

**TSA Research Project Report**

**Financial Investment Services & Capital Market Act  
and  
Changes to KSDA's Role and Organizational Structure**

**2009. 10.**

**Korea Financial Investment  
Association**



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# **Part I. The Financial Investment Services and Capital Market Act and Changes to Financial Industry**

## **1. Background & Progress**

### **A. Background**

The previous regulations governing the capital market inhibited innovation and restricted the development of the capital market and related industries. These regulations applied to specific types of financial institutions, regardless of the similarity of the financial services they may offer. This often resulted in regulatory arbitrage and created loopholes in investor protection regulations. Under the previous regime, innovation was inhibited and the development of new financial investment products was restricted as only securities and derivatives that were expressly permitted by law may be offered. The previous regulations also restricted the integration of different financial industries within the capital market by banning business crossovers, except where the financial institution meets strict regulatory requirements. These restrictions made it almost impossible for financial institutions in Korea to enjoy the synergy and efficiency of integration that institutions in other advanced economies have, thereby making it difficult for Korean institutions to compete with them. The previous regulations do not include an advanced investor protection scheme, leaving investors exposed to risky products, without proper guidance or information. Furthermore, this gap is eroding investor confidence in the market.

### **B. Progress**

The Financial Investment Services and Capital Market Act (referred to as "the Act" or the "Capital Market Act") was created as the result of a government initiative in 2003 to consolidate the regulations governing the entire financial sector. The original plan was to encompass the banking, securities and insurance sectors under a single, overarching regulatory regime by merging the forty-odd financial statutes and reorganizing them into four regulatory functions: entry into the industry; disclosure of business; business conduct; and business scope.

However, after extensive research, the government decided in 2005 to implement a phased reform. Since the capital market was in the greatest need of reform and was also most likely to benefit, it became the priority. Compared to the banking and insurance sectors' regulations, securities regulations were segmented too narrowly, leaving gaps in government oversight and impeding financial innovation. If left unattended before the industry-wide consolidation, the imbalance between the different financial services sectors would likely to inhibit the effects of any reform. Similar enactments in other countries, including the U.K., Australia, and Japan, also endorse this idea. In February 2006, after conducting an in-depth study and analysis of

comparable legislations in other countries, a plan to consolidate the regulation of the capital market was announced. On July 3 2007, the National Assembly enacted the Financial Investment Services and Capital Market Act. Table 1.1 shows the enactment progress in greater detail.

Table 1.1 [Progress of the Financial Investment Services and Capital Market Act]

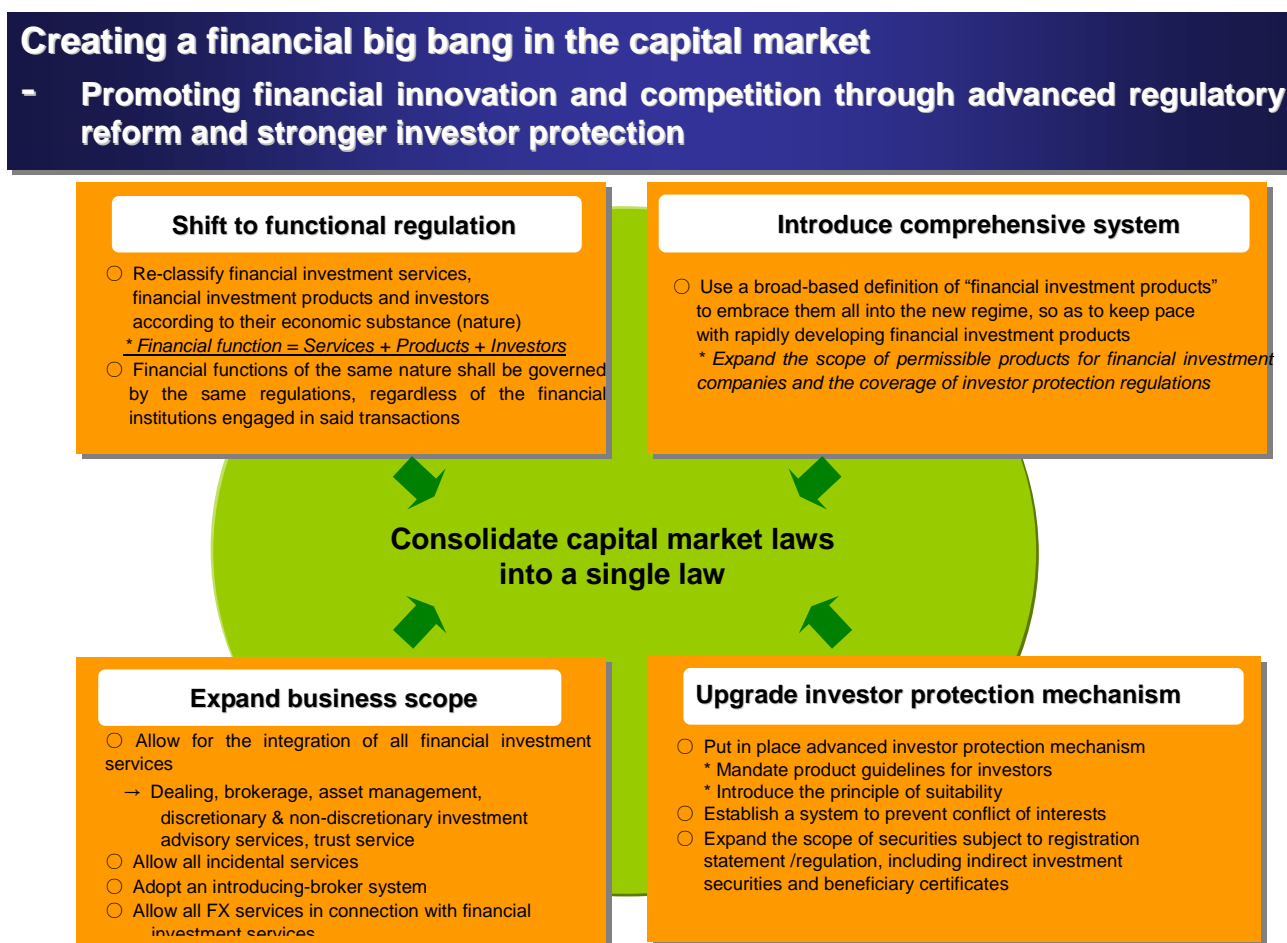
<b>When</b>	<b>What Happened</b>
May, 2005	Two task forces organized to formulate legislation to consolidate the capital market
Feb. 17, 2006	Plan announced to enact the Financial Investment Services and Capital Market Act
Feb. ~Mar., 2006	Seven information sessions held for banking, securities, insurance and other finance industries as well as the general business communities
Apr. 26~May 16, 2006	Four public hearings held
Jun. 30, 2006	Advance notice made for the draft bill of Financial Investment Services and Capital Market Act
Aug. 17, 2006	The bill passed the Parliamentary Regulatory Reform Committee
Aug. 23, 2006	The bill sent to the Ministry of Government Legislation
Dec. 29, 2006	The bill passed the state council and tabled before the National Assembly
Feb. 22, 2007	The bill presented to the Parliamentary Finance and Economy Committee for consideration
Apr. 12~Apr. 16, 2007	The FEC held the first and second public hearings on the bill
May, 2007	The Ministry of Finance and Economy and the Bank of Korea came to agreement on the securities companies' use of clearing and settlement arrangement systems
Jun. 15~Jun. 18, 2007	The bill passed the Finance and Economy Committee vote
Jun. 30~Jul. 2, 2007.	The bill passed the Parliamentary Legislation and Judiciary Committee
Jul. 3, 2007	The bill passed the National Assembly
Aug. 3, 2007	The Financial Investment Services and Capital Market Act promulgated

## 2. Key Changes

### A. Basic Framework

The Act was designed to streamline the current system in four key directions: a shift to functional regulation, the introduction of a comprehensive regulation system, the expansion of business scope, and the upgrade of investor protection mechanism.

Figure 1.1 [Basic Framework of the Act]



- **Shift to Functional Regulation.** The Act caused a shift from institution-based regulations to function-based regulations. This means the same financial function will be governed by the same regulations, as opposed to the previous system where different institutions performing the same function were often subject to different rules.
- **Comprehensive System Regulation.** The Act defines “financial investment products” in a broad and abstract way instead of enumerating specific products. The new definition was designed to respond to rapidly developing financial investment products and to allow the innovation of new financial investment products.

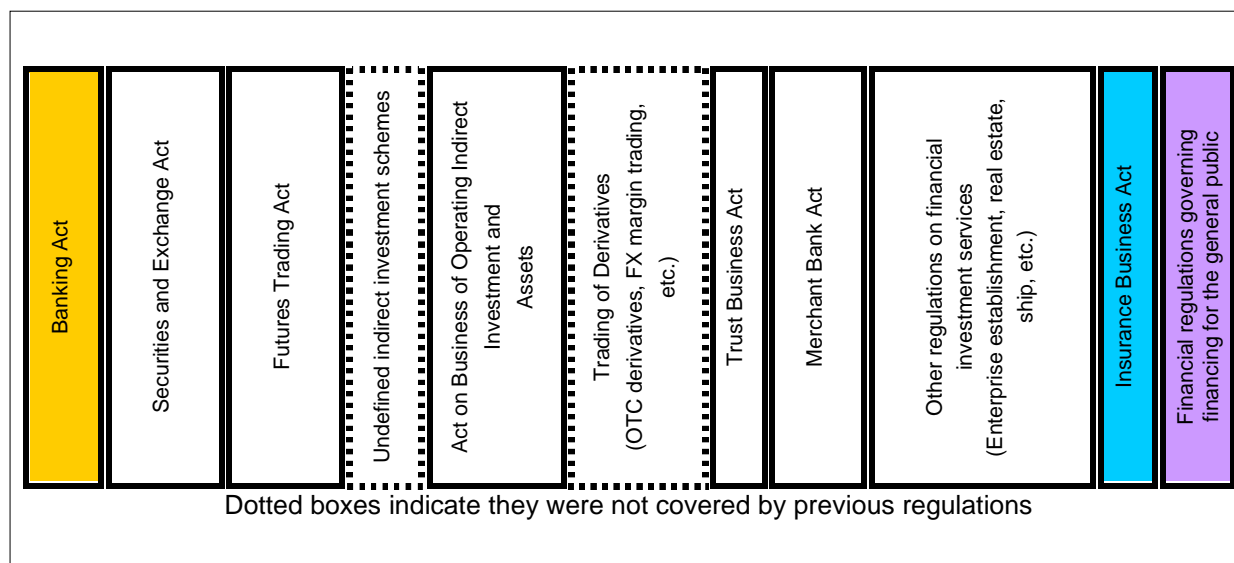
- **Expand Business Scope.** The Act was designed to promote synergy by facilitating the integration of financial investment services. It allows for the establishment of financial investment companies that can provide all six types of financial services. Incidental services and foreign currency services are also allowed in principle.
- **Upgrade Investor Protection.** The Act has put in place an advanced investor protection mechanism and strengthened product guidance by requiring financial investment companies to explain the details and underlying risks of their products to investors. It also introduces the “Know Your Customer” rule and the principle of suitability. Financial investment companies are required to know details about their investors and only recommend financial investment products that are suitable to the investor’s background and circumstances. The Act also requires financial investment companies to implement investor protection policies such as “Chinese Walls” to resolve possible conflicts of interests.

## **B. Coverage of the Act**

The six pieces of legislation governing the Korean capital market were replaced by the Act, and other conflicting financial regulations were revised to comply with the new legislation in consultation with the relevant government authorities. Regulations governing the banking and insurance sectors were kept separate. Figure 1.2 shows what areas the Act covers and doesn’t. The key contents of the Act are summarized in Table 1.2.



Figure 1.2 [Extent of Consolidation]



↓ **After Consolidation**

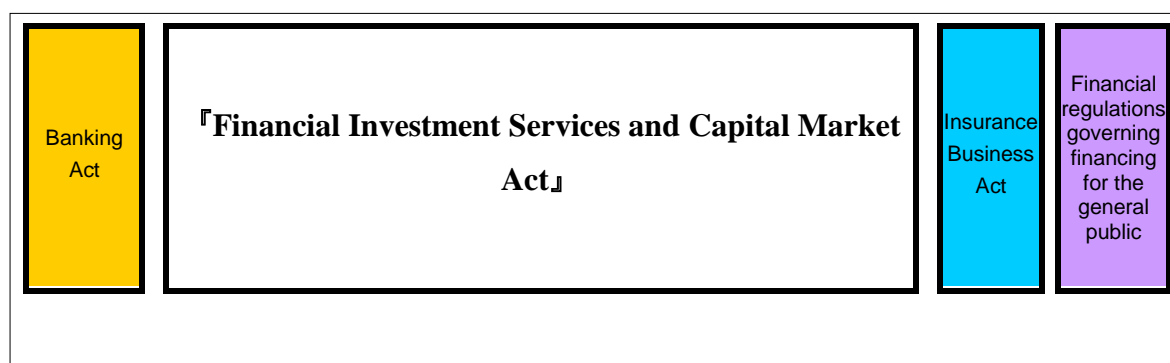


Table 1.2 [Structure of the Act: Comprised of Ten Parts with 450 Articles]

Part	Chapter	Contents
<b>Part 1.</b> <b>General Provisions</b>	-	Purpose and definition of the terms (financial investment products, financial investment services)
<b>Part 2.</b> <b>Financial Investment Services</b>	Chapter 1	Entry barriers
	Chapter 2	Corporate governance
	Chapter 3	Prudential regulation
	Chapter 4	Regulation on conduct of business

<b>Part 3. Issuance and Distribution of Securities</b>	Chapter 1~2	General provisions, regulations on disclosure
	Chapter 3	Regulation on corporate mergers and acquisitions
	Chapter 4	Disclosure of reports
	Chapter 5~6	Special cases and OTC transactions
<b>Part 4. Regulation on Unfair Trade</b>	Chapter 1~2	Ban on insider trading or market manipulation
	Chapter 3	Regulations on unfair trading
<b>Part 5. Collective Investment Scheme</b>	Chapter 1~9	Definition, incorporation, indirect investment securities, institutions, etc.
<b>Part 6. Financial Service- Related Institutions</b>	Chapter 1~6	Korea Financial Investment Association, Korea Securities Depository, Securities Finance Companies, etc.
<b>Part 7. The Korea Exchange</b>	Chapter 1~5	Organization of KRX, establishment and supervision of markets, etc.
<b>Part 8. Supervision and Disciplinary Action</b>	Chapter 1~4	FSC authorities, inspection, investigation, discipline, penalties, etc.
<b>Part 9. Supplementary Provisions</b>	-	Reporting, contributions, etc.
<b>Part 10. Penal Provisions</b>	-	Punishment, fines, etc.

### 3. Four Key Directions

#### A. Comprehensive System Regulation

##### ① Background

The previous regulations governing the capital market itemized all permissible financial products and prohibited unspecified products. It also defined the types of underlying assets permissible. This positive-list regulatory system not only made it very difficult for service providers to introduce innovative products and services, but it also led to gaps in the investor protection mechanisms. To structure and sell new type of products, the relevant regulations had to be revised to allow new products. If a party other than a financial institution developed a new type of financial product, there were no regulations in place to govern the said product. Table 1.9 shows the products permitted under the previous regulations.

Table 1.9 [Permissible Products under the Previous Positive List System]

<b>Securities</b>	<b>Permissible products:</b> 21 items including government bonds, municipal bonds, special bonds, corporate bonds, stocks, equity investment certificates, beneficiary certificates, MBS, ELW and ELS <b>Permissible underlying assets of securitized derivatives:</b> securities, currencies, commodities and credit risk
<b>OTC Derivatives</b>	<b>Permissible products:</b> 4 items (forwards, index forwards, swaps & options) <b>Permissible underlying assets:</b> securities, currencies, commodities, credit risk
<b>Exchange-traded Derivatives</b>	<b>Permissible products:</b> futures, options <b>Permissible underlying assets:</b> securities, currencies and commodities

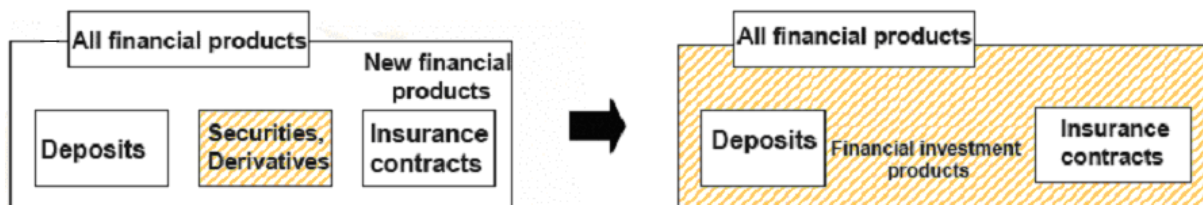
Only stipulated financial investment products were authorized to be handled by financial institutions and had the investment protection rules applied.

##### ② Scope of Financial Investment Products

Under the Act, the positive-list system is scraped and a comprehensive, all-inclusive system of regulation is introduced. The Act defines "financial investment products" broadly and abstractly as "products of investment value (with the possibility of the loss of the principal invested)" instead of enumerating the names of specific products, thus encompassing under its jurisdiction not only already existing products but also prospective future products that have not come into existence yet. This new definition allows financial investment companies to introduce

and sell state-of-the-art financial products and applies investor protection obligations to them. Figure 1.7 compares the scope of financial investment products with regulatory supervision before and after the Act.

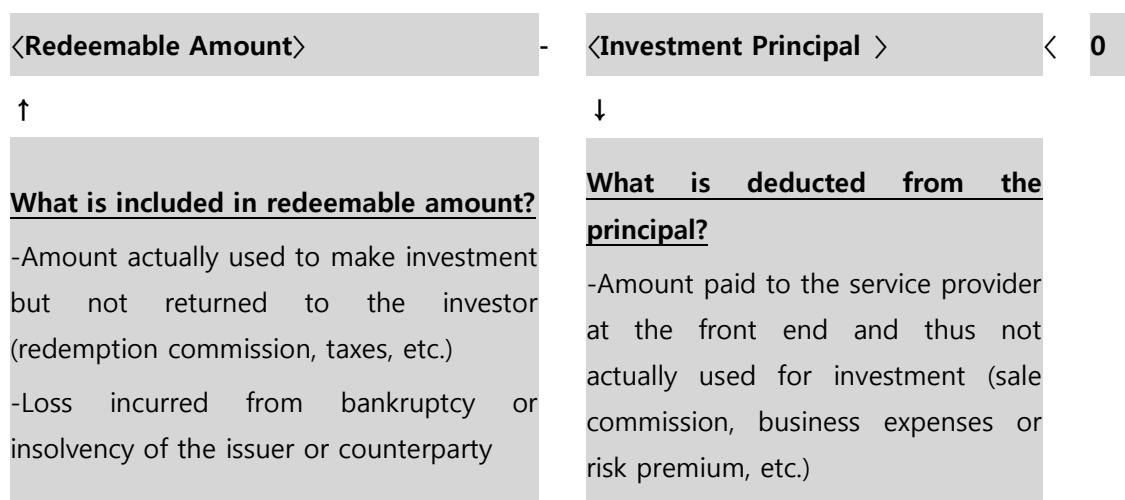
Figure 1.7 [Scope of Financial Investment Products]



### a. Definition of Financial Investment Products

The Act defines a "financial investment product" as "(1) a *right* arising from the transfer of money pursuant to a contract at a certain point in time, (2) in either *the present or future*, (3) with the full undertaking of the *burden of a loss* of the (investment) principal, a loss exceeding the principal, or possible additional payments in due course (4) to pursue *profit acquisition, loss avoidance or risk management*." The most essential phrase is "burden of a loss." If there is a possibility that the principal may not be fully redeemed, the product has "investment value" and thus is defined as a financial investment product. Figure 1.8 shows what constitutes investment value. When the redeemable amount minus the amount of investment principal is smaller than zero, it means the investor suffered a loss of principal, and thus the product is regarded as having investment value.

Figure 1.8 [Investment Value]

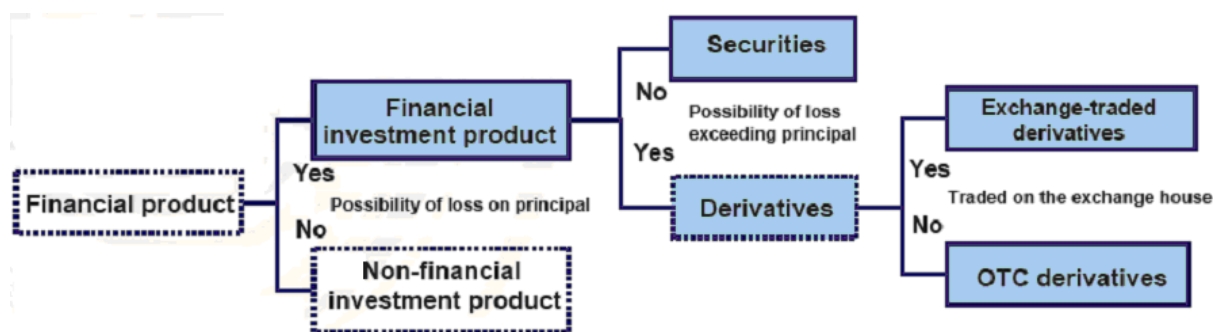


“Principal” is defined in detail in the enforcement decree of the Act. Sales loads are not taken into account, while redemption fees are, when calculating whether there was a loss. For example, if a person pays 10 dollars to buy a financial investment product and 1 dollar is deducted as a front-end sales load, the principal amount is 9 dollars, not 10. If a person who invested 10 dollars into a particular product receives 10 dollars after paying 1 dollar of redemption fees, the return is 11 dollars, not 10 dollars.

### b. Criteria of Classification of Financial Investment Products

Financial investment products are divided into the two subcategories of securities and derivatives depending on the possibility of loss beyond the investment principal. Derivatives, depending on the marketplace the product is traded in, are grouped as either exchange-traded derivatives or OTC derivatives. Figure 1.9 shows the classification criteria for financial investment products.

Figure 1.9 [Classification of Financial Investment Products]



### c. Types of Financial Investment Products

The concept of securities and exchange-traded or OTC derivatives is defined broadly under the Act. Securities are divided into six categories. Conventional securities like stocks and corporate bonds are categorized at a higher level, as with debt securities and equity securities, to cover similar types of other products. Newly introduced types of securities, such as derivatives-linked securities and investment contract securities, are also defined abstractly so that any collective investment securities yet unknown to the market can still be governed by the law. Securities without paper certificates are also regarded as securities under the Act. Figure 1.10 shows how the Act defines different types of financial investment products.

Figure 1.10 [Types of Financial Investment Products]

		Type	Definition	Example
<b>Securities</b>	<b>Con-ventional securities</b>	<b>Debt securities</b>	Representing debt liability	Government bond, municipal bond, corporate bond, commercial paper, etc.
		<b>Equity securities</b>	Representing equity contribution share	Stocks, subscription right, subscription certificate, contribution quota, etc.
		<b>Beneficiary certificate</b>	Representing beneficial interests	Trust beneficiary certificates, investment trust beneficiary certificates, etc.
		<b>Depository Receipt (DR)</b>	Securities of issuers that have received the deposit of equity securities	KDR, GDR, ADR
	<b>Investment contract</b>		- Investments made in a common public business with expectation of profits -Compensations depend upon a 3 <sup>rd</sup> party's efforts	Indirect investment securities, unregulated indirect investment securities, stocks, contribution quota, etc.
	<b>Securitized derivatives</b>		Rights under contract for the purpose of gaining profits or avoiding losses linked to fluctuations of underlying asset prices	ELS, ELW, FX-linked securities, reverse FRN, etc.
<b>OTC derivatives</b>		<b>Introduce a broad-based definition for forward, swap, and option</b>		
<b>Exchange-traded derivatives</b>		<b>Derivatives traded in exchanges</b>		

The Act also applies the same comprehensive system when defining underlying assets of derivative products and DLS. Instead of listing the names of permissible underlying assets, the definition is made at the highest level to include not just securities, currencies, commodities and credit risk but also "other natural, environmental, and economic risks."

## B. Shift to Functional Regulation

### ① Overview

#### a. Background

The previous regulations governing the capital market were institution-based regulations that were built around the types of financial institutions they applied to. Each law imposed different sets of entry barriers and regulations to its subject financial institutions, even though they may perform identical financial functions. This often resulted in regulatory arbitrage and loopholes in investor protection. For example, futures trading companies and asset management companies were previously required to explain their financial products to potential investors, while other financial institutions were not. Table 1.3 shows the previous laws governing the capital market, subject to financial institutions and their functions.

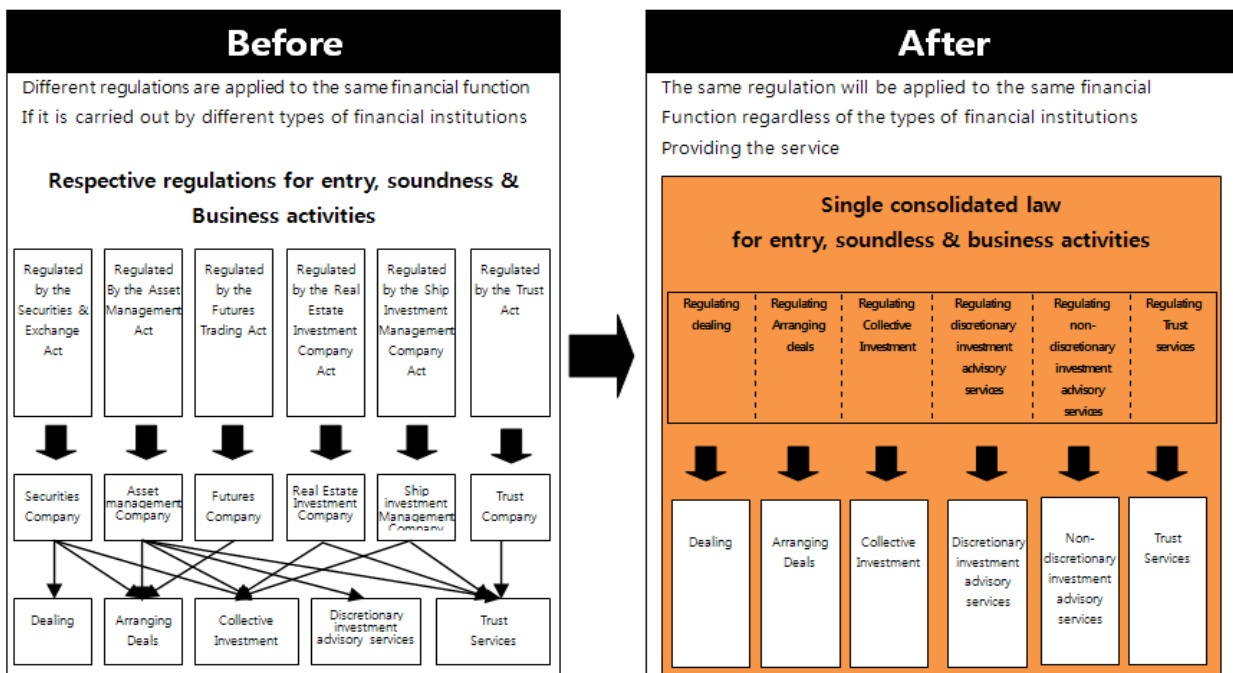
Table 1.3 [Institutional Regulations that Governed Capital Market]

<b>Governing Act</b>	<b>Financial Institutions</b>	<b>Permissible Financial Functions</b>
Securities and Exchange Act	Securities companies	Dealing, underwriting, brokerage, trust etc.
Futures Trading Act	Futures companies	Futures trading
Merchant Banks Act	Merchant banks	Brokerage, dealing, underwriting, discounting
	Money brokers	Money brokerage services
Trust Business Act	Trust companies	Trust services
Act on Business of Operating Indirect Investment and Assets	Banks, insurers	Sales of indirect investment securities
	Investment advisers	Non-discretionary investment advisory services
	Discretionary advisory co.	Discretionary investment advisory services
	Asset management companies	Management or instruction of management of assets of investment trust or investment companies
	-	Executive officer of PEF
	Trust companies	Trust service of investment trust properties
Corporate Restructuring Investment Companies Act	Asset management companies	Asset management and investment of corporate restructuring investment companies
	Asset custodian companies	Asset custodian business for corporate restructuring investment companies
The Real Estate Investment Company (REITs) Act	Asset management companies	Investment and management of assets of REITs or CrREITs
	Asset custodian companies	Asset custodian business for REITs or CrREITs
The Ship Investment Company Act	Ship Investment Mgmt Companies	Asset management of ship investment companies
	Asset Custodian Companies	Custodian of assets of ship investment companies
The Support for Small and Medium Enterprise Establishment Act	Technology project investment companies	Executive officer of Technology project investment cooperatives
The Industrial Development Act	Corporate restructuring vehicle investment companies	Executive officer of corporate restructuring vehicle investment companies
Special Act on Promoting Venture Businesses	Venture capitalists, individuals	Executive officer of Korea Venture Investment Corporation and investment partnerships

## b. Shift to Functional Regulations

The Act shifted regulation to a function-based system as opposed to the previous institution-based system, thus allowing the same financial functions to be governed by the same regulations, regardless of the type of institution that is performing said function. Figure 1.3 describes in detail how a single, consolidated act would replace the many institution-based regulations.

Figure 1.3 [From Institutional Regulations to Functional Regulations]



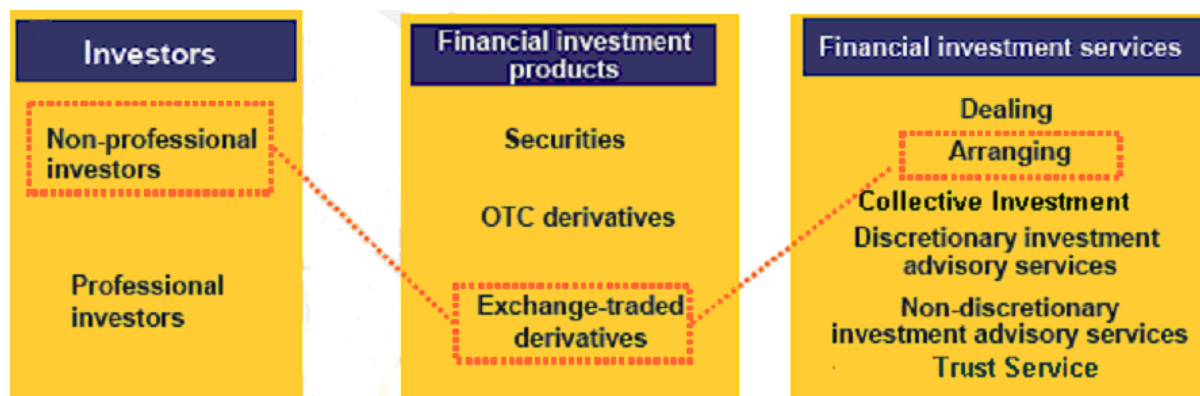
## ② Definition of Financial Functions

### a. Basic Concept

"Financial functions," are the key building block of the new regulations, and are classified by (i) financial services, (ii) financial investment products, and (iii) type of investors. These financial services, products, and investors are further classified, respectively, into six, three, and two subcategories depending on their economic nature. Figure 1.4 shows how the type of investor, financial investment product and financial investment service defines a financial function.



