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THE FINANCIAL INVESTMENT SERVICES AND CAPITAL MARKETS ACT (FSCMA) & COMMON CONCERNS IN THE MARKET

I. Introduction

Since the inauguration of the new administration, the government has put great emphasis on the importance of the financial industry as a main engine of growth for the nation's economy. To that end, the government is committed to providing all the support necessary with a particular focus on fostering the regulatory environment in which the financial market can thrive with maximum autonomy and momentum. In this way, the government wants to help laying out a solid basis for the local financial market to grow as an advanced market.

The Financial Investment Services and Capital Markets Act (FSCMA) was legislated in August 2007 and went into effect on February 4, 2009. The Act's main purpose is to sharpen Korean capital market's competitive edge in the global market. In line with this aim, the Act contains regulatory changes to enable the industry to provide combined products and services to consumers. This can be possible through the expansion of business scopes and implementation of more function-based regulations rather than sector-based ones.

As for the expansion of their business operational scopes, financial institutions are to enjoy much flexibility in product development, especially in diversifying financial products and services in line with the global trend toward diversification and

securitization. Accordingly, the government's policy also aims to cultivate sophisticated financial environments, suitable for the current climate in the global financial market.

Moreover, the government will gradually remove firewalls among financial sectors and ease the market entry and exit processes, providing optimal environment conducive to constructive competition within the financial industry. Therefore, the final end-users of financial products--individuals and institutions--will be able to choose from a wider range of products and services while having easier access to capital.

The FSCMA is expected to bring many positive effects to the market by stimulating balanced growth of the Korean capital market, which has been dependent on the banking sector. The Act, if successfully implemented, will help to accelerate the economic recovery.

Besides, by lifting the legal limitation on financial institutions' executives from serving more than one position, the government expects to stimulate innovative and creative spirits in the market in developing new financial products and services. Enforcing a "negative" regulatory system, which in principle allows all new entries, and streamlined approval process for new products will render additional boost to that end.

II. Common Concerns about the FSCMA in the Market

FSCMA went into effect in February, and this has raised some issues in the market especially among foreign investors regarding its potential effects on securities businesses including derivatives trading in Korea. Some have expressed a concern that FSCMA may discourage such trading, for instance. For this reason, the Financial Services Commission has put together some of common concerns in the market regarding FSCMA and wants to make a clarification,

First of all, it is important to note that the ultimate purpose of the Act is to provide a stronger investor protection, more than anything. As for the derivatives trading, FSCMA allows listed companies to engage in OTC derivatives trading without restriction. To do that, the only requirement is to submit a written notice to their investment counterparties of their intention to be identified as "professional investors." For better

investor protection, the Chinese Wall will be strengthened through stages. As for short sales, the government has already granted covered short sales while limiting naked short sale. It is of the government's intention to gradually remove the curbs on naked short sale in accordance with market stabilization and other conditions.

Issue #1: "Professional investors" status for derivatives trading

The Act provides provisions aimed at stronger investor protection, in line of which financial institutions are held responsible to educate their clients and to be subject to suitability check. Therefore, financial investment service providers must follow a confirmation process before they can engage in unrestricted OTC derivatives trading with listed companies.

According to this provision, a listed company can practice OTC derivative businesses with financial investment providers simply by notifying its trading counterparties its interest to be a "professional investor" through a written form. Listed companies can freely conduct all other types of financial businesses as "general investors" by filing to the Financial Supervisory Services.

The rationale behind the extra step to be professional investors for derivatives trading is to reduce legal conflicts and other social costs that may incur between financial investment providers and investors especially in case of incomplete derivatives transactions. By encouraging trades between well qualified and competent traders, the government expects this to help advance Korea's derivatives market in the long run.

Issue #2: Enforcement of the Chinese Wall

The Chinese Wall has been institutionalized to help the market cope with increasingly diversified and complicated business services of financial investment providers as a result of the enactment of FSCMA. Specifically, it is to prevent problems related to conflicts of interest within the insiders of financial institutions by secretly sharing undisclosed information.

Some global financial institutions have found the Chinese Wall cumbersome mainly due

to their unfamiliarity with such system as they are already handling the problems of conflicts of interest through their own tight system of internal control.

With such awareness the Korean government wants to make sure that the Chinese Wall does not impose market players excessive restrictions on information exchange particularly between global financial institutions' headquarters and their local branches.

To address this issue, the Financial Services Commission, in fact, held a seminar on Feb. 3 and explained the details of related regulations under the FSCMA and made it clear to the participants of the government's full commitment to continuously engaging in dialogues to stay keen on market feedback on the Act and to making necessary revisions. Especially for any provisions that are deemed excessive or simply unpractical, the government will look into ways of revising of the Enforcement Decree of the Act, among others.

In the future, the government wants to see it happen as the market gradually matures under the new Act that the Chinese Wall gets enforced independently by companies themselves within their own internal control systems.

Issue #3: Restriction on Short-Selling

While short-selling can play a positive role as a source of extra liquidity, it can also bring about adversary effects to the market, particularly through settlement defaults and stock price manipulation.

Therefore, major markets including the U.S. and Hong Kong restrict naked short-selling as they carry large default risks.

Covered short-selling, on the other hand, has been permitted in Korea in line with the government's sincere effort to make improvement to existing system as the need of doing so is addressed by the market. One example of this is easing of foreign investors' obligatory reporting of their purchase of shares in Korean market.

Short selling has been banned in Korea since Oct. 2008 in response to global market instability. This is, however, a temporary measure taken to prevent further

exacerbation of market uncertainty and to restore investor confidence. It has to be also taken into account that restriction of short selling is very much in line with the global trend toward strengthening regulation against such trading as it had posed regulatory challenge to such major markets as the U.S., the U.K, and Australia.

The Korean government plans to keep a close watch on the market developments and movements in other countries' short-selling regulations¹ and consider lifting the temporary ban of covered short-selling in due course.

¹ The U.S. and the U.K. have lifted their ban against short-selling, but Australia has decided to sustain it until March 6th due to continued instability in the financial market. It was originally to be lifted on Jan. 27th.