

# **Market Report for Republic of Korea**

**November 2016**

**Korea Financial Investment Association**

## I. Economic and Financial Background

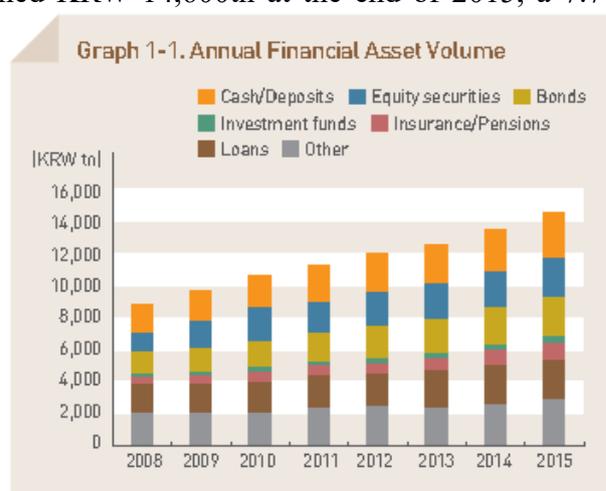
The Korean economy in 2015 was marked by further recovery and growth, a trend that has continued since the 2008 global financial crisis. Despite the persistent low interest rate environment and a stock market correction in China, Korea's economy and the capital market fared well in comparison to many other advanced nations, while at the same time having more stability than many emerging markets.

In 2016, the Korean economy continues to be affected by multiple downside risks both at home and abroad, including strikes at major automobile manufacturers, ongoing corporate restructurings and the increased probability of a U.S. Federal Reserve interest rate hike. Samsung's recent recall and halt in production of one of its smartphone models could heap further pressure on the country's economy, although the extent of the impact will largely depend on the ability of other Korean manufacturers to absorb the newfound demand. In order to shore up growth and meet its year-end economic growth target of 2.8%, in early October, the government unveiled a set of fiscal stimulus measures worth USD 8.9 billion to be implemented in the fourth quarter. This will likely translate into higher consumer sentiment, which leveled off in September following two consecutive months of improvement.

	2012	2013	2014	2015	2016
<b>GDP per Capita (USD)</b>	24,543	26,004	26,813	26,248	27,633
<b>GDP (USD bn)</b>	1,227	1,306	1,352	1,329	1,430
<b>Economic Growth (GDP, annual variation in %)</b>	2.3	2.9	3.3	2.6	2.5
<b>Unemployment Rate</b>	3.2	3.1	3.5	3.6	3.7
<b>Inflation Rate</b>	2.2	1.3	1.3	0.7	0.9
<b>Policy Interest Rate (%)</b>	2.75	2.50	2.00	1.50	1.25%
<b>Exchange Rate (vs USD)</b>	1,071	1,055	1,099	1,173	1,149
<b>Current Account Balance (USD bn)</b>	50.8	81.1	84.4	106	-
<b>Trade Balance (USD bn)</b>	28.3	44.0	47.2	90.3	95.5

The total volume of financial assets in Korea reached KRW 14,600tn at the end of 2015, a 7.7% year-on-year growth. As seen from Graph 1-1, this growth is a continuation of the steady increase in asset volume that has been maintained since 2008.

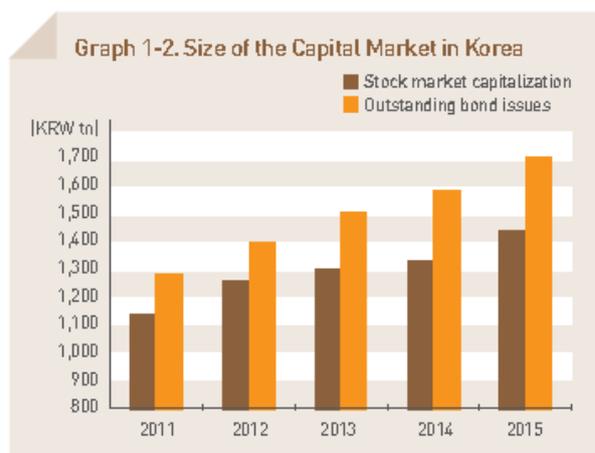
Cash and deposits once again made up the largest share of total asset volume in 2015, standing at just over 19%, while stocks stood just under 17%, bonds at 16.5% and funds at nearly 3%. Insurance/pensions and loans accounted for 7% and 17.5%, respectively. Overall, financial investment instruments took up a 36.2% share of the total financial asset volume, a 3.8%p increase from 2008.