Figure 1.4 [Financial Functions as a Combination of Investor, Product and Service]



- $2 \times 3 \times 6 = 36$  combinations

Two types of investors, three types of products and six different services create 36 different combinations, which represent every possible form of financial function. Types of services, products and investors are elaborated on in the next few pages.

### b. Classifying Financial Investment Services

Financial Investment Services are divided into six subcategories: dealing, brokerage, collective investment, trust services, discretionary investment advisory services and non-discretionary investment advisory services.

- **Dealing:** any trading, subscription for, or underwriting of financial investment products on one's own account; or an offer or agreement to trade, subscribe for, issue or underwrite financial investment products.
- **Brokerage:** any trading or subscription for financial investment products on another person's account; or an offer or agreement to trade, subscribe for, issue or underwrite financial investment products.
- **Collective Investment:** to acquire, dispose of, or otherwise manage assets by pooling funds from two or more investors without receiving regular instructions from them on the manner of management, and to distribute the return to the investors.
- **Non-discretionary Investment Advisory Service:** to provide advice upon the value of financial investment products or investment decisions.
- **Discretionary Investment Advisory Service:** to acquire, dispose of, or otherwise manage financial investment products on behalf of individual investors who delegated full or partial investment discretion to the service provider.
- **Trust Service:** to take custody of trust funds as under the Trust Act.

Table 1.4 compares these financial functions before and after the Act to describe how they are streamlined under the Act.

Table 1.4 [Classification of Financial Investment Services]

Before the Act			Under the Act	
(Bancassurance)	Insurance business		Insurance business (standstill)	
Banking	Mutual savings banks		Banking business (standstill)	
	Credit unions			
	(CMA)			
(Underwriting)	Futures business	Merchant banks	Dealings	
Banks, insurance companies, asset management companies (Sales of funds)				
Securities business				
Banks-insurance companies REITs-SICs, etc.	Asset management		Financial Investment Services	
	Non-discretionary investment advisory service			
	Discretionary investment advisory service			
Banks, securities, insurance	Trust service		Trust Service	

### c. Classifying Financial Investment Products

Financial Investment Products are classified into securities or derivative products depending on whether there is a risk of loss beyond the principal amount of investment. Derivative products are further divided into exchange-traded or over-the-counter products, depending on the place of trade.

- **Securities:** financial investment products with the maximum amount of loss not

exceeding the principle amount invested.

- **Exchange-traded derivatives:** forwards, options or swaps or their likes that are traded on the exchange.
- **OTC Derivatives:** forwards, options or swaps that are traded elsewhere.

#### d. Classifying Investors

The Act categorizes investors into professional and non-professional investors depending on their risk tolerance and hedging capabilities, as reflected in their expertise and total asset size. Because professional investors are considered capable of assuming and managing investment risks and therefore are requiring less protection, the Act is designed to relax investor protection obligations for professional investors. For example, financial institutions must explain the investment risks and recommend appropriate financial investment products to non-professional investors, but are not required to do so for professional investors.

The Act allows professional investors who wish to be treated as non-professional to receive the protection applicable to non-professional investors, upon the agreement of the service provider. However, regrouping in the opposite direction is prohibited so as to prevent financial investment companies abusing this function to avoid their investor protection obligations. It is mandatory for financial investment companies to maintain these investor categories at all times. Table 1.5 shows the criteria for professional investors and whether they may be treated as non-professional investors.

Table 1.5 [Criteria for Professional Investors]

Entity	Criteria	Shift to Non-professional
Government	-	×
Bank of Korea	-	×
Listed Companies	-	○
Financial Institutions	Banks (including Korea Development Bank, Industrial Bank of Korea, Korea Eximbank, National Federations of Agricultural and Fisheries Cooperatives); insurance companies; financial investment companies; securities finance companies; merchant banks; fund brokerage companies; financial holdings companies; specialized financial business companies; mutual savings banks and the national federation thereof; the National Forestry Cooperatives Federation; foreign financial institutions equivalent to the above.	×

<b>Others</b>	Korea Deposit Insurance Corporation and financial resolution institutions, Korea Asset Management Corporation, Korea Housing Finance Corporation, Korea Investment Corporation, Korea Financial Investment Association, Korea Securities Depository, KRX, Financial Supervisory Service, collective investment schemes, Credit Guarantee Funds; Korea Technology Credit Guarantee Funds	×
	Corporations operating and managing funds established in accordance with the law; corporations carrying on mutual aid projects in accordance with the law; and local governments	○
	Corporations filed with the FSC as a professional investors with 10 billion KRW or more in their balance worth of financial investment products (within 2 years after the filing)	○
	Individuals filed with the FSC as professional investors with 5 billion KRW or more in their balance worth of financial investment products and one year or more of investment experience (within 2 years after the filing)	○
	Foreigners equivalent to the above descriptions	△ <sup>1)</sup>
	Foreign governments; international organizations established in accordance with treaties; foreign central banks	×
	Corporations issuing stock certificates listed on overseas securities markets	○

1) △: The possibility for a non-professional investor of foreign origin to shift depends on the availability of this function under their domestic regulations.

### ③ Reform Service Regulations

#### a. Entry Regulations

The Act has the overall effect of relaxing entry barriers. Before the Act, all financial service providers had to obtain a charter. Under the Act, companies that wish to enter the financial investment sector are either required to obtain a license or register with the authorities depending on the risk level of the financial services they provide. Dealing, brokerage, collective investment and trust service require a license, while discretionary and non-discretionary investment advisory service providers could start business by simply registering. The Act provides that any application for registration is to be processed within a certain period of time from the date of application to eliminate the influence of individual judgment. The Act also allows financial investment companies the flexibility to extend their offered services by adding new functions to the existing ones (add-ons). Banks and other financial institutions are recognized as financial investment companies under the Act and are allowed to engage in financial investment services if permitted by the other pertinent regulations.

To ensure the same function is governed by the same set of regulations, entry requirements (equity capital, resources, and business plans) are differentiated according to the degree of risk embedded in each financial function. Services requiring a license tend to have higher entry barriers than services requiring registration. Dealing services command the highest level of barriers because the service providers and investors will have a debtor-creditor relationship. Riskier products and investors less capable of risk-taking also entail higher barriers. For example, a company that wishes to provide *dealing* services in *OTC derivatives* products to *non-professional* investors has to meet the most rigorous set of qualifying criteria. On the other hand, becoming a *non-discretionary investment advisory service* provider on *securities* for *professional* investors is the easiest.

[Degree of Entry Requirements]

- **Financial services:** dealing > brokerage, collective investment, trust service > discretionary and non-discretionary investment advisory services
- **Financial investment products:** OTC derivatives > exchange-traded derivatives > securities
- **Investors:** Non-professional investors > professional investors

Among the entry requirements, the criteria of a “fit and proper” business plan is only required of license applicants because it is a qualitative analysis and is susceptible to the individual views of the tester. Table 1.6 shows all possible combinations of financial functions that financial investment companies can become licensed or registered to engage in. There is a total of 42 units—36 combinations and their variants.

Table 1.6 [Units of Licensing or Registration and Minimum Equity Capital Requirements]

Units of Licensing or Registration and Minimum Equity Capital Requirements (Total: 42 categories, 200 billion KRW) – (Unit: billion KRW)						
Code	Financial Services		Financial Products		Investors	Equity Capital
1-1-1	Dealing	Including underwriting	Securities		both	50 <sup>1)</sup>
1-11-1			Debt securities <sup>2)</sup>		both	20 <sup>1)</sup>
1-111-1			Government bonds <sup>2)</sup>		both	7.5 <sup>1)</sup>
1-12-1			Equity securities		both	25 <sup>1)</sup>

				(excl. collective investment) <sup>2)</sup>		
1-13-1				Collective investment vehicle <sup>2)</sup>	both	5 <sup>1)</sup>
11-1-1		Excluding underwriting	Securities		both	20 <sup>1)</sup>
11-11-1				Debt securities <sup>2)</sup>	both	8 <sup>1)</sup>
11-111-1				Government bonds <sup>2)</sup>	both	3 <sup>1)</sup>
11-112-1				Corporate bonds <sup>2)</sup>	both	4 <sup>1)</sup>
11-12-1				Equity securities (excl. collective investment) <sup>2)</sup>	both	10 <sup>1)</sup>
11-13-1				Collective investment vehicle <sup>2)</sup>	both	2 <sup>1)3)</sup>
11r-1r-1				RP securities <sup>4)</sup>	both	6
12-112-1		Underwriting only	Securities	Debt securities <sup>2)</sup> Corporate bonds <sup>2)</sup>	both	6 <sup>1)</sup>
1-2-1			ETD		both	10 <sup>1)</sup>
1-21-1				Equity	both	5 <sup>1)</sup>
1-3-1			OTC Derivatives		both	90 <sup>1)</sup>
1-31-1				Equity	both	45 <sup>1)</sup>
1-32-1				Non-equity	both	45 <sup>1)</sup>
1-321-1				Currency IR	both	18 <sup>1)</sup>
2-1-1	Brokerage		Securities		both	3 <sup>1)</sup>
2r-1-2	(RP Brokerage)		(Securities)		professional <sup>5)</sup>	0.5
2-11-1				Debt	both	1 <sup>1)</sup>

2-12-1			securities <sup>2)</sup>		
			Equity securities (excl. collective investment) <sup>2)</sup>	both	1 <sup>1)</sup>
2-13-1			Collective investment vehicle <sup>2)</sup>	both	1 <sup>1)</sup>
2-2-1		ETD		both	2 <sup>1)</sup>
2-21-1			Equity	both	1 <sup>1)</sup>
2-3-1		OTCD		both	10 <sup>1)</sup>
2-31-1			Equity	both	5 <sup>1)</sup>
2-32-1			Non-equity	both	5 <sup>1)</sup>
2-321-1			Currency IR	both	2 <sup>1)</sup>
2e-121-1	Brokerage (ECN)	Securities	Equity securities (excl. collective investment) <sup>2)</sup> Listed stocks	both	15 <sup>1)</sup>
2i-11-2i	Brokerage (OTC securities brokerage)	Securities	Debt securities <sup>2)</sup>	professional <sup>5)</sup>	3
3-1-1	Collective Investment	All CIS (Mixed CIS)		both	8 <sup>1)</sup>
3-11-1			Securities CIS (incl. MMF)	both	4 <sup>1)</sup>
3-12-1			RE CIS	both	2 <sup>1)</sup>
3-13-1			Special asset CIS	both	2 <sup>1)</sup>
4-1-1	Trust Service	Trust properties of all types		both	25 <sup>1)</sup>
4-11-1			Money as trust property	both	13 <sup>1)</sup>
4-12-1			Trust property other than	both	12 <sup>1)</sup>

4-121-1			money			
				RE Trust	both	10 <sup>1)</sup>
5-0-1	Non-discretionary investment advisory service		All financial investment products		both	0.5 <sup>1)</sup>
6-0-1	Discretionary investment advisory service		All financial investment products		both	1.5 <sup>1)</sup>
<p>1) Half the amount for professional investor-only service providers (Code # starts with 0-0-2)</p> <p>2) Including securities deposit receipts based on the securities thereof</p> <p>3) Half the amount if the service provider is selling or purchasing one's own CIS</p> <p>4) RP securities: government or municipal bonds, public offering bonds of listed companies or public corporations, secured bonds, public offering ABS or MBS, beneficiary certificates, etc.</p> <p>5) Not applied to all professional investors</p>						

Once licensed, financial investment companies are required to maintain the necessary qualifications for the license thereafter, with only a few exceptions. Requirements for equity capital have been eased to 70 percent of the original amount, and the financial capability requirements for major shareholders have been rendered void. Table 1.7 describes how the requirements for major shareholders change for entry and for the maintenance of business. Before the Act, local branch offices of international financial investment companies were partially exempted from equity capital requirements (for comprehensive securities business, 15 billion KRW minimum instead of 50 billion KRW). The special advantage provision was deleted from the Act. Instead, the equity capital required to maintain the dealing service they were engaged in prior to the Act has been set at 50 percent of the original amount.



[Table 1.7] Major Shareholder Requirements

< Major Shareholder Requirements: for Entry >	<Major Shareholder Requirements: for Maintenance>
<ul style="list-style-type: none"> <li>- Investment capacity: equity capital, contribution amount not to be borrowed</li> <li>- Financial prudence: debt ratio (non-financial institutions), financial prudence criteria (financial institutions)</li> <li>- Social standing: no major shareholder of insolvent financial institutions, no record of fines or heavier punishment</li> </ul>	⇒
	<ul style="list-style-type: none"> <li>- Investment capacity: not applied (no borrowing requirement still applicable)</li> <li>- Financial status: not applied</li> <li>- Social standing: no major shareholder of insolvent financial institutions, no record of fines larger than 500 million KRW (applied only to the largest shareholder)</li> </ul>

### b. Prudential Regulations

The Act has put in place prudential regulations for all financial functions. All financial investment companies are subject to:

- Capital adequacy ratio regulations
- Restrictions on transactions with major shareholders
- Disclosure obligations for finance and management status

However, discretionary and non-discretionary investment advisory service providers are exempt from prudential regulations since they operate using their own account. Figure 1.5 describes the level of prudential regulations that apply to different financial functions, and why.

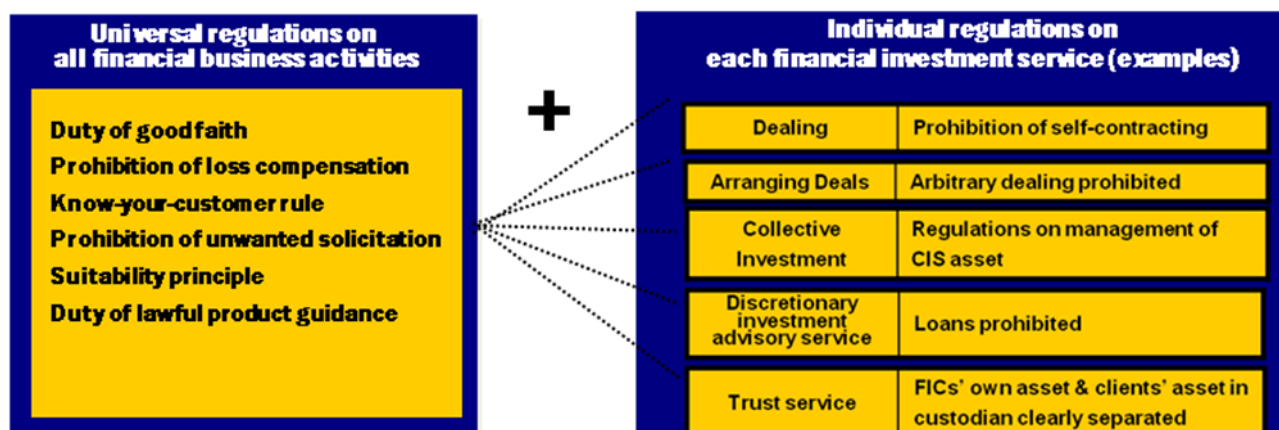
Figure 1.5 [Graduation of Prudential Regulations by Financial Functions]



### c. Regulations on Business Activities

Under the Act, the regulations on business activities were overhauled. Some regulations are universal for all six financial services, while others are service-specific. The duty of good faith, prohibition of loss compensation, and product guidance are examples of regulations that are commonly applicable to all financial investment companies. Some regulations are specifically applicable to a specific service. Figure 1.6 demonstrates examples of universal and specific regulations.

Figure 1.6 [Universal Regulations and Service-specific Regulations on Business Activities]



Depending on the type of investors, these regulations may be exempt. For example, the know-your-customer rule and product guidance obligations don't apply to professional investors, who are better equipped to deal with risks. For the same reason, dealings in high-risk products (OTC derivatives) are only permitted for professional investors.

Table 1.8 [Key Common Business Regulations]

Regulation	Contents	Status
Duty of Good Faith	Requires companies to comply with the Duty of Good Faith and conduct their financial businesses fairly	Expanded
Division of Investor	Investors categorized into non-professional and professional investors	New
Know-your-customer Rule	Requires companies to determine the characteristics of the investor (purpose of investment, financial status etc.) through interviews and questions, and receive written confirmation	New
Suitability Principle	Investment recommendations should fit on the investment purpose, financial condition, investment experience and other factors of the investor	Expanded
Duty of Product Guidance	When recommending investments, companies should receive written confirmation that the investor is informed of the contents of the product and understands the risk	Expanded
	After failing to perform the duty of product guidance, the company will liable for compensating for	New
Prohibition of Unwanted	Prohibition of burden sharing contracts	Expanded
	Prohibition of promising profit	Expanded

Solicitation	Prohibition of unwanted solicitation through visits and phone calls, unless investor desires it	New
Regulation on Standard Agreement	Companies should notify the FSC and make announcements of any changes or establishment of standard agreements	Expanded
Regulation on Advertisement	Prohibition of investment advertising by non-financial investment companies	New
	Regulation on mandatory inclusion of risks and other factors concerning the product in advertisements	Expanded

#### **d. Regulations on Corporate Governance**

The Act replaces the Securities and Exchange Act's regulations concerning the corporate governance of securities companies, and imposes new regulations on all financial investment companies. Financial investment companies with greater assets than others will be subject to heavier regulations. Table 1.8 shows the criteria for the enhanced regulations before and after the Act. The following are the key contents of corporate governance regulations under the Act:

- Changes to major shareholders should be approved by the relevant authorities (or reported to the authorities after the fact in the case of discretionary or non-discretionary investment service providers).
- Financial investment companies with total assets of no less than 2 trillion KRW, and managing funds of no less than 6 trillion KRW are required to have outside directors and an audit committee.
- Financial investment companies with total assets of no less than 100 billion KRW and managing funds of no less than 3 trillion KRW are required to have a full-time auditor (newly introduced).
- Financial investment companies are required to establish internal control standards and procedures, and appoint a compliance officer.

The Act also adopts more stringent qualifications for the officers of financial investment companies to ensure more transparent management and to match the rigorousness of the regulations to those governing other financial sectors. The following disqualifying conditions are newly introduced under the Act:

- An officer or an employee who has been subject to a disciplinary action of any financial supervisory institution in Korea or any other country cannot operate as an officer of a financial investment company within the time periods set forth from the time of discipline: five years for dismissal, four years for suspension, and three years for a warning or pay cut.

- An officer or an employee who has been subject to disciplinary action by an organization to which he or she belongs cannot operate as an officer of a financial investment company within the time periods set forth from the date the discipline period ends: four years for suspension, three years for a warning or pay cut.
- An officer or an employee who voluntarily offered their resignation before a disciplinary action was taken, or if said officer would have been subject to such an action, cannot operate as an officer of a financial investment company within three years of said action.

When an incumbent officer is suspended or warned, the disqualifying effect will not be applied until their term of office is over.

Table 1.8 [Criteria for Enhanced Corporate Governance Regulations]

<Previous>

Category	Outside Directors	Audit Committee	Full-time Auditor*	Compliance Officer
Securities Companies	Total assets no less than 2 trillion KRW	Total assets no less than 2 trillion KRW	-	All
Futures Companies	Total assets no less than 2 trillion KRW	Total assets no less than 2 trillion KRW	-	-
Asset Management Companies	Indirect Investment Vehicle assets no less than 6 trillion KRW	Indirect Investment Vehicle assets no less than 6 trillion KRW	-	All
Trust Service Providers	-	-	-	-
Discretionary investment Advisory Service Providers	-	-	-	-
Non-Discretionary Investment Advisory Service Providers	-	-	-	-

\* Companies listed in the KOSPI or KOSDAQ market with a total asset of 100 billion KRW or more are required to employ a full-time auditor.

**<Under the Act>**

	<b>Outside Director/ Audit Committee</b>	<b>Full-time Auditor</b>	<b>Compliance Officer</b>
Financial Investment Companies	Total assets no less than 2 trillion KRW or managing funds of no less than 6 trillion KRW	Total assets of 100 billion KRW or managing funds of no less than 1 trillion KRW	All but discretionary and non-discretionary investment advisory service providers with 500 billion KRW or less of funds to advise on or manage

**e. Other Regulatory Reforms**

- Extraterritoriality

The Act is unique from the previous regulations in that it stipulates extraterritoriality. Under the previous financial laws, there were controversies over whether Korean financial laws could be applied to overseas activities that affect Korea. Without any stipulations on extraterritoriality, there was uncertainty over the punishment of stock price manipulation, illegal cross-border supply and such. Taking these facts into consideration, the Act retains jurisdiction over activities conducted abroad if they affect Korea. However, the Act does not apply (1) when a foreign dealings or brokerage services provider receives an order from a resident in Korea without any solicitation or advertisement, or (2) when a foreign dealer negotiates or executes an agreement underwriting the securities issued overseas by a Korean dealer.

- Extended Coverage

Since the Act regulates all financial functions with “investment value,” or the possibility of the loss of the principal amount invested, it will be also applicable to: (1) deposit accounts or insurance products with investment value; (2) OTC derivative trading by banks; and (3) the dealing and brokerage of securities and derivatives in foreign currency.

- Regulations on High Risk Products

Issuance of certain types of derivative-linked securities is considered a form of dealing and allowed only by securities and OTC derivative dealing service providers.

**④ Functional Regulation on Collective Investment**

For reasons of investor protection, the Act is applied, in principle, to fund managements and investment funds. However, it is applied in public offering funds that require investor protection. The Act recognizes exceptions in the industry policies of each government agencies and allows the heads of each agency to inspect and supervise their concerned industry.

## **a. Regulation on Collective Investments**

### **i. Fund management**

Under previous laws concerning asset management, qualification requirements (entry barriers) existed only for fund managers of investment companies and investment trusts. Such requirements were either nonexistent or insufficient in fund managers of corporate reform, real estate and ship investment companies, and venture investment, corporate reform and technology investment unions. In accordance with the Act, all entities must be approved as collective investors by fulfilling the stipulated requirements in order to legally manage funds.

### **ii. Prudential Regulation and Regulation on Business Activities**

Unlike investment organizations under the asset management law during the previous regime, prudential regulations and business activity rules for venture investment, corporate reform and technology investment unions were absent or insufficient. The Act applies prudential regulation and regulation on business activities to all collective investors authorized by the Act. According to the Act, prudential regulation is applied to entities that are only collective investors, whereas companies that conduct collective investment business as a part of their operations are exempt. In addition, regulations on business activities were applied to ensure seamless investor protection.

## **b. Regulation on Funds**

Under the previous asset management laws, indirect investment organizations and other investment unions were subject to registration. This is comparable to the approval system applied to real estate/ship investment companies. Meanwhile, new technology unions were not required to register. In addition, the law did not require separation of funds and assets, external supervision or public disclosure from indirect investment organizations.

However, the Act, in relation to each individual law, requires public offering funds to reach agreements with concerned government agencies prior to registration at the FSC. The head of the said government agencies are entitled to request submission of documents and inspect them. The agencies can also request measures from the FSC and the FSC is obliged to carry them out. The Act requires funds to separate its assets, adopt external supervision and make public disclosures.

## **C. Expand Business Scope**

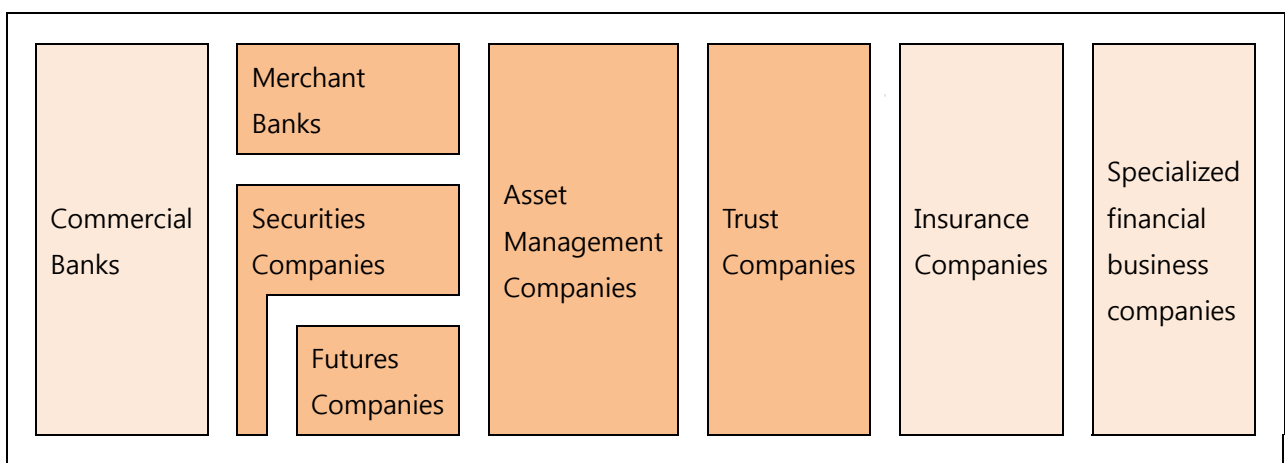
### **① Permission for Business Crossovers**

Unlike the previous regulations that maintained a strict segregation between financial services that a financial institution could offer, the Act was designed to promote synergies by

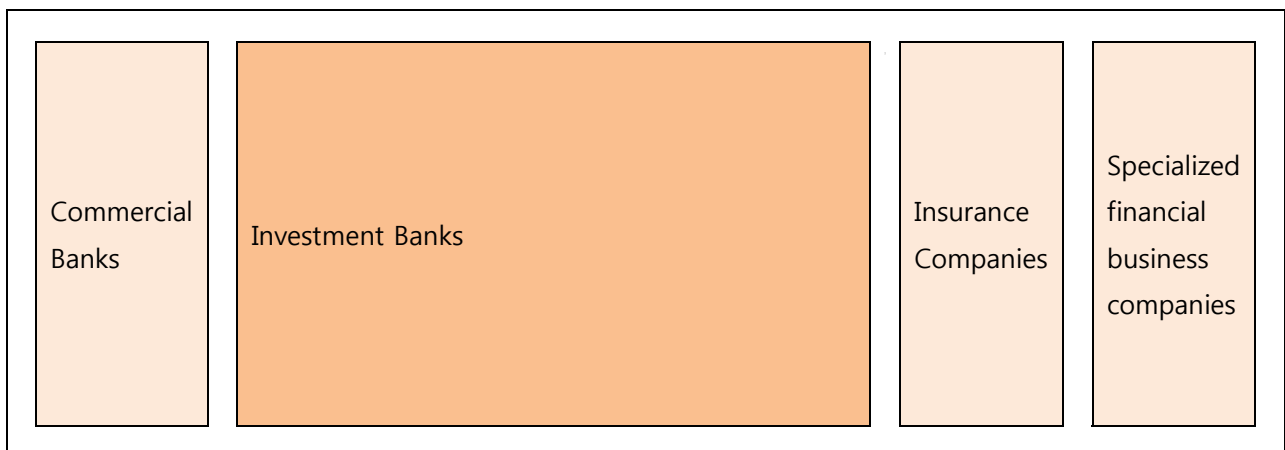
removing boundaries among financial investment services. In other words, it allows a single financial investment company to offer all six financial investment services, paving the way for emergence of investment banks as seen in other advanced markets. However, only services concerning capital market have been integrated and the business scope of commercial banks, insurance companies, and other specialized financial institutions remain standstill. Figure 1.11 shows what kind of segregated financial services have been integrated under the Act and what not.

Figure 1.11 [Change of Financial Service Offering Structure under the Act]

**<Previous>**



**<Under the Act>**



The Act significantly expands the scope of underlying assets for derivative products, but this will not affect business licenses for dealers or brokers of derivative products: i.e. financial companies that are allowed to provide dealing and brokerage services for derivatives when the Act comes into effect will still be able to deal in all derivative products under the Act without any restrictions.

*Cf.* Financial investment services allowed for commercial banks and insurance companies:

Non-financial investment companies like banks or insurance companies are partially allowed to provide services recognized as financial investment services under the Act. These institutions will be allowed to keep those businesses under the Act (the principle of standstill). Table 1.10 describes the kind of financial investment services allowed for institutions other than financial investment companies.

Table 1.10 [Financial Investment Services Allowed for Non-Financial Investment Companies]

	<b>Dealing</b>	<b>Brokerage</b>	<b>Collective investment</b>	<b>Investment advice</b>	<b>Trust service</b>
<b>Commercial banks</b>	Trading or counter sales of government or municipal bonds, RP sales, sales of beneficiary certificates, sales of OTC derivatives	Trading or counter sales of government or municipal bonds, sales of beneficiary certificates, arranging deals of OTC derivatives	Collective investment service (investment trust)	-	Trust service
<b>Insurance companies</b>	Sales of beneficiary certificates	Sales of beneficiary certificates	Collective investment service (variable insurance)	-	Trust service
<b>Merchant banks</b>	Securities business, sales of foreign currency OTC derivatives	Securities business, brokerage of foreign currency OTC derivatives	Collective investment service	Investment advisory service	Trust service
<b>Money brokers</b>	-	Brokerage of securities or OTC derivatives	-	-	-

## ② Allowing Incidental Services

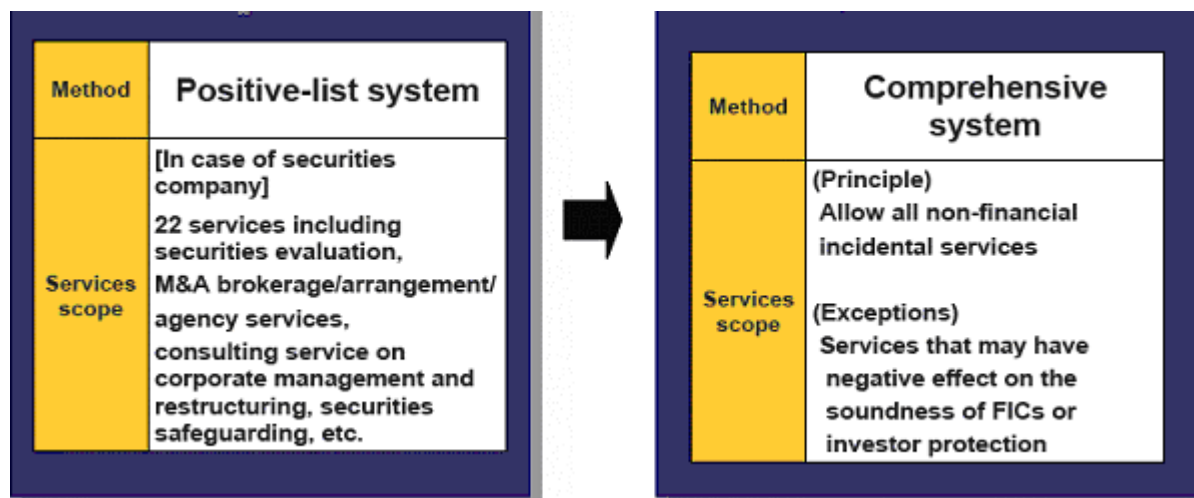
The previous regulations maintained a positive-list system for incidental services. That is, the law specified incidental services allowed for each type of financial institutions and prohibited the rest. The Act changed this into a comprehensive system, where all incidental services are allowed in principle with only a few exceptions. Figure 1.12 shows how the principle governing incidental services has changed under the Act.



