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Press Release

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New Measures Proposed to Advance the Bond Market

The Financial Supervisory Commission announced a set of proposals aimed at advancing the bond market on December 14. The new proposals are the work of a joint public-private task force created in February this year to recommend improvement in four key areas—corporate bond underwriting, market liquidity, trading of repurchase agreements, and disclosure—and help raise the transparency and efficiency of the bond market.¹ The legal and regulatory amendments needed for the changes proposed by the task force are expected to be completed by June, 2007.

Bond Market Trend

Since the financial crisis, the bond market has shown a steady growth with the total issue amount and the trading volume increasing more than two-fold and five-fold, respectively, since 1998. Recently, however, corporate debt-financing has been declining amid falling capital demand for corporate investment and investors showing preference for cash accumulation.

Bond Market Trends: 1998-2006

		(In trillions of won)								
		1998	1999	2000	2001	2002	2003	2004	2005	Nov. 2006
Issue Amount	Total	334	364	423	505	564	608	662	722	773
	Corporate	119	111	128	141	141	136	116	107	100
	Percent	35.6	30.5	30.3	27.9	25.0	22.4	17.5	14.8	12.9
Trading Volume	Total	343	733	726	1,378	1,124	1,443	1,792	1,829	1,514
	Corporate	191	219	136	131	112	89	70	58	42
	Percent	55.7	29.9	18.7	9.5	10.0	6.2	3.9	3.2	2.8

Corporate Bond Underwriting by Securities Companies

As a result of weak capital demand and the growth of privately placed issues, the market for corporate bond underwriting has been shrinking, putting a downward pressure on profits securities firms generate from underwriting.

¹ The task force comprised regulators, industry experts and representatives from the FSC/FSS, Korea Exchange, Korea Securities Dealers Association, Korea Securities Depository, Korea Securities Research Institute, Korea Fixed Income Research Institute, credit rating companies, securities firms, and institutional investors.



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Securities firms authorized to underwrite bond issues numbered 45, 31 of which took part in an actual bond underwriting. Fees generated from underwriting averaged KRW3 billion for each securities firm in 2005.

Because local securities firms compete more on underwriting fees than on funding ability, risk analysis, raising interest among investors, and other critical underwriting capabilities, they have thus far failed to build the kinds of reputation that investors generally expect. Local securities firms are also continually exposed to legal risks for inadequate attention to investor protection, e.g., poorly administered due diligence and faulty prospectus.

Task Force Proposal

As a way to discourage unhealthy competition and improve the overall caliber of corporate bond underwriting, the task force proposes limiting the pool of lead managers to *specialized bond dealers* fully capable of taking on underwriting risks; other securities firms may continue to participate in underwriting an issue together with the lead manager.² Securities firms that arrange due diligence and meetings with prospective investors during the underwriting process are to receive more favorable considerations in performance review of the specialized bond dealers.

The task force also suggests looking into FSC/FSS securities issuance fee structure on a mid- to long-term timeframe with a view to reducing cost on both the issuers and the underwriters.

Improving Market Liquidity

Approximately 80% of bond trading currently takes place off-exchange by securities firms acting as brokers using a variety of online messenger programs (e.g., MSN, Yahoo) to process and execute orders. The task force found that the prevailing practice fragments market liquidity, limits trading information available to the market, and restricts the pool of potential buyers and sellers.

Exchange and Off-Exchange Bond Trading

	(In trillions of won)				
	2002	2003	2004	2005	Nov. 2006
Exchange-trading	47.9	212.6	377.5	365.4	280.0
Off-exchange trading	1,076.2	1,230.0	1,414.3	1,462.8	1,234.4
Total	1,124.1	1,442.6	1,791.8	1,828.1	1,514.4
Proportion of off-exchange trading	95.7%	85.3%	78.9%	80.0%	81.5%

² Specialized bond dealers refer to financial institutions authorized by the Financial Supervisory Service to engage in market-making as provided for under Article 5-30 of Regulation on Supervision of Securities Business. Currently, there are 13 securities firms and 7 banks authorized to act as specialized bond dealers.



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Task Force Proposal

The off-exchange bids and offers that are currently scattered among different securities firms should be centralized under Korea Securities Dealers Association (KSDA) to improve the transparency and liquidity of off-exchange bond trading. Pricing information centralized under KSDA should be disclosed via the KSDA or the member electronic networks. The execution and settlement of trading, however, is to continue individually as before.

Repurchase Agreement Transactions

In 2005, the market for repurchase agreements (RPs) reached approximately KRW44 trillion, about 21% of the money markets. On the other hand, the outstanding balance from RP trading among financial institutions came to about KRW2.6 trillion. In part, the task force attributes the limited trading of RPs among financial institutions to regulations that restrict the types of securities and financial institutions eligible for RP trading. Trading restrictions on MMF and other investment funds are also said to be a contributing factor.

Task Force Proposal

The task force recommends repealing regulatory provisions restricting the types of securities eligible for RP trading so that all the recognized securities (e.g., commercial papers, beneficiary certificates, and stocks) can be utilized in RP transactions. Expanding the types of entities eligible for RP trading is also recommended. For MMF and other investment funds, the task force sees a need to consider relaxing the existing investment restrictions in the future.

Strengthening Prompt Disclosure on Exchange-Listed Issuers

Currently, the Stock Market Disclosure Regulation that Korea Exchange (KRX) enforces provides for prompt disclosure only for companies whose shares are listed at the exchange. The task force found that the KRX disclosure rules give bond investors inadequate protection from companies that list only debt on the exchange. (Of the 248 exchange-listed debt issuers, 74 were debt-only companies)

Task Force Proposal

The task force proposes that debt-related disclosures be made mandatory for exchange-listed issuers to improve transparency and investor protection. Debt-related disclosures are to include default on notes and other debt obligations, suspension of bank accounts, stock and debt transactions, and other events that may have material effect on the valuation of exchange-listed debt securities.



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Expected Benefits of the Task Force Proposals

The task force expects the proposed changes to facilitate more transparent and more efficient bond trading. By providing more reliable pricing information to buyers and sellers, the proposed changes are also expected to reduce information asymmetry in the bond market and improve conditions for debt underwriting for securities firms. The market infrastructure for the debt market is likely to improve as well with a more centralized debt-pricing information system, and investors will benefit from more stringent disclosure standards for exchange-listed debt issuers.

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