Financial Services Commission

# Press Release

May 27, 2022

## GOVERNMENT APPROVES REVISION BILL TO FSCMA FOR INTRODUCING BUSINESS DEVELOPMENT COMPANIES

The government approved the revision proposal for the Financial Investment Services and Capital Markets Act (FSCMA) during a cabinet meeting held on May 26. The revision proposal introduces business development companies (BDCs), a new form of venture capital investment vehicle focused on investing in startups and innovative companies and which offer more cashability as they are listed on an exchange. BDCs will be required to invest at least a certain portion (e.g. 60%) of funds' assets to startups and innovative companies and will be operated as closed-end funds, which will help companies to raise funds stably for a longer period of time. In addition, to allow investors to more easily liquidate their investment, BDCs will be operated as exchange-listed to enhance their cashability.

The government expects that the introduction of BDCs will help (a) provide a more stable way of raising funds for early-stage businesses while providing retail investors an opportunity to diversify their investment into startups and innovative companies using an already established investment mechanism, (b) increase vitality in the economy by utilizing abundant market liquidity as venture capital and (c) promote sound investment practices on non-listed companies as BDCs will be operated by professional entities and will come under the purview of the FSCMA's regulatory framework.

### BACKGROUND

On May 26, 2022, the government approved the revision proposal for the FSCMA at a cabinet meeting with a goal of introducing business development companies, a new form of investment vehicle focused on investing in startups and innovative companies before they become listed on a major exchange.

### KEY DETAILS

**(BASIC DIRECTION)** As a new form of investment vehicle, BDCs will be introduced in a way that incorporates the advantages offered by both publicly offered funds and private funds—application of an economy of scale and investor protection mechanisms offered by publicly offered funds and utilization of flexible management strategies offered by private funds—to provide capital to non-listed startups and innovative companies.

**(CORE ELEMENTS)** BDCs will be structured in a way that incorporates the advantages of both publicly offered funds and private funds throughout all stages from licensing to fund structuring to management to recovery.

- **(LICENSING)** Through a licensing system, BDCs will be managed by entities that can ensure capability and responsibility.

<Licensing Direction: Revision to Enforcement Decree Necessary>

- **(ENTITIES SUBJECT FOR LICENSING)** Asset management companies, venture capital companies, etc.
- **(REQUIREMENTS)** Should have equity capital above a certain level and professional personnel who are experts in securities management
- **(CONFLICT OF INTEREST PREVENTION SYSTEM)** Application of relaxed measures for certain areas (e.g. corporate finance) but the current conflict of interest prevention requirement to be applied generally.
- **(LARGE SHAREHOLDER REQUIREMENT)** Application of eased standards on large shareholders relative to those applied to financial investment businesses for granting a new license to facilitate the entry of entities that are especially qualified for investing in innovative companies on a continuing basis.

→ Concrete details of revisions of subordinate law such as the Enforcement Decree to be communicated to markets on a continuing basis.

- **(FUND STRUCTURE)** BDCs will be structured as closed-end funds (redemption restricted) for a term of at least five years to allow formation of "patient venture capital." In addition, through a revision to the Enforcement Decree of the FSCMA, the authorities plan to set a minimum capital pool (e.g. KRW30 billion) later on to enable formation of sizable and effective venture capital.

- **(FUND MANAGEMENT)** While allowing flexibility in investment strategies, the authorities will put in place mechanisms to ensure stability in asset management considering BDCs' attributes of publicly offered funds. With borrowing and lending made available through BDCs, the scope of support extended to invested companies will be expanded and capital supply tailored to the needs of invested companies will be made possible.[1] In addition, the authorities will also put in place mechanisms aimed at ensuring stability in asset management through a requirement on investing in safe assets[2] and an application of investment limit on the same company.

<Comparison of Regulation on Fund Management by Type>

| Type | Publicly offered fund | BDC | Private fund |
|---|---|---|---|
| Borrowing | Not allowed | Allowed (within 100% of maximum net asset*) | Allowed (within 400% of net asset) |
| Lending | Not allowed | Allowed | Allowed |
| Investment Limit on the same company | Within 10% of total assets Within 10% of total equity stocks | Within 20% of total assets Within 50% of total equity stocks | N/A |
| Requirement for safe asset investment | N/A | Within 10% of total assets | N/A |

* Specific limit to be determined in the revision to the Enforcement Decree.