Figure 1.12 [Regulations on Incidental Services and Their Scope]

<Previous>

<Under the Act>



To keep incidental services in check, service providers that wish to engage in any incidental service are required to report to the Financial Services Commission seven days prior to the beginning of that service. The Act also provides the FSC with the authority to limit or order alteration to the reported incidental services.

### ③ Allowing Other Financial Services for Financial Investment Companies

#### a. Credit Granting and Payment Guarantee

The previous regulations prohibited, or only allowed to a very limited degree, credit granting and payment guarantees by financial investment companies (securities companies). This has been changed under the Act. Financial investment companies are able to provide leverage loan services as investment banks in other countries do when arranging M&A deals. Dealing service providers are able to make payment guarantees to investors, except for major shareholders or those who are in a special relationship with the company. Dealing and deal arranging of CDs and loans, and loan brokerage are also allowed for financial investment companies under the Act.

#### b. Settlement and Remittance Services

Under the previous regulations, financial investment companies were not allowed to use the retail payments settlement system of the Korea Financial Telecommunications & Clearing Institute (KFTC). This means customers of financial investment companies cannot make payments from their accounts, transfer money in or out of them, or use CD/ATM services. To prevent any disruption of settlement system, financial investment companies are required to provide collateral equivalent to the settlement limit.

#### ④ Expanding Outsourcing

Under the previous regulations, outsourcing was prohibited in principle. Under the Act, this has been changed to “allow outsourcing in principle with a few exceptions.” All incidental services and additional financial services described in the previous paragraphs above can be outsourced, but the outsourcing of “principal services” will be limited. For example, to outsource any financial investment services, the contractor must hold a license or be registered to perform the service.

There are also designated “core” services for which outsourcing is prohibited. For example, decision-making regarding the duties of the compliance officer, internal auditing, risk management, credit risk analysis and assessment cannot be delegated to a third party. This is common to all six types of financial services. In collective investment, trust services and investment advisory and consignment, all principal services are basically regarded as “core” services, and thus outsourcing is prohibited, except for the followings: simple administrative tasks; management or management instructions of assets in foreign currency; safekeeping and maintenance services; management or management instructions of assets in Korean currency up to 20 percent; research and analysis regarding asset management; assessment of collective investment properties (not the decision-making); placing of orders for securities, derivatives, or overseas payment methods. Contractors are not allowed to subcontract the delegated services, except for: operation and maintenance of IT equipment systems, billing, document filing, management or management instructions of assets in foreign currency, custody and management services. The details of services allowed for outsourcing are shown in table 1.11.

Table 1.11 [What Financial Investment Services Can Be Outsourced?]

	Principal Services (delegation permitted only for qualified contractors )	Core Services (delegation prohibited)	Subcontracting allowed
Common	-	<ul style="list-style-type: none"> <li>➢ Duties of compliance officer</li> <li>➢ Internal auditing</li> <li>➢ Risk management</li> <li>➢ Credit risk analysis &amp; assessment</li> </ul> <p>* The service provider cannot delegate the decision-making authority regarding the above services</p>	<ul style="list-style-type: none"> <li>➢ Repetitive or simple duties relating to commissioned services: e.g. operation and maintenance of IT systems; billing; operation of call centers; custody; investigations; research analysis; legal review; accounting management; bonds collection, etc.</li> </ul>

Dealings	<ul style="list-style-type: none"> <li>➤ Execution and termination of dealing contracts</li> <li>➤ Offering quotations</li> <li>➤ Acceptance, delivery, execution &amp; confirmation of transaction orders</li> <li>➤ Underwriting and valuating of securities</li> <li>➤ Pricing of underwritten securities; administrative affairs concerning subscription and distribution</li> </ul>	<ul style="list-style-type: none"> <li>➤ Execution and termination of dealing contracts</li> <li>➤ Offering quotations</li> <li>➤ Underwriting of securities</li> </ul>	-
Brokerage	<ul style="list-style-type: none"> <li>➤ Execution &amp; cancellation of brokerage contracts</li> <li>➤ Daily marking-to-market</li> <li>➤ Handling deposit money and closing transactions (for ETD)</li> <li>➤ Acceptance, delivery, execution &amp; confirmation of transaction orders</li> </ul>	<ul style="list-style-type: none"> <li>➤ Execution &amp; cancellation of brokerage contracts</li> <li>➤ Handling deposit money and closing transactions (for ETD)</li> </ul>	-
Collective Investment	<ul style="list-style-type: none"> <li>➤ Execution &amp; cancellation of investment trust contracts; establishment of investment limited liability company, limited partnership, or undisclosed association</li> <li>➤ Management or giving instructions for the management of collective investment assets</li> <li>➤ Valuation of collective investment properties</li> </ul>	<ul style="list-style-type: none"> <li>➤ Execution &amp; cancellation of investment trust contracts; establishment of mutual fund or investment trust;</li> <li>➤ Execution &amp; cancellation of investment advisory service contracts</li> </ul>	<ul style="list-style-type: none"> <li>➤ Management or giving instructions of management of assets in foreign currency</li> </ul>
Non-discretionary investment advisory service	<ul style="list-style-type: none"> <li>➤ Execution &amp; cancellation of non-discretionary investment advisory service contracts</li> <li>➤ Providing investment opinions</li> </ul>	<ul style="list-style-type: none"> <li>➤ Execution &amp; cancellation of discretionary investment advisory service contracts</li> </ul>	-
Discretionary investment advisory service	<ul style="list-style-type: none"> <li>➤ Execution &amp; cancellation of discretionary investment advisory service contracts</li> <li>➤ Management of commissioned properties</li> </ul>	<ul style="list-style-type: none"> <li>➤ Execution &amp; cancellation of trust service contracts</li> </ul>	-
Trust service	<ul style="list-style-type: none"> <li>➤ Execution &amp; cancellation of trust service contracts</li> <li>➤ Execution &amp; cancellation of safekeeping &amp; maintenance of collective investment properties</li> <li>➤ Safekeeping &amp; maintenance of collective investment or trust properties</li> <li>➤ Management of such properties</li> </ul>	<ul style="list-style-type: none"> <li>➤ Management of assets in Korean currency worth over 20% of the total asset value; or delegation of such service to a foreign contractor</li> <li>➤ Safekeeping and maintenance of trust properties (excluding securities deposit receipts or assets in foreign currency)</li> </ul>	<ul style="list-style-type: none"> <li>➤ Management of assets in foreign currency</li> <li>➤ Safekeeping and maintenance of assets in foreign currency</li> </ul>
* Regarding the outsourcing of financial services other than “financial investment services” under the Act, the service provider is subject to relevant regulations governing the service.			

However, all outsourcing contracts must be reported to the FSS at least seven days before commencing the outsourced business. If the consignee causes the investor to suffer loss, the consignor uses vicarious liability of master.

## ⑤ Introducing the Broker System

The Act introduced the concept of “investment solicitation agent,” which is equivalent to the introducing broker system in other markets, to vary the channel of access to financial products for investors. Under the previous regulations, those who wish to buy a financial product had to make a visit in person to an office of the selling financial institution. This caused a significant amount of inconvenience to investors. Investment solicitation agents in Korea will perform the role of intermediary when selling the products on behalf of financial institutions.

The solicitation agents are required to be certified individuals who completed the relevant training and passed the qualifying test. Unlike introducing brokers in other countries, all solicitation agents in Korea must be tied to a particular financial investment company. Financial investment companies are responsible for registering their introducing brokers with Korea Financial Investment Association (hereunder “the Association”), and the Association should make the list available for public reference.

Investment solicitation agents are subject to the same set of investment solicitation regulations imposed on financial investment companies. When a breach of such obligations by a solicitation agent incurred loss to investors, the hiring company is jointly liable for compensation. The agents are not allowed to represent financial investment companies, collect money or other properties from investors, hire subcontractors to perform the duties he or she was delegated to, or engage in loan brokerage. To protect investors, solicitation agents should inform the investor of the name of the company he or she is working for, and that he or she is not authorized to sign a contract on behalf of the FIC.

## ⑥ Expanding the Scope of Collective Investment

### □ Expanding the Scope of Permissible Vehicles and Investment Assets

Collective investment is a concept newly introduced to Korea’s capital market by the Act. The previous regulations governing this particular service sector were the Act on Business of Operating *Indirect Investment*. However, the term “indirect” is misleading in that trust service or discretionary investment advisory service are also “indirect” in nature. *Collective investment* is characterized by “pooling” of assets, an essential quality that distinguishes this from other types of indirect investment.

Under the previous regulations, only three types of collective investment vehicles were permitted: investment trusts, mutual funds, and private equity funds (PEF). These are extended under the Act to include basically all vehicles that can be established under the civil or commercial codes of Korea, including limited partnership, limited liability, dormant partnership and general partnership.

The scope of investment assets is also changed under the Act from the previous positive list system to comprehensive definition system. The previous regulations enumerated assets

allowed for collective investment as securities, futures, real estate, derivatives, tangible properties, CP, insurance claims, fishing and mining rights. The Act gives a comprehensive definition of assets permissible for collective investment as "assets in any form with monetary value." This will set the stage for advent of funds investing in intellectual property rights, patents or other intangible assets in the future. Means of management is no more limited to acquisition and disposal of properties under the Act.

□ **Reclassifying & Deregulating Funds**

Under the previous Indirect Investment Act, funds were classified into seven categories, depending on the main investment assets (securities, derivatives, real estates, commodities, MMF, fund of funds, and special assets). The previous regulations impose restrictions on the types of assets each type of fund was allowed to make investments in. The Act has scrapped the restrictions on investment assets, and reclassified funds into four categories, depending on the main investment assets (equaling over 50 percent): securities funds, real estate funds, special assets fund, and MMF. Derivative funds have been reclassified into one of the four categories depending on their underlying assets. Also, the Act created a new class of fund called "mixed assets funds" with no limitation of investment assets.

Fund deregulation has been also implemented in resale restriction. Before the Act, indirect investment in real estate and commodities was subject to resale prohibition. Resale was also restricted when a portion of the indirect asset was invested in real estates and commodities. The abolishment of investment assets restrictions enabled investment in all types of assets, from funds to real estate and commodities. As a result, resale prohibition was placed under free decision of the asset management companies.

Table 1.12 shows the types of funds under the Act and investment assets each fund is allowed to invest in.

Table 1.12 [Reclassification of Funds under the Act & Permissible Investment Assets]

<Previous>

	<b>Securities Funds</b>	<b>Derivatives Funds</b>	<b>Real Estate Funds</b>	<b>Commodities Funds</b>	<b>MMF</b>	<b>Fund of Funds</b>	<b>Special Assets Funds</b>
Securities	○	○	○	○	○	○	○
Derivatives	○	○	○	○	×	×	×
Real Estate	×	×	○	×	×	×	×
Commodities	×	×	×	○	×	×	×
Special Assets	×	×	×	×	×	×	○

\* ㉑ Securities funds: over 40% of fund assets invested in securities ㉒ Derivatives funds: over 10% of fund assets invested in exchange or OTC derivatives to evade risk ㉓ Real estate funds: fund assets invested in real estate ㉔ Commodities funds: fund assets invested in commodities ㉕ MMF: fund assets invested in short-term financial products ㉖ Fund of funds: over 50% of fund assets invested in other funds ㉗ Special assets funds: fund assets invested in special assets

\* Commodities: commodities such as gold, grain, oil, and processed products of such

Special assets: shares of PEF, insurance claims, money receivables, CP, beneficiary rights in trust (films etc.), beneficiary rights in various business activities etc.

<Under the Act>

	Securities Funds	Real Estate Funds	Special Assets Funds	MMF	Mixed-Assets Funds
Securities	○	○	○	○	○
Derivatives	○	○	○	×	○
Real Estate	○	○	○	×	○
Commodities	○	○	○	×	○
Special Assets	○	○	○	×	○

#### □ Deregulating Private Equity Funds

The Act will relieve regulatory burden of private equity funds in two ways. The general investors' meeting is no longer mandatory under the Act, and PEFs are not required to monitor the asset management company. The Act also allows the establishment of hedge funds for the first time in Korea. Table 1.13 compares the regulations on public and private funds, before and after the Act.

Table 1.13 [Regulations on Public Funds and PEFs Before and After the Act]

Regulations	Public Fund (Previous)	PEF (Previous)	PEF (Under the Act)
Register to FSC	Y	Y	Y
Allowed only for asset management companies	Y	Y	Y
Mandatory commission to asset custodian companies	Y	Y	Y
Fair treatment of beneficiaries	Y	Y	Y
Evaluation (Mark-to-market)	Y	Y	Y

Obligation to provide prospectus	Y	Exempt	Standstill
Caps for commissions or fees	Y	N	Standstill
Asset management regulations (investment cap in a single asset class)	Y	Exempt	Standstill
Mandatory audit of accounting	Y	Exempt	Standstill
Public announcement of standard agreement (Articles of Association)	Y	Exempt	Standstill
Mandatory reports for asset management or custodian companies	Y	Exempt	Standstill
<b>Mandatory general investors' meeting</b>	Y	Y	<b>Exempt</b>
<b>Mandatory monitoring of asset management companies</b>	Y	Y	<b>Exempt</b>

□ Expanding Regulatory Authority to Investment Companies with Real Business Substance

The Act applies functional regulations to investment companies that are not defined as “financial investment companies” but are still regarded as performing the same financial functions. For example, venture capitalists are allowed to raise capital to an extensive range, and create profits by investing and loaning the raised funds. In this sense, venture capitalists are clearly investment companies in business substance, but are not subject to the same level of regulations as other financial institutions. The Act applies to venture capitalists and other similar entities that make direct investments with leveraged funds and funds from shareholders, distributing dividends afterwards, but are not subject to proper regulations. Table 1.14 shows the types of institutions that fall under this category and the regulations that apply to them, and how these changed under the Act.

Table 1.14 [Functional Regulations on Investment Companies with Real Business Substance]

<Previous>

Name	New Technology Project Financing Businesses	Real Estate Investment Trusts	Venture Capitalists	Corporate Restructuring Companies
<b>Investment Targets</b>	New technology projects	Real estate	Startups, venture businesses	Insolvent companies
<b>Entry Requirement</b>	Registration	License	Registration	Registration
<b>Entry Regulation</b>	○	○	△	△

<b>Prudential Regulation</b>	○	x	△	x
<b>Regulations on Business Activities</b>	x	△	x	△
<b>Supervising Authority</b>	FSC	Ministry of Construction and Transportation	Small and Medium Business Administration	Ministry of Commerce, Industry and Energy

<Under the Act>

<b>Name</b>	<b>Mono-line Investment Financial Companies</b>			
<b>Investment Targets</b>	New Projects	Real estate	Startups, venture businesses	Insolvent companies
<b>Entry Requirement</b>	Registration			
<b>Entry Regulation</b>	○			
<b>Prudential Regulation</b>	○			
<b>Regulations on Business Activities</b>	○			
<b>Supervising Authority</b>	FSC			

### ⑦ Deregulation of OTC Derivative Trading

The Act streamlined regulations for OTC derivative trading. Previously, OTC derivative trading was only permitted for institutional investors. Under the Act, individual, non-professional investors will be able to trade OTC derivatives for hedging purposes. Previously, securities companies should keep their NCR above 300 percent in order to engage in OTC derivative trading. This was lowered to 200 percent under the Act, with the total scraping of the NCR requirement planned to be phased in over three years. Table 1.15 shows the details of deregulation for OTC derivative trading under the Act.



Table 1.15 [Deregulation on OTC Derivative Trading]

Regulation Categories	Previous	Under the Act
1. Transaction	Transactions between two parties	Status quo maintained
2. Risk Management	<ul style="list-style-type: none"> <li>➤ Trade with institutional investors only</li> <li>➤ Total risk 30% of equity capital or less</li> <li>➤ Total credit derivative risk 5% of equity capital or less</li> </ul>	<ul style="list-style-type: none"> <li>➤ Trade with non-professional investors permitted for hedging purposes</li> <li>➤ Status quo maintained (Total risk needs to be regulated; the percentage TBD by FSC regulations)</li> <li>➤ Deleted</li> </ul>
3. Investor Protection	<ul style="list-style-type: none"> <li>➤ Trading to be discontinued when NCR drops below 300%</li> <li>➤ Product descriptions to be submitted to the FSS</li> <li>➤ Every transaction to be approved by a standing officer</li> <li>➤ Counterparties to be adequately informed</li> </ul>	<ul style="list-style-type: none"> <li>➤ Eased (NCR 200%, applicable for 3 years)</li> <li>➤ Deleted (redundant with regulations on investment solicitation &amp; standards agreement)</li> <li>➤ Eased (Standards agreement to be approved, individual agreements using said standards to be exempt)</li> <li>➤ Deleted (redundant with product guidance obligation)</li> </ul>
4. Others	<ul style="list-style-type: none"> <li>➤ Monthly trading records to be reported to FSS</li> </ul>	Status quo maintained (for statistical purposes)

### ⑦ Expanding the Scope of FX Services

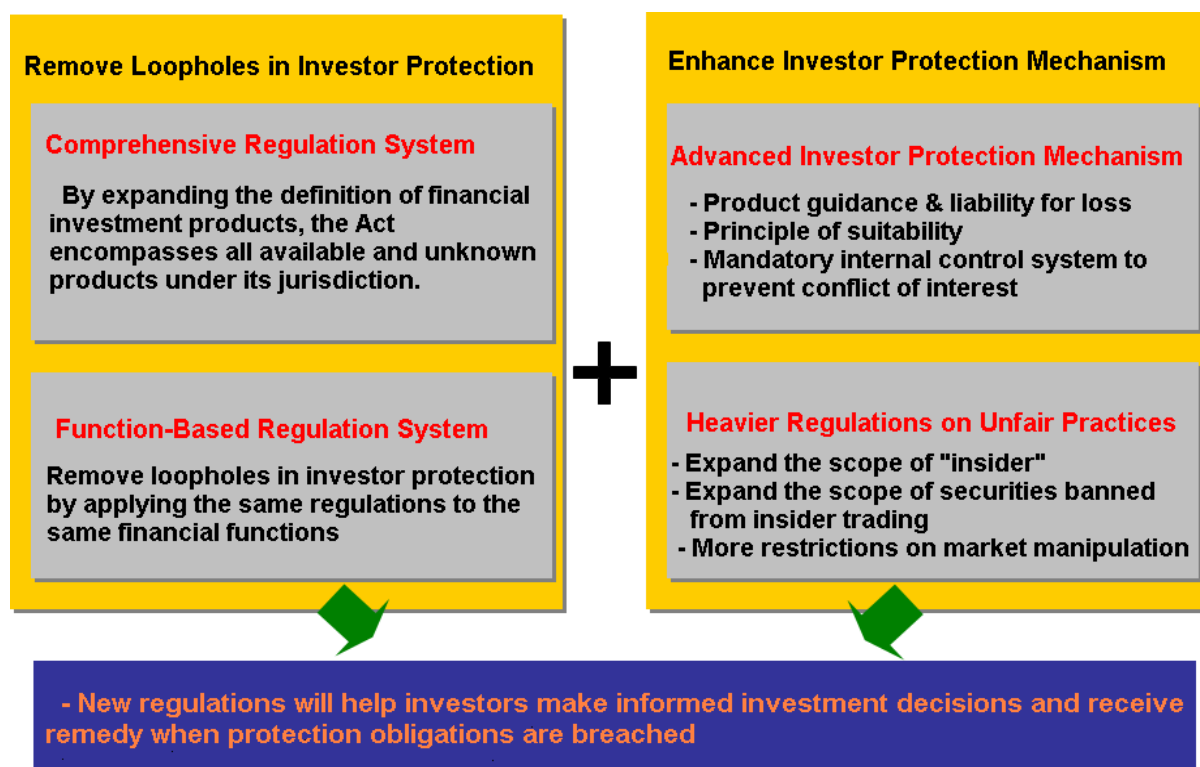
Under the Act, financial investment companies will be allowed to offer services in foreign currencies without any restrictions. The previous regulations enumerated the permissible financial services that could be offered in foreign currencies, and this often led to gaps between the authorized services and services offered in foreign currencies. The Act stipulates that any services licensed or registered can be offered in foreign currencies as well as in the domestic currency. Financial investment companies can also offer currency exchange services to investors in regard to the authorized services.

All foreign currency transactions will be permitted for the purpose of the management (investment or hedging) of a company's own assets, provided that such transactions are fully compliant with the Foreign Exchange Transaction Act. For example, financial investment companies without derivative trading or brokerage licenses can trade foreign currency derivatives for the management of their own assets.

## D. Upgrading Investor Protection

The Act has removed loopholes in investor protection from the previous regulations by adopting a comprehensive definition of financial investment products and function-based regulations. It also has put in place an advanced investor protection mechanism and strengthened product guidance by requiring financial investment companies to explain the details and underlying risks of their products to investors. It introduced the "know-your-customer" rule and the principle of suitability. Financial investment companies are required to know details about their investors and recommend financial investment products suitable to their investors' backgrounds and circumstances. The Act also protects the privacy of investors by prohibiting unwanted investment solicitation. Unfair business practices will be more stringently restricted under the Act. Figure 1.13 shows the basic framework of investor protection system under the Act.

Figure 1.13 [Basic Framework of Investor Protection under the Act]



### ① Regulations on Investment Solicitation

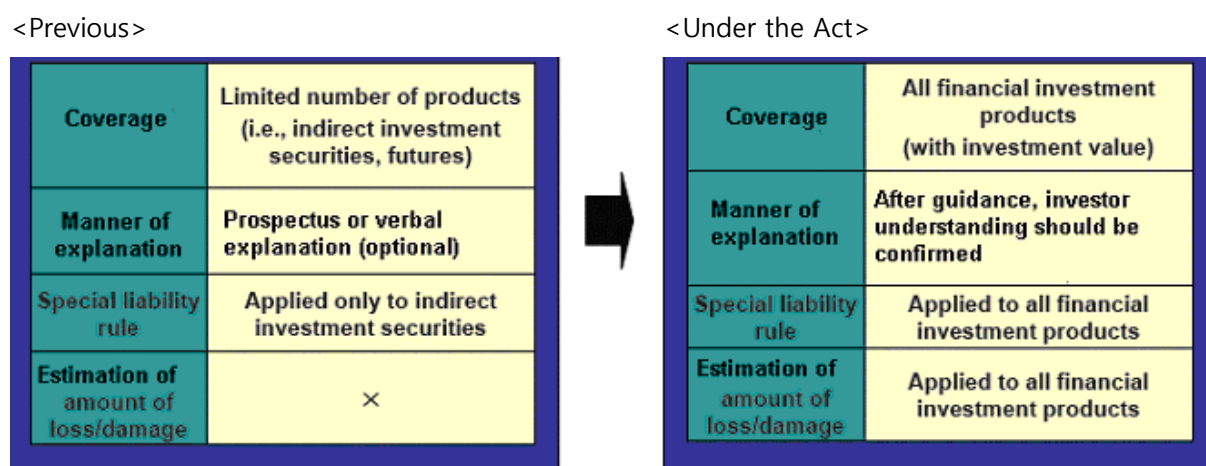
#### a. Product Guidance Obligation

Under the Act, financial investment companies are obligated to provide investors with details of the underlying risks of their products when soliciting for investment. Under the previous institution-based regulations, product guidance rules were not universally applied. For example, verbal explanations were mandatory for futures companies, asset management companies and

REIFs, while investment advisory service providers and ship investment companies only needed to provide prospectuses to investors. Securities companies, investment trusts, and venture capitalists were not subject to any product guidance obligations. The Act applies the same level of product guidance regulations to all types of financial investment companies.

The Act also ensures that the explanations are understood by potential investors by requiring all financial investment companies to receive signatures or recorded verbal agreements from investors, indicating the product guidance was duly provided and understood. Misleading guidance, such as falsifications or omissions of information, is strictly prohibited. When an investor incurs a loss due to misleading, or lack of, guidance, the financial investment company is liable for the loss. Determination of a loss incurred is defined as any loss to the investment principal. However, product guidance obligations are not required for professional investors. Figure 1.14 shows how product guidance obligations are strengthened under the Act.

Figure 1.14 [Product Guidance Obligations under the Act]



**b. Principle of Suitability**

Prior to solicitation, financial investment companies are required to acquire a detailed investor profile, such as their financial status, purpose of investment, experience, etc. through interviews or other contact, and document the said information and confirm it with the investor (know-your-customer rule). With this information, financial investment companies are required to recommend financial investment products that are suitable to the investor’s background and circumstances (principle of suitability). The know-your-customer rule and the principle of suitability are only applicable to non-professional investors.

**c. Other Regulations on Investment Solicitation**

The Act protects the privacy of investors by prohibiting unsolicited contact. Phone calls or house visits are prohibited unless the investor explicitly requests it. This regulation is also

applicable to OTC derivative products. The repeated solicitation of a refused product will be also prohibited. However, this rule will not apply for insurance products with investment value, recurrence after a month, solicitation of a different product, or the solicitation of a similar product to a previous purchase.

## ② Regulations on Investment Advertisement

The Act imposes regulations on investment advertisements—the first of its kind in Korea. All advertisements should specify the name of the financial investment company, the product's details, and the risks associated with the product. Additionally, advertisements of collective investment products should advise the investors to read the prospectus and that the loss of the principal investment amount may occur. Any misleading expression that may imply a guarantee of profit or compensation of loss is prohibited. Furthermore, only financial investment companies are permitted to advertise financial investment products. Exceptions can be made for the Associations, financial holdings companies, and issuers or sellers of securities. All advertisements should be reviewed by a compliance officer and by the Association.

*Cf.* Advertisement is considered to be different from investment solicitation in that solicitation targets a particular investor or investor group, while advertisements are aimed at an unspecified mass audience.

## ③ Expanding the Scope of Disclosure and Registration Requirements

Under the previous regulations, some securities were exempt from issuance registration obligations, despite the need for investor protection. For example, MBS or bank bonds have the same economic substance as corporate bonds, but registration statements were not mandatory. The Act has streamlined registration statement requirements so that investor protection is not neglected, but also so the cost of issuance does not pose an unnecessary burden on financial investment companies. All securities, excluding bonds issued by the government, municipalities, or their equivalents, are subject to registration statements. The solicitation of products before registration is prohibited, but generic ads are permitted under some circumstances. Generic ads refer to the advertisement of simple facts, such as the name of the issuer, the general conditions of the securities and the date of issuance.

When making a public offering, financial investment companies are required to distribute prospectuses to all non-professional investors. Under the previous regulations, prospectuses were only provided to those investors who explicitly asked for them. Under the Act, this remains in place for professional investors

#### ④ Establishing a System to Prevent Conflict of Interests

Since the Act will expand the potential scope of business within a single financial investment company, conflicts of interest are likely to occur. Recognizing this possibility, the Act has introduced multiple mechanisms to prevent such conflicts of interest. The following are prevention measures under the Act:

- **Mandatory Prevention of Conflicts of Interest.** The Act, in principle, prohibits pursuing one's own or other investors' interests by sacrificing the interest of another investor.
- **Cases of Conflicting Interests Explicitly Prohibited.** Specific cases of possible conflicts of interests are enumerated by the Act and explicitly prohibited as unfair business activities. These activities are listed in Article 71 for dealers and brokers, and in Article 85 for collective investment service providers.
- **Internal Control System to Monitor for Possible Conflicts of Interest.** All financial investment companies are required to put in place an internal control system to detect any possible conflicts of interest and to take the necessary preventive measures. For example, when a possible conflict of interest is identified, the investors should be informed and the potential conflict of interest should be eliminated. If it cannot be eliminated, trading of the product in question should be prohibited.
- **Mandatory Establishment of Chinese Walls.** Financial investment services with high potential for conflicts of interest are required to have Chinese Walls in place. This includes the prohibition on the sharing of information, employees or officers, office space, and IT equipment. However, segregation is not mandatory for all six different financial investment services. Dealing and brokerage services do not have a high potential for conflicts in interest and thus a Chinese Walls between those two services is not necessary. The same holds true for collective investment services and trust services. Chinese walls will be established to separate dealing and brokerage from corporate finance or collective investment and trust services. Investment advisory services can be operated without Chinese Walls, except for with corporate finance and the management of the company's own assets. Chinese Walls are also mandatory between financial investment companies and its subsidiaries.

#### ⑤ Other Reforms for Investor Protection

##### a. Abolishing Discretionary Trading System

Previous discretionary trading by securities companies was criticized for posing excessive regulatory burdens and for being unrealistic. These issues have been rendered void under the Act

with any registered discretionary advisory service providers being able to conduct discretionary trading.

#### **b. Reforming Regulations on Proprietary Trading**

Previously, employees or officers of financial investment companies could not make direct investments into securities or futures and could only buy securities savings worth up to 50 percent of their monthly income. However, there are few internal control systems in place to monitor their trading, which could lead to unfair business activities. The Act has introduced regulations used in other countries to allow proprietary trading in principle and to strengthen internal controls so as to prevent any unfair activities. Employees and officers of financial investment companies cannot open accounts for proprietary trading at companies other than their own (Exceptions can be made for products unavailable at their company). They cannot hold more than one account, and the company should be notified of their trading records on a monthly basis.

#### **c. Reforming Regulations on Business Names**

The previous regulations required the use of particular words (securities or investment) in the business names of financial companies. However, under the Act, this has been abolished. Non-financial investment companies are still banned from using certain words in their business titles (securities, derivatives, collective investment, investment advisory services, trust services).

#### **d. Introduce a Cooling-off System**

The cooling-off system has been introduced in the Act as a means of investor protection. When a financial investment company concludes a contract with an investor, the company is required to provide the investor with the contractual document immediately. Within seven days of concluding the contract, the investor can cancel the contract in writing without incurring any liability. The immediate delivery of contract documents may be exempted for repetitive contracts, delivery via mail or email, or if the investor declines it in writing.

