidance will allow KRX member firms and their clients to accurately monitor order flow, proactively conduct surveillance and identify trading patterns that are of concern to the KRX. By empowering market participants with the information they need to institute more advanced surveillance, member firms can proactively and pre-emptively address trading practices that the exchange does not want to see in the market, before they are flagged by the KRX and warning letters are issued.

The current practice of restricting KRX member firms from sharing guidelines with their clients limits the ability of KRX member firms as brokers to engage in well-informed consultation with their clients. The provision of publicly available guidelines can help clients avoid activity that may inadvertently give the appearance of inappropriate behaviour. Further, a relative lack of guidelines in English also contributes to unwanted asymmetry of information between market participants that are onshore vs offshore. The insufficient English language disclosure has been noted in ‘Equal Rights to Foreign Investors’ in the commentary of the 2022 MSCI report on Korea (cited above)¹². Providing information in a consistent manner to the broader market would avoid any information asymmetry among market participants, and save them from attempting to implement their own controls in a way that is not aligned with the surveillance intentions. The industry, both global and domestic firms, would benefit from more clarity and feedback in this regard.

¹² ‘MSCI Global Market Accessibility Review’, p32, MSCI, June 2022. <https://www.msci.com/documents/1296102/8ae816b1-fa03-bae3-0bb4-1a3b2bf387bf?t=1654804221837>



ASIFMA's Recommendation: Our membership recommends that the KRX considers publicly sharing (with all investors rather than just with KRX member firms) rules and procedures that are clear and comprehensive, and that include explanatory material written in plain language (in both Korean and English), so that all participants can fully understand the guidance, expectations and case studies on trading behaviours that would trigger warning letters. For example, some other regulators and exchange trade surveillance teams issue periodic compliance bulletins outlining common deficiencies and good practices observed, to offer the industry a better understanding of surveillance work and regulatory expectations. Doing so would not only allow market participants to assist the KRX by proactively conducting their own surveillance, but ensure firms are fully aware of their obligations, allowing them to implement controls to prevent unwelcome trades from reaching the market in the first place. This will promote a more level playing field with consistent rules for all participants in the Korean capital markets.

We would additionally encourage more regular dialogue between the KRX surveillance teams and market participants on the topic of surveillance and trading practices, which ASIFMA could help facilitate. In particular, discussions could cover common trading practices by international investors and some of the context for surveillance flags. For example, ASIFMA members could provide constructive feedback on how participation rates and trade sizes relative to historic norms are used in common trading strategies and why consideration of these other factors should be included to avoid false positives.

For reference, the Chinese exchanges, together with their Hong Kong counterparts, have hosted several workshops with market participants to transparently communicate their expectations and also hear from both domestic and international trading experts about common trading strategies, market practices and investor behaviours. We recommend that the FSC, the FSS, and the KRX consider leveraging this kind of highly effective model of market communication and information sharing of regulatory expectations and dialogues with market participants. We understand that the KRX may be implementing material changes to their trade surveillance framework and triggers. International market participants, who provide significant liquidity to the Korean market, would appreciate a discussion with the KRX to understand the details and provide feedback that would help minimise false positives.

2. Abnormal Trading Warning Issuance and Adjudication

Upon identifying trading which they deem to be “abnormal”, the KRX requires its members to issue warning letters to their clients. The overwhelming majority of our members indicate that the information provided by the KRX to brokers in connection with these warnings does not always provide enough context to identify the abnormal behaviour, and that brokers need to spend time to identify the relevant case officer at the KRX to seek clarity around the nature and timing of the alleged offense. This can be problematic, especially if innocuous and genuine trading inadvertently carries the appearance of inappropriate behaviour which, as stated above, can be difficult to pre-empt without the disclosure of clear abnormal trading guidelines.

ASIFMA's Recommendation: The industry recommends a more transparent and formal framework to govern the adjudication process for warning letters. The KRX should grant member firms the



opportunity to engage clients and provide context, background, and an explanation of mitigating factors and controls for better context of the incidents that are the subject of warning letters. We ask that KRX directives for issuing a warning letter be accompanied by more detailed information about the nature and timing of the alleged violation, along with the name and contact information of the case officer to engage with for adjudication.

While clear breaches of publicly available abnormal trading guidelines might reasonably result in an immediate warning, we recommend that the KRX adopts an adjudication process whereby it proactively engages with investors to understand the context, background, and mitigating factors of any apparent abnormal behaviour that is not expressly prohibited in KRX guidance, before issuing a warning for such behaviour.

In Japan, for example, when a trading pattern warrants scrutiny, it is a common practice for the exchange to engage the trading member in a dialogue, which is characterized by a series of Q&As and fact finding discussions prior to the formulation of a conclusion or the issuance of corrective actions. This is similar to the proactive discussions by Chinese and Hong Kong exchanges with market participants to clarify the context of such activity before deciding to issue warnings.

By enhancing the process to allow for KRX member firm feedback and a system for discussion between the investor and the KRX, both parties can benefit from an enhanced mutual understanding that accrues through open dialogue. By enriching the workflow with well-informed dialogue and adjudication, the process will benefit through the issuance of more effective warnings or requests to take preventative action on more targeted behaviours. Additionally, there will be more educated traders in the market and the formation of a shared understanding of investor trading activity across KRX member firms, their clients, the KRX, and other regulatory bodies.

3. Market Structure Changes: Regulator Announcements, Public Consultations and Timeframes

Our members have noted that market structure changes in Korea are not only frequent, but also seldom accompanied by a public consultation or announcement in English via circular nor fully communicated to all market participants simultaneously. The industry also notes that the timelines offered for both consultations and changes are often too short (e.g., 3-4 weeks post-announcement) for market participants to offer feedback, plan, test and implement.

For example, market participants have heard that the KRX is planning to roll out a new algorithmic trading framework including changes to tick size in early 2023; however, the majority of international broker and investor community have not received critical information to help them adequately prepare for market structure changes, due to the limited capability for onshore members to share the relevant document with offshore affiliates. Meanwhile, a new surveillance monitoring regime went live on September 26, 2022. Given the dramatic impact that tick size reductions would have on trading (reduced size at touch, more frequent price changes, etc.), the industry strongly recommends delaying the new tick-size regime until after the new surveillance guidelines can be fully understood and adjusted to. Considering the complexity of these two initiatives, the market would benefit from the KRX allowing for a full public consultation (with sufficient notice and comment period) and ideally working closely with ASIFMA members and with domestic participants on finalizing the new



framework to ensure sufficient transparency and alignment with international standards and best practices.

ASIFMA's Recommendation: Market structure changes should be preceded by public consultations and announced via circulars, available in English, and simultaneously and fully communicated to all market participants whether they are onshore or offshore. Market structure consultations should also provide sufficient timelines required for global coordination and preparation. To ensure smooth implementation of market structure reforms, market participants should be afforded sufficient time to facilitate builds and testing. Additionally, implementation (go-live) dates should generally avoid the week before, week of, and the week after major index rebalance events.

B. Top Broker Leaderboard and Block Trading Mechanism

1. Top Broker Leaderboard

The Top Broker Leaderboard is a mechanism unique to the Korean market which discloses (in real-time) the top five brokers for the day per stock (based on their buying and selling volumes). While ASIFMA strongly supports market transparency, we understand that the real-time nature of this mechanism can be misinterpreted and harm domestic retail investors, while also creating investment frictions for institutional investors.

According to a 2022 research paper from KCMI¹³, the increased accessibility of information (of which the Top Broker Leaderboard is an example) may exacerbate the extent to which retail investors are negatively impacted by their behavioural biases. The disclosure of the Top Broker Leaderboard in real time only considers the total flow and fails to account for the current direction of trade flow, resulting in herding behaviour among retail investors.

In particular, retail investors may lack the appropriate understanding that published broker volumes are an aggregate of both principal and agency (client) orders and therefore represent a wide range of varying directional views. These views may not be correlated to the broker's own internal views of the market or their research recommendations. Given that some retail investors have been known to trade based on the perceived directional activity of foreign brokers, the real-time publication of this data can be misleading and harmful. We further note that the net direction may be misinterpreted as well, due to futures activities in the opposing direction.

