

FSC PROPOSES CAPITAL MARKET REFORM

The FSC proposed capital market reform initiatives aimed at facilitating financing for innovative companies through capital markets.

Background

Corporate financing in Korea has been centered on bank loans and state-backed guarantees, dwarfing the role of capital markets.¹ Moreover, fundraising in capital markets is tilted towards listed companies, making it difficult for unlisted companies in start-up or early-growth stages to raise capital.

The proposal was designed to (i) strengthen the role of capital markets in corporate financing, balancing with loan markets; (ii) develop private capital market to provide growth capital for innovative companies; and (iii) overhaul the regulatory framework for securities firms to help them play a more active role in innovative companies' fundraising.

Reform proposal

- ▶ The FSC will diversify and facilitate fundraising options for start-ups and venture companies (※ Details to be outlined in December 2018 and a proposal to revise the Capital Markets Act to be submitted to the National Assembly in the first quarter of 2019).
 - The scope of a private placement will be widened from “a fundraising which offers investment proposals to less than 50 investors” to “a fundraising from less than 50 investors who actually made investments.”
 - Currently, a company can raise capital of less than KRW 1billion via a small public offering, less burdened with regulatory requirements. The small public offering will be expanded to two-tier caps – a fundraising of less than KRW3 billion and one between KRW 3billion and KRW 10billion – with different levels of consumer protection measures.
 - Currently, start-ups of less than 7 years in business are allowed to raise up to KRW 700million via crowdfunding. The scope of companies will be expanded to SMEs, and the ceiling on crowdfunding will be raised to KRW 1.5billion.
- ▶ The FSC will introduce a new scheme of Business Development Company (BCD), a specialized investment company to invest in unlisted companies. BCD is similar to a special-purpose acquisition company(SPAC) in that the company first raises funds through its IPO before identifying an investment target. Differentiated from SPAC, BCD is aimed at boosting the value of a private

¹ Outstanding corporate bonds in Korea amounted to KRW234.4 trillion (as of 2017), accounting for just 29% of outstanding corporate loans, which came to KRW814.4 trillion.

company through its financing and management support to realize returns on investments. BCD will make it easier for retail investors to invest in unlisted companies. (※ Details to be announced in the first quarter of 2019)

- ▶ The FSC plans to broaden and diversify a pool of professional investors. Currently, individuals with a financial investment balance of more than KRW 500million and an annual income of more than KRW 100million are allowed to register with the Korea Financial Investment Association (KFIA) as 'professional investors.' Those with total assets of more than KRW 1billion also qualify for the registration of 'professional investors'. The criteria will be widened to include those who have investment experience and can afford financial losses or those with expertise in securities markets – e.g. bankers, lawyers, accountants, angel investors and etc. (※ Details to be announced in December 2018 with an amendment proposal for the enforcement decree of the Capital Markets Act)
- ▶ The regulatory framework for private equity funds(PEFs) will be reshaped. The FSC will abolish the current 10% rule that divides PEFs from hedge funds. Currently, PEFs are required to own a more than 10% stake in a company in which they invest, while hedge funds are restricted from exercising voting rights on shares exceeding of 10%. Both PEFs and hedge funds will come under a single regulatory scheme with eased restrictions on fund management. The FSC will introduce a new scheme of institutions-only PEFs (tentatively named) which raise funds only from institutional investors. Retail investors will be allowed to invest indirectly in institutions-only PEFs through funds of funds. (※ A revision to the Capital Markets Act to be proposed)
- ▶ IPO regulations will be eased to allow IPO advisors more room to maneuver in pricing and allocating of shares. Corresponding to greater autonomy, IPO advisors will be held more accountable for due diligence. (※ Details to be announced in the first quarter of 2019)
- ▶ KONEX will be reinvented as a pre-Kosdaq incubating market specialized in helping KONEX-listed firms move to the Kosdaq market. (※ Details to be announced in November 2018)
- ▶ Securities firms specialized in financing SMEs will only be required to register for business. The minimum capital for business will be lowered to KRW 500million, with a limited scope of business such as brokerage service for private offering or trading unlisted stocks. (※ Details to be outlined in December 2018 and a proposal to revise the Capital Markets Act to be submitted to the National Assembly in the first quarter of 2019).

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