Source : The Bank of Korea, Flow of Funds

Korea's stock market capitalization as of late 2015 was KRW 1,448tn, an increase of 8.3% year-on-year, and outstanding bond issues stood at KRW 1,713tn, jumping 7.7% from the same time a year earlier.

Compared to GDP, Korea's stock market capitalization is 92.9% and outstanding bond issues are 109.9%. Put into a global context, these percentages are substantially lower than those of other advanced economies. Stock market capitalization compared to GDP was 139.7% in the US, 136.1% in England, and 118.7% in Japan, while outstanding bond issues relative to GDP marked 205.6%, 204.4% and 271.1% respectively in these countries.



Source : The Bank of Korea,  
Korea Financial Investment Association

Among the financial sectors, the banking sector boasts the largest total assets and equity. At the aggregate level, the securities sector comes in third next to life insurance. However, on an individual firm basis, the average asset amount and equity were KRW 6.1tn and 0.8tn respectively, ranking 5th behind the banking, life insurance, credit card and property insurance sectors.

**Table 1-1. Size of Financial Sectors**

[Units: # of companies, KRW tn, %]

	Banking	Life insurance	Non-Life insurance	Credit card	Securities	Asset management
No. of companies	17	25	31	8	56	93
Total assets	2,448	724	226	97	344	5
Equity	175	64	29	25	46	4
Net profit	4.4	3.6	2.7	2.0	3.2	0.5
ROE	2.1	5.8	9.6	8.4	7.3	11.9

Statistics as of 2015

Source : Financial Supervisory Service, Monthly Financial Statistics Bulletin

Corporate financing through the Korean capital market (stocks and bonds) in 2015 reached KRW 131tn, which is up 7.5% from the previous year. Meanwhile, market-based financing increased by 38.9% year-on-year, amounting to KRW 8tn. Both IPOs and paid-in capital increases once again showed better results than the year before. In particular, IPOs raised 1.7 times more capital compared to the previous year, backed by offerings from industry giants such as Mirae Asset Life Insurance (KRW 300bn) and DoubleU Games (KRW 277.7bn). A 6% increase was witnessed for capital raised in the bond market, and issuance of corporate bonds diminished, whereas issuance of financial bonds, ABS and bank bonds increased.

In 2015, non-financial assets, including real estate, accounted for 63.1% of household assets, whereas the share of financial assets was 36.9%. Although the proportion of non-financial assets remains greater than financial assets, the latter is on the rise. Among financial assets, cash and deposits take up the largest share at 43.1%, although it continues to diminish. Financial investment instruments, such as stocks, bonds and funds, account for 25%, with the share of stocks and bonds slowly expanding.

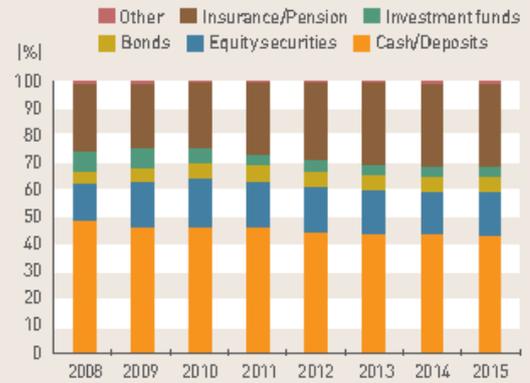
**Table 1-2. Household Non-Financial & Financial Assets**

(Units: %)

	2010	2011	2012	2013	2014	2015
Non-financial assets	66.9	66.7	65.7	64.8	64.1	63.1
Financial assets	33.1	33.3	34.3	35.2	35.9	36.9