Additionally, the KRX lacks an effective block trading mechanism (see section B.2 for recommendations on improving block trading mechanism). Large trades often need to be executed in the lit market, which exposes global investors to potential third-party front-running and price slippage. To avoid slippage, global investors instead will often execute larger trades through multiple brokers, which can be expensive, inefficient and operationally complex.

ASIFMA's Recommendation: We strongly suggest that the dissemination of Top Broker Leaderboard data should not be on a real-time basis and suggest publishing the data on an aggregated weekly basis,

¹³ "Behavioral biases and the trading of individual investors in the Korean stock markets", KCMI, 3 February 2022. https://www.kcmi.re.kr/en/report/report_view?report_no=1481&s_report_subject=&s_report_type=&pg=3



complemented by enhanced investor education. Doing so would allow for trade transparency, while protecting the interests of both retail and institutional investors. As a related matter, ASIFMA recommends improving block trading mechanisms to minimize information leakage resulting from real-time disclosure of the Top Broker Leaderboard.

2. Minimum Crossing Requirements

The thresholds for crossing negotiated trades in Korea (where the broker has arranged both the buyer and seller for a security) are restrictive compared to other developed markets, which results in investment frictions for institutional investors. The minimum thresholds for K-BLOX transactions (5,000 lots or KRW 100 million for KOSPI and KRW 50 million for KOSDAQ) are considerably higher than those in Hong Kong and Japan where there are no minimum notional value restrictions. Furthermore, flexibility on execution price is limited because K-BLOX transactions can only occur at round integer price levels - limiting the ability to cross at the midpoint price of the best available bid and offer when dictated by market conditions.

A KRX mechanism called A-BLOX¹⁴, or “Auction-based Block Trading Service”, was introduced in 2010 to expand the toolset for crossing. However, once again minimum size thresholds (KRW 500 million for KOSPI and KRW 200 million for KOSDAQ) and unconventional price mechanics (limit orders are not supported and intraday executions are based on the partial day VWAP benchmark) have led to negligible usage since launch.

While most equity exchanges globally disseminate post-trade crossing activity intraday (typically within 15 minutes), Korea stands as an outlier by only publishing this information at the end of the day, in aggregated form.

ASIFMA’s Recommendation: The industry recommends the below modifications to the block trade mechanism.

- 1) The K-BLOX minimum crossing thresholds should be lowered or removed altogether.
- 2) The K-BLOX pricing mechanism should support decimal places to accommodate transactions representing prices in more granularity.
- 3) The A-BLOX mechanism would benefit from an industry consultation to gather feedback on changes and improvements.
- 4) Crossing transactions should be disseminated during continuous trading hours and reported at a trade level, rather than in aggregate.

C. Foreign Exchange

Global investors need the ability to transact in KRW in the local market to support their securities transactions. However, by the time KRX trading ends at 3:30pm, the onshore FX window is closed as well, which causes investors to bear overnight risk from either sourcing funds the day before or after. Whilst there is a deep and liquid offshore market for KRW, which enables global investors to hedge their currency risk, it does not provide for the delivery of KRW that investors require to meet their

¹⁴ “KRX introduces new auction-based Block Trading Service”, *Financial Services Commission*, 21 July 2010. <https://www.fsc.go.kr/eng/pr010101/21914>



settlement obligations for equities transactions. It is encouraging that the Ministry of Economy and Finance is considering extending the FX window to contribute to Korea's path towards MSCI DM classification¹⁵, and we hope the extension can materialize sooner.

ASIFMA's Recommendation: We recommend that the market hours of the domestic FX market be extended to allow for an appropriate window of time between the close of the equities market and the FX market (e.g., 5pm). Such an action will allow investors to enter FX spot transactions to facilitate the settlement of their transactions on KRX thereby avoiding the heavy costs of funding their investments ahead of execution or avoiding the overnight currency risk. This would also align the Korean FX market with its regional and global peers that typically continue to function after their domestic exchanges have closed. For example, on 6 January 2020, India removed trading hour restrictions for the Indian Rupee, allowing it to be freely traded at any time.¹⁶ Similarly, China also extended the trading hours for the onshore renminbi in 2016 to 11:30pm to allow overlap with European and American markets.

D. Short Sales

1. Limited Short Sales Accessibility

In response to the market volatility caused by the international outbreak of COVID-19, a full short sales ban was imposed in Korea in March 2020 and remained in effect until being partially lifted in May 2021, for securities listed in the KOSPI 200 and KOSDAQ 150 indexes. The partial resumption of short sales activities was welcomed and appreciated by ASIFMA members, although the 2022 MSCI report indicates a lack of timeline on the complete lift of the short sales ban, for which ASIFMA has noticed a strong industry demand.¹⁷

While ASIFMA understands the concerns of retail investors regarding short sales, we believe that the transparent dissemination of short sales guidelines and appropriate monitoring of illegal short sales activity can mitigate any risk to the market. We also believe the FSC has made good progress in market education, allowing retail investors to safely begin engaging in short sales.¹⁸

ASIFMA's Recommendations: As an extension of the partial lift of the short sales ban in May 2021, for the benefit of the industry as a whole, members would like to see further lift of the short sales ban for greater efficiency and liquidity in the Korean market. The alleviation of the restriction on short sales

¹⁵ "South Korean won trade faces turning point", *East Asia Forum*, 25 May 2022.

<https://www.eastasiaforum.org/2022/05/25/south-korean-won-trade-faces-turning-point/#:~:text=Trading%20hours%20are%20currently%20open,%3A30pm%2C%20Korean%20Standard%20Time.>

¹⁶ "Risk Management and Inter-bank Dealings- Permitting AD Cat-I banks to voluntarily undertake user and Inter-Bank transactions beyond onshore market hours", *Reserve Bank of India*, 6 January 2020.

https://www.rbi.org.in/scripts/BS_CircularIndexDisplay.aspx?id=11780

¹⁷ 'MSCI Global Market Accessibility Review' p32, *MSCI*, June 2022.

<https://www.msci.com/documents/1296102/8ae816b1-fa03-bae3-0bb4-1a3b2bf387bf?t=1654804221837>

¹⁸ 'Short-selling is back in Korea, hits KOSDAQ harder on the first day', *Pulse News*, 3 May 2022.

<https://pulsenews.co.kr/view.php?year=2021&no=425422>



would be a welcomed change by international investors in the Korean market, and would also be well perceived by MSCI in their assessment to potentially upgrade Korea's market status.

2. Operational Burden and Disruption Resulting from Recently Announced Reporting Requirements

Additional reporting regulations announced by the FSC in July 2022 can create further operational burdens on all market participants. Full details of the new requirements are currently pending but are expected to involve supplemental reports on loans/borrowings for short sales purposes that exceed 90 days and extend details on large short positions. These reports are in addition to a new criterion around the overheated short sales rule that may result in daily disruptions for investors who are hedging their positions and would act as a deterrent to foreign investors.

While ASIFMA appreciates the desire to monitor the extent of short sales and prevent illegal short sales activities, the new reports are supplementary to an already rigorous reporting regime with penalties that extend beyond those imposed in comparable regional markets.

ASIFMA's Recommendations: We suggest a timely consultation to be conducted with ASIFMA and PASLA members ahead of the implementation of the new rules on short sales ban to estimate their impact and collect investors' feedback.

3. Short Sales Reporting

The current minimum short position reporting threshold of 0.01% of outstanding shares is low and creates a relatively heavy reporting burden for market participants, compared with those in other comparable jurisdictions. A higher threshold level would help provide a simpler and more efficient reporting regime that still offers accurate and useful information to the Korean regulatory authorities, and would align with other Asia Pacific jurisdictions. The onerous reporting requirement is a factor discouraging active participation in the Korean market by new entrants from offshore.

Additionally, while the FSS homepage is available in English, its short position reporting website is provided solely in Korean. Global investors may therefore have difficulties filing accurate and timely short position reports without the assistance of independent Korean-based service providers.

ASFIMA Recommendations: ASIFMA suggests that the reporting threshold be revised to reflect either a higher value of 0.2% of outstanding shares (as adopted in Japan and Singapore) or a minimum monetary value of the short position (preferably whichever is the lesser of the two). Revising the reporting thresholds to bring them in line with other Asia Pacific jurisdictions will assist Korean regulators in streamlining reporting obligations for the market whilst continuing to provide useful and accurate information for regulatory review.

