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## Press Release

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June 14, 2013

### REVISION TO ENFORCEMENT DECREE OF THE FINANCIAL INVESTMENT SERVICES AND CAPITAL MARKETS ACT (FSCMA)

#### BACKGROUND

The revised Financial Investment Services and Capital Markets Act (FSCMA) was promulgated in May 28, 2013<sup>1</sup>, which includes vitalizing investment banking (IB) business, introducing alternative trading systems (ATSS), and amending the current regulatory framework of asset management businesses.

In line with the revision to the FSCMA, the FSC plans to revise the Enforcement Decree of the FSCMA to stipulate specific terms on matters delegated by the Act and further improve the current capital markets system.

#### KEY CONTENTS

##### 1. Stimulate investment banking (IB) business

**(Requirements to be registered as an IB)** A securities firm will be required to hold equity capital worth KRW 3 trillion or more and have the mechanism of risk management and internal control.

**(Prime brokerage service<sup>2</sup>)** The scope of customers with whom IBs can provide prime brokerage service will be expanded to financial companies, pension funds, overseas hedge funds as well as Korea-based hedge funds stipulated in the revised Act.

**(Credit extension for companies)** The Enforcement decree specifies the scope of credit extension that IBs can provide companies as loans, payment guarantee, and bill discount. It also details types of credit extension<sup>3</sup> exempted from the rule which limits a total amount of credit extension by an IB not to exceed its equity capital.

##### 2. Improve capital market infrastructure

**(Introduction of ATS)** To be registered as an ATS, a securities firm will be required to hold equity capital worth KRW 20 billion or more. The Enforcement Decree specifies types of products that can be traded through ATSS as stock certificates and depository receipts (DR).

ATSS will be subject to the same rules applied to exchanges in regard with measures on

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<sup>1</sup> The revised Act is scheduled to be enforced from August 29, 2013 in three months since its promulgation.

<sup>2</sup> Prime brokerage service is a package of service that IBs offer hedge funds such as asset management & custody service, credit extension, and advisory service.

<sup>3</sup> Some types of loans with a limited impact on the soundness of IBs, e.g. loans using funds raised by the third party through collateral of hedge funds, bridge loans linked to M&A brokerage service, guaranteed loans, etc.

market surveillance and market stabilization such as daily price limit or trading halt, while it will be granted greater autonomy and flexibility in regard with trading business<sup>4</sup>.

Securities firms, however, can execute customers' orders as customers want if there were specific direction from customers.

**(Strengthened requirements to be authorized as exchanges)** Exchanges will be required to meet strengthened requirements to prevent conflicts of interests that may arise as exchanges will be monitoring and liquidating ATSS such as stricter internal control standards and information barriers (or 'Chinese walls' ) between concerned divisions.

**(Regulations on credit rating agencies)** The Enforcement Decree sets rules on business practices by credit rating agencies to ensure fairness and independence of credit rating business and protect investors.<sup>5</sup>

### 3. Revision to regulations on asset management business

**(Real estate investment advisory service)** Investment advisory companies and discretionary investment companies will be allowed to invest in real estate in addition to financial investment products.

Investment advisory companies and discretionary investment companies will be required to establish a separate company<sup>6</sup> on an add-on basis to invest in real estate properties.

**(Regulations on fund of funds)** Regulations on a domestic fund to make a 100% investment in overseas fund will be eased.

(Before revision) Overseas fund that makes more than 90% of investment in foreign currency assets

(After revision) Overseas fund that makes more than 70% of investment in foreign currency assets

**(Decertification of asset management firm)** Before the revision, an asset management firm which has not been in operation for six months since acquisition of certification was subject to decertification. The Enforcement Decree further specifies the provision that a company subject to decertification as a company which has not had any assets under management for six months (one year for real estate management firm and specialized asset management firm) since acquisition of certification.

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<sup>4</sup> Trading size, minimum quotation size, trading hours, anonymous block trading

<sup>5</sup> Information exchanges between credit rating agencies, receipt of unfair financial benefits in regard with credit evaluation, credit evaluation in exchange for providing other products or services will be all regulated as 'unfair business practices'.