Source : The Bank of Korea, National Balance Sheet

**Graph 1-4. Household Financial Asset Composition**



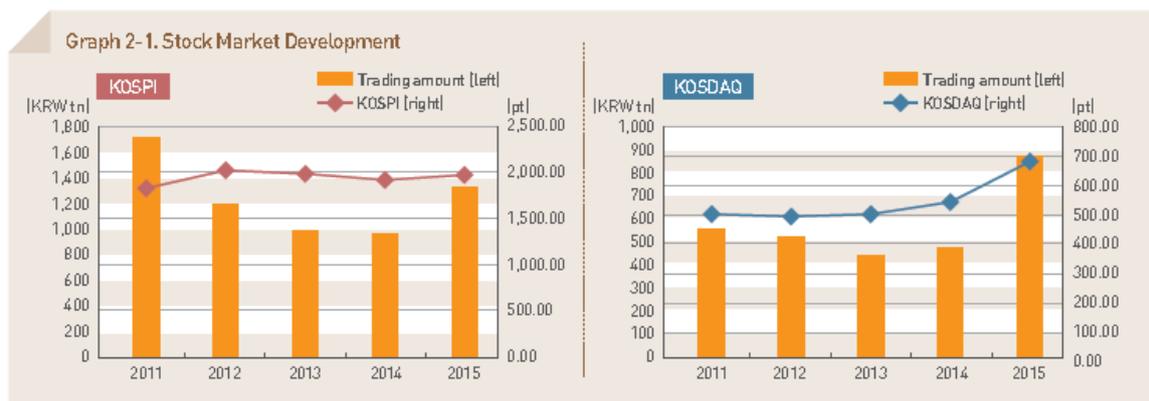
Source : The Bank of Korea, Flow of Funds

## II. Capital Market Performance

### 1. Stock Market

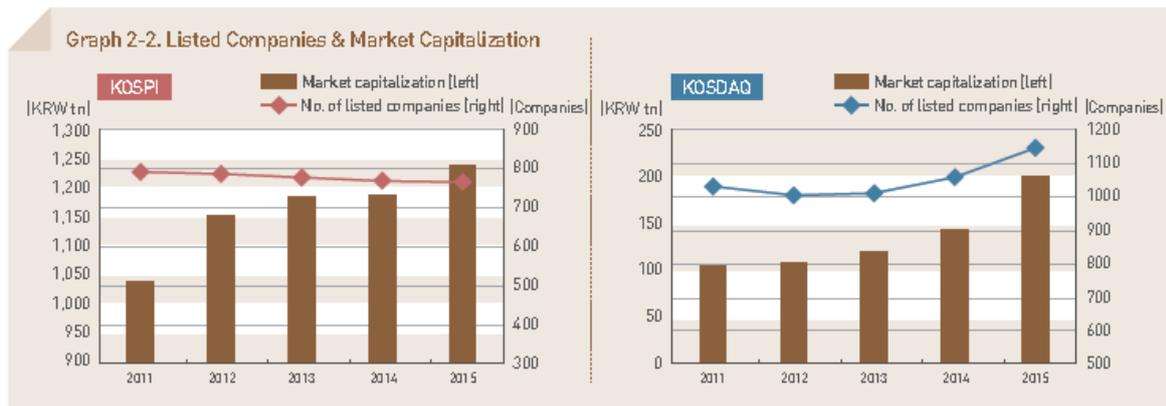
In 2015, the Korean equity market's trading amount displayed vibrant growth. QE policies increased liquidity globally, domestic developments such as an upward adjustment of the price limit on equities to  $\pm 30\%$  and the adoption of the Market Maker System added vigor to the market.

Specifically, the KOSPI index was hovering at around 2,000pts as of late 2015, with the trading amount making a recovery, from below KRW 1,000tn in 2013 and 2014 to KRW 1,327tn in 2015. As opposed to the KOSPI, often described as being trapped in a narrow band, the KOSDAQ index gained 25.7% year-on-year to reach 682.35pts, coupled with an 81% surge in the trading amount to KRW 874tn.



Source : Korea Exchange

In the KOSPI market, the total number of listed companies as of late 2015 was 770, with 3 de-listings being carried out. Market cap recorded KRW 1,243tn, a 4.2% increase year-on-year. Meanwhile, in the KOSDAQ market, the total number of listed companies was 1,152, with market cap recording KRW 202tn. An increase of 91 listed companies and a 40.9% gain in market cap in the KOSDAQ market over the previous year demonstrated the vibrancy of SME and venture financing.