As the exclusive Korean language format of the FSS reporting facility presents challenges to global investors, providing an English language option for the reporting facility would greatly improve the ability of global investors to independently provide accurate and timely reporting in line with regulatory requirements.

E. Other KRX Trading Related Matters

1. Korea Exchange Participation

Other securities exchanges around the Asia Pacific region have adopted measures to increase participation and competition, which we would like to bring to the attention of the KRX for consideration.

Firstly, several exchanges around the region have opened their market making schemes to non-participants. From the perspective of the exchange and the regulator, this mechanism increases liquidity and turnover, improves competition, and reduces spreads, providing a clear benefit for investors. There are incentives extended to the market makers, which may include reduced transaction fees, market data concessions, and trading exemptions around short sales.

Examples of some other Asia Pacific exchanges include:

- **Hong Kong Exchanges & Clearing Ltd (HKEX)** has introduced the “Designated Specialist” (DS) programme for Exchange Traded Products (ETPs). The DS programme permits liquidity providers who are not exchange participants to take part in ETP market making activities in Hong Kong. The DS program opens up opportunities for liquidity providers to tap the potential in Asia ETF marketplace. All ETPs, including ETFs and Leveraged and Inverse Products listed on HKEX, are eligible.
- **Australian Securities Exchange (ASX) and CBOE Australia**, both opened up market making on ETFs to non-participants with the introduction of a tripartite agreement, to be signed by the market maker, the market makers broker, and the ASX/CBOE.
- **Japan Exchange (JPX)** requires market makers to be registered as a Japan FSA “High Speed Trader” but they do not need to be an exchange participant. This regime was established in July 2018, and from inception market makers were not required to be exchange members.
- **Singapore Exchange (SGX)** does not require market makers to be exchange participants. Market makers inform SGX which account they will use for market making, so that the SGX can monitor performance.

Secondly, JPX has introduced a “Remote Trading Participant” scheme for the Tokyo Stock Exchange (TSE). According to JPX, *“this is a type of trading participant which allows foreign securities brokers without a business presence in Japan to directly participate in the exchange market”*. This scheme was introduced on the TSE in February 2009 and on the Osaka Stock Exchange in June 2009.

ASIFMA’s Recommendations: ASIFMA recommends the KRX to increase participation and competition. The KRX could consider introducing non-exchange members to participate in market making, similar to what other developed markets have done in the Asia Pacific region.

2. Program Trading (‘Basket’) Flagging Reporting

Our members welcome and appreciate the KRX’s proactive removal of pre-reporting requirements for program trading. However, the KRX continues to require market participants to flag basket orders as “arbitrage” or “non-arbitrage” when a single person (natural or legal) sends a single order of 15 or



more distinct KOSPI components (or 10 or more names for KOSDAQ) within a specific timeframe. Violating this requirement may subject member firms to either a written warning or a summary fine. This requirement is very difficult to manage, given the complexity of trading strategies and the speed of systems.

Furthermore, the KRX does not disclose the timeframe for execution of basket orders that triggers the flagging requirement, so brokers often rely on their own experiences to identify when baskets need to be tagged. The ambiguity can result in over-flagging of program trading orders. Since the KRX discloses program trading details to the market, over-flagging can distort market statistics and hamper investors' confidence in the disclosures.

ASIFMA's Recommendations: ASIFMA understands that the KRX sought industry opinion on this issue in January 2022, and understands that the recommendations from the global broker community to the KRX was to relax the requirement - by either increasing the number of components (e.g., 30 or 50 names or more), or lift the requirement to ensure that flagging remains relevant and operates in the best interests of the Korean financial markets and its continued growth and development. We would be grateful if the KRX could consider those recommendations.

3. Give-ups and Position Transfers for Futures

a) Give-Ups

The inability to give-up futures and options (for example, the 3 year and 10 year KTB futures and KOSPI 200 derivatives) contracts is not aligned with international practices and prevents fair execution practices. For example, for US Treasury futures, when a client account or a fund account opens a futures brokerage account with a clearing member of the exchange, there are additional give-up agreements that can be put in place to facilitate trading such futures with either the futures broker that the account is opened with, or any other brokers that have the give-up agreement. In Korea, this give-up function does not exist. Therefore, even if there are two accounts being managed the same way, the futures trades will inevitably end up having different prices because their futures accounts are at different brokers.

ASIFMA's Recommendations: ASIFMA recommends that Korea follow the international best practice of allowing investors to give-up all futures contracts, which would allow investors to have the flexibility to decide who they want as their execution and clearing brokers (these can be different brokers) and offer them operational and funding flexibility, as trades can be given up in the event of an error.

b) Position Transfers

While inventory position transfers held by a foreign investor are allowed through the KRX's booking interface, the process is complex, especially for futures and options positions given the margin requirement. In order to transfer positions, the foreign investor's IRC and investor code must be identical between brokers and the entire portfolio must be transferred. IRCs would be identical across different brokers. However, as each broker may have different standards when assigning the investor code even to the same IRC, position transfers often



become restricted. While it is possible to transfer futures through this booking exercise by blocking certain trades from transfer and offsetting them in new accounts, such an exercise requires clients to register a new account solely to effect partial position transfers, which is unnecessarily complicated and operationally burdensome. Investors often wish to use position transfers to transfer positions from one broker to another or to offset risks (for example, clients may have offsetting positions with different brokers). Affording position transfer flexibility would allow clients to consolidate their positions and risks with one broker without the aforementioned market impact risks.

ASIFMA's Recommendations: ASIFMA recommends that the KRX amend the pre-requisites for position transfers across brokers to be in line with international standards, where position transfers are allowed as long as the end beneficiary of the positions remains the same.

4. Market Data and Market Structure

a) Market Data Licensing Fees

KOSCOM's unique pricing on market data licensing yields high costs which subsequently serve as a deterrent by foreign investors trading on the KRX to establishing relationships with multiple brokers and diversifying participants' access to the KRX markets. International investors prefer to connect to multiple brokers to benefit from different service offerings, mitigate counterparty risks or obtain sufficient execution capacity. Under the KOSCOM pricing model, if a client uses multiple brokers, each broker that accesses the data is considered a 'direct connection equivalent' and therefore incurs a separate fee which is passed onto the end client. The approach by KOSCOM on these costs, unlike other exchanges in the region, quickly compounds cost and therefore plays a large role in business decisions such as: 1) how much a product is traded, 2) the degree of broker diversification, and 3) the level of participation in financial investment in that market. As a consequence, clients have less flexibility on how they can trade which ultimately lowers their participation in the KRX. Additionally, brokers are not allowed to pass data on to clients without charging a fee.

ASIFMA's Recommendations: ASIFMA recommends KOSCOM to revise its market data pricing model to align with those at other exchanges around the region by charging a set fee to brokers accessing the market, which will allow investors to achieve best execution by being able to choose and trade through multiple different brokers. Alternatively, a bundled deal for end-clients where the incremental cost of additional market data feeds decreases could also provide a potential solution.

b) Enhancing the KOSCOM Data Feed and KRX Market Data Structure

ASIFMA notes that KOSCOM data feeds have fallen behind global market standards. For example, the KRX's existing market data currently only uses lines with a speed of 8-45 Mbps, which contrasts with other global major exchanges, which use 10G lines or higher. We are delighted to learn that the speed will increase to 100Mbps possibly from early 2023 (despite possibly remaining at that level for multiple years thereafter). Additionally, the KRX limits the

number of order lines into the exchange to a maximum of 10 per broker; in contrast, other exchanges (e.g., SGX, HKEX, and JPX) have “unlimited” offerings. This limitation makes it significantly more difficult for new participants to access the market in a timely and competitive manner.

ASIFMA’s Recommendations: To ensure KOSCOM’s data feeds remain competitive and in line with developments in other exchanges, ASIFMA recommends the KRX to:

- 1) Increase the Order and Market Data Bandwidth lines to 10G or higher.
- 2) Increase the bandwidth and the number of lines which member firms are allowed to have. The number of “session (PIDs)” should also be increased above and beyond the current 98 for derivatives and 110 for cash equity. We are glad to learn that the KRX is proposing changes to 150 PIDs for derivatives. It is crucial for the KRX to give member firms the option to purchase more lines (or larger bandwidths), as long as the member firms' business justifies these purchases and they are willing to bear the cost.

