Republic of Korea
Bond Market Guide

Contents

Acknowledgement ix

I. Structure, Type, and Characteristics of the Bond Market 1
A. Classification and Descriptions of the Korea Bond Market 1
B. Descriptions of Public Offering and Private Placement Markets 4
C. Exchange Listed Market 4
D. Professional (Wholesale) Market and Retail Market 5
E. Definition of Professionals and Professional Investor 5
F. Methods of Issuing Bonds 5
G. Credit Rating Agencies and the Credit Rating of Bonds 9
H. Bond-Related Systems for Investor Protection 13
I. Listing of Bonds and Medium-Term Notes 18
J. Governing Laws on Bond Issuance 25
K. Related Legal and Regulatory Issues of the Market 25
L. Self-Governing Rules of the Market 26

II. Primary and Secondary Market-Related Regulatory Framework 27
A. Related Rules and Regulations on Issuing Debt Instruments 27
B. Regulations and Rules related to Buying Debt Instruments in the Secondary Market 30
C. Taxation Framework and Tax Requirements 40

III. Trading of Bonds and Trading Market Infrastructure 43
A. Over-the-Counter Trading of Bonds 43
B. Exchange Trading of Bonds 44
C. Bond Repurchase Market 50
D. FreeBond 61
E. Secondary Market Yields and Terms of Bond Issues 64
F. Transparency in Bond Pricing 65
G. Business Process Flowchart (Over-the-Counter Market/Delivery versus Payment) 66
H. Business Process Flowchart (Exchange Market/Delivery versus Payment) 67
J. Short Sale of Bonds 76
K. Korea Treasury Bonds Exchange-Traded Funds Market 76
M. Bond-Related Futures Market: Korea Treasury Bonds Futures Market 78

IV. Possible Impediments for the Realization of a Cross-Border Market 82
A. Tax-Related Issues 82
B. Disclosure and Investor Protection Rules for Issuers 83
C. Restriction for Qualified Institutional Investors in Private Placement 87
D. Registration Requirement for Foreign Investors 88
E. Reporting Requirements for Non-Resident Trade Report and Foreign Exchange-Denominated Instruments 89
F. Non-Resident Requirements 89
G. Restrictions on Over-the-Counter Transactions by Non-Residents 89
H. Credit Rating System and Its Relation to Regulations....90
I. The Use of Omnibus Accounts for Settlement 90
J. Availability of Information in English 92
K. Restrictions in Accounting Standard 92
L. Limited Opportunities to Utilize Bond Holdings....93
M. Degree of Lack of Liquidity in the Secondary Market 93

V. Description of the Securities Settlement System....94
A. Existence of Uniform Legal Framework for All Types of Securities....94
B. Dematerialization or Immobilization versus Physical Securities....94
C. Legal Ownership Structure of Dematerialized or Immobilized Securities 94
D. Legal Ownership Transfer Mechanism 95
E. Existence of a Central Securities Depository and Book-Entry System for Debt Instruments....95
F. Settlement System in Korea....96
G. Existence of Delivery versus Payment and Real-Time Gross Settlement Mechanism 97
H. Existence of Post-Trade Matching Mechanism....98
I. Existence of Execution Matching Mechanism....98
J. Settlement Scheme for Corporate Bonds, Government Bonds and Others (Gross-Gross, Gross-Net, Net-Net) 99
K. Settlement Cycle for Corporate Bonds, Government Bonds and Other Debt Securities 99
L. Brief History of the Development of the Securities Settlement Infrastructure 100
M. Issues on Current Settlement Infrastructures....101
N. Expected changes on settlement infrastructures 101

VI. Costs and Charging Methods 103
A. Registration Fee at the Central Securities Depository 103
B. Transfer Fee (Book-Transfer Fee) at the Central Securities Depository....103
C. Average Ongoing Costs for Debt Instruments....103
D. Market Charges 104

VII. Market Size and Statistics....105
A. Bonds Issued....105
B. Outstanding Amount of Bonds Issued....106
C. Bond Trading Volume and Value (Over the Counter)....106
D. Bond Trading Volume and Value (Exchange)....107
E. Statistics of Over-the-Counter Institutional Repo Market 108
F. Size of Local Currency Bond Market in US Dollars....109
G. Size of LCY Bond Market in % of GDP....110
H. Size of FCY Bond Market in % of GDP (BIS) 112
I. Size of FCY Bond Market in USD (Local Sources) 113

J. Issuance Volume of LCY Bond Market in USD ... 114
K. Foreign Holdings in LCY Government Bonds ... 116
L. Trading Volume ... 117
M. Domestic Financing Profile ... 118

VIII. Next Step ... 119
A. Group of 30 Compliance ... 119
B. Group of Experts Final Report: Summary of Barriers Market Assessment – Korea (April/2010) ... 120
C. Revision of the *Commercial Act* and Corporate Bond Effective 2012 ... 122
D. Commissioned Company System for Bondholders ... 124
E. Bankruptcy Procedures ... 125

Appendixes ... 127

References ... 133

Boxes, Figures, and Tables

Boxes

Box 1.1 Korea Financial Investment Association Rules on Securities Underwriting ... 8
Box 1.2 Financial Services Commission Regulation on Public Disclosure of Information on Over-the-Counter Trading ... 14
Box 1.3 Korea Financial Investment Association Regulation on Reporting on the Records of Over-the-Counter Trading ... 15
Box 1.4 Financial Services Commission Regulation on Reporting Quote Information ... 15
Box 1.5 Korea Financial Investment Association Regulation on Reporting on the Information on Quotation 16
Box 1.6 Korea Financial Investment Association Regulation on Disclosure of the Closing Quotes ... 17
Box 2.1 Definition of Foreign Corporation ... 36
Box 2.2 Scope of Foreign Corporation ... 36
Box 2.3 Definition of Foreign Nationals ... 36
Box 2.4 Definition of Omnibus Account Regarding Foreign Investment in Bonds ... 37
Box 2.5 Regulations Regarding Exemptions from Registration ... 37
Box 2.6 Regulations on Special Cases for Foreigner Investment Registration ... 38

Figures

Figure 1.1 Bond Listing System ... 19
Figure 2.1 Procedure for Applying for Foreign Investor Investment Registration Certificate through a Local Agent ... 40
Figure 2.2 Procedure for Applying for Foreign Investor Investment Registration Certificate in Person ... 40
Figure 3.1 Structure of the Bond Over-the-Counter Market ... 44
Figure 3.2 Repo Trading Mechanism ... 50
Figure 3.5 Operation of FreeBond ... 62
Figure 3.6 Process to List or Trade KTB ETF on the KRX ... 77
Figure 3.7 Separate Trading of Registered Interest and Principal of Securities ... 78

Tables

Table 1.1 Korean Credit Rating Agencies 9
Table 1.2 Bond Grades and Definitions 10
Table 1.3 Grade Hierarchy and Definition 11
Table 1.4 Korean Bond Pricing Agencies 12
Table 1.5 Initial Listing Criteria for Domestic and Foreign Bonds 18
Table 1.6 Listing Fees 23
Table 2.1 Minimum Net Asset Requirement for Investment Trading Business (W Billion) 32
Table 2.2 Minimum Net Asset Requirement for Investment Brokerage Business (W Billion) 33
Table 2.3 Minimum Net Asset Requirement for Collective Investment, Trust, Investment Advisory, and Discretionary Investment Businesses (W Billion) 34
Table 2.4 Questions and Answers on Investment Registration Certificate and Documentation 35
Table 2.5 Official Documents that Authenticate the Lawful Identity of the Investor 39
Table 3.1 Proportion of Korea Exchange Bond Market (W trillion, %) 43
Table 3.2 Classification of Quotation Price, Quantity, and Trading Units 45
Table 3.3 Description of Settlement Process 46
Table 3.4 Trading Rules for Small-Lot Bond 47
Table 3.5 Bonds Eligible for Trading in the Special Market 47
Table 3.6 Requirements for Appointment as PPD 49
Table 3.7 Bonds Eligible for Trading at the Repo Market 51
Table 3.8 Settlement in the Repo Market 53
Table 3.9 Settlement at the REPO Market 55
Table 3.10 KRX Repo Trading System 55
Table 3.11 KRX Repo Settlement System 56
Table 3.12 Expiration of Repo 57
Table 3.13 Details of the Repo Trade Submitted by Repo Sellers or Brokerage Firms 59
Table 3.14 Questions and Answers on FreeBond and Over-the-Counter Trade Matching 64
Table 3.15 Secondary Market Yield and Terms of Bond Issues 64
Table 3.16 Types of Real-Time Bond Index 65
Table 3.17 Questions and Answers related to Market Infrastructure: InSet and SAFE 71
Table 3.18 Questions and Answers related to Clearing/Securities Settlement (Answered by KSD) 75
Table 3.19 Listed Korea Treasury Bond Exchange-Traded Funds 77
Table 3.20 Korea Treasury Bond Exchange-Traded Funds Trading System 77
Table 3.21 Korea Treasury Bonds Futures Trading System 79
Table 3.22 3-Year Korea Treasury Bonds Futures 79
Table 3.23 Underlying Basket Bonds for 3-Year Korea Treasury Bonds Futures 79
Table 3.24 Specification of 5-Year Korea Treasury Bonds Futures 80
Table 3.25 Underlying Basket Bonds for 5-Year Korea Treasury Bonds Futures 80
Table 3.26 Specification of 10-Year Korea Treasury Bonds Futures 81
Table 3.27 Underlying Basket Bonds for 10-Year Korea Treasury Bonds Futures 81
Table 4.1 Overview of Credit Rating Framework and Governing Regulations 90
Table 5.1 Brief History of the Development of the Securities Settlement Infrastructure 100
Table 5.2 Korea Securities Market Settlement System 101
Table 5.3 Main Contents of the New Securities Settlement System 101
Table 6.1 Fee Rates by Classification of Bond 103
Table 6.2 Maintenance Fee (Deposit Fee) at the Central Securities Depository (monthly basis) 103
Table 6.3 Brokerage Commission 104
Table 7.1 Bonds Issued (W billion) 105
Table 7.2 Outstanding Amount of Bonds Issued (W billion) 106

Table 7.3 Bonds Issued (W100 million) 106
Table 7.4 Bond Trading Volume and Value Exchange (W100 million) 107
Table 7.5 Trading Value and Balance (W100 million) 108
Table 7.6 Trading Volume of the Purchased Securities (W 100 million) 108
Table 7.7 Size of LCY Bond Market in USD (Local Sources) ($ billion) 109
Table 7.8 Size of LCY Bond Market in % GDP (Local Sources) (% GDP, $ billion) 110
Table 7.9 FCY Bonds to GDP Ratio ($ billion) 112
Table 7.10 FCY Bonds Outstanding (Local Sources) ($ billion) 113
Table 7.11 Issuance Volume of LCY Bond Market in USD ($ billion) 114
Table 7.12 Foreign Holdings in LCY Government Bonds (W billion) 116
Table 7.13 Trading Volume ($ billion) 117
Table 7.14 Domestic Financing Profile ($ billion) 118
Table 8.1 Global Clearing and Settlement – A Plan of Action 119
Table 8.2 Summary of Barriers Market Assessment – Korea (April 2010) 120
Table 8.3 Question and Answer related to the New Commercial Act Scripless Provisions (Answered by KSD) 124

Acknowledgement

The Asian Development Bank (ADB) Team, comprising Satoru Yamadera (Economist, ADB Office of Regional Economic Integration, - September 2011), Seung Jae Lee (Principal Financial Sector Specialist), Shinji Kawai (Senior Financial Sector Specialist [Banking]), Shigehito Inukai (ADB consultant), Taiji Inui (ADB consultant), and Matthias Schmidt (ADB consultant), would like to express their sincere gratitude to national member and expert institutions Korea Financial Investment Association (KOFIA), Korea Exchange (KRX), Korea Securities Depository (KSD) and Korea Capital Market Institute (KCMI). They kindly provided answers to the questionnaires prepared by the ADB team, thoroughly reviewed the draft of the Market Guide, and gave their valuable comments.

It is also noteworthy to mention that the creation of the so-called ASEAN+3 Bond Market Forum-Korea (ABMF-K) group comprising of the abovementioned members, experts, and other volunteer supporters is a major achievement (as market associations go, it is an excellent suggestion for other markets) and the effort undertaken and the commitment given by the group was substantial.

The ADB team also would like to express special thanks to Citibank, Deutsche Bank AG, HongKong Shanghai Banking Corporation (HSBC), J.P. Morgan, and State Street for their contribution as international experts in providing information from their respective market guides, as well as their valuable expertise. Because of their cooperation and contribution, the ADB Team started the research on solid ground.

Last but not least, the Team would like to thank all the interviewees who gave their comments and responses to questions during the market consultations.

It should be noted that any part of this report does not represent official views and opinions of any institution which participated in this activity as ABMF members and experts. The ADB Team bears responsibility for the contents of this report.

February 2012

Asian Development Bank (ADB) Team

List of Interviewees:

Seoul, 27 June 2011
- Korea Exchange (KRX)
- Korea Capital Market Institute (KCMI)
- Korea Financial Investment Association (KOFIA)
- Financial Supervisory Service (FSS)
- Korea Securities Depository (KSD)

Seoul, 28 June 2011
- SC First Bank
- Citibank Korea
- Lee & Ko (Law Firm)
- Bank of Korea

Seoul, 29 June 2011
- HSBC
- J.P. Morgan Chase

I. Structure, Type, and Characteristics of the Bond Market

A. Classification and Descriptions of the Korea Bond Market

1. Classification of Bonds

Publicly offered bonds are classified by type of issuer into the following:

i. Government bond,
ii. Municipal bond,
iii. Special bonds including monetary stabilization bond (MSB), bank bonds, and other financial bonds,
iv. Corporate bonds, and
v. Asset-backed securities (ABS).

2. Description of Bonds

a. Government Bonds

The first government bonds in the Republic of Korea were the nation-building government bonds in 1949. Since then, a wide variety of government bonds have been issued and integrated into Korea Treasury bonds (KTB) since the "Bonds on Fund for Management of Government Bonds" were issued in 1994.

Currently, government bonds issued include KTB, National Housing Bond (NHB) Type 1 and 2, and Foreign Exchange Equalization Fund Bonds (FEEFB), which are denominated in foreign currency. Among these, KTB are issued in the largest volume and trading is active. Accordingly, the on-the-run KTB market yields serve as a benchmark yield.

There are currently four types of KTB issued by maturity—3-year, 5-year, and 20-year—depending on the rate of interest. These fall into fixed-interest type bonds (3-year, 5-year, 10-year, and 20-year) and inflation-linked KTB (10-year maturity). Inflation-linked KTB links the principal and coupon rate of the KTB to prices, thereby eliminating inflation risk that comes with investing in KTB, thus ensuring the purchasing power parity of the bonds.

b. Municipal Bonds

Municipal bonds are issued by local governments, which comprise industrial development bonds and subway construction bonds.

c. Special Bonds

Special bonds consist of MSB issued by Bank of Korea, bank bonds issued by commercial banks, and other financial bonds issued by financial institutions excluding commercial banks.

d. Corporate Bonds

i. Issuance of Corporate Bonds

Corporate bonds issuances are divided into direct issuances and indirect issuances depending on who issues the bonds.

(1) **Direct issuance**

(2) **Indirect issuance.** Indirect issuance comprises of firm commitment, stand-by agreements, and a best-effort-basis depending on who handles the risk related to the underwriting. In addition, bonds comprise of par value, discount issue, and issues at a premium.

ii. Types of Corporate Bonds

Corporate bonds can be categorized into bonds with guarantees or collateral, ways of paying interest, and the rights given to holders of corporate bonds.

(1) **Bonds with Guarantees or Collateral**. Bonds with guarantees or collateral can be classified further into guaranteed bonds, collateral bonds, and non-guaranteed bonds.

(a) **Guaranteed Bonds**
Guaranteed bonds refer to corporate bonds where a financial institution guarantees the redemption of the principal and interest. Guarantees of the principal and interest payments are provided by banks, Korea Credit Guarantee Fund, Korea Technology Finance Corporation, merchant banks, financial investment companies, and surety insurance companies. The issuing company pays a guarantee fee to the guaranteeing company.

(b) **Collateral Bonds**
Collateral bonds are secured by physically guaranteeing redemption of the principal and payment of interest. They are issued in accordance with the *Secured Bond Trust Act*.

(c) **Non-guaranteed Bonds**
Non-guaranteed bonds are issued by the issuer's credit without the guarantee or collateral provided by a financial institution for principal redemption. Most Korean corporate bonds are issued as debentures.
The underwriters of the bonds are required to undergo credit assessment of the debentures from two or more different credit rating agencies.

(2) **Bonds Categorized by Interest Payment**
Bonds categorized by their interest payment are coupon bonds, discount bonds, and compound bonds.

Coupon bonds refer to corporate bonds with coupons denoting the payment of interest at a regular schedule.

Discount bonds are corporate bonds where the principal and interest rate are the par value, and the interest is discounted in the lump sum.

Compound bonds involve the computation of compound interest for the interest cycle. Thereafter, the principal and interest are paid in a lump sum on the date of maturity.

(3) **Bonds Categorized by Redemption Period**

Depending on the redemption periods, bonds can be divided into short-term bonds, medium-term bonds, and long-term bonds. Generally, short-term bonds have redemption periods under 1 year; medium-term bonds, between 1 year and 5 years; and long-term bonds, over 5 years. Of note, long-term bonds refer to bonds that mature in 10 or 20 years in the United States of America.

(4) **Bonds Categorized by Method of Interest Payment**

In addition, there are fixed-income bonds and floating rate notes (FRN) depending on how interest is paid. Fixed-income bonds involve the payment of fixed periodic returns, and FRN has a variable interest rate that is linked to the benchmark interest rate.

(5) **Bonds categorized by Bondholder**

Bonds categorized by the holder of bonds are convertible bonds, bonds with warrant, exchangeable bonds, participating bonds, and bonds with embedded option.

Convertible bonds (CB) can be converted to the issuing company's equity on certain conditions. Meanwhile, bonds with warrants entitle the holder to purchase a certain quantity of any future issue of the company's stocks at a fixed price after a set period of time has passed.

Exchangeable bonds permit the holders to exchange their bond holding for the listed shares of a company under previously agreed conditions within a set timeframe. Participating bonds entitle the holder to receive dividends.

Bonds with embedded options allow the issuer to redeem all or part of the bond before it reaches its maturity date. The options include call options where the issuer can redeem the principal and interest before maturity and put options, which allows the holder of the bond the right to demand the issuer to repay the principal on the bond.

e. Asset-Backed Securities

An ABS is a security issued based on underlying assets originating from corporations or financial institutions. By standardizing and pooling the financial assets from originators in specific terms, such assets are securitized utilizing the cash flows of underlying assets and credit enhancement. The ABS then channels the principal and interest to the concerned parties.

B. Descriptions of Public Offering and Private Placement Markets

1. Public offering

Public offerings generally refer to actions with the aim of selling to multiple ordinary investors. The *Financial Investment Service and Capital Market Act* (FSCMA) defines public offering as public offering and public sale.

The term "public sale" in the Act refers to gathering 50 or more investors, as calculated by a formula prescribed by presidential decree and Financial Services Commission (FSC) regulation on issuance, public disclosure, etc. of securities, to make an offer to sell or invite offers to purchase securities already issued (see FSCMA Art. 9. 9 in Appendix 1).

In other words, this means soliciting 50 or more investors (the sum of those who have received recommendations) that have not made, applied to, or bought the same type of securities as the securities being offered within 6 months from the day offers to buy are made. As such, the FSCMA refers to recommendations for application for public offering and sale to the public during the previous 6 months. Here, "public" refers to parties that are subject to the offers and sale, consisting of 50 or more investors.

2. Private Placement

Private placement refers to a private offering of securities for new issuance to investors. It entails that the issuer issues securities directly to certain demand-side parties to raise capital from them. This means that the bond certificate is only issued to the subscriber, or has undergone third-party underwriting. It is referred to as private placement since it is not intended for the public.[1]

An official definition of "private placement" can be found in Art. 9, *Financial Investment Service and Capital Market Act* (see Appendix 1.1).

C. Exchange Listed Market

The Korean bond exchange market is comprised of the inter-dealer market (IDM) and the retail market. Between these markets, primary dealers mainly participate in the IDM.

Before the Asian financial crisis in the late 1990s, the Korean bond market comprised mostly corporate bonds. In 1998, during the financial crisis, the International Monetary Fund (IMF) bailout prompted the Korean government to announce the "Measure to Improve Government Bond Policies and Vitalize the Bond Market." As part of the process to facilitate development of the government bond market, primary dealers (PDs) were introduced in 1999, and the IDM was opened in the Korea Exchange (KRX). Participants in the IDM are limited to financial investment firms and banks. The bid-and-ask order details presented by each dealer are collected and disclosed on the system, and transactions are made among dealers. The tick size is W1 and uses the limit-order method. The order quantity is a whole number multiple of W1 billion. The market is open from 9:00 a.m. to 3:00 p.m., and transactions are

[1] Korea Financial Investment Association, 2010 *Capital Market in Korea*. Korea Financial Investment Association, p.117–118.

made through individual competitive bidding using multiple prices depending on the priority of best quotation and time principle from the presented bid-ask price. Settlement generally takes place through Bank of Korea (BOK)-Wire and the bonds are transferred through escrow accounts at the Korea Securities Depository (KSD). It is thus similar with, yet slightly different from the over-the-counter (OTC) market-delivery versus payment (DVP) method. In other words, the OTC-DVP method settles the total amount for each transaction, while in the exchange market, the funds are settled depending on the participant, and bonds are subtracted depending on the participant and bond issues. The settlement date is T+1.

In the ordinary bond market, transactions generally involve retail bonds, small-cap government and public bonds, and equity-linked corporate bonds, with ordinary investors being the main participants. Retail and small-cap bonds are traded in units of W1,000, while equity-related corporate bonds and ordinary bonds are traded in units of W100,000. Transactions are concluded through individual competitive bidding through four types of competitive bidding principles, depending on the priority of price, time, brokerage, and quantity.

D. Professional (Wholesale) Market and Retail Market

Discussion on the professional (wholesale) market is currently under "Qualified Institutional Buyer (QIB) market."

E. Definition of Professionals and Professional Investor

The FSCMA classifies an ordinary investor and a professional investor based on their professional knowledge and experience, as well as the amount of assets. A professional investor refers to an investor who does not need any strong investor protection measures considering its own expertise and experience, such as a nation, a local municipality, a central bank, and a financial institution. Most individual investors fall under the classification of an ordinary investor with the exception of an investor whose financial investments exceeds W5 billion. Such classification aims to protect ordinary investors from taking huge risks in making investments due to the lack of such understanding of the financial investment instruments.[2]

F. Methods of Issuing Bonds

1. Government Bonds (Korean Treasury Bonds)

The procedure for issuing KTBs is enumerated below:[3]

a. Establish Plans to Issue Korean Treasury Bonds

The Ministry of Strategy and Finance should discuss with relevant agencies any plans to issue KTBs and the issue is subject to deliberation by the National Assembly. A detailed issuing plan should also be established within the annual KTB issuance limit approved by the legislature. An announcement of issuing plans and bidding should

2 Footnote 1, p. 297.
3 Footnote 1, p. 125.

then be released. The Minister of Strategy and Finance announces annual/monthly plans for each year. In principle, the date and time of bidding the issuing amount, coupon rate and settlement will be disclosed up to 3 days prior to the commencement of bidding.

b. Bidding

The bidding date for KTBs is as follows:

i. 3-year KTB: Every first Monday
ii. 5- year KTB: Every second Monday
iii. 10-year KTB: Every third Monday (Wednesday for inflation-linked KTB)
iv. 20-year KTB: Every fourth Monday

Bidding time are scheduled from 10:40 a.m. to 11:00 a.m. Bidding is done through the BOK-Wire, a network operated by the BOK. The bid interest rates are grouped in intervals of 3 basis points (bp) from the highest successful bid downwards within the range of amount to be issued. The highest successful bid's interest rate in each group is applied. Participants in the bidding are:

i. Only KTB primary dealers are eligible to participate in KTB auctions.
ii. Non-primary dealer bidders may bid through KTB primary dealers who act as proxy agents.
iii. However, if a retail investor bids through a primary dealer, the bid security deposit and written bid should be submitted in advance.

c. Announcement of Bidding and Results

The Minister of Strategy and Finance announces the details of bidding and the accepted bids when they are complete.

d. Issuance of Korean Treasury Bonds and Settlement of Successful Bids

The issuance of KTB and payment of the successful amount are done after the bidding date. On the day of settlement, the KSD is notified by BOK-Wire immediately after the underwritten amount is remitted, and the settlement and issuance are completed. All KTB types are registered, issued and deposited at the KSD. Accordingly, transaction and exercise of rights are possible without issuance of physical bond certificates.

2. Corporate Bonds

The procedure for issuing corporate bonds is enumerated below:[4]

a. Company Registration

An entity seeking to issue corporate bonds must register with the FSC for public issue of non-guaranteed bonds.

b. Acquire Credit Rating

The company, after registration with FSC, must submit itself for credit assessment. The evaluation will require a period of 2 to 4 weeks. A credit rating from two or more credit rating agencies is also required.

4 Footnote 3.

c. Decision by Board of Directors

Issues related to issuing corporate bonds are decided through a resolution by the company's board of directors, which indicates the issuing amount, issuing interest rate, managing company, and other relevant information.

d. Sign to Pay Principal and Interest as Agent

The company must decide where to pay corporate bond and which institution will pay the principal and interest after the corporate bond is issued as indicated by its agent in the application form and bond certificate.

e. Select Manager and Trustee

The company will then select a managing company that will underwrite and manage the corporate bonds, and a trustee that will take the necessary measures to protect the bond holders from the period of time involving payment for bonds to principal repayment.

f. Due Diligence

The lead manager then checks for risk factors through due diligence of companies.

g. Submit Securities Report

The company subsequently Submit securities report and attached documents (subscription agreement, trustee agreement, principal and interest payment agency agreement, etc.) to the Korea Financial Investment Association (KOFIA).

h. Effectivity

Unsecured corporate bonds take effect 7 days after the registration statement submission. Secured bonds, collateral bonds, and ABS take effect 5 days after the registration statement has been submitted. Shelf registration for corporate bonds is 5 days after registration statement submission.

i. Submit Prospectus

When the bond takes effect after the submission of the registration statement, the issuer distributes and discloses the prospectus to its branches, KOFIA, and firms that will accept applications.

j. Issuance and Payment

Issuance, payment and listing take place simultaneously.

k. Issuance Reporting

After issuance is complete, an issuance report is submitted to the Financial Supervisory Service (FSS).

l. Report Underwriting by Managers

Managers must report underwriting performance to KOFIA 5 days from issuance day. Regulations on securities underwriting is detailed in Chapter 3 of KOFIA Rule (Box 1.1).

Box 1.1 Korea Financial Investment Association Rules on Securities Underwriting

<table>
<tr><th colspan="2">KOFIA Rule
3. REGULATIONS ON SECURITIES UNDERWRITING BUSINESS</th></tr>
<tr><td colspan="2">CHAPTER III UNDERWRITING OF NON-GUARANTEED BONDS</td></tr>
<tr><td>Article11. (Underwriting of Non-Guaranteed Bonds)</td><td>(1) In the case of an underwriter underwriting non-guaranteed bonds, such bonds shall be those that have been rated by at least two (one agency, in the case of underwriting ABS issued in the form of bonds pursuant to the Act on ABS or in inevitable cases such as the business suspension of credit rating agencies) credit rating agencies from among those approved for the credit ratings business pursuant to the provisions of the Act on Use and Protection of Credit Information. However, non-guaranteed bonds issued by foreign corporations, etc., shall be deemed as those rated in accordance with this provision if they are rated by two or more credit rating agencies (referring to international credit rating agencies as prescribed by the Governor of the Financial Services Commission in Item e of [Article 2-11(2)1] of the FSC's Regulations on Securities Issuance and Disclosure; the same hereinafter in this chapter). [Amended on 26 February 2009]
(2) In the case of underwriting non-guaranteed bonds, the issuer of non-guaranteed bonds and the trustee for the subscription of such bonds (hereinafter referred to as "trustee") shall enter into a standard trustee agreement on non-guaranteed bonds (hereinafter referred to as "standard trustee agreement"). However, this provision shall not apply to non-guaranteed bonds falling under any of the following Items:
1. Bonds issued by credit-specialized financial companies under the Credit-Specialized Financial Business Act;
2. Bonds issued by merchant banking corporations;
3. Bonds issued by banking institutions under the Banking Act;
4. Bonds issued by financial investment companies;
5. ABS issued in the form of bonds pursuant to the Act on ABS;
6. ABS issued in the form of bonds pursuant to the Act on Mortgage Backed Bonds Companies; and
7. Bonds announced by the Association, among those issued by corporations subject to other special acts.
(3) Notwithstanding Paragraph (2), in the case of underwriting non-guaranteed bonds issued by foreign corporations etc., a trustee agreement modified from the standard trustee agreement may be used upon the Association's approval.
(4) The standard trustee agreement on non-guaranteed bonds mentioned in Paragraph (2) shall be determined by the Association.
(5) The issuer and trustee of non-guaranteed bonds shall not have a relationship falling under any Item of [Article 6(1)]. However, this provision shall not apply to non-guaranteed bonds issued by the Korea Exchange and other securities financial companies.</td></tr>
<tr><td>Article 12. (Determination of Issuing Conditions of Non-Guaranteed Bonds)</td><td>The lead manager shall, in relation to the underwriting of non-guaranteed bonds, determine the issuing conditions, such as the coupon rate, upon consultation with the issuer.</td></tr>
<tr><td>Article 13. (Restrictions on the Managing Underwriter of Non-Guaranteed Bonds)</td><td>(1) A financial investment company in any of the following relationships with the issuer shall not be allowed to engage in the business of managing underwriter for non-guaranteed bonds of the financial investment company concerned. However, this provision shall not apply to non-guaranteed bonds issued by the Korea Exchange and securities financial companies:
3. Relationships where an issuer or a related party of the issuer holds 5/100 or more of a managing underwriter's stocks, etc.;
4. A managing underwriter or a related party of the managing underwriter holds 5/100 or more of the issuer's stocks; and
5. Relationships falling under any Items of [Article 6 (1) 4 through 6].
(2) The lead manager of non-guaranteed bonds shall not, if the underwriter and issuer have a relationship as defined in [Article 6 (1)1], allow the underwriter concerned to underwrite the largest portion of stocks, or to engage in practical managing affairs such as participation in determining the underwriting price; provided, however, that this provision shall not apply to non-guaranteed bonds issued by the Korea Exchange and securities financial companies.</td></tr>
</table>

continued on next page

Box 1.1 continuation

Article 14. (Underwriting of Won-Denominated Bonds)	A financial investment company shall underwrite won-denominated bonds that satisfy the requirements of any of the following Items: 1. Won-denominated non-guaranteed bonds shall receive a rating from two or more (one in unavoidable case such as the agency's suspension of business) credit rating agencies. [Amended on 26 February 2009]; and 2. Won-denominated bonds shall be registered and issued pursuant to [Article 309 (5)] of the Act (excluding the bonds sold overseas).
Article 18. (Disclosure of Business Records of a Managing Underwriter of Bonds)	(1) The managing underwriter (including a broker for offering and private placement) for bond issuance (including the privately-placed bond issues) shall prepare and report to the Association the matters related to an issuer, in accordance with <Annexed Paper 3: Forms>, within five (5) days from the date of issuance. However, in the case of jointly engaging in the managing affairs, the managing underwriter that prepares the securities registration statement shall report to the Association. [Amended on 26 February 2009] (2) The Association may post the information that it was notified of by the managing underwriter pursuant to Paragraph (1) on its Internet website.

Source: Korea Financial Investment Association. 23/12/2009. Regulations on Securities Underwriting Business.

G. Credit Rating Agencies and the Credit Rating of Bonds

1. Private Credit Rating Agencies for Bonds

There are four credit rating companies in Korea—Korea Ratings, KIS Pricing, NICE Pricing Services, and SCI Pricing. Table 1.1 provides a general overview of Korean credit rating agencies.

Table 1.1 Korean Credit Rating Agencies[a]

	Korea Ratings	KIS	NICE	SCI
Capital	W34.05 billion	W5 billion	W5 billion	W17.75 billion
No. of employees	170	109	121	217
Web site	www.korearatings.com	www.kisrating.com	www.nicerating.com	www.sci.co.kr
M/S (%)[b]	34.3	33.4	31.6	0.6
Largest shareholder	Fitch (73.55%)	Moody's (50%+1 share), KIS (50%–1)	NICE (100%)	SP Partners (19.19%)
Initiation of operations	November 1987	September 1985	June 1987	Established April 1992 Began credit assessment from January 2000
Bonds for evaluation	Corporate bonds, CP, ABS	Corporate bonds, CP, ABS	Corporate bonds, CP, ABS	CP, ABS
Partner companies in credit assessment	Fitch	Moody's	Japan R&I, China Dagong Rating	Japan JCR

[a] As of June 2009.
[b] Market share source was generated from the Financial Supervisory Service press release.
ABS = asset-backed securities; CP = commercial paper
Sources: Press Release 279 of the financial Supervisory Service, 13 March 2009: Credit Information Services Providers' Operating results: 2008

2. Credit Rating Assessment

a. Corporate Bond Assessment

When a company issues corporate bonds to raise long-term capital for over 1 year from the direct financing market, they are required to obtain a credit rating from a specialized credit rating agency for all non-guaranteed bonds to protect small-cap investors who lack professional knowledge on the issuer, and to induce a reasonable price in the bond market.

All non-guaranteed corporate bonds, excluding government bonds and bonds for which the government has guaranteed the payment of principal and interest as well as municipal bonds and MSBs issued by BOK, must receive a credit rating to be included in the trusted assets of banks and investment trust companies. In other words, bonds being issued without guarantee, including those by ordinary companies, specialized lenders, financial investment firms, commercial banks, the Korea Development Bank, government-funded agencies and pension funds, must first receive a credit assessment from a specialized credit rating agency. Corporate bonds' credit ratings are used as criteria for deciding upon investment when issuing and trading non-guaranteed bonds. It is also used as criteria for the mark-to-market value of funds that are subject to mark-to-market.

Bonds are rated in 10 grades depending on how much of the principal and interest is payable, from AAA to D. AAA to BBB are investment grade where the principal and interest are deemed to be recoverable, while BB to C are classified as speculative grade as they are heavily influenced by change in the investment environment.

Table 1.2 Bond Grades and Definitions

Grade	Definition
AAA	Highest ability to repay principal and interest
AA	Excellent ability to repay principal and interest but slightly less than AAA-rated bonds
A	Very good ability to repay principal and interest but vulnerable to economic conditions and environment
BBB	Good ability to repay principal and interest but possibility exists of economic conditions and environment deterioration lowering its ability to repay principal and interest going forward
BB	Although its ability to repay principal and interest is not immediately problematic, the bonds have speculative factors since stability to go forward is not guaranteed
B	Ability to repay principal and interest is lacking; is speculative; in recession repayment of interest is not certain
CCC	Uncertainties currently exit in its ability to repay principal and interest. Highly speculative given the high risk of default.
CC	Higher uncertainty factors exit compared with the upper grades.
C	High risk of default; lacks ability to repay principal and interest
D	Unable to repay

Note: Among the above grades, AA to B are marked with the signs + or – to denote the superior or inferior recoverability of principal and interest.
Source: Korea Investors Service.

b. Commercial Paper Assessment

Issuance condition and the decision to invest are determined by the credit rating of the issuers of commercial paper (CP), which is issued to raise short-term operating funds.

Accordingly, the government has objective credit rating agencies grade the credit of issuing companies and disclose the results to develop the commercial-note market into one where blue-chip companies may raise short-term capital. This assessment is used to protect investors and enable financial institutions to serve as brokerages, and ensure financial soundness of management.

Companies that seek to obtain short-term financing by issuing unsecured debentures or notes to borrow and lend money among customers with merchant banks, brokerage houses, and banks acting as intermediaries are required to undergo credit assessments for their commercial paper.

Credit rating grades for commercial paper are used to determine the soundness of the commercial paper (unsecured commercial paper and merchant bank intermediary notes) issuance and are used as criteria for deciding terms and conditions of issuance. Credit ratings for commercial paper comprise six grades from A1 to D. Among the grades, A1 to A3 are investment grades where the issuers have been acknowledged to have the ability to repay principal and interest in a timely manner; B and C are speculative grades where the repayment of principal and interest on time is heavily influenced by changes in the environment.

Table 1.3 Grade Hierarchy and Definition

Grade	Definition
A1	Best ability to repay on time and best stability of repayment ability
A2	Very good ability to repay on time but stability slightly inferior to A1
A3	Good ability to repay on time with good stability but inferior to A2
B	Adequate ability to repay on time but speculative issues exist on its stability depending on short-term changes in conditions
C	Highly speculative issues in ability to repay on time and in its stability
D	Cannot repay

Note: Among the above grades, A2 to B grades are marked with + or – to denote the superior or inferior ability to repay principal and interest.
Source: Korea Investors Service

c. Asset-backed Securities Assessment

Asset-backed securities (ABS) are given credit rating grades the same way as non-guaranteed corporate bonds or commercial paper, depending on the type (ABS and Asset Backed Commercial Paper). The credit rating system and definitions are made the same as the system and definition of non-guaranteed corporate bonds and commercial paper, thereby easing decisions on the issuer's ability to repay principal and interest on the ABS.

3. Mark-to-Market of Bonds

a. Summary

In November 1998, after the Asian financial crisis, the government introduced the mark-to-market policy to enhance transparency of trusted asset management, secure confidence, and raise the asset quality of financial institutions. Before the mark-to-market system was introduced, bonds were evaluated on book value. This latter method prompted questions on its accuracy, given that it derived a mathematical average of the principal and interest during the time it was held, regardless of any changes in the value of the bonds due to interest changes in the market. This resulted in a difference between the market price and book value and became problematic when it was sold before maturity or if a company went bankrupt.

Mark-to-market aligns market value and valuation by assessing the value of a bond by reflecting changes in the interest and credit of the issuer. Bond prices change depending on the market interest rate, akin to daily fluctuations in the price of equity. Mark-to-market refers to evaluating this changing bond price and using the market or fair price. To this end, KOFIA announced the "mark-to-market base yield" in November 1998 to enhance the mark-to-market system.

After valuations by bond rating agencies became mandatory in 2004, KOFIA halted its mark-to-market and changed its mark-to-market base yield to types of bonds, yield to maturity (YTM), and market yield, which is a type of reference yield that KOFIA discloses. From November 2009, the yield-reporting companies for deriving yield by bond type, YTM, and market yields changed from financial investment firms to credit assessment companies. In addition, KOFIA has also been monitoring the valuation price of each credit rating agency according to its sampling standards aiming to evaluate each bond rating agency as per the *Regulations on the Operations and Business of a Financial Investment Company*. KOFIA monitors approximately 10,000 issues per month by various rating agencies. The results are reported to each company and to the FSS. These results are posted at KOFIA Bond Information Service (www.kofiabond.or.kr) each quarter.

b. Private Credit Rating Agencies for Bonds Established

In July 2000, the FSS designated three companies—Korean Bond Pricing Co., Ltd., NICE Pricing Services, and KIS Pricing—to implement the mark-to-market policy by providing the market value of all bonds held by financial institutions, thereby increasing the effectiveness of the mark-to-market policy's risk management. The three companies have been rating bonds from November 2000.

Table 1.4 Korean Bond Pricing Agencies

Name	KBP	KIS Pricing	Nice Pricing Services
Capital	W5 billion	W3 billion	W6.55 billion
Largest shareholder	Korea Ratings	KIS	NICE

Sources: Korea Financial Investment Association, Chapter 9 in 2010 *Capital Market in Korea*

c. Effect of Bond Mark-to-Market Valuation

The bond mark-to-market valuation has brought about the following changes in Korea's bond market:[5]

i. Vitalizing the Secondary Bond Market

With bond transactions being limited to a few issues, the trading of certain issues that had not been purchased or sold recently often plunged due to price uncertainty. However, with the mark-to-market policy resulting in the disclosure of the fair prices of all issues, their prices were benchmarked and trading became reinvigorated. In

5 Footnote 1, p. 149–150.

addition, with the price of bonds and the value of funds changing each day, financial institutions started trading bonds proactively, avoiding the previous practice of holding them until maturity.

ii. Energizing of the Primary Bond Market

Previously, trading of corporate bonds was severely restricted, which meant that trading prices were uncertain despite the bond ratings, making setting yields difficult. This depressed lead managers' business and underwriting. However, due to the introduction of the mark-to-market policy, the fair prices of issued corporate bonds given by bond rating agencies are now benchmarked as market prices. This has facilitated greater issuance of corporate bonds.

iii. Facilitation of New Product Development

Providing fair prices for new products that are issued in response to market demands including option embedded bonds, swaps, and structured notes has facilitated the issuance and distribution of these products. It has also enabled the design of structured notes and pricing models to be presented to financial institutions and the market, thereby facilitating investment and new issuances. In addition, it has provided market prices and spot yield curves, which are the basics of risk management and enable prior analysis of risk factors for new products.

iv. Enhancement of Transparency and Expertise of the Investment Trust Industry

The practice of mark-to-market pricing of bonds included in funds has enhanced the transparency of fund management. It has also promoted specialization in bond investment and the rational valuation of investment performance, thereby raising investor awareness of trust products. In addition, through mark-to-market pricing of held bonds, the rational valuation of assets was enabled, providing market values to all bonds held by financial institutions, which increased the effectiveness of the mark-to-market policy's risk management.

