



Deregulation of Hedge Funds and Other Amendments to the Enforcement Decree of the Financial Investment Services and Capital Markets Act

The Korean government has announced that the amendment to the Enforcement Decree of the Financial Investment Services and Capital Markets Act (the “Amended Decree”) will take effect on or about early October this year. Summarized below are the key provisions outlined in the press release issued by the Financial Services Commission (the “FSC”).

I. Deregulation of Hedge Funds

1. Expanded Eligibility Criteria for Hedge Fund Investors

At present, only certain qualified investors (banks, insurance companies, financial investors, pension funds and mutual aid associations) are permitted to make investments in hedge funds. However, reflecting a shift toward the global hedge fund paradigm, the Amended Decree will permit individuals investing KRW 500 million or more to invest in hedge funds.

2. Greater Diversity in Asset Management

To facilitate diversification and innovation in investments in securities, derivatives, commodities and other types of financial assets, the Amended Decree abolishes the requirement that hedge funds invest 50% or more of their assets in companies undergoing restructuring.

In addition, restrictions on borrowings and investments in derivatives have been relaxed so as to enable hedge funds to utilize short selling, leveraging and other diverse investment strategies to the extent permitted under the FSCMA. For example, the FSCMA provides for a certain limit on borrowings as promulgated by the Enforcement Decree which shall not exceed 400% of fund asset values. However, borrowings are currently limited by the Enforcement Decree to 300% of fund asset values. This limit will be increased from 300% to 400% of fund asset values upon the Amended Decree becoming effective. Limits on estimated maximum losses on derivatives investments will also be increased from 100% to 400% of fund asset values.

3. Separate License Criteria for Hedge Fund Management Companies

The Amended Decree introduces a new category of “mixed asset funds” under which hedge fund management companies will be issued licenses and approvals. However, such designation will only be given to asset management companies, securities firms and investment advisory companies that meet certain qualifications in terms of their equity capital, track record and head count of professional fund managers. In recognition of the unique nature of fund investment patterns, which favor investment in diverse investment products, mixed asset funds will be subject to almost no restrictions on their selection of investment products.

As for qualifications, the required minimum equity capital for a mixed asset fund will be KRW 6 billion.

When evaluating a fund’s track record, its equity capital, amount of assets under management and performance will be considered. For example, in order to qualify as a mixed asset fund, an asset management company would be required to have assets under management of more than KRW 10 trillion, while an investment advisory company will be required to have trust assets of more than KRW 500 billion. Securities firms will be required to have equity capital of more than KRW 1 trillion. Detailed requirements will be further provided in the FSC’s Regulations on Financial Investment Businesses.

A mixed asset fund will also be required to have at least 3 professional fund managers with experience in hedge fund operations in or outside of Korea.

4. Strengthened Monitoring and Supervision through Reporting Obligations

To protect investors and minimize inherent system risks and keep pace with the global trend toward regulation of the financial industry, the Amended Decree requires hedge fund management companies to report their major management strategies, categories of investment products, status of leverage and derivatives on a quarterly basis in accordance with the guidelines established by the FSC.

II. Regulatory Reforms on Prime Brokers

1. Easing up of Chinese Wall Regulations

Currently, securities firms are prohibited from engaging in the trading/brokerage and fund asset custody businesses together within one business unit. Under the Amended Decree, however, prime brokers will be permitted to carry on trading/brokerage and asset custody businesses within the same business unit of a securities firm, so long as the prime broker service unit is managed separately from the other business units of the securities firm, so as to avoid conflicts of interest.

2. Extension of Credit to Hedge Funds

While securities firms are currently allowed to provide loans to hedge funds that are collateralized by securities under custody only, the Amended Decree will allow prime brokers to extend to hedge funds (i) unsecured loans and (ii) loans collateralized by the securities comprising the hedge funds' own assets.

3. Exceptions to Fund Asset Custody Businesses

Under the Amended Decree, as an exception to the restriction on prime brokers servicing hedge funds, prime brokers will be allowed to engage in transactions between hedge fund assets under their custody and their own assets.

In addition, prime brokers will be allowed to delegate a certain portion of their fund asset custody services, such as custody of share certificates and rights attached thereto, to other custodians (i.e. banks and the Korea Securities Finance Corporation).

For additional information, please contact following professionals at Shin & Kim.

Young-Hee Jo	(TEL: +82 2 316 4236, E-Mail: yhjo@shinkim.com)
Young-Hwan Byeon	(TEL: +82 2 316 1675, E-Mail: yhbyeon@shinkim.com)
Genny S. Kim	(TEL: +82 2 316 4292, E-Mail: gskim@shinkim.com)

Seoul Office Tel: + 82 2 316 4114 Beijing Office Tel: + 86 10 8447 5343 Shanghai Office Tel: + 86 21 6235 0411

SHIN&KIM

The content and opinions expressed within SHIN & KIM's regular newsletter are provided for general informational purposes only and should not be considered as rendering of legal advice for any specific matter.

<http://www.shinkim.com>