Our members also note that the KRX currently maintains two separate venues for its equities and derivatives trading platforms (cash equities based in Seoul and derivatives based in Busan). This market structure creates multiple competitive and structural issues, particularly for new market participants as they seek to gain access to the Korean market. Given its complexity, ASIFMA would welcome the opportunity to collaborate with the KRX to discuss the industry’s views on this important topic in greater detail.

c) KRX Next-Generation Matching Engine

The next generation upgrade will be a key event in the development of the Korean market and provides the KRX an opportunity to significantly develop its offerings from a market safeguards perspective, and to better meet global standards. Core control features that are available on other platforms in the region include 1) bulk order delete message types, 2) independent (end-client) kill switch, 3) delete on disconnect, 4) self-match prevention and 5) market maker protection.

ASIFMA’s Recommendations: At present, the KRX does not provide the features available in other platforms in the region (although we understand that the aforementioned features 1, 3, and 4 along with Drop Copy are in scope for upgrade). We recommend that all of them be incorporated into the next generation upgrade. These functionalities will allow liquidity providers to effectively provide liquidity whilst managing their risk exposure effectively. This will improve market quality through increased liquidity provision, tighter spreads, and more accurate pricing.

5. Small Financial Penalties

The KRX can impose “Summary Penalties” on KRX member firms for cases which are deemed minor wrongdoings and intended to be dealt with quickly. The maximum amount for these penalties is capped by regulation at KRW 2 million (approximately USD 1400). This is distinct from and less severe



than “Disciplinary Action”, which can result in a major monetary fine, suspension of membership/trading privileges, or the issuance of a warning/attention notice. ASIFMA members caution that *any type* of monetary fine, even very small amounts from Summary Penalties, are viewed by international clients, brokers, and foreign regulators with a high degree of severity. The current structure creates an unnecessary number of escalations, disclosures, and challenges for participants which far exceeds the original intentions of the penalty.

ASIFMA’s Recommendations: ASIFMA recommends adopting international practice to eliminate these small monetary fines and issue cautionary guidance notes instead.

6. Overheated Stocks

The KRX has criteria (based on closing price, turnover ratio and volatility) for designating a stock as “over-heated”. Once a stock is considered over-heated, the stock is traded in 30-minute auctions for the next three days¹⁹. We understand that the KRX provides a list of stocks that are considered overheated and gives prior warning if a stock is likely to be added to that list (all in English).²⁰ However, the issue around Korea’s overheated stock mechanism is the cost of execution. When a stock fails to trade in the continuous trading market for 3 days, it impacts fair price formation and the ability of market participants to trade freely. This creates an implicit execution cost which market participants have to bear.

ASIFMA’s Recommendations: ASIFMA recommends that the KRX leverage volatility control mechanisms (“VCMs”), rather than limiting trading to 30-minute auctions. ASIFMA has conducted a comparative review of the VCMs of exchanges in the region and would be happy to explore with the KRX how to improve the VCM framework in Korea.

7. Clearing Issues

We appreciate efforts taken by the KRX to initiate positive changes in the securities and derivatives market in the last couple of years. These would include implementation of capped default fund liability, phased removal of discounts offered in client margins, phased implementation of margin floor and buffer to address procyclicality in margins. However, our members have indicated that there are still some gaps in the KRX’s Central Counterparty (“CCP”) risk framework which, if unaddressed, could result in difficulties during events of market stress. For example, the KRX’s proportion of CCP capital in the default waterfall (skin in the game) is not relative to the default fund or to the level of risk that it manages, as it is a fixed amount. While a well-defined default management process has been implemented and recovery tools are available in the over-the-counter (“OTC”) derivatives segment, the lack of a recovery framework for listed securities and listed derivatives market does not provide clarity on what close out tools the CCP will deploy for illiquid contracts (like OTM Options) and how it

¹⁹ ‘Measures to ease temporary overheat’, KRX.

<http://global.krx.co.kr/contents/GLB/06/0602/0602010204/GLB0602010204.jsp#71a41c9db05a316843888945c79033e7=8>

²⁰ See ‘price stabilization’ tab under ‘market alert’, KRX.

<https://engkind.krx.co.kr/main.do?method=loadInitPage&scrnmode=1>



will be able to establish a matched book in default situations (i.e. closing the defaulting party's position and instead matching the non-defaulting party with another non-defaulting party). With respect to auctions in the OTC derivatives segment, we would encourage the KRX to enhance the auction process in line with the recommendation provided in the latest industry papers.²¹ Additionally, the relaxed timelines for investors to post the variation margin (by 12pm on T+1) exposes the KRX as the CCP to the risk of under-collateralisation. The lack of a scalable and appropriate variation margin service outside of the KSD system and the ability to satisfy such with non-cash collateral (instead of only cash and cash equivalents like G7 bonds or high quality liquid assets) causes this process to be very manual and cumbersome, adding to the concern of under-collateralization. Further, liquidity of corporate bonds and equities (which are included in eligible collateral criteria towards initial margin) could come under pressure in stressed market conditions.

ASIFMA's Recommendations: To address the foregoing issues, our members recommend that the KRX consider a wide range of potential enhancements. For example, the KRX's skin in the game across all segments could be calculated relative to the level of risk which the KRX manages (i.e. as a proportion of its default fund). While we understand that the KRX may need to use tools like variation margin gains haircut ("VMGH") and Partial Tear Up ("PTUs") to establish a matched book, this should be done with an explicit approval of the regulator, based on a monetary and/or time-based cap and with adequate disclosures on price for tear up. KRX should also accept only cash and cash equivalents for margin obligations within a tighter timeframe, which would go a long way in addressing these concerns. There is also currently an absence of liquidity and concentration risk add-on charges under the current margin methodology in both the listed securities and listed derivatives segment. KRX should continue to consider reflecting the liquidity risk and concentration risk of the clearing members across segments into the margin methodology. The methodology could be further improved by extending the lookback period to at least 5 years coupled with adjusting the decay factor higher. While the current decay factor reacts quickly to new information, it may also lead to undesirable outcomes if the model overreacts or if it quickly forgets about past periods of stress. A decay factor closer to 1 would reduce the responsiveness to market shocks. We welcome the implementation of the margin floor based on 10-year history, though a stress-based VaR floor appears to be more effective to reduce procyclicality by preventing margin levels from falling to low levels during benign market conditions. The stress margin component should include an adequate number of extreme market movements for all margined products over the past 30 years, or as long as reliable data have been available.

We also note that there are currently legally enforceable netting and collateral opinions for the OTC derivatives segment, but not for the listed securities and listed derivatives segments. The KRX should consider putting in place a legally enforceable construct contemplating a default by or bankruptcy of the clearing house in the listed securities and listed derivatives segment, which should not be managed differently than the OTC derivatives segment.

²¹ "Central counterparty default management auctions – Issues for consideration" CPMI IOSCO, June 2020.
<https://www.bis.org/cpmi/publ/d192.pdf>



As it is important for these gaps to be addressed (and the above list of gaps and recommendations is not exhaustive), ASIFMA would welcome the opportunity to discuss the KRX's CCP risk framework and potential solutions for such in greater detail.

8. Retail Participation in Equity Derivatives

Prior to 2009, Korea had strong retail investor participation in equity derivatives through Equity Linked Warrants ("ELWs"). The hedging activities of warrant issuers contribute to significant liquidity on other exchanges in Asia. Regulatory changes introduced to limit the investors eligible to trade ELWs and place restrictions on the quality of market making that could be provided led to the decline of the market and withdrawal of many issuers. Various initiatives since introduced to encourage retail participation in the futures and options market have not quite yielded the desired effect.

ASIFMA's Recommendations: The ELW market, designed for retail investors and giving them easy access through their regular stock trading account, does not have margin calls so their capital is protected and requires issuers to either appoint or act as market makers, which provides liquidity and fair prices. To encourage high quality issuers to participate in the ELW market and to encourage a more active ELW market, we recommend a gradual amendment of the market making rules so as to promote tight spreads and trading in large lot sizes.

