Management and Regulation of Qualified Investment Type Private Collective Investment Vehicles under the Amended Financial Investment Services and Capital Markets Act

- With the focus on comparison with existing real estate funds -

The Financial Investment Services and Capital Markets Act, as amended on July 24, 2015 and effective as of October 25, 2015 (the "Amended FSCMA," with the previous version to the amendment referred to as the "Former FSCMA"), is causing phenomenal changes to the regulatory framework for private collective investment vehicles (the "CIVs" or individually "CIV") and substantial deregulations relating to the entrance, establishment, management and sales of private CIVs. In particular, real estate collective investment vehicles (the "REFs" or individually "REF") under the Former FSCMA will established in the form of qualified investment type private collective investment vehicles (the "Qualified Investment Type Private CIVs") under the Amended FSCMA, where it is expected that various changes will take place in relation to the establishment and management of private CIVs.

[Regulatory Framework for Private CIVs]

Prior to the Amendment
General Private CIVs
Qualified Private CIVs (Hedge Funds)
PEFs
Corporate Financial Stability PEFs

Post-Amendment
Qualified Investment Type Private CIVs
Management Participation Type CIVs

[Comparison for Private CIVs for Pre- and Post-Amendment]

Description		Prior to the Amendment		Post-Amendment
Types of CIVs		General Private CIVs (including REFs)	Qualified Private CIVs (i.e., Hedge Funds)	Qualified Investment Type Private CIVs
Asset Manager		Authorized collective investment manager	Authorized collective investment manager	Registered qualified private collective investment manager
Qualification		N/A	National government, financial institutions, pension funds or listed companies; or Individual who invests at least KRW 500 million	Qualified Investor: - Professional investor - Non-professional investor (whether individual, corporate or institutional) which invests in a private fund satisfying the minimum investment amount
Fund Establishment		Registration required prior to selling the collective investment securities	Report after establishment	Report after establishment
ASSET Manage-ment	Investment in Real Estate	O	O	O
	Investment in Securities (For non-controlling purposes)	O	O	O
	Investment in Derivative Instruments	O (Up to 100% of net assets of the funds)	O (Up to 400% of net assets of the funds)	O (The gross value* shall not exceed 400% of the net assets of the funds.)
	Guarantee or Provision of Collateral for any party other than the relevant CIVs	X	O (Up to 50% of the collective investment assets)	O (The gross value shall not exceed 400% of the net assets of the funds.)
	Minimum Investment Requirement	- Under the previous FSCMA, REFs must have allocated at least 50% of their assets in real estate (including securities relating to real estate).	N/A	N/A

Borrowing	X - Where a substantial number of requests are made for redemption of beneficiary certificates, the funds were able to borrow up to 10% of the collective investment assets of the funds. - In case of acquisition of real estate with the funds' assets, the funds were able to borrow up to 200% (or another limit otherwise approved at the general meeting of collective investors) of the net assets of the funds.	O (Up to 400% of the collective investment assets)	O (The gross value shall not exceed 400% of the net assets of the funds.)

*** The gross value referred to in Derivative Instruments, Guarantee or Provision of Collateral and Borrowing in the table means the sum of the (i) appraised value at risk relating to derivative instruments, (ii) amount of debt guarantee or value of collateral provided and (iii) total amount of loan.**

1. Changes in Regulatory Framework for Private CIVs

One of the major amendments to the regulatory framework for private CIVs is to combine four categories of private CIVs ((i) general private CIVs, (ii) qualified private CIVs (hedge funds), (iii) private equity funds (the "PEFs") and (iv) corporate financial stability PEFs) into two categories: "qualified investment type private CIVs" and "management participation type private CIVs". Accordingly, the general private CIVs (including REFs) and the qualified private CIVs under the Former FSCMA are integrated into and regulated as the qualified investment type private CIVs under the Amended FSCMA. Moreover, whereas funds needed to be established separately for each type of investment targets such as real estate or special assets under the Former FSCMA, it is now possible under the Amended FSCMA, by eliminating such limitation, to incorporate various types of investment targets into a single qualified investment type private CIV.

2. Limitations on Investment in Private CIVs by Non-Professional Investors

As the regulations with respect to the establishment and management of qualified investment type

CIVs are relaxed under the Amended FSCMA, only qualified investors are permitted to make direct investments to such CIVs given that the CIVs are more likely to be exposed to higher risks under such relaxed regulations. The qualified investor means a professional investor or a non-professional investor with an investment amount exceeding a certain threshold level (either KRW 100 million or KRW 300 million depending on the ratio of loans etc.* of the relevant CIV) (Article 249-2 of the Amended FSCMA and Article 271 of the Enforcement Decree thereof). Therefore, individual investors and non-listed corporations whose investment amounts fail to meet the relevant threshold level are no longer permitted to make direct investment in CIVs.