<sup>6</sup> Minimum equity capital for real estate investment consulting company and discretionary investment company (general investor / professional investor)  
- Real estate investment consulting company (KRW 300mil / KRW 150mil)  
- Real estate discretionary investment company (KRW 1.2bn / KRW 600mil)

**(Improved flexibility in operating PEF)** PEF with a right to participate in management may invest in financial products under the following conditions;

- in case a PEF is capable of acquiring share of 10% through exercising management rights guaranteed by stocks and mezzanine securities (CB, BW) it holds, or
- in case a PEF is capable of exercising de facto control over the company such as appointing board members in accordance with investment agreements.

The Enforcement Decree states minimum requirements of PEF general partners (KRW 100mil equity capital, 1 manager).

#### 4. Grant listed companies more flexibility in their financial management

**(Improved method of estimating value of corporate mergers)** The Enforcement Decree strengthens the role of independent evaluation agencies in evaluating value of mergers, while it allows companies more flexibility in estimating the value of mergers.

Listed companies will be allowed to flexibly estimate the value of mergers within certain ranges, while they were previously required to fix the estimate.<sup>7</sup>

**(Introduction of contingent capital<sup>8</sup>)** The Enforcement Decree sets details on certain conditions for debt to be converted into equity and the timing that the conversion comes into effect.

Conditions<sup>9</sup> to be met for conversion should be publicly announced through securities market. The conversion will go into effect in two business days (T+2) since the trigger event occurred.

In order to protect investors, securities firms will be required to include the reasons that debt are converted into equity in their reports, and strengthened regulations will be applied when securities firms sell their customers contingent capital.

#### 5. Improved effectiveness of regulations on underwriting, disclosure, and unfair transaction

**(Reporting of portion of shares held by an executive or major shareholder)** The Enforcement Decree specifies conditions under which a financial investment firm is exempt from reporting the portion of shares held by its executive or major shareholder in accordance with Presidential Decree.

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<sup>7</sup> (Before revision) MIN [ (a weighted average of stock prices for a month, a week, and the most recent day), stock price on the most recent day] → (Revised) (a weighted average of stock prices for a month, a week, and the most recent day ± 10%

<sup>8</sup> Contingent capital refers to a new type of bond that either converts into equity or offers haircut to its principal and interest payment when certain pre-determined conditions are met.

<sup>9</sup> Corrective measures by financial authorities, indices of financial institutions' soundness, stock prices for a certain period of time

**(Exemption of financial investment firms' reporting duty)** A financial investment firm will no longer be required to report insignificant change in portion of shares held by its executive or major shareholder of less than KRW 10 million.

**(Eased regulation on financial firms' reporting duty)** Professional investors<sup>10</sup> which have low possibility of taking advantage of insider information will be given a longer deadline for reporting (due 10<sup>th</sup> of the second month of a quarter).

**(Disclosure of executives' remuneration)** A corporation will be required to submit business report describing the remuneration of executives if the amount "exceeds KRW 500 million".

**(Reward to an informant who reports an unfair trading)** Reward presented by the Financial Supervisory Service will be expanded from the current KRW 100 million to KRW 2 billion to encourage reporting unfair trading.

**(Restriction on using nonpublic information)** Companies which are not listed in the stock exchange but went public through back-door listing will be subject to regulation on using nonpublic information.

A company which went public through business takeover, asset takeover, and contribution in kind will be also regarded as back-door listing company and be subject to regulation on using nonpublic information.

## 6. Future Plan

The FSC will post a legislative notice of the revised Enforcement Decree on June 14. The revision procedure will be completed by August 29 when the revised FSCMA is scheduled to be enforced after going through review by the Regulatory Reform Committee and the Ministry of Government Legislation.

Revision to subordinate regulations such as the Regulation on Financial Investment Business will be made swiftly after making preliminary announcement in July.

The FSC will form a task force team comprised of market experts, associations, and the FSS to establish best practice guidelines to help prompt implementation of the revised Enforcement Decree.

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<sup>10</sup> Government, autonomous government, Bank of Korea, Korea Deposit Insurance Corporation, Korea Investment Corporation, Korea Finance Corporation, Korea Credit Guarantee Fund, pension fund