9. Trading Halt

In March 2018, Samsung Electronics accounted for around 20% of KOSPI's market cap and represented the fourth most valuable stock in all of Asia. Thus, when shares of Samsung Electronics suffered a trading halt for 3 days in connection with a stock split, it had a significant effect on the Korean market and investors. Initially, the trading halt had been set to 10 days, but fortunately the length of the halt was shortened to minimize the impact on the liquidity of the market.

ASIFMA's Recommendations: Noting the significant improvement made from an originally planned 10 days of trading suspension, further enhancement of the system to eliminate any trade suspension for corporate actions would be welcomed by global investors, and more consistent with international market practice.

F. Foreign Investor Market Access Infrastructure

1. Account Structure

In the aftermath of the global financial crisis, the industry has developed a greater appreciation for regulators' need to have sufficient transparency at an ID level to properly supervise against market abuse. In Korea, the IRC framework has been complemented by the investor group account (i.e., bulk trading account) regime for listed stocks, which largely works well for the market. Members offer the below recommendations to further enhance the framework:

a) IRC Application

We learnt that the FSS rotation period for the division in charge of issuing foreign investor IDs is 1 year. Due to the frequent personnel changes, members have experienced different regulators in charge, each with different interpretations on how to enforce existing documentary requirements for special IRC applications.

Even though the FSS periodically publishes guidelines on the requirements for obtaining a foreign investor ID, the interpretation and application of the guidelines have in some cases been different by personnel in charge and trending towards a stricter application in recent years. For example, a Certificate of Incorporation (“COI”) now needs to be provided as the identification document for the fund to be registered. Previously, COI alternative documents such as a COR (“Certificate of Residence”) or a screen copy of identity on a regulatory website, etc., were accepted without challenge. Furthermore, if a prescribed COI document is not available, the underlying reasons need to be explained, which is sometimes difficult to procure from the investor. Thus, the FSS should consider relaxing such requirements to be more in line with global standards.

ASIFMA’s Recommendations: The requirement for foreign investors to obtain an IRC prior to participating in the Korean securities market is a well-known and understood practice amongst the foreign investor community. It would be helpful to maintain consistency and flexibility in the requirements for the IRC application process so that new entrants to the market are able to access the market quickly without undue administrative burden. We request that the application of the guidance be consistent and flexible, taking into account the circumstances faced by foreign investors in responding to various documentation requirements.

b) IRC requirements for iCSDs, Global Custodians and Triparty Agents

Although the 2017 adoption of omnibus structure for trading at the local broker level was well received by the industry, it did not solve the post-trade hurdles faced by iCSDs and Global Custodians. To allow iCSDs, Global Custodians and Triparty Agents to offer Internal Settlement of securities positions from offshore between beneficial owner held IRC accounts, fully fledged omnibus structure at the local custodian and KSD will have to be implemented. That would entail removing the IRC registration requirements. To comply with the regulators’ transparency requirements, Global Custodians are open to developing disclosure reporting processes at the beneficial owner or IRC account level.

ASIFMA’s Recommendations: ASIFMA and its members would welcome the opportunity to discuss and share ideas with the Korean regulators on ways to align the regime for holding and settling of transactions in Korean securities by foreign investors to the international securities settlement infrastructure which would make the Korean market more accessible for investment.

c) Account Structure for Use of Korean Securities as Collateral

In response to the global financial crisis, the Basel Committee on Bank Supervision and International Organization of Securities Commissions (“IOSCO”) developed and finalized their



Final Framework on Margin Requirements for Non-Centrally Cleared Derivatives in 2013 (“Uncleared Margin Rules”), which implemented initial and variation margins for OTC derivatives. As cash collateral has become increasingly scarce, participants have focused on the ability to utilize non-cash inventory (e.g., securities and treasuries) to cover their margin obligations. Furthermore, a key characteristic of developed markets around the world is the presence of an efficient repo and securities lending and borrowing (“SLB”) scheme, which are often leveraged by investors to manage their capital requirements.

SLB transactions in Korea are often used to support offshore financing transactions by foreign institutions where Korean securities are posted as loan securities, and such transactions are intermediated by Korean intermediaries. In these transactions, the ability to move Korean securities off-market, with demand being mostly in KTBs, MSBs and listed equities, is necessary due to the requirement to hold the securities under each IRC account under Korean law. Such off-market movement of listed securities is permitted as an exemption when entering into SLB transactions intermediated by a Korean intermediary. However, there is an added complexity of having to move the Korean loan securities between lenders and borrowers across custodians. These types of movements of securities are very expensive and introduce settlement risk, particularly when there is significant flow of these assets. This operational hurdle has limited both support and participation in the Korean market by foreign institutions in using Korean securities for financing purposes through SLB transactions. In other markets, tri-party agents act as agents to facilitate the use of securities assets as collateral. Under this structure, lenders and borrowers can have accounts with one custodian and their securities positions in SLB transactions can move between the lender and borrower under a single omnibus account established in the name of the triparty agent which is also the global custodian for foreign investors. As the movement of the securities is a books and record transfer between the borrower and the lender under the global custodian’s account, this structure has the benefit of reducing transaction costs and settlement risks, leading to increased participation and liquidity in the market.

ASIFMA’s Recommendations: A more detailed review to broaden the scope of application of omnibus account structures would help increase access to the Korean market by foreign institutions and use of KTBs and MSBs as collateral for financing transactions. If global custodians and sub-custodians were allowed to utilize true omnibus accounts (instead of the IRC based segregated accounts), such feature would allow for much greater participation and increase the liquidity for the Korean financial market.

2. Collateral Management

a) Broader Re-use of Korean Securities Collateral

There are largely two ways of posting Korean securities as collateral depending on the type of securities and the transaction type: 1) pledge) or 2) title transfer of collateral by way of securities lending (so called, “*Dambo Daecha*”):



- 1) Pledge (*Jil Kwon*): Previously, the transfer of the collateral to the pledgee in the event of default of the pledgor (off-exchange change in beneficial ownership) had to first be approved by the FSS. We are glad to learn the transfer of securities from a pledgor to the pledgee on an OTC basis upon enforcement of a pledge in connection with a master agreement-based OTC derivatives, securities lending or repo transactions has been allowed with a post-transfer filing to the FSS since an amendment of the rule in Oct 2021. The exception to this relaxation is the few names subject to Foreign Ownership Limits.
- 2) Title Transfer Collateral (*Dambo Daecha*): On the reuse of KTBs and MSBs received as collateral on a title transfer basis ("Title Transfer Collateral"), the market has experienced some practical impediments to broader application of this new regime introduced in 2017. Namely, there is limited reuse of the Title Transfer Collateral permitted under the law. Currently, the law allows for the reuse of Title Transfer Collateral only for the purpose of (i) repo transactions and (ii) posting as collateral to other parties. Even though posting of collateral to third parties is allowed under the law, the KSD operationally does not allow for reposting of the Title Transfer Collateral if it is posted in the form of a pledge whilst reposting in the form of Title Transfer Collateral is permitted. Further impediment to the legally permitted reuse of Title Transfer Collateral is the inability of clients to open more than one Title Transfer Collateral account with an intermediary even though the collateral would be kept under the same IRC. At times the KTBs and MSBs may need to move from different custodians particularly where a tri-party agent is involved thereby necessitating multiple Title Transfer Collateral account under the same IRC. We understand that the limitations stem from (i) ensuring traceability of the movement of the KTBs and MSBs for withholding tax purposes so that the original holder (i.e., the initial lender of the Title Transfer Collateral) is the party that pays the withholding tax (same issue as discussed under "c) Repo and SLB" below) and (ii) the prohibition on foreigners from trading in listed securities off-exchange. As noted in this Paper, due to the globally coordinated requirement for margin posting for OTC derivative transactions under the Uncleared Margin Rules, the ability to post Korean securities as collateral in derivative transactions is important for foreign investors and allowing further flexibility in the reuse of Title Transfer Collateral will increase liquidity in KTBs and MSBs.