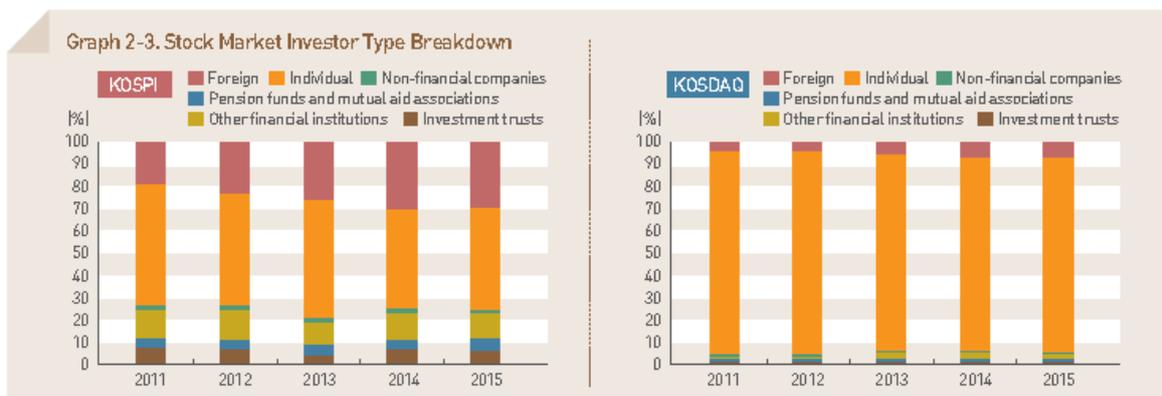


Source : Korea Exchange

Individual investors made up the largest portion of the Korean stock market, followed by foreign investors and institutional investors.

Looking first at the KOSPI market, individual investors accounted for 46.5% of the total trading amount, while foreigners took up 28.7%. Institutional investors, including investment trusts, pension funds and mutual aid associations, assumed 23.5%. Up to 2013, individual investors made up more than half of the trading amount, but since then, the market has become somewhat balanced as foreign investment continues to grow.

In contrast, the KOSDAQ market is still dominated by individual investors, who make up approximately 90% of the total trading amount. While the proportion of foreign and institutional investments has grown over the past five years, it is still significantly low, with each comprising about 5% of the market.



Source : Korea Exchange

The total number of securities companies in Korea as of late 2015 was 56, dropping by two from the year before. This number peaked in 2013 at 62, and then began to drop over the next two years. This was mostly due to corporate restructuring and the re-organization of securities companies during the 2014-2015 period, following a prolonged market recession. Out of the six companies, two closed due to sustained losses, three were involved in strategic M&As, and one filed for bankruptcy.

Interestingly, while the overall number of securities companies fell, equity capital continued to grow. Total equity capital stood at KRW 46tn as of late 2015, an average increase of KRW 0.82tn per company. This demonstrates the trend of securities companies growing in size through paid-in capital increases and strategic M&As.

Securities companies recorded KRW 3.2tn in net profit, a whopping 91.1% increase compared to KRW 1.7tn for the previous year. Despite suffering a net loss of KRW 0.2tn in 2013 due to the market slowdown, as trading amounts started to increase and brokerage commission profits improved accordingly, their net profit continued to rise, recording its highest level since 2007.

Profitability at securities companies improved, with ROE growing for two consecutive years. ROE hit 6.9% in 2015, a 2.9%p rise compared to the year before.