#### **e. Reforming Disclosure Requirements**

The Act has streamlined the timely disclosure rules for corporate information. Under the previous regulations, companies were required to report any significant issues in management or future plans to both the FSC and the Korea Exchange, as some disclosure items were managed by the FSC with others managed by the Korea Exchange. As such, this system was inconvenient as the forms required by each organization were different. On the other hand, the Act designates the Korea Exchange as the single channel to receive corporate information for timely disclosure requirements. Among the disclosure items under the previous regulations, key information or

corporate actions are designated “material changes” under the Act, which are to be reported to the FSC instead of Korea Exchange. This is known as the “material change report.” The number of items to be reported to the FSC is reduced from the previous number of 70 to around 20, and the Act enumerates each item specifically.

#### **f. Strengthening Regulations on Unfair Trading**

The Act has strengthened regulations on unfair trading on the following three aspects:

- **Expanding the Scope of Insider Trading.** Under the previous regulations, restrictions on insider trading were limited to the securities issued by the company, while the “insiders” only included the officers, the issuer and contractor. The Act extends the scope to include derivative products’ underlying assets, which are issued by the company. The definition of an insider has also been widened to include subsidiaries, their employees and officers, other companies engaged in contract negotiations with the issuer and their employees and officers.
- **Expanding the Scope of Short-term Sales Margin to Be Disgorged.** When an insider gains unfair profit by usurping inside information, that person is required to disgorge the profits. Under the previous regulations, the types of securities that were subject to this rule were limited to a few examples. The previous law limited the scope to just stock-related securities. In contrast, the Act expanded the application of this rule to all types of securities.
- **Strengthening Regulations on Market Price Manipulation.** Under previous regulations, the manipulation of spot prices with the intention of gaining profits in futures trading was prohibited, but this regulation was not applied to the other way around. Under the Act, regulations on market price manipulation are applied in both directions, as well as the unlawful linkage between spot trading and DLS trading.

#### **g. Reforming M&A Regulations**

The five-percent rule under the previous regulations exempted state, municipalities, government funds and other designated entities from disclosure obligations. However, it was widely recognized as unreasonable to have exceptions to this rule, given the rule was created for investor protection. Under the Act, the rule is indiscriminately applied to all entities. However, if the buyer does not have the intention to exert managerial rights, the time limit for mandatory disclosure is prolonged for institutional investors and the like.

The previous law required entities with significant stock holdings to report to report to the FSC and the Korea Exchange of such acquisition of shares within five days, but did not require the shareholders to report such information to the issuing company. However, the Act requires that the buyer notify the issuing company as well as the FSC and Korea Exchange of any

information regarding the five-percent rule.

The Act has adopted a comprehensive system for securities subject to mandatory tender offers. Previous regulations enumerated the types of securities for which a tender offer should be made publicly. The Act defines an overarching boundary for the types of securities so as to include new securities products that may emerge in the future. Also, the issuer is required to give an opinion on a tender offer – either “approve,” “disapprove,” or “neutral” and reasons for that choice.



## **4. Expected Effects of the Act**

### **A. More Efficient Money Brokerage Function in the Capital Market**

#### **① From the Perspective of Businesses**

Under the Act, companies will be able to better finance their business and hedge risks. Various structured products will become available for corporate financing in addition to the traditional means of raising capital, such as stocks and bonds. The advent of new breeds of derivative products will also help companies hedge risks arising from the process of business management.

#### **② From the Perspective of Consumers**

The new financial environment to be created by the Act will be beneficial for investors as well. New types of financial investment products with diverse combinations of risk and levels of return will enable the fine-tuning of asset management practices to suit the individual investment needs of consumers, encouraging a more stable flow of reserve funds into the capital market.

#### **③ From the Perspective of Financial Investment Companies**

The Act will provide the necessary impetus to spur the formation of financial investment companies that are much larger in size and more competitive than the current market players. Large service providers are beneficial to the corporate capital market as they are better equipped to design structured products and make principal investments. The key beneficiaries are likely to be innovative venture businesses.

### **B. Investor Protection and the Subsequent Investor Confidence in the Market**

#### **① From the Perspective of Consumers**

The introduction of the duty of product guidance and advanced investor protection mechanisms will help investors make informed decisions when making their investment choices.

#### **② From the Perspective of Businesses**

Improved investor protection will result in greater investor confidence in the capital market, attracting more surplus funds to the capital market. More funds mean better market capability for raising capital for businesses. Since businesses tend to have better risk-taking and

decision-making abilities, the regulations on investor protection can be partly removed for corporate investors to give them a wider range of choices.

### C. Preparing for the Advent of Advanced Financial Investment Companies

#### ① Same Business Scope with Advanced IBs

Since the segregation of the service sector has been eliminated under the Act, domestic financial investment companies are free to choose similar business model to advanced investment banks. Leading investment banks in advanced economies are engaged in a wide range of securities services, IBs, asset management, PI and other services, and are permitted to structure and sell new derivative products with no limitations on their underlying assets or securities. Figure 1.15 shows how their business scopes will change under the Act.

Figure 1.15 [Changes in the Business Scope of Financial Investment Companies under the Act]

	Principal investment		Corporate financing		Securities service	Asset management			
	Dealing	Investing	Under-writing	Advisory	Brokerage	Discretionary	Non-discretionary	Asset managing	Trust
Conventional securities	Merchant bank Securities co.					Asset management co.			Trust Co.
Conventional derivatives									
New type of securities									
New type of derivatives									

↓

	Principal investment		Corporate financing		Securities service	Asset management			
	Dealing	Investing	Under-writing	Advisor	Brokerage	Discretionary	Non-discretionary	Asset managing	Trust
Conventional securities	FICs								
Conventional derivatives									
New type of securities									
New type of derivatives									

#### ② Creating Synergy Through Integrated Services

Under the Act, financial investment companies will be able to enjoy synergy generated by the combination of different financial investment services. The combination of securities and

futures businesses will create positive synergy for investors and financial investment companies by allowing financial investment companies to provide comprehensive securities services to investors through the trading and brokerage of all financial investment products.

The combination of corporate financing, asset management and principal investment will also produce powerful effects. Whether managing corporate financing businesses, or M&A arrangements, financial investment companies will be able to make direct investments using their own assets earned from their asset management. By integrating various wealth management activities, financial investment companies will also be able to provide comprehensive asset management services by varying their product offerings (structured securities, indirect investment products, wrap accounts, specialized trust products, etc.).

### **③ Strengthening Competitiveness by Varying Product Offerings**

Financial investment companies will be able to structure and sell a virtually unlimited range of financial investment products, as suited to their business needs under the Act. This is expected to greatly enhance their competitive edge on the global stage. Investment banks are likely to provide much better corporate financing services by using highly sophisticated derivative models to help companies structure unique securities or underwrite them. Asset management services will be also highly customized under the Act to meet the investment needs of individual groups of investors, who will be able to choose from a variety of DLS, indirect investment schemes, derivative products and other state-of-the-art financial investment products. The advent of new financial products is expected under the Act, e.g. fund-linked notes, which can guarantee high returns at relatively lower risks. Wide-ranging derivative products will give investors the opportunity to enjoy custom-made risk-hedging services.

### **④ Achieving Economy of Scale**

The Act will pave the way for the emergence of much larger financial investment companies, that are more competitive than existing companies, by changing the structure of the services permitted for financial investment companies. The changed structure can be seen in Figure 1.11.

By achieving economy of scale, financial investment companies will be able to use their own assets to make principal investments, one of the essential capabilities required by an investment bank. By engaging in diverse financial service sectors ranging from IB, PI, asset management, and corporate financing, financial investment companies can build a common customer (investor) base and maximize their customer profitability. The growth in the assets they manage will also save in the costs of capital management and securities transactions. Business

operations are likely to enjoy greater efficiency, since growing front-office organizations will be still able to share back office functions, IT equipment, and certain other items of common use.

### ⑤ Influence on Each Sector

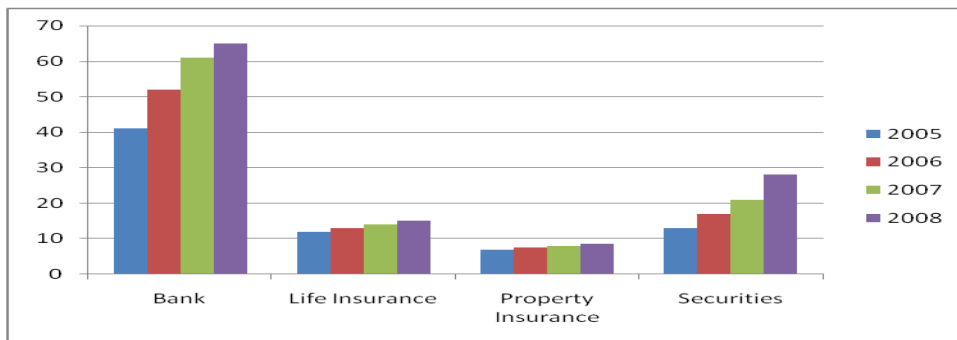
Although the Act excludes banks and the insurance sector, it seeks to bring fundamental changes to the capital market as a whole. Therefore, it is expected to have a significant influence on the financial system and each financial sector. Table 1.16 provides a basic overview of the influence the Act has on each sector.

Table 1.16 [Effect of the Act]

	<b>Effects of the Act</b>	<b>Influence</b>
Banks	Increase in opportunities to diversify revenue structure	Positive
	Possibility of an outflow of funds from financial investment firms conducting retail settlement	Negative
	Contraction of banks' trust business	Negative
Insurance	Improvement in the asset management conditions of insurance firms	Positive
	Increased possibilities for insurance firms' participation in retail settlement	Positive
	Intensifying competition from overlapping businesses	Negative
Securities	Increased role and net volume of the capital market	Positive
	Accelerating increase in the size and specialization of capital market-related financial firms	Positive
	Increased product competitiveness from business crossovers in comprehensive financial services	Positive
	Strengthening of operational foundations	Positive
	Intensifying the market domination of foreign financial firms	Negative
Asset Management	Affiliate-centered increase in size	Positive
	Foreign asset management firms' entrance in retail market and intensifying competition	Negative

In the short to medium-term outlook, the act is expected to affect the banking, insurance, securities, futures and asset management industries, and its market effects will include; an increase in the connection between banks and the securities market; an increase in the number of methods corporations use to secure funds; intensified competition among large-scale financial (financial investment, banking, foreign) firms; and accelerated capital market integration centered around retail business investment advisors. In the long run, the Act is expected to be a catalyst, changing the center of the financial system from the bank to the market.

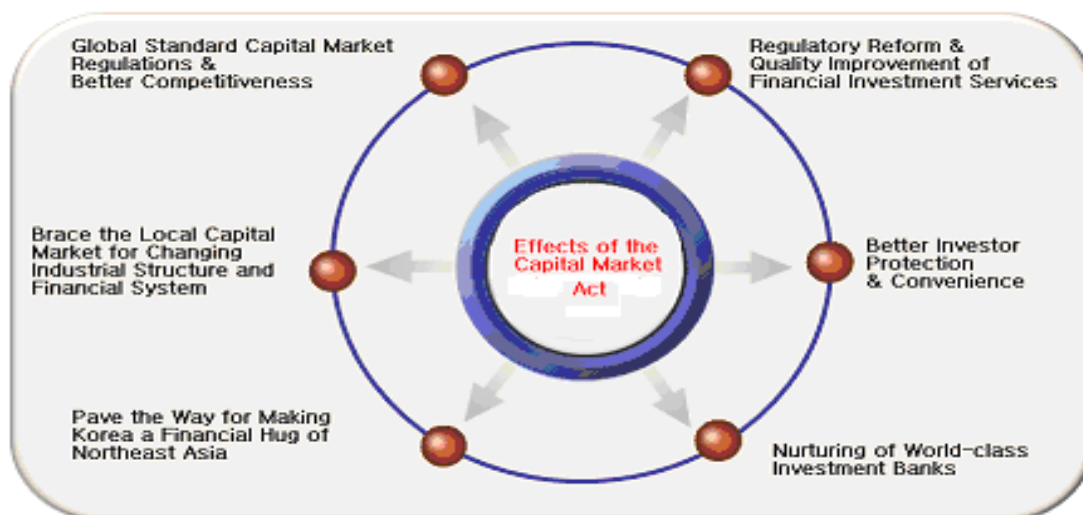
Figure 1.16 [Overview Financial Sector Equity] , (Trillion KRW)



#### D. Conclusion

The Financial Investment Services and Capital Market Act has come at a time when Korean society faced multiple economic, social and financial challenges. The traditional industrial mix of Korea seems to have run its course and there is a pressing need to find a new breed of industries for future growth. Korea's rapid aging trend, low interest rates, and low inflation all indicate a growing demand for a more efficient capital markets. The Act will open the door to new opportunities and competition for the Korean capital market. The consolidation of Korea's capital market will bring new horizons to investor protection, quality of services, the emergence of world-class investment banks and the overall development of the capital market. With the necessary regulatory reforms to respond to global competition for a more efficient capital market, the Act is expected to change the paradigm of the Korean capital market and lay the foundation for making Korea a financial hub of Northeast Asia, and a truly advanced capital market.

Figure 1.17 [Expected Results of the Act]



## Part II. Changes to KSDA's Role and Organizational Structure

### 1. KSDA's Role

#### A. As-Is

##### ① Mission and Legal Status of KSDA

###### a. Mission and History of KSDA

The Korea Securities Dealers Association (KSDA) was a non-profit organization founded on November 25 1953, the same year the bloody war on the Korean Peninsula drew to an end. Its establishment was based on Article 162 of the Korea Securities and Exchange Act, and was motivated by the need to rebuild the nation and finance its industries amid the ruins of war. Ever since, KSDA had played a pivotal role in introducing the securities industry to Korea, as well as developing Korea's securities market into one that carries global weight. KSDA's mission was to maintain fair business practices among securities companies, protect investors, and ensure the sound development of the Korean securities market. The followings are the key milestones of KSDA history. The full chronology of KSDA history is shown in Table 2.1.

- Milestones

- i . Soon after its foundation, KSDA and the government created a committee to establish a securities market, which resulted in opening of the Korea Exchange (then the Korea Stock Exchange) in 1956. KSDA also organized a research group called the Securities Research Committee, which greatly contributed to formulation of the Securities and Exchange Act of 1961.

- ii . March 1977, the Korea Securities Training Institute was established to provide training for professionals engaged in the securities industry.

- iii . January 1992, the Korea Securities & Economic Research Institute (later renamed the Korea Securities Research Institute) was formed with the goal of directing the future of the local capital market toward achieving long-term stable development and enhancing the standing of the securities industry in the economy.

- iv . July 1996, KSDA opened a new stock market, the Korea Securities Dealers Association Automated Quotation (KOSDAQ), to help venture businesses and SMEs raise capital.

- v . March 2000, the Third Market (later renamed Free Board) was inaugurated to facilitate in the trading of unlisted stocks filling the vacuum created by KOSDAQ's merger with the Korea Exchange.

vi. June 2005, the Korea Council for Investor Education was created to provide well-structured, efficient education for investors in the fields of securities, futures and asset management.

vii. October 2008, the Korea Emerging Market Center was established to introduce the Korean capital market to the various emerging markets and to create a cooperative network with them—providing systematic support for Korean securities companies to enter emerging markets.

Table 2.1 [Chronology of KSDA]

2000s	Oct. 7, '08	Establishes Korea Emerging Market Center as a partner institution to the state agency Financial Hub Korea
	Mar. 25, '08	Begins joint training programs between academia and industry with the aim of nurturing a global pool of financial professionals (e.g. the program by KAIST and ICMA Centre)
	Dec. 4, '07	Launches BQS (Bond Quotation System) to collect and disseminate all the OTC bond trading quotes in a single, centralized system
	Oct. 3, '07	Signs MOU with the U.K.'s ICMA Centre for the development and operation of joint training programs
	Apr. 27, '07	Registers KSDA as a licensed credit information collecting agency
	Dec. 4, '06	Announces Free Board Index for the first time
	May 21, '06	Hosts Asia Securities Forum 2006 in Seoul
	Sep. 1, '05	Opens KSDA Busan Office
	Jul. 13, '05	Launches Free Board (Third market renamed the Free Board)
	Jun. 16, '05	Establishes The Korea Council for Investor Education with eight other private and public institutions, representing the combined industries of securities, futures and asset management (with KSDA functioning as the Secretariat)
	Apr. 26, '04	Announces its commitment to customer satisfaction
	Sep. 18, '02	Moves to new offices
	Apr. 1, '01	Installs Self Regulation Committee
Sep. 1, '00	Launches KOSDAQ Surveillance System (KOSS) to ensure market integrity by maintaining oversight of stocks and detecting abnormalities	
1990s	Oct. 9, '98	Establishes KOSDAQ Committee to ensure the integrity and efficiency of the KOSDAQ market
	Oct. 1, '97	Korea Securities & Economic Research Institute separates from KSDA and is renamed Korea Securities Research Institute

	May 29, '97	Acquires new legal status - KSDA registered as a special entity
	Jul. 1 '97	Opens new KSTI regional training center in Asan, South Chungcheong Province, Korea
	Apr. 20, '97	Hosts the 10th International Council of Securities Association Conference
	Jul. 1, '96	Launches Korea Securities Dealers Association Automated Quotation Market (KOSDAQ): private sales under the Intermediary office for the OTC bond market are changed to auction trades under the KOSDAQ Stock Market Company to help ventures and SMEs
	May 17, '96	Establishes KOSDAQ Stock Market Company with 5 billion KRW of paid-in capital and 100 percent of its subscription met by KSDA and its members
	May 1, '93	Creates Intermediary Office for OTC Bond Market to facilitate bond trading
	Mar. 29, '92	Joins the International Council of Securities Associations (ICSA) to facilitate international securities trading, information exchange and understanding among members, thereby contributing and encouraging the sound development of the international securities market
	Jan. 3, '92	Establishes the Korea Securities Economic Research Institute with the aim of conducting in-depth research into the overall capital market so as to set the long-term direction for stable development of the market and to enhance the status of the securities industry, with the ultimate goal of providing effective support to the relevant authorities in the policy-making process
	Oct. 21, '91	Creates Intermediary Office for OTC Stock Market: the market adopts private sales to enable over-the-counter trading between members
	May 4, '90	Launches Securities Market Stabilization Fund to boost the depressed stock market
1980s	Mar. 3, '89	Establishes Investor Protection Center to help investors better understand and protect their rights
	Apr. 1, '87	Establishes OTC stock market as an independent stock market from the Korea Exchange under the leadership of KSDA, as required by a 1986 government initiative to create a market for the stock trading of SMEs
	Oct. 29, '84	KSDA office building completed after two years of construction in Yeouido, heralding the advent of a new financial district
1970s	Mar. 12, '77	Reopens the Korea Securities Training Institute as an affiliate of KSDA: The Korea Investment Corporation dissolved to form a better organization, management of KSTI transferred to KSDA (Dec. 15, 1976)
	Feb. 12, '77	Transfers to the role of underwriter: Korea Investment Corporation dissolved to form a better organization, the role of underwriter transferred to KSDA



	Jun. 9, '76	Securities Public Relations Association becomes affiliated to KSDA to enhance the efficiency of PR activities for the securities industry
1960s	Sep. 11, '62	Begins broadcast of quotation information: sessions directly aired to member companies enabling them to provide the latest price information to investors
	Jan. 15, '61	Enacts the Securities and Exchange Act to provide institutional support for the efficient exchange of securities, thanks to the Securities Research Committee, a committee jointly launched by KSDA and the government in 1960
1950s	Mar. 3, '56	Establishes the Korea Stock Exchange (later renamed Korea Exchange)
	Nov. 25, '53	Establishes Korea Securities Dealers Association: The five founding members — Daehan Securities, the first company given a securities business license in Korea (1949), Koryo Securities (1952), Youngnam Securities (1953), Kukje Securities (1953) and Dongyang Securities (1953)—hold the inaugural meeting and formulate the Articles of Association

### **b. Legal Status**

Established to ensure market integrity and investor protection, KSDA was a self-regulatory organization for the securities industry with official status bestowed by the Securities and Exchange Act. Founded in November 1953, KSDA was initially a non-profit, voluntary organization consisting of five members without any legal authority. When the Securities and Exchange Act was revised in June 1997, KSDA was given new status as a special statutory entity.

## **② Management of KSDA**

### **a. Overview**

The recent upheavals in the global financial market demanded that KSDA play an extended role, not just as an SRO administering the rules, but also a player in the market to better ensure the fairness and transparency of business practices and to protect investors. KSDA's key functions were providing policy recommendations to the government and relevant authorities, and to act as a forum for its members to facilitate an exchange of opinions with the aim of achieving stable development of the local securities market. Management of KSDA was steered by the General Meeting, the Board of Directors and several committees.

### **b. Governance Structure**

The previous governance structure of KSDA consisted of two layers, one for member services and the other for self-regulation, with the General Meeting and the Board of Directors sitting above them as the principal governing bodies. An independent committee, entitled the Self Regulation Committee, oversaw KSDA's self-regulatory function. This dual-layered structure was

created as a means to ensure the fair and impartial exercise of regulatory authority over the securities industry, with the two bodies remaining within the same organization for the sake of operational efficiency.

On April 11 2001, the organization took an important step toward bolstering the public aspects of its identity and its decision-making capacity. Representation of membership at the Board of Directors (member directors) was reduced from eight directors to three, while the number of independent directors was increased from three to five. The directors' selection process was also overhauled with their selection being made by popular vote at the General Meeting, as opposed to appointment by the Chairman of the Board and approval at the General Meeting as was previously done.

Other affiliated or complimentary groups with KSDA included three advisory committees to the Board, management, policy, and international affairs respectively, the Securities Industry Council, and the Korea Securities Training Institute (KSTI). The Securities Industry Council was created to stimulate discussion about current issues facing the securities industry and its future direction. KSTI is in charge of nurturing the talent pool for the securities industry.

### **c. Responsibilities of the General Meeting, the Board and Committees**

#### **i. General Meeting**

The General Meeting was the supreme decision-making body of KSDA. Its meetings were considered valid only when a majority of its members are present, and any decisions it makes must be agreed upon by a majority of the members present. Only regular members had voting voices at the General Meeting. In the event of a deadlock, the Chairman held the deciding vote.

The agenda of the General Meeting may include: the formulation and amendment of the Articles of Association; business planning and reports; the budget and settlement of accounts; expulsion of members; the dissolution of KSDA; and any other matters deemed necessary by the Board of Directors or the Chairman.

#### **ii. Board of Directors**

The Board of Directors was responsible for the management of KSDA's general affairs and it met once a month. The quorum for Board Meetings consisted of a majority of its members, and its decisions were made by a majority of those present. The Board consisted of a maximum of fifteen members, including the Chairman, three Vice Chairmen, three or fewer member directors and five or fewer independent directors.

The Board of Directors had the authority to approve: new members; formulations, amendments or repeals of internal regulations regarding the Board, committees or office organizations; payroll; use of reserve funds; use of capital raised by penalty impositions; investment or contributions; acquisition and disposal of real estate; the agendas submitted for

consideration at the General Meeting; and other important matters deemed necessary by the Chairman of KSDA.

### **iii. Self-regulation Committee**

The Self-regulation Committee was responsible for protection of investors and the planning of self-regulatory regulations under Section 55 of KSDA Articles of Association. The committee was comprised of three independent directors named by the Board of Directors, two representatives of member companies designated by the Board of Directors and two securities experts, with the Standing Vice Chairman of KSDA sitting as the committee chair.

The Committee primarily dealt with: formulations, amendments or repeal of the rules and regulations concerning self-regulation and members' business activities; auditing and discipline of member companies or their officers that may have violated securities-related laws and regulations or KSDA rules and regulations; the execution or support for the inspection of a member handed over by the authorities; and other matters in connection to KSDA's self-regulatory functions and investor protection.

### **iv. Committees**

KSDA had a number of committees, organized according to Section 40.1 of the Articles of Association, in the fields of management, policy, international affairs, nominating and compensation. Each committee was comprised of a number of representative directors of member companies and the Standing Vice Chairman of KSDA. Each representative director of KSDA's member companies were invited to declare his or her choice of committee to be assigned to, and the Chairman of KSDA made them the offer of committee membership.

Each committee had in principle one committee chair and one vice chair. The committee chair was appointed from among the member directors, and the vice chairman from among the committee members, both by the Chairman of the Board.

- **Role of the Management Advice Committee**

The Management Advice Committee offered opinions on such matters as: revision of the Articles of Association of KSDA; business planning, reporting and other matters related to management of KSDA; budget planning and settlement; admission and secession of members and membership fee collection; the operation of training centers and office buildings; and other matters that did not fall within the competence of other committees.

- **Securities Policy Committee**

The Securities Policy Committee primarily provided advice on: policy reassessment and recommendations; market operations; the formulation and repeal of rules and regulations concerning the business operation of KSDA members; research of, and PR for, the securities market; and the management and business practices of members.

- International Affairs Committee

The International Affairs Committee chiefly advised on: the preparations for, and promotion of, the globalization of the securities market and the formulation and repeal of rules and regulations related thereto; membership of international companies; and other policy recommendations regarding globalization.

- Chairman Candidate Recommendation Committee and Compensation Committee

The main task of Chairman Candidate Recommendation Committee was to nominate candidates for the election of chairman. The candidates should be someone with extensive knowledge and experience in corporate management and the securities industry in particular, and who met the qualification criteria stipulated in Article 33 of Securities and Exchange Act.

The Compensation Committee oversaw the administration of the annual and retirement compensation programs for the officers and established, revised, or repealed the strategy for them. The Compensation Committee could deal with other matters if the committee chair deemed them necessary.

#### **v. Dispute Resolution Committee**

The Dispute Resolution Committee deliberated and made decisions regarding disputes arising between members, or between a member and its customer, in relation to the business conducted by the member according to Article 162.2 of Securities and Exchange Act. The organization and operation of the Dispute Resolution Committee was within the competence of the Board of Directors. The committee was made up of seven dispute settlement experts, including legal counsels.

When a member of KSDA or a customer requested the committee to resolve a dispute it has with another KSDA member, the counter-party member was obliged to submit to the committee's authority. The committee might request for the member or its officers to supply confirmation of the facts or for the submission of documents or oral statements if deemed necessary.

#### **d. Selection of Chairs and Their Duties**

The Chairman of KSDA represented the association itself and chaired the General Meeting and the Board of Directors meetings. The Chairman was selected at the General Meeting from among the candidates nominated by Chairman Candidate Recommendation Committee.

Vice Chairmanship was held by three people, one standing and two non-standing Vice Chairmen. The Vice Chairmen assisted the Chairman in the management of the association, and, according to the order in which they have been ranked by the Chairman or by their seniority, assumed the Chair in the event of the incumbent's absence or incapacity. The General Meeting chose two non-standing Vice Chairmen from among the representative directors of regular

member companies, or a top manager if the member is a local branch of international securities company. The standing Vice Chairman was appointed by the Chairman and confirmed by the General Meeting.

The Board of Directors was comprised of eight or fewer members, made up of independent directors and member directors who were elected at the General Meeting. Independent directorship was a non-standing position and the holders were selected from among those who have sufficient experience and knowledge of the securities industry. Member directors also served part-time and were selected from among the representative directors of KSDA members.

The auditors were divided into two groups: independent auditors and member auditors. Both the independent auditors and member auditors were non-standing positions and were elected at the General Meeting. An independent auditor would be someone qualified or sufficiently experienced to perform the responsibilities of an auditor, while a member auditor would be a representative director of a member company. KSDA could also have five or fewer executive managing directors, who were appointed by the Chairman and confirmed by the Board of Directors. Table 2.2 shows the numbers and terms of office of KSDA officers.

Table 2.2 [Numbers and Terms of Office of Officers]

Title	Number	Term of Office
Chairman	One	3 years
Vice Chairman	Not more than three (including one standing)	2 years (3 years for Standing Vice Chairman)
Member Directors	Not more than three	2 years
Independent Directors	Not more than five	2 years
Member Auditors	Not more than two	1 year
Independent Auditors	Not more than two	1 year

#### e. Membership

The types of KSDA membership are described in Table 2.3.

Table 2.3 [Membership Types]

<b>Regular Membership</b>	Securities companies engaged in full-service securities business (dealing, brokerage and underwriting) with capital stock (operating funds in case of a local branch of international securities companies) of KRW50 billion or more
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<b>Special Membership</b>	Securities companies that do not qualify for regular membership
<b>Associate Membership</b>	Institutions allowed to be concurrently engaged in securities business under the Securities and Exchange Act; institutions engaged in the bond intermediary businesses for companies that were approved to execute those activities, as stipulated in Item 1, Paragraph 2, Article 28 of the Securities and Exchange Act outside the KRX; asset management companies established under the Indirect Investment and Asset Management Act; licensed bond valuation agencies; Korea Listed Companies Association; and KOSDAQ-Listed Companies Association

KSDA had 36 regular members (35 domestic, one international) 25 special members (12 domestic, 13 international), and 38 associate members at the present. Table 2.4 shows the number of members of KSDA.

Table 2.4 [Members]

<b>Membership</b>	<b>Number of Members</b>	<b>Remarks</b>
Regular Members	36	35 domestic, 1 international
Special Members	25	12 domestic, 13 international
Associate Members*	38	
Total	99	

#### **i. Obligations and Rights of Members**

##### **□ Admission Fee**

Any entity aspiring to become a member was only required to fill-out and submit a membership application. However, to become a regular member, the entity was required to pay an admission fee in a lump sum. The fee was 1.2 billion KRW for becoming a regular member and 0.2 billion for becoming an associate member.

##### **□ Membership Fees**

Those who wish to apply for membership of KSDA were subject to admission fees and membership fees when admitted into the KSDA, for the ordinary expenditures of the KSDA.

Regular members and special members were required to pay fixed-rate membership fees, while associate members, authorized to underwrite, sell or offer securities and other related businesses, paid a flat fee. The fixed-rate membership fees amounts were calculated as follows:

- The amount incurred from by multiplying a fixed rate by trading value (excluding trading value of bonds) on the KOSPI or KOSDAQ market, or by the trading value of securities on the electronic communication network market, or by the trading value of securities on the OTC Market.
- The amount incurred from by multiplying the trading value by a fixed rate in the case of stock index futures
- The amount incurred from by multiplying the trading value by a fixed rate in the case of stock index options and individual stock options

The basis and the rates of membership fees were within the competence of the Board of Directors. The Board also has the authority to exempt any member from payment, as it deems necessary. The basis value and rates of membership fees are shown in Table 2.5.

Table 2.5 [Basis Value and Rate of Membership Fees]

Market	Product	Basis Value	Rate
Stock Market	Stocks	Trading Value	0.001026%
Futures Market	Futures on stocks	Sale Value	0.00071%
Options Market	Options on stocks	Option Value	0.000855%

□ **Reporting and Submission of Documents**

Members of KSDA were obliged to declare or report to KSDA in accordance with the prescribed forms, or to submit materials when required by the Articles of Association or other KSDA regulations.