* KRW 100 million if the sum of the (i) appraised value at risk relating to derivative instruments, (ii) amount of debt guarantee or value of collateral provided and (iii) total amount of loan does not exceed 200% of the total net assets of the CIV, or 300 million won if otherwise.

3. Deregulation on Entrance, Establishment and Sale of Private CIVs

- A collective investment manager was formerly required to obtain authorization for collective investment business from the Financial Services Commission (the "FSC"); however, under the Amended FSCMA, the concept of qualified private collective investment business is newly introduced and one only has to register in order to manage such investment (Article 249-3(1) of the Amended FSCMA).
- Under the Former FSCMA, the set-up or establishment of a general private CIV (including REF) required registration with the FSC. Under the Amended FSCMA, however, qualified investment type private CIVs only need to be reported to the FSC within two (2) weeks after the set-up or establishment thereof, substantially easing regulations related to the establishment of CIVs (Article 249-6(2) of the Amended FSCMA).
- Under the Former FSCMA, the selling of collective investment securities was only possible through investment traders or investment brokers. Under the Amended FSCMA, however, qualified private collective investment managers are permitted to make direct sales with respect to the qualified investment type private CIV that they manage (Article 249-8(8) of the Amended FSCMA). Also, when selling qualified investment type private collective investment securities, the principle of adequacy shall not be applied, or, which is to say, it shall not be required to obtain information about the investment purpose, status of property, experience in investment, etc. of the non-professional investors unless the non-professional investors request otherwise (Article 249-4(2) of the Amended FSCMA).

4. Deregulation on Asset Management

A. Investment Targets and Ratio of Investment

Under the Former FSCMA, REFs were required to invest 50% or more of their assets in real estate (including real estate securities and other real estate-related properties). However, under the Amended FSCMA, qualified investment type private CIVs are permitted to make investments freely without being restricted to invest only in certain types of properties and in certain ratios (Article 249-8 of the Amended FSCMA excludes Article 299 from application). Such deregulation takes a step further than real estate investment trusts (REITs) where 70% or more of total assets should be real estate.

B. Borrowing / Debt Guarantee and Provision of Collateral

The REFs were prohibited from borrowing money on their own account in principle under the Former FSCMA; provided that exceptions applied when borrowing was needed for (i) making payments for redemption or (ii) acquiring real estate properties with the funds' assets. Also, under the Former FSCMA, debt guarantee and provision of collateral for anyone other than the relevant CIV were prohibited.

Under the Amended FSCMA, qualified investment type private CIVs are permitted to (i) invest in derivative securities, (ii) guarantee debt or provide collateral and (iii) borrow money up to 400% of net assets in principle. However, no exceptional cases were provided for to allow borrowing in excess of statutory borrowing limits based on a resolution by the general meeting of collective investors (Article 249-7(1) of the Amended FSCMA and Article 271-10(1) of the Enforcement Decree thereof).

C. Property Retention Period

Under the Former FSCMA, the REFs shall not, in principle, (i) acquire a domestic real estate property only to dispose of it within one (1) year (in case of acquiring an unsold house, within the period as specified under the collective investment agreement) from the acquisition or (ii) dispose of a land without any building or other structure erected thereupon before implementing a real estate development project in respect of such land. Such restriction relating to property retention period also applies to qualified investment type private CIVs under the Amended FSCMA albeit under a different provision.

D. Loan

Under the Former FSCMA, collective investment managers of REFs were enjoined from providing any loan while managing collective investment assets unless such loan was provided (i) to a certain financial institution for a short term of not exceeding 30 days or (ii) to a corporation related to real estate development (Articles 83(4) and 94(2) of the Former FSCMA).

The qualified investment type private CIVs under the Amended FSCMA are expressly exempted from the application of such restriction and are not otherwise prohibited from lending by any other provisions. On the other hand, the Amended FSCMA does not provide any separate provision that positively permits qualified investment type private CIVs to lend either. Therefore, there may be two conflicting views with respect to the possibility of lending by qualified investment type private CIVs under the framework of the Amended FSCMA. One is that under the Act on Registration of Credit Business, Etc. and Protection of Finance Users (the "RCBPFUA"), the money lending business may be carried out only by those who have been registered for credit business except credit financial institutions otherwise permitted and authorized under other applicable laws. Pursuant to such view, given that qualified investment type private CIVs are not expressly permitted to lend money, the qualified investment type CIVs would still be prohibited from engaging in money lending. The other view is that the Amended FSCMA should be construed as permitting qualified investment type private CIVs to lend money since the specific restriction in money lending provided under the Former FSCMA no longer applies to qualified investment type private CIVs and Amended FSCMA does not otherwise prohibit them from lending in any provision.