H. Bond-Related Systems for Investor Protection

1. Overview

KOFIA places the highest of priority on protecting investors. As a self-regulatory organization, KOFIA promotes discipline and fair practices in the securities markets. It also recommends policies to the government to improve regulations and laws to better protect all market participants, especially investors. KOFIA also contributes to the protection of bond investors through the standard debenture entrustment contract, which sets forth the roles and responsibilities of the trustees, and monitors whether they are maintaining their ability to repay the principal and interest on their loans.

When an event of default occurs to the issuer, which is one of the major details of an entrustment contract based on relevant provisions in the contract, the trustee announces this information to the trust and Bond Information Service (BIS), which enables notification to all the investors.

2. Disclosure in the Secondary Market

a. Disclosure of Over-the-Counter Trade Execution Details

After a brokerage house sells a bond in the OTC market, it must report to KOFIA the details of the transaction within 15 minutes, categorized by the nature of transaction. KOFIA then discloses this information.

The disclosure mandate was introduced in 2000 to enhance market transparency and increasing credibility in trade price. Aspirations towards enhancing market transparency and encouraging more bond derivatives into the market was the reason behind the introduction of the 15-minute rule. Previously, the details of a transaction were reported to KOFIA after 3:00 p.m. when the market was closed. Under such system, transaction details could not serve as market information in a timely manner, undermining discovery function of the appropriate price, which hindered the development of bond derivatives.

In 2000, when the disclosure of trade execution details was introduced, the details of the transaction had to be reported within 30 minutes. This was reduced the following year to within 5 minutes, and then settled to within 15 minutes in 2002. In order to increase the accuracy of reporting details of OTC bond transactions, KOFIA created the Bond-Trade Report and Information Service (B-TriS), which enables real-time management of data between KOFIA and financial investment companies. As of June 2010, an average of 3,724 trade executions was reported daily. The 15-minute rule not only enhanced market transparency, but reduced the cost of searching for price information. Furthermore, it increased the pace of the information distributed through the real-time provision of issues, trading volume, yields, and investor categorization codes, and encouraged more investors to trade bonds.

The disclosure mandate is stipulated under Art. 5–8 of the *FSC Regulation on Financial Investment Business* and the *Regulations on Business Conduct and Services of Financial Investment Companies* of KOFIA (Boxes 1.2 and 1.3).

Box 1.2 Financial Services Commission Regulation on Public Disclosure of Information on Over-the-Counter Trading

Article 5–8. (Public Disclosure of Information on Over-the-Counter Trading)	(1) The Association (KOFIA) shall systematically manage information about the issuance of bonds and disclose it to the public, such as terms and conditions of issuance that investment traders or investors need for over-the-counter trading. (2) The Association shall manage the data of yields from trading bonds in the over-the-counter market, the quote information and the details of trading or brokerage by cases and disclose them to the public, so that investment traders or investors can refer to them for over-the-counter trading.

Source: Financial Services Commission (FSC). 2010. *Regulations on Financial Investment Business.*

Box 1.3 Korea Financial Investment Association Regulation on Reporting on the Records of Over-the-Counter Trading

Article 7–5. (Reporting on the Records of Over-the-Counter Trading, etc.)	(1) A financial investment company engaged in bond trading shall, when trading or brokering bonds with investors in the OTC market, report the records on the case-specific trading and brokering related on such bond trading within 15 minutes from the point of settlement of the sales agreement through the electronic media, etc. to the Association. In this case, the details on the scope of reporting, etc. shall be prescribed by the chairman of the Association.

Source: Korea Financial Investment Association. 26/03/2010. *Regulations on Business Conduct of Financial Investment Companies.*

b. Disclosure of Over-the-Counter Quotation Information

Besides the 15-minute rule, which promotes post-trade transparency, it was also necessary to introduce a service for enhancing pre-trade transparency so that market transparency in general and liquidity could be enhanced. Therefore, KOFIA introduced the Bond Quotation System (BQS) in 2007. At that time, most OTC bond trades were using private messenger services, such as Yahoo and MSN, as a negotiating method. Compared with telephone negotiation, private messenger contributed, in part, to a reduction in bid-ask spreads and increased liquidity. However, it also comprised of multiple messenger groups, and thus dispersed liquidity and made it difficult to access market quotation information in real time. In fact, private messenger served as an entry barrier for new participants such as retail investors and foreigners. Therefore, the government announced the introduction of the disclosure of OTC quotation information in line with the "Reformation of Bond Trading Market" (12 December 2006).

KOFIA requires financial investment firms (including banks and merchant banks), as well as inter-dealer brokers (IDBs), to report, in real time, all the information on quotes and exercise price of all bonds traded in the OTC market through the BQS. Through this system, all OTC quotes are collected and disclosed, enhancing the function of price discovery and increasing transparency and liquidity in the OTC market. Disclosure of quotation information is provided for in Art. 5-9 of the *FSC Regulations on Financial Investment Business* and Art. 7-3 of KOFIA's *Regulations on Business Conduct and Services of Financial Investment Companies* (Boxes 1.4 and 1.5).

Box 1.4 Financial Services Commission Regulation on Reporting Quote Information

Article 5–9. (Reporting on Quote Information)	Every investment trader or inter-dealer broker shall report quote information and the details of trading or brokerage by case to the Association when engaging in over-the-counter trading or brokerage.

Source: Financial Services Commission. 18/01/2011. *Regulations on Financial Investment Business.*

Box 1.5 Korea Financial Investment Association Regulation on Reporting on the Information on Quotation

Article 7–3. (Reporting on the Information on Quotation)	(1) A financial investment company engaging in bond trading shall report the information on quotation in relation to OTC trading or the brokering of OTC trading of bonds through the proprietary bond trading system to the Association without delay. [Amended on 26 February 2010] (2) Notwithstanding Paragraph (1), in cases where a company falling under Sub-item b of Item 8 of [Article 5–1] of the Regulations on the Financial Investment Business (hereinafter referred to as the "banks, etc." in this Article) trade or broker bonds in the OTC market through a financial investment company engaged in bond trading excluding banks, etc., the reporting shall be substituted by such financial investment company engaged in the bond trading thereof. (3) In cases where the Association judges that reporting on the information on quotation cannot be conducted ordinarily due to Acts of God [*sic*], emergencies and computing errors, etc., it may designate the methods and timing of reporting differently. [Amended on 26 February 2010] (4) Details on the scope of reporting on the information on quotation pursuant to Paragraph (1) shall be prescribed by the chairman of the Association. [Amended on 26 February 2010] [The Title of this Article Amended on 26 February 2010]

Source: Korea Financial Investment Association. 2010. *Regulations on Business Conduct of Financial Investment Companies.*

c. Disclosure of Final Quotation Yields

When the market closes, KOFIA posts the yield of each bond that represents the Korean bond market on its BIS. Thus, they can be used as major indices for economic policies, financial institutions' asset management, and the appraisal of investment performance (tallied at 11:30 a.m. and 3:30 p.m. each working day and/or disclosed at 12:00 noon and 3:30 p.m. each working day). The final quotation yield disclosed by KOFIA comprises of the final quotation yields for particular yields to maturity (eight types, 15 yields) and final quotation yields by yield to maturity (five types, 47 yields). In addition, to help energize the OTC bond market, KOFIA discloses base yields that are used for daily closings and derives the final settlement price for government bonds (3-year, 5-year) and MSB (364 days), and market-making quotation yields for bond-specialized dealers. KOFIA also discloses CP issuance information management, yields and indices, Certificate of Deposit (CD) yields and transaction status, customer repurchase agreement (RP) transaction status, and intermediary transactions of RP among institutions. Moreover, since December 1999, KOFIA has announced on a daily basis the KOFIA-Bloomberg Bond Index, an indicator of changes in the bond value of certain groups over time.

From 27 February 2009, KOFIA began to disclose default rates and recovery rates to enhance the price discovery function of the high-yield bond market, and promote the development of new bond-related products, and to use as raw data for risk management. In addition, from June 2009, KOFIA has provided real-time bond indices, enabling real-time assessment of the bond market and the development of new index-linked bond products, including exchange-traded funds (ETFs). Related to this, the first Korean KTB ETF was listed on KRX on 29 July 2009. Art. 7–8 of the KOFIA *Regulations on Business Conduct and Services of Financial Investment Companies* stipulates the disclosure of closing quotes.

Box 1.6 Korea Financial Investment Association Regulation on Disclosure of the Closing Quotes

Article 7–8. (Disclosure of the Closing Quotes)	(1) The Association shall disclose the closing quotes in each of the following Items through the electronic media, etc.: 1. The yield of a particular remaining period; and 2. The yield for each maturity of the remaining period; 3. [Deleted on July 21, 2009]. (2) The selection standards of a financial investment company engaged in bond trading to report the yield in relation to the disclosure of the closing quotes and the yield disclosure methods in accordance with Paragraph (1) shall be prescribed by the chairman of the Association.

Source: Korea Financial Investment Association. 26/03/2010. *Regulations on Business Conduct of Financial Investment Companies.*

3. Introduction of the Electronic Disclosure System

KOFIA has played a key role in improving transparency of OTC bond trading and valuation. Starting in July 2002, all securities companies have been required to report trading details to KOFIA within 15 minutes after trading execution. KOFIA has built a sophisticated website (www.kofia.or.kr) which discloses pricing information to public and vendors. Information disclosed include name of the firm, branch number, type of transaction, counterparty, and other details about the securities traded. KOFIA publishes an average of more than 2,000 transactions a day involving W10 trillion to W15 trillion.

To keep the public informed about interest rate movement in benchmark bonds, KOFIA releases on a daily basis two important daily bond yields to the public. The first one, the representative bond yield (RBY), represents a weighted-average yield of certain bonds in terms of trading volume. The second is the final quotation bond yield (FQBY), which is the final yield at which bonds are traded or the last yield quoted for daily transactions. FQBYs of certain types of different bonds are regarded as benchmark yields in the Korean bond markets. FQBYs are currently released twice daily at 12:00 noon and 4:00 p.m.

On 4 December 2007, KOFIA launched the BQS, the OTC BQS, which is a system that collects and disseminates all data pertaining to quote information on OTC trading. With the implementation of the system, quotes are collected in a single, centralized system. This is expected to gradually contribute to better price discovery, and enhance transparency and liquidity in the secondary market. The market rate formed through this system will function as a benchmark rate and improve the efficiency of the secondary market.

Under the existing supervision regulation of securities business, securities companies, banks, and specialized bond brokers are required to report to the KOFIA in real-time the OTC quotes for the bonds they hold. The quote information collected is then released by the KOFIA in real time. As of January 2008, 84 financial institutions report their quotes to the BQS.

From 27 February 2009, KOFIA has disclosed default rates and recovery rates to enhance the price-discovery function of the high-yield bond market, to develop new bond-related products, and to use as raw data for risk management. In addition, from

June 2009, it has announced real-time bond indices, enabling real-time assessment of the bond market and the development of new index-linked bond products including ETFs. Related to this, the first Korean KTB ETF was listed on the KRX on 29 July 2009. As of April 2011, seven types of bond ETFs are listed and traded with a total value of about $1.3 billion.

I. Listing of Bonds and Medium-Term Notes

1. Criteria

a. Rationale

Bond listings mean that bonds issued on the stock market are allowed to be traded.[6]

b. Advantages of Bond Listings

The advantages of bond listing include:

i. **Improving public confidence in the issuing firm.** This is made possible by making public the company's operations and information on bond listings.
ii. **Used as substitute securities and collateral assets.** Listing is used as the consignment guarantee money of stocks, futures, and options trading, and as the deposit money and security deposit to be paid to the public institution.
iii. **Selected to be incorporated as an investment for financial products**. Financial institutions like investment trusts incorporate mostly listed securities as constituents for funds.

c. Listing Criteria

Bonds are listed in accordance with the provisions specified in the *Listing Regulation*. The KRX lists the bonds whose listing has been requested after careful examination of listing eligibility. Table 1.5 shows the listing criteria for domestic and foreign bonds.

Table 1.5 Initial Listing Criteria for Domestic and Foreign Bonds

Classification	Initial listing of domestic bonds	Initial listing of foreign bonds
Issuing corporation	Corporation with capital stock of at least W500 million. This requirement is not applied to secured bonds, mortgage bonds and asset-backed securities.	It should be a corporation listed on one of foreign exchanges. Listing of foreign stock or Depository Rceipts on the stock market or KOSDAQ market of Korea Exchange. Shall be a corporation that has issued the stocks by way of public offering or distribution.
Net Worth	-	Net worth of more than W10 billion. Capital should not have been impaired as of the end of the latest fiscal year.
Public offering or secondary distribution	The bonds should have been issued through public offering or secondary distribution.	The bonds should have been issued through public offering or secondary distribution.
Total amount issued	It should be more than W300 million. In case of secured bonds or mortgage bonds, it should be more than W50 million.	It should be more than W300 million. In case of secured bonds or mortgage bonds, it should be more than W50 million.

continued on next page

6 Korea Financial Investment Association. Art. 390 (2) 1 of the FSCMA on listing regulations stipulates that: "Listing regulations shall include… matters regarding listing standards and listing review of securities."

Table 1.5 continuation

Classification	Initial listing of domestic bonds	Initial listing of foreign bonds
Total par value of unredeemed bonds	Total par value of unredeemed bonds should be at least W300 million. In case of secured bonds or mortgage bonds, it should be more than W50 million.	Total par value of unredeemed bonds should be at least W300 million. In case of secured bonds or mortgage bonds, it should be more than W50 million.
Uniform bond certificates	The bond certificates concerned should be the uniform certificates specified in the FSCMA.	-
Denomination of bond certificates	In case of convertible bonds, they should be one denomination (W100,000).	In case of convertible bonds, they should be one denomination (W100,000).
Registered bonds	In case of convertible bonds, it should be registered under the *Bond Registration Act*.	It should be registered under the *Bond Registration Act*.
Credit rating	-	Credit rating by a credit appraisal agency should be higher than BBB.[a]

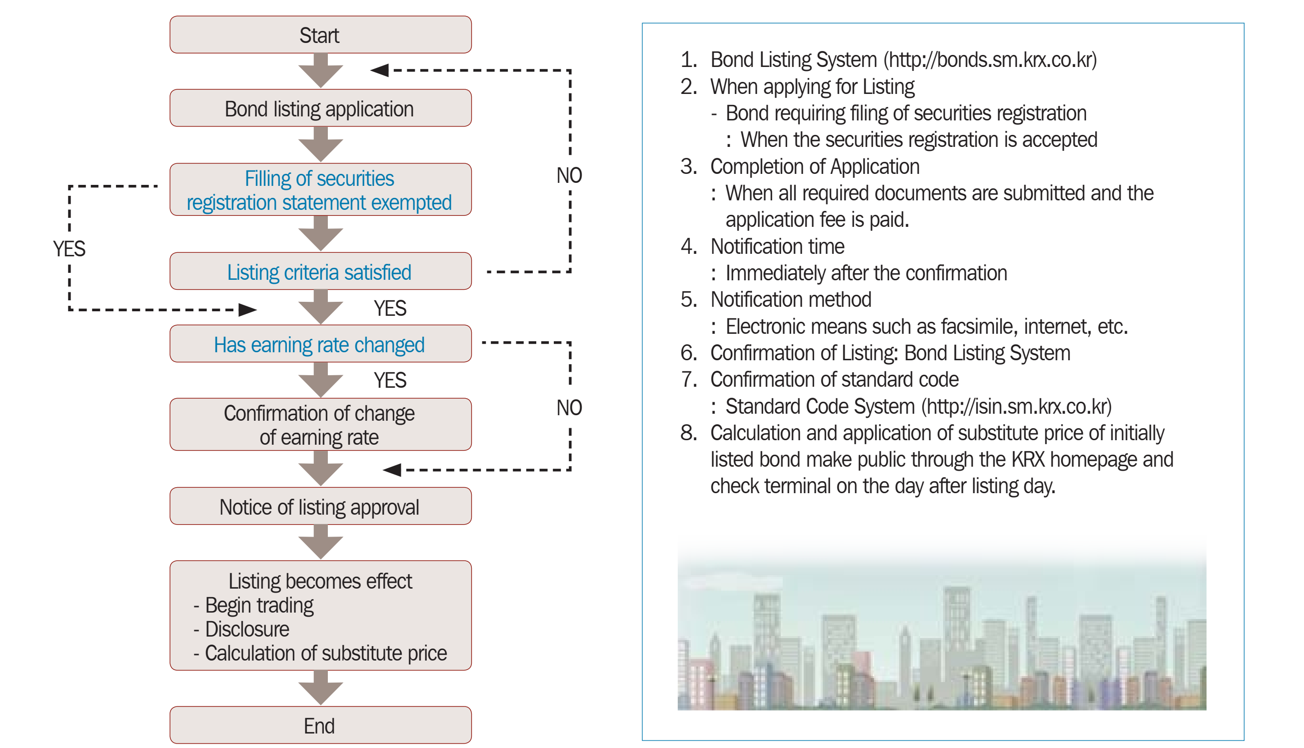
[a] Table of corporate bond rating by domestic credit rating organization.
Notes: Government bonds, municipal bonds, and specific laws bonds are listed when the listing application is received without listing examination. However, the listing criteria are applied to the specific laws bonds that require filing of securities registration statement.
Source: Korea Exchange, http:\\eng.krx.co.kr

2. Procedure

a. Listing Procedure

Listing application for bonds can be submitted over the Internet using the bond listing system, http://bonds.krx.co.kr (available only in Korean). The supplementary documents can be submitted by facsimile or when the securities registration statement is uploaded through the bond listing system. The result can also be confirmed over the Internet. Figure 1.1 illustrates the bond listing system.

Figure 1.1 Bond Listing System



Source: Korea Exchange, http:\\eng.krx.co.kr

b. Listing of Government Bonds

Government bonds are listed upon receipt of the listing application, without listing examination. Of the government bonds issued presently, Treasury bonds and foreign exchange stabilization bonds are listed on the issuing day according to the regulations governing shelf listing of bonds; the National Housing Bonds (NHB [1 and 2]) are listed on the first day of each month.

Listing of Treasury bonds and foreign exchange stabilization bonds are handled by the Bank of Korea (BOK) over the Internet. Listing of NHBs (1 and 2), on the basis of the application for self-listing for bonds scheduled to be issued during the following year at the end of each year, the Korea Exchange (KRX) lists the scheduled quantity on the first day of each month, and adjusts the listing value upon receiving the notice of issuance value following confirmation of bond issuance for the concerned month.

c. Listing of Municipal Bonds

The same with government bonds municipal bonds are listed without listing examination, taking into account their public benefits. Listing of shelf-listed municipal bonds, i.e., the provincial development bonds and local subway bonds, is handled in the same way as NHBs (1 and 2), and listing of bonds issued through public offering is handled in the same way as corporate bonds.

The documents required for listing application for provincial development bonds and subway bonds are an application for self-listing and a report on result of issuance. The documents required for listing of municipal bonds issued through public offering include an application for listing, trust deed, underwriting agreement or sales contract, a copy of an agreement on offering on commitment (only in case where the concerned bonds are issued through indirect offering). Listing application for bonds can be submitted over the Internet.

d. Listing of Special Bonds

Listing requirements and methods for specific laws bonds differ depending on bond type.

i. Monetary Stabilization Bonds

The same as government bonds, listing application for monetary stabilization bonds is made on the day of sale or bidding, and they are listed on the issuance day.

ii. Shelf-listed Bonds

Industrial financial bonds, Korea National Housing Corporation (land) bonds, and land development bonds are listed as shelf-listed bonds in the same way as local subway bonds, which are municipal bonds. This means, on the basis of application for self-listing for the bonds scheduled to be issued in each month during the following year at the end of each year, the KRX lists the scheduled quantity on a fixed day (for example, on 27th of each month for industrial financial bonds), and adjust the listing value upon receiving the notice of issuance value following confirmation of issuance of bonds for the concerned month.

iii. Public Bonds

Bonds of public corporations are issued indirectly through securities firms. For their convenience, the issuing firms are allowed to compile all bonds issued during the month and submit the listing application for such bonds collectively by 10th of the following month.

iv. Presale Bonds

Listing of presale bonds (bonds are issued together after accumulating all bonds sold during the month, thus their issuing date is same, but sale dates are different), which are bank bonds, is handled as a shelf listed bond until June 2001. However, with the abolition of the taxation regulations concerning the holding period in July 2001, presale bonds are listed by giving a different name to each sale date (with same issuing date).

v. Bonds Requiring Filing of Securities Registration Statement

Filing of the securities registration statement was exempted for the merchant bonds, card bonds, lease bonds, discount financial bonds, and new technology financial bonds. Such bonds issued during the month were accumulated and listing application was made by 10th of the following month. However, with the amendment of the *Securities and Exchange Act* (SEA) in July 2001, the filing of the securities registration statement became an obligation. Consequently, in accordance with the bond issuance plan for a fixed duration (up to 1 year period), issuers of such bonds has to file an application for self-listing with the Financial Services Commission (FSC), and an application for additional self-listing has to be filed every time bonds are issued during the specified period. Listing application should be made after filing the application for additional self-listing.

e. Listing of Corporate Bonds

Corporate bonds are required to list on the issuing day and the issuing firms submit a listing application; the KRX then lists the bonds after listing examination. Listing application should be made after the FSC has accepted the securities registration statement.

f. Listing of Foreign Bonds

Foreign bonds refer to the bonds issued by a foreign legal entity (including foreign corporations established in accordance with foreign governments, foreign municipal governments, foreign public organizations and foreign status and laws, as well as the international financial bodies established by an international convention). Because of the difficulties involved in assessing the trustworthiness and/or soundness of foreign corporations, listing of foreign bonds requires a careful listing examination. Accordingly, in order to ascertain the facts that issuing conditions of bonds meet the requirements for investor protection and are compatible with the listing and trading systems of the KRX, anyone who intends to list foreign bonds is required to consult with the KRX on matters such as listing procedures and time prior to submission of an application. This process also enables initiation of appropriate measures.

3. Application Form

a. Application Form

The applicant for the initial bond listing must submit the initial bond listing application form (bond listing request for national bonds) and attached documents.

b. Related Documents

i. Samples such as government bonds, municipal bonds, monetary stabilization bonds, and specific laws bonds that are continually issued for sale throughout the month are submitted only once but are omitted when issuing registered bonds.
ii. For indirect issuers, copies of the trust instrument, acceptance contract, or sales contract, and collection consignment contract.
iii. Business description (including corrections to statements)
iv. Financial statements and auditor's reports for the past 3 business years
v. Auditor's report on the financial statements of the most recent business year
vi. Documents that verify the payment of bond
vii. Miscellaneous documents deemed necessary by the KRX

Exempted Documents are:

i. Documents (iii) to (vii): Municipal bonds of secondary distribution, specific laws bonds (except for specific laws bonds that submit the securities registration statement), and bonds that are exempted from filing the securities registration statement.
ii. Documents (iv) to (v): Guaranteed bonds and non-guaranteed bonds that submit business reports based on Art. 159 of the Financial Investment Services and Capital Market Act (FSCMA).
iii. Documents (ii) to (v): If securities registration statement that has come into effect has been submitted.

c. Application Form for Foreign Bonds

Application documents for foreign bonds include:

i. As defined in statutes or appropriate documents
ii. For indirect issuers, copies of the trust instrument, acceptance contract, or sales contract, and collection consignment contract
iii. Copy of the assignment contract as a listing representative
iv. Auditor's report, or comparable documents, on the financial statements for the past 3 business years
v. Copy of the credit rating report
vi. Miscellaneous documents deemed necessary by the KRX

Documents (i) to (vi) are exempted if securities registration statement that has come into effect have been submitted.

d. Methods for Submitting Documents

Documents may be submitted through the following:

i. Mail, by means of someone, electronic document or fax.
ii. Among the accompanying documents that must be submitted, those that were not submitted at the time of the listing application may be submitted within 3 days after the concerned bond is issued.

4. Listing Fees and Annual Dues

a. Rationale

The KRX collects listing fees from institutions that apply for bond listings. The purpose of the fees that must be paid when listing is for the KRX to maintain the various expenses required to provide all sorts of services to the issuing institution. Included are listing fees and annual dues.

b. Listing Fees

i. Initial Listing Fees

The following amounts are applied for listing amounts classified by issue using face values when calculating initial listing fees for bonds (Table 1.6). However, for shelf-listed bonds and non-shelf-listed bonds, the monetary amount for listing bonds issued on the same day continuously throughout the month is calculated by assigning bonds issued on the same day as one issue by each listing request date. Listing fees are paid when the listing request is made. For shelf-listed bonds, they are paid when the results for the issue are announced.

Table 1.6 Listing Fees

Listing Amount (W billion)	**Listing Fees** (W thousand)
<1	100
≥1 and <2	150
≥2 and <5	300
≥5 and <10	700
≥10 and <15	1,000
≥15 and <25	1,200
≥25 and <50	1,300
≥50 and <100	1,400
≥100 and <200	1,500
≥200 and <500	1,600
≥500	1,700

Source: Korea Exchange, http:\\eng.krx.co.kr

ii. Listing Change Fees

Bond listing corporations that change listed bonds due to mergers, spin-off, or business transfers, and corporate name changes are charged with change listing fees of W300,000 per bond.

iii. Relisting Fees

Bonds that are applicable to bond delisting standards due to bankruptcy, etc. are delisted. However, if the cause for delisting is solved and the bond is relisted, then a fee of W300,000 is charged per bond.

c. Annual dues

The total annual dues during the remaining repayment period for bonds must be paid in advance at the time of the listing application; for shelf-listed bonds, annual dues are paid when the issue results are announced. In this case, monetary amounts (rounded to the lowest W100) calculated by monthly installments (rounded down to the lower month) are used for remaining repayment periods of less than a year. If the remaining repayment period is greater than 5 years, then the monetary value is calculated based on 5 years.

The standard charges and fees for the annual dues of bonds are based on the listing date (relisting date) and charged W100,000 for the remaining repayment periods of 1 year per each issue. However, for shelf-listed bonds and non-shelf-listed bonds, annual dues for the amount of bonds issued on the same day continuously throughout the month are based on the issuing date.

The dues are charged by assigning the amount of bonds issued on the same day-month one issue, categorizing them by interest payment methods and by remaining repayment periods.

d. Fee Exemptions and Restoration

The following are fee exemptions and restoration:

- Listing fees and annual dues: Government bonds, municipal bonds, and monetary stabilization bonds.
- Annual dues: Bonds that exist for less than a year from the listing date; bonds that are issued by KRX securities trading members (excluding bond specialist members).
- Change listing fees are imposed on listed bonds of corporations when listings change (changes to listings) due to changes to stocks and due to mergers of the listed corporation's stock certificate occur.

e. Restoration

The KRX restores the listing fees and annual dues (pursuant to Clause 4) for bonds that are denied their listing applications. Corporations that list bonds must follow the stipulations agreed to in the listing contract when their bonds are delisted during the remaining repayment period and have already been prepaid for.

According to the notifications for the cause of delisting and the restoration of annual dues, monthly installments up to the delisting date are deducted from the total annual dues paid and the remaining amount is restored to the corporation (rounded to the lowest W100).

More details on listing fees and dues can be found under Rules and Regulations in the Korea Exchange website.[7]

7 Korea Exchange. www.krx.co.kr

J. Governing Laws on Bond Issuance

The *Regulation on Securities Issuance and Disclosure (RSID)*, enacted in February 2009, is an FSC regulation that overhauled the *Regulation on the Issuance and Disclosure of the Securities* by adding regulatory improvements and additional authorities entrusted by FSCMA.

To ensure the fairness of securities issuance and investor protection, RSID specifically defines items which investors should be notified of in the form of descriptions on the registration statement and investment prospectus, along with the forms and other documents they should accompany. In particular, when it comes to the registration statements of collective investment securities and asset-backed securities (ABS), and the registration statement on mergers, business transfers and split-offs, split-and-mergers, comprehensive exchanges or transfer of stocks, RSID defines different specifics and required documents.[8]

K. Related Legal and Regulatory Issues of the Market

1. Legal and Regulations in the Korea Bond Market

a. Financial Investment Services and Capital Market Act

In February 2009, Korea's financial regulatory structure witnessed a fundamental change in with the enforcement of the Financial Investment Services and Capital Market Act (FSCMA). In order to promote fair market competition, financial innovation and stricter investor protection, FSCMA drastically altered the regulatory framework of the Korean capital market.

With its implementation, the previous major capital market laws such as SEA, *Futures Trading Act*, *Korea Securities and Futures Exchange Act*, *Indirect Investment Asset Management Act*, *Trust Business Act*, and *Merchant Banks Act* were all abolished and replaced by FSCMA.

b. Regulations on Securities Underwriting Business

The *Regulations on Securities Underwriting Business*, enacted in December 2008, is a KOFIA regulation that stipulates the obligations of underwriters (securities companies) to protect investors. The obligations are created under KOFIA's self-regulation function with the aim of maintaining order in the primary market, and regulating underwriting business practices among members companies.[9]

2. Purpose of Regulations

The purpose of these regulations is to prescribe necessary matters in conducting securities underwriting business in accordance with Art. 286(1) of the FSCMA by financial investment companies that have received accreditation for financial investment business from the FSC, or those that engage in such business by registering with the FSC.

8 Footnote 1, p. 316.
9 Korea Financial Investment Association. 2008. *Regulations on Securities Underwriting Business.*

L. Self-Governing Rules of the Market

1. Self-Regulatory Organizations

a. Korea Financial Investment Association (KOFIA)

The KOFIA is an incorporated membership organization with the purpose of maintaining business order between members, assuring fair trade, protecting investors, and promoting the sound development of financial investment services. Members of the association are financial investment firms, general administration companies, collective investment scheme assessment companies, bond assessment companies, and members under the conditions prescribed by its Articles of the Association. KOFIA aims to promote fair business practices among member companies, create a fair business culture in the securities trading market, and maximize the function of investor protection. As such, KOFIA undertakes such activities as self-regulation to protect investors and maintain market order among member companies; dispute mediation between members regarding their business activities; registration and management of investment advisers and managers; OTC trading management for non-listed stocks and non-listed bonds; and establishment of dispute mediation rules for the industry's self-mediation of conflicts.

b. Korea Exchange

KRX is a stock company, which aims to fix and stabilize fair prices in the transactions of securities and exchange-traded derivatives, and facilitate the stability and efficiency of other transactions. It established and operates the stock market, the KOSDAQ market, and the futures market.

Under FSCMA, the stock market is a market established for the trading of securities, such as debt securities, equity securities, beneficiary securities, investment contract securities, derivative-combined securities, and securities depository receipts. KOSDAQ was established for the trading of specific securities designated by FSCMA, such as corporate bonds and stocks. Therefore, the stock market and KOSDAQ differ in the kinds of stocks they deal. The futures market is a market established by the KRX for trading exchange-traded derivatives.

The responsibilities of KRX include:[10]

i. the establishment and operation of the stock market, KOSDAQ, and the futures market;
ii. transactions of securities and exchange-traded derivatives;
iii. transaction confirmation;
iv. debt acquisition;
v. deduction;
vi. confirmation of settlement securities, settlement item, and settlement amount;
vii. settlement execution guarantees;
viii. follow-up measures on settlement failure and settlement instruction as a result of transactions on the securities market and the derivatives market;
ix. report and disclosure of a listed corporation; and
x. self-resolution of disputes arising from transactions in the stock market, KOSDAQ, and the futures market.

[10] Footnote 1, p. 320–321.

II. Primary and Secondary Market-Related Regulatory Framework

A. Related Rules and Regulations on Issuing Debt Instruments

1. Disclosure requirements

In the preparation and disclosure of an investment prospectus, Art. 123 of the *Financial Investment Service and Capital Market Act* (FSCMA) states that:[11]

> When an issuer publicly offers or sells securities in accordance with Article 119, the issuer shall file an investment prospectus (hereinafter referred to as "investment prospectus"), prepared in accordance with the manner prescribed by Presidential Decree, with the Financial Services Commission (FSC) on the day on which the relevant registration statement becomes effective (or the day on which the supplements to a universal shelf registrationstatementarefiled,incaseswherethesupplementstotheuniversal shelf registration statement shall be field in accordance with Article 119 (2) and keep it at a place specified by Ordinance of the Prime Minister to make it available to the public for inspection.
> <Amended by Act No. 8863, Feb. 29, 2008>
>
> No investment prospectus shall contain any description different from the one described in the relevant registration statement (including any supplements to a universal shelf registration statement under Article 119 (2); hereafter the same shall apply in this Chapter) or omit any description stated therein: Provided, that a description of the balance between confidentiality in corporate management, etc. and protection of investors, etc., as prescribed further by Presidential Decree.
>
> An issuer of the collective investment securities specified by Presidential Decree shall file an additional investment prospectus separately from the one under paragraph (1) in accordance with the following subparagraphs, with the Financial Services Commission (FSC), and shall keep it at a place specified by Ordinance of the Prime Minister to make it available to the public for inspection: Provided, that such filling, keeping, and disclosure

11 Chapter I, Part III of the *Financial Investment Service and Capital Market Act.*

may be omitted, if offering or selling such collective investment securities is discounted:
<Amended by Act No. 8863, Feb. 29, 2008>

A revised investment prospectus shall be filed at least once after the investment prospectus under paragraph (1) is filed within an interval prescribed by Ordinance of the Prime Minister; and
In cases where an amendment to registration is filed in accordance with Article 182 (8), an investment prospectus in which such amendment is reflected shall be filed within five days after a notice of amended registration is delivered.

2. Credit Rating Requirements

Regulation 11 of the *Regulations on Securities Underwriting Business* provides for the credit rating requirements of non-guaranteed bonds. Chapter III of the regulation states that:[12]

In the case of an underwriter underwriting non-guaranteed bonds, such bonds shall be those that have been rated by at least two (one agency, in the case of underwriting ABS issued in the form of bonds pursuant to the Act on ABS or in inevitable cases such as the business suspension of credit rating agencies) credit rating agencies from among those approved for the credit ratings business pursuant to the provisions of the Act on Use and Protection of Credit Information.

However, non-guaranteed bonds issued by foreign corporations, etc., shall be deemed as those rated in accordance with this provision if they are rated by two or more credit rating agencies (referring to international credit rating agencies as prescribed by the Governor of the Financial Services Commission (FSC) in the Item of [§2-11(2)1] of the FSC's Regulations on Securities Issuance and Disclosure; the same hereinafter in this chapter).

3. Lead Time for Registration Approval

The minimum lead time (number of business days) for registration approval is provided for in Art. 120 of the FSCMA, which states that:[13]

The registration of securities under Article 119 (1) and (2) (hereinafter referred to as "securities registration") shall be effective on the day after the expiration of the time period prescribed by Ordinance of the Prime Minister, considering the type of securities or the characteristics of the transaction, etc., which shall begin on the day on which the registration statement is submitted and accepted by the Financial Services Commission.
<Amended by Act No. 8863, Feb. 29, 2008>

The Financial Services Commission (FSC) shall not refuse to approve a registration statement, unless it is not prepared in conformity with the

---

12 Regulation 11 on Underwriting of Non-Guaranteed Bonds, Chapter III of the *Regulations on Securities Underwriting Business*.
13 Footnote 12, Art.120 on "Effective Date of Registration Statement, etc."

> prescribed form of the registration statement, there is any false description or representation in the registration statement concerning a material fact, or any description or representation of a material fact is omitted.
> <Amended by Act No. 8863, Feb. 29, 2008>
>
> The effectiveness under paragraph (1) shall not include any effect of acknowledging that the descriptions of the relevant registration statement are true or correct, or the Government's assurance or approval of the value of the securities.
>
> An issuer of securities shall, when it intends to withdraw its securities registration, file a withdrawal statement with the Financial Service Commission (FSC) no later than the day before the date set for offering to acquire or purchase the securities stated in the relevant registration statement.
> <Amended by Act No. 8863, Feb. 29, 2008>

4. Availability of Shelf Registration and Associated Documentation Requirements

If the bond issuer uses the shelf registration, the bond issuer must submit the "universal shelf registration statement" to the Financial Services Commission (FSC). The legal provision for shelf registration is stipulated at Art. 119 (2) in FSCMA, which states that:[14]

> When a registration statement for a total amount of securities to be publicly offered en bloc over a certain period of time (hereinafter referred to as "universal shelf registration statement") in accordance with the guidelines and methods prescribed by Presidential Decree, considering the type of securities, scheduled issue period, frequency of issuance, requirements for the issuer, etc., is submitted to and accepted accordingly by the Financial Services Commission (FSC), such securities may be publicly offered or sold without necessarily submitting a registration statement each time such securities are publicly offered or sold during the period of time stated therein, notwithstanding paragraph (1).
>
> In such cases, the documents related to the universal shelf registration statement (hereinafter referred to as "supplements to universal shelf registration statement"), as prescribed by Presidential Decree, shall be submitted each time such securities (excluding collective investment securities, specified by Presidential Decree) are publicly offered or sold.
> <Amended by Act No. 8863, Feb. 29, 2008>

5. Regulated Suspension Period

The maximum regulated suspension period is 6 months. The suspension period is imposed by the Financial Supervisory Service (FSS), if some financial investment institutions violate the regulation or the FSCMA.

14 Footnote 12, Art. 119 (2) on "Registration of Public Offering and Sale."

B. Regulations and Rules related to Buying Debt Instruments in the Secondary Market

1. Continuous Disclosure Rules or Requirements

Art. 33 on "Business Report and Public Disclosure" of FSCMA states that:[15]

> A financial investment business entity shall prepare business reports for three, six, nine, and twelve months respectively from the commencement date of each business year, and shall submit them to the Financial Services Commission (FSC) within the period of time prescribed by Presidential Decree, not exceeding 45 days after the lapse of each relevant term as specified above.
> <Amended by Act No. 8863, Feb. 29, 2008>
>
> A financial investment business entity shall keep a summary of the business reports submitted under paragraph (1) containing the material facts of each business report for public disclosure, in the head office, branch offices, and sales offices for one year from the date on which the report is submitted to the Financial Services Commission (FSC), and shall also disclose it to the public through its Internet homepage, etc.
> <Amended by Act No. 8863, Feb. 29, 2008>
>
> In the event that anything that is likely to produce a significant impact on the business management status of a financial investment business entity, such as occurrence of any massive financial scandal or non-performing claims, as prescribed by Presidential Decree for each type of financial investment business, the financial investment business entity shall report it to the Financial Services Commission (FSC), and shall disclose it to the public through its Internet homepage, etc.
> <Amended by Act No. 8863, Feb. 29, 2008>
>
> A financial investment business entity shall submit reports indicating monthly business affairs in addition to business reports under paragraph (1) to the Financial Services Commission (FSC) by the end of the next month.
> <Newly Inserted by Act No. 9407, Feb. 3, 2009>
>
> Matters concerning the business reports submitted under paragraph (1), the descriptions contained in the document for public disclose under paragraph (2), and the public disclose of the business management status under paragraph (3), the reports submitted under paragraph (4) and other necessary matters shall be prescribed by Presidential Decree.
> <Amended by Act No. 9407, Feb. 3, 2009>

[15] Art. 33 on "Business Report and Public Disclosure, etc.," Section 1, Chapter III, Part II of the *Financial Investment Service and Capital Market Act.*

2. Restrictions for Investors

a. Licensing

Pursuant to Article 12 (1) of FSMCA, an entity that wishes to run a licensed financial investment business shall select all or part of its business units for licensing from FSC. A single business unit can be defined through the combination of factors such as the types of financial investment business, the scope of financial investment products, and classes of investors. More specifically, the constituents of financial investment business are the six types of investment business such as investment trading, investment brokerage, collective investment, investment advisory, trust, and discretionary investment business. The product scope consists of securities, exchange-traded derivatives, and over-the-counter (OTC) derivatives. Investors are divided into ordinary and professional investors.

In addition, in accordance with Article 18 (1) of FSCMA, an entity that wishes to operate a registered financial investment business shall create a single business unit by combining the aforementioned three factors and select all or part of the business units for registration with FSC as a financial investment business. The Enforcement Decree of FSCMA sets forth the minimum level of net assets required to run each licensed or registered business unit based on the associated risk and the required level of investor protection for each service. For example, a higher level of minimum net assets is required for investment trading and trust services, compared to investment brokerage and collective investment services, respectively. Likewise, as the registration of a business unit is a relaxed means of an entry, it requires a lower level of minimum net assets than a licensed business unit.

With regard to the financial investment instrument, OTC derivatives require the highest level of net assets. Between securities and exchange-traded derivatives, securities require a higher minimum level of net assets due to the more frequent release of new products on the market. In addition, the minimum net asset requirement is reduced to half of financial investment firms to add more services, grow in size, and enhance their expertise through lowered entry barriers.

Based on the Enforcement Decree, if a financial investment company launches an investment trading service that handles debt securities, equity securities, beneficiary securities, derivatives-combined securities, and securities depository receipts, the company should hold a minimum account of net assets of W50 billion. But in the case of only managing debt securities, the net asset requirement is W20 billion, while equity securities business (excluding collective investment securities) alone requires a minimum net asset of W25 billion. Table 2.1 shows the minimum net asset requirement for an investment trading business.