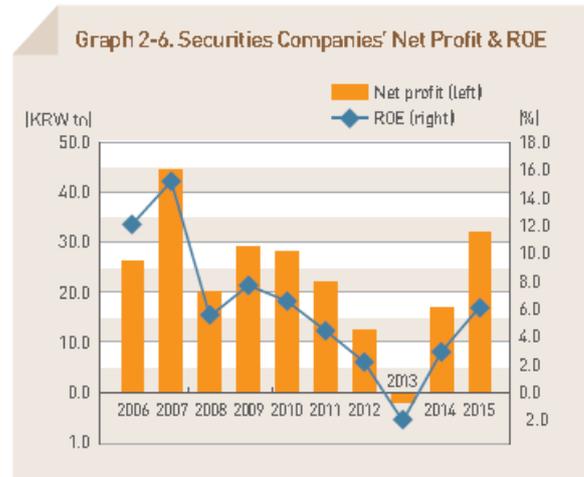
In 2015, brokerage commission profits for securities companies surged by 32.6% year-on-year to KRW 7.9tn, but trading profits fell by 9.1% to KRW 4.2tn.

Brokerage commission profits, which account for the largest proportion of total commission profits, surged 36.4% compared to the previous year owing to a rise in trading amounts, recording KRW 4.6tn in 2015. This is equivalent to 58% of total commission profits.

The second largest source of commission profits was investment banking services, which includes securities underwriting and advisory services, and M&A business activities. Here, commission profits increased 32.4% year-on-year to KRW 1.2tn.

Income from asset management services, such as fund distribution, investment advisory services, discretionary investment services and investment trust services recorded KRW 0.9tn.

Although brokerage commissions still make up the largest portion of the commission income structure, profits from IB services and asset management services demonstrated steady growth.

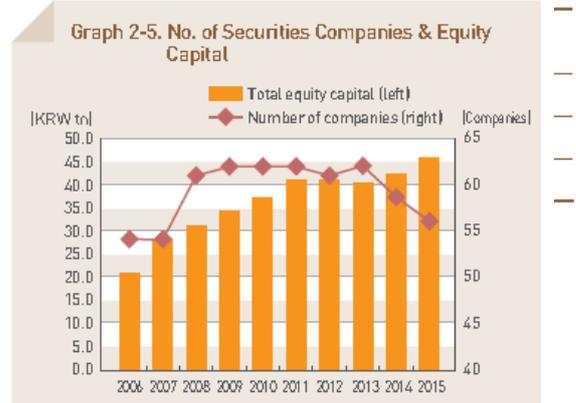


Source : The Bank of Korea, Flow of Funds

**Table 2-1. Profit Structure at Securities Companies**

[Unit: KRW tn]

	2014 (A)	2015 (B)	Growth (B-A)	Growth Rate
Commission Profits	6.0	7.9	1.9	32.6%
Brokerage	3.4	4.6	1.2	36.4%
IB Services	0.9	1.2	0.3	32.4%
Asset	0.8	0.9	0.1	13.8%



Source : Financial Supervisory Service, Monthly Financial Statistics Bulletin

On the other hand, securities companies saw a KRW 0.9tn drop in bond trading profits compared to the previous year, as bond interest rates fell at a slower pace in 2015. This led to trading profits for securities companies dropping to KRW 4.2tn in 2015, a decline of 9.1% from 2014.

## 2. Bond Market

Trading activity in the Korean bond market was up compared to 2014. This was partly due to the Bank of Korea’s decision to lower the base rate twice, from 2% to 1.75%, and then to 1.5%, during the first half of the year, and a surge in demand for safer assets due to heightened global financial volatility and the possibility of a US interest rate hike. Another key factor was the introduction of the “Performance-Based Market Making System”, which channels liquidity into the market and fuels the growth of market-listed bonds.

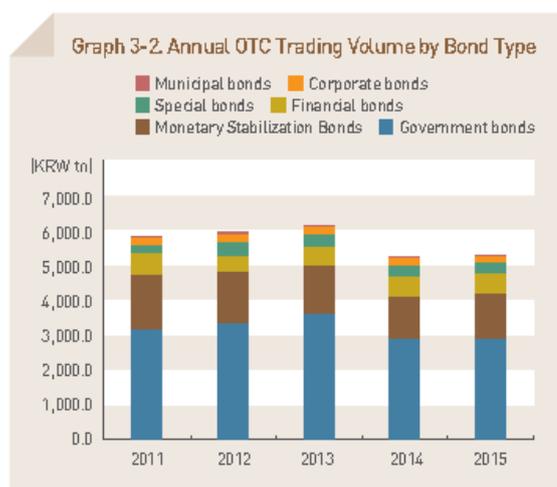
While total trading volume took a slight downturn in 2014 due to reduced interest rate volatility, it rebounded in 2015, jumping 6.5% year-on-year to reach approximately KRW 7,000tn.