ASIFMA's Recommendations: Removing the operational hurdles for holding of securities via an omnibus account structure for the purpose of posting collateral through SLB transactions or as margin would allow much greater liquidity for KTBs and MSBs. Additionally, ASIFMA recommends that the legally and operationally permissible reuse of KTBs and MSBs posted as Title Transfer Collateral be further expanded from the currently permitted scope to give market participants the ability to reuse KTBs and MSBs as collateral more effectively, which will contribute towards enhancing the liquidity of KTBs and MSBs. Limitations in setting up security interest and collateral management are cited as one of the key factors which make active participation in the Korean market difficult for foreign investors. We request that the regulators, the KSD and ASIFMA along with its members discuss ways to promote more active usage of the KTBs and MSBs.



b) Security Interest

The creation of a security interest under Korean Law is well established for parties transacting as principal. However, in the context of utilizing Korean assets as collateral (KTBs, MSBs and listed equities) in the form of a pledge, there are issues when transacting with agent lenders. Typically, agent lenders enter into a master securities lending agreement with a borrower as agent on behalf of all their underlying lenders. In the context of the providing collateral under a GMSLA master agreement, in other developed markets, agent lenders agree to hold the security interest over collateral as a trustee for their beneficial owners. This allows loans and collateral positions to be managed across all beneficial owners efficiently. However, in Korea, the concept of holding a security interest on trust is not recognized under Korean Law (Korea recognizes the concept of a trust, but not a trust over a security interest, with the exception of a security trustee for bond issuances which was created under the Secured Bond Trust Act). As a result, there is no way to perfect a security interest over Korean collateral under the GMSLA master agreement for SLB transactions on behalf of the beneficial owners by agent lenders, which impacts the use of collateral in Korea as agent lenders find it difficult to accept Korean collateral.

ASIFMA's Recommendations: ASIFMA hence recommends recognizing a trust over a security interest or reviewing ways to allow agent lenders to accept security interest on behalf of beneficial owners.

c) Repo and SLB

- 1) **Operation & Tax:** If bonds acquired through a repo or SLB transaction that meets certain conditions under Korean tax law ("Qualified Repo/SLB Transactions") are held (including for pledge purposes) or transferred through a series of Qualified Repo/SLB Transactions, withholding tax on coupons applies only to the initial Repo seller or SLB lender under the Korean tax code. In order to ensure the correct handling of withholding tax, tracking of the transfer of the bonds would be necessary in order to verify that they have been acquired or transferred via Qualified Repo/SLB Transactions.

Based on KSD's customary practices, when a Repo buyer or an SLB borrower receives KTBs or MSBs from a counterparty via a repo or SLB transaction, as applicable, the bonds will be tagged as "non-disposable shares" ("처분제한수량"). In order to reuse these bonds, they need to be retagged as "disposable shares" ("처분가능수량"), via request by phone to KSD.

Once the bonds are retagged as "disposable shares", the KSD will stop tracking the bonds for withholding tax purpose. That means that the transferee of the bonds must pay the withholding tax first and then a request has to be filed with the National Tax Service for a refund. We believe this process is complicated and operationally costly, which discourages market participants from utilizing KTBs or MSBs the same way they would with other developed markets' sovereign bonds.



ASIFMA's Recommendations: Once the National Assembly adopts the Korean government's recently proposed amendment of the tax laws (following a welcome measure that applied a zero tax rate on a temporary basis), foreign investors will be officially exempt from withholding tax on interest income and capital gains tax on KTBs and MSBs. As the above-described issue would be adequately addressed by the exemption of withholding tax, ASIFMA recommends that the Korean government enact and consistently maintain the proposed tax exemption.

- 2) FX hedge: When offshore entities need to do FX swap hedge on the back of KTB/MSB repo transactions or SLB transactions, FX spot transactions can be executed by deliverable KRW, but forward transactions can only be executed by a Non-Deliverable Forward unless the counterparty is a Korean bank because of the FX reporting requirement under the Korean FX regulations. Although this limitation is manageable, the transactions are not so quick and easy to effect as a result.

ASIFMA's Recommendations: ASIFMA recommends that deliverable KRW forward transactions between non-Korean residents be exempt from the above-mentioned FX reporting requirement, which would provide more flexibility to foreign investors that intend to hedge their positions in Korean securities.

3. Client Accounts with the KSD – iCSD Linkage

Accessing domestic markets through an iCSD is often the preferred route for foreign investors. It streamlines the settlement and custody processes and broadens the pool of securities available for financing and margining. Making these processes efficient requires a certain level of standardisation, appropriate account structures and tax regimes. In 2009, Korea exempted foreign investors from withholding tax on interest income and capital gains tax on investments in KTBs and MSBs and allowed iCSDs to operate under omnibus accounts established in the iCSD's name for holdings in KTBs and MSBs by foreign investors. As a result, both iCSDs, i.e., Clearstream and Euroclear, successfully opened links with the Korean bond market. However, following the change in tax policy in 2010 which discontinued the exemption on withholding tax on interest income and capital gains tax on KRW denominated KTBs and MSBs by foreigners, Euroclear suspended its link to the Korean bond market, and Clearstream didn't but its activity became limited. Today, Clearstream only offers segregated account access through custody accounts opened under the foreign investor's IRC through their local custodian. Although it is permissible at the custodian or KSD level for iCSDs to open an omnibus account under the iCSD's name, the omnibus structure is impractical due to various operational requirements as a result of the re-adoption of the withholding tax regime in 2010 and the IRC registration requirements for the underlying investors within the iCSD's books. Indeed, an omnibus account under the name of the iCSD at KSD level is not useable under the current tax regime, making it impractical for KTBs and MSBs to settle offshore on the iCSD's platform ("Internal Settlement"). Internal Settlement is a key component of the iCSD service offering, which permits the underlying investors within the iCSD's books to settle securities "offshore" without having to settle domestically. Internal Settlement may occur during any day or time when the iCSD platform is open for business, thus allowing the investors to settle securities outside of the local market hours. It is important to



note that the overall position that is held by the iCSD within the omnibus account held at local CSD level remains unchanged whenever Internal Settlements are taking place.

As a separate regime, at the custodian level, the SNA (Special Nominee Account) - introduced in Korea in 2017 for foreign investors in listed securities - has to be opened with a local broker where foreign investors can execute trades on an omnibus account level. However, the trade needs to settle on an underlying IRC level basis with local custodians. So at the local custodian side, there is no change from the existing segregated account structure. Therefore, to allow Internal Settlement - the key efficiency feature of the iCSD model – a true omnibus account structure is required meaning no IRC requirement at the underlying investor, beneficial owner level within the iCSD's books.

On the tax side, while the non-exemption of withholding tax and capital gains tax has for many years discouraged foreign investors from participating in the Korean market, the Korean government's recently announced amendment of its tax laws exempting foreign investors from withholding tax on interest income and capital gains tax on KTBs and MSBs would enable iCSDs – subject to having a true omnibus account structure - to operate efficiently as each underlying investor's tax obligation would not need to be tracked.

ASIFMA's Recommendations: We welcome the MOEF's proposal to provide foreign investors exemption from capital gains tax and withholding tax when investing in KTBs and MSBs. We look forward to its adoption by the National Assembly and its continued application as a policy measure. As mentioned in the "Account Structure" section, ASIFMA recommends removing the IRC requirements for the underlying investors of the iCSDs. This will allow – together with the revised tax regime – iCSDs to reactivate their linkages to the Korean market and offer internal (offshore) settlement to international investors.

G. Tax

We acknowledge that the recent changes introduced in Korean tax law, including the reduction of Securities Transactions Tax rates, the Deemed Beneficial Owner rules and the recent announcement to exempt foreigners from taxes on investments in KTBs and MSBs have been positive developments for the Korean market. However, to ensure that tax policy intentions are achieved and to continue opening up the Korean market to foreign investors, we have a number of recommendations detailed below.

a) OIV

Following the implementation of the current Overseas Investment Vehicle ("OIV") regime in 2012, non-public funds investing into Korea were required to provide details of the underlying investors (and to provide updates every time there is a change), while public funds are required to provide the percentages of each investor's residency (every 6 months) in order to obtain tax treaty relief (in both cases, withholding tax rates were applied on a look-through and blended basis). Obtaining this information has been a key barrier inhibiting many OIVs from accessing tax treaty benefits in Korea. OIVs typically use a financial intermediary (e.g., a retail bank or broker) to distribute its investment products, and would not always have access to information on who the underlying investors are, nor be in a position to obtain this information from the financial intermediary. Exchange Traded Funds



(ETFs) in Hong Kong are a good example. For Korean tax purposes, they are OIVs, and would only see the depository as the investor without being able to obtain the details of the underlying investors from the depository. As such, many OIVs have either been unable to obtain the information or have chosen not to obtain the relief.