Table 2.1 Minimum Net Asset Requirement for Investment Trading Business (W Billion)

Business Area	Financial Investment Product	Minimum Net Assets (ordinary and professional/professional)
Trading	Securities [1]	50/ 25
Trading	Debt securities [2]	20 / 10
Trading	State, local government and special bonds	7.5 / 3.75
Trading	Equity securities (excluding collective investment securities)	25 / 12.5
Trading	Collective investment securities	5 / 2.5
Trading	Exchange-traded derivatives	10 / 5
Trading	Exchange-traded derivatives (securities for underlying asset)	5 / 2.5
Trading	OTC derivatives	90 /45
Trading	OTC derivatives (securities for underlying asset)	45 / 22.5
Trading	OTC derivatives (non-securities for underlying asset)	45 / 22.5
Trading	OTC derivatives (currency/interest rates for underlying asset)	18 / 9
Trading (Excluding underwriting)	Securities [1]	20 / 10
Trading (Excluding underwriting)	Debt securities [2]	8 /4
Trading (Excluding underwriting)	State, local government and special bonds	3 / 1.5
Trading (Excluding underwriting)	Corporate bonds	4 / 2
Trading (Excluding underwriting)	Equity securities (excluding collective investment securities)	10 / 5
Trading (Excluding underwriting)	Collective investment securities	2 / 1
Trading (Excluding underwriting)	Repurchase agreement (RP)[3]	6 (Professional)
Trading (Excluding underwriting)		6 / 3

[1] Securities mean financial investment instruments that comprehensively cover debt securities, equity securities, beneficiary certificates, derivatives-combined securities and securities depository receipts (Article 3 of FSCMA).
[2] Debt securities include state bonds, local government bonds, special bonds, corporate bonds and corporate commercial papers.
[3] Financial instruments for RP include government bonds, public offering bonds issued by listed companies and state-owned companies, guaranteed bonds, ABS and MBS for public offering and beneficiary certificates.
Source: Korea Financial Investment Association, Chapter 12 in *2010 Capital Market in Korea*.

For the brokerage business, the minimum net asset requirement is W1 billion with the amount halved to W500 million if the company only targets professional investors who require relatively lower levels of protection. Based on this formula, a company that wants to carry out both brokerage and dealing will require a total net asset of W11 billion, which is broken down to W1 billion for brokerage and W10 billion for dealing. Table 2.2 shows the minimum net asset requirements for investment brokerage business.

Table 2.2 Minimum Net Asset Requirement for Investment Brokerage Business (W Billion)

Business Area	Financial Investment Product	Minimum Net Assets (ordinary and professional/professional)
Brokerage	Securities [1]	3 / 1.5
Brokerage	Debt securities [2]	1 / 0.5
Brokerage	Equity securities (excluding collective investment securities)	1 / 0.5
Brokerage	Collective investment securities	1 / 0.5
Brokerage	Repurchase agreement (RP) [3]	0.5 (Professional)
Brokerage	Exchange-traded derivatives	2 / 1
Brokerage	Exchange-traded derivatives (securities for underlying asset)	1 / 0.5
Brokerage	OTC derivatives	10 / 5
Brokerage	OTC derivatives (securities for underlying asset)	5 / 2.5
Brokerage	OTC derivatives (non-securities for underlying asset)	5 / 2.5
Brokerage	OTC derivatives (currency /interest rates for underlying asset)	2 / 1
Brokerage (ECN)	Listed securities	15 / 7.5
Brokerage (OTC bond transaction)	Securities; debt securities	3 (Professional)

[1] Securities mean financial investment instruments that comprehensively cover debt securities, equity securities, beneficiary certificates, derivatives-combined securities and securities depository receipts (Article 3 of FSCMA).
[2] Debt securities include state bonds, local government bonds, special bonds, corporate bonds and corporate commercial papers.
[3] Financial instruments for RP include government bonds, public offering bonds issued by listed companies and state-owned companies, guaranteed bonds, ABS and MBS for public offering and beneficiary certificates.
Source: Korea Financial Investment Association, Chapter 12 in *2010 Capital Market in Korea*.

For the collective investment business, a company must have a minimum net asset of W8 billion to run all types of funds such as equity funds (including money market funds), real estate funds, special assets funds, and mixed assets funds. However, only W2 billion is required to run a single type of fund, such as real estate funds or special assets funds.

In the trust business, net assets of W25 billion are required if a financial investment company is to manage all types of trust properties, while monetary trust alone requires only a minimum of W13 billion in net assets.

For registered businesses such as investment advisory and discretionary investment services, a minimum net asset of W500 million and W1.5 billion are required, respectively. In addition, if a bank or an insurance company wishes to offer financial investment services concurrently, the minimum net asset requirements for the services should be examined based on an amount with the capital requirements for banking or insurance business (as prescribed in the banking act or the insurance act) deducted.

Table 2.3 Minimum Net Asset Requirement for Collective Investment, Trust, Investment Advisory, and Discretionary Investment Businesses (W Billion)

Business Area	Financial Investment Product	Minimum Net Assets (ordinary and professional/professional)
Collective investment	Securities collective investment scheme (CIS) Real estate CIS Special asset CIS Mixed assets CIS Short-term finance CIS	8 / 4
Collective investment	Securities CIS Short-term finance CIS	4 / 2
Collective investment	Real estate CIS	2 / 1
Collective investment	Special asset CIS	2 / 1
Trust	Money, securities, monetary claims, movables, real estate, rights related with real estate, intangible property rights	25 / 12.5
Trust	Money	13 / 6.5
Trust	Securities, monetary claims, movables, real estate, rights related with real estate, intangible property rights	12 / 6
Trust	Movables, real estate, rights related with real estate	10 / 5
Investment advisory	Securities, exchange-traded derivatives, OTC derivatives	0.5 / 0.25
Discretionary investment	Securities, exchange-traded derivatives, OTC derivatives	1.5 / 0.75

Source: Korea Financial Investment Association, Chapter 12 in *2010 Capital Market in Korea*.

3. Definition of Qualified Institutional Investors and Professional Investors

The government is currently looking into the implementation of the Qualified Institutional Buyer (QIB) system in the Korean bond.

4. Requirements and Restriction for Non-residents

a. Foreign Investor Registration

Foreign investors who wish to acquire or dispose of securities listed on the securities market, or securities offered or sold for listing, must register with the FSS. The documents required by FSS should be submitted in person or through a local agent[16] and an investment registration certificate (IRC) will be issued. After submitting an IRC, a licensed local investment dealer or investment broker may open an account for securities trading on behalf of foreign investors. Under the respective laws, including the FSCMA, foreign investors are permitted to acquire securities within certain investment ceilings. Currently, they can invest in 37 stock issues of 36 companies as of 30 November 2009.

Foreign investor registration aims to manage the matters pertaining to foreign investment limits and other related issues. Through the system, statistics on foreign investment including foreign holdings will also be managed. Furthermore, the IRC is used to authenticate the real name of an investor when opening an account.

[16] This is based on Art. 6-22 of the *Regulations on Financial Investment Business*. Foreign investors may designate their respective local agent to represent them in exercising their rights on the securities acquired and in handling other related matters. Any one of the entities listed below may be designated as a local agent for a foreign investor: Korea Securities Depository, foreign exchange banks, investment dealers, investment brokers, collective investment managers, and internationally recognized securities depository institutions. No other person or entity may be appointed a local agent by a foreign investor. A designated agent shall fulfill its fiduciary duty.

Table 2.4 Questions and Answers on Investment Registration Certificate and Documentation

Q&A related to IRC/Documentation (Answered by FSS)	
Questions	**Answers**[a]
IRC concept: IRC concept being reviewed by FSS; good news and should be projected to FIIs; what timeline for review (even if no exact date?)	The FSS is always open to comments and suggestions by foreign investors. As an effort to ease the IRC process for foreign investors, the FSS currently operates [an] electronic registration system for foreign investors where foreign investors/custodians can submit IRC application and the required documents on-line [*sic*]. At this time the FSS does not have an official comment to make with regards to IRC but the FSS welcomes opinions of foreign investors and that we try to seek measures that may make the Korean financial market more accessible to foreign investors.
Granting of IRC: Is there an official FSS commitment on turnaround or which should be official version for SF1 market guide?	The FSS tries not to create any unnecessary delays with the IRC granting process and if all the required documents have been submitted, it usually takes no more than four hours (4 hrs) [*sic*].
IRC process: Participants mentioned 'upon presentation of documents' or similar; does that mean that docs have to actually be submitted to FSS or only to custodian who then bears sole responsibility and applies online?	The documents may be submitted to FSS by the investor or through the custodian who is acting on behalf of the investor. The documents can either be submitted either in person or through the FSS online system.

[a] Provided by Financial Supervisory Service.
FII = foreign institutional investors; FSS = Financial Supervisory Service; IRC = investment registration certificate; SF1 = Sub-Forum 1
Source: <Please indicate source>.

b. Investors Subject to Registration

Generally, individuals of foreign nationality who have not maintained residence in Korea for more than 6 months will be subject to registration if they intend to invest in listed securities. The same applies to corporations. Any corporation that does not have an office in Korea and was established according to foreign laws must register in order to invest in listed securities in Korea. This means that citizens residing outside Korea need not register for an IRC because of their Korean nationality. However, foreign corporations (local subsidiaries) established by Korean nationals are viewed as foreign entities; therefore they must register with the FSS for an IRC. In addition, the main office and branch offices (except branch offices established within Korea) of a foreign corporation are viewed as a single foreign entity and are only required to have one IRC issued.

In the case of funds, however, a master fund and sub-fund cannot be registered together according to Art. 6–10(2) of the *Regulations on Financial Investment Business*, in order to ensure the effectiveness of investment registration. If they are registered together, a single beneficiary owner may eventually have more than two certificates. However, when a master fund is not yet registered, each sub-fund is able to register individually since these sub-funds are considered separate beneficiary owners.

Box 2.1 to 2.3 show the relevant laws regarding investors subject to registration.

Box 2.1 Definition of Foreign Corporation

Article 9 (Definition of Other Terms)	The term “foreign corporation, etc.” in this Act shall mean a person falling under any of the following subparagraphs: 1. Foreign government; 2. Foreign municipal government; 3. Foreign public organization; 4. Foreign company established under foreign Acts and subordinate statutes; 5. International institution designated by the Presidential Decree; or 6. Other corporations located in a foreign country as designated by the Presidential Decree.

Source: Financial Investment Services and Capital Markets Act.

Box 2.2 Scope of Foreign Corporation

Article 13 (Scope of Foreign Corporation)	(1) The term “international institution designated by the Presidential Decree” under Article 9(16)(v) of the Act shall mean an international institution established in accordance with a treaty. (2) The term “corporations located in a foreign country as designated by the Presidential Decree” under Article 9(16)(vi) of the Act shall mean those falling under any of the following subparagraphs: 1. A fund or association established, supervised or managed in accordance with foreign Acts and subordinate statutes; 2. A fund or association established, supervised or managed by a foreign government, foreign municipal government or foreign public organization; or 3. A fund or association established, supervised or managed by an international organization established in accordance with a treaty.

Source: Enforcement Decree of the Financial Investment Services and Capital Markets Act.

Box 2.3 Definition of Foreign Nationals

Article 6–1. (Definitions)	(1) The term “foreign national” refers to a private individual of foreign nationality without his/her domicile, or abode in Korea for six months or longer, or a foreign legal entity as defined in Article 9(16) of the Act.

Source: Financial Services Commission. 16 November 2011. *Regulations on Financial Investment Business.*

c. Exemption from Registration

Foreign nationals, foreign-incorporated entities, or local branches of a foreign corporation engaging in business activities in the Republic of Korea that qualify as “foreigner under national treatment” status shall be exempt from registration upon submitting documents verifying their status. Registration will also be exempted in the case of acquiring stocks on the OTC market for the purpose of “direct investment,”[17] as well as disposing of direct investments, but the details of the relevant transactions must be reported promptly to the FSS.

17 This is based on Article 2(1)(iv)(a) of the *Foreign Investment Promotion Act*. In general, with the amount of the foreign investment being W50 million or more, the term “foreign investment” shall refer to where a foreign investor purchases 10% or more of holdings of a Korean corporation or where a foreign investor purchases holdings after signing such contracts as a management participation contract or a research and development contract with a Korean corporation.

Exemption from registration will also apply to cases where government bonds and market stabilization bonds are acquired and sold by using "omnibus accounts" under the name of the International Central Securities Depository (ICSD)[18] while having an ICSD account at the same time. Box 2.4 below provides the definition of omnibus account on foreign investment in bonds and Box 2.5 provides the regulations regarding exemptions from registration.

Box 2.4 Definition of Omnibus Account Regarding Foreign Investment in Bonds

When foreigners intend to engage in bond trading activities, they entrust the International Central Securities Depository (ICSD) with custodial and settlement services. The ICSD then opens an account with the country of the investment destination under its own name to carry out investment services, such as managing customers' accounts and making orders. Such an integrated account is referred to as an omnibus account. Though the account is opened under the ICSD's own name, the beneficiary owners of the investment capital are those customers (foreigners), involved in transactions with the ICSD. Therefore, the ICSD carries out securities investment on behalf of its customers, and the profits will be returned to the customers.

With the amendment to the old Regulations on Supervision of Securities Business, the exemption of registration has been made applicable to individual investors if they engage in the trading of government treasury bonds and monetary stabilization bonds through a Euroclear or Clearstream omnibus account. Also, the trading of treasury bonds and monetary stabilization bonds among foreigners is possible when they use an ICSD account. Additionally, with the amendment to the Detailed Rules of the Regulations on Financial Investment Business, institutional improvements have been made to support foreign investment in bonds. Such improvements include easing the reporting obligation for foreign investors when they engage in bond transactions through an omnibus account.

Source: Korea Financial Investment Association, Chapter 14 in *2010 Capital Market in Korea*.

Box 2.5 Regulations Regarding Exemptions from Registration

Article 6–1. (Definitions)	1. The term "foreigner treated as a citizen" refers to any of the following foreigners: provided that excluded herein are non-residents as defined in Article 10(2)(i),(ii), and(vi6) of the Enforcement Decree of the Foreign Exchange Transaction Act: (a) A person who works in a business office or any other office in Korea or who engages in any business activity in Korea; and (b) A foreign legal entity that has its principal place of business in Korea or a domestic branch office, liaison office, or any other office of a foreign legal entity;
Article 6–10. (Application for Registration of Investment)	(2) Notwithstanding paragraph (1), the registration of investment is not required in any of the following cases: 1. Where it is intended to dispose of stocks acquired by exercising a right to overseas securities within three months from the date of acquisition; 2. Where it is intended to acquire or dispose of stocks in connection with direct investment: provided that the cases where stocks are acquired from the securities market are excluded herein; and 3. Where it is intended to acquire or dispose of state bonds or monetary stabilization bonds through an account opened in the Korea Depository in the name of an international depository and clearing organization that has completed the registration of investment; provided that, excluded herein are cases where the obligation to report is waive in the manner prescribed by the Governor of the Financial Supervisory Service, the details of bonds traded by a foreigner through an international depository and clearing organization that has completed the registration of investment in its own name.
Article 6–26. (Special Exceptions to Application)	(3) As to cases where a foreigner intends to acquire bonds issued in Korean won in Korea by a foreign corporation and sold overseas (including cases where a foreigner acquires the bonds in Korean won sold in Korea by such foreign corporations for retiring them after purchasing), Articles 6–10, 6–14, 6–15, and 6–21 shall not apply. (4) As to foreign exchange stabilization bonds issued in foreign currency in Korea by the Government, Articles 6–7, 6–10, 6–14, 6–15, and 6–21 shall not apply.

Source: Financial Services Commission. 18/01/2011. *Regulations on Financial Investment Business.*

[18] This is based on Article 5-1(1) (i) of the *Detailed Rules of the Regulations on Financial Investment Business*. This shall refer to Euroclear and Clearstream.

d. Special Cases for Foreigner Registration

When registering an investment, one ID is issued per beneficiary owner. There are certain exceptions, however, to make investment more convenient for foreign investors. Overseas branches or business offices of a domestic investment dealer or investment broker can register separately when it is necessary to arrange the outsourcing of transactions in the securities market. A foreign financial institution can register separately under its own company name when it needs to manage its own assets and customers' assets separately.

An investment dealer or an investment broker can also separately file for registration of an investment under its own name when it is necessary to process entire orders for an investor group and distribute them. An investor group refers to a large number of foreign investors (foreign corporations only) whose investment management activities are managed by one and the same person under relevant laws or agreements.

A foreign investor group can make orders by using the same ID. Here, foreign investors eligible for making orders are those where the investment manager of the investor group has reported to the relevant investment dealer or investment broker before engaging in trading. Investment dealers and brokers have an obligation to make and keep a record of orders, order execution and order distribution.

Box 2.6 Regulations on Special Cases for Foreigner Investment Registration

(1) Notwithstanding Article 6-10 (2), the registration of investment may be done additionally in the name of the relevant financial institution or similar in any of the following cases: Provided, that a statement shall be added to indicate that the registration is for the separate management of customers' assets in cases under subparagraph 2, or that the registration is for processing orders from an investor group in cases under subparagraph 3:

1. Where it is necessary for an overseas branch office or an overseas business office of a domestic investment trader or broker or an investment trader or broker in Japan that are specified in subparagraph 1 of the notification with regard to the remittance of Japanese investors' fund for securities to make an arrangement for the entrustment of transactions in the securities market;
2. Where it is necessary for a foreign financial institution or similar to manage assets for management separately by segregating its own assets from customers' assets; and
3. Where it is necessary for an investment trader or broker to process orders from an investor group by consolidating the orders in accordance with Article 6-7 (3).

(2) Any overseas depository that intends to acquire underlying stocks in order to issue depository receipts or secondary depository receipts shall file for registration of investment for each underlying stock of the depository receipts in addition to the registration of investment filed for the investment of its own assets, and in such cases the registered name shall include the class of the depository receipts and the name of the underlying stocks in addition to the name of the overseas depository.

(3) Any foreigner who intends to acquire securities in accordance with Article 6–7 (1) 8 or 9 may file for the registration of investment for each issue of the securities, and in such cases the registered name shall include the name in which the securities were issued in addition to the name of the foreign depository.

Source: Financial Services Commission. 18/01/2011. *Regulations on Financial Investment Business.*

e. Registration Application Procedure

i. Summary

A foreign investor who wishes to register with the FSS in person or through a local agent may do so by submitting the completed registration application form (Form No. 34 of Supplementary Volume 1 of *Detailed Rules of the Regulations on Financial Investment Business*) to the FSS, along with the official documents that authenticate the lawful identity of the investor. After confirming all the documents, the FSS will issue the IRC to the foreign investor directly or through a local agent. Table 2.5 shows the documents that authenticate the identity of a foreign investor.

Table 2.5 Official Documents that Authenticate the Lawful Identity of the Investor

For an individual investor	A passport or any other equivalent document issued by a foreign government stating the name, the date of birth and other personal information of the applicant may suffice. Notarization is required when submitting a copy. (Notarized letter of authorization is required when registering through a local agent.)
For a legal entity	A certificate of incorporation (COI) and other similar documents issued by a central government, local governments, or a public regulatory authority of a foreign nation stating the name of the entity, the date of incorporation, the name of the issuing authority and the date of the issuance may suffice. Notarization is required when submitting a copy. (Notarized letter of authorization is required when registering through a local agent.)

Source: Korea Financial Investment Association, Chapter 14 in *2010 Capital Market in Korea*.

Although separate registrations were required in the past for those investing in stocks and bonds, the registration system was improved to permit investing in stocks and bonds with a single IRC with the amendment to the *Regulations on Supervision of Securities Business* on 26 May 1998. However, investors that only have one registration certificate issued for stock investment prior to the amendment must register for bond investment separately if they wish to invest in bonds

The FSS has developed an electronic registration system for foreign investors to shorten the time required for investment registration, which has been in operation since 1 June 2007. Under the system, financial institutions (local agents of foreign investors) file investment registration applications and submit relevant documents through the Financial Information Exchange System (FINES) to the FSS, and receive registration certificates electronically.

ii. Detailed Procedures

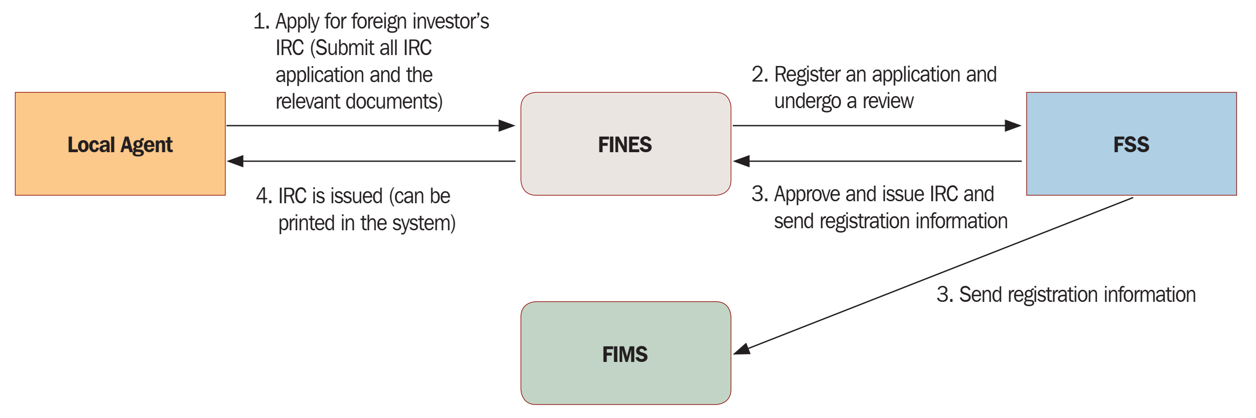
Detailed discussions on for IRC through a local agent or in person can be found in "Capital Market in Korea."[19]

1) Designating a Local Agent and Registering through the Agent

The local agent applies for the foreign investor's IRC by electronically submitting the IRC application and relevant documents to the FSS through FINES (http://fines.fss.or.kr/). The FSS then reviews the documents. When approved, an IRC will be issued electronically (Figures 2.1 and 2.2 below for the detailed procedure for registration).

19 Footnote 1, p. 233–234.

Figure 2.1 Procedure for Applying for Foreign Investor Investment Registration Certificate through a Local Agent

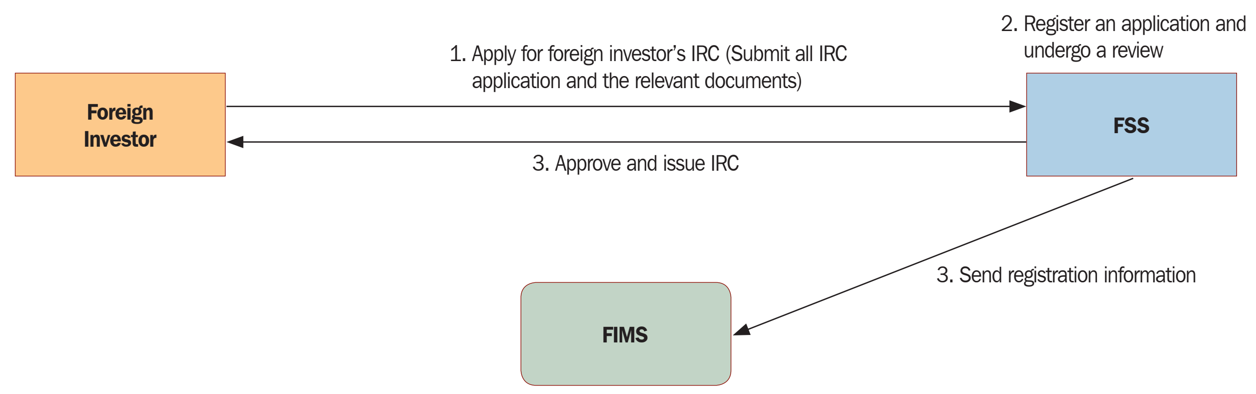


Source: Financial Services Commission.

2) Registering in Person

Foreign investors can submit the IRC application and all official documents, authenticating their identities in person. The FSS will issue an IRC after confirming the documents.

Figure 2.2 Procedure for Applying for Foreign Investor Investment Registration Certificate in Person



Source: Financial Services Commission.

C. Taxation Framework and Tax Requirements

1. Tax on Financial Investment Instruments

a. Taxable Income

According to the *Income Tax Act* (ITA), "interest and discount amounts" are considered taxable interest income.

Bonds are usually issued at par or at discount. Bonds issued at par pay interest on a quarterly or yearly basis to bondholders based on the coupon rate, considering the market interest rate at the point of issuance. Bonds issued at discount pay the principal and amount of interest simultaneously at the point of maturity. The term "discount amount" in this context means an amount of interest paid at the point of maturity of the bonds issued at discount. That amount shall be the difference between the amount of redemption at maturity and the value of bonds discounted by the market interest rate at the point of issuance.

The taxable discount amount stipulated in ITA only refers to issuance discount (the amount according to the market interest rate at the point of bond issuance), not the market discount (the amount according to the market interest rate at the point of early bond redemption). If a person redeems their bonds before maturity, they have to pay tax on the amount of interest accrued during possession of the bonds. For instance, if an investor who bought 3-year discount bonds with an amount of W3 million of discount wants to sell the bonds after only a year of possession, out of the total discount amount of W3 million, W1 million—the discount amount allocated for one year of possession—is the interest income liable for taxation. (This is referred to as the holding period tax system for bonds.)

Usually both the interest and discount amount of bonds are taxable, except when they are 1) government bonds; 2) industrial finance bonds; 3) deposit protection fund bonds and compensation fund bonds for deposit protection fund bonds; and 4) monetary stabilization bonds issued by the Bank of Korea on the open market. In these cases, to help promote and develop the government bond market, only the amount of interest accrued by the coupon rate exclusive of the discount amount if considered to be taxable interest income according to Subparagraph 2 of Art. 22-2 of Enforcement Decree of Income Tax Act. Furthermore, if a person transfers his/her bonds to another person before maturity, they could accrue capital gains due to the interest rate difference between the interest rate at the point of bond issuance and at the point of the transfer. But Korea's taxation law do not levy tax on capital gains accrued from the transfer of bonds. When calculating taxable income, the amount of interest and dividend income shall be included in the total gross income accrued during the corresponding year according to Art. 16 (2) and Art. 17 (3) of ITA. Therefore, necessary expenses are not recognized as expenses.

b. Receipt Date of Income

The date of receipt of income from bond interest shall be the date of receipt of such payments for interest and discount amounts for bearer public bonds, and the payment date under the agreement for interest and discount amount in the case of non-bearer public bonds, according to Subparagraph 2 and 3 of Art. 45 of EDITA. The receipt income accrued from coupon interest shall be the date of coupon, which is the receipt date of such payment. As for the discount, the receipt date of income shall be the date of maturity, which is the receipt date of such payment.

In the case of the sale of bonds before maturity, the receipt date of income from interest shall be the sale date of the relevant bonds. Therefore, when discount bonds are sold before maturity, the receipt date of income from the sale of the relevant bonds shall be the sale date, and if the bonds were redeemed at maturity, the date of redemption at maturity shall be the date of income from such payment according to Subparagraph 10 of Art. 45 of EDITA.

Meanwhile, in the case of commercial notes or cover notes with short maturity terms traded by the passbook in custody, the receipt date of income shall be the date of discount sale if the owner of the notes decides to pay withholding tax on the same day. (Such bonds are referred to as prepaid interest bonds).[20]

[20] Footnote 1, p. 265–267.

III. Trading of Bonds and Trading Market Infrastructure

A. Over-the-Counter Trading of Bonds

The over-the-counter (OTC) market accounts for 80% of the Korean bond market. The Korea Exchange (KRX) market accounts for 20% of the Korean bond market.

Table 3.1 Proportion of Korea Exchange Bond Market (W trillion, %)

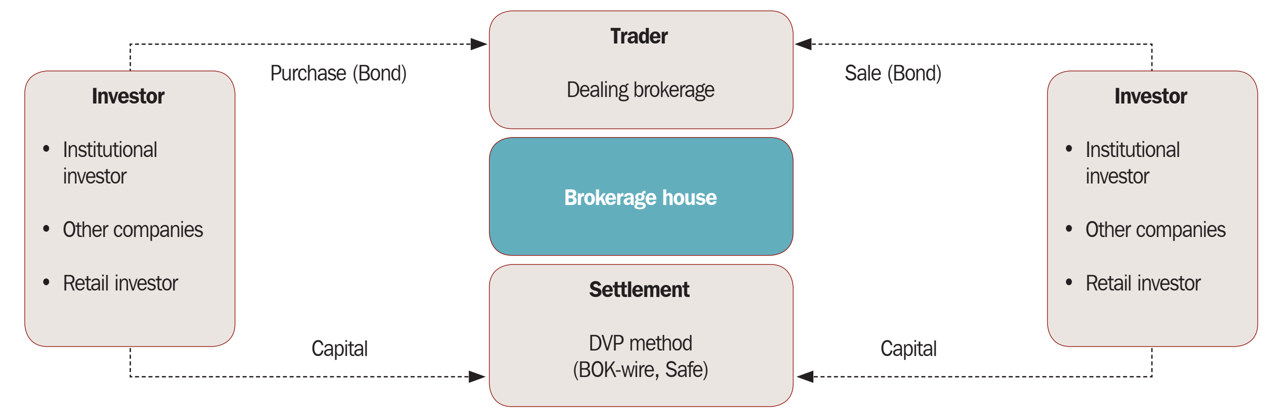
Year	B0nd Market (Total)				KTB				KTB (Benchmark only)			
	KRX	OTC	Total	Market Share of KRX	KRX	OTC	Total	Market Share of KRX	KRX	OTC	Total	Market Share of KRX
2000	26.9	928.2	955.1	2.8%	21.6	251.3	273.0	7.9%	17.3	71.3	88.6	19.5%
2001	13.8	1,401.7	1,415.5	1.0%	10.1	443.1	453.2	2.2%	4.1	166.2	170.2	2.4%
2002	47.9	1,079.9	1,127.8	4.2%	42.6	343.2	385.8	11.0%	11.9	106.1	118.0	10.0%
2003	212.6	1,234.1	1,446.7	14.7%	207.9	453.9	661.9	31.4%	123.6	153.9	277.5	44.5%
2004	377.5	1,439.5	1,817.0	20.8%	358.4	707.8	1,066.2	33.6%	256.8	313.8	570.5	45.0%
2005	365.4	1,541.3	1,906.7	19.2%	337.7	729.3	1,067.0	31.6%	272.8	345.5	618.3	44.1%
2006	295.5	1,341.6	1,637.1	18.1%	267.4	660.1	927.5	28.8%	215.6	338.0	553.6	38.9%
2007	355.8	1,185.5	1,541.3	23.1%	316.7	570.5	887.2	35.7%	183.7	199.7	383.4	47.9%
2008	376.3	1,417.2	1,793.5	21.0%	321.2	603.0	924.3	34.8%	169.3	247.5	416.8	40.6%
2009	504.4	2,073.6	2,578.0	19.6%	427.1	1,057.2	1,484.3	28.8%	225.2	544.4	769.6	29.3%
2010	584.2	2,785.8	3,370.0	17.3%	413.7	1,542.8	1,956.5	21.1%	312.3	673.7	986.0	31.7%
2011	**350.1**	**1,407.2**	**1,703.4**	**20.2%**	**330.1**	**742.5**	**1,072.0**	**30.8%**	**306.0**	**346.5**	**052.0**	**48.9%**
Jan	53.6	226.7	280.3	19.1%	49.1	110.2	159.3	30.8%	43.8	38.9	82.6	53.0%
Feb	44.5	188.1	232.6	19.1%	41.4	95.4	136.8	30.3%	38.0	51.7	89.7	42.3%
Mar	60.4	261.7	322.2	18.8%	55.8	139.8	195.6	28.5%	51.0	84.0	115.0	44.3%
Apr	51.6	223.9	275.5	18.7%	47.5	121.0	168.6	28.2%	44.1	56.7	100.8	43.7%
May	66.3	231.9	298.2	22.2%	61.7	117.6	179.3	34.4%	58.69	65.3	124.0	47.3%
Jun	79.70	274.88	354.6	22.5%	74.55	158.46	233.0	32.0%	70.52	69.95	140.5	50.2%

Source: Korea Exchange.

Before the Korean government made it mandatory for primary dealers (PD) to deal in the exchange market to develop the Korea Treasury bond (KTB) market (in October 2002), the OTC market accounted for 98-99% of all bond trading. The main participants in the OTC bond market are institutional investors, including banks, asset management companies, pension fund managers, and insurance companies. Institutional investors trade bonds through financial investment firms that serve as brokers. In other words, each institutional investor presents an ask and a bid price to the financial investment firms they trade with, and the investment firm matches the ask price and bid price to establish a deal. The investment firms, which serve as brokers, exchange offers and bid prices among themselves, thereby facilitating trading. In other words, financial investment firms are central to facilitating bond trading in the OTC market among institutional investors.

The Korea Financial Investment Association (KOFIA) introduced the OTC Bond Quotation System (BQS) in collaboration with the Financial Supervisory Commission (FSC). BQS was introduced to increase transparency in the OTC bond market.

Figure 3.1 Structure of the Bond Over-the-Counter Market



Source: Korea Financial Investment Association, Chapter 9 in *2010 Capital Market in Korea*.

B. Exchange Trading of Bonds

a. Ordinary Bond Trading System

i. Bonds Eligible for Trading

All bonds listed on the KRX, such as government bonds, municipal bonds, specific laws bonds, convertible bonds (CB), bonds with warrants (BW), exchangeable bonds (EB), corporate bonds, etc. are eligible for trading.

ii. Trading Hours

Trading hours are from 9:00 a.m. to 3:00 p.m. every day except holidays and Saturday.

iii. Offer Price

Price quotations are accepted and the time for receiving quotation is from 8:00 a.m. to 3:00 p.m. Quotation price, quotation quantity, and trading units are classified in Table 3.2 as per equity-linked bond, general bond, and foreign currency bond. There is no price change limit.

Table 3.2 Classification of Quotation Price, Quantity, and Trading Units

Classification	Equity-linked bond	General Bond	Foreign currency bond
Quotation price unit	W1	W1	1 point
Quotation quantity unit	Face value W10,000	Face value W10,000	10,000 point
Trading unit	Amount of bond note (min. face value W100,000)	Face value W100,000 (small-lot/retail bond: W1,000)	10,000 point

Source: Korea Exchange. http:\\eng.krx.co.kr

iv. Price Determination in Individual Competitive Auction with Single Price (Simultaneous Offer Trading)

Under this system all the quotations, received in a certain span of time, are deemed to have been received at the same time, and the trading is made in single price which shall then be applied to initial price determination, or the same occurring after resumption of either the market or trading (applying quotations received 10 minutes since resumption).

(1) In the above case, the trade shall be executed between the matched quotations as follows:
   (a) The total quantity of offers with the price lower than the matched price and the total quantity of bids with the price higher than the matched price.
   (b) With regard to bids and offers at the matched price, the quantity are mentioned below:
      (i) total quantity of either bid or offer quotations at the matched price; and
      (ii) among the quantities of quotations on the counter side, the quantity above the trading unit of the issue concerned.

(2) Priority of simultaneous quotation is as follows
   (a) Price priority
   (b) In case of same price range, the quotations for customer account transactions have priority over the quotations for proprietary account transactions
   (c) Quantity priority per quotation
   (d) The order of quantity allocation (10 times of trading unit → 100 times → 1000 times → half of the residual → the total residual quantity)

v. Price Determination in Multiple Price Auction (Continuous Auction)

In case the lowest offer price matches the highest bid price among the competitive bids and offers, trading shall be made at the price of quotation received first, and trades between the matching bids and offers are executed according to the priority of quotations (priorities in price and time).

vi. Reported Trading System

When the members request the KRX to execute a trade between the bid and offer quotations of which the issue of debt security, price and quantity are the same, the KRX execute such trade at such price and quantity.

To input a report in the KRX's system through the member's system, the KRX executes the reported trading between corresponding quotations and at the same time it considers settlement is finished.

vii. Settlement

Table 3.3 Description of Settlement Process

Item	Descriptions
Kind of trading	Applicable only to the same day settlement (T+0) trading
Settlement between investors and securities company	
Time limit of settlement	By 3:30 p.m. of settlement date In case of registered bond, registration notice or registration certificate shall replace the sold bonds, and required documents for the change of registration shall be attached.
Collection of commission for customer account trading	If trading is made through entrustment of selling or buying from an investor, a member company shall collect commission according to the rates reported to the Korea Exchange.
Settlement by a member	
Time limit of settlement	By 4:00 p.m. of settlement date
Settlement method	A member has to make a payment to settlement agency prior to time limit after netting. Settlement of foreign currency bond shall be made in Korean won conversed by basic rate on the settlement date according to *Foreign Exchange Control Regulation*
Settlement by Securities Delivery Bill	If it is impossible to deliver the traded bonds due to defective bonds, selling small-lot bond, foreigner's selling or selling bonds with low liquidity, the securities delivery may be replaced by Securities Delivery Bill issued by the Korea Exchange.

Source: Korea Exchange. http:\\eng.krx.co.kr

b. Small-Lot Public Bond Trading System

i. Small-Lot Bond Standard

Small-lot bond means the one issued in that month and in the previous month based on trading date with an amount of less than W50 million at face value per account (per person in case of common account).

ii. Applicable bonds

(1) Type-I National Housing Bonds
(2) Seoul Subway Debentures and Seoul regional development debentures
(3) Public bond for community development issued by special city, metropolitan cities and provinces according to the *Regional Public Enterprise Act*
(4) Provincial subway debentures (Busan, Daegu, Daejon, Kwangju, and Incheon)

iii. Market Concentration Trading System of Small-Lot Bond

Market concentration trading system of small-lot bond was introduced for the purpose of improving convenience of buyers of the "add-on" fractional bonds and mitigating personal burden by raising easier exchange of bonds to be bought by persons at the time of registration of real-estate or automobile. Taking into consideration liquidity of bonds, eligible bonds in this system are the bonds having been issued in that month or in the preceding month, and the quotation of trading is less than W50 million per account (or per person in case of common account).

(1) Report of Small-Lot Bond Self-Trading

In spite of the above system, if trading price of small-lot bond is above market price or made after trading hours, it is possible to have self-trading, with limitation to the trading with settlement in that day, outside of market on the basis of reported market yield. In this case the member is liable to report to the KRX the trading hour, name of issue, quantity and price (yield).

(2) Exclusive Member for Buying Small-Lot Bond

In order to have smooth trading the KRX nominates, among member companies, exclusive members for buying small-lot bond who submit compulsory bids, which is being run with 20 firms as of March 2010.

(3) Reported Market Price System

Reported market yield means the one calculated by the KRX; arithmetic average price disregarding high price of 10% and low price of 20%. The KRX calculates the said ratio when an exclusive member company reports a desired price for the purchase to enhance easier exchange by persons who are to compulsorily purchase the "add-on" fractional bonds and to promote consumption of bonds based on market fair price. Reported market price is applied to trading at the time of market closing of the next day so that a person can dispose the public bonds they owned at this price.

iv. Trading Rules Applicable to Small-Lot Bond.

Table 3.4 shows the trading rules especially applicable to small-lot bond.

Table 3.4 Trading Rules for Small-Lot Bond

Item	Descriptions
Common account for small-lot bond only	One-time trading for the "add-on" fractional bonds by an individual is possible through common account only for small-lot bond under the name of a member without opening a separate account.
Bid price per kind of bond	Seoul subway debentures, Seoul regional development debentures, and provincial subway debentures shall be classified into categories per same issuance date, and their bid prices are submitted as one group
Trading unit	Face value W 1,000
Priority of simultaneous quotation	W10 million → W50 million → W300 million → W500 million → the residual
Trading at market closing	Single price by reported market price of previous day shall be applied to trading from 20 minutes prior to closing till market closing

Source: Korea Exchange. http:\\eng.krx.co.kr

c. Primary Dealer Trading System

i. Bonds Eligible for Trading

Government bonds are traded exclusively in the special market. Applicable bonds are Korea treasury bonds (KTBs), monetary stabilization bonds, and Korea Deposit Insurance Corporation (KDIC) bonds. The details of the bonds eligible for trading in the special market are shown in Table 3.5.

Table 3.5 Bonds Eligible for Trading in the Special Market

Item	Details
Benchmark KTBs	The most recently issued (on-the-run) KTBs in their respective maturity ranges. Primary dealers are required to perform market making for the benchmark KTBs.
Non-benchmark KTBs	KTBs other than the benchmark issue (off-the-run issues)
Monetary stabilization bonds	The most recent two MSB issues whose outstanding amounts are W200 billion or more (among 1-year and 2-year maturity of MSBs)
KDIC bond	The most recent two 5-year KDIC bonds issues whose issuance amounts are W200 billion or more.

KTB = Korea Treasury bonds; MSB = monetary stabilization bonds; KDIC = Korea Deposit Insurance Corporation
Source: Korea Exchange. http:\\eng.krx.co.kr

ii. Trading Hours and Quotation Price

(1) Trading Hours

Trading hours are from 9:00 a.m. to 3:00 p.m. for specialized market of government bonds. Holidays are public holidays, Labor Day, Saturday, 1 day at the end of the year, and other necessary days designated by the KRX.

