Amendments to Financial Investment Services and Capital Markets Act

On July 27, 2011, the Financial Services Commission (FSC) issued a press release announcing a proposed amendment to the Financial Investment Services and Capital Markets Act (FSCMA). The purpose of this amendment is to create a regulatory foundation for the development of the Korean capital markets in the wake of the global financial crisis by improving the financial market infrastructure and direct financing capability of listed companies to maintain the market's integrity while reinforcing the regulation of domestic investment banking and asset management businesses.

The key provisions of the amendment to the FSCMA outlined in the FSC's press release are summarized below.

I. Development of Investment Banking Business

To distinguish from other existing securities companies, securities companies meeting certain qualifications shall be classified as "comprehensive financial investment service providers". Such qualified comprehensive financial investment service providers shall be allowed to engage in (i) prime brokerage services such as securities lending and borrowing, custody service of hedge funds assets and the provision of credit to hedge funds (subject to execution of a standard prime brokerage contract) and (ii) comprehensive corporate financing services such as corporate lending and internalization of order executions for unlisted company stock. With such expanded business scope, comprehensive financial investment service providers will be subject to the BIS capital adequacy requirements in addition to the net capital ratio regulations.

II. Reform of Capital Markets Infrastructure

A newly created category of financial investment service-provider – the multilateral trading facility (or alternative trading system, (ATS)) – will be introduced. Similar to a stock exchange, an ATS will be permitted to trade listed stock through an electronic system after obtaining a license from the FSC.

Another newly created category of financial investment service-provider – the clearing business as central counterparty (CCP) for financial business transactions – will also be subject to the licensing requirement. All over-the-counter (OTC) derivatives which may have a significant impact on the Korean capital markets upon default will be required to be cleared through clearing service-providers.

The emergence of new types of financial investment businesses and a stock exchange licensing system will require a change in the concept of the "financial investment products market" under the FSCMA; as such, the existing regulations prohibiting the establishment of a trading facility similar to a stock exchange will be replaced with new regulations prohibiting the establishment of an unlicensed stock exchange in order to establish a legal basis to strengthen the regulation of illegal OTC transactions.

As credit rating businesses serve as an important infrastructure in bond markets, the relevant provisions of the Credit Information Act governing credit rating businesses will be consolidated into the FSCMA.

III. Innovations to Regulatory Framework for the Asset Management Industry

As part of the FSC's attempt to bring innovative changes to the regulatory framework governing the asset management industry, asset management businesses (i.e., the management of assets pooled from two or more investors) will be clearly distinguished from discretionary investment management businesses (i.e., the management of assets of a single investor on a segregated account basis).

In addition, the investor protection mechanism will be reinforced by imposing a fiduciary duty on collective investment businesses owed to investors – for example, an asset management company is obliged to exercise the voting rights of the collective investment vehicle for the interest of its investors.

Amendments to the regulations on trust business will also be made, which will include the expansion of the scope of trust assets to include more diverse trust assets as well as classifications of management trust that currently fall outside the scope of financial investment products.

In line with private equity funds' investment objective to control management, clear investment guidelines for mezzanine securities such as CBs or BWs will be added, and a supplemented monitoring system including a registration system for GP managers and periodic reporting requirements will be introduced.

IV. Direct Financing by Listed Companies

To facilitate efficient and diversified financing, listed companies will be allowed to issue contingent capital securities and warrants, subject to certain restrictions on the issue price and reasons for the issuance of warrants, which are designed to prevent abuse of diversified financing methods as part of the investor protection mechanism.

Allocations of unsubscribed shares in relation to shares issued to existing shareholders will be restricted so as to prevent allocating unsubscribed shares to third parties at a discount. Listed companies will be required to adopt new procedures for the issuance of unsubscribed shares, except in certain limited circumstances.

The shadow voting system based on which the Korea Securities Depository (KSD) exercises proxy voting rights will be abolished in 2015, and the regulations on the granting of powers of attorney will be amended for the proper functioning of general shareholders meetings.

Consistent with the recently amended Korean Commercial Code, the regulations on treasury shares and redemptions of treasury shares of listed companies will be amended, and to protect members of employee stock option plan associations (ESOP), new regulations aimed to supplement an offering period for shares preferentially allocated to members of the ESOP will be introduced.

V. Regulations on Unfair Trading Practices and Public Disclosure Requirements

To prevent price manipulations using unlisted securities and OTC derivatives, excessive scalping and use of information by secondary recipients, the regulations on unfair trading practices will be reinforced. Specifically, unlawful acts that are currently subject to fines such as a violation of disclosure requirements will be subject to criminal charges, and acts causing disruptions to the market will be punished in a more effective manner. A fine on an unlawful act will be cancelled if a court judgment has been executed in respect of the same act so as to protect the due process rights of those who committed such acts.

In the underwriting business, arrangers will be subject to the same civil liability as underwriters for any false description or misrepresentation of a material fact in registration statements. For the issuance of warrants or securing other large-scale capital funding, listed companies will be subject to strict public disclosure requirements.

VI. Other Supplementary Regulations

To minimize uncertainties arising from the broad definition of financial investment products and to establish a legal basis for the application or exemption of the FSCMA, the regulations on financial investment products such as derivative linked securities will be amended.

Given that banks and insurance companies engaging in the trust business face excessive requirements to maintain an internal control system to prevent conflicts of interest as compared to financial investment companies engaging in the trust business, the regulations on concurrent engagement of trust business by financial investment companies will be relaxed in light of practical considerations.

The proposed amendment to the FSCMA drafted by the FSC will be available for public comment for 20 days from July 27, 2011 to August 16, 2011.

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