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Press Release

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PLAN FOR IMPROVED DISCRETIONARY INVESTMENT SERVICES

BACKGROUND

Since 2010, with socio-economic changes such as the aging population and low-interest rate trends, there has been growing demand for "discretionary investment services," or customized services in asset management.

[Trends in contract volume for discretionary investment services]

(Unit: trillion won, %)

	2008	2009	2010	2011.6
Asset management firms	145.0	158.9	186.4	207.1
Securities firms	9.9	8.4	35.6	45.9
Investment advisory firms	9.5	9.5	12.7	14.8
Total (year-on-year increase)	**164.4**	**176.8** (7.5)	**234.7** (32.7)	**267.8** (14.1)

The growth in demand for discretionary investment services appears to be driven by investors seeking for alternative investments as investors' sentiment about fund investment was dampened and interest rates have been kept low since the global financial crisis.

In particular, advisory wrap accounts have shown a significant increase in contract volumes.

*Contract volumes (trillion won): 1.1 (April 2010)→5.2 (Dec. 2010) → 9.1 (June 2011)

Despite such growth in size, discretionary investment services still fall short of expectations in terms of providing customized services and investor protection.

① **(Regulatory arbitrage)** The reason discretionary investment service providers are given greater autonomy* in their operations is because of the assumption that they provide customized one-on-one services; however, they are only required to meet the same level of "know-your-client" (KYC) requirements with other regular financial investment products.

*Discretionary investment services are not subject to the 10% portfolio investment rule applied to mutual funds.

② **(Collective management)** There is a controversy about collective management as some wrap accounts are managed under one model portfolio and perceived as just a short-term investment product rather than a customized asset allocation service.

③ **(Investor protection)** As discretionary investment services mostly just employ short-term equity investment strategies focused on a few number of stocks, there is a need for investor protection against increased market volatility.

Against this backdrop, the FSC has come up with a plan for further improvements in discretionary investment services as one of mid-and-long term asset management services.

KEY CONTENTS

I. Strengthened requirements for customized services

1. **("Know-your-client" requirement)** Discretionary investment services will be subject to stricter KYC requirement than other regular financial investment products in general in order to provide customized services.

*(general financial investment products) investment purpose, investment experience, customers' financial status (additional requirements for discretionary investment services) customers' age, risk-taking capability, income, financial assets, etc.

Based on the collected KYC information, discretionary investment service providers will be required to classify their clients into at least five different categories.

<Example> Investor profile classification

Considering (i) investors' investment tendencies (subjective factors) and (ii) risk-absorbing capabilities (objective factors e.g. investment period), investors will be classified into five categories: passive, risk-adverse, risk-neutral, active, and aggressive.

Classification		Risk-absorbing capabilities (e.g. investment period)				
		Short-term	Short-to-mid	Mid-	Mid-to-long	Long-term
Investment tendencies	Class1 (high-risk)	Risk-neutral	Aggressive	Aggressive	Aggressive	Aggressive
	Class 2	Risk-neutral	Active	Active	Aggressive	Aggressive
	Class 3	Risk-averse	Risk-neutral	Active	Active	Active
	Class 4	Risk-averse	Risk-averse	Risk-neutral	Risk-neutral	Risk-neutral
	Class 5 (low-risk)	Passive	Risk-averse	Risk-averse	Risk-neutral	Risk-neutral

2. **(Criteria for asset allocation)** With a variety of financial products such as equities, bonds, funds and ELS, asset allocation groups will be created for each type of investors. Within the same group of asset allocation, there should be at least two subgroups.

<Example> Investor types – Asset Allocation Matching

Asset class \ Investor type	Aggressive	Active	Risk-neutral	Risk-averse	Passive
Group 1 (equities)	Stock 1	Stock 3			
	Stock 2	Stock 4			
Group 2 (bonds)	Corporate bonds with speculative grades, equity-linked bonds etc.		⇄	Corporate bonds with investment grades, gov't bonds	
Group 3 (funds)	Equity-type funds		⇄	Gov't bond funds, MMF	
Group 4 (hybrid assets)	Equities, derivatives, corporate bonds with speculative grades, equity-linked bonds		⇄	Gov't bonds, MMF, principal guaranteed ELS	

3. **(Restriction on improper contracts)** Discretionary investment service providers will be restricted from signing contracts with clients that do not meet their investor profile.

4. **(Risk notification and enhanced explanations for clients)** Discretionary investment service providers will be required to provide sufficient explanation on risks involved in discretionary investment such as greater volatility stemming from the absence of investment diversification rules and possible intervention by investors in asset management.

II. Best practice guidelines on management of advisory wrap accounts

1. **(Information control)** As real-time flows of data on advisory wrap account operations cause preceding or mirroring trades, it should be stated on the contract that information availability might be restricted for a certain period of time with the consent from investors to prevent such trading activity.

2. **(Management fees & contingent pay)** Discretionary investment service fees should be indicated in annual rates, and service providers are required to provide investors with detailed information about other fees such as early termination charges. They are also required to set criteria for contingent pay, which should be stated on a contract and informed to investors.

3. **(Management of investment advisory firms)** Discretionary investment service providers are required to set evaluation criteria in selecting advisory firms and banned from paying contingent pays to advisory firms.

4. **(Internal risk management)** Discretionary investment service providers should have risk management standards in operating advisory wrap accounts. They are also required to set principles in regard with conflicts of interest among investors and preventing contingent payment.

FUTURE PLAN

Strengthened requirements for customized services will be enforced through the revision of *Korea Investment Association's Rules on Standard Practice in Investment Advice* along with the enforcement of *Regulations on Financial Investment Business* (scheduled for January, 2012).
Best practice guidelines on management of advisory wrap accounts will be enforced in early November.

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