(2) Quotation

Price-based limit quotation is used in this market. The quotation tick-size is W1; quotation quantity unit is face value W10,000 and trading unit is W1 billion.

(3) Kinds of Quotation

Quotation is divided into market-making quote and trading quote. The former is further divided into a two-way market-making quote and one-way market-making quote. A two-way market-making quote is the one that a primary dealer or a preliminary primary dealer submits as buying and selling quote simultaneously while one-way market-making quote is the one that a bond dealer (general dealer) submits as selling or buying quote.

Trading quote means a one-way quote that a participant submits to trade with market-making quote. In case of customer account trading, only one-way market-making quote and trading quote are available

iii. Trading Execution and Settlement

The specialized market of government bonds adopts a full automatic trading system based on the Internet-order environment of the KRX Trading System (KTS) for government securities in accordance with the individual competitive trading principle of multiple prices (simultaneous quotation not available).

Multilateral netting settlement and collective settlement are applied thereto so that in spite of innumerable trading by participants, it is possible for the KRX to minimize quantities of settlement bonds and the needed money. At present, payment adopts the fund-transfer method through Bank of Korea (BOK)-Wire while settlement of government bonds adopts transfer method between deposit accounts at the Korea Securities Depository (KSD).

Settlement period is T+1 (or T+2 for trading on the preceding day of reserves day) and time limit is 4:00 p.m. of the settlement day.

(1) Trading Execution and Settlement (Summary)

(a) Method of Trading Execution
- (i) Full automatic trading method using Internet-order environment and individual competitive trading principle of multiple prices (simultaneous quotation not available) to be applied
- (ii) Settlement method: Multilateral netting settlement and collective settlement
- (iii) Payment: Fund transfer method through BOK-Wire
- (iv) Settlement of government bonds: Transfer method between deposit accounts at KSD

(b) Settlement Period and Time Limit
  (i) Settlement period: T+1 (or T+2 for trading on the preceding day of reserves day)
  (ii) Time limit: 4:00 p.m. of the settlement day

iv. Participants in Government Bonds Market

Participants in the government bonds market include:

(1) Government bond dealers such as (i) securities companies and (ii) banks which, have obtained the permit from the government and are the members of the KRX; and
(2) Ordinary institutional investors, such as (i) pension funds, (ii) insurance companies, and (iii) asset management companies.

Depending on their functions, government bond dealers are categorized into primary dealer ("PD") and the ordinary dealer ("dealer").

PDs have rights to directly participate in the underwriting of KTBs in the primary market, but are required to act as market maker in the KTS of the KRX. Dealers are able to participate in the KTS of the KRX, but are not allowed to directly underwrite KTBs in the primary market. There are 20 PD companies as of the end of December 2010.

v. Primary Dealer System

Primary dealer is rendered benefit such as preferential bidding opportunity in the issuance market of government bonds, bidding on behalf of non-competition bidding participants, takeover of government bonds and financial support. Meanwhile, the PD is a market maker who takes over more than 5% of total government bonds issued and performs market-making duties in specialized market for government bonds.

A Preliminary Primary Dealers (PPD) shall be nominated as a PD 1 year after its appointment as PPD by the Minister of Strategy and Finance if the agency submits application for PD, and satisfies the following requirements (Table 3.6):

Table 3.6 Requirements for Appointment as PPD

Item	Details
Financial soundness	Securities firm: net capital ratio for business >= 350% Bank, merchant bank: BIS net worth ratio >= 10.0%
Dealing manpower	More than five persons with more than 3 years experience
Research manpower	More than three persons with more than 3 years experience
Back-office manpower	More than four persons with more than 1 year experience
Business period of government bonds dealing	More than 2 years from permission date for government bond dealer to the application date for PPD

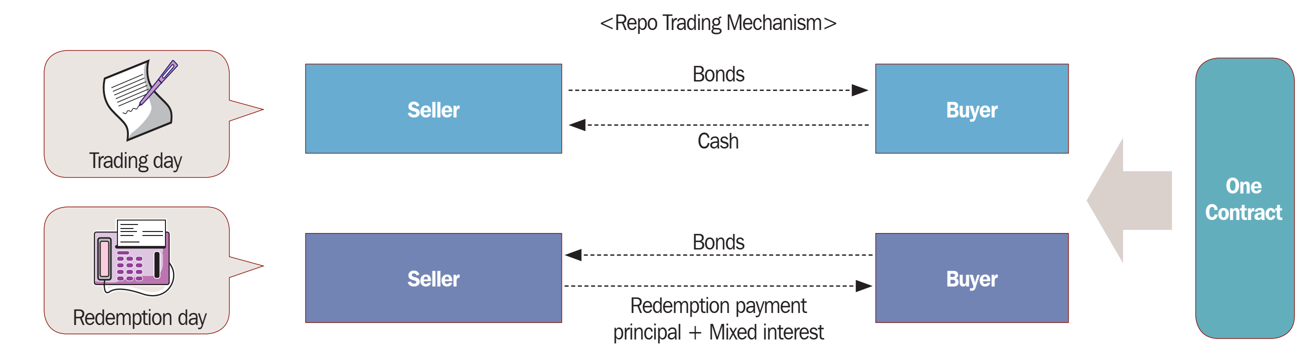
BIS = Bond Institutional Settlement; PPD = Preliminary Primary Dealer
Source: Korea Exchange. http:\\eng.krx.co.kr

C. Bond Repurchase Market

1. The Repurchase (Repo) Market

Figure 3.2 illustrates the repo trading mechanism.

Figure 3.2 Repo Trading Mechanism



Source: Korea Exchange.

Besides bonds, stocks and real estate property may be used as an underlying asset for repurchase agreement. However, repo traditionally refers to a short-term loan transaction using bonds as collateral and the repo market is closely related to the bond market. Because the repo transaction uses bonds as underlying asset, it not only influences the supply and demand in the bond market, but also offers the opportunity to profit from the price difference between the repo and bond, which. helps the process of price discovery. Thus, the repo market plays as bridge between the short-term money market and capital market.

2. Korea Exchange Repo Trading System

a. Bonds Eligible for Trading

Securities which can be transacted by repo are bonds, stocks, commercial paper (CP), Certificate of Deposit (CD) and monetary stabilization bond (MSB). However, transaction with repo at the KRX market is limited only to certain bonds listed in Table 3.7. The reason is to secure stability of repo transactions through restriction of the objects to the ones with low risk, high liquidity, diversified investor base, and stable cash flow. Accordingly, excluded from repo transactions are such bonds as redemption-by-installment bond, floating rate note except Korea Treasury bond, equity-related bond, mortgage bond, privately-offered bond, subordinate bond, asset-backed bond, etc. In other words, tradable securities in the KRX repo market are government bonds (Treasury bond, foreign-exchange stabilization bond), specific laws bond (MSBs, KDIC bond) and blue-chip company bond (credit rating over AAA) that satisfy aforementioned requirements.

Table 3.7 Bonds Eligible for Trading at the Repo Market

Classification	Applicable Items	Requirements
Government bonds	Treasury bonds Foreign exchange stabilization bond	More than W200 billion of outstanding amount Vanilla bond
Specific law bonds	Monetary stabilization bonds KDIC bonds	
Corporate bonds	Unsecured debentures issued by companies in KOSPI stock market Guaranteed bonds	Above requirements + bonds of issuer and guarantee agency with credit rating over AAA

KDIC = Korea Deposit Insurance Corporation; KOSPI = Korea Composite Stock Price Index
Source: Korea Exchange. http:\\eng.krx.co.kr

Among bonds with outstanding amount of at least KRW 200 billion as of the trading day, only KTBs, Korea International Bond, monetary stabilization bond, bonds issued by the KDIC and corporate bonds with credit rating AAA or higher are eligible for repo trade. The reason for specifying the bonds, eligible for repo trade is to ensure the reliability of repo trade by limiting the eligibility to those bonds with low risk, high liquidity and diversified investors base (outstanding balance of at least W200 billion). Even if the bonds meet the requirements noted above, if the yield of bond displays an erratic pattern of a possibility that the bond would be redeemed early or converted into another security, such bond is not eligible for repo trade. Thus, only plain vanilla bonds with no conditions attached are eligible for repo trade.

b. Kinds of Trading Period

The main reason why a bond dealer uses the repo market is to resolve the temporary shortage of fund and the excess or shortage of securities, which may arise during market making in the cash market; hence, most of repo term is less than 1 year.

There are 10 types of Repo term, i.e., overnight, 2 days, 3 days, 4 days, 7 days, 14 days, 21 days, 30 days, 60 days, and 90 days. The repurchase date for each repo term is the 2nd day, 3rd day, 4th day, 5th day, 8th day, 15th day, 22nd day, 31st day, 61st day, and 91st day, respectively, counting from the day on which the purchase price is settled (in case the repurchase date is a market holiday, it is postponed the next business day).

Most markets of advanced countries generally adopt term repo which specifies trading period at the contract date of repo, and most of the periods are within 1 month.

The term repo is applied to the KRX repo market following international tendency and eight terms (1-day, 2-day, 3-day, 4-day, 7-day, 14-day, 21-day and 30-day). Having less than 1 month trading period with abundant liquidity, 60-day and 90-day repo are available.

c. Trading (Submission of Quotation) Hours

Quotation receiving and trading time at the repo market of the KRX is from 9:00 a.m. to 3:00 p.m. and is the same as that of KTS.

d. Quotation Price

According to the characteristic of repo trading, repo rate is applied to quotation in the repo market and is quoted in yield terms, to two decimal places. Quotation quantity unit and trading unit are W10,000 and W5 billion, respectively. Only designated quotations are applicable in the case of repo selling, while both designated quotations (a kind of special collateral quotations) and non-designated quotations (a kind of general collateral quotations) are accepted in repo buying. Participants in the market places orders with the KRX through a web browser installed in their own personal computer.

e. Participants in Repo Market

No restriction is imposed on participation in the repo market for repo trading made OTC because it is made through a broker or directly between parties concerned. Those who are entitled to participate in the KRX repo market are same as direct participants of KRX trading system for government securities to effectively support dealer financing and promote link trading like arbitrage trading between markets. That is, only securities members and bond specialist members (banks) of KRX can participate in the market. To participate in the repo market, every participant has to follow these procedures: permission of trading on bonds (from the Financial Service Commission) → acquisition of membership in the KRX → submission of agreement of repo trading to the KRX → registration as participant → acquisition of electronic authentication. In addition, the government has also participated in the market since 2 June 2003 in accordance with introduction of the repo trading system for KTB.

f. Trade Execution in the Repo Market

i. Trade Execution

The OTC market is accompanied by time and cost resulting from observation of quotation due to non-concentration of quotation information. To improve such problem, the KRX repo market adopts, as a standardized intra-market trading, an individual competitive trading (perfect competition trading) with multiple prices which aims to secure smooth contract trading and transparency of trading through concentration of quotations (only principle of price over time priority is applied without individual competitive trading with single price.). Namely, quotations submitted by participants are collected from the screen of the repo trading system at the KRX as per price range and in the order of submission, and then trade execution is made according to perfect competition trading method by multiple prices. Furthermore, designated buying quotations in the quotation book (refer to terminology of intra repo market) shall compete in selling quotations for the same item, and non-designated buying quotations are able to compete all kinds of selling quotations.

Trading shall be realized at repo rate of the preceding quotation if there is an agreement between selling quotation at the highest repo rate and buying quotation at the lowest repo rate. Generally speaking, contract price (or repo rate) in the repo market has a tendency to be formed higher than rediscount rate of the BOK but lower than interest of unsecured short-term financial market (call rate). Start leg price is not changed for the period until repurchase date in spite of substitution or exchange of bonds (fixed repo rate).

ii. Money for Trading

As per money to be paid by buyer to seller in consideration of trading bonds according to the contract, it is calculated through applying haircut to the market value of the bonds. The money for trading mentioned here is a fund to be lent by a buyer to a seller and it shall be the calculation basis of repurchase interest. The seller shall pay the same money back with repurchase interest to buyer on repurchase date.

In case of repo trading at the KRX, the market value of the object bond shall be calculated on the basis of the price of a fair evaluation agency, and a buyer of repo (lender of money) is required to hold excess security according to haircut. The formula for such is:

Trading amount = trading bonds (total face value) × market value/100 ÷ Haircut,

where the market value is the value calculated on the basis of bond par value W10,000. This means the simple arithmetic average of evaluation value which is the result of re-calculation, with due regard to transition period until the application day, of yield of the said bond to be announced by the market-value evaluation agency for evaluation of trading bonds and margin bonds. Haircut is the discount rate for taking risk of price fluctuation during repo transaction period, and it means the ratio to be claimed by a buyer to a seller and has a function of initial margin.

g. Closing of Trading

i. Settlement in the Repo Market

As a clearing agency for securities based on the *Financial Investment Service and Capital Market Act* (FSCMA), the KRX guarantees performance of settlement in relation to repo transactions. Therefore, it plays the role of CCP (Central Counter Party) of seller and buyer, respectively, as far as settlement is concerned. Additionally, it provides each concerned party with buy-back service for agreement of non-repurchase since the execution of repo trading (tri-party Agent). Therefore, participants may participate in the repo market free from worry about settlement default.

Table 3.8 Settlement in the Repo Market

Item	Descriptions
Settlement and repurchase agency	KRX (settlement guarantee)
The KRX (settlement guarantee)	Settlement by netting after unifying trading repurchase and additional deposit on that day
Settlement method	Cash payment: transfer through BOK-Wire based on data calculated/informed by the KRX Securities delivery: transfer through Safe System of KSD based on data calculated/ informed by the KRX
Time limit settlement (on that day)	Trading on that day: trading day 4:00 p.m. Repurchase on that day: repurchase date 4:00 p.m. Additional deposit: accrual day of deposit 4:00 p.m.

BOK = Bank of Korea; KRX = Korea Exchange; KSD = Korea Securities Depository
Source: Korea Exchange. http:\\eng.krx.co.kr.

ii. Return of Dividend

If dividend occurs from trading bonds during the repo trading period, the buyer should pay back the pertinent dividend to the seller according to the contract. Time of payback is the day of accrual in case of classic repo adopted by the KRX. On the other hand, the buyer returns it after deduction from repurchase amount in case of sell/buyback. Meanwhile, in most advanced countries, withholding tax is not levied on financial income. Therefore, their procedures of dividend return are simple. However, the procedures in Korea, which maintains withholding system on financial income, are rather complicated in the case of repo trading, which results in restriction of trading.

iii. Marking to Market

Marking to market means a series of procedures to maintain value of securities on a proper level through collecting additional deposit after calculating disclosed risk of one or the other party's all agreement of non-repurchase with the same party in preparation of price fluctuation of trading bonds per trading day to guarantee settlement performance of repo trading.

In marking to market, there are such methods as direct execution between parties, one acted by a tri-party agent and the other executed by a CCP of an international trend. In the case of repo trading at the KRX, the KRX shall play the role of a CCP for both parties and shall be responsible, as a repurchase agency, for doing marking to market and collecting additional deposit when disclosed to risk.

vi. Repurchase Amount

The repurchase amount is the money to be paid to a buyer by a seller according to trading agreement and is calculated as follows:

Repurchase amount = Trading amount × (1+repo rate × Repo transaction period/365)

h. Settlement by Cash

It might happen that a person, who is to pay back trading bonds or maintenance margin security on repurchase date, meets an uncontrollable situation being unable to secure bonds due to lack of liquidity of object bonds in spite of his sufficient financial ability to pay. As such it might be difficult for some dealers to make bonds settlement and the adverse effect of such settlement default might spread if the situation is left without any measures. Thus, to prevent such situation, the KRX has a system of settlement by cash in place of settlement by bonds under the condition of imposing adequate penalty subject to agreement of both seller and buyer. The rate of penalty depends on the premium required for re-buying the corresponding bonds by the other party, and other market situations.

i. Settlement at the Repo Market

Repo trading shall expire if the repurchase date arrives. The contract expires on the repurchase date in case of normal arrival of expiration. However, if any of the following causes occur either on trading bonds or on a party, then the date of the occurrence shall be the repurchase date for stabilization of repo transactions, and the contract shall be terminated earlier than the original date. In cases of normal arrival of repurchase date and the repo seller's refusal of exchange, the contract shall expire through exchanging trading bonds and repurchase amount.

In case of settlement default by a party, however, all the contracts between the parties shall be able to be settled by cash. As in the case of repo trading at the KRX, the KRX as CCP shall pay instead the shortage money resulting from the settlement of cash and file a claim against the defaulting party to get appropriate compensation.

Table 3.9 Settlement at the REPO Market

Item		Descriptions
Normal repurchase		Arrival of repurchases date
Early repurchase	Finalization per trading	Refusal of exchange by a seller Delisting of trading bonds Earlier refund of principal and interest of trading bonds
	Finalization of all agreements of non-repurchase (finalization as Single Agreement)	Settlement default by seller or buyer (including additional deposit) Suspension or ban from trading with banks due to dishonor of bill or check/suspension of business/bankruptcy, dissolution, application of rehabilitation or commencing de-facto rehabilitation according to laws

Source: Korea Exchange. http:\\eng.krx.co.kr

j. Trading/Settlement System

i. Korea Exchange Repo Trading System (Summary)

Table 3.10 KRX Repo Trading System

Items	Systems
Type of REPO trading	- Term REPO - Classic REPO
Market participant	a security's member of the KRX (including bond specialist member)
Counter trading party	the KRX (anonymous trading)
Eligible bonds for	- government bonds (treasury bond, foreign, exchange stabilization bond) - specific laws bond (monetary stabilization bonds, KDIC bond) - corporate bond (credit rating over AAA) * as of the trading day, total par value of unredeemed bonds should be more than W200 billion
Trading unit	KRW5 billion (par value basis)
Market valle	value calculated by the KRX based on evaluation values of 3 bond pricing agencies nominated by the head of FSC (simple arithmetic average price)
Trading amount	maket value of trading bond/[haircut (2%) + 1]
repo rate	Annual interest rate that the seller agreed to pay at the time of repurchase
Repo terms and repurchase date	1 day (Overnight), 3-day, 7-day, 14-day, 21-day, 30-day, 60-day, 90-day (8 Repo terms)
Trading (offering) hours	09:00 a.m. to 3:00 p.m.
Trading method	individual competition trading with multiple prices (price/time priority) (no auction at single price)
Realization of trading	when there is a match between bid and asked

continued on next page

Table 3.10 continuation

Items	Systems
Kinds of offer	- ask: only designated quotation is accepted - bid: designated/non-designated are accepted * designated: designation of a specific item * non-designated: non-designation of a specific item
Quotation unit	0.01%
Price limit	not applicable * safety device for prevention of offer input by mistake (dealer's terminal/trading system)
Source: Korea Exchange. http:\\eng.krx.co.kr	

ii. Korea Exchange Repo Settlement System (Summary)

Table 3.11 KRX Repo Settlement System

Items	Systems
Repurchase agency	KRX
Settlement obligation	KRX
Settlement method	- cash payment: transfer in-between BOK reserves accounts (BOK-Wire) - securities delivery: account transfer on depositor's account (KSD Safe)
Time limit to settle	- trading portion: by 4:00 p.m. of trading day - repurchase portion: by 4:00 p.m. of repurchase day - deposit money/dividend: by 4:00 p.m. of accrual day
repurchase amount	trading amount × (1 + repo rate × contract term/365)
Return of dividend (including transfer pay)	return of interest accrued from trading bond/maintenance margin bond
Marking to market	- settlement method: evaluation of whole quantities considering all the contracts as single contract per counterpart - Margin Call: when requested amount for settlement exceeds exemption rate
Type of deposit	- haircut (initial deposit): the amount to be borne by a seller due to discount of market value of trading bonds at initial trading contract - additional deposit: deposit to be paid according to Margin Call of the KRX
Payment of deposit	- type: cash/bonds - payment: report by 1:00 p.m./payment by 4:00 p.m.
Substitution of bonds	- reason: request by seller (only for non-designated buying, it is allowed once per contract) - available period: next day of trading settlement - one day prior to repurchase - application/response: by 1:00 p.m./2:00 p.m. - substitute bonds: bonds having more than evaluation value of trading bond before substitution (1 item among same category)
Exchange of bonds	- reason: request by buyer due to dishonor of issuer of trading bonds - available period: next day of trading settlement - one day prior to repurchase day - application/response: by 1:00 p.m./by 2:00 p.m. (earlier repurchase in case of refusal) - exchangeable bonds: bonds having more than evaluation value of trading bond (1 item among same category)
Earlier repurchase	- reason: settlement default of a party to contract, etc. - settlement method: securities or cash
Source: Korea Exchange. http:\\eng.krx.co.kr	

k. Accounting Procedures under the Repo System

i. Repo Trading Day

The repo seller shall deliver bonds, fill trading amount received from buyer in the account of 'selling of repo bonds' of short-term debt account, and re-assort collateral transferred to buyer from commodity (investment) bonds to 'repo bonds'.

The repo buyer shall receive bonds, fill money paid to seller in the account 'buying of repo bonds' of short-term lending, and deal secured debt provided by seller with notes.

ii. Spot Trading of Repo Buying Bonds

The seller, who sells secured bonds at spot market (spot selling) after buying repo, shall be responsible to buy the bonds at spot market and to return them so that restoration shall be recorded as 'financial liability'. The seller shall offset substitutive payment and financial liability when effecting substitutive payment of interest. When repurchasing bonds (spot), the seller shall debit financial liability, and shall compare preceding evaluation value with buying price of bonds to reflect profit and loss on 'evaluated profit and loss of repo trading'.

Following spot trading of buying bonds, the seller is liable to make voluntary payment of withholding tax for interest accrued during spot trading period, and thus, he shall enter the amount into 'tax on interest income' account, and then debit at the time of paying it to tax office.

iii. Expiration of Repo

Accounting procedures at the time of expiration of repo trading are divided into three kinds as follows:

Table 3.12 Expiration of Repo

Kind of Expiration of Repo Trading	Accounting Procedures
Normal expiration or early repurchase by refusal of exchange	Seller/buyer offset trading amount and repo buying/selling account and appropriate the refunded interest for payment/income commission account
Cash settlement or early repurchase by settlement default	Seller/buyer deal repo trading bond based on spot selling/buying
Early repurchase by early refund	Seller deals repo trading bond based on spot selling and buyer appropriates cash by early refund for debt account and offset in case of repurchase

Source: Korea Exchange. http:\\eng.krx.co.kr

3. Over-the-Counter Institutional Repo Market

i. Repo Market in Korea

The repo markets in Republic of Korea consist of 1) the institutional repo market where repo trading occurs mainly for the purpose of financing and operating funds between financial institutions, 2) the customer repo market where financial institutions trade with non-financial corporations or individuals in terms of received deposits, and 3) the BOK repo market where the central bank, as a part of its open market operation, trades with financial institutions in order to manage the money supply and interest rates.

Most financial institutions can participate in the OTC institutional repo market, whereas only financial institutions who are the members of the KRX are allowed to trade in the KRX repo market.

ii. Direct Trade versus Brokered Trade

Repo trades in the OTC institutional repo market are divided into direct trades and brokered trades. Under direct trades, the participants themselves look for their counterparties. If they have a difficulty finding a counterpart, they may request a brokerage company to find one for them. A brokerage company serves as a bridge between compatible participants based on their trading conditions. There are four brokerage companies in the OTC institutional repo market. According to the trade volume as of 30 June 2011, the percentage of brokered trades is approximately 75%.

iii. Tri-Party Repo Agent

A tri-party repo agent is an independent third party that provides services, including settlement and collateral management services after repo trades are executed. The KSD acts as a tri-party repo agent that provides participants with the aforementioned services to facilitate repo trades in the OTC institutional repo market from their initial execution to their repurchase date.

iv. Participants

The regulations for financial investments prescribe that financial institutions are eligible as participants in the OTC institutional repo market. Any participant who opens a securities ledger in the KSD and receives approval from the KSD can participate in the KSD's repo system. The KSD regulates that foreign participants must appoint a standing proxy for their repo transactions.

v. Eligible Securities

Securities that are allowed to be traded in the OTC institutional repo market are those prescribed in the FSCMA. Bonds, CPs, exchange-traded funds (ETFs) and equities are eligible for the KSD's repo system as long as these securities are deposit-eligible, subject for evaluation, and denominated in Korean won. Equities have been eligible for repo since October 2011.

vi. Types of Transactions

A participant normally designates a repurchase date at the time of concluding a repurchase agreement. This type of transaction is a fixed-term repo. On the other hand, an open-ended repo has no designated repurchase date. In the OTC institutional repo market, both types of transaction are used, and the repo term completely depends on the agreement between a repo seller and a repo buyer. Most of the repo term is 1 day.

vii. Business Hours of the Korea Securities Depository Repo System

The KSD's tri-party repo services are administered from 9:00 a.m. to 5:00 p.m.

If necessary, the KSD may change the business hours, in which case the KSD shall give its participants prior notice on the change of business hours.

viii. Trade Capture and Matching

i. Submission of Details of Repo Trade

Upon the execution of repo transactions, repo sellers (for direct trades) or brokerage firms (for brokered trades) shall submit the details of the repo trade to the KSD. Upon receiving the details of the repo trade, the KSD shall notify repo buyers (for direct trades) of the details of the repo trade, or notify repo sellers and buyers (for brokered trades) of the details of the repo trade.

Table 3.13 Details of the Repo Trade Submitted by Repo Sellers or Brokerage Firms

Item	Content	Option
Basic Information	Counterparty, repo position (buy/sell), purchase price, purchased securities, repo rate	-
Type of Transaction	Term: fixed maturity (enter transaction period) Open: no fixed maturity (no need to enter transaction period)	Term/Open
Transaction/ Single Agreement	-Transaction: to separate from existing trades with the same counterparty and enter into a transaction. -Single agreement: combine with other repo transactions entered into with the same counterparty to form a single agreement.	Transaction/Single
Settlement Agent	If the party wishes to settle through its settlement agent, the name of the settlement agent needs to be entered. (The details of the settlement agent shall be registered in advance.)	A/C No. of securities ledger held with the settlement agent
Methods of Settlement	DVP: simultaneous settlement through the DVP system between the BOK (central bank) and the KSD. FOP: separate settlement of securities and payment (the participant may choose the type of payment).	DVP/FOP
Base Currency	A range of currencies are available for purchase.	Korean won/US dollar/ Japanese yen/euro
Charges	The party subject to the service charges to the KSD	Both parties/Seller/Buyer
Interval of Repo Interest Payment	Enter the interval if it has been agreed that the repo interest shall be paid/received on a regular basis.	Daily, 1–,2–,3–,4–,6-month, Repurchase date
Daily Mark-to-Market	Whether to choose the KSD'S daily Mark-to-Market process	Yes/No
Threshold	To specify the ratio or amount of exemption from the obligation to maintain the margin ('threshold")	Margin amount or ratio
Margin Ratio	Enter the agreed margin ratio, if any. If a margin ratio is not specified, the margin ratio is calculated by dividing the purchased securities' market value on the start-leg settlement date by the purchase price and the ratio is automatically entered into the KSD's repo system.	-
Fund Information	If the sellers or buyers or both parties are asset management companies, fund information is needed	-

A/C =account; BOK = Bank of Korea; DVP = delivery versus payment; FOP = free of payment; KSD = Korea Securities Depository
Source: Korea Securities Depository

ii. Trade Matching

If there is no discrepancy between the details of the repo trade agreed by buyers and sellers, repo sellers or buyers who are notified of the details of the repo trade shall confirm the contents of the details of the repo trade. Upon the completion of confirmation, the KSD shall finalize the settlement statement by giving a Repo reference number for each transaction.

i. Settlement of Repo Trade

i. Start-Leg Settlement

Settlement of securities is done by book-entry transfer from the seller's securities ledger to the buyer's securities ledger. Settlement of fund is done by using the account with the BOK or the account with the commercial bank.

The delivery-versus-payment (DVP) system functions through a direct link between the securities settlement system of the KSD and the financial wire network of the BOK. This allows real time and simultaneous settlement on a gross, trade-by-trade basis for start-leg settlement. If the details of the repo trade are matched, the KSD repo system checks whether there are sufficient numbers of securities for the transactions in the seller's securities ledger. If there are securities sufficient to cover the purchased securities in the account, the KSD system then locks the securities balance to prevent it from being used for other purposes and instructs the buyer to transfer the funds via the BOK. Upon the buyer's completion of the payment, based on such instruction, the settlement of the purchased securities is executed.

On the other hand, when the trade parties are using the free-of-payment (FOP) method, they should make payment for start-leg settlement using the agreed-upon payment means, and the seller needs to notify that fund settlement has been made through the KSD repo system. Upon such notice by the seller, the settlement of the purchased securities is completed.

ii. Close-Leg Settlement

Repo trades are terminated on the repurchase date. However, if the trade parties agree otherwise, or the event of default occurs, repo trades may be terminated before the repurchase date. In cases where repurchase date is designated at the time of concluding an agreement for repo trades, one party may, at any time, ask the KSD for the termination of the repo transaction with the consent of the other party even before the repurchase date. In cases where there is no designated repurchase date, and unless otherwise agreed upon by the parties of the repo transaction, they shall request for the termination of the repo transaction, provided, that such request is made at least three business days, including the desired repurchase date, in advance.

In case of an event which causes the default of a contractual obligation of a seller or buyer, the repurchase date for the relevant repo transaction shall be deemed to have been prematurely arrived. The KSD shall notify the relevant participants of such fact and terminate the repo transaction. Both DVP and FOP methods can be used for the close-leg settlement.

j. Trade Management

i. Rollover

The parties may apply for rollover on the termination date. In this case, only the existing transactions are terminated on the day when such an adjustment is made, and the parties engage in a new transaction. The settlement may be completed by making payment of the repo interest. Conditions other than the termination date would consistently apply to the new transaction.

ii. Substitution of Purchased Securities

The seller in a repo transaction may substitute the purchased securities, in whole or part, for other securities with the consent of the buyer. Meanwhile, in case the redemption of purchased securities is scheduled or in case depreciation of the purchased securities' market value is expected due to insolvency, decree of bankruptcy, commencement of the rehabilitation proceedings or other reasons on the part of the issuer of the purchased securities, the buyer can request the exchange of purchased securities with other securities. The seller should comply with such request of the buyer.

iii. Change in Repo Trade Conditions

The parties may change part of the trading conditions, if necessary. In this case, the new conditions will apply only to the changed part and all other terms and conditions will remain constant.

k. Mark-to-Market

In order to minimize market risk, the KSD carries out mark-to-market (MTM) on a daily basis. Since the purchased securities is used as collateral in repo trades, the value of the purchased securities must be monitored on a daily basis to ensure that they do not drop below a certain range. Due to the MTM, sellers and buyers can minimize exposure to the risk arising from price fluctuations and enhance the stability of the repo trade. When the repo transaction is terminated, the KSD repo system returns any margin involved in the transaction to each paying party. With regard to purchased securities and margin securities, the KSD shall conduct MTM on a daily basis in the following order:

i. Calculation of the required collateral value,
ii. Calculation of the transaction exposure,
iii. Calculation of the net margin, and
iv. Calculation of the amount of the net exposure.

After conducting daily MTM, the KSD shall notify repo sellers or buyers of the result of the MTM no later than 10:30 a.m.

The party who incurred the net exposure of the other party shall pay cash margin or securities margin with the consent of the other party. The amount of margin equals to the amount of the net exposure to the other party with net exposure. The margin transfer must be fulfilled no later than 2:00 p.m. on the notified date.

l. Income Payment Management

Although legal title to the purchased securities passes to the buyer in repo trades, economic costs and benefits of the purchased securities remain with the seller. Therefore, if a coupon is paid, it will be handed over to the seller on the coupon value date. The KSD assists the buyer's interest payment process in order to boost the convenience of repo sellers or buyers.

The methods of the interest payment vary depending on whether the purchased securities are held in the repo account of buyer's securities ledger. If the buyer holds the purchased securities in his or her repo account, the interest is automatically paid to the seller. The KSD's repo system will directly pay the interest to the seller on the relevant interest payment date.

On the other hand, if the buyer transferred the purchased securities from his or her repo account to somewhere, the buyer should pay the interest to the seller on the interest payment date through the KSD.

D. FreeBond

1. FreeBond

a. Background

Similar to developed nations, the bond market in Republic of Korea has traditionally used telephone voice trading as a negotiated sale method. With the advances in information technology after the Asian financial crisis, instant messenger became an important trading method, particularly among young brokers, as the advantages of speed and storage function became widely known. This new method sped up the way trading is executed and enabled market participants to overcome limitations, contributing to the development of the Korean bond market.

However, private messenger undermined price discovery function, and when it crashed or slowed down, the bond market as a whole was paralyzed. In addition, there were structural problems since it was difficult to adapt to the needs of market participants. Against this backdrop, the government created a taskforce in March 2009 and announced the Reformation of Bond Trading Market that October, which aims to establish a specialized bond trading system. Based upon the measure, KOFIA established the online bond trading system, FreeBond and launched it in April 2010.

Since the late 1990s, major developed nations have successfully introduced electronic bond trading systems using advances in information technology. However, in the case of Republic of Korea, legal restrictions have hindered the introduction of alternative trading system(ATS).

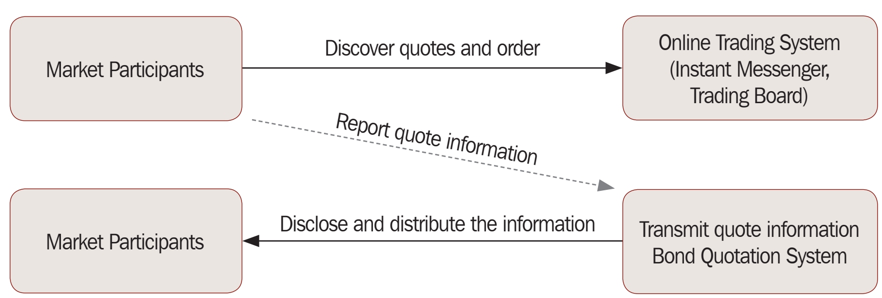
b. Main Contents

i. Definition and Composition of FreeBond

FreeBond, operated by KOFIA, enables financial investment firms and market participants to discover quotes and supports trade negotiations. Participants refer to bond trading brokers, dealers, managers, and traders who apply to use the system and are approved by KOFIA pursuant to regulations on registration of financial investment companies. In addition, KOFIA's operation enables continuous communication with market participants, better reflecting the needs of participants.

As for the bond information system (BIS) and information vendors, FreeBond comprise of two main components: instant messenger and T-Board (Figure 3.5). Unlike private messenger, chat rooms are included in the system. T-Board offers trading functions such as bid/ask prices discovery, orders, negotiation and confirmation, and analyses and reference. Instant messenger, a replacement of the current private messenger, provides functions specialized for bond trading including 1: N chatting and automatic storage of chatting records, on top of the general functions of private messenger.

Figure 3.5 Operation of FreeBond



Source: Korea Financial Investment Association. Chapter 9 in *2010 Capital Market in Korea*.

1) Market participants discover bid/ask price on FreeBond and execute orders.
2) Quote information is transmitted to BQS.
3) The concentrated information is disclosed to the market through KOFIA's Bond.

ii. Characteristics of FreeBond

The major strengths of FreeBond are its specialization, security, and stability. In terms of specialization, the system can only be used by bond trading professionals in line with the *Regulation on Business and Operation of Financial Investment Companies*. When a financial investment company applies to use the system and receive approval from KOFIA, bond traders from that company are able to access FreeBond. Under this system, FreeBond can develop into a specialized system, unlike private messenger which anyone can access.

In addition, T-Board enables market participants to find quotes in real time, issues of interest, information on bond issuance, and it offers a bulletin board for trading. Unlike private messenger, chat histories and quotes are encrypted, preventing hacking from occurring. Furthermore, its use is managed by KOFIA's registration process, enhancing credibility in the system.

To boost the stability of FreeBond, the system is backed up with double servers to prevent system failures from trade concentration, and it is managed around the clock.

iii. Expected Effects

The success of FreeBond in the market with its wider use by market participants is expected to become a turning point in the advancement of the OTC bond market in Republic of Korea for the following reasons:

1) It will significantly improve the bond trading infrastructure.
2) The formalized and safer FreeBond will not only boost the security of bond trading but it will also integrate the market which had been divided by different messenger groups.
3) Users can enjoy the ease and convenience of bond trading on FreeBond. Information asymmetry will be reduced, and price discovery and the search of trading counterparts will be easier.

FreeBond was designed by and for bond traders, which makes it especially "market friendly" and thus convenient for users. The system reflects all the requirements needed for trading, such as a variety of trading methods and analyses.

When FreeBond adds the settlement function and builds a global network with advanced bond trading system in the future, foreign investors will find it more convenient to participate in the Korean bond market and domestic financial institutions will be able to expand into overseas markets. This will eventually lead to the globalization of the Korean bond market. In addition, the use of bond market information concentrated in the system will make it possible to calculate real-time bond indices and facilitate the development of new products, such as bond ETFs and interest derivatives.

While the bond and equity markets are the two major pillars supporting the Korea capital market, the bond market is still underdeveloped compared to the equity market. However, the launch of FreeBond will spur the advancement of the bond market, allowing it to serve its main role in the capital market.[21]

Table 3.14 Questions and Answers on FreeBond and Over-the-Counter Trade Matching

Questions	Answers[a]
KSD mentioned OTC trade matching is done at KOFIA, but outside FreeBond; details?	• KOFIA does not perform the role of matching over-the-counter bond transactions. • Participants in the over-the-counter bond market including securities firms and investors conduct the discovery of ask/bid prices, negotiations, transactions through FreeBond (KOFIA) and private messenger services such as Yahoo. - After transaction occurs, matching is confirmed by each trading party, and settlement is made in T+1 - T+30 through the KSD's SAFE system and the Bank of Korea's BOK-wire, using delivery versus payment. • Based on the needs of the market and the relevant laws, KOFIA plans to transform FreeBond into an ATS equipped with a settlement function.
KOFIA requires trade reporting within 15 minutes; everybody agrees this is good for transparency, etc.; however, requirement is to report trades at IRC level – this is a big issue for CPs because allocation of trades across individual (IRC) accounts may not happen within 15 minutes; possible chance to help ease market issue	• KOFIA's *Regulations on Business Conduct and Services of Financial Investment Companies* and the Enforcement Bylaws (hereinafter be referred to as the "Regulations, etc.") require financial investment companies to report the trading of bonds to KOFIA within 15 minutes of the trade. However, the 15-minute rule does not apply to commercial papers. ※ Types of bonds subject to the 15-minute rule: government bonds, municipal bonds, monetary stabilization bonds, bank debentures, other financial bonds, corporate bonds, and asset-backed securities - Under separate provisions* of the Regulations, etc., the trading of commercial papers must be reported to KOFIA by 5:30 p.m. on the day of trade. Therefore, the issue described in the question above is not likely to occur. * Art. 7–14 of the "Regulations on Business Conduct and Services" of Financial Investment Companies and Article 52 of the Enforcement Bylaws ※ In accordance with the *Act on Issuance and Distribution of Electronic Short-Term Bonds*, which is expected to take effect in January 2013, most CPs are likely to be replaced by short-term bonds. In this scenario, the trading of short-term bonds will not be subject to the 15-minute rule.

[a] Provided by KOFIA
ATS = Alternative Trading System; IRC = investment registration certificate; KOFIA = Korea Financial Investment Association; KSD = Korea Securities Depository; SAFE = Speedy, Accurate, Faithful, and Efficient
Source: Korea Exchange. www.krx.co.kr

E. Secondary Market Yields and Terms of Bond Issues

Table 3.15 Secondary Market Yield and Terms of Bond Issues

Type of Bond	Instrument	Time to Maturity
Government	KTB 3years	2 years 6 months–3 years
	KTB 5 years	4 years 6 months–5 years
	KTB 10 years	9 years–10 years
	KTB 20 years	10 years–20 years
	NHB1 5 years	4 years 6 months– 5 years 1 month
Municipal	Region15 years	4 years 6 months–5 years 1 month
Special	Land 3 years	2 years 6 months–3 years 1 month

continued on next page

[21] Footnote 1, p. 144–147.

Table 3.15 continuation

Type of Bond	Instrument	Time to Maturity
MSB	MSB 91days	85 days–91 days
	MSB 364 days	10 months–1 year
	MSB 2 years	1 year–2 years
Financial	KDB 1 years	10 months–1 year 1 month
Corporate	Corp 3 years -non AA-	2 years 9 months–3 years

KDB = spell out; KTB = Korea Treasury bond; MSB = monetary stabilization bond; NHB = National Housing Bonds;
Source: Korea Exchange. www.krx.co.kr

F. Transparency in Bond Pricing

Transparency in the Republic of Korea OTC bond market has been enhanced so dramatically due to the KOFIA's role as a self-regulatory organization.

1. The Role of Korea Financial Investment Association

KOFIA, based on FSCMA, FSC Regulations under FSCMA, and FSC Enforcement Rules under FSCMA, manages the information related to the transactions of bonds and their disclosure. Through these actions, KOFIA enhances the price discovery function of the OTC bond market and increases price transparency. In addition, KOFIA is working toward developing a wide variety of policies in order to help the development of the Korean bond market.