③ **Roles and Functions of KSDA**

a. **Major Tasks Required by Law**

i. **Statutory Tasks**

The Securities and Exchange Act specified the key tasks of KSDA and granted it the authority to create or revise regulations and impose them upon its members. Business licenses were only granted to those entities capable of complying with the rules and regulations of the association.

- Statutory Tasks
  - To maintain fair business practices among its members and protect investors
  - To arbitrate and resolve disputes with regard to the business activities of its members
  - Tasks related to OTC trading of stocks not listed in KOSPI or KOSDAQ markets
  - Registration and licensing of securities professionals engaged in the brokerage of securities
  - Research and analysis of the rules and regulations
  - Training
  - Other tasks incidental to the above
  - Tasks required by presidential decrees

## **ii. Tasks Stipulated in the Articles of Association**

KSDA stipulated itself a variety of tasks to perform for market integrity and investor protection in its Articles of Association, in compliance with the Securities and Exchange Act and its regulations. To facilitate the execution of those activities, KSDA also drafted a series of rules and regulations.

- Tasks Stipulated in the Articles of Association
  - Self-regulatory functions to maintain best business practices among members and to ensure investor protection
  - Mediation of disputes arising from the business activities of its members
  - OTC trading of stocks that were not listed in KOSPI or KOSDAQ markets
  - Registration and licensing of securities professionals
  - Operation of the Korea Securities Training Institute for training securities professionals
  - Performing research and studies aimed at developing the domestic capital market and the securities industry
  - Public relations activities for the securities market
  - Policy recommendations to the government and other relevant authorities for the development of the securities industry and capital markets
  - Support for members in their business operation
  - Auditing and discipline of members in breach of regulations
  - Inspection of members, as lawfully commissioned by the Financial Supervisory Service
  - Tasks commissioned by the Korea Futures Associations
  - Rent and leasing of buildings, facilities, etc.
  - Research contracts, publications, sales, etc
  - Other tasks incidental to the above



### iii. Key Roles and Functions

- As a Think Tank for the Securities Industry

- Member Support

One of the key roles of KSDA was to provide support to its members establishing management strategies amid the imminent sweeping changes to the financial environment the upcoming Financial Investment Services and Capital Market Act would bring. KSDA also made recommendations for necessary deregulation to the government and encouraged local securities companies to expand their operations into emerging capital markets as a way of stimulating overseas investment and helping them secure future sources of profit.

- Development of Securities Industry

With regard to the Act, KSDA conducted a series of studies on similar legislation in other countries and made recommendations to improve the initial draft of the Act. KSDA also published an annotated version of the Act in Korean and English.

- Self-regulation

- Maintain Fair Business Practices

KSDA's responsibilities for market integrity included creating rules, the auditing and discipline of its members and dispute resolution. Revising underwriting rules, advertisement review standards and use of standard agreements were some of the examples of the regulations KSDA imposed upon its members. For investor protection, KSDA also enforced sales practice obligations on its members, such as the obligation to inform an investor of the risks, costs and rewards associated with a particular product, and the obligation to perform a suitability analysis for said product. The full list of KSDA regulations is available in Table 2.6.

KSDA also had the authority to audit its members to eradicate unfair sales practices or to review the suitability of in-house sales practice standards. If breaches by a securities company or an individual professional were found, rigorous investigation and strict discipline follow.

KSDA mediated and settled disputes involving securities companies. KSDA also provided search services for securities accounts for heirs of the deceased, free legal counseling and other administrative services free of charge.

Table 2.6 [List of KSDA Regulations]

Title	Contents
Regulations on Training for Collective Investment Scheme Sales	Training for, and administration of, the examination for people engaged in sales of collective investment schemes
Regulations on Certified Futures Consultant	Administration of the examination to certify

Examination	futures consultants
Regulations on Certified Financial Planner Examination	Administration of the examination to certify financial planners; training of real estate asset managers
Regulations on Examination for Certified Securities Professionals	Administration and management of the examinations for securities professionals
Rules on Disclosure of Benchmark Yields for the Calculation of Final Settlement Prices of Interest Rate Futures	How to define and announce benchmark yields of government bonds and monetary stabilization bonds
Standards of Spread Table Calculation	Principles and standards to calculate spread table
Rules on Disclosure of Note Trading of Securities Companies	Rules that limit the vehicles of trading or brokerage of notes to either notes or a passbook; ensures that the company's credit rating is recorded with the notes traded; the mandatory reporting for securities companies of the calculation method of trading unit price and yields of notes to KSDA
Rules on Disclosure of OTC Bond Trading	Mandatory reporting to KSDA of OTC bond trading records, yields, and quotes
Standard Trustee Agreement on Guaranteed Bonds	Obligations and responsibilities of the bondholders; authority and obligations of the trustee; bondholders and their meetings; revision procedures of a trustee agreement
Deliberation Criteria on Exclusive Right to Use New Products	Review of applications for, and the grant of, exclusive rights to use new products
Convention on the Protection of New Products of Securities Companies	Organization and operation of the New Product Deliberation Committee; application procedures for exclusive rights
Rules on Securities Underwriting Business	Rules on offer prices and the obligations of underwriters, qualifications of issuers, etc.
Regulations on Business Conduct of Securities Companies	Regulations on the suitability analysis of investment recommendations; benefit restrictions; restrictions on illegal

	discretionary trading and risk disclosure for high-risk investments; employee management; professionals management; account management; restrictions on wrap accounts and securities savings; public disclosure of securities companies and advertisement deliberation;
Regulations on Operation of Self-regulation Committee	Operations of Self-regulation Committee and its authorities
Regulations on Operations of Securities Dispute Resolution	Organization and operation of the Dispute Resolution Committee; application procedures
Regulations on Credit Information of the Securities Industry	Collection and distribution of credit information; protection of information providers
Regulations on Quotation Intermediation of OTC Stocks	Regulations governing margins; right to refuse orders suspected of anomalies; restraint on the means of correction of mistakes
Regulations on Procedure of Free Board Reserve Designation	Criteria of reserve designation; procedures; obligations of the reserve companies
Rules on Management of Agreements of Securities Companies	Writing standard agreements in relation to securities companies; restrictions on non-standard agreements; revision procedure on standard agreement; obligation of reporting on implementation progress for members advised to revise their agreement

□ Efficient, Systematic Support for Members and Others

KSDA was committed to building a robust base of institutional investors to expand the securities market. It campaigned and urged the government through various channels to raise the stock investment cap imposed on the pension funds, as well as inviting private universities and other newcomers to invest in the stock market, so as to form a bigger middle market.

Enhancing the integrity and professionalism of the securities industry was another key priority of KSDA. To better equip finance and investment service businesses to compete in the global market, KSDA encouraged them in a variety of ways to expand in size and hone their

expertise. KSDA's responsibilities for greater levels of professionalism also encompassed preparations for the smooth enforcement of the CTR (Currency Transaction Report) and CDD (Customer Due Diligence) and it helped its members prepare for the impending changes to these state fund regulations. As a licensed agency, KSDA also collected and distributed the credit information of securities companies.

KSDA took part in the policy-shaping process by expanding its communication channels with authorities and opinion leaders. Using the same channels, it functioned as a liaison between the authorities and industry, creating synergy between the two. It listened and conveyed constructive opinions of the industry to the government and communicated the government's policies back to the industry.

- Free Board

The Free Board was the name of the electronic marketplace for over-the-counter (OTC) stock trading, which provides real-time quotes, volume information and other statistics. In May 2005, KSDA launched the OTC trading service, called the OTCBB (Over-The-Counter Bulletin Board), which was renamed the Free Board in July 2005. As of October 2008, the total market capitalization of the Free Board stood at 3.92 trillion KRW (approx. 3.1 billion USD) and the total trading volume at 29.8 billion KRW (approx. 2.3 billion USD), with 69 designated companies registered.

- Over-The-Counter Bonds Market

KSDA monitored and analyzed the OTC securities market to ensure market integrity and to protect investors. By operating the Bonds Information Service, it collected and disclosed quotes and trades information, and created standards for securities trades. It also announced various market indexes (e. g. the Bond Market Survey Index, Market Credit Risk Index, and Herfindahl-Hirschman index) and 371 yields of 41 different types of securities, including period average yields of closing quotes, and YTM by types of bonds and remaining time to maturity indexes.

- Public Relations Activities

KSDA was devoted to promoting the securities industry to the public in order to stimulate the market and expand the investor base. It conducted various advertisement activities for the development of the securities industry by initiating long-term investment campaigns, introducing new products and such.

- Training of Professionals and Operation of Training Facilities

- Training of Securities and Finance Professionals: KSDA professional training was versatile in its coverage and global in its geographical reach. Not only did the programs cover a

wide range of skills, including futures and options trading, sales performance enhancement and comprehensive asset management, but world-renowned institutions like the US' NYIF, the UK's ICMA Centre, and Australia's FINSIA had also all agreed to cooperate with KSTI and implement exchange programs. KSTI also offered online classes for the public at its cyber institute and runs an online placement agency for securities professionals.

- Administration of Examinations for Certified Professionals: Test administration for certified FP, FRM, and CIA were also part of KSDA's roles.
- Operation of the Asan Training Institute: KSDA provided a venue for training as part of its member services. When not in use by its members, the facility was leased to outside parties. To enhance the utilization of the facility, KSDA strengthened its advertising activities with lease agencies.

□ Investor Education

KSDA provided a variety of education opportunities to investors, especially the youth. To create a robust pool of responsible future investors, KSDA hosted an annual competition for high school students where students were required to answer securities-related questions. For the general public, diverse securities courses were offered, often at a venue of the users' convenience. It also ran a regular training program for primary and secondary school teachers. Customized courses and materials were also available.

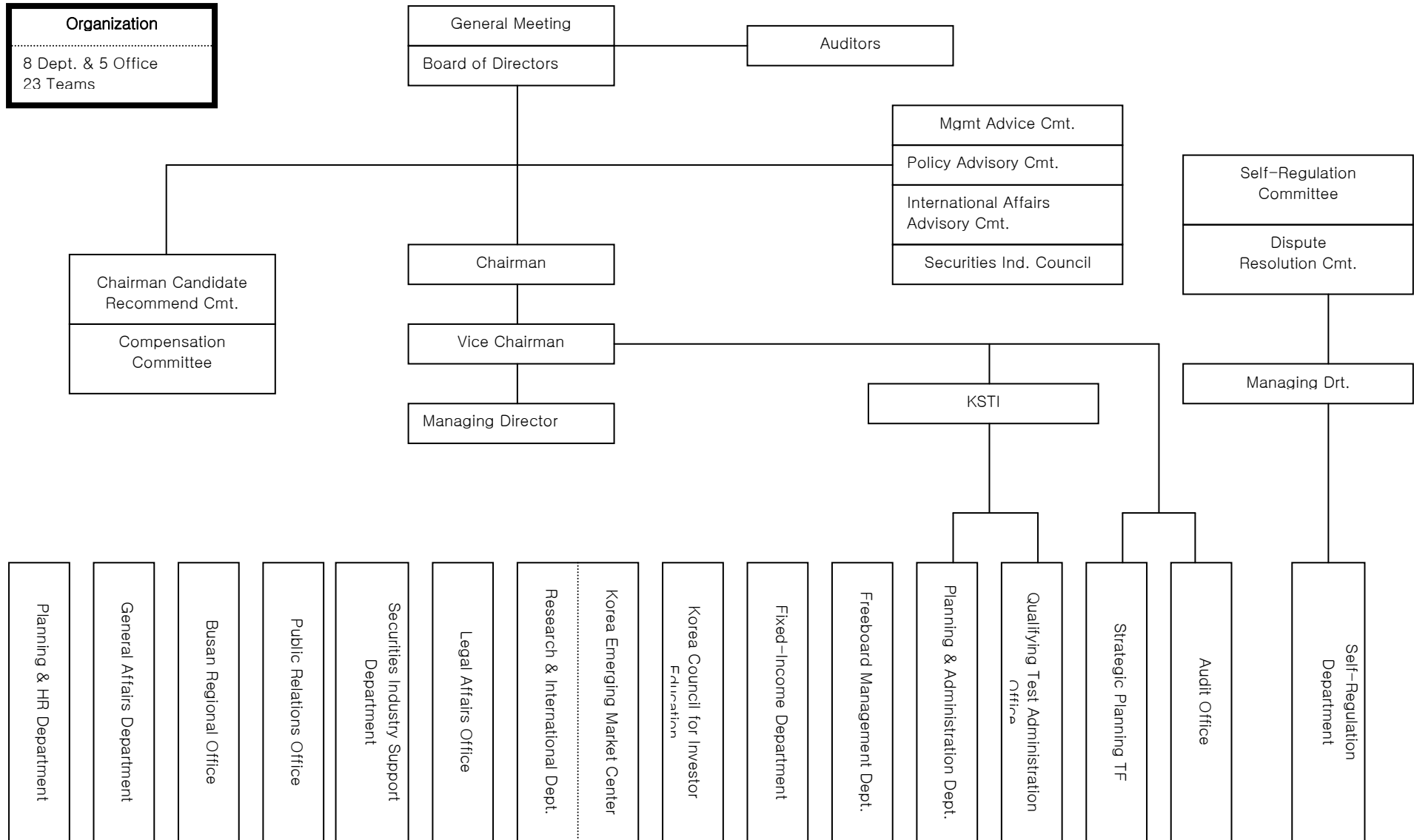
□ Cooperation with Overseas Counterparts

KSDA was devoted to upgrading the Korean securities industry by building a global network. It served as a liaison between the local securities industry and the global securities community by helping local companies with cross-border operations and representing their interest when negotiating overseas financial services. It also participated in eleven international events, including the International Council of Securities Associations (ICSA) and hosted an international seminar for the development of the capital market. Another responsibility of KSDA, in-line with improving overseas cooperation, was to produce and regularly update its English publications and homepage to introduce the Korean securities industry to the world.

## **b. Organization and Personnel**

KSDA was composed of 14 departments and 23 teams, and had under its management control the KSTI and the Secretariat of Korea Council for Investor Education, for financial expert training and investor education. Figure 2.1 is the organizational chart of KSDA.

Figure 2.1 [Organizational Chart of KSDA]



### **i. Departments and Their Roles**

#### Research and International Department / Korea Emerging Market Center

The Research and International Department / Korea Emerging Market Center had three units, each responsible for international cooperation, research, and the pioneering of emerging markets, respectively.

- International Team

The responsibilities of the International Team mostly concerned cross-border partnerships and joint efforts. The International Team dispatched representatives to, and hosts, international events, networks and exchanges with securities professionals in other countries and arranges visits to international capital markets and educational programs at international organizations. The team was also charged with the international PR for the Korean securities industry, attraction of foreign investment; support for KSDA's members in their international relations; publication of English versions of the Korean securities regulations; and other documents and maintenance of the English homepage.

- Research Team

The Research Team primarily dealt with policy and regulation research regarding the securities market and industry, analysis of the economy and trends in the local and international capital markets, hosting symposiums or conferences on the securities market and industry, operation and maintenance of the securities library and publication of securities journals.

- Korea Emerging Market Center

The Korea Emerging Market Center provided assistance to member companies initiating operations in an emerging market. The Center coordinated the roles and activities of local and foreign agencies in relation to member companies. The Center also hosted events, seminars and conferences on emerging markets and hosted education and training courses about them. Other responsibilities of the Center were studying and researching emerging markets and the publication of materials relating to said research.

#### Securities Industry Support Department

Securities Industry Support Department was comprised of two teams: the Securities Industry Team and the Member Support Team.

- Securities Industry Team

The Securities Industry Team's primary responsibilities included: securities policy and regulation reform; operation of committees and working-level committees for the development of the securities industry; protection of customer deposits; credit information management; money laundering prevention; operation of the new product deliberation

committee; development and management of financial products; research and study of derivative-related regulations; and creation and revision of rules and regulations for the committees and working-level committees for the development of the securities industry.

- Member Support Team

The Member Support Team's responsibilities included: admission into and secession from the KSDA; operation of advisory committees and working-level committees; public disclosure of management analysis and the operating reports of members; calculation and billing of membership fees; collection and processing of statistical data and trend analysis on the futures and options markets; processing and publication of statistical data in the securities market; compiling and publication of a directory of securities personnel and other materials for KSDA members; and the formulation, revision or repeal of in-house regulations regarding the advisory committees and working-level committees.

- Free Board Management Department

The Free Board Management Department had two teams: Market Support Team and Market Operation Team.

- Market Support Team

The Market Support Team created the annual plan of the Free Board and drafted reforms to improve existing policies or regulations. It also had the authority to interpret the operating rules of the Free Board. Other responsibilities included researching regulations in other countries, introduction of new designations to the market, PR activities, complaint accommodation, training and support for the designated companies, and formulation, revision or repeal of regulations and rules.

- Market Operation Team

The Market Operation Team is charged with creating new designations and the revision or cancellation of designations. It also operated the management of designated companies, Free Board trading and disclosures, ex-dividend dates and other market treatments and the processing of statistical data and the publication of materials on the Free Board.

- Legal Affairs Office

The Legal Affairs Office researched and studied the laws and regulations governing securities and publishes the results of their research, including: the deliberation of new or revised regulations governing the securities practices of KSDA members; publication of laws, regulations and other materials; legal counseling and support for members in relation to the



laws and regulations governing securities; recommendations of legislation or revision to finance statutes.

□ Planning & HR Department

Planning and Human Resources Department had two teams.

● Planning Team

The Planning Team's primary functions were: establishing management goals, plans, detailed action plans and management strategies and assessment of their implementation; profit structure and budget of KSDA; accession to and secession from other organizations; compiling and publication of materials concerning KSDA; the organization's management and the assignment of responsibilities and duties associated with the office of Chairman and other officers; deliberation and decision-making on the General Meeting or Board of Directors meetings, and creation, revision or abolition of the Articles of Association and other in-house regulations.

● Human Resources Team

The Human Resources Team was in charge of: general personnel and payroll management, including rewards and penalties; benefit packages; travel expenses; management of the Compensation Committee and the performance assessment of KSDA officers; training of KSDA employees and union members; administration of the Employee Welfare Fund; counseling services for employees; management of the employee proposal system; and creation, revision and rescission of in-house regulations and rules concerning the above matters.

□ General Affairs Department

General Affairs Department was comprised of three units: The General Affairs Team, Accounting Team and Information Technology Team.

● General Affairs Team

The General Affairs Team primarily dealt with: acquisition, management and disposal of assets, their maintenance and repairs, contracting and purchasing; management and confidentiality; protection of seals and documentation; cultivation and promotion of organizational culture; organization of events and national campaigns; litigations involving KSDA; joint efforts with other organizations; the acquisition, disposal, leasing and maintenance of real estate; creation, revision and rescission of in-house regulations concerning contracting and building maintenance.

- Accounting Team

The Accounting Team's key responsibilities were: planning and management of funds; accounting, settlement and tax matters; collection and management of membership fees; handling of cash or marketable securities and management of credits and debts; operation of Employee Mutual Aid; management and payment of Employee Welfare Fund; creation, revision or rescission of in-house regulations governing accounting (excluding contracts) and Employee Mutual Aid.

- Information Technology Team

The Information Technology Team chiefly dealt with: the planning and examination of IT operations; the negotiations and adjustment of the IT operations of KSDA members; the establishment and operation of IT systems; the development and maintenance of websites; IT training; and IT data management.

- Self-Regulation Department

The Self-regulation Department was comprised of three units: the Regulation Planning Team, Member Auditing Team, and Dispute Resolution Office.

- Regulation Planning Team

The chief responsibilities of the Regulation Planning Team were: operation of the Self-Regulation Committee and the research and study of self-regulatory regulations; creation, revision and rescission of rules and regulations governing KSDA's self-regulation functions; underwriting of securities and review of advertisements; tasks associated with wrap accounts; creation, revision or rescission of standard agreements for members and examination of agreements; creation, revision or rescission of standard principles; and the guidance of internal regulations.

- Member Auditing Team

The key responsibilities of the Member Auditing Team were: planning audits of members; execution of an audit into any breaches of regulations conducted by a member's executives or employees; (including commissioned audits) and disciplinary actions.

- Dispute Resolution Office

The key responsibilities of the Dispute Resolution Office were: operation of the Dispute Resolution Committee; drafting of dispute resolution regulations; resolution of disputes arising in relation to the business activities of KSDA members; treatment of complaints and petitions regarding securities trading; treatment of petitions and counseling regarding regulations governing securities business; transfer or filing of petitions to relevant authorities; account search services; and other counseling or inquiries concerning securities business; creation, revision or rescission of internal regulations on the Investor Protection Center.

□ Fixed-Income Department

- Fixed-income department has a single team entitled the Fixed Income Market Team.

The Fixed-Income Department mostly dealt with: the creation and revision of regulations governing the OTC bond market; disclosure of closing quotation yields and trend analysis in the securities market; disclosure and monitoring of OTC trading of securities; quotes for OTC securities, primary dealer quotes, and interest rate futures benchmark yields; announcement of the bond index, corporate bond index and bond market index; public relations activities for financial investment-related products and OTC bond market; operation of the Bond Information Service center; collection and processing of statistical data, including transaction records; improvement of regulations and policies concerning the bond market; research and study of bond markets at home and abroad; standardization of bond trading; and the protection of bond investors.

□ Public Relations Office

Public Relations Office responsibilities were: media relations; hosting press conferences and other media events; media sponsorship and advertising; PR for KSDA and the securities industry; publication of PR materials; cultivation of industry culture; and the collection and analysis of industry trend information. It's PR activities were focused on the development of the securities industry using various methods such as long-term investment campaigns and introduction of new products.

□ Audit Office

The Audit Office's responsibilities were: the planning and reporting of audit results; action-taking for the results and follow-ups; surveillance to prevent irregularities; acceptance of outside auditing by the FSC and other parties; examination of the Articles of Association and other KSDA regulations for suitability; compliance checks of risky projects or projects with more than a certain amount of budget; and the creation, revision or rescission of in-house regulations governing auditing.

□ Busan Regional Office

The Busan Regional Office mainly dealt with: complaint procedures with regards to securities trading; maintaining the fair sales practices of the local branch offices of KSDA members; mediation of disputes arising in relation to the business activities of local branch offices of KSDA members; arranging local training programs and events on securities; PR activities aimed at local communities; and communications with the head office and the execution of tasks assigned by it.

□ Strategic Planning Task Force

The Strategic Planning Task Force was comprised of the Innovation Planning Team and CS Team.

● Innovation Planning Team

The Innovation Planning Team generally dealt with: general affairs associated with the establishment of the Korea Financial Investment Association; study of materials and collection and analysis of trends with regard to the organization and operation of the consolidated association; and the operation of working groups under the Market Efficiency Committee.

● Customer Services Team

Customer Services Team was charged with overall affairs concerning customer services and social involvement, including: drafting of action plans; the arrangement of classes and other events; research and publication; and the assessment of performance and the reporting of results.

**ii. Korea Securities Training Institute**

□ Overview

The Korea Securities Training Institute (KSTI) was a public education institute established under Section 172 of the Securities and Exchange Act to train securities professionals and enhance public understanding of the industry. By supplying qualified and experienced workers with professional integrity and strong work ethics, the KSTI aimed to inspire investor confidence. Table 2.7 shows chronology of the KSTI.

Table 2.7 [Chronology of the KSTI]

Sep. 1974	Within KSDA, a department dedicated to training is established; Training for securities professionals begins for the first time
Apr. 1975	KSTI established as an affiliate to Korea Investment Corporation
Dec. 1976	KSDA takes over the training function of Korea Investment Corporation
Mar. 1977	KSTI reopened as an affiliate of KSDA
May 1997	Construction of the training facility in Asan City is completed
Mar. 2000	Cyber KSTI established for online training
Jul. 2000	The Securities Professional Mediation Center opens
Sep. 2006	Signs MOU with FINSA of Australia and the HKSI of Hong Kong
May 2007	Signs MOU with the SFI of Taiwan
Oct. 2007	MOU signed with the ICMA Centre of the U.K.

## □ Organization

The presidency and vice presidency of KSTI were held by standing officers of KSDA. KSTI was comprised of a department and an office for the training and management of certified professionals, respectively. It also had two committees, one for curriculum review and the other for the administration of qualifying tests.

## □ Roles of KSTI

[Planning and Administration Department]

The Planning and Administration Department was composed of three units: Special Training Team, Regular Training Team and the Asan Training Team.

### ● Special Training Team

The chief responsibilities of the Special Training Team were: business planning of KSTI; budgeting, settlement and accounting for KSTI; development of overseas-related courses and special training courses; operation of overseas-related training and special training; management of enrollment records and issuance of certificates; development and appointment of trainers; payment of trainer fees and other expenditure; support for the training programs of member companies; and cooperation and joint efforts with other training institutes.

### ● Regular Training Team

The Regular Training Team mainly dealt with: development of regular courses and e-learning courses; operation and assessment of the regular training and e-learning training programs; customization of training programs and consulting; management of enrollment records and issuance of certificates; the development, appointment, performance assessment and management of trainers; development and maintenance of the operation system and KSTI website; publication of learning materials and other media and introductory materials; and maintenance of facilities and equipment.

### ● Asan Training Team

The Asan Training Team primarily handled: PR activities and the marketing of training programs; development of an operation plan of training facilities; PR for the training facilities and leasing them out; operation of classes and other affairs associated with training; the maintenance and repair of buildings and equipment; and other matters recognized as necessary by the head of KSTI.

[Qualifying Test Administration Office]

The Qualifying Test Administration Office's responsibilities were: qualification review of securities industry personnel; registration and cancellation of the registration of securities

professionals; management of registered securities professionals and any disciplinary actions; administration of qualifying tests for securities professionals; the creation, revision and rescission of regulations governing the qualifying tests for securities professionals; and the research and study of the regulations governing securities professionals in and outside Korea.

□ Training Records

KSTI training was designed to be customer-oriented and flexible so it can quickly adapt to the changing needs of the versatile financial environment. Table 2.8 shows the status of training offered by the KSTI.

Table 2.8 [KSTI Training Records]

		2006	2007	2008	Growth Rate
Group Training	General	1,832	1,979	95	-95%
	Professional	1,270	2,040	2,553	25%
	Qualifying	462	523	566	9%
	One-offs	208	620	943	52%
	Subtotal	3,772	5,162	4,157	-19%
e-Learning		29,402	27,931	46,865	68%
Sum		<b>33,174</b>	<b>33,093</b>	51,022	

**iii. Korea Council for Investor Education**

□ Overview

The Korea Council for Investor Education (KCIE) was founded in June 2005 by nine financial institutions as a non-profit organization. Its establishment was prompted by the need for a consolidated educational institution to provide efficient, well-structured training programs on securities, futures and asset management for investors. Some of the key goals of KCIE were promoting desirable investment practices, boosting investor confidence, building on investors' ability to make sound investment decisions, sharpening the competitive edge of the local capital market and introducing sophisticated market practices.

All of the KCIE programs are provided free of charge, including classes on stocks, futures and asset planning and management.

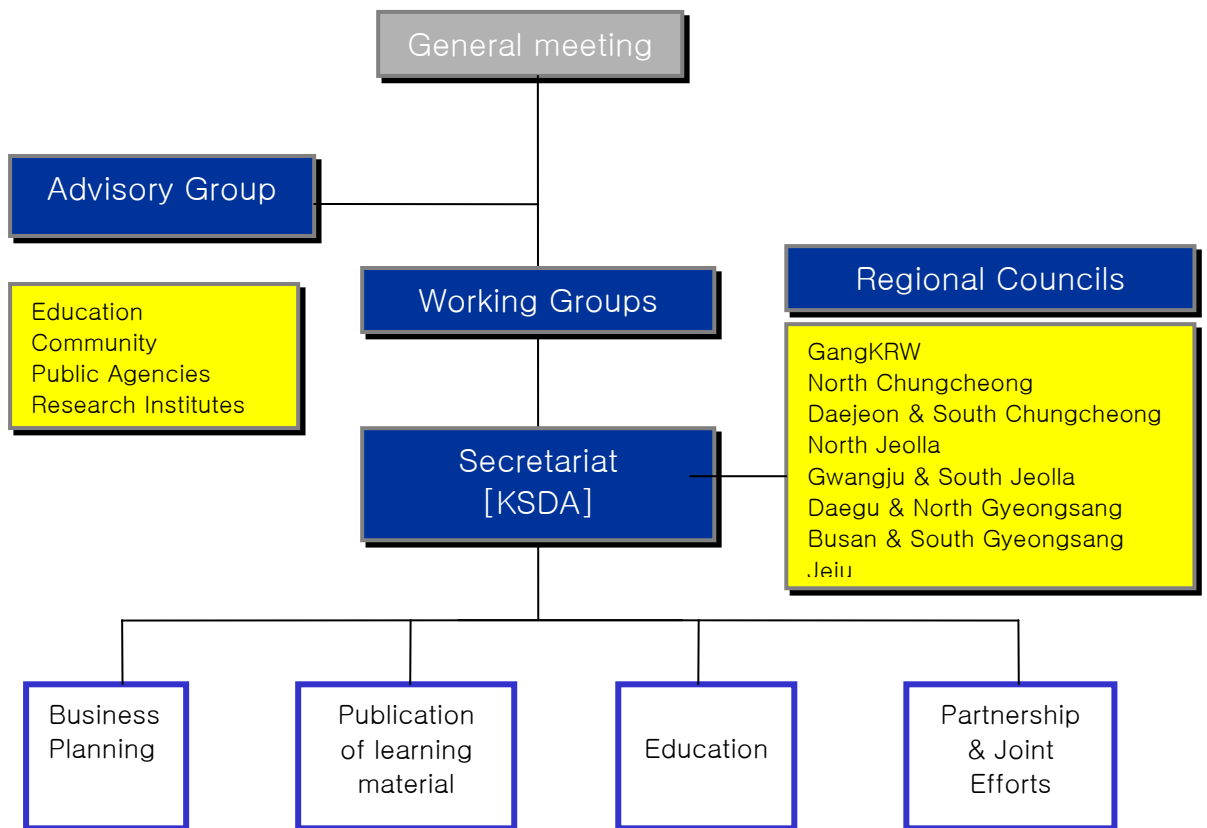
□ Members

The nine principal institutions making up KCIE’s membership were: KSDA, Korea Exchange, Korea Securities Depository, Korea Securities Finance Corporation, COSCOM, Asset Management Association of Korea, and the Korea Futures Association. It also has two state agencies—Financial Services Commission and Financial Supervisory Service—as special members.

□ Organization

The organizational structure of the KCIE is shown in Figure 2.2.

Figure 2.2 [Organizational Structure of the KCIE]



The General meeting was comprised of representatives of KCIE member institutions, with the chairmen of KSDA and the Korea Stock Exchange acting as the joint chairmen. The chairman of KSDA manages all the regular affairs of the Council. The working groups were comprised of executives from members, with the KSDA executives presiding. The Investor Education Office of KSDA operated the Secretariat, as KSDA provided all the manpower required. The Advisory Group was consisted of 6 groups from academic and educational circles and the securities industry. The Regional Offices was consisted of 8 regional councils representing the different regions.

