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## Press Release

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July 26, 2011

### REVISION BILL OF THE FINANCIAL INVESTMENT SERVICES AND CAPITAL MARKETS ACT

#### **BACKGROUND**

*The Financial Investment Services and Capital Markets Act* (“FSCMA”) was established in 2007 as a comprehensive overhaul of capital markets regulations in order to promote autonomy and innovation in capital markets.

Since the FSCMA took effect in February 2009, however, we had to weather the impacts of the global financial crisis. As a result, we still fell short of bringing about innovative changes that we initially intended with the enactment of the FSCMA such as creation of globally competitive investment banks (IBs).

Meanwhile, after the financial crisis, global discussions on strengthening financial regulations and global coordination have been underway; and now is the time for us to domestically carry out what we have discussed at the global level.

Against this backdrop, we see this is the right time to lay the foundation for the future of Korea’s financial industry, while coping with current global and domestic financial issues (e.g. Europe’s fiscal crisis, Korea’s household debts).

The FSC has drafted a revision bill of the FSCMA, made public for 20 days from July 27 to August 16.

#### **KEY REVISIONS TO THE FSCMA**

##### **I. Development of Korean IBs**

For the development of home-grown investment banks capable of financing new growth industries and large overseas projects,

1. Securities companies that meet certain statutory requirements such as equity capital and risk\* management capability will be qualified as investment banks (or “comprehensive financial investment services providers”).



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\*Given that securities companies can start prime brokerage services just with a revision of the FSCMA Enforcement Decree, the minimum amount of equity capital for a security firm to provide investment banking services will be set at 3 trillion won, which could be further raised later depending on developments after the revision of the FSCMA.

2. The revision bill has regulations on corporate lending, internalization of order execution in place in order to help IBs provide a comprehensive set of corporate financing services.
3. When IBs provide prime brokerage services, they will be allowed to provide credit to hedge funds for investments other than securities.
4. Reflecting risks involved in investment banking businesses, the Basel capital adequacy requirements will be applied to securities firms in addition to net capital ratio (NCR) regulations.

## **II. Improvement of Asset Management Regulations**

In preparation for an aging society with low-birth rates, the bill is aimed to further develop asset management businesses so that they can provide investors with stable and profitable investment products.

1. Asset management companies will be required to exercise their voting rights as shareholders in fund assets in accordance with investors' interests; and in order to promote mergers between small funds, procedures for merger will be simplified without undermining investors' rights.
2. With longer life expectancy, there is a growing need for customized investment services for more diversified financial assets. In order to help asset management companies meet these demands, ① a clear distinction will be made between collective investment business and discretionary investment services; ② regulations on trust business will be revised; and ③ some regulations on fund operations will be eased.

## **III. Reform of Capital Markets Infrastructure**

1. A license system will be introduced to allow new stock exchanges or an alternative trading system (ATS). Financial investment business providers will be able to operate an ATS with an approval from the FSC. If trading volume through an ATS exceeds a certain threshold, the ATS operator will be able to ask for a permission to become a stock exchange, which is additionally required to carry out self-regulatory functions in listing and market supervision.
2. The proposed revision creates a new category of "clearing business for financial investment transactions" and lays a legal foundation for establishing a central counter party (CCP). By introducing a license system for a clearing business provider, it aims to provide clearing services for a variety of products (e.g. OTC derivatives, securities lending, RPs).



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For OTC derivatives transactions that can significantly affect markets if defaulted, they will be mandatorily required to be cleared through clearing houses.

3. Regulations on credit rating business, currently under the Credit Information Act, will be governed under the FSCMA, given that credit rating business has an important role in bond markets. In addition, the revision will expand the business scope of credit rating companies, while strengthening their responsibility for investor protection and public disclosure requirements.

#### **IV. Diversification of Direct Financing Channels**

In order to diversify listed companies' funding tools while preventing them from abusing such tools, and help general meetings of shareholders properly function,

1. Listed companies will be allowed to issue contingent securities and warrants in addition to "securities" currently allowed under the Commercial Act. However, in order to support sound market practices, the purpose of issuing warrants and issue price will be limited, and the issuance of separable BW will be restricted.
2. Companies will be required to follow due process in dealing with forfeited shares. When issuing shares at a discount, companies will be mandatorily required to issue pre-emptive rights certificate.
3. The "shadow voting" system, in which the Korea Securities Depository (KSD) exercises proxy voting rights, will be abolished in 2015, and regulations on the granting of a Power of Attorney will be amended to help general meetings of companies' shareholders properly function.

#### **V. Strengthened Regulations on Unfair Trading Practices**

In order to prevent overseas IBs or hedge funds from exploiting regulatory arbitrage from Korea's relatively lax regulations, regulations on unfair market practices such as price manipulation will be strengthened.

Price manipulation using unlisted securities (e.g. ELS) or OTC derivatives will be punished with criminal charges if underlying assets of such products are listed securities. Acts of market abuse such as scalping will be subject to administrative sanctions. Fines will be imposed on a broader range of market abusive acts in order to sanction such acts in a prompt manner, while fully protecting the procedural rights of those under investigation.

For stronger investor protection, securities firms will be required to take more responsibility in providing underwriting/brokerage services; and companies will face stricter requirements for public disclosure in large-scale funding, for example, by issuing warrants.



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## **EXPECTED OUTCOME**

### **(For Korea's financial industry)**

The revision is expected to help grow home-grown IBs that can compete with global IBs in terms of funding capacity and reputation. Financial investment companies will be able to offer a total package of corporate financing services such as finding out and financing start-up companies with growth potential, providing M&A advisory services, not just brokerage services. The growth of the PEF market and prime brokerage services will be followed by the development of a pool of financial experts and back office services.

### **(For the financial market infrastructure)**

More competition, brought into the market with the revision, will strengthen the competitiveness of the KRX and help us lead the development of Asian capital markets, faced with a global trend of mergers among stock exchanges across the globe.

The introduction of CCPs will reduce default risks of OTC derivatives transactions and help meet growing demands for clearing business as RP trading and securities lending increase.

### **(For companies)**

The development of mezzanine finance is expected to provide more efficient and diverse financing methods to small-and-medium sized companies and new growth industries. As general meetings of shareholders play a proper role, Korean companies will be managed in a more transparent and efficient manner.

### **(For investors)**

More innovative and customized financial products will be provided to meet a variety of investment demands, broadening investors' options.

Strengthened regulations on unfair trading practices will enhance the credibility of Korean capital markets among investors and eliminate regulatory arbitrage between domestic and overseas markets.

Lee, J. Ernst  
Spokesperson, Foreign Media  
Foreign Press & Relations Office  
Financial Services Commission

Tel: +82-2-2156-9582  
Fax: +82-2-2156-9589  
E-mail: [happyhero@korea.kr](mailto:happyhero@korea.kr)