2. Disclosure of Real-Time Bond Index

The purpose of the disclosure is to yield real-time bond index based on KOFIA's FreeBond, which is used as a benchmark index for bond ETFs (see Table 3.16).[22] The expected effect is to understand real-time trends of the bond market in the following areas:

Table 3.16 Types of Real-Time Bond Index

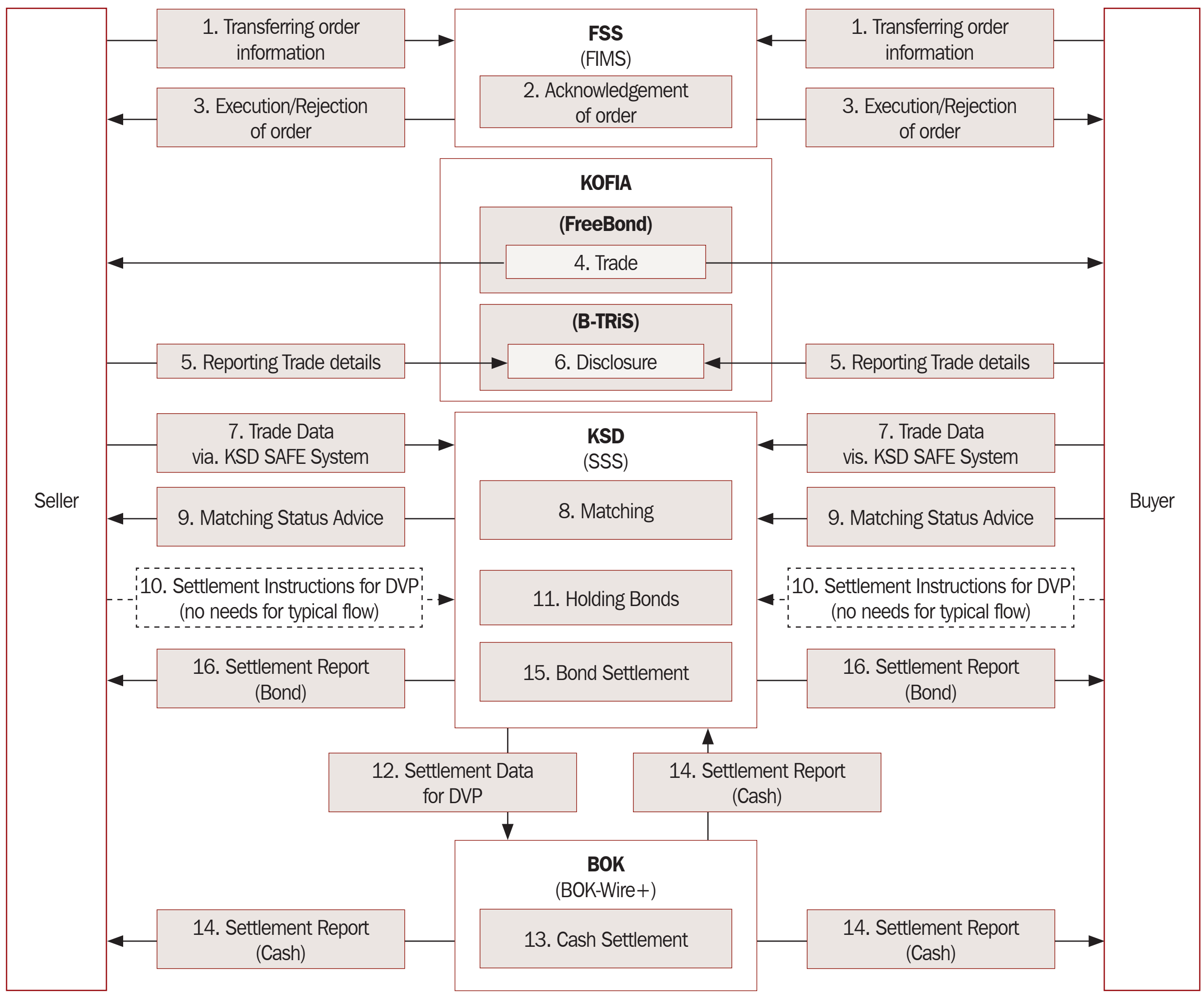
Index Name	Cycle	Source	First Disc.	Starting Index	Standard Point of Time
MKFTB Index	30 second	FreeBond	June 2009	100	'04.6.16
KTB Index	1 minute	Collected by KRX, etc.	June 2009	10,000	'09.6.1
KEBI TB Index	5 minute	FreeBond	July 2009	100	'09.6.30
MK MSB Index	1 minute	FreeBond	January 2010	10,000	'10.1.1
MK MMI* Index	1 minute	FreeBond	July 2010	10,000	'10.6.1
KOBI Credit Index	1 minute	FreeBond	December 2010	10,000	'10.9.1

Source: Korea Financial Investment Association

a. (Investor-side) Facilitate spread trading between spot bonds and bond ETFs, and enable investment in baby bonds.
b. (Issuer-side) Reduce capital-raising costs due to the increased demand.
c. (Financial firms-side) Use as a standard to evaluate investment performance and as a risk management index.

22 Footnote 1, p.156–159.

G. Business Process Flowchart (Over-the-Counter Market/Delivery versus Payment)



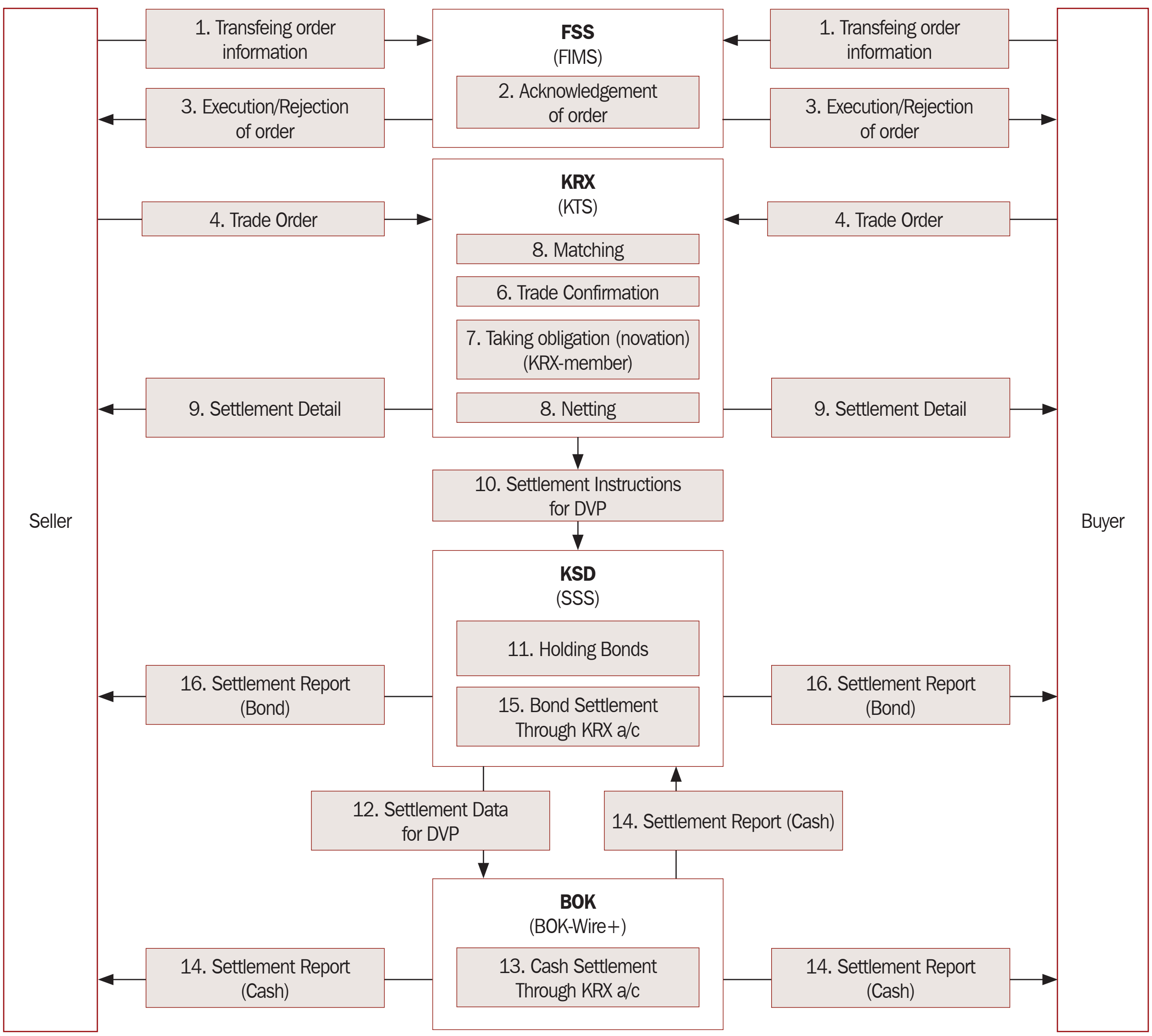
Source: ABMF SF2.

OTC Market

1. If the client is a foreign investor, the seller side and/or the buyer side of securities companies transfer order information to Financial Supervisory Service (FSS) via Foreign Investment Management System (FIMS).
2. FSS acknowledges or rejects order.
3. If holding is enough, FSS transfers order information to the seller side and/or the buyer side of securities companies and Korea Exchange.
4. The seller and buyer trade over the counter with a formalized bond trading system, whose name is FreeBond.
5. Both the seller and buyer must report trading details to the KOFIA within 15 minutes after trading execution.
6. KOFIA discloses this information on its Bond-Trade Report and Information Service (B-TrIS).

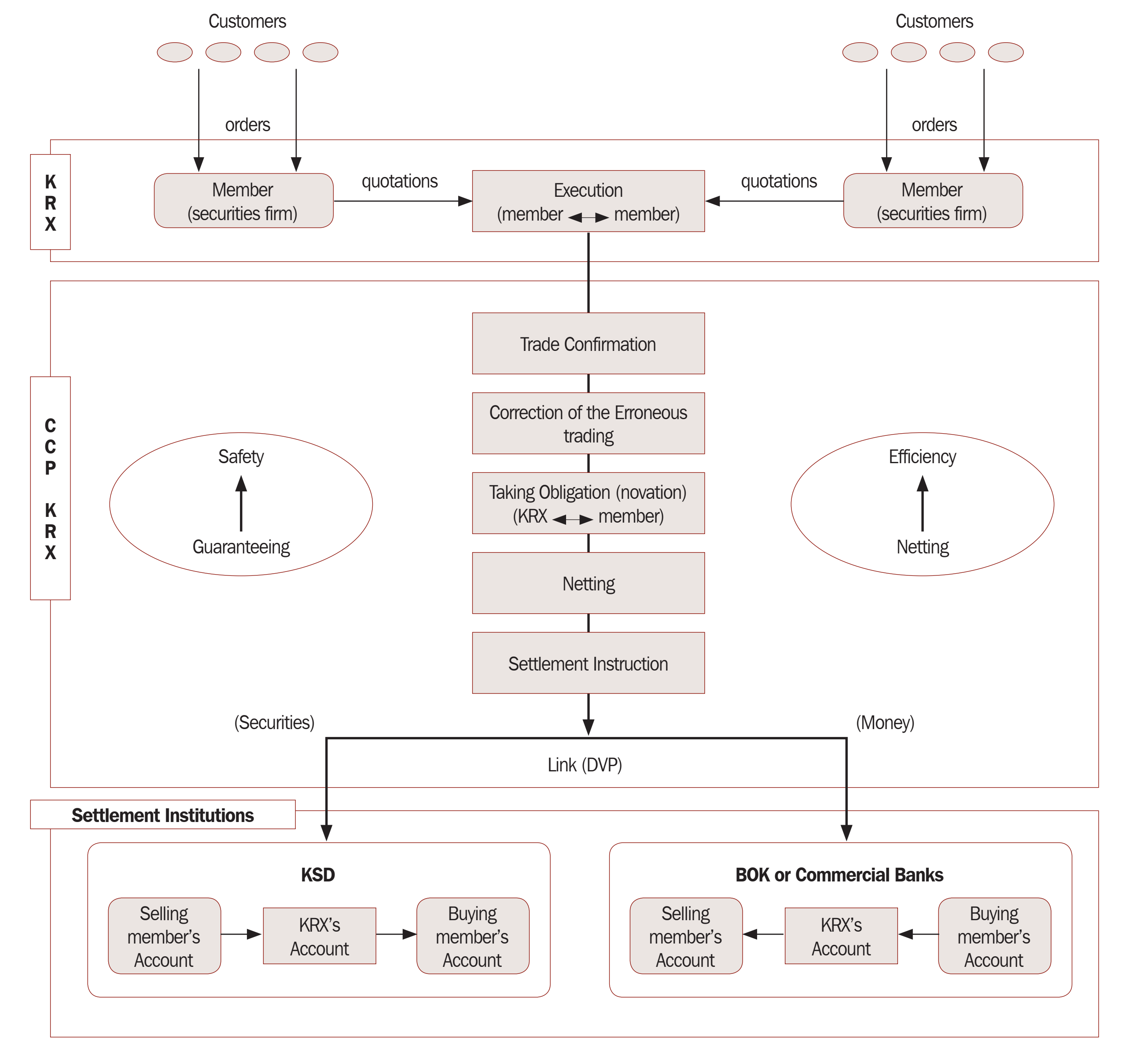
7. The seller and buyer send trade data to KSD.
8. KSD collates trade data from the seller and buyer.
9. KSD sends matching status advise to the seller and buyer.
10. The seller and buyer send settlement instructions for DVP to KSD.
11. KSD holds bonds before cash settlement.
12. KSD sends settlement data to BOK.
13. BOK executes cash settlement.
14. BOK sends settlement report to the seller, the buyer and KSD.
15. KSD executes bond settlement.
16. KSD sends settlement report to the seller and buyer.

H. Business Process Flowchart (Exchange Market/Delivery versus Payment)



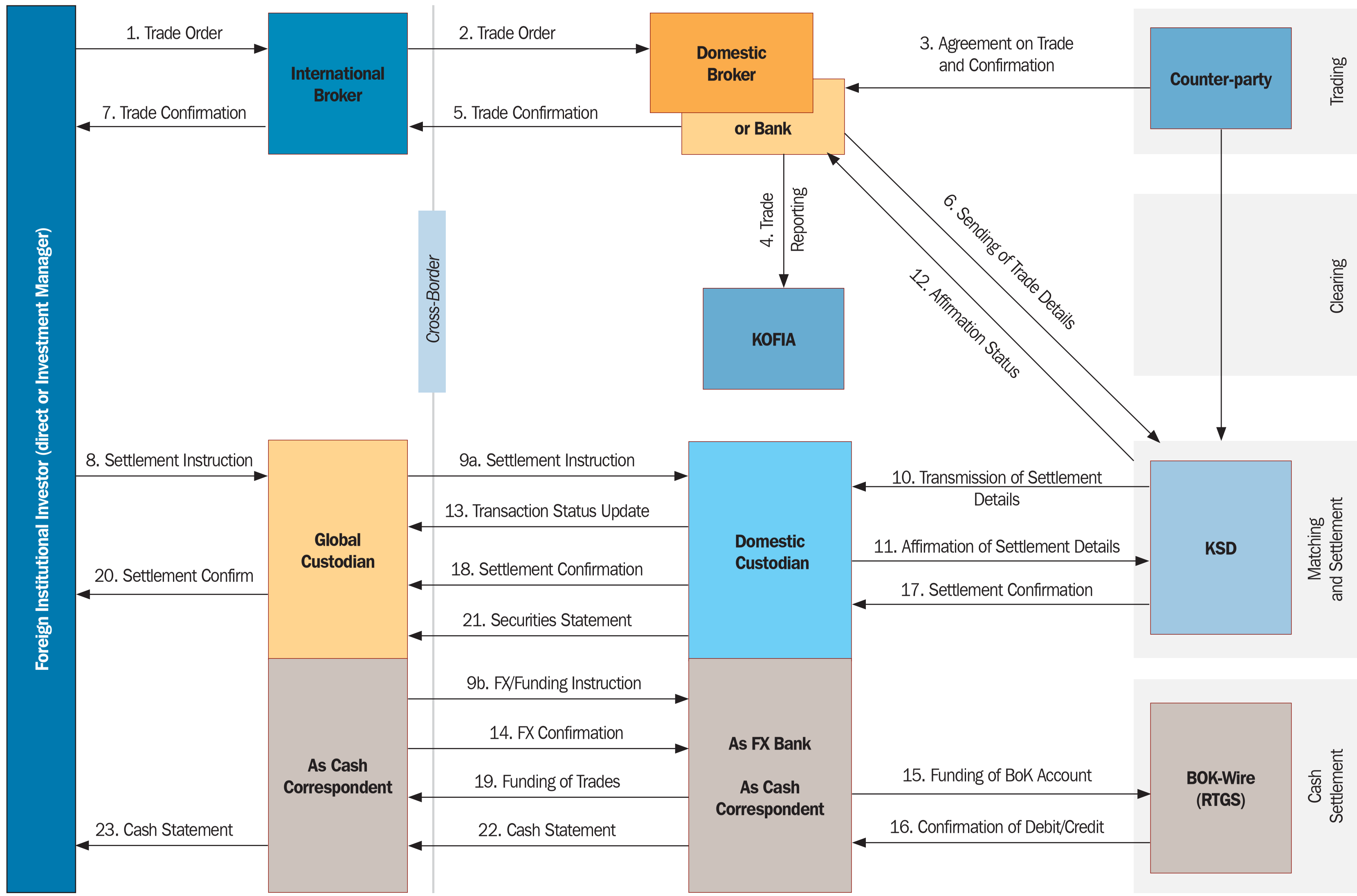
Source: ABMF SF2.

Clearing / Settlement Flow Chart provided by Korea Exchange



Source: ABMF SF2.

I. Korea Over-the-Counter Bond Transaction Flow (For Foreign Investors)



Source: ABMF SF2.

Trade Date: T
Settlement Date: T+2

Description of Steps in the OTC Bond Transaction Flow for Foreign Investors

Trade Date

1. Foreign Institutional Investor places order with International Broker
2. International Broker places order with Domestic Broker/Bank
3. Domestic Broker/Bank trades OTC with Counterparty (via phone or, e.g., Bloomberg)
4. Domestic Broker/Bank and Counterparty report trade to KOFIA within 15 minutes of trade
5. Domestic Broker/Bank send trade confirmation to International Broker
6. Domestic Broker/Bank sends trade details to KSD
7. Foreign Institutional Investor receives trade confirmation

T+1

8. Foreign Institutional Investor instructs Global Custodian on securities settlement details, and foreign exchange (FX)/funding
9. Global Custodian instructs Domestic Custodian on (a) securities settlement details, and (b) FX/funding requirements
10. KSD sends Preliminary Settlement Data to Domestic Custodian, via SAFE
11. Domestic Custodian affirms settlement details
12. KSD sends affirmation status to Domestic Broker/Bank
13. Domestic Custodian reports transaction status update to Global Custodian
14. Domestic Custodian sends FX confirmation to Global Custodian

Settlement Date

15. Domestic Custodian funds BOK account
16. Upon transfer of cash, BOK sends settlement confirmation to Domestic Custodian
17. Upon transfer of securities, KSD sends settlement confirmation to Domestic Custodian
18. Domestic Custodian sends settlement confirmation to Global Custodian
19. Global Custodian funds account with Domestic Custodian, or into foreign currency (FCY) nostro (before end of day)
20. Global Custodian sends settlement confirmation to Foreign Institutional Investor
21. Domestic Custodian sends securities statement to Global Custodian
22. Domestic Custodian sends cash credit/debit confirmation in cash statement to Global Custodian
23. Global Custodian sends credit/debit confirmation in cash statement to Foreign Institutional Investor (FII)

Additional Comments on the OTC Bond Transaction Flow for Foreign Investors

- Bond transactions in the OTC market have been subject to mandatory book-entry settlement (at KSD) since 1995. Market participants pre-match through KSD's InSet system

- OTC market participants have option to negotiate settlement date between T+1 and T+30. Assumption of T+2 of more representative for FII trades
- 4 – Trade reporting by all trading counterparties to KOFIA within 15 minutes
- 6 – Here, trading counterparties actually send trade details into KSD
- 10 – KSD sends future settlement details to Domestic Custodian, and
- 11 – Domestic Custodian only needs to affirm/confirm details, based on client instructions received
- 12 – Subsequently, KSD send affirmation status back to trading counterparty
- 16,17 – Sequence set based on typical sequence in other markets, where CSD sends request for funding, cash then settles first, upon which securities side settles; whether sequence of actual sending confirmations is as expected, would need to be confirmed

Table 3.17 Questions and Answers related to Market Infrastructure: InSet and SAFE

Questions	Answers[a]
Exactly what does InSet represent, at what stage in the settlement process?	1) Definition InSet stands for Institutional Settlement, and refers to the settlement of over-the-counter (OTC) securities. For OTC bond transactions, Bond Institutional Settlement handles the entire settlement process. 2) Features (RTGS) The Bond Institutional Settlement system processes the settlement of securities and cash for OTC transactions of bonds, CDs, and CPs in the RTGS (Real-Time Gross Settlement, DVP model 1) method to eliminate principal risk. (Consecutive settlement) In addition, taking account of the characteristics of OTC bond transactions, the Bond Institutional Settlement also implemented 'consecutive settlement,' to reduce settlement liquidity risk for participants. (Cash settlement through central bank) The Bond Institutional Settlement system is connected to the Bank of Korea BOK-Wire+ by CCF (Computer-to-Computer Facility) method, and settlement operations are conducted by exchanging electronic messages. 3) Access paths (Participation) An application must be submitted to participate in Bond Institutional Settlement. The documents required for application are Account Opening and Participation Application Form, Cash Settlement Account Reporting Form, and documentation for authorized operations staff. (Link between participant and KSD) The participant (securities firm, asset management company, custodian bank, etc.) is linked to KSD by CCF. Participants who do not have this type of connection can process operations by means of web server.
Exactly what does SAFE represent, at what stage in the settlement process: we also heard of SAFE+?	SAFE is the acronym of the information technology (IT) system implemented and operated by KSD in order to conduct its CSD functions. (SAFE stands for Speedy, Accurate, Faithful and Efficient.) SAFE+ (SAFE Plus) is KSD's next generation system. The former system was overhauled to enhance efficiency and stability. SAFE+ went live in February 2011 and it is the current system operated by KSD.[b]

continued on next page

Table 3.17 continuation

<table>
<tr><th>Questions</th><th>Answers[a]</th></tr>
<tr><td>KSD's Next Generation System SAFE+?
(Korea Securities Depository Newsletter)</td><td>KSD's Next Generation System SAFE + went live on 7 February 2011, after a development period of over 23 months.

Background:
The object of KSD's Next Generation System implementation was to respond swiftly and flexibly to rapidly changing financial environment and customer needs, and to evolve into a customer-oriented low-cost high-performance global IT system.
Ten years had passed since the existing SAFE system was set up, and the aging IT system and low capacity became factors of instability and reduced scalability.
The lack of system flexibility restricted the entry of new products, and expansion of account number and account book structures, as well as causing other IT and business operations issues.
These factors ultimately necessitated the implementation of a new IT system.

KSD Next Generation System Implementation Background
1) Instability and lack of scalability due to aging system and insufficient capacity
2) Restrictions on introducing new products and creating global linkages caused by the system's complexity and lack of flexibility
3) Increasing customer complaints and unsatisfactory response to various customer needs due to provider-oriented IT scheme
4) Limitations on accommodating new participant and services types due to lack of scalability
5) A need to prepare foundation for introducing the Electronic Securities System

Development Period
KSD launched the Next Generation IT System Task Force in July 2007, and established a comprehensive implementation plan.
Then in the project preparation stage, BPR/ISP consulting for system implementation was conducted for six months beginning from December 2007 in order to establish the directions and Master Plan.
Based on the results of the BPR/ISP consulting, the SI, external PMO and system auditor for the project were selected, and the SI project took off on 6 March 2009.
* SI Project Period: 6 March 2009 to 7 February 2011 (23.5 months)

Major Tasks
Twelve project tasks including backbone system implementation went live in three stages. The SI project commenced in March 2009, with the 1st stage ITAMS system going live in October 2009, and the ERP and EP system in 30 November 2009.
The backbone operations system, the core of the Next Generation System, was developed for a period of 23.5 months: analysis 4 months, design 5 months, development 7 months, integration testing 5 months, and user testing 2 months.

Next Generation System Project Tasks

<table>
<tr><th>Stage</th><th>Project Task</th><th>Live Date</th></tr>
<tr><td>Stage 1</td><td>ITAMS</td><td>26 October 2009</td></tr>
<tr><td>Stage 2</td><td>ERP
EP(Enterprise Portal)</td><td>30 November 2009</td></tr>
<tr><td>Stage 3</td><td>Backbone operation system
Data standardization and metadata system
Network
Server/infrastructure
Database system
Security system
AP based monitoring system (ATMS)
Integrated IT management system (ITMS)
Unified messaging system (UMS)</td><td>7 February 2011</td></tr>
</table>
</td></tr>
</table>

continued on next page

Table 3.17 continuation

Questions	Answers[a]

Backbone operation system program development scale: 6,285 lines of code (LOC)

Operation	LOC	Operation	LOC
Securities Deposit	962	Securities Settlement	495
Entitlements	557	Collective Investment	951
Securities Management	971	Transfer Agent	706
International	553	Securities Registration	474
Securities Info	188	Common	428

Additionally, the KSD Next Generation System implementation project applied organized project management and methodology in conducting the project, and attained CMMI* Level3 upon system launch.

* Capability Maturity Model Integration (CMMI): System development and maintenance process improvement and organization maturity model developed by the Carnegie Mellon Software Engineering Institute (SEI)

Major Changes After Implementing the Next Generation System

The deposit and settlement system was overhauled and re-implemented to realize a customer-oriented system, bringing the following changes in terms of customers, IT system and business operations.

1) Enhanced customer convenience and service quality
- Customer-oriented User Interface. The previously separate SAFE and e-SAFE systems were integrated into a single UI to increase convenience. The new UI combines the former interface which was divided by the type of securities, operations and system into one single user-friendly UI.
- Improved file download/upload function. Automatic transmission of large volume data, such as beneficial owners lists which customers frequently send to KSD, by means of a Web Service method was introduced, eliminating the inconvenience of manually uploading and downloading files and enabling swift data processing.
  * HTTP and standardized messaging (XML) based data delivery method
- Integrated customer and user info management. User information, which had previously been managed separately for each system, has been integrated into one data management system to enhance customer service support.

2) Scalable and flexible system
- Support for electronic underwriting and issuance for financial bonds. Financial bond issuance and underwriting information was previously exchanged by means of instant messaging clients. The new system incorporated it into the financial bond electronic underwriting and issuance support system, enhancing efficiency and reducing risk.
  Data regarding issuance/underwriting, pre-notices, contracts, and related documents can be received and processed through the system.
- Speedier accommodation of new instruments. The operation of the deposit system used to be divided by securities type. It is now integrated to enable the flexible accommodation of new instruments.
- Foundation for the Electronic Securities System. By building a web system exclusively for issuing companies, one-stop services for corporate actions including capital increase, voting and appraisal rights can be provided. This also prepares the ground for retail investors and non-financial companies to hold deposit accounts as direct participants when the Electronic Securities System is implemented.

3) Enhanced stability and efficiency of deposit & settlement services
- Reorganized participant account number and management structure. The account numbering system has been extended (7 digits → 12 digits) to prepare for the inclusion of different account types after the implementation of the Electronic Securities System.
- Set-up for absorption of Separate Safe Custody System into Deposit System. The transition of the Separate Safe Custody System, based on physical shares, into the Deposit System, will be promoted in order to eliminate the inefficiency of issuing paper certificates and remove the legal risk associated with the beneficial owner and safe custody applicant being different parties.

continued on next page

Table 3.17 continuation

Questions	Answers[a]
	• Enhanced support for derivatives services. The application of the Computer to Computer Facility (CCF) method was expanded for securities lending and borrowing, Repo and secured call loan management system to dramatically speed up operation processing. • Expanded processing capacity of FundNet. In response to the growth and globalization of the fund market, the daily processing capacity of FundNet has been tripled (22,000 to approximately 60,000 cases). • Increased automation of corporate actions processing for foreign currency securities. The scope of automated corporate action services for foreign currency securities has increased from one type (cash dividends) to 6 types (capital increase, stock dividends, voting rights, etc.). 4) Application of latest IT and increased performance • For development, the CBD methodology was applied to draw business components to increase development productivity and enhance system scalability and flexibility. • In terms of UI, .Net Smart Client technology was adopted to improve performance and maximize user convenience. • The server and daily processing capacity has been doubled from that of the previous system. Processing speed is also expected to be twice as fast as the former system. KSD Next Generation System IT and Performance Changes

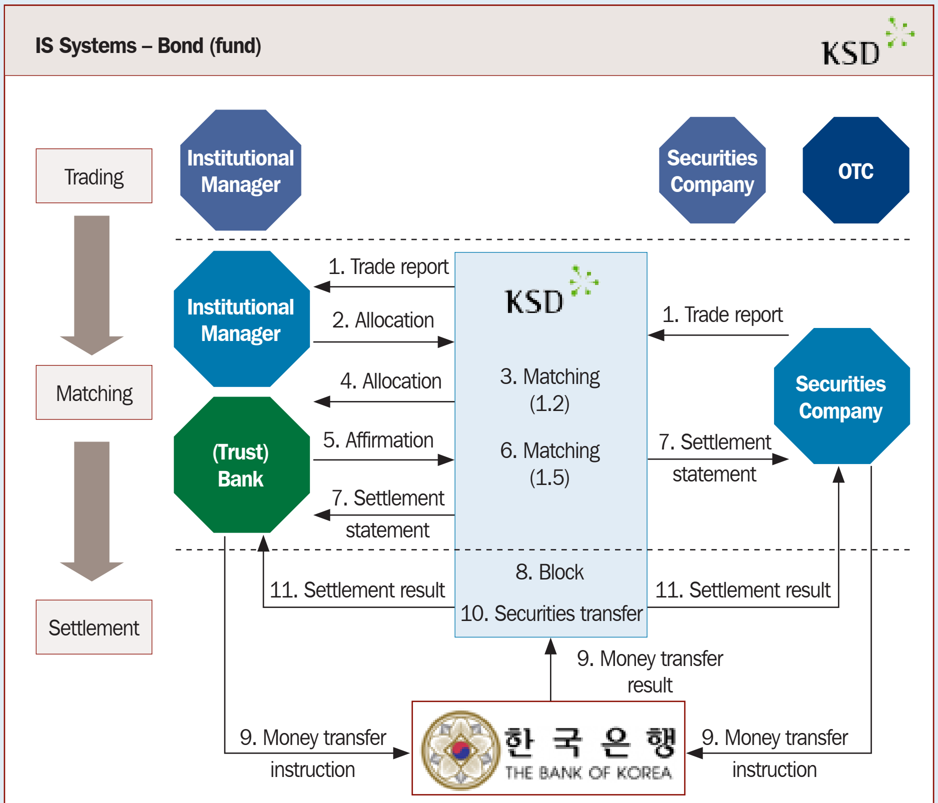
Division	SAFE	SAFE PLUS
Development Methodology	Information Engineering	Component-Based Development (CBD)
UI	ActiveX-Internet	.Net Smart Client
Interface	Closed and Web (html)	SOA-oriented Web Service
Server Capacity	approx 2.2 million tpmc	approx 6.45 million (2.9)
Processing Capacity (Daily)	approx 3.8 million	approx 8.34 (2.2)
Processing Speed	Speed increased over x 2	

Expected Effects

KSD's Next Generation System has been developed with the objectives of: i) expanding automation of operations, ii) creating customer-friendly user interface, iii) expanding processing capacity to respond to changes in the financial environment, and iv) implementing a system compliant with international standards.
The implementation of the Next Generation System is expected to bring cost reduction and value improvement amounting to about W43 billion annually for the entire market including both KSD and customers.

[a] Answer provided by Korea Securities Depository.
[b] Details are shown on the article in *KSD Newsletter,* Spring 2011.
Source: Korea Securities Depository.

Table 3.18 Questions and Answers related to Clearing/Securities Settlement (Answered by KSD)

<table>
<tr><th>Questions</th><th>Answers[a]</th></tr>
<tr><td>Please provide a very detailed flow identifying components and cut-off times, after internal deliberation:</td><td>Daily Operations
• Receipt of trade report and affirmation (by 7:00 p.m. on T+0)
Participant, ISIN, Quantity, Price, Consideration, Classification for bid or offer, Intended settlement date, Commission, Tax, etc.
• Correction of trade report is possible
• Transmission of settlement statement (7:00 p.m. on T+0)
• Securities block of the seller’s deposited balance (from 9:30 a.m. on T+1)
• Delivery and Payment (from 9:30 a.m. to 5:00 p.m. on T+1)


Source: ?????.</td></tr>
<tr><td>Market materials mention T+1 to T+30: some market participants mentioned T+0 settlements: so is it rather T+0 to T+30?</td><td>It depends on what criterion is used. The settlement cycle of OTC bonds transactions is T-1 to T+30. However, if exceptions and other transactions are included, the settlement cycle can be deemed to be T+0 to T+30.
<table>
<tr><th>KRX/OTC</th><th>Securities Type</th><th>Settlement Cycle</th></tr>
<tr><td>KRX</td><td>Trading of Government Bond</td><td>T+1</td></tr>
<tr><td>KRX</td><td>Trading of Bond Repurchase Agreement</td><td>T</td></tr>
<tr><td>KRX</td><td>Trading of Retail Bond</td><td>T</td></tr>
<tr><td>OTC</td><td>Bonds</td><td>T+1(T*)~T+30</td></tr>
<tr><td>OTC</td><td>CD, CP</td><td>T</td></tr>
<tr><td colspan="3">* Settlement on trade day (T) is possible in some exceptional cases.</td></tr>
</table></td></tr>
<tr><td>Officially T+1 for bonds, but T+2 to T+4 evident for FII trades: key question: what should be the mention in the SF1 ‘ultimate market guide?</td><td>The settlement cycle of the KSD bond settlement system is T+1 (from date of Trade Data input to date of Settlement Completion).</td></tr>
</table>

continued on next page

Table 3.18 continuation

Questions	Answers[a]
KSD system (which one actually) cut-off for OTC trades at EOD on T: Custodians cannot confirm in absence of client instruction: brokers forced to cancel/delete trade; then re-input into KSD on T+1(which could be SD).	There are two types of cut-off in the KSD system. One is the cut-off for inputting trade data on trade date (T), and the other is the cut-off for settlement on settlement date (T+1). Your statement above describes a situation in which the broker has entered the trade data before the EOD on T but the custodian has not confirmed the trade due to delay/absence of instruction from the client, causing the broker to delete the trade and re-input them on the next day (settlement date). However, if trade data is entered before the cut-off, and the custodian is unable to confirm the trades that day, the custodian can confirm the trades next day on the settlement date and process the settlement. Therefore, there is no need for the broker to delete the trade data and re-enter it on the settlement date.

[a] Answer provided by Korea Securities Depository.
Source: Korea Securities Depository..

J. Short Sale of Bonds

The regulating method on short sale of bonds is stipulated in FSCMA and Enforcement Rule of FSCMA. The regulation on short sale of bonds is less strict compared to that of equity securities. According to FSCMA, investors are not allowed to make short sale on the listed equity-linked bonds such as convertible bonds, bonds with warrant, participating bonds, and exchangeable bonds. On the other hand, other bonds are eligible for short sale.

As far as the listed equity-linked bonds, while naked short sale is not permitted, covered short sale is allowed. In case of conducting a covered short sale or placing a quotation after receiving an entrustment for a covered short sale, a member should not submit the quotation at a price lower than the latest market price.

In the OTC market, Enforcement Decree of FSCMA and Enforcement Rule of FSCMA allow only the "investment trader" prescribed in FSCMA to conduct short sale of bonds, both covered short sale and naked short sale. When conducting the short sale, the quotation price should be lower than the latest market price of both in the KRX market and OTC market. However, banks are currently prohibited from conducting the naked short sale.

K. Korea Treasury Bonds Exchange-Traded Funds Market

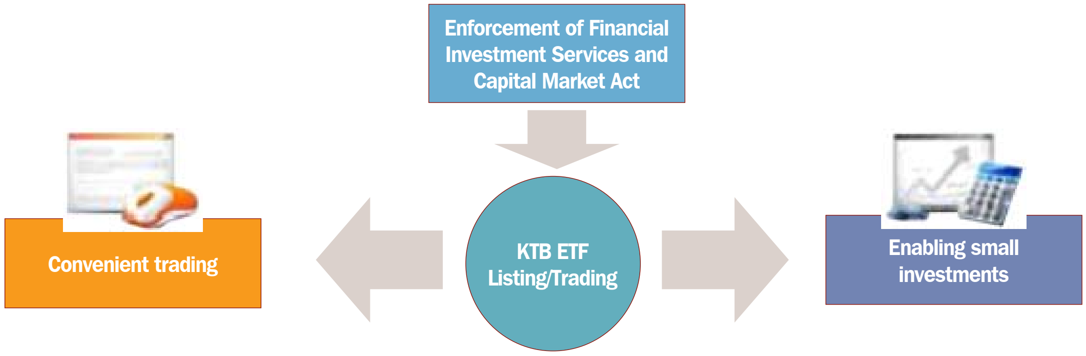
The enforcement of the FSCMA in February 2009 has led the introduction of ETFs tracking the yields of KTBs.[23] Subsequently, 3-year KTB ETFs were introduced in July 2009. Since KTBs are traded in the inter-dealer market in the Korea Exchange ("KRX") participated by mainly Institutional Investors, where the minimum trading unit is KRW 1 billion, and in the OTC market participated by the securities companies, where the average trading unit is KRW 10 billion, it is not easy for the retail investors to directly invest in KTBs. However, since KTB ETFs are priced at a range of W5,000 to W100,000 per share, the retail investors with small investment capital can easily purchases KTB ETFs, subsequently increasing the popularity of bond investment. As

[23] An Exchange Traded Fund (ETF) is an index fund designed to track the movement of underlying index and is traded like stocks in the exchanges. As an index fund, ETF offers the convenience of trading stocks, as well as the advantage of diversified investment.

of May 2010, five ETFs tracking the yield of 3-year KTBs are listed in the KRX, and it is expected that more KTB ETFs will be listed in the future.

To list KTB ETF on the KRX, the asset under management must be at least W10 billion and more than 100,000 shares must be issued. Settlement method of KTB ETF is the same as that of stocks. KTB ETF is settled on T+2 day, using the book entry clearing method through the account in the KSD.

Figure 3.6 Process to List or Trade KTB ETF on the KRX



Source: Korea Exchange.

Table 3.19 Listed Korea Treasury Bond Exchange-Traded Funds

Bond Index	Management Company	Name of ETF	Trust Principal	Listed Date
KTB index	Woori Asset Management KB Asset Management Mirae Asset Maps Korea Investment Trust	KOSEF KTB K-Star KTB Tiger KTB3Y KINDEX TB	W300 billion W300 billion W120 billion W100 billion	31 July 2009 29 July 2009 27 August 2009 31 July 2009
MKF TBI	Samsung Asset Management	KODEX TBOND	W100 billion	29 July 2009

Source: Korea Exchange.

Table 3.20 Korea Treasury Bond Exchange-Traded Funds Trading System

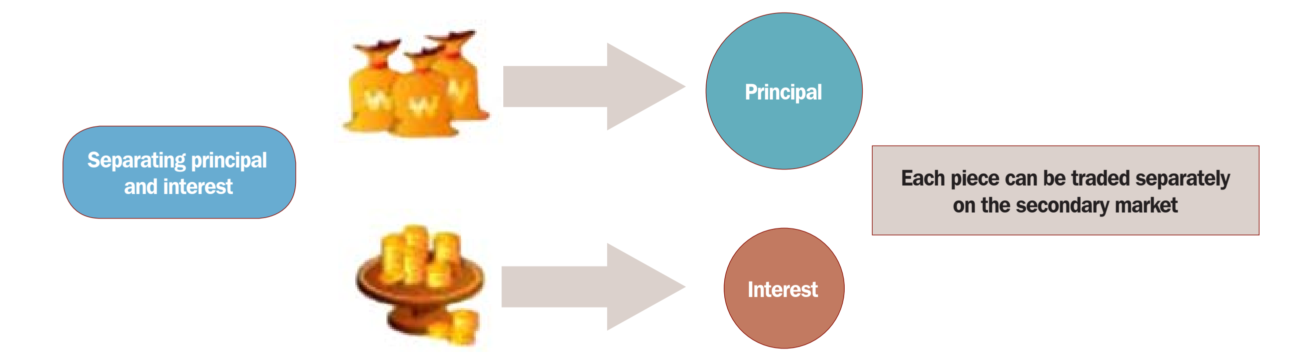
Item	Description
Trading hour	Regular session (9:00 a.m. – 3:00 p.m.) Off-hours session (7:30 a.m. – 8:30 a.m., 3:10 p.m. – 6:00 p.m.)
Tick size	W5
Trading unit	1 unit
Daily price limit	± 15%
Types of orders	Limit order, Market order, Limit-to-market-on-close order, Immediately executable limit order, Best limit order
Short selling	Allowed (Uptick rule is not applied)

* Trading hour, daily price limit and the types of order are the same as those of stocks.
Source: Korea Exchange.

L. Separate Trading of Registered Interest and Principal of Securities

Separate Trading of Registered Interest and Principal of Securities (STRPS) refers to the bonds whose coupons have been separated from the principal.