It this connection, notwithstanding the absence of any express language prohibiting qualified investment type CIVs from lending, the Korean financial authority appears to be of opinion that the Amended FSCMA may not be construed as permitting qualified investment type private CIVs to lend money. The Korean financial authority's conservative interpretation seems to be concerned with potential problems which may arise from management and supervision of lending business conducted by qualified investment type private CIVs and possible resistance from various stakeholders including banks, credit financial institutions and credit service providers.

E. Issuance of Beneficiary Certificates with Differential Rights and Redemption

The beneficiary interest in the investment trust were required to be issued equally under the Former FSCMA; however, qualified investment type private CIVs under the Amended FSCMA may issue beneficiary certificates with differential rights in respect of repayment of trust principal and distribution of profits etc.(Article 249-8(1) of the Amended FSCMA excludes Article 189(2) from application).

Furthermore, the REFs under the Former FSCMA were established as closed-end funds; however, qualified investment type private CIVs under the Amended FSCMA are not subject to such restriction (Article 249-8(1) of the Amended FSCMA excludes Article 230 from application).

F. Additional Funding of Existing Real Estate Private Funds

A collective investment manager who has managed real estate private funds prior to the date of enforcement of the Amended FSCMA (Oct 25, 2015) may continue to set-up and establish real estate private funds pursuant to the Former FSCMA for a period of up to three (3) years from the date of enforcement of the Amended FSCMA (Article 4(1) of the Addenda of the Amended FSCMA). However, a term of existence of the real estate private funds so set-up and established shall not exceed four (4) years from the date of enforcement of the Amended FSCMA, on a condition that new or additional collective investment securities may be issued by the collective investment manager to the extent of the sum of collective investment properties of the real estate private funds that are liquidated or dissolved after the date of enforcement of the Amended FSCMA (the "Upper Limit") among the collective investment properties held by the real estate private funds under management at the time of the enforcement of the Amended FSCMA (Paragraphs 2 and 3 of Article 4 of the Addenda of the Amended FSCMA).

However, the Upper Limit does not apply if collective investment securities are issued to, and subscribed by, an investor after October 25, 2015 (i) pursuant to a capital call agreement whereby the investor has agreed to subscribe collective investment securities upon receipt of the request for such subscription of the collective investment securities, (ii) for the purpose of distributing dividends upon closing of accounts of an existing real estate private fund, or (iii) for the purpose of complying with an agreement that is executed by an existing real estate private fund to hedge against foreign exchange risks.

5. Tax Issues

The REFs under the Former FSCMA enjoyed certain tax benefits provided under special tax provisions as set forth below. However, notwithstanding that qualified investment type private CIVs are introduced under the Amended FSCMA, such special tax provisions have not been amended to be applicable to qualified investment type private CIVs. Therefore, based on contextual interpretation, the special tax provisions are construed as not applicable to qualified investment type private CIVs, and as such, the qualified investment type private CIVs would be entitled to the tax benefits to a much lesser extent compared to the tax benefits enjoyed by the existing REFs unless otherwise further amended.

<Tax Benefits for Existing Real Estate Funds>

=> Article 87-6 of the Restriction of Special Taxation Act: This article provides for special tax treatment for dividend incomes paid in respect of beneficiary certificates of real estate funds investing 50% or more of their assets in rental housing.

=> Article 180-2 of the Restriction of Special Local Taxation Act: This article includes special tax provisions that the properties acquired as collective investment properties of a real estate fund under Article 229-2 of the Former FSCMA are not subject to heavy local tax rates until December 31, 2015. (However, such heavy local tax rates would not be imposed unconditionally only because this provision is not readily applicable to qualified investment type private CIVs; rather, it would depend on a number of factors including whether five (5) years have elapsed from establishment of the trustee of the qualified investment type private CIV in a metropolitan city and whether the target real property is located in an overpopulation control area.)

=> Article 106 of the Local Tax Act: This article excludes any land which corresponds to Article 106(1)2 of the same Act among the lands owned by an REF from the target of aggregate real estate tax by classifying such land as a separately taxable land (Article 106(1)3(E) of the Local Tax Act and Article 102(5)23 of the Enforcement Decree thereof).

In case you have any questions relating to any of the above, please contact us for more detailed consultation.

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