The OIV regime was recently amended so that OIVs meeting certain conditions (i.e. a corporate type of fund which is entitled to tax exemption or reduced tax rates in respect of Korean source income in accordance with an applicable tax treaty and is liable to tax in its jurisdiction under such tax treaty) would be treated as the beneficial owner of Korea sourced income (through the Deemed Beneficial Owner Rule), and would be eligible to claim tax treaty benefits at the OIV level. It is common for many OIVs to be set up as non-corporate vehicles, such as unit trusts in many Asia Pacific markets including Hong Kong and Singapore. As non-corporate structures, they will not necessarily meet the definition of a Deemed Beneficial Owner and are unable to obtain tax treaty benefits due to the difficulties in providing the percentages of the underlying investor's residency. Although there have been changes in the Deemed Beneficial Owner Rule under the recent amendment, the requirement that the OIV be a foreign corporation for purposes of Korean tax law and the requirement to provide the percentages of the underlying investor's residency have remained the same since the rule was first introduced in 2020. Based on feedback from ASIFMA members, only a small number of OIVs had been able to claim tax treaty benefits since the rule came into effect on 1 January 2020.

ASIFMA's Recommendations: Our members request that for regulated public funds, their vehicles be treated as the Deemed Beneficial Owner without the need to provide any investor information and the Deemed Beneficial Owner Rule should not be limited to OIVs that are foreign corporations under Korean law. This achieves tax neutrality by giving the same tax outcome for different OIV legal entity structures and better aligns Korea with other markets in the Asia Pacific region that provide for withholding tax relief (e.g., Australia, Japan, etc.).

b) Securities Transaction Tax

The Securities Transaction Tax applicable to Korean securities traded on Korea's stock exchanges has a continued and detrimental impact on the Korean securities market. While it is encouraging that the Ministry of Economy and Finance has gradually reduced the Securities Transaction Tax rates since 2019 (from 30 bps to 23 bps for transactions on KOSPI, KOSDAQ, and K-OTC, and from 30 bps to 10 bps for transactions on KONEX), we note that Korea's Securities Transaction Tax remains one of the highest in Asia. Moreover, based on the government's recent announcement, the Securities Transaction Tax (which was previously planned to be further lowered to 15 bps (KOSPI and KOSDAQ) starting in 2023 with the adoption of financial investment income tax regime) will be lowered to 20 bps for 2023 and 2024 and then finally reduced to 15 bps starting in 2025 as such adoption has been postponed to 2025.

ASIFMA's Recommendations: ASIFMA recommends that the Korean government consider a more significant reduction in the Securities Transaction Tax to assist in further growth of the domestic equity market as Korea's Securities Transaction Tax regime remains one of the highest in Asia.



c) Taxes on KRX-listed ETFs

Presently, foreign investors are subject to withholding tax at 22% on the income derived from a transfer or redemption of KRX-listed ETFs with foreign equity constituents - for example, an ETF on the S&P 500. However, a KRX-listed ETF with domestic equity constituents, such as an ETF on the KOSPI 200, is not subject to such withholding tax. This inconsistent application of tax on a specific financial product (ETFs) is unnecessarily complex and is a major disincentive for foreign investment into Korea. Other developed markets throughout Asia Pacific do not have this uneven tax structure, certainly not for ETFs. Further, given the availability of S&P 500 based ETFs listed in other Asia Pacific jurisdictions, on a comparative basis, similar KRX-listed ETFs becomes less competitive as an investment product amongst its peers in the region.

ASIFMA's Recommendations: One of the reasons for exempting foreign investors from taxation on gains from investment in ETFs with Korean equity constituents would be that their direct investment in such underlying Korean listed stocks is also exempt from taxation. Gains from foreign investors' direct investment in foreign equities are not taxed in Korea being non-Korean source income. ASIFMA therefore recommends that the Korean government consider the removal of taxes on ETFs with underlying foreign equity constituents, which will lead to a consistent application of tax between ETFs with foreign equity constituents and those with domestic equity constituents, and place Korea in equal footing amongst its peers in the region for similar products.

H. Other Recommendations

1. Laws Regulating Staffing and Work Hours

Currently, dual hatting for compliance officer and risk management officer positions is allowed for financial investment companies and insurance companies providing that their asset size is below a certain threshold amount under the Act on Corporate Governance of Financial Companies. However, dual hatting is not allowed for branches of global banks regardless of their asset size.

An amendment was made to allow dual hatting for branch offices of global banks whose total asset size is less than KRW 700 billion, if they do not engage in any derivatives sales and trading, but this should be relaxed further.

Additionally, the Amendment to the Labour Standards Act, promulgated on March 20, 2018 (the "Work Hours Reduction Act"), reduces the maximum work hours per week (including holidays) from 68 hours to 52 hours. The industry applauds KOFIA for successfully negotiating exemptions for fund managers and research analysts who experience time periods where significant overtime is required or who may need to participate in late night conference calls with colleagues in other offices.

ASIFMA's Recommendations: ASIFMA welcomes the new administration's intention to allow more flexibility in labour-related issues and recommends further flexibility given the global nature of the financial services industry. Additionally, exemptions should also be applicable to corporate finance staff for similar reasons.

2. Minimum Capital Requirements

When applying for a financial investment business license, applicants must designate the target customer classification. There are two types of target customer classifications for licensing purposes: 1) professional investors only or 2) professional and general investors. Per Appendix 1, the minimum capital requirements for securing a securities and/or derivatives dealing license are extremely high relative to the rest of the region and the rest of the world, and introduces a higher cost of doing business. Although Korean regulators previously announced that they would seek to remove the requirement to classify the two investor types, and would only set the minimum capital requirements at the existing levels for businesses targeting professional investors only, the minimum required capital remains one of the highest in the region and over 13x that of Hong Kong (per Appendix 1). For example, licenses 1-1-2 (full securities dealing) and 1-3-2 (full OTC derivatives dealing) covering only professional investors require approximately USD 17.5 million and USD 31.5 million of capital, respectively.

ASIFMA's Recommendations: ASIFMA welcomes the announcement²² in December 2021 that may have moderately reduced the minimum capital amount. ASIFMA recommends that the barrier for entry into the Korean financial market be further relaxed by reducing the minimum capital requirements to encourage more global participants to secure the required licenses while efficiently managing their costs and allocating their resources, paving the way for more activity and liquidity to enter the Korean market.

3. 24 Hour Proprietary Trading Restriction Post-Research Publication

Korean law imposes a 24-hour proprietary trading restriction upon a research report being finalized for publication, and the restriction is applicable to licensed Korean broker dealers and their affiliates. We understand that this rule was originally drafted based on the Financial Industry Regulatory Authority ("FINRA")'s (now retired) NASD rules 2001-4 (Trading Ahead of Research Reports) in order to prevent proprietary traders from front-running research reports. The rule was amended subsequently and has now become FINRA 5280 (Trading Ahead of Research Reports), which focuses on controlling information between the research and trading divisions by establishing adequate information barriers.

ASIFMA believes that restricting the trading of affiliates involved in the preparation of the research piece for a full trading day is overly restrictive, especially given the stringent information barrier required by current Korean laws and regulations. Although there are exemptions in place for certain types of trading activities, the amount of time and effort required to ensure compliance with the relevant rules is overly onerous.

²² 'Revised Enforcement Decree of FSCMA and Subordinate Rules to Take Effect from December 9', *Financial Services Commission*, 7 Dec 2021.
<https://www.fsc.go.kr/eng/pr010101/77013?srchCtgr=&curPage=&srchKey=sj&srchText=&srchBeginDt=20211201&srchEndDt=20211231>



ASIFMA's Recommendations: ASIFMA recommends that the 24-hour proprietary trading restriction be abolished and to instead refocus the relevant regulation on ensuring that proper information barriers exist between firms' research and trading divisions.

4. Foreign Ownership Limits

Foreign Ownership Limits ("FOLs") can create significant costs for foreign investors. FOLs increase execution risk and any increase in risk raises the threshold for investing in any asset for institutional investors.