Figure 3.7 Separate Trading of Registered Interest and Principal of Securities



Source: Korea Exchange.

For example, 5-year KTB issued on 10 September 2010 pays the interests on 10 March and 10 September of each year for the next 5 years. By stripping this 5-year KTB, a total of 11 zero-coupon bonds (10 coupon payments and one principal) may be traded. The opposite concept of the STRIPS is called "reconstitution," which is recombining each zero coupon bonds into original one.

STRIPS was first introduced in the US in 1985, and now used in many Organisation of Economic Co-Operation and Development countries, including Canada, Belgium, Germany, Italy and Japan. Republic of Korea first introduced STRIPS for 5-year KTB in March 2006 to promote the growth of market for long-term bonds. However, the stripping of KTBi is not allowed because the principal of KTBi is linked to inflation. The KTB holder can request stripping of KTB using the BOK-Wire via the KSD. Same method can be applied to send the written request for the reconstruction.

M. Bond-Related Futures Market: Korea Treasury Bonds Futures Market

1. Korea Treasury Bonds Futures Trading System

As the issuance volume of KTBs increased, KTB futures was introduced to provide a risk management tool in September 1999. Along with the growth of bond market size and introduction of bond mark-to-market requirement in July 2000, there was a need to manage the risk associated with the price volatility. To address this need, 3-year KTB futures was introduced first, and then 5-year KTB futures in August 2003 and 10-year KTB futures in February 2008 to provide the tools for managing the risk of price volatility of medium-term and long-term KTB.

Table 3.21 Korea Treasury Bonds Futures Trading System

	10 year KTB Futures	5 year KTB Futures	3 year KTB Futures
Underlying asset	10 year KTBs with 5% coupon rate (Face value W100 million)	5 year KTBs with 5% coupon rate (Face value W100 million)	3 year KTBs with 5% coupon rate (Face value W100 million)
Trading unit	Face value W100 million	Face value W100 million	Face value W100 million
Tick size	0.01	0.01	0.01
Tick value	W10,000 (= 100,000,000 × 0.01 × 1/100)	W10,000 (= 100,000,000 × 0.01 × 1/100)	W10,000 (= 100,000,000 × 0.01 × 1/100)
Trading hour	9:00 a.m. – 3:15 p.m. (Last trading day: 9:00 a.m. – 11:30 a.m.)	9:00 a.m. – 3:15 p.m. (Last trading day: 9:00 a.m. – 11:30 a.m.)	9:00 a.m. – 3:15 p.m. (Last trading day: 9:00 a.m. – 11:30 a.m.)
Contract month cycle (Listed contract months)	March, June, September, and December (2 contract months)	March, June, September, and December (2 contract months)	March, June, September, and December (2 contract months)
Last trading day (Final Settlement day)	Third Tuesday of the contract month (the next business day following the last trading day: t+1)	Third Tuesday of the contract month (the next business day following the last trading day: t+1)	Third Tuesday of the contract month (the next business day following the last trading day: t+1)
Settlement method	Cash settlement	Cash settlement	Cash settlement
Daily price limit	None	None	None
Quotation price limit	Base price ± 2.7%	Base price ± 1.8%	Base price ± 1.5%
Launch date	25 February 2003	22 August 2003	29 September 1999

Source: Korea Exchange.

2. Specification of 3-Year Korea Treasury Bond Futures

Table 3.22 3-Year Korea Treasury Bonds Futures

Item	Description
Underlying Asset	3-Year Korea Treasury Bond with 5% coupon rate and semiannual coupon payment
Contract Size	W100 million
Contract Months	The first two consecutive months in the quarterly cycle (March, June, September, and December)
Trading Hours	9:00 a.m. to 3:15 p.m. (09:00 a.m. to 11:30 a.m. on the last trading day)
Tick Size and Value	0.01 point, representing a value of W10,000
Last Trading Day	Third Tuesday of the contract month
Final Settlement Day	The following day of the last trading day
Final Settlement	Cash
Position Limit	It can be adopted when the KRX deems necessary
Listing Date	29 September 1999

Source: Korea Exchange.

3. Underlying Basket Bonds for 3-Year Korea Treasury Bond Futures

Table 3.23 Underlying Basket Bonds for 3-Year Korea Treasury Bonds Futures

Underlying basket bonds used to determine the final settlement price for KTB3 F 1203

Issue Name	Code No.	Issue Date	Maturity	Coupon Rate
Treasury 0350–1406	KR1035017162	10 June 2011	10 June 2014	3.50%
Treasury 0300–1312	KR10350170C2	10 December 2010	10 December 2013	3.00%
Treasury 0350–1609	KR1035017196	10 September 2011	10 September 2016	3.50%

continued on next page

Table 3.23 continuation

Underlying basket bonds used to determine the final settlement price for KTB3 F 1206				
Issue Name	**Code No.**	**Issue Date**	**Maturity**	**Coupon Rate**
Treasury 0325–1412	KR10350171C0	December 10, 2011	December 10, 2014	3.25%
Treasury 0350–1406	KR1035017162	June 10, 2011	June 10, 2014	3.50%
Treasury 0350–1609	KR1035017196	September 10, 2011	September 10, 2016	3.50%

Source: Korea Exchange.

Among KTBs with a 6-month coupon payment, KRX has the discretion to select single or plural bonds which will be included in the basket and then used to compute the final settlement price. KOFIA sends KRX the yields for each individual bond in the basket, as of 11:30 a.m. and 3:30 p.m. every trading day, and KOFIA also distributes the information to KOSCOM and other information vendors.

4. Five-Year Korea Treasury Bonds Futures

a. Specification of 5-Year Korea Treasury Bonds Futures

Table 3.24 Specification of 5-Year Korea Treasury Bonds Futures

Item	Description
Underlying Asset	5-year Korea Treasury Bond with 5% coupon rate and semiannual coupon payment
Contract Size	W100 million
Contract Months	The first two consecutive months in the quarterly cycle(March, June, September, and December)
Trading Hours	09:00 a.m. to 3:15 p.m. (09:00 a.m. to 11:30 a.m. on the last trading day)
Tick Size and Value	0.01 point, representing a value of W10,000
Last Trading Day	Third Tuesday of the contract month
Final Settlement Day	The following day of the last trading day
Final Settlement	Cash
Position Limit	It can be adopted when the KRX deems necessary
Listing Date	22 August 2003

Source: Korea Exchange.

b. Underlying Basket Bonds for 5-Year Korea Treasury Bonds Futures

Table 3.25 Underlying Basket Bonds for 5-Year Korea Treasury Bonds Futures

Underlying basket bonds used to determine the final settlement price for KTB3 F 1203				
Issue Name	**Code No.**	**Issue Date**	**Maturity**	**Coupon Rate**
Treasury 0350–1609	KR1035017196	10 September 2011	10 September 2016	3.50%
Treasury 0400–1603	KR10350171399	10 March 2011	10 March 2016	4.00%
Underlying basket bonds used to determine the final settlement price for KTB3 F 1206				
Issue Name	**Code No.**	**Issue Date**	**Maturity**	**Coupon Rate**
Treasury 0350–1609	KR1035017196	10 September 2011	10 September 2016	3.50%
Treasury 0400–1603	KR10350171399	10 March 2011	10 March 2016	4.00%

Source: Korea Exchange.

5. Ten-Year Korea Treasury Bonds Futures

a. Specification of 10-Year Korea Treasury Bonds Futures

Table 3.26 Specification of 10-Year Korea Treasury Bonds Futures

Item	Description
Underlying Asset	10-Year Korea Treasury Bond with 5% coupon rate and semiannual coupon payment
Contract Size	W100 million
Contract Months	The first two consecutive months in the quarterly cycle(March, June, September and December)
Trading Hours	09:00 a.m. to 3:15 p.m. (09:00 a.m. to 11:30 a.m. on the last trading day)
Tick Size and Value	0.01 point, representing a value of W10,000
Last Trading Day	Third Tuesday of the contract month
Final Settlement Day	The following day of the last trading day
Final Settlement	Cash
Position Limit	5,000 contracts (contract month in which the last trading day belongs)
Listing Date	25 February 2008

Source: Korea Exchange.

b. Underlying Basket Bonds for 10-Year Korea Treasury Bonds Futures

Table 3.27 Underlying Basket Bonds for 10-Year Korea Treasury Bonds Futures

Underlying basket bonds used to determine the final settlement price for KTB3 F 1203				
Issue Name	**Code No.**	**Issue Date**	**Maturity**	**Coupon Rate**
Treasury 0425-2106	KR1035027161	10 June 2011	10 June 2021	4.25%
Treasury 0500-2006	KR1035027062	10 June 2010	10 June 2020	5.00%
Underlying basket bonds used to determine the final settlement price for KTB3 F 1206				
Issue Name	**Code No.**	**Issue Date**	**Maturity**	**Coupon Rate**
Treasury 0425-2106	KR1035027161	10 June 2011	10 June 2021	4.25%
Treasury 0500-2006	KR1035027062	10 June 2010	10 June 2020	5.00%

Source: Korea Exchange.

Among KTBs with a 6-month coupon payment, KRX has the discretion to select single or plural bonds which will be included in the basket and then used to compute the final settlement price. KOFIA sends KRX the yields for each individual bond in the basket, as of 11:30 a.m. and 3:30 p.m. every trading day and KOFIA also distributes the information to KOSCOM and other information vendors.

IV. Possible Impediments for the Realization of a Cross-Border Market

A. Tax-Related Issues

1. Withholding Tax on Interest Income

Republic of Korea withholds tax on interest income as a rule, with different rates applied depending on the investor's residency. For residents, a 15% withholding tax is levied on interest income from bonds. For nonresidents, a 10%–15% tax is levied for residents of countries with a tax treaty and a 25% tax is levied for residents of countries without a tax treaty.

Tax withholding on interest income affects the after-tax rate of return. Even if the host country does not withhold tax on interest income, foreign investors must pay tax in their home country. In addition, if the host country does levy withholding tax and if it exceeds the tax amount that foreigners have to pay to their home country, they can receive reimbursement for the difference. Accordingly, tax withholding does not necessarily lead to a lower after-tax rate of return. Nonetheless, the inconvenience arising from processing tax returns and adjusting tax based on the holding period make bond trading complicated. Thus, international bond investors, including bond funds that invest in bonds in different countries, tend to avoid countries where withholding tax is imposed.

For this reason, some countries, including developed countries, seek bond investments from foreigners by abolishing withholding tax or exempting nonresidents from withholding tax on interest income. The Working Group 2 organized under the Asian Bond Market Initiative (ABMI) recommended abolishing or lowering withholding tax on interest income for foreign investors to attract increased foreign investment in domestic bonds. Following this ABMI recommendation, Thailand and Malaysia abolished their respective withholding taxes on interest income for foreign investors. In January 2009, in the middle of the currency crisis caused by the global financial crisis, the Korean government decided to exempt nonresidents from withholding tax on interest income from all government bonds and monetary stability bonds (MSBs).

2. Re-Imposition of the Withholding Tax

However the government re-imposed a flexible tax (currently 14%) on interest income and a 20% tax on capital gains from Korean Treasury Bonds (KTBs) and MSBs held by foreign investors, effective 1 January 2011. This was made following the passage of legislative bills in December calling for the restoration of the withholding tax in order to mitigate capital flow volatility and minimize systemic risks to the domestic economy.

3. Responsible Authorities

The Ministry of Strategy and Finance (MOSF) has supervisory power over tax policy and administration. Within the ministry, the National Tax Service is responsible for enforcing tax laws and regulations.

Republic of Korea, taxes are levied at both the national and local levels. National taxes consist of internal taxes, customs duties and surtaxes. Internal taxes are further subdivided into direct and indirect taxes. Local municipalities administer local taxes and such taxes include general and specific taxes. Korean securities-related taxes consist of securities transaction taxes and income taxes. The securities transaction tax is considered and indirect tax, whereas the securities income tax is part of the direct tax category.[24]

B. Disclosure and Investor Protection Rules for Issuers

1. Overview

Art. 1 of the *2009 Financial Investment Services and Capital Markets Act* (FSCMA) stipulates that "the purpose of the Act is to contribute to the development of the national economy by facilitating financial innovation and fair competition in the capital market, protecting investors, enhancing the development of the financial investment business and heightening the fairness, reliability and efficiency of the capital market."

When the financial assets of an ordinary investor are unfairly treated by a financial investment business entity or such an entity recommends financial investment instruments by providing misleading or false information that is not adequate for an ordinary investor considering their investment purpose, the investor will lose confidence in the capital market. As such, investor protection is crucial not only to protect the rights of investors as the consumers of the market, but also to promote the sound development of the capital market. Since many of the articles in FSCMA include investor protection, it is hard to detail all the relevant provisions governing investor protection; however this chapter will discuss the major provisions of FSCMA relating to investor protection.

2. Disclosure for Ordinary Investors

The term "disclosure" refers to the provision of information to general public so that anyone may have access to such information. Unlike institutional investors or other professional investors, ordinary investors are highly like to be excluded from material information that may have a significant impact on the value of stocks and other

[24] ADB, 2010, *Bond Market in Japan and Korea*, Asian Development Bank, Philippines

financial investment vehicles. Therefore, such material information shall be disclosed to ensure fair-trading in the financial market. FSCMA stipulates a series of provisions concerning the matter.

The provisions of disclosure are related to investor protection in that the purpose of these provisions is to prevent damages being inflicted upon ordinary investors due to information asymmetry. Investors shall make reasonable and informed decisions based on such publicly disclosed information.

3. Disclosure of Financial Investment Business

Information on financial investment instruments and financial investment business entities is disclosed on the Korea Financial Investment Association (KOFIA) website (http://www.kofia.or.kr). KOFIA's electronic disclosure system posts information on financial investment instruments, financial investment business entities, and professional investors. Matters that a securities company must disclose include commission rates, management disclosure, ad hoc disclosure, and net capital ratio.

Commission rates are provided by the amount of trading and the methods of transaction (online or offline). Management disclosure includes information on any cases of litigation or restrictions relevant to the securities company.

The disclosed information can be utilized to assess the compliance of the company to the internal controlling policies for investor protection. A collective investment business discloses information on asset management companies and funds.

An asset management company provides periodic disclosures including closing accounts reports, periodic reports, and periodic management disclosure as well ad hoc disclosures. A collective asset management entity shall submit an asset management report of funds at least once every three months, including the operating performance of funds, total amount of asset and liabilities of funds, the assessed value of each type of asset that belongs to the funds, the total number of stocks traded, total trading amount, turnover rate during the pertinent management period, matters concerning professional investment managers, and the fees for each investment broker.

Ad hoc disclosure for a fund and an asset management company includes the details described below. An asset management company shall immediately disclose the occurrence of any massive financial scandal or non-performing claims. Such information is material to assess the soundness of the company since any massive financial scandal or non-performing claim represents inadequate risk management or internal control systems within the company. Meanwhile, the ad hoc disclosure of funds provides information such as changes in fund managers, decisions on deferment or resumption of redemption and the reasons thereof, details of resolutions of the general meeting of collective investors, and details of a change in the base price.

The KOFIA website also posts information on professional managers including securities investment advisors, derivatives investment advisors, and fund investment advisors with their company names and business areas.

4. Disclosure in the Secondary Market

A listed company shall make periodic disclosures as well as ad hoc disclosures when it is deemed necessary. The information on a listed company is easily accessible on the website of Korea Exchange (KRX).

a. Periodic Disclosure

Periodic disclosure includes annual, semi-annual and quarterly reports. Anyone can have access to the information via the electronic disclosure system on the websites of KRX or Financial Supervisory Service (FSS). A listed corporation shall submit an annual report to Financial Supervisory Commission (FSC) and KRX within 90 days of the end of the business year. An annual report shall include an overview of the company, the trade name, details of its business, the remuneration of executives, matters concerning finance (financial statements), the accounting auditor's audit opinion, the organization of the company including the board of directors, shareholders, executives and employees, details of transactions with major shareholders, executives or employees of the company, and matters concerning investor protection. Such information is material to the selling or purchasing of stocks of the company and assessing the value of securities.

A semi-annual report is a six-monthly business report and a quarterly report is a three-monthly report calculated from the commencement date of the pertinent business year. A listed company shall submit the reports to FSC and KRX within 45 days of the closing of each term.

If any of the following events that may have a significant impact on the management of a company occur, the company shall submit a report on the details of the events to FSC by the following day from when such events occurred. The events include:

i. a bill or check issued by the corporation is returned or its check account transactions in a bank are suspended or banned;
ii. its business activities are completely or partially suspended; and
iii. there is an application filed for commencement of proceedings for rehabilitation under the *Debtor Rehabilitation and Bankruptcy Act*.

A person who has acquired or disposed of securities issued by a corporation has the right to make a claim for damages caused by a false description or an omission of a material fact in a business report. The claim for damages can be made against the directors of the corporation, the person in charge of the business report, or the auditor.

In addition, when a business report has not been submitted, or a false description or an omission of a material fact exists, the FSC may suspend any securities issuance by the company for up to 1 year, file criminal complaints, or recommend the dismissal of executives.

b. Ad Hoc Disclosure

Ad hoc disclosure refers to reports that listed companies shall prepare without delay in order to immediately notify KRX of any material changes related to their business operations. KRX provides the disclosure requirements for the stock exchange and

KOSDAQ, respectively. Since the ad hoc disclosure typically contains the material information that may have a significant impact on the value of the company and the stocks, anyone may access such information through the KRX website.

Although the ad hoc disclosure includes a massive amount of information, it can be classified into three categories and KRX shall be notified of the following information by the following day from which such events have occurred.

First, matters that may have an impact on the operation or production of a listed company, such as a full or partial suspension of business operations that takes up 10% or more of the sales volume or any administrative measures thereof; the suspension of transactions that makes up 10% or more of sales; or the conclusion of contracts for product supply or sales.

Second, events that may change the financial structure of a listed company, for example the increase and reduction of capital, retirement of stocks, disposal of treasury stocks and stock splits that may have an impact on securities issued by a listed company; new facility investments that take up 10% or more of the equity that may have an impact on production; short-term borrowings that take up 10% or more of the equity that could have an impact on the credit or liability of the company; natural disasters that could have an impact on the profit and loss of a listed company by 5% or more at the year's end; and any decisions made on stock dividends.

Third, matters that may have an impact on the management of a listed company such as any changes in corporate governance due to changes in the largest shareholders; or litigation related to the company is brought to court, or a judgment on litigation is made.

Art. 392 of FSCMA prescribes that, in order to secure the effectiveness of disclosure, banks shall notify KRX of material information that is likely to affect investors' decision without delay; for example, where any issued bill or check defaults, or where any current account transaction with the bank is suspended or prohibited.

c. Fair Disclosure

Korea's securities market introduced the fair disclosure rule in November 2002. The rule requires that if a company discloses information to selective investors and it is deliberate, the company shall also provide such information to ordinary investors at the same time. When the disclosure is accidental, the company shall disclose such information to ordinary investors on the same day without delay.

The purpose of fair disclosure is to prevent insider trading and information asymmetry, and to allow more investors to receive the material information in a timely manner. The rule also aims to make the market fairer and more transparent and thereby enhances investor confidence. Fair disclosure is to supplement the ad hoc disclosure system and is implemented by KRX, a self-regulatory exchange. Detailed disclosure information is accessible on the website of the KRX website.

The information released in fair disclosure is different from that of periodic or ad hoc disclosures in that it pertains to expected data, such as business projection, management projection, projection of sales, operating income or loss, net income or loss before tax from continuing operations, and net income or loss. Such information is material since it has a direct impact on stock prices, and if it were selectively disclosed only to institutional investors or analysts, individual investors would be disadvantaged when making investment decisions.

In this regard, fair disclosure is a regulation to protect ordinary investors.[25]

C. Restriction for Qualified Institutional Investors in Private Placement

FSCMA in Chapter II stipulates the legal provisions on the restriction of investors. The legal provisions are as follows:[26]

Section 1. Requirements and Procedure for Authorization

Article 11 (Prohibition against Business Activities without Authorization)

No one may engage in a financial investment business (excluding an investment advisory business and a discretionary investment business; hereafter the same shall apply in this Section) without authorization (including authorization for changes) for the financial investment business under this Act.

Article 12 (Authorization for Financial Investment Business)

(1) An entity that wishes to engage in a financial investment business shall select all or part of its business units (hereafter referred to as "authorized business units"), as defined by Presidential Decree, by specifying the constituents enumerated in following subparagraphs, and shall obtain authorization for a single financial investment business from the Financial Services Commission: <Amended by Act No. 8863, Feb. 29, 2008>
   1. The type of financial investment business (referring to investment trading business, investment brokerage business, collective investment business, and trust business, and also including an underwriting business in the category of investment trading business);
   2. The rage (referring to the type of collective investment scheme under Article 229 in the case of a collective investment business, or referring to the trust property under subparagraphs of Article 103 (1) in the case of a trust business) of financial investment instruments (referring to securities, exchange-traded derivatives, and over-the-counter derivatives, including state bonds, corporate bonds, and other instruments specified by Presidential Decree in the category of securities, and also including derivatives based on underlying assets of stocks and other instruments as specified by Presidential Decree in the category of derivative); and
   3. The class of investors (referring to the classification of professional investors and ordinary investor; hereafter the same shall apply).

[25] Footnote 1, p. 281–287.
[26] Chapter II of the *Financial Investment Services and Capital Market Act*.

(2) An entity that wishes to obtain authorization for a financial investment business under paragraph (1) shall satisfy all of the following requirements:
   1. An entity shall fall under any of the following items: Provided, That an investment brokerage business entity willing to run an electronic securities brokerage business under Article 78 shall be a stock company under the Commercial Act and a member of the Korea Exchange:
      a. A stock company under the Commercial Act or one of the financial institutions specified by Presidential Decree; and
      b. A foreign financial investment business entity (referring to a person who runs a business corresponding to a financial investment business in a foreign country in accordance with the Acts and subordinate statutes of the foreign country), who has installed a branch office or any other business consistent with the business it currently runs in the foreign country;
   2. An entity shall have its own equity capital equivalent to or more than the amount set by Presidential Decree, which shall be at least 500 million won for each authorized business unit;
   3. An entity's business plan shall be feasible and sound;
   4. An entity shall be equipped with human resources, an electronic computer system, and other physical facilities adequate for protecting investors and running a financial investment business in which it intends to engage;
   5. No executive may fall under any subparagraph of Article 24;
   6. The major shareholders or a foreign financial investment business entity shall meet all of the requirements set forth under the following categories:
      a. In the case subparagraph 1 (a), its largest shareholder (including shareholders who are specially related persons of the largest shareholder; and where the largest shareholder is a corporation, persons who exercise de facto control over matters material to the management of the corporation, as specified further by Presidential Decree, shall be included herein) shall have adequate investing capabilities, good financial standing and social credibility; and
      b. In the case of subparagraph 1 (b), the foreign financial investment business entity shall have adequate investing capabilities, good financial standing and social credibility; and
   7. An entity shall have a system for preventing conflicts of interest between the financial investment business entity and investors, as well as between a specific investor and other investors.

(3) Further details necessary for fulfilling requirements for authorization under paragraph (2) shall be prescribed by Presidential Decree.

D. Registration Requirement for Foreign Investors

As the aforementioned in Sec. 2.04, foreign investors are required to register to FSS for participating in bond market. However, there is exemption from registration, which is as follows:[27]

[27] Footnote 1, p. 235–236.

Foreign nationals, foreign-incorporated entities, or local branches of a foreign corporation engaging in business activities in Republic of Korea that qualify for "foreigner under national treatment" status, shall be exempt from registration upon submitting documents verifying their status. Registration will also be exempted in the case of acquiring stocks on the over-the-counter market for the purpose of "direct investment" as well as disposing of direct investments, but the details of the relevant transactions must be reported promptly to the FSS. Exemption from registration will also apply to cases where government bonds and market stabilization bonds are acquired and sold using "omnibus accounts" under the name of the International Central Securities Depository (ICSD) through an ICSD account.

E. Reporting Requirements for Non-Resident Trade Report and Foreign Exchange-Denominated Instruments

According to the *Detailed Rules of the Regulations on Financial Investment Business*, foreign investors or corporations and institutions related with securities trading for foreigners have an obligation to report.[28]

F. Non-Resident Requirements

Based on Subparagraph 2 of Par. 1 of Art. 1 of *Income Tax Act* (ITA), a person who holds an address in Korea or has held a temporary domicile in Korea for one or more years is referred to as a resident. Any foreign investor not meeting that definition is defined as a non-resident.

Therefore, according to this definition, a person who does not have an address or temporary domicile in Korea for one or more year is defined as a non-resident. The address in this context is determined by the objective facts of a living relationship, such as the existence of a family living together in Korea and of property located in Korea. The term domicile in this context means the place where a person has resided for a long time, besides their address, and in which there is no general living relationship, according to Par. 1 and 2 of Art. 1 of EDITA.

G. Restrictions on Over-the-Counter Transactions by Non-Residents

The KOFIA prohibits OTC transactions of listed securities between nonresidents. Nonresident investors can make transactions of listed securities through the KRX by making orders to the securities companies that are members of the KRX. If a non-resident investor wants to trade listed bonds OTC, the trade should be conducted through the intermediation of Korean securities companies. This regulation applies to almost all bonds issued in Korea since most publicly-issued domestic bonds are listed on the exchange market for tax purposes.

In many countries, bonds are generally traded in the OTC market. When foreign financial companies want to trade Korean bonds owned by them or their clients,

[28] Footnote 1, p.253.

they naturally try to find counterparties in the OTC market with whom terms can be negotiated. If a transaction in the OTC market has to be made through a Korean securities firm, it is possible that foreign investors will have to pay additional costs or lose the possibility of finding an advantageous trading opportunity. Such possibilities may keep foreign financial companies from investing in Korean bonds or recommending Korean bonds to their customers.[29]

H. Credit Rating System and Its Relation to Regulations

Table 4.1 Overview of Credit Rating Framework and Governing Regulations

Items	Description
Introduction	- Credit rating for commercial papers and corporate bonds began in 1985 and 1986 respectively - Legal requirement for receiving two or more credit ratings for issuance of securities imposed in 1994
Development Path	- Government led development
Legal Framework	- Designation before 2001 - Licensing after 2001
Purpose of the Use of Credit Rating	- Oversight of the soundness of the financial institutions - Protection of investors
Regulations on the Use of Credit Rating	- Capital Market Consolidation Act and Regulation on Supervision of Banking Business
Barriers to Entry	- Licensing from the Financial Supervisory Commission
Regulations on Licensing and Associated Legal Definitions	- Use and Protection of Credit Information Act and its Enforcement Decree - Regulation on Supervision of Credit Information Business and Guidelines for Authorization or License of Credit Information Business
Perspective on Credit Rating Agencies	- Domestic regulations attach significance to the role of CRAs as offering of information.
Civil Liability	CRAs are subject to civil liability. - Article 750 of the Civil Act (Definition of Torts) - Articles 125, 127 and 162 of the Capital Market Consolidation Act - Article 40 of the Use and Protection of Credit Information Act * Criminal liability stipulated under Article 50 of the Use and Protection of Credit Information Act
Supervision and Regulation of Credit Rating Agencies	- Government led development of credit rating market à Emphasis placed on the need for supervision for the purpose of regulating domestic financial markets and protecting investors

Source: NICE.

I. The Use of Omnibus Accounts for Settlement

Foreigners who invest in Korean domestic bonds normally depend on local or global custodians to settle their transactions and keep the bonds they have acquired. In making settlement for securities transactions, custodians usually use omnibus accounts through which they consolidate all of their clients' transactions into a single account and make payments and deliveries using that account.

The foreign exchange regulation in Korea, however, requires that payments to settle securities transactions by foreigners must be processed through the individual account of each foreign investor. Since omnibus accounts for payments are not allowed for foreign investors, the custodian banks in charge of settling the bond transactions

[29] Footnote 26.

of foreign investors have to make payments through the individual account of each foreign investor. This leads to added costs and inconvenience.

Despite the higher costs and added inconvenience, foreign investors can still get settlement service for their transactions of Korean domestic bonds from local or global custodians. The real problem caused by the prohibition on the use of omnibus accounts lies with the fact that ICSDs, such as Euroclear and ClearStream, which usually provide settlement service for local bonds as well as international bonds, do not provide settlement service for local bonds of the countries where omnibus accounts are not allowed. Since ICSDs provide settlement services as well as depository services for bonds in many countries, international bond investors tend to use ICSDs to settle their international bond transactions. It is likely that these investors stay away from countries where ICSDs do not provide settlement services since investing in such countries requires the hiring of an additional custodian bank instead of relying upon the convenience of a single custodian taking care of all of their international transactions.

Prior to 2007, ICSDs did not provide settlement service for Korean bonds because the use of omnibus accounts by foreign investors was prohibited. As a consequence, it is plausible that Korea may have been losing potential foreign investments from those who would have invested in Korean bonds had they been able to settle their transactions through ICSDs. To address this shortcoming, the Korean government allowed ICSDs to use omnibus accounts to settle transactions of domestic bonds by foreign investors. The revised regulation stipulates that Clearstream and Euroclear can provide settlement services for the country's government bonds and MSBs through their omnibus accounts set up at the Korea Securities Depository (KSD).

Allowing omnibus accounts not only provides foreign investors with the benefit of lower cost and convenience in settlement, but also enables them to avoid significant institutional impediments. First, foreign investors do not have to register with the Financial Supervisory Service and get an investment registration certificate in advance if they settle their transactions of Korean domestic bonds through an ICSD. They can simply hold Korean domestic bonds at the representative omnibus account under the title of an ICSD.

In addition, the new regulation enables OTC transactions of Korean domestic bonds when these are deposited in and settled through the omnibus accounts of an ICSD. As a result, a foreign investor may now sell Korean government bonds to another foreign investor through a direct OTC transaction when both parties engage in the transaction via financial institutions that have settlement accounts at an ICSD.

Allowing ICSDs to make settlements using a representative omnibus account, however, may cause some problems in relation to the income tax exemption for foreigners. As was mentioned earlier, the Korean government decided to give foreign investors exemption from withholding tax on interest income from government bonds and MSBs in January 2009.

Since foreign investors no longer need an investment registration certificate if they settle their transactions through the omnibus account of an ICSD, a domestic investor can easily disguise himself as a foreign investor by making settlement through an ICSD to gain a tax exemption on interest income.

Under this system, the settling members of ICSDs that acquire Qualified Financial Intermediary (QFI) status are allowed to make settlement of Korean domestic bond transactions for their customers through the omnibus accounts of ICSDs.

In order to qualify as a QFI, a financial institution is required to assess customer adequacy of foreign investors for tax exemption and keep track of the bond transactions and holding records of foreign investors so that they can report to Korea's National Tax Service as necessary.

In spite of the clear benefits, the use of omnibus accounts is an exception rather than a rule. It is only the ICSDs that are allowed to use omnibus accounts.

Therefore, foreign investors who do not settle their domestic bond transactions through ICSDs are still subject to restrictions such as registration requirements, prohibition of direct OTC transactions between foreign investors, and prohibition on the use of omnibus accounts.[30]

J. Availability of Information in English

As Korean is used as the working language in domestic bond markets, there is a language barrier for foreign investors and traders. In addition, the supply of English-language documents on investment analyses of domestic bond markets for foreign investors is insufficient.[31]

K. Restrictions in Accounting Standard

FSCMA in Chapter III stipulates the legal provisions on Accounting. The legal provisions are as follows:[32]

> Article 32 (Accounting)
>
> Each financial investment business entity shall comply with the following in accounting: <Amended by Act No. 8863, Feb. 29, 2008; Act No. 9407, 3 Feburary 2009>
>
> The fiscal year shall be the term specified by Ordinance of the Prime Minister for each type of financial investment business;
>
> The propriety property of each financial investment business entity, the trust property, and other property of investors specified by Ordinance of the Prime Minister shall be clearly separated in accounting; and

30 Footnote 26.
31 Footnote 26.
32 Chapter III of the *Financial Investment Services and Capital Market Act*.

A financial investment business entity shall follow the general accounting principles of financial investment and standards for accounting under Article 13 of the Act on External Audit of Stock Companies determined by the Financial Services Commission, and provided by public notice, after going through a resolution of the Securities and Futures Commission.

Matters not provided for in paragraph (1) in relation to the accounting of the proprietary property of a financial investment business entity, types of account titles and order of arrangement, and other necessary matters shall be determined by the Financial Services Commission, and provided by public notice. <Amended by Act No. 8863, Feb. 29, 2008>

L. Limited Opportunities to Utilize Bond Holdings

Bond investors in general make active use of their bond holdings to enhance returns from their investment. For instance, bonds can be used as collateral to cover counterparty risk in OTC derivative transactions.

They can be utilized for lending and borrowing transactions, as well as repo transactions. In Korea, however, such opportunities are quite limited because neither the inter-institution repo trading nor the lending and borrowing transactions of bonds are active. Moreover, there exists a limitation on the maximum amount of Korean won that foreigners can borrow through repo transactions or lending and borrowing transactions.

These restrictions deprive foreigners of the opportunity to enhance the returns from their investment in Korean bonds, rendering investment in Korean bonds less attractive.[33]

M. Degree of Lack of Liquidity in the Secondary Market

Liquidity in the secondary market for bonds is relatively low in Korea, making investors in domestic bonds exposed to a higher liquidity risk. Various factors are responsible for the relatively low liquidity.

First, most large domestic investors, including pension funds and insurance companies, tend to be buy-and-hold investors.

Second, the market-making ability of bond dealers is quite limited. Finally, based on market convention, the minimum trading unit in the OTC market is set at W10 billion, which is extraordinarily high compared to minimums in other countries.[34]

33 Chapter II of the *Financial Investment Services and Capital Market Act*.
34 Footnote 26.

V. Description of the Securities Settlement System

A. Existence of Uniform Legal Framework for All Types of Securities

The FSCMA on the securities aims to contribute to the development of the national capital market, protecting investors, rearing the development of financial investment business, and heightening the fairness, reliability, and efficiency of the capital market. In this Act, bonds are defined such as "debt securities" including local government bonds, special bonds, corporate bonds, corporate commercial papers, and other similar instruments.

B. Dematerialization or Immobilization versus Physical Securities

1. Dematerialized Securities

Securities which are not issued in paper form and whose ownership is held and is transferable by book-entry in a ledger is maintained by a central securities depository (CSD) or account management institution.

2. Immobilized Securities

Physical securities and non-certificated securities held and transferred by book-entry in a ledger maintained by a CSD or account management institution. See Table 8.3

C. Legal Ownership Structure of Dematerialized or Immobilized Securities

1. Dematerialized Securities

The ownership of dematerialized securities is held individually through an account opened at the CSD or account management institution.

2. Immobilized Securities

The method of holding the securities is same as dematerialized securities, but the ownership is not held individually, and is held collectively with a share in the joint ownership. That is, ownership of deposited securities is held in the form of indirect possession through the central depository (direct possessor) and account management institution (indirect possessor). See Table 8.3

D. Legal Ownership Transfer Mechanism

1. Dematerialized Securities

These are delivered by book-entry across the accounts of the transferor and transferee opened at the CSD or account management institution.

2. Immobilized Securities

The same method is used as dematerialized securities. However,

a) the account structure of dematerialized and immobilized securities is explained based on the two-tier account structure.
b) the form of ownership for dematerialized securities cites the common view in the academia of Japan, and the form of ownership for immobilized securities is explained in terms of the Korean deposit and settlement system.

E. Existence of a Central Securities Depository and Book-Entry System for Debt Instruments

Securities deposit is a process through which rights over securities are transferred, altered, and nullified by book-entry without the actual movement of physical certificates. To benefit from the securities deposit system, participants such as brokers or institutional investors have to open participant accounts at the CSDs and deposit their securities at the CSDs.

In Korea, the Korea Securities Depository (KSD) is the single CSD and provides securities deposit service.

1. The Deposit System

The securities deposit system consists of KSD as an operator, participants and their customers as users, and deposit-eligible securities as objects.

Securities holdings of participants are held in custody on a fungible basis at KSD and are settled on a book-entry basis by recording debit/credit on the account book, a legal ledger kept by KSD and its participants.

2. Benefits

a. Safe and Convenient Securities Transaction

When participants and their customers trade securities, they do not have to return their securities because KSD settles transactions by book entry without the physical movement of securities.

As a result of the securities deposit system provided by KSD, transactions of deposited securities are conducted in a safe and convenient way without the risk of loss and theft of physical securities and the burden of incidental expense.

b. Corporate Action Service

Participants and their customers who have deposited their securities at KSD do not have to withdraw securities to exercise their rights against issuing companies. KSD provides corporate action services in relation with the deposited securities on behalf of them including dividends and principal and interest. Therefore, KSD participants and their customers can enjoy expedient and convenient corporate action services.

c. **Comprehensive Securities Information Service**

KSD participants and their customers can benefit from the comprehensive securities information service provided by KSD. KSD collects and manages all the information related to deposit-eligible securities. Issuance information, deposit information, lost and stolen securities, and corporate action information, to name a few.

F. Settlement System in Korea

The settlement system in Korea has developed in three major directions.

a. **The Book-Entry System**

The book-entry system was introduced as a protection measure against paperwork crisis, which refers to situations where the transfer of real securities or administration of reading slips arising from the sudden increase of securities trading cannot be dealt with. After the emergence of paperwork crisis, countries from around the world have tried to reduce inconveniences and risks that follow the transfer of real securities by depositing mainly securities at the CSD. Therefore, this system uses electronic methods for the transfer of securities by immobilizing securities or disposing of physical securities.

b. **The Multilateral Net Settlement System**

The multilateral net settlement system was introduced to reduce settlement charges and operational expenses. Compared with the gross base settlement system, this system reduces settlement funds and securities by approximately 90%. It also reduces an astonishing number of processed cases for settlement and has therefore established itself as a modem day settlement system.

For multilateral netting, trading data must be received and confirmed, and the deposit must be collected in order to guarantee settlement performance. After multilateral netting, instructions for the book entry exchange of securities and book entry transfers for charges are made to both the depositing organization and bank. Such duties have been carried out mainly by the clearing house.

c. **The Central Counterparty System**

The central counterparty (CCP) system was introduced to eliminate various legal risks. It refers to intervening between parties that trade in one more financial market. Through innovations, open offers, and debt assumption, the CCP becomes the buyer for all sellers and seller for all buyers.

Although the multilateral netting system greatly reduces settlement charges for market participants, if netting controls do not receive legal approval, netting settlement must be restored to the gross base settlement.

This incurs high liquidity and system risk in the market. Since problems for the legal effectiveness of multilateral netting arise from the lack of mutuality(1:1), each country tries to satisfy the requirements by initiating the CCP system to convert the transaction contract structure from a multilateral to 1:1 composition (Korea's civil law also stipulates an appropriation of 1:1). Since the CCP simultaneously possesses the status of a contracting party, performance of transaction contracts, that is, all authority and responsibilities related to settlement clearing, reverts to the CCP.

The traditional meaning (in a broad sense) of a settlement system is differentiated today into 'clearing system' and 'settlement system in a narrow sense'. The clearing system has merged the aforementioned second and third processes and has developed into a clearing institution (clearing house) with the CCP being the core concept.

The settlement system in a narrow sense is specialized by the CSD, which is in charge of book entry exchanges of securities, and the payment settlement system (central and commercial banks), which is responsible for the transfer of charges.

Korea's securities market has also developed by following this path. The CCP is operated in-house by the KRX, the book entry exchanges of securities is managed by the KSD, and the transfer of charges is handled by the BOK and commercial banks.

The FSCMA provides a clear definition of the role of the clearing house and settlement organization in the securities market. Under the law, KRX should play the role of a clearing house, and KSD should serve as the settlement organization.[35]

G. Existence of Delivery versus Payment and Real-Time Gross Settlement Mechanism

1. Delivery versus Payment

The settlement of bond purchases in the over-the-counter (OTC) market is possible from the current business day, to the following business day (T+1), through to the 30th business day (T+30) under the agreement between the parties in the transaction. T+1 is most common. However, repo, retail bonds, and Money Market Fund(s) included bond transaction may be settled the same day.

Settlement of bonds in the OTC market is done by the delivery versus payment (DVP) of securities and payment, which aims to simultaneously deliver the bonds and settle the payment in order to increase the safety and efficiency of bond trading.

Introduced in November 1999, DVP involves simultaneous bond settlement, where remittance between the customer's account using the KSD's SAFE system and settlement using a BOK-Wire account takes place at the same time.

In other words, KSD sends the securities for sale to the purchasing institution's escrow account, while the purchasing institution orders BOK to remit the settlement to the selling institution through their current account at the KSD.

35 Korea Exchange. http://www.ksd.or.kr/eng/html/services/settlement.home

The value of DVP in OTC trading of bonds in the first half of 2009 was W1,099 trillion, marking an approximately 42% increase year-on-year. By type, government bonds accounted for the largest portion of bonds remitted at W787 trillion (71.6% - including monetary stabilization bonds); financial bonds W173 trillion (15.7%). Other bonds, including special bonds and corporate bonds, totaled W139 trillion (12.7%).[36]

H. Existence of Post-Trade Matching Mechanism

1. Reporting Duties of the Dealers

In order to facilitate price discovery and enhance post-trading transparency in the OTC market, the Korean government introduced the Bond Trade Report and Information System (B-TrIS) in 2000. Under this system, licensed bond dealers are required to report the specifics of each transaction to the Korea Financial Investment Association (KOFIA) through computer terminals within 15 minutes after the transaction has been conducted. KOFIA is then required to post the trading details.