- Investor Education Secretariat

The Secretariat was divided into two groups: the Education Planning Team and Education Operation Team.

- Education Planning Team

The Education Planning Team’s chief responsibilities were: annual planning and budgeting; the structuring of education programs; planning and development of courses—content and materials; PR for the education programs; research and studies; and cooperation and joint efforts with other educational institutions.

- Education Operation Team

The Education Operation Team was primarily charged with: operation of online and off-line education programs; the operation of initiatives and events for the regional offices; and other general affairs for investor education.

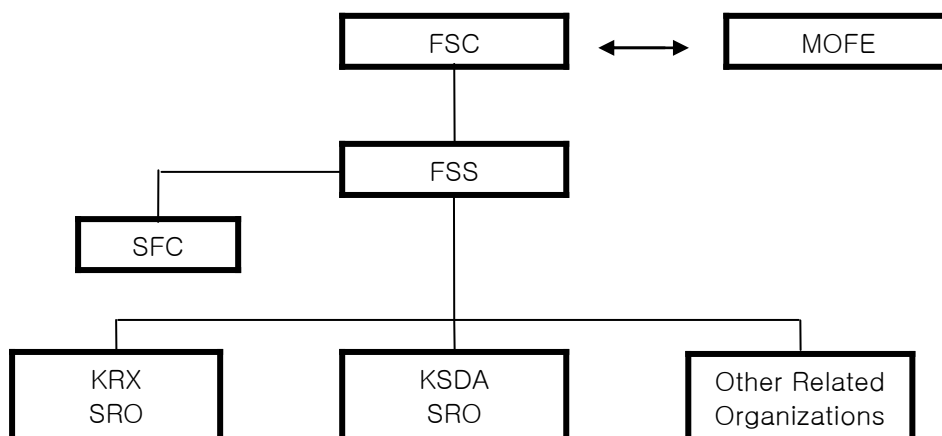
#### ④ Relationship with the State Regulatory Authorities

##### a. Relationship with Public Regulations

The law required that any new or revised rules or regulations of KSDA were reported to the relevant authorities, and that the Chairman of the Financial Services Commission was entitled to order alterations to the above mentioned rules. The Chairman of the FSC also has the power to require changes to KSDA’s articles of association, the dissolution of the association or the dismissal of any of its officers, and demand the submission of any information concerning KSDA’s operation or assets, or to order an investigation into them.

KSDA is also legally obliged to submit its business plans, balance sheets, inventory of properties and other financial statements annually to the relevant authorities. Figure 2.3 shows the supervisory structure of the securities market.

Figure 2.3 [Supervisory Regime Governing the Securities Market]





MOFE (Ministry of Financial and Economic), FSC (Financial Services Commission), FSS (Financial Supervisory Services), SFC (Securities and Futures Commission), KRX(Korea Exchange)

#### **b. Adjustment of Scope of Functions**

- Rule-Making Function

One of the key roles of KSDA was that as a rule-maker. The principle was to keep these effects within the boundary of legal requirements, although some of the self-regulatory rules enforced by KSDA do require higher level of compliance than required by law.

- Compliance Check

KSDA was entitled to conduct investigations into matters involving KSDA members' compliance with regulations. The investigative authority given to KSDA was as extensive as that of the public regulations in terms of scope, method and purpose. However, to avoid redundancy and to ensure the efficiency of their investigative efforts, KSDA operated in cooperation with the state and limited its investigative scope to areas that are exclusive within its self-regulatory rules.

- Disciplinary Measures and Sanctions for Non-Compliance

When a member fails to comply with any laws or regulations, it is subject to double punishment from the public authorities as well as from applicable self-regulatory organizations. The disciplinary actions of self-regulatory organizations are reviewed by the state for their appropriateness. If a necessary action was not taken, the responsible organization may see its charter cancelled or suspended. If any member of an SRO finds a disciplinary action to be harsher than the legal requirement, the member may seek a tort claim to receive compensation. Unlike in the U.S., a member does not have the right to appeal a disciplinary action to the state authorities.

### **⑤ Relationship with Other Self-Regulatory Organizations**

#### **a. Scope of Authorities**

The scope of KSDA and the KRX's authority were rarely redundant, except in certain duty of care requirements. The KRX governed trading activities in the securities market, from entrustment to settlement, while KSDA was charged with the regulation of OTC securities markets and the promotional activities of member companies, such as investment solicitation.

#### **b. Scope of Examination**

The two SROs established cooperative arrangements with each other to remove any redundancies from their respective scopes of examination in order to relieve the burden of

compliance from the securities companies. The scope of examination of the SROs is restricted to their respective scopes of authority, except for the examination of loss protection offers.

### **c. Disciplinary Authority**

If a company that belongs to multiple SROs violates state laws or regulations, the company is, in principle, subject to punishment from the multiple SROs. In reality, a company rarely receives multiple punishments except in the case of the offering of loss protection, since KSDA punishments were mostly imposed for promotional activities such as investment solicitations. When a company that belongs to multiple SROs violates self-regulation rules, the company is subject to punishment from one of the SROs, depending on the effectiveness of the punishment. There would be no sanctions taken by the state.

## **B. KSDA Initiatives for the Development of the Securities Industry**

### **① Initiatives to Attract More Participants to the Stock Market**

#### **a. Nurturing Institutional Investors**

In the 2004 revision of the Framework Act on Fund Management, pension funds and other public funds in Korea were granted in-principle approval for stock investment, thanks to a KSDA initiative that took effect. To obtain in-principle approval, KSDA conducted in-depth research of the relevant statutes in other countries so as to introduce more sophisticated provisions to Korea's statutes, including the lifting of the stock investment ban. At the same time, KSDA helped the government generate positive publicity for the revision by commissioning op-ed columns advocating the proposals in major newspapers. The revision resulted in the solid expansion of the market's participant base, as well as enabling more sophisticated management of pension funds.

The year 2005 witnessed the introduction of the corporate pension system—the Korean equivalent of the U.S. 401(k) plan—which allowed corporate retirement funds to be invested in the stock market. KSDA had long promoted this system as part of its initiatives to expand the institutional investor base by conducting extensive research on how the stock investment of pension funds occurred and was regulated in overseas markets, and by hosting seminars for those engaged in corporate pension fund management.

#### **b. Attracting the Middle Market**

KSDA also encouraged broader participation by the Middle Market (private colleges and universities, or employee welfare funds) in the stock market to further expand the investor base of the securities market. The regulations governing the asset management of private colleges and universities were revised to allow up to 50 percent of their reserve funds to be invested in the stock market, in principle. KSDA helped private colleges and universities set up joint investment pools, and other investor groups form similar common asset management frameworks that suited their particular investment needs.

### **② Enhancing the Competitiveness of the Securities Industry**

#### **a. Expansion and Specialization as a Means to Achieve Global Competitiveness**

As the Financial Investment Services and Capital Market Act was to bring fundamental changes to Korea's financial environment, KSDA developed and shared its unique strategies and visions so finance and investment companies could embrace these changes and equip themselves to become more competitive. By benchmarking leading investment banks in other countries, KSDA presented a long-term business model for the local securities industry—the key aspect of

which is expansion and specialization. Tangible efforts were made to create a suitable environment for securities businesses to best pursue this model. The streamlining of restructuring procedures, tax incentives for corporate restructuring and the introduction of simpler criteria for the establishment of a financial holdings company were some of the examples of these efforts. In addition, KSDA has also encouraged local securities companies to bid for local M&A opportunities as part of its initiative to remove obstacles to M&A deals.

In June of 2008, eight new securities companies were granted permission to establish themselves, bringing the total number of securities companies to 61. The increase may appear unrestrained at a glance but not necessarily so, provided that each company has its own area of specialty. The United States' FINRA has as many as 5,000 securities companies as members, and Japan's JSDA has 321 members, many of which specialize in different areas. This indicates that competitiveness is not achieved through selection and concentration, but through well-designed strategies that can make a company stand out.

#### **b. Training Finance Professionals**

With the government's plan to make Seoul a major financial hub of Asia and with other anticipated changes to the finance environment, KSDA was building a comprehensive framework of support through the training of finance professionals and specialists. To introduce more sophisticated training courses, KSDA had signed MOUs for general cooperation and the joint training of finance and investment personnel with overseas financial training institutions, including the Hong Kong Securities Institute (HKSI), the U.K.'s International Capital Market Association (ICMA) Centre, the Financial Service Institute of Australia (FINSIA), and the Taiwanese Securities & Futures Institute (SFI).

The association had also developed a master plan for fostering new finance and investment professionals, a key initiative. Starting in 2008, the plan had an additional 3 billion KRW earmarked annually to form a global joint partnership between industry and academia, and to provide member companies with the resources to cultivate highly qualified professionals. The plan was expected to help meet future demand for qualified finance professionals under the Financial Investment Services and Capital Market Act and to resolve the shortage of competent resources caused by the recent increase in the number of newly established companies.

#### **KSDA Initiative to Promote Close Partnership among the Government, the Industry and Universities for Training of Professionals**

As enrollments in Master's degree programs jointly operated by industry and academia (e. g. Financial MBA) took up a school's admission quota, many schools are reluctant to open new programs. This phenomenon called for the government to introduce a more flexible quota system. KSDA was seeking a way to accredit advanced training programs provided by training institutions.

KSDA was planning to continue investing and developing its global joint training programs between industry and academia in the near future. Most programs would have been about either one of the three areas most demanded by the industry: IB, enterprise analysis and asset management. Other advanced joint programs with renowned training institutions in the U.K., U.S., and Australia would have been developed in the future.

Table 2.9 [KSDA Joint Global Training Programs]

Partner Institution	Title	Duration	Seats
ICMA Centre 1)	Master's Course (in IB, FRM, and two others)	Sep.-Oct., '08	20
	Securities and Derivative Product Specialists	Jun.-Nov., '08	20
	Asset Management	Oct.-Nov., '08	20
	Regulation & Compliance 2)	Oct.-Nov., '08	20
KAIST 3)	Financial Engineering	Mar.-Aug., '08	30
Peking University, China	Chinese Financial Experts	Apr., '08	20
ICMA Centre	Financial Risk Mgt.	May-Sep., '08	20
	Investment Banking	Jun.-Sep., '08	20
HKUST 4)	Capital Market Analysis	Jun.-Sep., '08	20
Total			190

1) ICMA: International Capital Market Association

2) Co-developed and operated by KSDA and the U.S. FINRA & the U.K. ICMA Centre

3) KAIST: Korea Advanced Institute of Science and Technology

4) HKUST: Hong Kong University of Science & Technology

### c. Support for Globalization of the Securities Industry

In an effort to convince the financial service industry to join the export industries, KSDA had established and operated the Korea Emerging Market Center. The Center, in partnership with the state agency Financial Hub Korea, was helping local securities companies extend their operations out into emerging markets, particularly in Southeast Asian countries.

The Center was also expanding its global network in order to achieve better international cooperation. By successfully hosting the ICSA Annual General Meeting and the ASF Forum in Seoul and by inviting securities industry personnel from key emerging markets to Seoul for

training programs, the Center contributed in improving the international image of the Korean stock market.

The Korea Emerging Market Center was charged with: (1) accepting complaints of difficulties or suggestions concerning initiating operations in an overseas markets made by KSDA members; (2) conducting research of the finance industry trends and related regulations in emerging markets, and the publication of its findings; and (3) providing training programs to introduce the Korean capital market to emerging market personnel from Southeast Asia and elsewhere.

#### **d. Softening Detrimental Price Competition in the Securities Market**

KSDA member companies had been engaged in intense price competition, slashing their online brokerage commission to a scanty 0.015 percent. In order to prevent unhealthy price competition that could harm the long-term competitiveness of the industry, KSDA encouraged its members to distinguish themselves through the quality of their services or products rather than by undercutting their rivals. To help improve their earnings, KSDA also decided to exempt market making trades for equity option products from all transaction commissions.

#### **e. Help Settlement Arrangements of Retail Payment by Securities Companies Soft-land**

KSDA played a key role in helping the clearing and settlement arrangements of retail payments take root among securities companies. When the clearing system for retail payments was first made available to the securities industry with the aim of strengthening its competitiveness, the membership fees set by the Korea Financial Telecommunications & Clearings Institute (KFTC) were so high\* that it discouraged many securities businesses from using the system. Given that the purpose of using KFTC was to level the playing field for all financial service providers, thereby serving the public's interest, KSDA decided that the price barrier ought to be removed. By surveying other countries, KSDA argued that as the clearing system network has many characteristics of a public good, it should be made equally accessible to the entire finance industrial sector. KSDA was pushing for an adjustment of the membership fees to a reasonable level.

\* Membership fees set by the KFTC averages at 20.93 billion KRW per company, ranging from a minimum of 17.39 billion KRW to a maximum of 29.13 billion KRW.

KSDA provided additional support to help the soft-landing of this newly introduced scheme. To minimize the operational risks of the clearing and settlement arrangements, KSDA drafted a standard work manual that introduced the different types of systems available and the standard procedures to follow for each system. It was also lobbying for the removal of unfair provisions concerning the use of overdraft or loans on bills or deeds from the membership contract.

### ③ Developing Korea's Capital Market

#### a. Creating a Desirable Investment Culture and Providing Investor Education

##### i. Creating a Desirable Investment Culture

KSDA had promoted long-term indirect investment in stocks to individuals as a part of their savings portfolio. As a result, stock and fund investment in Korea had shown exponential growth, thanks to its "10 Shares Per Person" campaign which encouraged investment in blue chip stocks and stock funds, and other concerted efforts to encourage long-term indirect investment by the government, the association and the industry. By the mid 2000s, every household in Korea was in possession of at least one fund account. The followings are some statistical evidence that reflects this sensational growth:

- Between 2003 and the end of July 2008, the size of stock funds skyrocketed from a mere 11 trillion KRW to 143.7 trillion KRW.
- The size of the funds with automatic purchase plans grew more than tenfold from 6.5 trillion KRW in March 2005 to 73.6 trillion KRW as of the end of June 2008.
- The total number of fund accounts had reached 25.11 million at the end of June 2008.
- The total number of stock accounts stood at 12.04 million at the end of July 2008.

However, this remarkable pace of growth did not come without adverse side effects. Many investors, mindful only of short-term performances, had frequently replaced their fund manager or swarmed to a handful of hot funds or asset management companies. KSDA was committed to assuring the quality, as well as the quantity, of growth to curb the growing instability and imbalance in the asset management market this behavior encourages, and to foster a more desirable investment mindset.

##### ii. Providing Investor Education

KSDA established the Korea Council for Investor Education to provide efficient and stable education programs to local investors. The KCIE greatly contributed to the creation of a desirable investment culture and improves the investors' abilities to make reasoned investment decisions by developing a well-structured curriculum that is provided nation-wide through its eight provincial offices. Over 60,000 investors benefit annually from KCIE education programs.

KSDA was also committed to the globalization of investor education in Korea. The association had led international efforts to found the Asia Forum for Investor Education (AFIE) with the aim of further developing the Asian capital market. Through the AFIE, the KCIE had introduced successful examples of Korea's investor education programs to the emerging

markets of Asia, which has helped them shape their investment culture, as well as indirectly supporting Korean securities companies expand their operations to these nations. The first AFIE conference will be held during the first half of 2010 in Seoul.

#### **b. MSCI/FTSE Status Upgrade**

In September 2008, the Korean stock market finally attained "Developed" status in the FTSE indexes, thanks to the concerted efforts of KSDA, the government and industry. In 2009 MSCI Barra is also expected to follow suit and upgrade Korea's status. The Morgan Stanley-controlled index provider announced in June 2008 that it was initiating consultations on proposals to graduate Korea to developed market status. The government and industry are working in close cooperation with each other to promote this reclassification. In October 2008, a joint delegation was sent to the headquarters of MSCI Barra. The final decision will be announced no later than June 2009, with a preliminary assessment scheduled for release this June.

The upgrade, if approved, will be a boon to the Korean stock market, primarily because there is simply more investment capital in the developed market indices. (The MSCI Barra upgrade is expected to add an estimated minimum value of 4.8 billion USD to the Korean market) It will also help the market attract more long-term investors and will subsequently help improve market fundamentals. There will be less of a "Korean discount" or the selling rushes prevalently witnessed in recent times among investors trying to shed risk from their portfolio. This will in turn help temper the "wag-the-dog" effect, the distortion in the cash market caused by the futures trading.



KSDA conducted the following promotional activities to help Korea's accession to MSCI Barra's Developed Market Group:

- A meeting with MSCI Barra President Henry A. Fernandez in New York (October 18, 2007)
- Two presentations arguing for the upgrade made to the MSCI Barra review team visiting Korea (November 2007 and March 2008)
- Meetings with representatives and working-level staff from international securities companies where they were asked to assist KSDA explain to global custodian banks (HSBC, Citibank, Standard Chartered, Deutsche Bank, etc.) how the Korean government had worked to improve the country's stock market, and for testimonials to submit to MSCI Barra. (April 2008).
- Distributing PR materials to over 700 institutional investors around the globe discussing the reforms made in Korea's exchange rate policies (April 2008).
- Suggesting an extension in the opening hours of the foreign exchange market to government (July 2, 2008)
- A meeting with a team of MSCI Barra personnel, including the president, who were visiting Korea (August 2008)
- A joint visit to MSCI Barra headquarters with the Minister of Planning and the Budget to argue Korea's case for the upgrade (October 2008)

### **c. Stimulating the Free Board and Bond Market**

Realizing that asset management was disproportionately large in the Korean capital market when compared to corporate finance, KSDA had been working on stimulating the Free Board and bond market.

- Free Board

With the aim of providing better financing for frontier, innovative companies that entail high investment risk, KSDA was committed to reducing the entry barriers to, and the costs of, the Free Board, and to inspiring commercial interest in the market. To that end, many suggestions had been made, including more attractive incentive packages for designated companies, the introduction of auctions, wider exemptions to capital gains tax and measures to motivate the formation of investment partnerships dedicated to the Free Board. With the signing of an MOU with Techno Park in April 2008, KSDA was seeking to build a cooperative regime with the government agencies charged with the development of industries to establish a system\* that would better identify promising candidates for designation.

\* The introduction of a preliminary designation, the opening of Techno Park Business Sector, and the establishment of Tech-Investment Information System.

KSDA had also strengthened PR activities for the Free Board, emphasizing its increasing role as a crucial means of raising capital for unlisted companies, and for investment returns for investors, at a time when IBs were gaining increasing importance due to the introduction of the new consolidated financial legislation.

To distinguish the Free Board from the relatively new KOSDAQ market, KSDA had engaged in an extensive PR campaign for the market and was enhancing the quality of services the Free Board offers to investors—all with the goal of attracting more unlisted companies to the market. KSDA had expanded its distribution network of investment information for the Free Board, and had regularly contributed op-ed columns to magazines specializing in SMEs and venture businesses. The services offered to the designated companies have been improved to facilitate the use of the Free Board—for example, KSDA held several introductory sessions for designated companies explaining the public disclosure procedures.

- Bond Market

As part of the implementation of the second-stage of its two-phased plan to stimulate the bond market, KSDA was revamping the bond market's infrastructure. Despite recent efforts to reinforce the market integrity of the OTC bond market, such as building a centralized quotation disclosure system (Bond Quotation System) and an information center for bond operations (Bond Information Service), the development of the bond market is still stymied by an inadequate secondary market. Given this situation, KSDA was seeking to introduce an Alternative Trading System for bonds to enhance transparency and liquidity and to foster bond brokers.

#### **d. Enhancing Market Integrity and Boosting Investor Confidence**

KSDA was supporting securities companies in their adoption of a more advanced risk management system. As advanced overseas markets introduce new NCR and RBS (Risk-Based Supervision System), the Association helped member companies adapt themselves more efficiently to changes in the finance environment.

KSDA also played a role in improving the regulations governing margin trading and credit trading and had prepared measures to ensure the effectiveness of the upcoming revised regulations. By introducing a "frozen account" system and registering as a credit information collection agency to make credit information available for a wider audience, KSDA continuously strived to strengthen the market integrity of the stock market.

#### **e. Overhauling the Self-regulation Regime**

In another aspect of KSDA's drive to enhance the quality of its regulation services, KSDA overhauled its own rules and regulations making it more customer-oriented. By consolidating the various charters of KSDA, the Asset Management Association of Korea and the Korea Futures Association, the three SROs ensured consistency between the regulations of these different industries. Furthermore, the new regulations were grouped by financial functions, so as to provide one-stop regulation-related services. These efforts will contribute to the individual self-regulation of companies and provided them with the convenience of greater regulatory freedom.

KSDA drafted a single volume of in-house regulation standards so that finance and investment companies engaged in multiple business lines could easily create their own set of standards and so that there would be no conflict of interest between separate business areas. Rather than imposing regulations from the outside, KSDA tried to enhance the self-regulation capacity of finance and investment companies by supporting them in the establishment of efficient internal regulation systems.

As the Act introduced more rigorous regulations on investment solicitation, such as a stricter suitability principle and an obligation to inform, KSDA presented the industry with standards of investment solicitation principles and procedures, so that the finance and investment companies may be less exposed to legal risk.

To ensure market transparency and to boost investor confidence in the stock market, KSDA sought for ways to strengthen the self-regulation capacity of its member companies. The Association proposed to the government that self-regulation by individual securities companies and SROs should be at the core of market regulations. While public regulations tend to be one-size-fits-all and inflexible, self-regulation could more easily avoid those pitfalls. KSDA expected the transition from governmental to self-regulation would serve as a catalyst to create healthy competition and innovation among the securities companies and create a culture of responsible management.

## **C. KSDA and the Financial Investment Services and Capital Market Act**

### **① KSDA's Role in Building the Act's Foundation**

#### **a. Nurturing Institutional Investors**

When the Korean government initiated its plan to overhaul regulation of the financial sector, their aim was to consolidate regulation for the entire financial sector, including commercial banks and insurance companies. However, research indicated that while the banking and insurance industries were relatively well equipped to compete in the global market, the capital market was still in a stage of relative infancy. To strike balance among the different financial sectors and to ensure the maximum efficiency of any revision, a phased approach was decided upon. The regulations governing the capital market were to be consolidated initially, with the integration of the entire financial regulations occurring at a later date.

KSDA played a central role in developing and promoting the idea of consolidating capital market regulation as the first phase of financial regulatory consolidation. In an attempt to seek ways of expanding the business scope of securities companies, KSDA commissioned a research project examining the notion of consolidating the Securities and Exchange Act and the Futures Exchange Act, and permitting securities companies to engage in asset management. To persuade the government authorities, opinion leaders and other stakeholders, KSDA held discussions and explanatory sessions for the government, parliament, KSDA member companies, academia and research institutes – more than 40 such sessions in total. KSDA also hosted seminars, one for officials of the Ministry of Planning and Budget and the second (a closed-door session) to discuss consolidating the capital market regulations under the theme, “Japan's Financial Products Exchange Act: Directions and Arguments.” Thanks to the strenuous effort of KSDA, the government decided to take a phased approach to consolidation and announced their decision on December 28, 2005.

#### **b. Organizational Reform**

KSDA revised its organizational structure to better equip itself as the organization supporting the upcoming enactment process, and to help contribute to the development of the securities industry. KSDA divided the tasks required for the development of the securities industry into the short-term and long-term. The Members' Service Team was upgraded to department-level and was charged with carrying out short-term tasks, while the Securities Industry Support Department was charged with long-term tasks. The Securities Regulations Team was placed under the Industry Support Department to provide company-wide support for the rule making process that was to occur.

## ② Supporting the Enactment of the Act

### a. Campaigning for Successful Enactment

KSDA provided multi-faceted support for smooth enactment of the Act. It conducted case studies and provided support for external studies concerning the major issues arising from the enactment process of the Act. KSDA also translated the financial regulations of the U.K., Japan, Singapore, Hong Kong, Australia, Germany and other countries into Korean as reference materials for the drafting of the Act. The Association conducted extensive research into the effects of consolidation on the capital markets of Australia and the U.K. in an attempt to estimate the economic effects of consolidation in Korea. The Association also hosted four international symposiums on ways to improve the regulatory environment of Korea's capital market with the aim of boosting public confidence in the Act. KSDA held discussion sessions for different groups of interested parties – over 30 in total – collecting the voices of the securities industry and making suggestions for improvements to the government. The groups invited include officials from the Ministry of Planning and Budget and the chairmen of the boards of member companies. The Association also created and distributed a compilation of relevant materials for National Assembly members and provided support for the explanatory sessions, discussions and public hearings at the National Assembly (10 times in total).

### b. Public Relations

KSDA had campaigned for the need to introduce a more sophisticated financial system as a means of promoting the Act. It created a commercial for TV, radio and cable TV networks, airing it from November 2006 to April 2007. The channels included major broadcasters like KBS, MBC, and SBS, Internet portal sites such as Naver and Daum and key cable news channels like MBN and Wow TV. KSDA also extended its support to the press, providing a series of articles about the positive changes expected under the Act, and op-ed pieces for major newspapers and magazines arguing the need for capital market regulations to be consolidated. KSDA also held 20 interview sessions for the press, promoting the positive aspects of the Act.

### c. Follow-up Support

KSDA worked to relieve the regulations governing the securities industries during the process of drafting lower-level regulations under the Act. To reflect the voices and interests of the securities industry, KSDA established a joint task force with the securities industry regarding the Act. The task force conducted surveys of securities companies in regards to the draft bill and made appropriate suggestions.

KSDA also translated whole provisions of the Act into English for reference purposes and published booklets explaining the Act. Furthermore, KSDA provided support to the government and the securities industry in regards to the revision of the Holdings Company Act (supporting deregulation) and for the possible enactment of Financial Product Sales Act (recommended on behalf of the industry).

**d. Providing Information for Overseas Investors**

KSDA performed a survey of AXISS Australia, the UK's IFSL, and other relevant organizations to see how capital market consolidation is being introduced or explained overseas. It also held several international conferences, seminars and presentations to publicize the need for the consolidation of the Korean capital market and its benefits, especially for overseas investors. Investor relation activities were extensively performed overseas to promote Korea's capital market as becoming more competitive with the enactment of the Act.

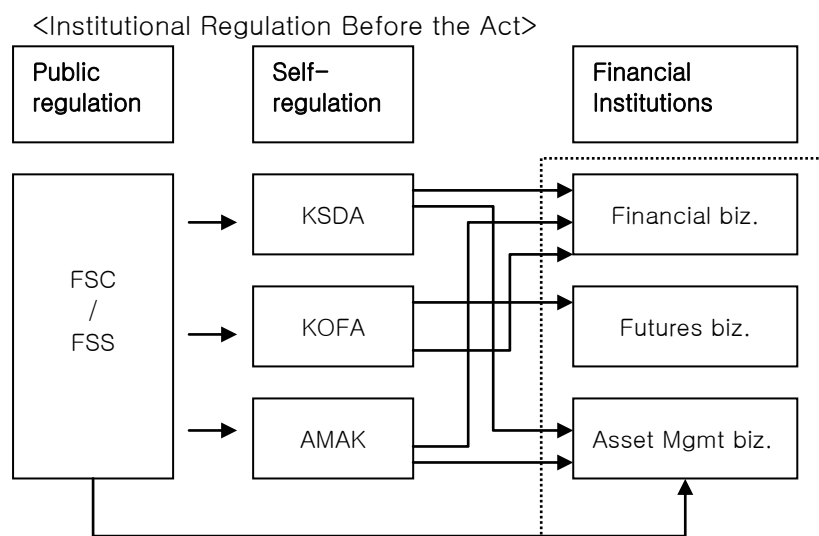
## Part III. Korea Financial Investment Association

### 1. Background of Foundation and Legal Status

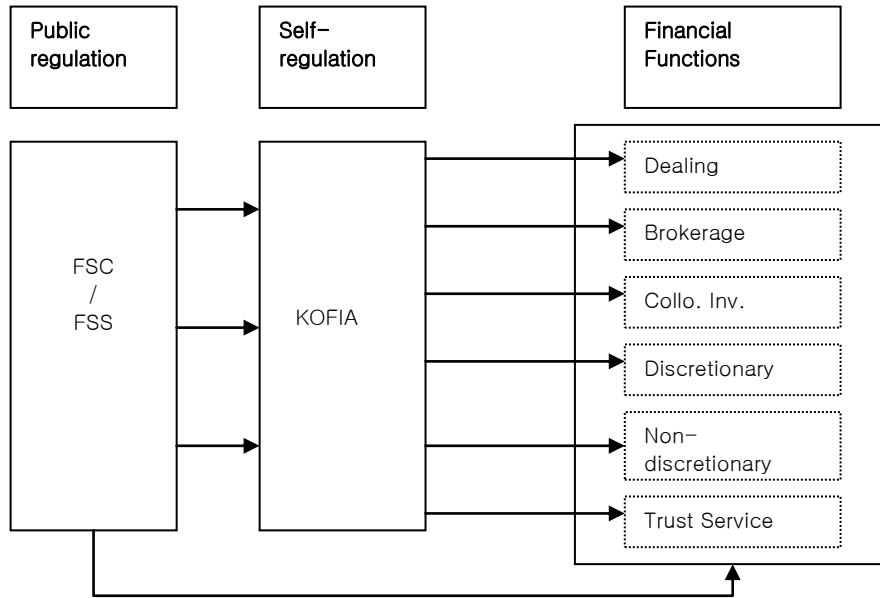
#### A. Background of Foundation

On February 4, 2009, the Korea Financial Investment Association (KOFIA) was formed, creating a single, consolidated self-regulatory body for the finance and investment industry. Three organizations - the Korea Securities Dealers Association, Asset Management Association of Korea and Korea Futures Association - were merged to form KOFIA. The decision to create a consolidated regulatory organization was mandated in the Financial Investment Services and Capital Market Act. Since business crossovers were allowed under the Act, the system of multiple self-regulatory regimes has become obsolete, with the old system being designed for an environment of strict segregation of businesses. As the public regulation system was being overhauled into a functional-based one, it was deemed necessary to do the same for the self-regulatory system. Figure 3.1 shows the changes to the self-regulation system before and after the Act took effect. Table 3.1 shows in detail the legal status and the degrees of independence each SRO had before the Act took effect.

Figure 3.1 Self-regulatory System



<Functional Regulation Under the Act>



\* AMAK and KOFA were established in 1996. Along with KSDA, they played a central role in nurturing Korea's capital market into one of the world's major markets by creating a sound investor base, establishing a healthy investment culture, creating order in the market and nurturing financial professionals.