ASIFMA's Recommendations: Some countries have adopted mechanisms to minimize the problems caused by FOLs, such as the creation of non-voting shares or depository receipts. Some market participants view the NVDR mechanism in Thailand as an effective mitigant to the challenges around FOL compliance. ASIFMA recommends reviewing the FOL in certain stocks and allowing for greater ease in trading of Korean stocks without having to make exceptions for FOL stocks.

5. Investor Relations

Corporate action announcements are often made only in Korean, making it difficult for foreign investors to get timely and accurate information. While the KRX official website offers the English language option (see footnote 10), a large proportion of the information is in Korean only.

ASIFMA's Recommendations: Providing English language versions of investor relations materials would facilitate the dissemination of company information to foreign investors and would reduce one of the frictional costs of investing in Korea (information on both the English version of the Korea Investor's Network for Disclosure ("KIND") and the FSS's Data Analysis, Retrieval and Transfer ("DART") disclosure system is more limited than the respective Korean versions). Similarly, providing English language versions of reporting templates and websites used for regulatory filings (e.g., net short position report, 5% disclosure report) would facilitate more participation from global investors and their intermediaries.

6. IPO Issues

In relation to equity capital markets, there are opportunities to improve the efficiency and attractiveness of Korea's Initial Public Offering ("IPO") market. Korea's uniquely complex requirements result in operational challenges and unnecessary legal risk for market participants, including intermediaries. Streamlining these requirements, in line with international practice, would help reduce these risks, increase market efficiency and enhance Korea's competitiveness as a destination for investment.

Two examples:

- 1) Korean IPOs with both domestic tranche and international tranche require two underwriting agreements to be executed:
 - i. Firm Commitment Underwriting Agreement ("FCUA") – domestic; and
 - ii. Supplemental Underwriting Agreement ("SUA") – international.



On the one hand, FSS policy requires a final FCUA be attached as an exhibit to the Securities Registration Statement (“SRS”), filed approximately one month before launch); on the other hand, an amended SRS must be filed when the public offering price is determined taking into consideration book-building results as required by KOFIA. To comply with both sets of requirements, the FCUA and SUA are first executed the day before the issuer files the SRS with the FSC with a pricing ‘out’, before then re-executing a revised FCUA and SUA following pricing. Generally, due diligence ‘outs’ are not explicitly accepted by issuers, although it is generally understood that underwriters can be expected to rely on the pricing ‘out’ to walk away before pricing if necessary.

ASIFMA’s Recommendations: The above-described bifurcated process is unnecessary. A single agreement at pricing can reflect the intent of the parties and the underwriter’s contractual obligation, and would be in line with other markets.

- 2) KOFIA’s Regulations on Securities Underwriting Business are relatively complicated. IPOs are required to be allocated based on minimum thresholds for,
- i. 20% to employee stock ownership plans (“ESOPs”),
 - ii. 25% to retail investors,
 - iii. 5% to high-risk / high-yield investment trusts, and
 - iv. remainder to institutional investors (also see a Nov 2020 FSC announcement²³ for the proportions for the public and high-risk high-yield investment trust).

Where a mismatch arises between these specific requirements and actual demand, especially in relation to ESOPs, adherence to the regulations can be a challenge.

ASIFMA’s Recommendations: While reallocation is possible if the SRS filing and the underwriting agreement stipulate that reallocation will occur when demand for any of the groups falls below the prescribed allocation amount, we would recommend KOFIA to consider simplifying the rule to provide greater flexibility to account for actual demand from the outset.

7. Data Privacy

Free movement of data between jurisdictions is one of the preconditions for efficient and mature financial systems. Currently, there is no internationally recognised and agreed framework or standard for classifying different categories of data and regulating the conditions under which data can be transferred between jurisdictions. Hence every country has its own rules for handling data and cross-border data flows. There is no doubt that the clearer and more straightforward and liberal the rules are, the easier it would be for financial institutions to operate internationally and for capital to flow with minimum friction.

The Korean data privacy rules and cross-border data regulations compared with other jurisdictions (such as the EU, Japan, Singapore and HK SAR) have certain characteristics that tend to hinder the business environment from being competitive and are not harmonised with international best

²³ ‘Government to Increase Amount of IPO Shares Available for Retail Investors’, *Financial Services Commission*, 18 Nov 2020. <https://www.fsc.go.kr/eng/pr010101/22538>



practises. For example, certain data privacy compliance obligations (e.g., separate consents, localisation of resident registration number, and excessively detailed privacy policy requirements) are quite unusual compared to other Asia Pacific jurisdictions. For instance, when a financial company enters into a financial transaction with a customer, the collection, use and provision of the related transaction information (“financial transaction information”) are subject to the Act on Real Name Financial Transactions and Confidentiality (“Real Name Act”), and provision of financial transaction information (such as relating to securities transactions) to a third party requires a prior written consent from the client (both individual and corporate clients). While the Real Name Act specifies certain cases where the consent requirement is exempted, providing financial transaction information to HQs, other offshore affiliates or to home regulators is not covered by such exceptions, which makes it difficult for global financial institutions to comply with the reporting and data sharing requirements of their HQs and home regulators.

Moreover, when obtaining explicit consent, the data controller is required to provide the data subject with a notification that must contain an overly onerous level of detail. In particular, data subjects must be notified of the precise identity of each data recipient, as opposed to the typical norm of only having to notify data subjects of the broad categories of data recipients. The same notification in relation to the identity of the recipient is similarly mirrored for a data outsourcing/entrustment scenario, whereby the precise identity of the data recipient (referred to as an ‘outsourcee’) must be posted on the website of the data controller, typically by way of a privacy notice.²⁴

Data controllers are also required to notify data subjects in the event of any personal data breach, regardless of the scale or severity of the breach. There should be a calibrated approach to requiring breach notification based on criteria including the nature, scale, severity of the breach, and the potential risk of serious harm as a result thereof.²⁵

Korea also has data localisation requirements that pose challenge to global firms’ operation and technology deployment globally. Korea requires financial institutions (including Korean subsidiaries of foreign financial institutions) to localise data processing systems in the case of processing unique identification information or personal credit information through cloud computing services, which restricts global financial institutions’ ability to leverage global firmwide technology and cloud arrangements.

ASIFMA’s Recommendations: There will often be cases where foreign financial institutions need to provide clients’ financial transaction information to HQs, other offshore affiliates or home regulators. We recommend that the consent requirement be eased for such cases. If the exceptions cannot be broadened to explicitly cover such cases, the relevant regulations could permit provision of such information by providing notice to clients instead of obtaining consent.

We also recommend that, in line with global best practises, Korea (i) consider requiring a more reasonable level of detail of data recipients to be provided to data subjects in connection with data transfer to third parties or outsourcing of data processing (e.g., broad categories of data recipients

²⁴ Article 17(2) PIPA, Article 26(2) PIPA + Article 28(2) of the PIPA Enforcement Decree

²⁵ Article 34 of PIPA



instead of precise identity), (ii) consider requiring notification of personal data breach to data subjects in accordance with reasonable criteria (e.g., upon meeting certain thresholds in terms of nature, scale and severity instead of for all cases), and (iii) reconsider the requirement for onshore data processing system and cloud computing services where appropriate and allow financial institutions to leverage firmwide cloud arrangements.

Appendix 1

Minimum Capital Requirements (See [Section H.2](#))

Jurisdiction	License type	Minimum/Base capital requirement
Korea	Type 1-1 full securities dealing	KRW 50 billion (~USD 35 million) to cover all types of investors; Half of the above amount to cover only professional investors
	Type 1-3 Full OTC derivatives dealing	KRW 90 billion (~USD 63 million) to cover all types of investors Half of the above amount to cover only professional investors
Japan	Type-I financial instruments business, (incl. OTC derivatives business)	JPY 50 million (~USD 340,000)
Hong Kong	Type 1 dealing in securities	Depending on level of activities, up to HKD 10,000,000 (~USD 1.3 million)
Singapore	Dealing in capital markets products that are securities, units in a collective investment scheme or exchange-traded derivatives contracts	Depending on license applicant's status, up to SGD 5 million (~USD 3.5 million)
	Dealing in capital markets products that are OTC derivatives contracts	Depending on license applicant's status, up to SGD 5 million (~USD 3.5 million)



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