Since the regulation allows exceptions to the 15-minute reporting requirement, however, a number of transactions in the OTC market are reported after 3:00 p.m. even if the transactions were conducted between 9:00 a.m. and 3:00 p.m.

2. Collection and Reporting of the Transactions Data

The transactions data, including the price and the trading volume in the KRX government bond market, are available on a real time basis to eligible participants. For transactions in the OTC market, KOFIA collects trading data reported by licensed bond dealers and reports them on the website on a real time basis. Trading data are also provided to various data vendors.[37]

I. Existence of Execution Matching Mechanism

Clearing is the process of transmitting, reconciling and, in some cases, confirming payment orders or securities transfer instructions prior to settlement, possibly including the netting of instructions and the establishment of final positions for settlement. After netting, participants of securities market can have a final position, securities delivery or cash payment.

Trade reporting is the first step for settlement. An exchange and trading parties in the OTC market have to report their trades to the clearing house (CCP) or the CSD (KSD). Trade reporting is a very important process in an organized market because, after receiving trade reporting, a Clearing House interposes itself as counterparty and guarantees the completion of the whole trades.

The next process is trade comparison (matching). Comparison is the process of comparing the trade details to ensure that trading parties agree with respect to the

36 Footnote 1, p. 154.
37 Footnote 26.

terms of the transaction. It is done by clearing houses for exchange markets and by settlement organizations for OTC Markets.

The next step of clearing is netting. Netting is an agreed offsetting of position or obligation by trading partners or participants. Netting is the process of reducing multiple credit/account obligations among multiple traders to several credit/account obligations. Netting is classified into bilateral netting and multilateral netting by the numbers of trade parties. Bilateral netting is that both parties of transactions become the settlement counterparts and netting is carried out between two institutions. But, multilateral netting reduces a large number of individual positions or obligations to a small number of obligations or positions.

J. Settlement Scheme for Corporate Bonds, Government Bonds and Others (Gross-Gross, Gross-Net, Net-Net)

Settlement is the completion of a transaction, wherein the seller transfers securities or financial instruments to the buyer and the buyer transfers money to the seller. It is classified into DVP and free of payment (FOP) depending on connection and separation of delivery and payment.

The characteristic of DVP is to deliver and receive securities and funds at the same time. The characteristic of FOP is to deliver and receive securities and funds separately.

According to Bank for International Settlement (BIS), DVP model is divided into three types. First, **DVP1** is the settlement method which in every transaction, delivery and receipt of securities and funds occurs in the whole quantity standard. In short, DVP1 is the settlement method of settling on a trade by trade basis. In **DVP2**, securities delivery occurs in Gross amount of standard, as soon as seller's securities are fulfilled. But funds are netted at the end of processing cycle. In **DVP3**, securities and funds are settled by net basis occurring at the end of processing cycle. This model can economize the liquidity of securities and funds.

KRX provides clearing services as a CCP for stock market and. It also provides clearing and settlement services for the futures market. Meanwhile, KSD provides settlement services for cash market, like the stock market and KOSDAQ. Unlike the KRX Market, KSD provides clearing services as well as settlement services for FreeBond, stock's OTC market, and bond's OTC market. The settlement for stock OTC market and bond OTC market is called institutional settlement.

K. Settlement Cycle for Corporate Bonds, Government Bonds and Other Debt Securities

The settlement cycle is T+2 for stock transactions and KSD employs DVP Model 3 (Netting of Securities and Cash). Currently, KSD is providing settlement services for exchange transactions, institutional transactions, and OTC transactions.

1. Benefits

a. Low Cost-High Efficiency Back-Office Infrastructure Service

All the post-trade processes such as trade reporting, confirmation, settlement data production, and settlement result notification are processes through KSD, which has led to the automation and standardization of post-trade operations carried out by KSD.

As a result, KSD plays the role of the low cost-high-efficiency back-office infrastructure, sharply reducing the operational burden of KSD participants.

b. Settlement Obligation Reduction

Because of the net settlement system of KSD, settlement system participants can benefit from settlement obligation cut and risk reduction. For example, participants of the Bond Institutional Settlement System are enjoying, on average, a daily settlement liquidity reduction of about W5 trillion.

c. Credit Enhancement

The settlement system guarantees settlement finality. Therefore, brokers can trade with any counterparty regardless of his credibility. In other words, as settlement risk (counterparty risk) is removed by KSD, they can trade with any counterparty that they would like to trade with.[38]

L. Brief History of the Development of the Securities Settlement Infrastructure

Table 5.1 Brief History of the Development of the Securities Settlement Infrastructure

Classification	Period	Settlement System
Early stage of modernization	1956–1967	Latter settlement system
Capital market development	1969–1978	The latter settlement system had shifted new regular-way system
Market liberalization	1979–1985	The securities deposit system was established to enhance effectiveness of the book-entry clearing system
Expansion of the capital market	1986–1995	The settlement of bonds traded between institutional investors was required to be carried out through wire transfer via the KSD in order to avoid risks and inefficiency in the settlement process.
Asian financial crisis and reform measures	1996–2003	The BOK-Wire with the book-entry system of KSD for DVP of the OTC bond transactions is introduced.
Enhanced competitiveness of the capital market	2004–2009	

Source: Korea Financial Investment Association. 2010 *Capital Market in Korea*.

Most bonds are traded in the OTC market. KSD operates the OTC bond market settlement system to process bond transactions traded on the OTC market.

DVP settlement of bonds and funds is conducted through real-time gross settlement (RTGS) during the business hours of the next business day after the trade date once the required bonds and funds have been secured.

[38] Korea Securities Depository. www.ksd.or.kr

KSD is not liable for failed trades that must be handled directly by the involved parties. Since November 1999, the BOK has linked BOK-Wire with the book-entry system of KSD for DVP of the OTC bond transactions and therefore eliminating principal risk in OTC bond transactions.

The OTC market operates efficiently because of the existence of a very well functioning clearance and settlement system operated by KSD with direct linked to BOK-Wire.

Table 5.2 Korea Securities Market Settlement System

	Government bonds	Ordinary Bonds
Participants	Banks and securities companies	Securities companies
Clearing house	KRX	
Settlement agency	KSD	
Settlement method	Multilateral netting	
Settlement date	T+1	T+0
DVP	Yes	Yes
Fund settlement	Via BOR-Wire	Via designated commercial banks
Securities Settlement	Book-Entry	Book-Entry

Source: Bank of Korea

[The Korea Bond Market, the Next Frontier, p.68 published by the Korea Securities Dealer Association in June 2008; please refer to http://www.voxeu.org/index.php?q=node/4060]

M. Issues on Current Settlement Infrastructures

With relative higher quantity growth of Korean securities market, enhancement of the Securities Settlement System is being pursued for the stability and the competitive edge. KSD is now developing the new securities settlement system.

Table 5.3 Main Contents of the New Securities Settlement System

Category	AS-IS	TO-BE	Organizations
Stock Exchange Settlement	DVP3(DNS)	DVP3(CNS)	KSD, KRX
Institutional Settlement	DVP3	DVP2	KSD
Government Bond Settlement	DVP3	DVP1	KSD, KRX
Liquidity Provision	-	Intraday RP system	KSD, BOK
Stock Exchange Payment Settlement Bank	Shinhan Bank, Woori Bank	BOK	KSD, BOK

Source: Korea Securities Depository.

N. Expected changes on settlement infrastructures

1. Enhancement of Efficiency in Securities Settlement

a. (Stock exchange, Government bond) Through putting settlement beginning timing forward, try to increase speed of settlement

b. (Stock exchange) By re-deducting settlement which is carried over through continuous net settlement (CNS), reduce settlement volume
c. (Institutional settlement of stocks) In line with DVP2 method, reduce settlement amount by W1.2 trillion per day(Reduction by 64%)
d. (Intraday RP) By providing liquidity required for government bond settlement, try to activate settlement

2. Enhancement of Safety of Securities Settlement

a. (Stock exchange) By changing settlement bank into BOK, enhance safety of settlement
b. (Institutional settlement of stocks) With introduction of CCP system, get rid of risks of non-performance of settlement
c. (Government bond) Settlement in line with DVP1 after deduction will result in removal of risks
d. (Intraday RP) Solve settlement concentration by providing liquidity required for government bond settlement

3. Scientific Settlement Risk Management

a. (Stock exchange) Improve settlement risk management through management of collectable limit of securities
b. (Institutional settlement of stocks) Remove advance settlement risk through net liability limit management and surplus value management, etc.

VI. Costs and Charging Methods

A. Registration Fee at the Central Securities Depository

Table 6.1 Fee Rates by Classification of Bond

Classification	Fee Rate
Domestic entity issuing bond	- W10 billion and less: W100,000 - W10 billion and more: Registration amount × 1/100,000 (Ceiling: W500,000)
Foreign entity issuing bond	- W10 billion and less: 500,000 - W10 billion and more: Registration amount × 5/100,000 (Ceiling: 10,000,000)

Source: Korea Securities Depository.

B. Transfer Fee (Book-Transfer Fee) at the Central Securities Depository

A book-transfer fee of W1,000 per transaction levies on the transferor.

C. Average Ongoing Costs for Debt Instruments

Table 6.2 Maintenance Fee (Deposit Fee) at the Central Securities Depository (monthly basis)

Range	Fee Rate
W1 trillion and less	W0.00125 per W10,000
Over W1 trillion up to W3 trillion	W125,000 + W0.001 per W10,000
Over W3 trillion	W325,000 + W0.00075 per W10,000

Source: Korea Securities Depository.

Interest payment and/or redemption fee at the Central Securities Depository (CSD) are note applicable.

D. Market Charges

Brokerage commission is determined by each broker company. Normally, brokerage commission rates range as follows:

Table 6.3 Brokerage Commission

Security	Rate
Equities on KRX	0.4% – 0.5%
Equities in OTC	0.5%
Bonds in KRX	0.1% – 0.3%
Bonds in OTC	Nil

Source: Korea Securities Depository.

VII. Market Size and Statistics

A. Bonds Issued

Table 7.1 Bonds Issued (W billion)

Year	Treasury Bonds	National Housing Bonds	Industrial Finance Debentures	For. Exch. Sta. Fund Bonds
2001	21,830.1	5,439.6	9,631.7	3,600.1
2002	19,350.1	7,617.6	12,350.1	7,500.0
2003	34,520.0	7,090.3	13,964.9	7,800.0
2004	55,950.0	5,539.2	18,622.6	
2005	62,550.0	8,209.1	21,761.4	
2006	60,668.2	10,621.2	24,756.6	
2007	48,259.0	8,550.4	27,150.1	
2008	52,054.0	8,472.8	26,519.0	
2009	84,976.0	9,544.4	23,333.4	
2010	77,721.4	8,938.9	9,176.0	

Year	Monetary Stabilization Bonds	Seoul Metropolitan Subway Bonds	Corporate Bonds	Total
2001	78,033.5	482.8	87,194.9	206,212.7
2002	69,840.4	561.7	77,522.0	194,741.9
2003	91,735.0	549.2	61,757.6	217,417.0
2004	134,722.5	473.0	50,379.0	265,686.3
2005	165,125.3	545.6	48,103.0	306,294.4
2006	150,048.7	391.3	41,678.2	288,164.2
2007	156,690.0	553.0	45,259.8	286,462.3
2008	151,390.0	359.7	52,758.5	291,554.0
2009	375,460.0	633.4	84,208.1	578,155.3
2010	248,150.0	611.8	83,573.8	428,171.9

Source: Economic Statistics System, Bank of Korea.

B. Outstanding Amount of Bonds Issued

Table 7.2 Outstanding Amount of Bonds Issued (W billion)

Year	Treasury Bonds	National Housing Bonds	Industrial Finance Debentures	For. Exch. Sta. Fund Bonds
2001	50,919.0	20,645.0	24,383.9	8,699.9
2002	55,615.2	25,706.6	24,610.2	15,849.9
2003	81,483.3	30,050.6	25,232.4	23,649.9
2004	123,061.3	32,347.7	28,645.4	22,199.9
2005	170,475.2	37,086.0	30,744.7	15,300.0
2006	206,798.4	42,853.5	35,419.6	8,100.0
2007	227,373.3	43,336.9	41,604.1	3,000.0
2008	239,290.3	44,920.7	49,538.4	
2009	280,853.3	48,262.8	35,060.9	
2010	310,076.7	49,029.1	28,003.2	
Year	**Monetary Stabilization Bonds**	**Seoul Metropolitan Subway Bonds**	**Corporate Bonds**	**Total**
2001	79,121.3	3,057.4	154,400.4	341,226.9
2002	84,277.9	3,136.5	180,048.5	389,244.8
2003	105,496.7	2,945.4	187,355.9	456,214.2
2004	142,773.0	3,061.0	153,283.1	505,371.4
2005	155,235.0	3,319.5	142,549.6	554,710.0
2006	158,390.0	3,382.8	134,420.4	589,364.7
2007	150,340.0	3,457.1	135,663.6	604,775.0
2008	126,937.2	3,410.1	149,803.7	613,900.4
2009	149,237.2	3,520.7	188,748.7	705,683.6
2010	163,530.0	3,583.7	201,725.8	755,948.5

Source: Economic Statistics System, Bank of Korea.

C. Bond Trading Volume and Value (Over the Counter)

Table 7.3 Bonds Issued (W100 million)

Trading Date		Government	Municipal	Special	MSB	Bank	Other Financial	Corporate	ABS	Total
2012	Volume	821,761	4,366	91,373	617,245	186,613	46,872	62,330	12,973	1,843,532
	Value	843,999	4,114	92,999	619,013	184,623	47,314	63,046	13,075	1,868,183
	Contract	9,471	4,692	1,471	5,491	1,817	1,659	3,989	349	28,939
2011	Volume	31,486,143	117,355	2,403,340	15,956,478	4,856,646	940,007	1,753,851	275,443	57,789,264
	Value	32,202,136	111,581	2,437,617	16,022,653	4,853,266	951,173	1,771,071	277,178	58,626,676
	Contract	333,406	90,426	35,683	135,364	47,660	36,555	105,048	4,951	789,093
2010	Volume	31,510,281	143,899	2,244,644	13,935,147	5,554,625	764,515	1,368,993	181,444	55,703,548
	Value	32,413,217	135,575	2,280,063	14,032,922	5,568,539	778,720	1,392,164	182,700	56,783,899
	Contract	331,183	99,863	48,219	113,286	53,687	35,822	118,942	7,678	808,680
2009	Volume	21,660,552	136,198	2,031,982	10,700,265	4,914,948	561,695	1,249,880	219,329	41,474,850
	Value	22,216,735	125,303	2,057,037	10,778,689	4,945,600	570,930	1,262,461	221,393	42,178,149
	Contract	255,755	49,706	34,812	82,533	51,524	53,454	130,514	16,351	674,649
2008	Volume	12,517,635	93,791	1,233,733	8,941,243	4,304,773	355,323	583,334	135,963	28,165,796
	Value	12,619,115	86,353	1,234,308	8,939,350	4,271,178	355,609	580,605	138,971	28,225,489
	Contract	160,330	48,440	23,699	81,672	66,152	75,713	62,786	17,149	535,941

continued on next page

Table 7.3 continuation

Trading Date		Government	Municipal	Special	MSB	Bank	Other Financial	Corporate	ABS	Total
2007	Volume	11,732,450	71,292	609,938	7,650,093	2,649,135	263,880	517,138	167,291	23,661,218
	Value	11,692,788	65,473	608,232	7,651,597	2,626,304	264,409	516,641	176,975	23,602,418
	Contract	159,645	43,256	25,167	127,747	54,351	22,270	42,412	25,213	500,061
2006	Volume	16,496,779	76,927	699,720	9,153,818	2,912,707	300,428	677,148	319,352	30,636,878
	Value	16,563,813	69,589	702,018	9,089,381	2,879,561	302,387	679,145	325,413	30,611,308
	Contract	245,655	43,946	13,768	156,558	52,433	15,376	29,254	46,357	603,347
2005	Volume	18,849,444	75,148	845,051	10,266,213	2,256,637	297,401	785,981	436,766	33,812,641
	Value	18,808,631	69,885	852,262	10,185,561	2,226,617	301,524	791,275	460,964	33,696,719
	Contract	273,781	52,170	13,628	147,869	34,232	26,542	32,667	45,892	626,781
2004	Volume	16,067,582	60,978	983,227	8,621,678	2,235,317	471,721	917,967	498,574	29,857,044
	Value	16,411,212	58,974	1,001,053	8,567,177	2,204,685	475,751	926,649	523,690	30,169,189
	Contract	236,829	60,948	17,658	116,167	34,636	73,600	35,918	12,533	588,289
2003	Volume	10,394,804	63,158	1,280,154	9,148,202	2,403,334	677,163	809,360	848,770	25,624,944
	Value	10,533,114	64,460	1,315,162	9,117,833	2,353,265	685,531	812,929	877,341	25,759,634
	Contract	170,965	74,900	23,040	121,887	41,223	66,486	25,515	12,571	536,587
2002	Volume	7,574,527	61,916	1,334,249	7,769,542	2,071,386	1,113,120	989,664	1,248,497	22,162,902
	Value	7,617,011	58,380	1,379,313	7,723,625	2,017,727	1,143,083	990,716	1,278,718	22,208,573
	Contract	133,791	76,183	23,404	101,117	31,689	25,064	27,778	16,572	435,598
2001	Volume	9,804,344	82,470	4,944,284	8,554,052	926,085	991,852	1,572,787	1,062,971	27,938,845
	Value	10,043,899	82,173	5,076,428	8,552,186	907,539	1,027,099	1,562,848	1,080,313	28,332,484
	Contract	157,637	95,323	57,817	92,223	16,035	18,318	38,876	11,475	487,704

Source: KOFIA, www.kofiabond.or.kr

D. Bond Trading Volume and Value (Exchange)

Table 7.4 Bond Trading Volume and Value Exchange (W100 million)

Trading Date		Government	Municipal	Special	MSB	Bank	Other Financial	Corporate	ABS	Total
2012	Volume	330,395	2,637	137	7,752	450	362	2,128	93	343,955
	Value	334,193	2,427	152	7,778	466	367	2,086	93	347,564
	Contract	109,101	9,116	66	86	428	217	14,461	16	133,491
2011	Volume	7,831,068	51,794	9,437	100,390	4,205	8,436	50,548	1,107	8,056,985
	Value	7,933,176	46,954	9,792	100,976	4,396	8,557	50,832	1,118	8,155,800
	Contract	2,133,693	153,005	1,891	1,476	4,829	5,920	244,858	300	2,545,972
2010	Volume	5,327,595	129,430	7,457	108,709	2,178	7,140	34,672	1,027	5,618,208
	Value	5,361,062	115,700	7,640	109,556	2,223	7,274	35,358	1,036	5,639,848
	Contract	3,695,803	410,662	1,429	1,224	6,693	6,709	209,825	542	4,332,887
2009	Volume	4,790,002	36,500	6,775	20,158	4,183	6,356	35,571	383	4,899,929
	Value	4,865,171	31,061	6,872	20,207	4,330	6,472	34,602	387	4,969,101
	Contract	1,201,577	810,125	1,046	427	11,626	3,387	257,508	626	2,286,322
2008	Volume	3,552,035	45,629	6,216	16,341	16,871	8,223	10,541	426	3,656,283
	Value	3,542,380	38,044	6,248	16,437	16,748	8,206	10,965	428	3,639,456
	Contract	748,509	133,233	1,852	1,376	8,346	4,558	47,324	367	945,565
2007	Volume	3,097,075	32,721	1,697	13,478	13,514	1,897	13,366	987	3,174,735
	Value	3,062,881	27,802	1,697	13,467	13,443	1,895	15,358	989	3,137,531
	Contract	353,152	73,704	511	630	3,588	460	91,276	234	523,555

continued on next page

Table 7.4 continuation

Trading Date		Government	Municipal	Special	MSB	Bank	Other Financial	Corporate	ABS	Total
2006	Volume	2,881,670	36,026	956	5,770	2,076	2,351	11,477	1,556	2,941,883
	Value	2,881,607	30,989	948	5,771	2,089	2,370	12,534	1,560	2,937,868
	Contract	236,332	66,459	104	55	1,972	37	67,679	103	372,741
2005	Volume	3,592,633	44,420	6,830	1,437	2,162	83	18,004	413	3,665,982
	Value	3,570,152	38,736	6,116	1,438	2,182	84	18,938	412	3,638,058
	Contract	290,234	69,526	7,535	16	3,070	6	81,467	93	451,947
2004	Volume	3,692,373	58,425	10,604	1,504	753	21	11,088	60	3,774,827
	Value	3,766,561	52,527	9,842	1,506	769	20	9,807	60	3,841,092
	Contract	100,194	62,832	6,989	15	4,252	19	93,675	2	267,978
2003	Volume	2,087,181	25,611	2,567	800	128	50	10,069	0	2,126,406
	Value	2,117,452	23,718	2,497	802	116	50	8,989	0	2,153,624
	Contract	47,985	60,600	4,222	8	1,135	10	57,291	0	171,251
2002	Volume	433,056	23,607	1,917	800	116	109	19,362	0	478,967
	Value	437,812	20,327	1,685	805	0	111	33,007	0	493,746
	Contract	34,817	52,519	2,182	2	16	16	47,000	0	136,552
2001	Volume	104,448	13,147	835	0	0	232	20,416	0	139,079
	Value	109,357	11,989	779	0	0	355	20,805	0	143,285
	Contract	24,597	33,790	698	0	1	477	25,882	0	85,445

Source: KOFIA, www.kofiabond.or.kr

E. Statistics of Over-the-Counter Institutional Repo Market

Table 7.5 Trading Value and Balance (W100 million)

Year	Trading Value[a]	Daily Average Balance
2010	9,645,590	109,665
2009	6,250,582	69,913
2008	4,641,507	40,386
2007	408,307	10,728
2006	74,681	13,789
2005	128,984	20,434
2004	139,516	22,308
2003	115,309	11,904
2002	103,476	8,805

[a] including only start-leg settlement amount.
Source: KOFIA, www.kofiabond.or.kr

Table 7.6 Trading Volume of the Purchased Securities (W 100 million)

	Government Bonds	Monetary Stabilization Bonds	Other Bonds	ETF	Sum
2010	2,946,487	1,937,101	5,231,954	0.245	10,115,541
2009	2,337,577	747,075	3,439,124	–	6,523,776
2008	1,451,192	926,562	2,590,293	–	4,968,047
2007	85,366	158,168	186,799	–	430,333
2006	6,171	21,897	53,361	–	81,429
2005	10,715	20,028	118,327	–	149,070
2004	22,396	17,642	115,485	–	155,523

Source: KOFIA, www.kofiabond.or.kr

F. Size of Local Currency Bond Market in US Dollars

Table 7.7 Size of LCY Bond Market in USD (Local Sources) ($ billion)

Date	Government	Corporate	Total
Mar-95	60.63	-	60.63
Jun-95	60.48	-	60.48
Sep-95	62.72	-	62.72
Dec-95	67.01	-	67.01
Mar-96	66.75	-	66.75
Jun-96	69.80	-	69.80
Sep-96	67.82	-	67.82
Dec-96	64.63	-	64.63
Mar-97	58.30	-	58.30
Jun-97	65.46	-	65.46
Sep-97	64.93	-	64.93
Dec-97	36.09	-	36.09
Mar-98	49.69	-	49.69
Jun-98	58.08	-	58.08
Sep-98	57.03	-	57.03
Dec-98	71.23	-	71.23
Mar-99	71.18	-	71.18
Jun-99	78.21	-	78.21
Sep-99	74.06	-	74.06
Dec-99	81.87	-	81.87
Mar-00	93.62	241.95	335.58
Jun-00	97.17	245.88	343.05
Sep-00	100.09	253.80	353.89
Dec-00	122.38	232.60	354.99
Mar-01	122.74	232.96	355.69
Jun-01	125.59	252.25	377.83
Sep-01	133.29	263.06	396.35
Dec-01	135.61	268.57	404.19
Mar-02	140.41	265.99	406.41
Jun-02	160.00	300.21	460.22
Sep-02	156.95	299.07	456.02
Dec-02	163.07	323.11	486.18
Mar-03	165.00	300.91	465.91
Jun-03	179.40	320.48	499.88
Sep-03	196.89	320.47	517.36
Dec-03	205.69	307.95	513.64
Mar-04	239.63	311.31	550.94
Jun-04	250.11	306.08	556.18
Sep-04	261.14	303.35	564.48
Dec-04	318.70	338.02	656.72
Mar-05	357.22	341.51	698.73
Jun-05	364.05	343.84	707.90
Sep-05	372.65	345.58	718.23
Dec-05	392.93	360.75	753.68

continued on next page

Table 7.7 continuation

Date	Government	Corporate	Total
Mar-06	425.20	381.02	806.21
Jun-06	453.84	412.87	866.71
Sep-06	469.95	421.08	891.04
Dec-06	480.63	441.17	921.80
Mar-07	486.79	464.28	951.07
Jun-07	506.68	495.93	1,002.61
Sep-07	507.80	522.95	1,030.75
Dec-07	498.32	529.06	1,027.38
Mar-08	476.85	520.31	997.16
Jun-08	455.75	513.67	969.43
Sep-08	382.32	458.42	840.74
Dec-08	368.46	448.24	816.70
Mar-09	360.35	426.96	787.31
Jun-09	414.26	485.89	900.15
Sep-09	458.69	540.39	999.08
Dec-09	444.10	572.15	1,016.25
Mar-10	490.03	604.63	1,094.66
Jun-10	457.44	571.05	1,028.49
Sep-10	495.86	625.79	1,121.65
Dec-10	492.20	656.94	1,149.15
Mar-11	524.27	687.20	1,211.48
Jun-11	546.51	727.24	1,273.75
Sep-11	501.17	677.88	1,179.05

Source: Asian Bonds Online. http://asianbondsonline.adb.org/korea/data/bondmarket.php?code=LCY_in_USD_Local

G. Size of LCY Bond Market in % of GDP

Table 7.8 Size of LCY Bond Market in % GDP (Local Sources) (% GDP, $ billion)

Date	Government (in %GDP)	Corporate (in %GDP)	Total (in %GDP)	Government	Corporate	Total
Mar-95	12.8	0	12.8	60.63	-	60.63
Jun-95	12.0	0	12.0	60.48	-	60.48
Sep-95	12.1	0	12.1	62.72	-	62.72
Dec-95	12.6	0	12.6	67.01	-	67.01
Mar-96	12.3	0	12.3	66.75	-	66.75
Jun-96	12.9	0	12.9	69.80	-	69.80
Sep-96	12.4	0	12.4	67.82	-	67.82
Dec-96	11.8	0	11.8	64.63	-	64.63
Mar-97	11.1	0	11.1	58.3	-	58.30
Jun-97	12.1	0	12.1	65.46	-	65.46
Sep-97	12.0	0	12.0	64.93	-	64.93
Dec-97	11.4	0	11.4	36.09	-	36.09
Mar-98	13.4	0	13.4	49.69	-	49.69
Jun-98	15.6	0	15.6	58.08	-	58.08
Sep-98	15.6	0	15.6	57.03	-	57.03

continued on next page

Table 7.8 continuation

Date	Government (in %GDP)	Corporate (in %GDP)	Total (in %GDP)	Government	Corporate	Total
Dec-98	17.1	0	17.1	71.23	-	71.23
Mar-99	17.4	0	17.4	71.18	-	71.18
Jun-99	17.6	0	17.6	78.21	-	78.21
Sep-99	17.0	0	17.0	74.06	-	74.06
Dec-99	17.0	0	17.0	81.87	-	81.87
Mar-00	18.5	47.7	66.2	93.62	241.95	335.58
Jun-00	18.6	47.1	65.7	97.17	245.88	343.05
Sep-00	18.8	47.7	66.5	100.09	253.80	353.89
Dec-00	25.7	48.8	74.4	122.38	232.6	354.99
Mar-01	26.6	50.5	77.1	122.74	232.96	355.69
Jun-01	26.0	52.2	78.2	125.59	252.25	377.83
Sep-01	27.2	53.6	80.8	133.29	263.06	396.35
Dec-01	27.3	54.2	81.5	135.61	268.57	404.19
Mar-02	28.0	53.0	81.0	140.41	265.99	406.41
Jun-02	28.1	52.8	80.9	160.0	300.21	460.22
Sep-02	27.5	52.3	79.8	156.95	299.07	456.02
Dec-02	26.8	53.2	80.0	163.07	323.11	486.18
Mar-03	28.3	51.5	79.8	165.0	300.91	465.91
Jun-03	28.8	51.5	80.4	179.4	320.48	499.88
Sep-03	30.1	49.0	79.0	196.89	320.47	517.36
Dec-03	32.0	47.9	79.8	205.69	307.95	513.64
Mar-04	35.2	45.7	80.9	239.63	311.31	550.94
Jun-04	36.2	44.3	80.5	250.11	306.08	556.18
Sep-04	36.9	42.9	79.8	261.14	303.35	564.48
Dec-04	39.9	42.3	82.2	318.70	338.02	656.72
Mar-05	43.4	41.5	85.0	357.22	341.51	698.73
Jun-05	44.7	42.2	86.9	364.05	343.84	707.90
Sep-05	45.5	42.2	87.8	372.65	345.58	718.23
Dec-05	45.9	42.1	88.0	392.93	360.75	753.68
Mar-06	47.1	42.2	89.4	425.20	381.02	806.21
Jun-06	48.6	44.2	92.7	453.84	412.87	866.71
Sep-06	49.5	44.4	93.9	469.95	421.08	891.04
Dec-06	49.2	45.1	94.3	480.63	441.17	921.80
Mar-07	49.7	47.4	97.1	486.79	464.28	951.07
Jun-07	49.9	48.8	98.8	506.68	495.93	1,002.61
Sep-07	48.7	50.2	98.9	507.80	522.95	1,030.75
Dec-07	47.8	50.8	98.6	498.32	529.06	1,027.38
Mar-08	47.6	52.0	99.6	476.85	520.31	997.16
Jun-08	47.1	53.1	100.2	455.75	513.67	969.43
Sep-08	44.9	53.8	98.7	382.32	458.42	840.74
Dec-08	45.2	55.0	100.2	368.46	448.24	816.70
Mar-09	48.7	57.7	106.3	360.35	426.96	787.31
Jun-09	51.4	60.2	111.6	414.26	485.89	900.15
Sep-09	51.9	61.2	113.1	458.69	540.39	999.08
Dec-09	48.5	62.5	111.1	444.10	572.15	1,016.25

continued on next page

Table 7.8 continuation

Date	Government (in %GDP)	Corporate (in %GDP)	Total (in %GDP)	Government	Corporate	Total
Mar-10	50.7	62.5	113.2	490.03	604.63	1,094.66
Jun-10	49.7	62.1	111.8	457.44	571.05	1,028.49
Sep-10	49.3	62.2	111.6	495.86	625.79	1,121.65
Dec-10	47.3	63.1	110.3	492.20	656.94	1,149.15
Mar-11	48.2	63.2	111.4	524.27	687.20	1,211.48
Jun-11	48.3	64.3	112.6	546.51	727.24	1,273.75

Source: AsianBondsOnline. http://asianbondsonline.adb.org/korea/data/bondmarket.php?code=LCY_in_GDP_Local

H. Size of FCY Bond Market in % of GDP (BIS)

Table 7.9 FCY Bonds to GDP Ratio ($ billion)

Date	as % of GDP	FCY Denominated Bonds	GDP
Dec-95	4.6	24.5	531.9
Dec-96	6.7	36.9	548.2
Dec-97	15.2	48.1	316.4
Dec-98	11.9	49.7	416.1
Dec-99	9.7	46.7	481.6
Dec-00	9.6	45.6	476.9
Dec-01	8.9	44.1	495.9
Dec-02	7.7	46.5	607.7
Dec-03	8.3	53.5	643.5
Mar-04	8.4	57.3	680.9
Jun-04	8.7	59.9	690.6
Sep-04	8.7	61.6	707.8
Dec-04	8.1	64.3	798.9
Mar-05	8.1	66.4	822.4
Jun-05	8.3	67.5	814.6
Sep-05	8.5	69.6	818.4
Dec-05	8.5	73.1	856.7
Mar-06	8.3	74.9	901.9
Jun-06	8.5	79.1	934.7
Sep-06	8.7	82.7	949.0
Dec-06	8.8	86.2	977.5
Mar-07	8.8	86.6	979.3
Jun-07	9.5	96.2	1,015.2
Sep-07	9.3	97.3	1,042.6
Dec-07	9.5	99.3	1,042.4
Mar-08	10.2	102.1	1,001.5
Jun-08	10.7	103.7	967.8
Sep-08	11.9	101.2	852.0
Dec-08	12.4	100.8	814.9
Mar-09	13.8	102.1	740.4
Jun-09	14.0	112.6	806.5
Sep-09	13.6	119.9	883.0
Dec-09	12.9	117.7	915.0

continued on next page

Table 7.9 continuation

Date	as % of GDP	FCY Denominated Bonds	GDP
Mar-10	12.3	118.5	967.3
Jun-10	13.0	120.0	919.8
Sep-10	12.7	127.8	1,005.3
Dec-10	12.7	132.1	1,041.6
Mar-11	12.9	140.1	1,087.8
Jun-11	12.7	144.1	1,131.4

Source: AsianBondsOnline. http://asianbondsonline.adb.org/korea/data/bondmarket.php?code=FCY_in_GDP

I. Size of FCY Bond Market in USD (Local Sources)

Table 7.10 FCY Bonds Outstanding (Local Sources) ($ billion)

Date	Government	Banks and Financial Institutions	Other Corporates	Total FCY
Mar-00	18.27	15.33	18.81	52.41
Jun-00	17.56	14.20	19.19	50.95
Sep-00	16.99	12.55	19.96	49.50
Dec-00	16.34	12.81	19.96	49.11
Mar-01	16.13	12.29	19.91	48.32
Jun-01	15.55	11.07	20.87	47.48
Sep-01	14.68	9.43	21.49	45.60
Dec-01	15.68	9.16	22.09	46.93
Mar-02	14.36	8.19	23.56	46.11
Jun-02	14.00	8.96	24.07	47.03
Sep-02	13.73	8.86	25.14	47.73
Dec-02	13.61	11.60	25.91	51.11
Mar-03	13.61	11.65	25.70	50.96
Jun-03	13.9	12.55	25.12	51.58
Sep-03	15.24	13.67	25.51	54.42
Dec-03	14.91	14.62	25.36	54.89
Mar-04	15.51	17.19	25.64	58.33
Jun-04	15.12	17.33	27.92	60.37
Sep-04	16.16	17.85	28.14	62.14
Dec-04	15.93	18.85	27.64	62.43
Mar-05	16.85	20.57	27.64	65.06
Jun-05	16.90	20.92	28.80	66.62
Sep-05	17.74	21.21	29.60	68.55
Dec-05	19.31	21.56	31.12	71.99
Mar-06	19.62	23.02	30.87	73.52
Jun-06	19.69	25.30	31.92	76.90
Sep-06	20.04	26.87	33.37	80.27
Dec-06	20.78	27.98	33.58	82.33
Mar-07	20.79	30.38	31.10	82.27
Jun-07	22.07	36.60	32.21	90.88
Sep-07	22.22	39.79	31.34	93.35
Dec-07	22.59	41.42	32.51	96.51
Mar-08	23.39	41.76	34.92	100.07

continued on next page

Table 7.10 continuation

Date	Government	Banks and Financial Institutions	Other Corporates	Total FCY
Jun-08	20.54	44.00	37.40	101.95
Sep-08	19.54	43.80	39.12	102.46
Dec-08	18.65	40.68	39.09	98.43
Mar-09	20.20	42.14	39.32	101.66
Jun-09	22.87	47.40	41.43	111.69
Sep-09	21.82	50.66	44.73	117.21
Dec-09	21.86	52.15	45.89	119.90
Mar-10	20.81	52.25	44.88	117.94
Jun-10	19.95	53.20	47.19	120.35
Sep-10	19.97	56.09	47.04	123.10
Dec-10	20.86	57.13	51.43	129.42
Mar-11	21.70	58.85	51.89	132.43
Jun-11	21.38	58.68	53.31	133.37

Source: AsianBondsOnline. http://asianbondsonline.adb.org/korea/data/bondmarket.php?code=FCY_Bonds_Outstanding

J. Issuance Volume of LCY Bond Market in USD

Table 7.11 Issuance Volume of LCY Bond Market in USD ($ billion)

Date	Government	Corporate	Total
Mar-95	21.3685	0	21.3685
Jun-95	12.0539	0	12.0539
Sep-95	12.5211	0	12.5211
Dec-95	18.0739	0	18.0739
Mar-96	16.1514	0	16.1514
Jun-96	13.9319	0	13.9319
Sep-96	7.6923	0	7.6923
Dec-96	14.9937	0	14.9937
Mar-97	11.1999	0	11.1999
Jun-97	17.1582	0	17.1582
Sep-97	5.1911	0	5.1911
Dec-97	9.2391	0	9.2391
Mar-98	57.2167	0	57.2167
Jun-98	109.4167	0	109.4167
Sep-98	78.0795	0	78.0795
Dec-98	34.8556	0	34.8556
Mar-99	19.1444	0	19.1444
Jun-99	11.2848	0	11.2848
Sep-99	8.0360	0	8.0360
Dec-99	35.5015	0	35.5015
Mar-00	49.3274	0	49.3274
Jun-00	21.1921	0	21.1921
Sep-00	15.7196	0	15.7196
Dec-00	18.0790	0	18.0790
Mar-01	26.8842	36.1346	63.0188

continued on next page

Table 7.11 continuation

Date	Government	Corporate	Total
Jun-01	18.5853	29.9402	48.5255
Sep-01	23.8562	31.9835	55.8397
Dec-01	18.5236	33.7431	52.2667
Mar-02	24.3905	23.9017	48.2922
Jun-02	26.3114	28.5287	54.8401
Sep-02	19.7602	22.4147	42.1749
Dec-02	18.2090	38.3449	56.5539
Mar-03	29.8130	20.5513	50.3643
Jun-03	25.6126	29.4787	55.0913
Sep-03	29.8057	24.9317	54.7373
Dec-03	38.2719	28.4699	66.7418
Mar-04	51.9361	22.8477	74.7838
Jun-04	38.8091	32.0122	70.8213
Sep-04	41.7127	27.7420	69.4547
Dec-04	61.1129	35.5648	96.6777
Mar-05	86.8622	28.9904	115.8526
Jun-05	52.7401	39.1762	91.9163
Sep-05	58.2147	34.8790	93.0937
Dec-05	54.0271	40.5181	94.5452
Mar-06	66.6303	40.7304	107.3607
Jun-06	62.7636	58.1568	120.9204
Sep-06	72.7083	41.5458	114.2541
Dec-06	57.4386	49.8023	107.2409
Mar-07	61.9453	55.8542	117.7994
Jun-07	60.7475	53.4278	114.1752
Sep-07	74.3211	55.5251	129.8463
Dec-07	62.8371	55.9958	118.8329
Mar-08	71.7022	41.2133	112.9155
Jun-08	54.5971	66.5530	121.1501
Sep-08	51.6464	45.8951	97.5415
Dec-08	38.3851	48.5073	86.8925
Mar-09	65.2926	56.2822	121.5748
Jun-09	117.2916	62.1825	179.4741
Sep-09	127.0526	56.4654	183.5180
Dec-09	89.8288	52.7283	142.5570
Mar-10	101.8717	63.2719	165.1436
Jun-10	82.8978	69.0244	151.9222
Sep-10	70.5639	71.3541	141.9181
Dec-10	42.2718	71.4183	113.6901
Mar-11	69.0742	66.7581	135.8324
Jun-11	82.5516	78.7608	161.3124
Sep-11	62.5343	65.8408	128.3750

Source: AsianBondsOnline. http://asianbondsonline.adb.org/korea/data/bondmarket.php?code=Issuance_Volume_LCY

K. Foreign Holdings in LCY Government Bonds

Table 7.12 Foreign Holdings in LCY Government Bonds (W billion)

Date	Foreign Holdings	Total	% of Total
Dec-02	257.6	197,617.3	0.13
Mar-03	368.6	200,927.1	0.18
Jun-03	358.7	208,827	0.17
Sep-03	360.4	204,582.4	0.18
Dec-03	549.7	209,945.5	0.26
Mar-04	1,050.3	225,748.6	0.47
Jun-04	879.4	230,716.9	0.38
Sep-04	848.5	242,566.8	0.35
Dec-04	1,063.9	254,596.6	0.42
Mar-05	907.4	264,998.0	0.34
Jun-05	1,171.7	282,842.6	0.41
Sep-05	1,389.9	279,836.5	0.50
Dec-05	1,392.4	282,773.8	0.49
Mar-06	2,067.2	291,869.2	0.71
Jun-06	2,827.9	303,090.5	0.93
Sep-06	3,003.3	311,293.4	0.96
Dec-06	3,866.9	312,261.2	1.24
Mar-07	5,377.3	318,965.8	1.69
Jun-07	7,133.3	323,446.3	2.21
Sep-07	16,379.7	322,568.2	5.08
Dec-07	25,278.7	323,564.8	7.81
Mar-08	27,699.5	336,912.0	8.22
Jun-08	29,674.6	341,889.5	8.68
Sep-08	23,759.4	328,759.8	7.23
Dec-08	21,721.7	358,145.0	6.07
Mar-09	19,610.2	368,041.3	5.33
Jun-09	21,857.2	380,109.3	5.75
Sep-09	26,251.1	400,957.0	6.55
Dec-09	29,248.6	420,280.7	6.96
Mar-10	33,303.1	452,747.7	7.36
Jun-10	39,946.7	458,967.7	8.70
Sep-10	45,715.5	489,992.4	9.33
Dec-10	47,617.4	483,404.2	9.85
Mar-11	50,569.8	498,935.9	10.14
Jun-11	56,350.1	517,216.5	10.89

