

FSC PROVIDES GUIDELINE ON UNDERLYING ASSETS FOR FRACTIONAL INVESTMENT SERVICE PROVIDERS

- A guideline on underlying assets provided for the issuance of trust beneficiary certificates by fractional investment service providers.
 - The guideline will provide a key reference for the review committee when selecting innovative financial services under the regulatory sandbox program.
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The Financial Services Commission introduced a guideline on the underlying asset requirement of trust beneficiary certificates when a designated innovative financial service provider under the financial regulatory sandbox program intends to provide fractional investment service through issuance of trust beneficiary certificates. The guideline has been prepared after having discussions with the innovative financial service selection committee (Nov. 28) and at FSC's regular meeting (Dec. 13).

In principle, fractional investment service providers need to first consider making use of the traditionally available investment vehicles. However, when it is deemed to be not viable, by applying the "principle of supplementarity," a regulatory exemption may be granted under the Special Act on Support for Financial Innovation to allow the issuance of trust beneficiary certificates as prescribed by the Financial Investment Services and Capital Markets Act (FSCMA).

Those applying to assume fractional investment business under the regulatory sandbox program should first look into ways to do so by making use of the traditionally existing means of investment vehicles permitted under current laws. Moreover, they should consider that there needs to be a sufficient level of contribution to innovation and investor convenience in issuing trust beneficiary certificates. In this regard, the "supplementarity principle" will be applied in a flexible manner to allow testing of innovative financial services, if the applying entity has given adequate consideration about the "supplementarity principle," and that if there is not much usage of traditional investment vehicles in the fractional investment market.

The trust beneficiary certificates' underlying asset requirements include the following.

First, an objective valuation and assessment should be available. The issuer of trust beneficiary certificates should determine the issuing price and quantity after assessing the value of trust assets, and the investor should be able to see the result of the trust's value assessment.

Second, it should not be a trust beneficiary certificate on paper only with an intention to bypass regulations. Merely changing the form of investment into a trust beneficiary certificate from a readily available asset type in the market to entice investors while bypassing regulations will not be permitted for investor protection purposes. Highly marketable asset types (e.g. securities) that can be easily circulated in small

amounts need to be proven for their distinctiveness and innovativeness for qualifying as underlying assets.

Third, disposal of assets should be easily available and the disposal procedure should be governed by domestic laws. If an approval or permission is required by a foreign law for disposal or acquisition of assets, or if the disposal or acquisition procedures are subject to a foreign law, it may complicate the collection of investment money for investors. This will not be permitted for investor protection purposes.

Fourth, the underlying asset should not be a pooled asset but a single asset without any linkage to an indeterminate business or investment project. The traits of pooled assets run against the aim of fractional investment, and they may cause damage to investors due to lower level of disposability vis-à-vis single asset types. An underlying asset linked to an indeterminate business project or investment project, such as a land development project, a project finance loan, or a bridge loan, will not be permitted.

Fifth, the nature of underlying assets should not come in conflict with financial market stability or run against any other social order. For instance, an attempt to securitize a housing property, which can have consequences for the government's real estate market policy (loan-to-value ratio, debt service ratio, etc.), or an underlying asset related to the gaming industry (casino, etc.) will not be permitted. Moreover, in the case that there exists a precedent where a regulatory examination has taken place and relevant rulemaking is already under way, the new entrant needs to demonstrate the distinctiveness and innovativeness vis-à-vis the existing service.

Apart from this underlying asset guideline, certain investor protection measures will be applied to both the truster and the trustee to promote sound operation of the securitization of trust assets.

This guideline will serve as a key reference for selecting innovative financial services under the financial regulatory sandbox program when the applying entity intends to provide fractional investment service through issuance of trust beneficiary certificates. The authorities expect that this guideline will help to boost predictability for business entities, strengthen investor protection in the fractional investment market and facilitate prompt review by the selection committee. Meanwhile, the authorities will actively work with the National Assembly in the amendment process of the FSCMA to swiftly establish a legal ground on trust beneficiary certificates.

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