Table 3.1

	<b>KSDA</b>	<b>KOFA</b>	<b>AMAK</b>	<b>KRX</b>
Governing Act	Securities and Exchange Act	Futures Trading Act	Act on Business of Operating Indirect Investment and Assets	The Korea Exchange Act
Legal Status	Statutory Entity (No multiplicity)	Voluntary organization (Establishment in multiple numbers possible if permitted by FSC)	Voluntary organization (Establishment in multiple numbers possible if permitted by FSC)	Joint stock company under the commercial code (No similar organization allowed)
How to Ensure Independence of Self-Regulation Function	Self-Regulation Committee	Self-Regulation Committee	Self-Regulation Committee	Market Oversight Commission
	Exclusively authorized to resolve all matters regarding self-regulation	Authorized to deliberate and resolve matters regarding member examination and discipline	Authorized to deliberate and resolve matters regarding discipline	Authorized to deliberate and resolve matters regarding market oversight and dispute resolution



		<p>* Revision or formulation of regulations under the authority of the Board of Directors</p> <p>* Board of Directors has the right to demand re-deliberation, weakening the independence of the organization</p>	<p>* Revision or formulation of regulations under the authority of the Board of Directors</p> <p>* Board of Directors has the right to demand re-deliberation, weakening the independence of the organization</p>	<p>Double-headed self-regulation function with the Board of Directors and Market Oversight Commission</p>
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The creation of a consolidated self-regulatory organization was expected to bring about maximum efficiency. Under the new self-regulation system, similar business activities were regulated by the same rules. Integrating the regulatory regime would also save on the cost of regulation and enhance responsibility by removing redundancies and blind spots.

The old self-regulatory regime inhibited efficient responses to the rapidly changing conditions of the financial market. The regulations governing the capital market were mostly made up of public regulations, which tended to be more rigid and inflexible than self-regulation. When a new type of product appeared that did not fall within the scope of the old regulations, it took time to revise the laws to extend legal coverage to the product. Because the public regulations were strong, self-regulation covered only a very limited range of regulations. For example, a self-regulatory regime did not have the authority to impose moral or ethical rules.

The existence of multiple SROs was not conducive to the development of the capital market. For example, multiple organizations often created redundant regulations, thereby leading to increases in compliance burdens and regulatory arbitrage. It was often confusing to know which entity should take charge of regulating certain complicated financial products. Moreover, KOFA and AMAK were not fully functioning self-regulatory organizations, since they did not have a truly independent self-regulation division and their governance structure was membership-oriented.

The old self-regulation system was institution-based. This was a bad fit for the new financial environment being created under the Act. The self-regulation system had to be revised to allow for business crossovers and it had to adopt a negative-list system. Investor protection also required strengthening.

## B. Development of Establishment

Table 2.2 [Development]

Aug 3 '08	Enactment of the Financial Investment Services and Capital Market Act provides the legal foundation for establishing the Korea Financial Investment Association
Aug 6 '08	Based on the recommendations of the Financial Service Commission, KSDA, AMOK and KOFA, five people selected to form the KOFIA Establishment Committee
Oct 31 '08	After KSDA, AMAK and KOFA general meetings approves the merger, a resolution to approve merger is announced and the three associations composes merger contract,.
Jan 19 '09	Executives elected at the first general meeting, including KOFIA's inaugural Chairman (Kun Ho Hwang, former Chair of KSDA) and the progress of KOFIA's establishment and KOFIA's articles of association were reported.

## C. Legal Status

KOFIA is a self-regulatory organization governing the capital market. Established on February 4, 2009 as mandated by Article 283 of the Financial Investment Services and Capital Market Act, KOFIA aims to maintain sound business practices among members, ensuring fair trade and protecting investors. It is composed of member firms and has a non-profit organization legal status.

Its roles are largely twofold: self-regulation for the market and support for its members. The Act grants self-regulatory authority to KOFIA and makes it mandatory for it to state the detailed rules in its Articles of Association. To prevent the two functions from colliding into each other, the decision-making processes should be mutually independent.

## 2. Organizational Overview

### A. Organization of the KOFIA

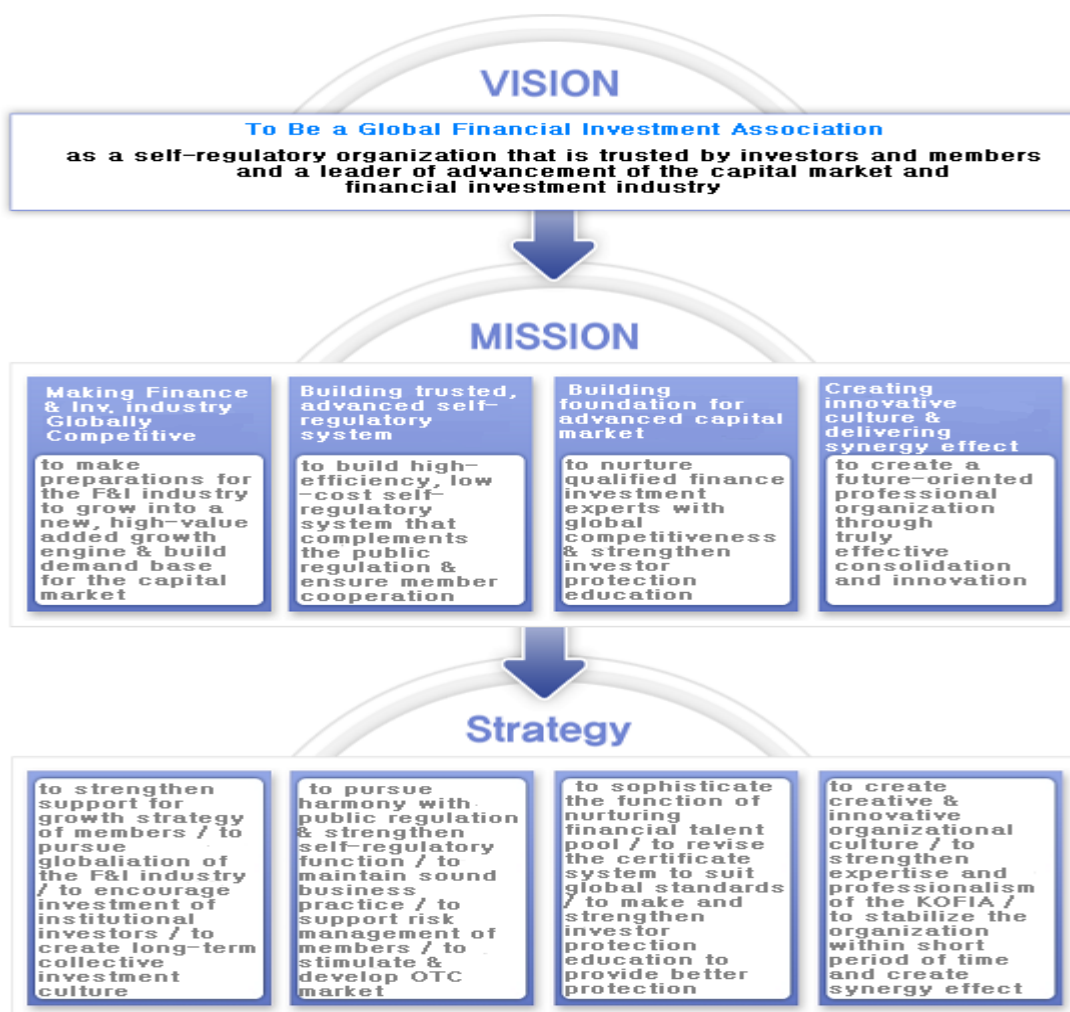
#### ① Organization

Korea Financial Investment Association is organized and operated by its members and it is a private organization established according to Article 283 of the Financial Investment Services and Capital Market Act.

#### ② Mission

Its mission is to maintain sound business practices, fair trading, and the protection of investors, thereby developing the capital market and financial industry. Figure 3.2 shows the vision and mission of the KOFIA.

Figure 3.2



### ③ Membership

There are three types of KOFIA membership: regular, special and associate membership. The details are described in Table 3.2.

Table 3.2. [Types of Membership]

<b>Regular Membership</b>	Licensed financial investment companies (dealing, brokerage, collective investment, trust service)
<b>Associate Membership</b>	Registered financial investment companies (discretionary and non-discretionary financial investment advisory services), institutions allowed to be concurrently engaged in investment business
<b>Special Membership</b>	General administration management companies, collective investment vehicle assessment agencies, bond rating agencies, Korea Listed Companies Association, KOSDAQ Listed Companies Association, Korea Securities Depository, and those who wish to join the KOFIA and acquire the approval of the Board of Directors

KOFIA has 135 regular members, 64 associate members and 16 special members. Table 3.3 shows the number of members of the KOFIA.

Table 3.3 [KOFIA Members]

<b>Membership</b>	<b>Number of Members</b>	<b>Remarks</b>
Regular Members	135	Securities companies, asset management companies, futures companies
Associate Members	64	Investment advisory service providers, banks / local branch offices of foreign banks, life insurance companies, financial holding companies, securities finance companies
Special Members	16	General administration management companies, collective investment vehicle assessment agencies, bond rating agencies, etc.
Total	215	

#### ④ Rights and Obligations of Members

##### a. Admission Fee

Any entity aspiring to become a member is only required to fill-out and submit a membership application. However, to become a regular member, the entity must pay an admission fee in a lump sum. The fee will be 10 million KRW per number of businesses the said entity is authorized to conduct. Since there are only four areas of business (dealing, brokerage, collective investment and trust) the maximum amount will be 40 million KRW. On the other hand, after taking the companies size and other factors into consideration, entities providing investment advise and discretionary investment will be exempt from admission fees for the time being, unless otherwise noticed.

[Membership Fee Apportionment of Regular Members]

- Annual membership fees are collected on the basis of the following calculations  
 $(\text{Trading index of concerned member} \div \text{Trading index of all members}) \times 70\%$   
 $(\text{Adjusted operational gains of concerned member} \div \text{Adjusted operational gains of all members}) \times 22.5\%$

- $(\text{Equity capital of concerned member} \div \text{Equity capital of all members}) \times 7.5\%$

- The period for calculating trading index, adjusted operational gains and equity capital will be the previous fiscal year of the year the board of directors approve KOFIA's budget.

- If the trading index, adjusted operational gains or equity capital of a member is unavailable at the time of calculation, making it impossible to calculate dues membership fees, then the membership fee is calculated using the volume of equity capital at the time of joining.

If the equity capital is under 30 billion KRW, the fee is 10 million

If the equity capital is over 30 billion and under 150 billion, the fee is 20 million

If the equity capital is over 150 billion, the fee is 30 million

Trading index is calculated by adding the results of multiplying a fixed-rate to each type of trading index

Table 3.4 [Membership Fee Rate of Regular Members]

	Type of Financial Investment Products	Base	Rate	
Securities	Stock, foreign depository receipt, warrant, ETF, stock warrant certificate	Trade Value	0.0008208% (0.08208/10,000)	
Free Board	Stock	Trade Value	0.0065% (0.65/10,000)	
OTC Derivatives	KOSPI 200 Futures	Contract Value	0.0001368% (0.01368/10,000)	Securities companies approved by the previous Securities and Exchange Act
	Stock Futures 1)	Contract Value	0.000855% (0.0855/10,000)	
	KOSDAQ Star Index stock 2)	Contract Value	0.0001368% (0.01368/10,000)	
	KOSPI 200 options	Option Value	0.000684% (0.0684/10,000)	
	Stock options	Option Value	0.000684% (0.0684/10,000)	
	KOSPI 200 futures	Contract Value	0.0000685368%	Futures companies

	Stock futures	Contract Value	0.000428355%		approved by the previous Futures Transaction Act	
	KOSDAQ Star Index futures stock 2)	Contract Value	0.0000685368%			
	National bond, interest rate, pork futures	Per contract	Deposit: 50 KRW, Proprietary: 44 KRW			
	US Dollar, Yen, Euro, Gold Futures	Per contract	Trade Execution	Deposit: 50 KRW Proprietary: 44 KRW		
			Final Settlement	Deposit: 100 KRW Proprietary: 88 KRW		
	KOSPI 200 options	Option Value	0.00142785%			
	Stock option share 3)	Option Value	0.0028577%			
US Dollar Option	Option Value	Trade Execution	Deposit: 0.00304608% Proprietary: 0.00253840%			
	Per contract	Exercising/ Allotment	Deposit: 20 KRW Proprietary: 17 KRW			
Collective Investment Securities	Remuneration earnings	Payment of Membership Fee	0.3346681820% 4)			
		Calculation by Trading Index	0.1673340910% 5)			
	NAV	Calculation by Trading Index	0.0007825377% 5)			

- 1) Both KSDA members and KOFA members before the establishment of KOFIA excluded
- 2) Collection currently postponed (Nov. 2005)
- 3) Collection currently postponed (Sep. 2002)
- 4) In 2008, AMAK began basing the calculation of the fee apportionment of its asset management members on remuneration earnings
- 5) In 2008, AMAK began basing the calculation of the fee apportionment of its members on remuneration earnings (1/2) and NAV (1/2)

Table 3.5 [Membership Fee of Associate Members]

Category		Membership Fee (KRW)		
Banks, Insurance firms etc.	Collective Investment Securities Dealing/Brokerage	Sales	Amount	
		Less than 1 trillion	5 million	
		1~5 trillion	4 million per 1 trillion	
		5~10 trillion	3 million per 1 trillion	
		10~20 trillion	2 million per 1 trillion	
		Over 20 trillion	1 million per 1 trillion	
	Trust	Entrusted Fund	Amount	
		Less than 1 trillion	1.25 million	
		1~5 trillion	1 million per 1 trillion	
		5~10 trillion	0.75 million per 1 trillion	

		10~20 trillion	0.5 million per 1 trillion
		Over 20 trillion	0.25 million per 1 trillion
	Collective Investment Asset Deposit and Management	3 million	
Merchant Banking		10 million	
Securities Finance Company		3 million	
Investment Advisor/ Discretionary Investor		2 million	

\* (Example) If fund sales record 22.5 trillion KRW, the membership fee is 58.5 million

- Less than 1 trillion: 5 million
- 1 ~ 5 trillion: 16 million (4 million × 4)
- 5 ~ 10 trillion: 15 million (3 million × 5)
- 10 ~ 20 trillion: 20 million (2 million × 10)
- Over 20 trillion: 2.5 million (1 million × 2.5)

\* \* (Example) If entrusted fund is 16.8 trillion KRW, the membership fee is 12.4 million

- Less than 1 trillion: 1.25 million
- 1 ~ 5 trillion: 4 million (1 million × 4)
- 5 ~ 10 trillion: 3.75 million (0.75 million × 5)
- 10 ~ 20 trillion: 3.4 million (0.5 million × 6.8)

### **b. Rights of Members**

Members of KOFIA have the right to attend General Meetings. Regular members may attend General Meetings, vote and speak at the meeting. Associate members have the right to attend General Meetings and speak, but not vote. Special members can attend the General Meeting and have a voice in matters that relate to them.

### **c. Obligations of Members**

All members of the KOFIA are subject to membership fees. Under KSDA, a fixed rate based on the trading value of each member was collected as the membership fee, but this has changed into contribution system. The amount of fees to be paid by each member is decided by the type of membership, business performance and size of the member company. The membership fees are used to provide KOFIA's budget for operation. The Board of Directors decides on the payment terms, procedures and means. When a member is disciplined under Article 45, paragraph 1, item 2 of the Articles of Association and has its membership suspended, the said member still has an obligation to pay the membership fee.

Members have the duty to operate their business in good faith and to make their utmost effort to protect investors. They are also obliged to comply with all regulations imposed by KOFIA, including the Articles of Association, other business regulations, resolutions and agreements approved or made by the General Meeting, the Board of Directors, or the Self-Regulation Committee.

It is mandatory for members to submit to KOFIA the relevant materials or reports required when it is deemed necessary for the operation of KOFIA.

## **B. Major Tasks**

### **① Statutory Tasks**

The Act specifies KOFIA's key tasks and grants it the authority to create or revise regulations and impose them upon its members. Business licenses are only granted to those entities capable of complying with the rules and regulations of the association.

- Statutory Tasks
  - To maintain fair business practices among members and protect investors.
  - To arbitrate and resolve grievances with regard to the business activities of members.
  - Tasks related to registration and management of professionals, including investment solicitors, research and analysis professionals and investment managers.
  - Tasks related to the OTC trading of stocks not listed in KOSPI or KOSDAQ markets.
  - Research and analysis of the regulations concerning the financial investment industry.
  - To provide education for investors and to establish and operate a foundation to this end.
  - Tasks related to training programs about the financial investment business.
  - Tasks commissioned to KOFIA under the Act or other laws.
  - Other tasks required by presidential decrees.

### **② Tasks Stipulated in the Articles of Association**

KOFIA stipulates itself a variety of tasks to perform for market integrity and investor protection in its Articles of Association, in compliance with the relevant laws and regulations. To facilitate the execution of those activities, KOFIA has drafted a series of rules and regulations governing the business practice of securities companies and the arbitration procedure of grievances.

- Tasks Stipulated in the Articles of Association:
  - Self-regulatory functions to maintain best business practices among members and to ensure investor protection.
  - Mediation of grievances arising from the business activities of its members (only when asked by the parties involved).
  - Tasks concerning the registration and management of professions as enumerated in Item 3, Paragraph 1 of Article 286 of the Act.
  - Tasks concerning the OTC trading of stocks that are not listed in KOSPI or KOSDAQ markets.
  - Research and analysis of the regulations concerning the financial investment industry.



- To provide education for investors and to establish and operate a foundation to this end.
- Tasks related to training programs about financial investment business
- Tasks commissioned to KOFIA by laws or regulations.
- Tasks related to keeping the records of disciplined employees or executives of member companies.
- Trading of debt securities (over-the-counter trading only).
- Tasks related to job training and the ethical training of executives or employees of member companies.
- Tasks related to the review of investment advertisements.
- Making suggestions to the government and relevant authorities for the development of the financial investment industry and the capital market.
- Creation, revision, nullification and implementation of rules governing the business practice of members for OTC derivatives or similar products.
- Tasks involved in member support or the enhancement of mutual benefits.
- Renting and leasing of buildings, facilities, etc.
- Research contracts, publications, and their sales, etc.
- Other tasks incidental to the above.

## **C. Governance Structure**

### **① Overview**

The current governance structure of KOFIA consists of two layers, one for member services and the other for self-regulation, with the General Meeting and the Board of Directors sitting above them as the principal governing bodies. The self-regulation function is named the Self Regulation Division. The member service function is composed of five divisions: Management Strategy Division, Securities Service Division, Derivative Product Division, Collective Investment Service Division, and Financial Investment Education Division. This dual-layer structure was created as a means to ensure the independence of KOFIA's self-regulation function.

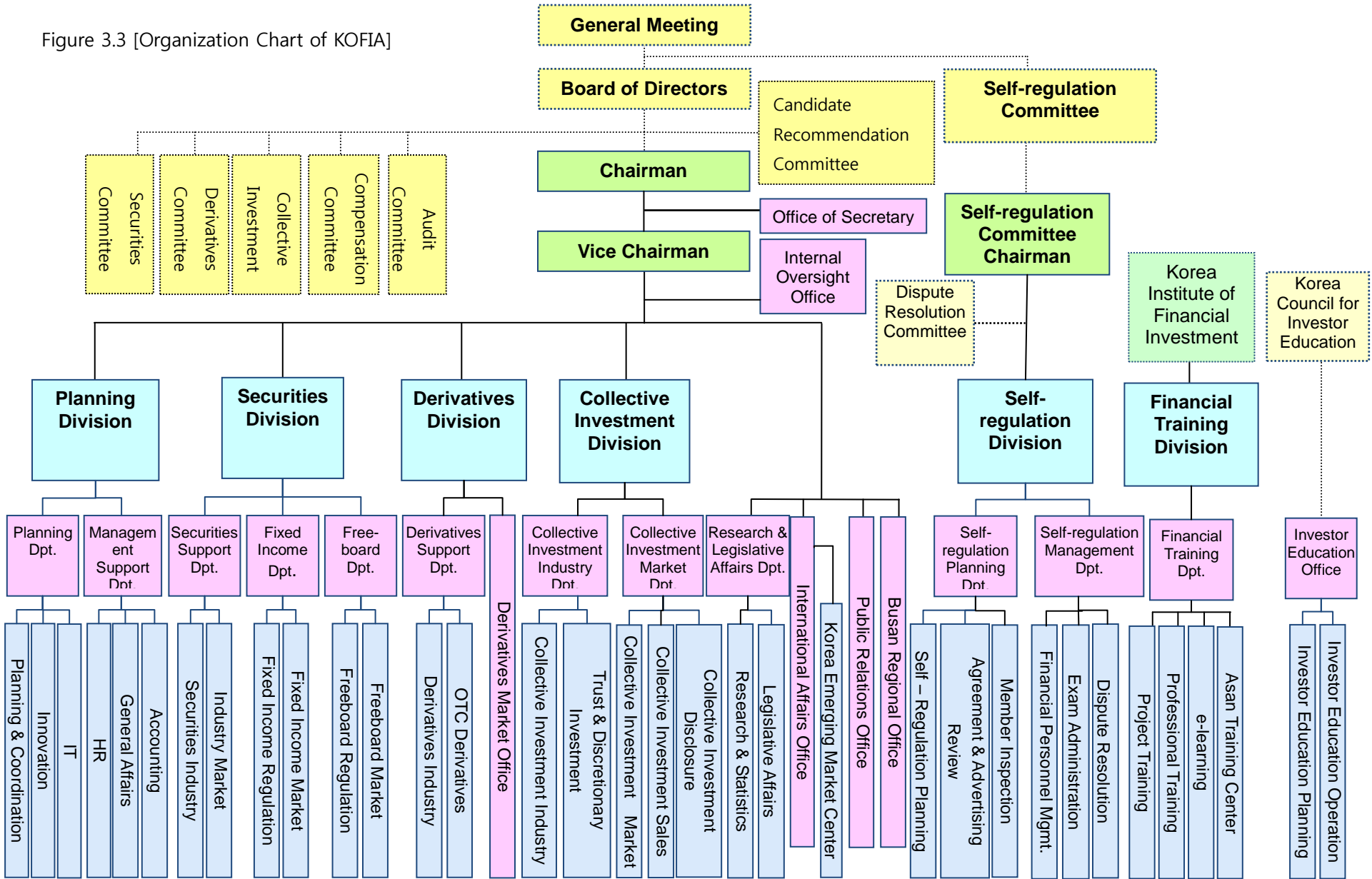
The Self-regulation Division with 35 members of personnel in two departments (one for planning and the other for operation). Their roles are: formulation, revision and planning of the rules (6 people), investigation of members and dispute mediation (8 people), review of advertisements and standard agreement (5 people), and the management of financial investment professionals and certificate test administration (14 people).

The Management Strategy Division composes two departments (the Planning Department and Management Support Department) with 33 personnel. Securities Service Division

has three departments (the Securities Support Department, Fixed-Income Department and Free Board Department) with 26 personnel. In the Derivative Product Division, 12 members of staff work in two departments (the Derivative Product Support Department and Derivative Product Market Department). There are two teams (the Collective Investment Industry Department and Collective Investment Market Department) with 15 employees in Collective Investment Service Division. Finally, the Division of Financial Investment Education Division only has one department with the same name, with 17 members of personnel working within the division.

The other groups that directly belong to the Vice Chairman are the Research and Regulation Department (11 members of staff), International Affairs Office (8 members of staff), Public Relations Office (7 members of staff) and the Busan Local Office. The Korea Council for Investor Education is a separate legal entity affiliated to KOFIA. Figure 3.3 shows the organization chart of KOFIA.

Figure 3.3 [Organization Chart of KOFIA]



## **② Decision-Making Body and Officership**

### **a. General Meeting**

The General Meeting of KOFIA is composed of regular members (135 financial investment companies), associate members (64 companies) and special members (16 institutions).

The agenda of the General Meeting may include: the formulation and amendment of the Articles of Association (excluding any revision of the Articles of Association pursuant to formulation, revision or nullification of relevant laws and regulations); appointment and discharge of officers; appointment and discharge of self-regulation committee members; business reports and settlement of accounts; expulsion of members; the dissolution of KOFIA; and any other matters deemed necessary by the Chairman, Board of Directors or the Self-Regulation Committee. The above agenda may be commissioned to the Board of Directors or the Self-Regulation Committee with the scope clearly verified when deemed necessary.

Voting rights at the General Meeting is only given to regular members. Ownership of voting right is decided by a dual-class system. Each member has equal share of the basic voting right, but disproportional voting rights are also given to each member according to the amount of membership fees they pay. The total voting right each member owns is the sum of their basic and disproportional voting rights. However, the total sum of voting right held by a single organization among the three associations consolidated cannot exceed two thirds of the entire voting rights of KOFIA.

### **b. Officers and Board of Directors**

#### **i. Organization**

The Chairman of KOFIA is selected at the General Meeting from among the candidates nominated by Chairman Candidate Recommendation Committee.

Vice Chairmanship is held by three people, one standing and two non-standing Vice Chairmen. The General Meeting chooses two non-standing Vice Chairmen from among the candidates recommended by members. The candidates are chosen among representative directors of the regular member companies. The standing Vice Chairman is recommended by the Chairman and appointed at the General Meeting. Major shareholders or full-time executives or employees of member companies cannot be candidates for the standing Vice Chairman.

The Board of Directors has four or fewer of its directors chosen among members, including the two non-standing Vice Chairmen. The four member directors are recommended by members firms and appointed at the General Meeting, among whom two will be named Vice Chairmen.

The Board of Directors also has six independent directors or fewer. The candidates for independent directors are recommended by the Chairman and appointed at the General Meeting, and at least one of them should be in the possession of professional knowledge of accounting or finance. Major shareholders or full-time executives or employees of member companies cannot be candidates for the standing vice chairman.

## ii. Power of Board of Directors

The Board of Directors has the authority to approve:

- Amendments to Articles of Association in accordance with formulation, revision or nullification of relevant laws and regulations
- New members or change of membership status
- The amount and terms and procedures of payment of membership fees
- Matters related to voting rights of members
- Formulation, revision or nullification of rules and regulations governing the business activities of members (except for the rules for self-regulation)
- Business planning and budgeting
- Virement of budget items
- Formulation, revision or nullification of the operating rules of the Board of Directors and committees answering to the Board of Directors, or in-house regulations
- Use of funds raised by monetary penalties
- Investment or contributions; acquisition and disposal of real estates
- Agenda for the General Meeting
- Other matters that are deemed necessary to be dealt with at the Board of Directors by the Chairman

When deemed necessary, the Board of Directors may commission the above matters to the Chairman within the clearly verified scope. Table 3.4 shows the number and terms of office of officers.

Table 3.6 [Numbers of Officers and Their Terms of Office]

	<b>Number</b>	<b>Term of Office</b>
Chairman	One	3 years
Vice Chairman	Three (including one standing Vice Chairman)	2 years (3 years for standing Vice Chairman)
Chairman of Self-Regulation Committee	One	3 years
Member Directors	Not more than four (including two non-standing Vice Chairmen)	2 years
Independent Directors	Not more than six	2 years

### **iii. Candidate Recommendation Committee**

Candidate Recommendation Committee is composed of three independent directors appointed by the Board of Directors and two additional members chosen by the Board of Directors from among those who are not major shareholders of member companies or full-time employees or executives. The members vote to choose the committee chair. The main role of the committee is to nominate candidates for the election of chairman, independent directors, chair and members of Self-Regulation Committee. A candidate for chairman should be someone with an extensive knowledge and experience in corporate management and the financial investment industry, and who meets the qualification criteria stipulated in the Act.

### **iv. Committees within the Board of Directors**

To ensure the professionalism and efficiency of divisions within KOFIA and to collect reasonable voices from the market and establish advanced system, four committees are instituted within the Board of Directors: the Securities Committee, Derivatives Committee, Collective Investment Committee, and Audit Committee.

The Audit Committee comprises of three members selected from the independent directors by the Board of Directors, one of who should be an expert of accounting or finance. The Chair of the committee is selected by voting among the members. The committee oversees auditing.

### **c. Self-Regulation Committee**

#### ● Organization

Self-Regulation Committee is composed of seven members (three experts of the financial industry, one legal expert, one expert in accounting or corporate finance and one representative of members) and one chairman. The Candidate Recommendation Committee recommends candidates for the committee from those who are not a major shareholders or full-time employees or executives of member companies. The members of the committee are appointed at the General Meeting. The chair of the committee is a full-time position, while the members are not. Their terms of office are two years and can be extended for another term.

#### ● Roles

The Self-Regulation Committee performs the following duties:

- Matters related to self-regulation to maintain fair business practices among members and protect investors
- Mediation of grievances arising from the business activities of members
- Formulation, revision or repeal of self-regulation rules
- Formulation, revision or repeal of rules governing grievance mediation

- Investigation and discipline of members in violation of rules, or recommendation of disciplinary measure against employees or executives of member companies
- Other matters similar to the above that are deemed necessary by the committee

- Resolution

The quorum for the committee meeting consists of a majority of its members, and resolutions are made by a majority of those present. If the chair or a member of the committee has a stake in the matter, the chair or member cannot execute his or her voting right.

- Dispute Resolution Committee

The Dispute Resolution Committee is established within the Self-Regulation Committee to resolve disputes that may arise among members or between a member and its client in relation to the member's business activities. The Self-Regulation Committee drafts the rules governing the mediation process. When a member or a client of a member requests mediation for grievance, the committee is obligated to accept the request. When the committee finds it necessary to acquire facts or materials in mediating a grievance, it can make a request for the confirmation of facts or the submission of the necessary materials or statements to the parties involved.

### ③ Organization and Roles

#### a. Management of Organization

To prevent any conflict of interest between the role of self-regulation and member support, KOFIA has instituted and is operating the Securities Division, Derivative Product Division and Collective Investment Division. According to Article 287, paragraph 1, item 3, of the Act and of Article 308, paragraph 1 of the Enforcement Decree of the Act, KOFIA is required to establish Chinese Walls between divisions that are in charge of different financial investment services and products. The purpose of this requirement is to ensure the efficiency and fairness of operation.

KOFIA may have six or fewer executive board members to aid the Chairman and the standing Vice Chairman. The Chairman appoints the executive board which reports to the Board of Directors. Their term of office is determined by the Chairman, but cannot exceed three years. Reappointment to the executive board is permissible.

#### b. Roles of Each Division

##### i. Planning Division

The Planning Division comprises of the Planning Department and the Management Support Department. The Planning Department consists of three teams: the Planning &

Coordination Team, Innovation Team and IT Team. The Support Department also comprises three teams: the HR Team, General Affairs Team and Accounting Team.

□ Planning Department

The Planning & Coordination Team's primary functions are: establishing management goals, plans, detailed action plans and management strategies and the assessment of their implementation; profit structure and budget of the General Meeting, Board of Directors and KOFIA; accession to and secession from other organizations; the compiling and publishing of materials concerning KOFIA; organizational management and assignment of responsibilities; performance of duties associated with the office of Chairman and other officers; deliberation and decision-making on the General Meeting or Board of Directors meetings; creation, revision or abolition of the Articles of Association and other in-house regulations; and cooperation with outside organizations.