Source: AsianBondsOnline.http://asianbondsonline.adb.org/korea/data/bondmarket.php?code=Foreign_Holdings

L. Trading Volume

Table 7.13 Trading Volume ($ billion)

Year	Govt Bonds	Corp Bonds	Total
Mar-98	8.31	32.21	40.52
Jun-98	14.37	29.14	43.51
Sep-98	10.38	52.54	62.92
Dec-98	30.23	81.92	112.15
Mar-99	46.49	80.66	127.15
Jun-99	142.15	115.86	258.01
Sep-99	39.07	62.05	101.12
Dec-99	72.02	75.34	147.36
Mar-00	69.18	86.64	155.82
Jun-00	109.09	69.53	178.62
Sep-00	164.54	70.88	235.42
Dec-00	177.20	59.30	236.50
Mar-01	187.21	97.65	284.86
Jun-01	155.61	87.63	243.24
Sep-01	198.03	107.19	305.22
Dec-01	171.26	76.05	247.31
Mar-02	145.60	64.52	210.12
Jun-02	141.18	65.85	207.03
Sep-02	185.14	61.13	246.27
Dec-02	152.50	85.63	238.13
Mar-03	187.37	75.38	262.75
Jun-03	180.26	66.41	246.67
Sep-03	225.62	57.86	283.48
Dec-03	232.18	52.71	284.89
Mar-04	236.86	57.51	294.37
Jun-04	287.07	62.48	349.55
Sep-04	287.75	54.57	342.32
Dec-04	323.28	58.89	382.17
Mar-05	374.51	53.32	427.83
Jun-05	306.20	53.05	359.25
Sep-05	310.90	49.41	360.31
Dec-05	270.02	57.14	327.16
Mar-06	302.65	55.97	358.62
Jun-06	293.55	66.71	360.26
Sep-06	293.89	56.86	350.75
Dec-06	282.96	59.21	342.17
Mar-07	271.91	59.30	331.21
Jun-07	272.39	57.26	329.65
Sep-07	250.02	50.79	300.81
Dec-07	249.91	58.19	308.10
Mar-08	275.90	79.13	355.03
Jun-08	247.47	73.39	320.86
Sep-08	215.03	63.41	278.44
Dec-08	230.68	77.31	307.99

continued on next page

Table 7.13 continuation

Year	Govt Bonds	Corp Bonds	Total
Mar-09	249.34	98.46	347.80
Jun-09	322.84	86.44	409.28
Sep-09	370.08	85.53	455.61
Dec-09	398.29	90.77	489.06
Mar-10	480.59	121.87	602.46
Jun-10	392.30	58.82	451.12
Sep-10	586.20	151.97	738.17
Dec-10	575.41	118.61	694.02
Mar-11	500.72	122.01	622.73
Jun-11	623.05	125.51	748.56
Sep-11	648.73	108.69	757.42

Source: AsianBondsOnline. http://asianbondsonline.adb.org/korea/data/bondmarket.php?code=Trading_Volume

M. Domestic Financing Profile

Table 7.14 Domestic Financing Profile ($ billion)

Date	Domestic Credit (% of Total)	Bonds (% of Total)	Equity (% of Total)	Domestic Credit	Bonds	Equity	Total
Dec-00	52.08	33.80	14.13	546.96	354.98	148.36	1,050.30
Dec-01	49.24	34.27	16.49	580.77	404.18	194.47	1,179.42
Dec-02	51.18	33.80	15.02	736.32	486.18	216.12	1,438.62
Dec-03	48.12	32.82	19.06	753.14	513.64	298.25	1,565.03
Dec-04	45.80	34.02	20.18	884.13	656.72	389.47	1,930.32
Dec-05	39.93	30.76	29.31	978.16	753.68	718.01	2,449.85
Dec-06	34.92	34.16	30.92	942.34	921.80	834.40	2,698.54
Mar-07	34.73	34.61	30.66	954.21	951.07	842.44	2,747.72
Jun-07	33.03	32.84	34.13	1,008.55	1,002.61	1,042.16	3,053.32
Sep-07	31.90	31.76	36.34	1,035.20	1,030.75	1,179.33	3,245.28
Dec-07	32.30	32.35	35.35	1,025.99	1,027.38	1,122.61	3,175.98
Mar-08	33.77	33.75	32.48	997.95	997.16	959.79	2,954.90
Jun-08	34.94	33.77	31.29	1,003.04	969.42	898.36	2,870.82
Sep-08	37.74	34.97	27.29	907.24	840.74	656.12	2,404.10
Dec-08	40.91	37.48	21.61	891.34	816.70	470.80	2,178.84
Mar-09	39.24	36.97	23.79	835.54	787.31	506.59	2,129.44
Jun-09	37.65	36.88	25.47	919.12	900.15	621.76	2,441.03
Sep-09	35.56	35.64	28.79	996.76	999.08	807.10	2,802.94
Dec-09	35.09	35.64	29.27	1,000.72	1,016.25	834.60	2,851.57
Mar-10	34.87	36.18	28.95	1,055.21	1,094.66	876.13	3,026.00
Jun-10	34.79	35.97	29.24	994.81	1,028.49	836.19	2,859.49
Sep-10	33.66	35.28	31.06	1,070.23	1,121.65	987.65	3,179.53
Dec-10	32.41	34.66	32.93	1,074.65	1,149.14	1,091.91	3,315.70
Mar-11	31.86	34.64	33.49	1,114.27	1,211.47	1,171.20	3,496.94
Jun-11	33.83	31.15	35.01	1,159.56	1,067.65	1,199.93	3,427.14

Source: AsianBondsOnline. http://asianbondsonline.adb.org/korea/data/bondmarket.php?code=Domestic_Financing_profile

VIII. Next Step

A. Group of 30 Compliance[39]

The so-called G-30 Recommendations were originally conceived as the Group of Thirty's Standards on Securities Settlement Systems in 1989, detailing in a first of its kind report nine recommendations for efficient and effective securities markets and covering legal, structural and settlement process areas. The recommendations were subsequently reviewed and updated in 2001, under leadership of the Bank for International Settlements (BIS), and through the efforts of a Joint Task Force of the Committee On Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organisation of Securities Commissions (IOSCO). Compliance with the G30 Recommendations in individual markets is often an integral part in securities industry participants' and intermediaries' due diligence process.

Table 8.1 Global Clearing and Settlement – A Plan of Action

	Recommendation	Implemented
1	Eliminate paper and automate communication, data capture, and enrichment.	No
2	Harmonize messaging standards and communication protocols.	No
3	Develop and implement reference data standards.	No
4	Synchronize timing between different clearing and settlement systems and associated payment and foreign exchange systems.	Yes
5	Automate and standardize institutional trade matching.	Yes
6	Expand the use of central counterparties.	No (Please see below note 1)
7	Permit securities lending and borrowing to expedite settlement.	Yes
8	Automate and standardize asset servicing processes, including corporate actions, tax relief arrangements, and restrictions on foreign ownership.	No
9	Ensure the financial integrity of providers of clearing and settlement services.	No
10	Reinforce the risk management practices of users of clearing and settlement service providers.	No
11	Ensure final. Simultaneous transfer and availability of assets.	Yes

continued on next page

39 Group of 30 (G30). 2003. *Global Clearing and Settlement – A Plan of Action*. http://www.partad.ru/wrld/word/g30app1.pdf

Table 8.1 continuation

Recommendation		Implemented
12	Ensure effective business continuity and disaster recovery planning.	No
13	Address the possibility of failure of a systematically important institution.	No
14	Strengthen assessment of the enforceability of contracts.	No
15	Advance legal certainty over rights to securities, cash, or collateral.	Yes
16	Recognize and support improved valuation methodologies and closeout netting arrangements.	No
17	Ensure appointment of appropriately experienced and senior board members (of the boards of securities clearing and settlement infrastructure providers).	Yes
18	Promote fair access to securities clearing and settlement networks.	Yes
19	Ensure equitable and effective attention to stakeholder interests.	No
20	Encourage consistent regulation and oversight of securities clearing and settlement service providers.	Yes

Source: Group of 30 (G30). 2003. *Global Clearing and Settlement – A Plan of Action.*

B. Group of Experts Final Report: Summary of Barriers Market Assessment – Korea (April/2010)

The GoE Report refers to the published results in 2010 of the Group of Experts (GoE) formed under Task Force 4 of the Asian Bond Market Initiative (ABMI). In the report, published under the leadership of the Asian Development Bank (ADB), a group of securities market experts from the private and public sector in ASEAN+3, as well as International Experts, assessed the ASEAN+3 securities markets on potential market barriers, the costs for cross-border bond transactions, and the feasibility for the establishment of a Regional Settlement Intermediary (RSI). The findings in the GoE Report lead to the creation of ABMF.

Table 8.2 Summary of Barriers Market Assessment – Korea (April 2010)

Potential Barrier Area	Current Situation	Market Assessment Questionnaire Scores	Overall Barrier Assessment
Quotas	Foreign investors have access to all fixed-income instruments, and there is no ownership limit for foreigners.	OK	OK
Investor registration	Foreign investors must obtain an investment registration certificate (IRC) prior to investing in Korea. The IRC contains a unique identification number, which notes the foreign investor's nationality and other information. The IRC number is used in all trading, settlement and registration activities. Foreign investors may apply for a single IRC covering both equities and bonds. The requirements are well defined and do not appear onerous - e.g., only one document needs notarisation. We are told that IRC can be issued 1 day after submission. However, there is an investor perception of difficulties in this area. Appears to be some controversy over 'parent child' area regarding splitting or consolidating holdings over a number of sub-funds. Perception gap - there appears to be a perception among many investors that registration requirements are onerous.	LOW	LOW
FX controls - conversion	Since December 2007, foreign investors are allowed to buy the Korean won without any underlying securities trade. Perception gap - there appears to be a perception among many investors that foreign exchange (FX) controls are still in place.	OK	OK

continued on next page

Table 8.2 continuation

Potential Barrier Area	Current Situation	Market Assessment Questionnaire Scores	Overall Barrier Assessment
FX controls - repatriation of funds	There is no restriction on the repatriation of income or proceeds from the sale of securities. Sales proceeds converted into foreign currency can either be remitted overseas or held in onshore foreign currency accounts.	OK	OK
Cash controls - credit balances	Foreign investors can buy an unlimited amount of Korean won, keep it as cash, fund a purchase trade or re-convert back into FCY.	OK	OK
Cash controls - overdrafts	Sales proceeds can be used to fund purchase trades having the same settlement date. In theory, foreign investors can borrow up to KRW 1 billion without any restriction, and up to W30 billion with prior notification to the central bank. However, banks are not allowed to lend to foreign investors for a “speculative” purpose in securities, which is not clearly defined, and hence in practice overdrafts are not provided. There is a current proposal to the National Assembly to lift this restriction.	LOW	LOW
Taxes	The default tax rate to foreign investors is 22% on cash balance interest and dividends and 15.4% on interest income on debt securities. The rates of withholding tax and CGT may be reduced under applicable double taxation agreements, subject to documentation. Historical information is needed to calculate the tax. There are no officially recognised tax reclaim procedures. Taxes may be reclaimed on a case by case basis, although the reclaim is not guaranteed. There is a perception among foreign investors that tax is high. This appears to be incorrect and may reflect previous higher rates. The government has proposed that foreign investors will be exempt from interest and capital gains tax for income from government bonds and monetary stabilisation bonds.	LOW	HIGH
Omnibus accounts	Omnibus accounts in general are not permitted. However, as from 1 January 2008, omnibus accounts in the name of ICSDs at KSD are permitted for foreign investors buying and selling Korean government bonds and monetary stabilization bonds. Accounts must be held on an individual basis at the sub-custodian, with the global custodian designation. Due to tax and other restrictions, ICSDs have been slow to open links although these have now been announced. The government is currently reviewing the rules to allow omnibus accounts to be introduced later this year.	HIGH	HIGH
Settlement cycle	The settlement cycle for bonds is: T+1(or by agreement).	OK	OK
Message formats	KSD, and most local market participants, use SWIFT message formats. KSD uses SWIFT for both settlement and corporate event messages.	OK	OK
Securities numbering	ISIN codes are available for all local bond issues, and are available at the time of issue. ISIN can be allocated at any time through the online allocating system of the KRX. KSD, and most local market participants, use ISIN.	OK	OK
Matching	There is no trade matching or pre-settlement matching system for bonds.	LOW	LOW
Dematerialisation	Almost all bonds are dematerialised, or immobilised at KSD.	OK	OK
Regulatory framework	The regulatory regime is regarded as stable and consistent although some investors mentioned high penalties for non-compliance, and that local custodians take a very cautious view. It is clear that the Korean government is making serious efforts to attract foreign investors.	-	OK

Source: Group of Experts (GoE) Final Report: Summary of Barriers Market Assessment – Korea (April 2010).https://wpqr1.adb.org/LotusQuickr/asean3goe/Main.nsf/h_58E34A1388F9070B48257729000C0A4E/90F408746827C16248257729000C1334/$file/Part3.pdf

C. Revision of the *Commercial Act* and Corporate Bond Effective 2012

1. Revisions to the Commercial Act

The *Commercial Act* was substantially revised recently, and the corporate bond market is facing important regulatory changes.[40] The revised bill includes several modifications related to corporate bonds. It provides a foundation that enables diversified types of bonds to be issued by: repealing restrictions on subscription and the total amount of bonds; introducing the indenture trustee system for investor protection; and modifying the issue procedure to ensure investor protection. Overall, this new version of the bill reflects various demands to improve the corporate bond system, and therefore it may bring about tremendous changes to the corporate bond market in Korea.

First, the revision provides an environment where diversified types of bonds can be issued. The current *Commercial Act* adopts a positive system for securities, under which only the types of securities stipulated by law can be issued, and permits only three types of corporate bonds: ordinary corporate bonds, bonds with warrant, and convertible bonds. The lack of variety has limited the innovative use of securities by companies. The revision paves the way for issues of diversified corporate bonds, i.e., corporate bonds that pay out dividends by the resolution of the board of directors; bonds that can be redeemed with, or converted to other stocks or securities; and bonds whose redemption or payments are linked to the value of other securities, currencies, or other assets and indexes that the Presidential Decree stipulates according to a pre-determined method.

In addition, the new bill allows the board of directors to entrust its bond-issuing authority to the president of a company. In order to prevent the abuse of power, the period of entrusting should be less than one year, and the board of directors still holds the power to determine the amount and types of bond issues. Furthermore, the revision repealed several corporate bond regulations: the limitation on the total amount of corporate bonds, restrictions on offering of new bonds, and restrictions on redemption in excess par value.

Currently, the *Commercial Act* stipulates that “the total amount of bonds shall not exceed four times the amount of net assets of the company as shown by the latest balance sheet.” However, this article has been criticized as ineffective in protecting creditors because the issuer could borrow from elsewhere or decrease its capital after the issue. Rather than protecting creditors, this article limits the company’s opportunity for financing through corporate bond issues. In response to the criticism, the new bill repealed the limit on the total amount of corporate bonds in attempt to expand a company’s financing opportunity.

Another change in this area is the restrictions on offerings of new bonds. The current law says that “a company shall not offer new bonds for subscription until the amount of bonds previously subscribed has been fully paid,” but this article was removed.

40 The National Assembly passed the revised bill in March 2011. The revision was published on 14 April 2011, and it will take effect from 15 April 2012.

Also important in this revision is the introduction of an indenture trustee system that is expected to enhance investor protection. Under the current Commercial Act, a commissioned company, which has been commissioned to offer bonds for subscription, undertakes dual duties: Serving the interest of the issuer during the subscription, but standing on the side of bondholders to protect their interest after the issue. However, this will change if the updated bill takes effect and the sole purpose of the trustee will be to protect the creditors' rights. The revision establishes new articles governing the qualification, duties, and responsibilities of trustees. However, an issuer is not obligated to appoint a trustee because doing so will incur huge costs. Those who share a special interest with the issuer or underwriter and those disqualified according to the Presidential Decree cannot act as a trustee. Only banks, trust companies, and others permitted by the Presidential Decree can become a trustee. The trustees should manage bonds with honesty and sincerity, and take on a fiduciary duty for bondholders as the updated bill stipulates. If a trustee violates the Commercial Act or goes against the resolution by the meetings of bondholders, the trustee faces a collective liability for damages.

Also added in the revision is the regulation about the authority, resignation, removal of the trustee, and the successor to the trustee. Last, the updated passage includes modifications on articles related to the bondholders' meetings, such as meeting procedures, voting rights, and how to exercise voting rights.

2. Impact of the Revision

The aforementioned changes in the *Commercial Act* are predicted to significantly address many problems related to corporate bonds. If the revision comes into effect, companies are expected to issue bonds more freely, and creditors will be able to enjoy better protection. There are good reasons for the high hopes.

First, the revision provides a basis for corporate bonds diversity. This should resolve the discrepancy in concept about securities between the *Commercial Act* and the Financial Investment Services and Capital Markets Act (FSCMA). While the former adopts a positive system to define securities, the latter uses a negative system that allows the issue of any new and innovative securities unless prohibited explicitly by law.

Under the previous circumstances, there was a lingering controversy whether any new securities permitted under the FSCMA fell under the categories of corporate bonds as defined in the *Commercial Act* or not. The updated bill adopts a wider definition for corporate bonds, and it creates a legal basis on which diversified securities can be issued. This will put an end to the controversy.

Second, as the limit on the total amount of issues is removed, companies should be able to finance themselves more flexibly. This will facilitate the introduction of bonds with new structures. Under the new law, companies will be able to issue diversified bonds tailored to their needs, and the volume of issue will be determined by market discipline.

Third, the revision paves the way for a system that substantially enhances the bondholders' interest. This will improve the international compatibility of corporate bond issues and enhance investor protection.

When a commissioned company protects the issuer during the subscription and works for bondholders after the issue procedure, bond holders are not fully protected. For example, if the issuer goes bankrupt, the commissioned company can only play a limited role in protecting bondholders. This gives rise to investor protection problems, and many other problems, such as undermining the credibility of corporate bonds. In order to tackle these matters, the revised Commercial Act introduces the concept of trustees, whose role is separated from the commissioned company.

Also, the updated bill adds new articles regarding the qualification and trustee's duties. This is meaningful because it creates a foundation that can substantially enhance bondholder protection. Certain limits, however, exist because the appointment of a trustee is not mandatory under the revision.

Table 8.3 Question and Answer related to the New Commercial Act Scripless Provisions (Answered by KSD)

Invite opinion from KSD on how new Commercial Act scripless provisions may/will influence physical certificates, for our future outlook?	(Application scope) In the amended Commercial Act, the electronic registration system covers securities under the Commercial Act, such as stocks, corporate bonds, warrants, and commercial securities. It is not applicable to other securities under the Financial Investment Services and Capital Markets Act such as government bonds, municipal bonds, special bonds, CDs, beneficiary securities (collective investment securities) and depositary receipts. (Application method) The Commercial Act is a general law, so adopting electronic registration is decided by the issuer (by amendment to the Articles of Incorporation). Therefore, the issuer will be able issue physical securities, unless electronic registration is made mandatory by the Listing Regulations of the Korea Exchange. (Effect of electronic registration to paper securities) The revised law delegates the particulars of the electronic registration to the enactment decree, but it seems that legislating a separate special law will be inevitable in order to implement the system. In case a separate special law pursuant to the amended Commercial Act is enacted, it will be possible to execute the electronic registration system, which implementation will bring benefits such as reduced securities issuance costs, causing electronic registration to replace physical securities.

Source: Korea Securities Depository.

D. Commissioned Company System for Bondholders

Korea revised the Commercial Act and introduced the commissioned company system for bondholders to increase investor protection and advance the corporate bond market. The amendment makes the use of a trustee voluntary. However, to develop the corporate bond market, Korea needs to make commissioned company system mandatory and resolve the conflict of interest problem. A strategic approach is required because the use of commissioned company may increase financing costs and thereby hinder corporate bond issues.

Market participants should explore ways to customize the trustee system for the Korean capital markets. Under the revised Commercial Act, only banks, trust companies, and others permitted by the Presidential Decree can become commissioned companies. Also, those who share a special interest with the issuer or underwriter and those disqualified according to the Presidential Decree cannot become trustees. However, the most important qualification factor should be the problem on conflict of interest. Just as in the US, the roles, rights, and duties of a trustee should be different before and after default.

In order for the revised Commercial Act to serve its purpose of revitalizing the corporate bond market, it is important to devise a system that helps create a safe investment environment for investors, and a convenient system for issuers. Before the revision goes into effect, financial institutions, issuers, investors, academics, legal professionals, and other market participants should discuss the trustee system to facilitate Korea's corporate bond market.

E. Bankruptcy Procedures

"The Asia-Pacific Restructuring and Insolvency Guide 2006" provides a guide to explain the restructuring and insolvency frameworks of Asia-Pacific countries, which also contains the report on Korea.[41]

According to the report

> On March 21 2005 the Korean government promulgated the Act on Rehabilitation and Bankruptcy of Debtors, also known as the Unified Insolvency Law, which will come into force on April 1 2006. The law consolidates the Corporate Reorganization Act, the Composition Act, the Bankruptcy Act and the Act on Rehabilitation of Individual Debtors in order to establish systematic procedures for the rehabilitation and liquidation of insolvent companies and individuals. In consolidating these statutes, the law abolishes the composition procedure and establishes a rehabilitation procedure which modifies and improves the previous reorganization procedure. As a result, the law provides for two corporate insolvency procedures: bankruptcy and rehabilitation. The Korean principles on bankruptcy were adopted from the German legal system, introduced to the Republic of Korea via Japan. The principles on rehabilitation were largely modeled on US federal law, such as Chapter 11 protections.
>
> In June 1998 almost all Korean financial institutions entered into the Financial Institutions Arrangement for Facilitating Corporate Restructuring (known as the Master Workout Arrangement), introducing an informal workout system into the Korean insolvency regime. The Korean government subsequently enacted the Corporate Restructuring Promotion Act, which replaced the Master Workout Arrangement with the aim of facilitating and expediting informal workouts. The act, effective from September 2001 until the end of 2005, is the basic law governing out-of-court, informal corporate rescue procedures. However, there has been some debate as to its constitutionality, which is currently under review by the Constitutional Court. Depending on the court's decision, the Korean government is considering amending the act to extend its effectiveness.

[41] Asian Development Bank. 2006. *The Asia-Pacific Restructuring and Insolvency Guide 2006*. http://www.adb.org/Documents/Guidelines/restructuring-insolvency/restructuring-insolvency.pdf

The number of insolvency cases, both formal and informal, has soared since 1997, leading to growth in the domestic distressed claims business.

Moreover, workouts are more popular than corporate reorganizations. Since the introduction of the Master Workout Arrangement, a total of 83 insolvent companies have been subject to workouts. While most of the blue-chip companies involved in workouts have successfully completed the procedure, the process is still ongoing for those in declining industries or industries requiring heavy equipment and installations.

As a response to difficulties in reaching agreement between creditors and a lack of professionalism in the management of insolvent companies, the government introduced the corporate restructuring vehicle in October 2000.

However, this has not yet been utilized as an effective restructuring vehicle.

The corporate restructuring company was also introduced in May 1999 to promote corporate restructuring of insolvent companies and to address financial institutions' non-performing loans. The primary role of the corporate restructuring company is to obtain managerial control of an insolvent company and enhance its corporate value through vigorous restructuring. The insolvent company is eventually sold, within eight years of the date of acquisition, in order for the corporate restructuring company to realize capital gains.

Appendixes

Appendix 1.1 Financial Investment Service and Capital Market Act

FSCMA	
(Article 9) Other Definitions	(7) The term "**public offerin**g" in this Act means the invitation of 50 or more investors, as computed by a formula prescribed by Presidential Decree, to make offers to acquire securities newly issued. (9) The term "**public sale**" in this Act means offering 50 or more investors, as computed by a formula prescribed by Presidential Decree, to make an offer to sell or invite offers to purchase securities already issued.
ENFORCEMENT DECREE OF FSCMA	
(Article 11) Public Offering and Public Sale of Securities	(1) In calculating fifty persons in accordance with Article 9 (7) or (9) of the Act, the number of persons who have been invited to subscribe securities of the same class as the securities in the instant case in any manner other than by public offering or public sale within six months before the public invitation to subscribe shall be aggregated, but persons falling under any of the following subparagraphs shall be excluded there from: 1. **Professionals** falling under any of the following items: **(3)** Persons under any provision of Article 10 (1) 1 through 4 (See below); **(4)** Persons specified and publicly notified by the Financial Services Commission among those falling under Article 10 (3) 12 or 13 (See below); **(5)** Accounting firms under the Certified Public Accountant Act; **(6)** Credit rating business entities under the Use and Protection of Credit Information Act (hereinafter referred to as "credit rating business entities"); **(7)** Persons who provide accounting, consulting, and similar services to the issuer with an officially recognized qualification certificate for certified public accountant, appraiser, attorney-at-law, patent attorney, tax accountant, etc.; and **(8)** Other persons specified and publicly notified by the Financial Services Commission as professionals who are in a position to have good knowledge of financial status, business affairs, etc. of the issuer; and 2. Related persons falling under any of the following items: (a) The largest shareholder (referring to the largest shareholder under Article 9 (1) 1 of the Act; hereinafter the same shall apply) of the issuer and shareholders who hold 5/100 or more of the total number of outstanding stocks; (b) Executives (including those under subparagraphs of Article 401-2 (1) of the Commercial Act; hereafter the same shall apply in this subparagraph) of the issuer and members of the employee shareholders' association under the Framework Act on Worker's Welfare; (c) Affiliated companies of the issuer and their executives; (d) Shareholders of a stock-unlisted corporation (excluding a corporation that has a record of it as having publicly offered or sold its stocks), in cases where the issuer is the stock-unlisted corporation;

continued on next page

Appendix 1.1 continuation

ENFORCEMENT DECREE OF FSCMA	
	(e) Executives and employees of a domestic affiliated company of the issuer, in cases where the issuer is a foreign enterprise established pursuant to laws and regulations of a foreign country, and sells stocks of the foreign enterprise to executives and employees of the domestic affiliated company in accordance with a stock option plan, etc. for improving welfare of employees; (f) Promoters of a company, if the company is being incorporated by the issuer; and (g) Other persons specified and publicly notified by the Financial Services Commission as related persons who are in a position to have good knowledge of financial status, business affairs, etc. of the issuer. (2) Even if the results of calculation under paragraph (1) shows that the number of persons who have been invited to subscribe is less than fifty persons and thus the invitation does not amount to a public offering of securities, it shall still be deemed as a public offering, in cases where it falls under the criteria prescribed and publicly notified by the Financial Services Commission for resale, taking into consideration the kind of securities, the characteristics of acquirers, etc. (3) In applying paragraph (1) to a public sale, the number of persons shall be calculated based on persons who are invited to subscribe outside of the securities market (excluding cases where a broker gets involved in trading listed stocks and securities depository receipts that are related to the stocks and that are listed on the securities exchange in accordance with Article 78 (1) of the Act).
Article 10 (Scope of Professional Investors)	(1) The term “professional investor specified by Presidential Decree” in the proviso to the main body of Article 9 (5) of the Act means a professional investor not falling under any of the following subparagraphs: 1. State; 2. The Bank of Korea; 3. A person who falls under any provision of paragraph (2) 1 through 17; 4. A person who falls under any provision of paragraph (3) 1 through 11; (2) The term “financial institutions specified by Presidential Decree” in Article 9 (5) 3 of the Act means any of the following financial institutions: 1. Financial institutions under the Banking Act; 2. The Korea Development Bank under the Korea Development Bank Act; 3. The Industrial Bank of Korea under the Industrial Bank of Korea Act; 4. The Export-Import Bank of Korea under the Export-Import Bank of Korea Act; 5. The National Agricultural Cooperative Federation under the Agricultural Cooperatives Act; 6. The National Federation of Fisheries Cooperatives under the Fisheries Cooperatives Act; 7. Insurance companies under the Insurance Business Act (hereinafter referred to as “insurance companies”); 8. Financial investment business entities [excluding concurrently-run financial investment business entities under Article 22 of the Act (hereinafter referred to as “concurrently-run financial investment business entities”)]; 9. Securities finance companies with authorization under Article 324 (1) of the Act (hereinafter referred to as “securities finance companies”); 10. Merchant banks; 11. Financial brokerage companies with authorization under Article 355 (1) of the Act (hereinafter referred to as “financial brokerage companies”); 12. Financial holding companies under the Financial Holding Companies Act; 13. Specialized credit financial business entities under the Specialized Credit Financial Business Act; 14. Mutual savings banks under the Mutual Savings Banks Act and their Central Federation; 15. The Forestry Cooperatives Federation under the Forestry Cooperatives Act; 16. The Korean Federation of Community Credit Cooperatives under the Community Credit Cooperatives Act; 17. The National Credit Union Federation of Korea under the Credit Unions Act; (3) The term “persons specified by Presidential Decree” in Article 9 (5) 5 of the Act means any of the following persons: 1. The Korea Deposit Insurance Corporation and reorganized financial institutions under the Depositor Protection Act; 2. The Korea Asset Management Corporation under the Act on the Efficient disposition of Non-Performing Assets, etc. of Financial Institutions and the Establishment of Korea Asset Management Corporation; 3. The Korea Housing Finance Corporation under the Korea Housing Finance Corporation Act; 4. The Korea Investment Corporation under the Korea Investment Corporation Act; 5. The Association; 6. The Korea Securities Depository established pursuant to Article 294 of the Act (hereinafter referred to as the “Securities Depository”);

continued on next page

Appendix 1.1 continuation

ENFORCEMENT DECREE OF FSCMA	
	7. The Korea Exchange established pursuant to Article 373 of the Act (hereinafter referred to as the "Exchange");8. The Financial Supervisory Service under the Act on the Establishment, etc. of Financial Services Commission (hereinafter referred to as the "Financial Supervisory Service"); 9. Collective investment schemes (excluding those specified and publicly notified by the Financial Services Commission); 10. The Korea Credit Guarantee Fund under the Credit Guarantee Fund Act; 11. The Korea Technology Credit Guarantee Fund under the Technology Credit Guarantee Fund Act; 12. Funds established pursuant to a relevant Act (excluding those under subparagraphs 10 and 11) and the corporations that manage and operate any of such funds; 13. Corporations that manage any mutual aid business pursuant to a relevant Act;

Source: Financial Service Commission, Republic of Korea, 4/11/2011 (Act) and 4/8/2011 (Decree), www.fsc.go.kr/eng/lr/list03.jsp?menu=0203&bbsid=BBS0087

Appendix 1.2 Regulation on Issuance, Public Disclosure, Etc. of Securities

Article 2–1 (Persons Excluded from Number Invited to Subscribe)	(1) "Persons specified and publicly notified by the FSC" in Article 11 (1) 1 (b) of the Decree refers to those falling under any of the following subparagraphs: 1. The Public Capital Redemption Fund under the Public Capital Redemption Fund Act; 2. The National Pension Fund under the National Pension Act; 3. The Veterans' Pension Fund under the Veterans' Pension Act; 4. The Non-Performing Asset Management Fund under the Act on the Efficient Disposal of Non-Performing Assets, etc. of Financial Institutions and the Establishment of Korea Asset Management Corporation; 5. The Deposit Insurance Fund under the Depositor Protection Act; 6. The Exchange Equalization Fund under the Foreign Exchange Transactions Act; 7. The National Housing Fund under the Housing Act; 8. A person specified in Article 56-2 of the Enforcement Rule of the Corporate Tax Act (excluding those under Article 10 (2) 16 or 17 or Article 10 (3) 10 or 11 of the Decree in such cases); <Amended Jul. 6, 2009> (2) "Persons specified and publicly notified by the FSC" in Article 11 (1) 1 (f) of the Decree refers to those under any of the following subparagraphs: 1. A company specializing in investment in start-up of small and medium enterprises under the Support for Small and Medium Enterprise Establishment Act; 2. A person similar to a company under subparagraph 1 or an expert under 3. any item of Article 11 (1) 1 of the Decree, who is specified by the Governor of the Financial Supervisory Service (hereinafter referred to as the "FSS Governor") as an expert with special knowledge of financial status or business prospects of an issuer. (3) "Persons specified and publicly notified by the FSC" in Article 11 (1) 2 (g) of the Decree refer to those falling under any of the following subparagraphs: 1. A company that uses products of an issuer (excluding a company in the process of incorporation) directly as raw materials or that supplies its products to an issuer (excluding a company in the process of incorporation), or an executive of such company; 2. A person engaging exclusively in distribution of products of an issuer (excluding a company still in the process of incorporation) under a distributorship contract with the issuer, or an executive of such person; 3. A member of an organization, such as an association, etc., if an issuer is a company (including a company still in the process of incorporation) in which members of the organization have jointly invested to engage in business activities for public purposes or public interest, such as the press, academic activities, and research; 4. A member of a specified local organization, such as a local chamber of commerce and industry, a local merchants' association, and a local farmers' or fishers' organization, if an issuer is a company (including a company still in the process of incorporation) in which members of such organization have jointly invested to engage in joint business activities, such as disposing of industrial waste, providing financial or insurance services, or manufacturing, processing or distribution of agricultural, fishery, or livestock products in the locality; 5. A member of an organization, such as an alumni association or clan association, if an issuer is a company (including a company still in the process of incorporation) in which members of such organization have jointly invested in accordance with a consensus to have the company engage in joint business activities; 6. A stockholder of a corporation that is not obligated to submit business reports pursuant to Article 159 (1) of the Act (hereafter referred to as "corporation exempted from submission of business reports" in this Article), if the stockholder receives securities issued by another corporation exempted from submission of business reports in consideration for a merger with the former corporation exempted from submission of business reports, all-inclusive exchange or transfer of stocks, division or divided merger;

continued on next page

Appendix 1.2 continuation

	7. Any other person similar to a related person under subparagraphs 1 through 6 above or any item of Article 11 (1) 2 of the Decree, who is specified by the FSS Governor as a specially-related person with special knowledge of financial status or business prospects of an issuer.
Article 2–2 (Criteria for Resale Deemed Public Offering of Securities)	(1) "Cases where it falls under the criteria prescribed and publicly notified by the FSC for resale" in Article 11 (2) of the Decree mean any of the following cases: 1. For equity securities (including depository receipts related to equity securities; the same shall apply hereafter in this Article and Article 2-3 (2), where securities of the same kind have a past record of public offering or public sale or are listed on the securities market. In such cases, securities issued by a company incorporated as a consequence of division or divided merger (excluding physical division under Article 530-12 of the Commercial Act) shall be deemed securities of the same kind as those issued by the divided company; 2. For securities other than equity securities, where the number of securities 3. issued is 50 or more or the number of securities split after issued is 50 4. or more and such securities are transferable; 5. Where securities that are subject to a right conferred in securities, such 6. As a right of conversion and a preemptive right to new stocks, fall [sic] under subparagraph 1 or 2. 7. <Deleted Jul. 6, 2009> (2) Notwithstanding paragraph (1), it shall be deemed that none of the following cases falls under the criteria for resale under paragraph (1) in issuing securities: 1. Where securities are deposited (including registration under the Registration of Bonds and Debentures Act; the same shall apply hereafter in this Chapter) in the Korea Depository (hereinafter referred to as the "Depository") immediately after the issuance of the securities and a deposit contract is made with the Depositor to agree that such securities (including securities acquired by exercise of rights conferred in the securities) shall not be withdrawn nor sold for one year from the date of deposit and such deposit contract is duly performed, or where measures necessary to prevent equity securities, acquired by the Government or the Korea Deposit Insurance Corporation as a result of investing in an insolvent financial institution pursuant to Article 12 (1) of the Act on the Structural Improvement of the Financial Industry (hereinafter referred to as the "Financial Industry Act"), from being resold to 50 or more persons within one year from the date of acquisition; 2. Where a special stipulation to prohibit splitting within one year is stated 3. on the face of securities, if securities under paragraph (1) 2 is less than 4. 50 units; 5. Where the period during which exercise of a right is prohibited is not less than one year after issuance in cases of paragraph (1) 3; 6. <Deleted Jul. 6, 2009> (3) The Depository may, if any of the following events occurs with respect to securities deposited pursuant to the main sentence of paragraph (2) 1, permit withdrawal of such securities upon the request of the issuer. In such cases, the Depository shall require deposit of such securities again or deposit of securities acquired by exercising a right, such as a right of conversion, immediately upon the event ends; 1. Where withdrawal is needed to exchange securities with those in a standardized size; 2. Where withdrawal is needed to exercise a right conferred in securities, such as a right of conversion and a preemptive right to new stocks; 3. Where withdrawal is needed to exchange securities with other securities for a merger, division, divided merger of companies or all-inclusive exchange or transfer of stocks; 4. Where withdrawal is needed to exchange securities with new ones for stock split or consolidation of shares, a change in the par or stated value; 5. Where the FSS Governor approves that withdrawal is needed for any other event similar to those set forth above.
Article 2–2–2 (Criteria for Resale Deemed Public Offering in Issuing Overseas Securities)	(1) Notwithstanding 2-2, where securities are issued overseas (referring to cases where essential activities related to the issuance, such as invitation to subscription, subscription, etc., are made overseas), and such securities, rights conferred therein, or securities issued by exercising such rights (hereafter referred to as "relevant securities, etc" in this Article) are issued under the condition that any resident under the Foreign Exchange Transaction Act (excluding financial investment business entity that acquires the relevant securities in accordance with the underwriting contract related to the issuance of the securities; hereafter in this Article, the same shall apply) is eligible to acquire the relevant securities at the time of the issuance or within one year from the issuance date, such cases shall be deemed "cases where it falls under the criteria prescribed and publicly notified by the FSC for resale" in Article 11 (2) of the Decree.

continued on next page

Appendix 1.2 continuation

	(2) Notwithstanding paragraph (1), any of the following cases shall be deemed not falling under the criteria for resale under paragraph (1): 1. Where a condition that relevant securities, etc. shall not be transferred to any resident at the time of issuance or within one year from the issuance date is stated on the face of such securities (limited to cases where any physical instrument is issued), the underwriting contract, acquisition contract, or a written invitation to subscription; the issuer or underwriting financial investment business entity requires an acquisitor to furnish a written consent with a signature confirming the condition attached to the issuance; and such securities are issued after making a devise for securing the performance of the written consent; 2. Where securities are deposited in an officially recognized depository in the issued place immediately after issued; a depository contract is made with a condition that the relevant securities, etc. shall not be withdrawn or transferred to any resident within one year from the date of deposit; and then such deposit contract is performed; 3. Where a professional investor under Article 11 (1) 1 (a) or (b) of the Decree (hereafter referred to as “professional investor” in this subparagraph) acquires (including acquisition from the issuer or underwriter at the time of issuance) corporate bonds, which shall not be convertible bonds, bonds with warrant, or exchangeable bonds, and such securities are transferred only between professional investors and all the following requirements shall be satisfied: (a) Securities shall be issued in foreign currency and the principal and interest shall be paid in foreign currency; (b) At least 80/100 of the amount issued shall be allocated to non-residents (limited to securities acquired from the issue or underwriter at the time of issuance); (c) Corporate bonds shall be those listed on a major overseas market specified by the FSS Governor (hereafter referred to as “major overseas market” in this item), those registered with or reported to a foreign financial investment supervisory agency of the country in which a major overseas market is established, or those for which any other procedure that may be deemed public offering is completed; (d) Measures shall be taken to state the condition that bonds shall not be transferred to any resident other than professional investors at the time of issuance or within one year from the issuance date on the face of such bonds (limited to cases where any physical instrument is issued), the underwriting contract, acquisition contract, or written invitation to subscription; (e) The issuer and managing company (limited to cases where a managing company is appointed; the same shall apply hereafter in this item) take the measures under items (a) through (d) and the issuer and managing company shall severally or jointly preserve relevant evidential documents; 4. Where relevant securities, etc. are issued otherwise with a structure under which any resident is unable to acquire such securities at the time of issuance or within one year from the issuance date.

Source: Financial Supervisory Service, www.fss.or.kr

References

- Deutsche Bank AG Domestic Custody Services, Market Guide
- State Street
- HSBC explanation materials for ADB Team
- 2010 – THE GUIDE TO CUSTODY IN WORLD MARKETS by State Street
- asianbondsonline.adb.org

Korea Capital Market Institute(KCMI)
Secretariat of ASEAN+3 Bond Market Forum-Korea KOFIA Building,
143 Uisadang-daero, Yeoungdeungpo-gu Seoul 150-974 Korea

Prof. Shigehito Inukai
Faculty of Law, Waseda University
1-6-1, Nishiwaseda, Shinjuku-ku, Tokyo, 169-8050
Tel & Fax (Direct): + 81-(0)3-3202-2472
Mobile: +81-(0)80-3360-7551
E-Mail: shige.inukai@me.com