- **(RECOVERY)** To help remove early investors' difficulty in recovering funds due to the long-term restriction on redemption, BDCs will be required to list on the Korea Exchange (KRX) within 90 days. As a result, even though BDCs are structured as

[1] Some innovative companies prefer loans over equity investment where equity dilution occurs.
[2] Duty to invest at least 10% of BDC's total assets in safe assets such as government bonds and monetary stabilization bonds.

closed-end funds, investment recovery will be possible for investors wishing to recover their funds during the investment term by selling stocks at the KRX.

- **(INVESTOR PROTECTION)** While applying investor safeguards placed on publicly offered funds such as the periodic and continuous disclosure requirements, the authorities will work to strengthen investor protections by establishing a seed funding requirement[3] and expanding the scope of disclosures (core business management issues of an invested company, etc.). In the process of revising the subordinate law, the authorities will consider other areas necessary for investor protections and incorporate them into the revision.

## DISTINCTIONS FROM EXISTING TYPES OF VENTURE CAPITAL INVESTMENT VEHICLES

There are various types of investment vehicles for startups and innovative companies which have made significant contributions to creating a venture capital ecosystem. However, each venture capital investment vehicle has certain restrictions. Business financing offered through government-sponsored financial institutions or venture capital is often supported by the government's fiscal resources and provides relatively small amount of funding for mostly early-stage startups. Publicly offered funds offering fund redemptions at a regular interval remain rather passive in making investment in non-listed companies. Participation in the previously categorized private equity funds (PEFs) for institutional investors that had strong attributes of venture capital (with management control, etc.) had been restricted to retail investors. Also, in all of the above investment schemes, investment is often tied-up for a certain period of time (e.g. 5 years), making it difficult for retail investors to readily invest in them.

In this regard, BDCs being introduced through the revised FSCMA are different in the following three aspects—(a) source and size of investment, (b) investment target and (c) access to retail investors.

**(SOURCE AND SIZE OF INVESTMENT)** The sources of funding for BDCs will be entirely private capital and an economy of scale is possible through large scale fundraising via public offering.

**(INVESTMENT TARGET)** BDCs will invest in businesses in wide-ranging stages from early-stage startups to businesses undergoing restructuring and even scaleups and can contribute to fostering unicorn companies.

**(ACCESS TO RETAIL INVESTORS)** Access for retail investors to invest in startups and innovative companies will be enhanced as BDCs are listed and traded on an exchange, offering more cashability to those that tended to avoid investing due to a long-term tie-up of investment funds.

[3] BDC fund manager should hold a certain share of securities (e.g. 5% or more) on a BDC managed by its own for a certain period of time (e.g. 5 years).

## EXPECTATION

The government expects that the revised rules will help channel abundant market liquidity to productive sectors and promote sound investment practices by matching the financing needs of startups and innovative companies with the retail investors' demand for investing in them. First, startups and innovative companies are able to secure stable financing which provides them with an opportunity to finance a considerable amount of money for their business over a long term. Second, ordinary investors will have the opportunity to diversify their investment by investing in startups and innovative companies through an already established investment mechanism within the system. Third, as abundant market liquidity will be utilized for venture capital, the revised rules are expected to bring more vitality to the economy. Fourth, the revised rules will help promote sound investment practices on non-listed companies as BDCs will be operated by professional entities and will come under the purview of the FSCMA's regulatory system.[4]

## FURTHER PLAN

The revision proposal for the FSCMA that has been approved at the cabinet meeting today will be submitted to the National Assembly in May or early June this year. The government will closely cooperate with the National Assembly to ensure a prompt approval and passage by the National Assembly. In addition, the FSC will seek consultation with relevant institutions and market participants right away to draw up further details through a revision to the subordinate law in the second half of this year.

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For press inquiry, please contact Foreign Media Relations at fsc_media@korea.kr.

[4] Satisfying retail investors' investment demand for venture capital by channeling their demand for making direct investment in non-listed companies toward portfolio investment via professional investment management entities, enforcement of investor protection mechanisms prescribed under the FSCMA, etc.