The Innovation Team is charged with: management innovation; the creation of organizational culture; overall affairs concerning customer service and social involvement, including the drafting of action plans, arrangement of events, research and publishing and assessment of performance and the reporting of results. The team also performs duties related to the profit structure of KOFIA, the membership system, accession or secession of members, changes of membership status, and determination of membership fees and billing.

The IT Team chiefly deals with: the planning and examination of IT operations; the implementation of new IT projects; the negotiations and adjustment of the IT operations of KOFIA members; the establishment and operation of IT systems; creation of mid- to long-term strategies for the advancement of the IT systems; the security and maintenance of data and programs; the building and maintenance of websites; IT training; and support for PC and printer users.

□ Management Support Department

The HR Team is in charge of: general personnel and payroll management, including rewards and penalties; benefit packages; travel expenses; management of the Compensation Committee and the performance assessment of KOFIA officers; training of KOFIA employees and union members; administration of the Employee Welfare Fund; counseling services for employees; management of the employee proposal system; and the creation, revision and rescission of in-house regulations and rules concerning the above matters.

The General Affairs Team primarily deals with: acquisition, management and disposal of assets, their maintenance and repairs, contracting and purchasing; management and confidentiality; protection of seals and documentations; organization of events and national campaigns; litigations involving KOFIA; joint efforts with other organizations; the acquisition, disposal, leasing and maintenance of real estate; the maintenance of buildings, facilities, utilities, machines, etc; management of fire-fighting appliances and communication equipment;



management of maintenance contractors; creation, revision and rescission of in-house regulations concerning documents, assets, contracting and building maintenance; establishment and adjustment of the wartime contingency plan for the civilian sector and security and policing activities.

The Accounting Team's key responsibilities are: planning and management of funds; accounting, settlement, and tax matters; collection and management of membership fees; handling of cash or marketable securities and the management of credits and debts; operation of Employee Mutual Aid; management and payment of Employee Welfare Fund; creation, revision or rescission of in-house regulations governing accounting (excluding contracts) and Employee Mutual Aid.

## **ii. Securities Division**

The Securities Service Division has Securities Support Department, Fixed-Income Department and Free Board Department. The Securities Support Department comprises Securities Industry Team and Securities Market Team. The Fixed-Income Department is composed of Fixed-Income Regulation Team and Fixed-Income Market Team. Free Board Department has Free Board Regulation Team and Free Board Market Team in it.

### **□ Securities Support Department**

Securities Industry Team's primary responsibilities include: securities policy and regulation reform; enhancement of competitiveness of the securities industry and deregulation; research and survey of securities markets and policies in Korea and elsewhere; operation of the Securities Committee and creation, revision and repeal of rules and regulations for the committee; support for member securities companies in their other business activities, incidental businesses, accounting and taxation; protection of customer deposits and money laundering prevention for the member securities companies; and development of financial products in relation to securities.

Securities Market Team's responsibilities include: securities market policy and regulation reform; operation of advisory committees and working-level committees; operation of meeting of presidents of member securities companies to discuss latest securities issues; public disclosure of management analysis and the operating reports of member securities companies; management of credit information of member securities companies; collection and processing of statistical data concerning securities and publishing of the results; management of member securities companies; and compiling and publishing of materials about member securities companies.

### **□ Fixed-Income Department**

Fixed-Income Regulation Team mostly deals with: reform of regulations and policies concerning bonds; research and study of bond-related products; support for bond-related sales

activities of member companies; research and study of bond markets in Korea and elsewhere; announcement of bond market index; protection of bond investors; public relations activities for bond market; and collection and processing of statistical data, including issuance records and OTC transactions.

Fixed-Income Market Team mostly deals with: reform of regulations and policies concerning bonds market; disclosure of closing quotation yields and trend analysis in the bonds market; disclosure and monitoring of OTC trading of bonds; quotes for OTC securities, primary dealer quotes, and IR futures benchmark yields; public relations activities for FI-related products and OTC bond market; formulation, revision and repeal of rules and regulations governing public announcement made by the bonds market; announcement of the bond index, corporate bond index and bond market index; operation of the Bond Information Service Center (a website); and monitoring of bond pricing.

□ Free Board Department

Free Board Regulation Team creates the annual plan for the Free Board and reform measures to improve existing policies or regulations for the Free Board. It drafts or revises rules governing the Free Board. It also has the authority to interpret the operating rules of the Free Board. Other responsibilities include research of stock market policies and regulations in Korea and other countries, introduction of new designations to the market, PR activities, training and support for the designated companies or companies of preliminary designation.

Free Board Operation Team is charged with new designations and the revision (added) or cancellation of designations. It also oversees the management of designated companies, Free Board trading and disclosures, ex-dividend dates and other market treatments, processing of statistical data concerning investment in the market, the publishing of materials on the Free Board, announcement of market performance records, management of Free Board stock index, and management of companies of preliminary designation.

**iii. Derivatives Division**

Derivatives Division composes Derivatives Industry Support Department and Derivatives Market Office. The Derivatives Industry Support Department is composed of Derivative Industry Team and OTC Derivatives Team. The Derivatives Market Office is not divided into teams.

□ Derivatives Industry Support Department

Derivatives Industry Team mostly deals with: reform of rules, regulations and policies concerning the derivative industry; research and study of market and industry policies in Korea and other countries; operation of Derivative Product Committee and formulation, revision and repeal of rules governing the committee; domestic and international PR activities for the derivative market; arrangements of events and seminars regarding derivatives; support for

derivative-related issue; and support for member derivative companies in their other business activities, incidental businesses, accounting and taxation.

OTC Derivatives Team's responsibilities are: reform of regulations and policies concerning the OTC derivative products; design of OTC derivative products and support; building and maintenance of OTC derivative database; monitoring of OTC derivative market; and risk management for OTC derivatives.

□ Derivatives Market Office

Derivatives Market Office mostly deals with: reform of regulations and policies concerning derivative market; analysis of market trend and prospect; risk management of derivative products; operation of advisory committee and working-level committees for derivative products; arrangement of executive-level and working-level meetings to deal with issues in the derivative market; acceptance and public announcement of statistical reports concerning derivatives; management of member derivative companies; research and development of new products for member derivative companies; publishing of periodicals for derivatives and other materials; sales of information concerning derivatives; and running of derivative risk management consulting programs for small and medium-sized businesses.

**iv. Collective Investment Division**

Collective Investment Division has two departments: Collective Investment Industry Department and Collective Investment Market Department. The Collective Investment Industry Department comprises Collective Investment Industry Team and Trust & Discretionary Investment Team. The Collective Investment Market Department is composed of Collective Investment Market Team, Collective Investment Sales Team, and Collective Investment Disclosure Team.

□ Collective Investment Industry Department

Collective Investment Industry Team mostly deals with: reform of rules, regulations and policies concerning the collective investment industry; enhancement of competitiveness and deregulation for the collective investment industry; development and management of new products concerning collective investment; formulation and revision of guidelines for collective investment; operation of Collective Investment Committee and formulation, revision and repeal of rules for the committee; and matters related to other tasks and incidental tasks of the Collective Investment Committee other than its primary tasks.

Trust & Discretionary Investment Team's primary roles are: reform of rules, regulations and policies concerning the industry of trust service and discretionary and non-discretionary investment advisory services; deregulation for the industry; formulation and revision of guidelines for the industry; money trust service; pension trust service; development and management of new products concerning the industry; property trust service; and support for the member trust service providers and discretionary and non-discretionary investment advisory service providers in their

other business activities and incidental businesses.

□ Collective Investment Market Department

Collective Investment Market Team performs the following tasks: reform of rules, regulations and policies concerning collective investment market; maintaining the safety of collective investment properties; formulation and revision of guidelines for management of collective investment vehicles; support for management of collective investment vehicles; promotion of long-term investment; operation of advisory committee and working-level committees for collective investment; fund registration and securities registration statement; collective investment agreement; trend analysis of the collective investment industry; publishing of materials concerning collective investment; matters related to foreign direct investment; hosting of seminars or conferences for collective investment; matters related to Global Investment Performance Standards; assessment of credit rating agencies; regular analysis of market trends; and management of member collective investment service providers.

Collective Investment Sales Team mostly deals with: reform of rules, regulations and policies concerning consignment of sales; formulation and revision of guidelines for collective investment vehicles; sales support for collective investment securities; operation of advisory committee and working-level committees for consignment; matters related to collective investment accounting; policy reforms for fund and taxation; and investigations and publishing for tax and accounting matters of the collective investment business.

Collective Investment Disclosure Team is charged with: public announcement of the member collective investment service providers; public announcement of collective investment vehicles; publishing of announcement materials; support of materials about overseas collective investment assets; creation of MIS report about monthly trend of investment trust; development indexes concerning collective investment vehicles; support for construction of a website to provide information about collective investment vehicles; matters related to standard codes of collective investment vehicles; and management analysis and public operating reports of member collective investment companies.

**v. Other Departments**

Other than the divisions described above, groups that directly belong to the Standing Vice Chairman are the Research and Legislative Affairs Department, Korea Council for Investor Education, International Affairs Office, Office of the Secretary, Internal Oversight Office, Public Relations Office) and Busan Local Office. The Research and Legislative Affairs Department has Research and Statistics Team and Legislative Affairs Team in it. International Affairs Office is composed of International Affairs Team and Emerging Market Center.

□ Research and Legislative Affairs Department

The Research and Statistics Team's primary responsibilities are: the research of policies

and regulations concerning the capital market and industry; management and adjustment of all research and study activities of KOFIA; research and analysis of economic and capital market trends in Korea and the world; writing of speeches and contributions for the Chairman and other officers of KOFIA; exchanges and cooperation with overseas research institutions; operation of securities library and management of publications; publishing of securities newspaper and results of research and study; recording of KOFIA's history and the publishing of related materials; and researching matters related to the capital market trends and statistical analysis.

The Legislative Affairs Team is charged with: the research and study of financial investment regulations and the publishing of related materials; deliberation when formulating, revising or repealing rules governing business activities of members; publishing of laws, regulations and other materials concerning financial investment; counseling services and support for members concerning the laws and regulations governing the financial investment industry; and making suggestions and recommendations for the formulation or revision of such laws and regulations.

□ International Affairs Office

The responsibilities of the International Affairs Team mostly concern cross-border partnerships and joint efforts. The team dispatches representatives to, and hosts, international events or conferences, networks and exchanges with other countries and arranges educational programs or visits to international capital markets. It also deals with matters related to international organizations. The team is also charged with the international PR for the Korean capital market; the attraction of foreign investment; introducing the Korean stock market to international visitors; publication of English versions of regulations and other documents; and the maintenance of the English homepage of the KOFIA.

The Korea Emerging Market Center provides assistance to member companies initiating operations in an emerging market. The Center coordinates the roles and activities of local and foreign agencies in relation to member companies. The Center also hosts events, seminars and conferences on emerging markets and hosts education and training courses on them. Other responsibilities of the Center include studying and researching emerging markets and the publishing of said research.

□ Internal Oversight Office

The Internal Oversight Office's responsibilities are: the planning of audit and reporting of audits; performing of regular and special audits; action-taking for the results and follow-ups; surveillance to prevent irregularities; acceptance of outside auditing by the FSC and other parties; examination of the Articles of Association and other KOFIA regulations for suitability; compliance checks of risky projects or projects with more than a certain amount of budget; attending open tenders and overseeing the take-over process of jobs; accommodation of internal complaints against KOFIA employees or executives; the creation, revision or rescission of in-house regulations

governing auditing; and works associated with national campaigns for anti-corruption, most notably the Social Pact on Anti-Corruption and Transparency.

- Office of the Secretary

The Office of the Secretary is charged with matters related to protocol, the office of executives and other general tasks for secretaries.

- Public Relations Office

Public Relations Office responsibilities are: media relations; hosting press conferences and other media events; media sponsorship and advertising; PR for KOFIA and the financial investment industry; cultivation of industry culture; publishing PR materials and hosting of promotion events; the collection and analysis of industry trends; and support for members in their public relations activities.

- Busan Regional Office

The roles of Busan Regional Office are: complaint procedures with regards to financial investment products; the collection of suggestions for improvement for financial investment policies and counseling; matters related to investor protection, such as counseling and answering questions concerning financial investment business; mediation of disputes arising in relation to the business activities of local branch offices of KOFIA members; arranging local training programs and events on finance; PR activities for financial investment business aimed at local communities; and communications with the head office and the execution of tasks assigned by it.

## **vi. Self-Regulation Division**

Self-Regulation Division is composed of two departments: the Self-Regulation Planning Department and Self-Regulation Management Department.

The Self-Regulation Planning Department has the Self-Regulation Planning Team, Agreement and Advertising Review Team, and Member Inspection Team. The Self-Regulation Management Department comprises of the Financial Personnel Management Team, Exam Administration Team, and Dispute Resolution Team.

- Self-Regulation Planning Department

Self-Regulation Planning Team's primary responsibilities are: the operation of Self-Regulation Committee; research and study of policies concerning self-regulation; formulation, revision and repeal of rules governing self-regulation; formulation, revision and repeal of standard internal control guidelines and other guidelines; and matters related to investor protection and standard investment solicitation rules.

The chief responsibilities of the Agreement and Advertising Review Team are: the creation, revision or rescission of standard agreements for members, and examination of agreements;

examination of advertisements; and review and management of new products.

The key responsibilities of the Member Inspection Team are: planning audits of members; execution of audits into any breaches of regulations conducted by members' executives or employees and disciplinary actions; conducting audits commissioned by FSC; and the collection and analysis of data concerning industry trends.

□ The Self-Regulation Management Department

Financial Personnel Management Team's responsibilities are: the formulation, revision or repeal of regulations governing financial investment professionals; research and study of policies concerning financial investment professionals; registration and cancellation of the registration of professionals; management of registered professionals and disciplinary actions; qualification assessment of financial investment personnel; registration and the management of investor solicitation agents (introducing brokers); designation and management of professional investors; administration of qualifying tests for financial investment professionals, excluding investment solicitation advisers; and the processing of statistical data concerning professionals and publishing of the results.

The Exam Administration Team performs the following tasks: the reform of policies concerning the financial investment professionals, including qualifying tests; operation of the Secretariat for the Sales Agents Management Committee; and administration of qualifying tests for investment solicitation advisers (including their supervisors).

The Dispute Resolution Team's key responsibilities are: the creation, revision or rescission of internal regulations for Grievance Mediation Committee; drafting of grievance mediation regulations; mediation of grievances arising in relation to the business activities of KOFIA members; treatment of complaints and petitions regarding the trading of financial investment products; treatment of petitions and counseling regarding regulations governing financial investment businesses; transfer or filing of petitions to relevant authorities; account search services; tasks related to investor protection, including counseling or inquiries concerning financial investment business; and operation of the Investor Protection Center.

**vii. Financial Training Division: the Korea Institute of Financial Investment**

□ Nature and Organization

Korea Institute of Financial Investment is a public education institution established according to Article 291 of the Act. The mission of the institute is to enhance the quality of financial investment personnel and to disseminate professional knowledge about the financial investment business. The institute took over the role of the Korea Securities Training Institute. One of standing officers of KOFIA holds the directorship of the institution.

#### □ Roles

The Financial Training Division has only one department, the Financial Training Department. Within it, the department has four teams: the Project Training Team, Professional Training sTeam, e-Learning Team, and the Asan Training Center.

The chief responsibilities of the Project Training Team are: business planning; budgeting, settlement and accounting; development of overseas-related courses and special training courses; operation of overseas-related training and special training; management of enrollment records and issuance of certificates; development and appointment of trainers; payment of trainer fees and other expenditure; statistics concerning training programs; and cooperation and joint efforts with other training institutes in Korea and foreign countries.

The Professional Training Team mainly deals with: the planning, development, promotion and operation of regular training courses; operation and assessment of the regular training programs; planning, development and operation of new training programs; customization of training programs and consulting; development and operation of special courses; management of enrollment records and issuance of certificates; development, appointment, performance assessment and management of trainers; publishing of learning materials and brochures; payment of trainer fees and other expenditures; matters related to employment insurance; management of documents and seals; acquisition and maintenance of facilities and equipment; other planning for professional training; and the creation of standards.

The e-Learning Team is charged with: the planning, development, operation and promotion of online training courses; development and management of the internet homepage of the institution and LMS; maintenance of trainer and student database; and other matters related to the planning or operation of e-learning.

The Asan Training Center primarily handles: PR activities and the marketing of education programs; development of an operation plan of education facilities; PR for the education facilities and leasing them out; operation of classes and other affairs associated with education; maintenance and repair of buildings and equipment; general affairs; and other matters recognized as necessary by the director of the institute.

### **viii. Korea Council for Investor Education**

#### □ Overview

The Korea Council for Investor Education (KCIE) was founded in June 2005 by nine financial institutions as a non-profit organization. Its establishment was prompted by the need for a consolidated educational institution to provide efficient, well-structured training programs on securities, futures and asset management for investors. Some of the key goals of KCIE are promoting desirable investment practices, boosting investor confidence, building on investors' ability to make sound investment decisions, sharpening the competitive edge of the local capital market and introducing sophisticated market practices.



All of the KCIE programs are provided free of charge, including classes on stocks, futures and asset planning and management.

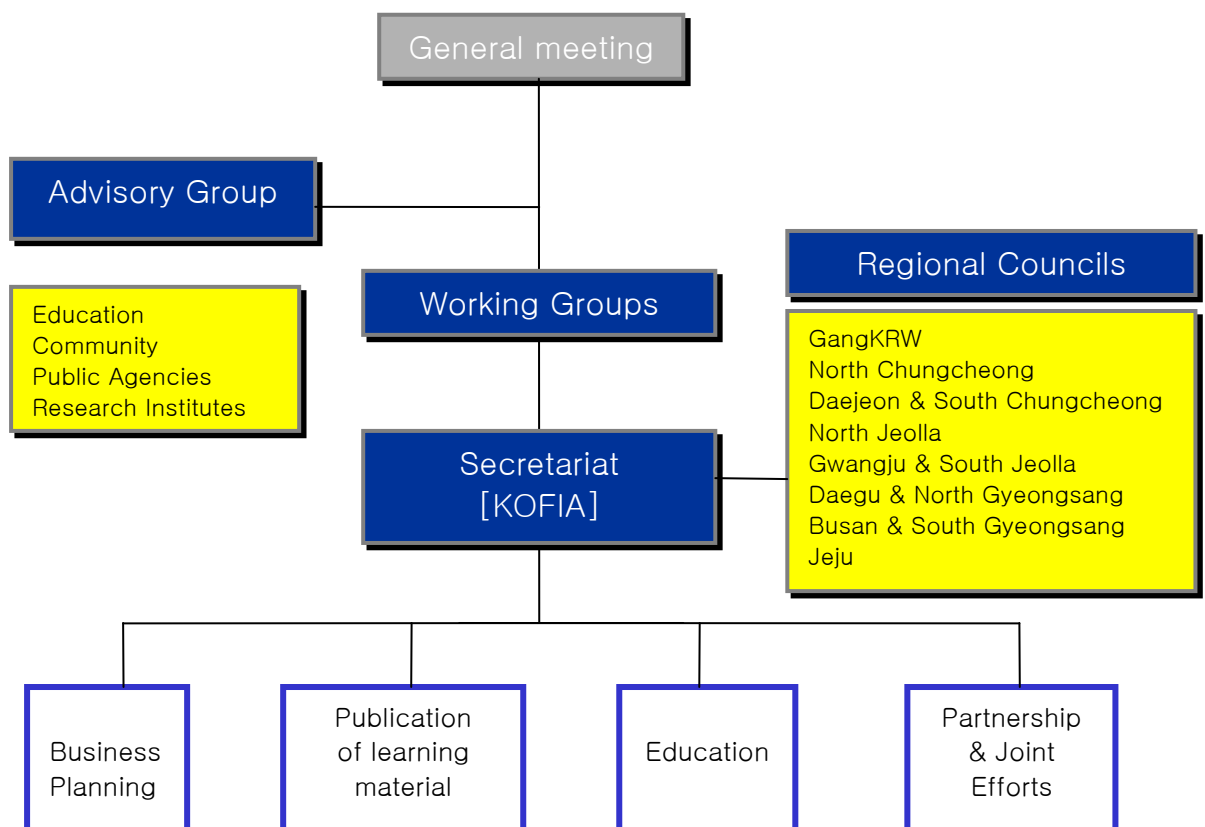
□ Members

The seven principal institutions making up KCIE’s membership are: KOFIA (KSDA, AMAK and KOFA merged), Korea Exchange, Korea Securities Depository, Korea Securities Finance Corporation and COSCOM. It also has two state agencies—Financial Services Commission and Financial Supervisory Services—as special members.

□ Organization

The organizational structure of the KCIE is shown in Figure 2.2.

Figure 3.4 [Organizational Structure of the KCIE]



□ Investor Education Office

The Office is divided into two groups: Investor Education Planning Team and Investor Education Operation Team.

- Investor Education Planning Team

The Investor Education Planning Team’s chief responsibilities are: annual planning and budgeting; the structuring of education programs; planning and development of courses, their content and materials; PR for the education programs; research and study; and cooperation and joint efforts with other educational institutions.

- Investor Education Operation Team

The Investor Education Operation Team is primarily charged with: the operation of online and off-line education programs; the operation of initiatives and events of the local offices; and other general affairs for investor education.

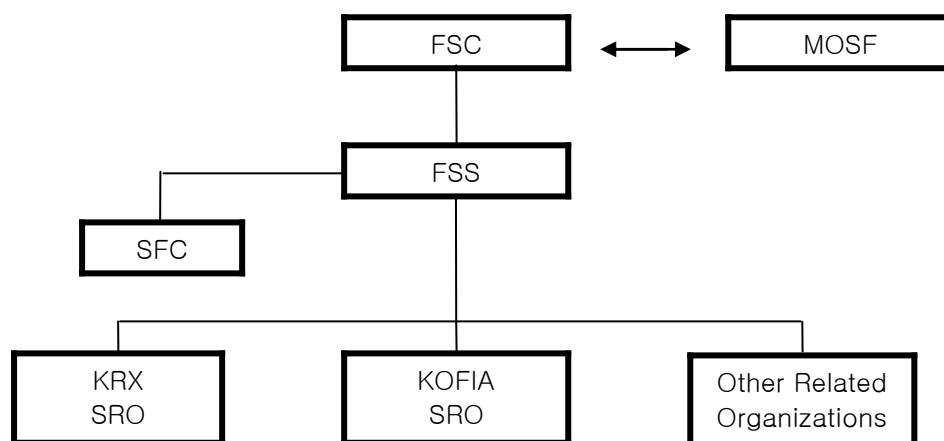
#### ④ Relationship with the State Regulatory Authorities

##### a. Public Regulatory System

The Act requires that any new or revised rules or regulations of KOFIA are reported to the relevant authorities, and states that the Chairman of the Financial Services Commission is entitled to order alterations to the above mentioned rules. The Chairman of the FSC also has the power to require changes to KOFIA’s articles of association, the dissolution of the association or the dismissal of any of its officers, and to demand the submission of any information concerning KOFIA’s operation or assets, or to order an investigation into them.

KOFIA is also legally obliged to submit its business plans, balance sheets, inventory of properties and other financial statements annually to the relevant authorities. Figure 2.3 shows the supervisory structure of the capital market.

Figure 3.5 [Supervisory Regime Governing the Capital Market]



MOSF (Ministry of Strategy and Finance), FSC (Financial Services Commission), FSS (Financial Supervisory Services), SFC (Securities and Futures Commission), KRX(Korea Exchange)

## **b. Adjustment of Scope of Functions**

- Rule-Making Function

One of the key roles of KOFIA is that as a rule-maker. The principle is to keep these effects within the boundary of legal requirements, although some of the self-regulatory rules enforced by KOFIA do require higher level of compliance than required by law.

- Compliance Check

KOFIA is entitled to conduct investigations into matters involving KOFIA members' compliance with regulations. The investigative authority given to KOFIA is as extensive as that of the public regulations in terms of scope, method and purpose. However, to avoid redundancy and to ensure the efficiency of their investigative efforts, KOFIA has operates in cooperation with the state and limits its investigative scope to areas that are exclusive to its self-regulatory rules.

- Disciplinary Measures and Sanctions for Non-Compliance

When a member fails to comply with any laws or regulations, it is subject to double punishment from the public authorities as well as from the applicable self-regulatory organizations. The disciplinary actions of self-regulatory organizations are reviewed by the state for their appropriateness. If a necessary action is not taken, the responsible organization may see its charter cancelled or suspended. If any member of an SRO finds a disciplinary action to be harsher than the legal requirement, the member may seek a tort claim to receive compensation. Unlike the in U.S., members do not have a right to appeal disciplinary actions to the state authorities.

## **⑤ Relationship with Other Self-Regulatory Organizations**

### **a. Scope of Authorities**

The scope of KOFIA and the KRX's authority is rarely redundant, except in some duty of care requirements. The KRX governs trading activities in the securities market, from entrustment to settlement, while KOFIA is charged with the regulation of OTC securities markets and the promotional activities of member companies, such as investment solicitation.

### **b. Scope of Examination**

The two SROs have established cooperative arrangements with each other to remove any redundancies from their respective scopes of examination in order to relieve the burden of compliance from the securities companies. The scope of examination of the SROs is restricted to their respective scopes of authority, except for the examination of loss protection offers.

### **c. Disciplinary Authority**

If a company that belongs to multiple SROs violates state laws or regulations, the company is, in principle, subject to punishment from the multiple SROs. In reality, a company rarely receives multiple punishments except in the case of the offering of loss protection, since KOFIA punishments are mostly imposed for promotional activities such as investment solicitations. When a company that belongs to multiple SROs violates self-regulation rules, the company is subject to punishment from one of the SROs, depending on the effectiveness of the punishment. There would be no sanctions taken by the state.

## 【KSDA v. KOFIA】

	KSDA	KOFIA
Governing Law	Securities and Exchange Act	Financial Investment Services and Capital Market Act
Year Established	1953	2009
Legal Status	Non-profit, special legal entity (Relevant laws mandated the establishment of the organization)	Self-regulatory organization mandated by the Financial Investment Services and Capital Market Act
Rule-making Power	Mandatory: required by the articles of association	Granted practical power in rule-making
Inspection	Optional as per the articles of association	Mandatory as per the articles of association
Authority to Sanction	Mandatory as per the articles of association	Mandatory as per the articles of association
Membership	Voluntary	Voluntary
Number of Members	Members: 99 Regular 36 (securities companies), Special members 16(securities companies), Associate 38	Members: 215 Regular 135(securities, futures, asset management companies), Associate 64, Special members 16
Membership Fee	- Admission Regular: 1.2 billion KRW Associate: 0.2 billion KRW - Annual Regular/Special: fixed-rate Associate: flat	- Admission (regular members only) 10 million KRW per area of business, maximum 40 million KRW - Annual Apportionment system
Scope of Regulation	Only securities business	Securities, asset management, futures, advisory and trust businesses, and other capital market participants
Executives	Chairman: 1 Vice Chairmen: 3 (1 standing vice chair included) Directors: 8 (3 member, 5 public) Auditors: 4 (2 member, 2 public)	Chairman: 1 Vice Chairmen: 3 (1 standing vice chair included) Self-regulation Committee Chairman: 1 Directors: 10 (4 member, 6 public)
Structure of Organization and Number of Employees	- Divided into member service and self-regulation with no separate divisions - Number of employees: 150	- Divided into member service and self-regulation with six explicit divisions, including, Securities, Derivatives, Collective, Investment, and Self-regulation - Number of employees: 235

Governance	<ul style="list-style-type: none"> <li>-Dual governance by the board of directors and the self-regulation committee</li> <li>-Majority of the board composed of independent directors to enhance fairness</li> <li>* The majority of the self-regulation committee is made up by the board's independent directors</li> </ul>	<ul style="list-style-type: none"> <li>-Dual governance by the board of directors and the self-regulation committee</li> <li>-Majority of the board composed of independent directors to enhance fairness</li> <li>*The self-regulation committee contains five members who are outside experts, one regular member who cannot be a director of member firm, and the committee Chairman</li> </ul>
Measures to Ensure Self-regulatory Independence	<ul style="list-style-type: none"> <li>- Established self-regulation committee</li> <li>* Installed in said entity in accordance with article of association</li> <li>- Exercises exclusive voting rights in regard to the overall self-regulatory operations</li> <li>- Does not recognize the board's request for reexamination</li> <li>- Ensure fairness through composition of committee members (5 out of 8 members external figures)</li> <li>* The self-regulation committee is consisted of eight members, two appointed by the chairman, five by the board and one ex officio member</li> </ul>	<ul style="list-style-type: none"> <li>- Established self-regulation committee with a standing Chairman</li> <li>* Mandatory installment in accordance with legal ground</li> <li>- Exercises exclusive voting rights in regard to the overall self-regulatory operations</li> <li>- Does not recognize the board's request for reexamination</li> <li>- Ensure fairness through composition of committee members (5 out of 7 members external specialists and 1 who is not a board member of a member firm)</li> <li>* The seven committee members are appointed by the general meeting from candidates selected by the Candidate Recommendation Committee. Candidates cannot be a major shareholder or full-time employee of a member firm</li> </ul>
Key Functions	<p><b>&lt;Self-regulation&gt;</b></p> <ul style="list-style-type: none"> <li>▶ Regulation of business activities</li> <li>▶ Management of OTC market</li> <li>▶ Review of standard agreements and advertisements</li> <li>▶ Regulation of underwriting</li> <li>▶ Settlement of disputes</li> <li>▶ Inspection and sanction of members</li> <li>▶ Consigned inspection on behalf of the FSC</li> <li>▶ Training industry professionals and managing financial participants</li> </ul>	<p><b>&lt;Self-regulation&gt;</b></p> <ul style="list-style-type: none"> <li>▶ Regulation of business activities</li> <li>▶ Management of OTC market</li> <li>▶ Review standard agreements and advertisements</li> <li>▶ Regulation of underwriting</li> <li>▶ Settlement of disputes</li> <li>▶ Inspection and sanction of members</li> <li>▶ Consigned inspection on behalf of the FSC</li> <li>▶ Training industry professionals and managing financial participants</li> </ul>

	<p><b>&lt;Industry affairs&gt;</b></p> <ul style="list-style-type: none"> <li>▶ Research on development of the securities industry and proposals to government</li> <li>▶ Member support</li> <li>▶ Operation of KSTI</li> <li>▶ Investor education</li> </ul>	<p><b>&lt;Industry affairs&gt;</b></p> <ul style="list-style-type: none"> <li>▶ Research on development of financial investment industry and proposals to government</li> <li>▶ Member support</li> <li>▶ Operation of KIFIN</li> <li>▶ Investor education</li> </ul>
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