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Press Release

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PROPOSED REVISION OF REGULATIONS ON FINANCIAL INVESTMENT BUSINESS

BACKGROUND

With the revision of *Enforcement Decree of the Financial Investment Services and Capital Markets Act* (FSCMA) publicly announced on September 30, aimed at introducing home-grown hedge funds (tentatively named “specialized private equity funds”) to Korea’s capital markets, the FSC proposed a revision of *Regulations on Financial Investment Business* in order to stipulate details mandated under the revised Enforcement Decree.

KEY CONTENTS OF THE REVISION

I. Regulations in regard with hedge funds

1. Strengthened mechanism for preventing conflicts of interest arising from operations of hedge funds (Article 4-64)

In order to prevent conflicts of interest, fund managers in charge of hedge fund operations, paid contingent remuneration, will be prohibited from operating other funds and discretionary investment assets, and sharing investment-related information.

*In addition, it will be restricted for fund managers to directly or indirectly advertize names, investment performance and strategies of private equity funds including hedge funds.

2. Criteria for hedge fund management firms and professionals

(Companies) Asset management companies with a total of funds and assets under management more than KRW 10 trillion will be allowed to operate hedge fund management business.

* “Track Record” criteria for securities and investment advisory firms

- (i) Securities firms with **equity capital more than KRW 1 trillion**
- (ii) Investment advisory firms with **assets under management more than KRW 0.5 trillion**



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(Persons in charge of hedge fund operation) Professionals with more than two years' experience in securities investment who complete a training program provided by the Korea Financial Investment Association (KOFIA) regarding hedge fund operations

*Persons with more than two years' experience in operating overseas private equity funds are also qualified for hedge fund operations.

3. Improved adjustments in calculating risk estimates (Article 4-54)

The methods of calculating estimated maximum losses that may arise from derivatives trading will be revised in a more reasonable fashion. For example, netting will be allowed for derivative products with different maturities but the same underlying asset if there is a virtual effect of reducing risks.

*Currently, netting is allowed only for derivative products with the same underlying assets and maturities.

II. Regulations on prime brokers

1. Criteria for prime brokers (Article 4-100)

- ① Equity capital: more than KRW 3 trillion
- ② Risk management system and internal control mechanism in place
- ③ System for preventing conflicts of interest: Prime brokerage business unit should be separated from other business units within a securities firm.

2. Prime brokerage services (Article 4-101)

(Business scope) On top of the services stipulated under the Enforcement Decree such as lending and borrowing of securities, financing, and custody and management of hedge fund assets, prime brokerage services include clearing and advisory businesses for fund assets under their management and custody.

(Service provision) Prime brokers will be asked to provide more than two types of services related to prime brokerage including financing, management and custody of fund assets.

(Scope of a Chinese Wall) Prime brokerage service unit will be allowed to use trading networks within existing securities firms for lending and borrowing of securities for professional investors and derivative products.



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3. Financing for hedge funds (Article 4-102)

A prime broker's lending to individual investors and hedge funds should not exceed its equity capital. However, the amount of lending to hedge funds with their securities as collateral will be excluded from the total amount of a prime broker's lending subject to the equity capital ceiling.

Prime brokers will be required to report their statement of credit lending to hedge funds and collateral management, following the procedures and methods set by the FSS.

FUTURE PLAN

The revised regulations are expected to be enforced in November after consultations with related government agencies and institutions and approval by the FSC.

The FSC will continue to make a joint effort along with a taskforce composed of the academia, industry and KOFIA in order to establish guidelines for hedge funds (expected to be announced in November).

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