The OTC market made up around 80% of the total bond trading volume, but this figure has been dropping over the years. To compare, the OTC sector took up 90.5% of total trading volume in 2010.

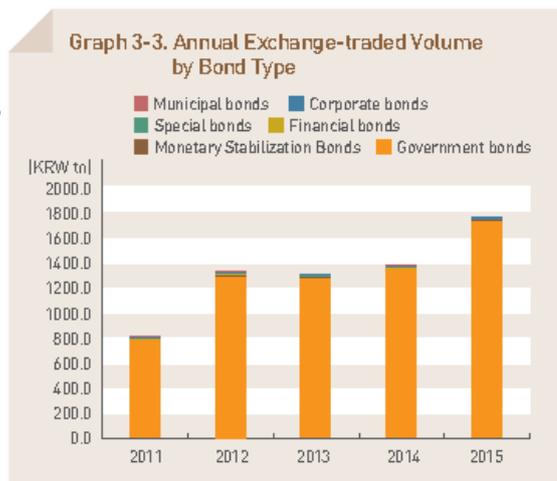
An analysis of trading volume by bond type shows that the proportion of Korea Treasury Bond (KTB) trading has been on a steady upward trend since the 2000s, and, at 60%, currently represents a dominant share of the secondary bond market. Improvements in government policies to nurture the KTB market, such as the introduction of fungible issues in May 2000 and increase in KTB issuance, greatly aided this growth.

Meanwhile, as government and public bonds have come to represent a bigger slice of the pie, the proportion of corporate bonds, including ABS, has comparatively diminished. In 2000, corporate bonds accounted for 14.7% of the total trading volume, but this figure started to slide down in 2004, to a mere 2.7% at the end of 2015.

Another conspicuous trait of the Korean bond market is the more pronounced concentration on KTBs in the



Source : Korea Financial Investment Association

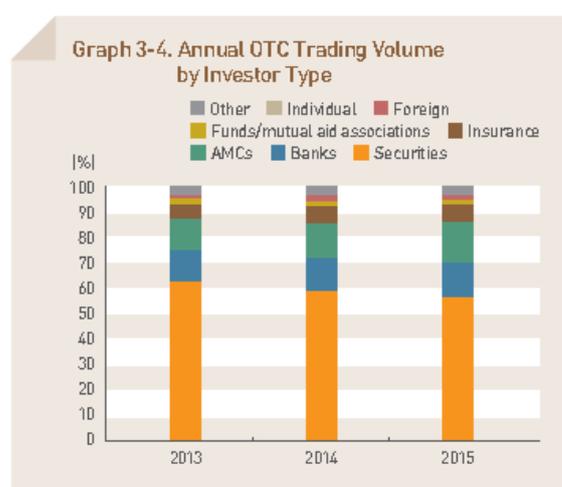


Source : Korea Exchange

exchange-traded market compared to the OTC market. Bond types (aside from government and public bonds) only account for a paltry 0%-2% of the entire exchange-traded market. This is a result of a government requirement that Primary Dealers (PDs) trade the benchmark index of government bonds on the exchange market, although the relevant policy was abolished in July 2008.

Nowadays, institutional investors – the main participants in the Korean bond market – usually trade bonds other than KTBs, such as MSBs, special bonds, financial bonds and corporate bonds, on the OTC market, with the exchange rarely used.

Most bond trading in the Korean OTC market is conducted by domestic institutional investors. A breakdown of trading volume by investor type demonstrates that securities companies make up the largest share with 60%, followed by banks, AMCs, insurance companies, and funds/mutual aid associations. Overall, domestic institutional investors comprised 95% of total trading volume. In 2015, trading among securities and insurance companies dropped by a small margin (-2.6%p and -0.1%p, respectively), while trading volume for banks (+0.8%p), AMCs (+2.3%p) and foreign investors (+0.4%p) increased.



Source : Korea Financial Investment Association

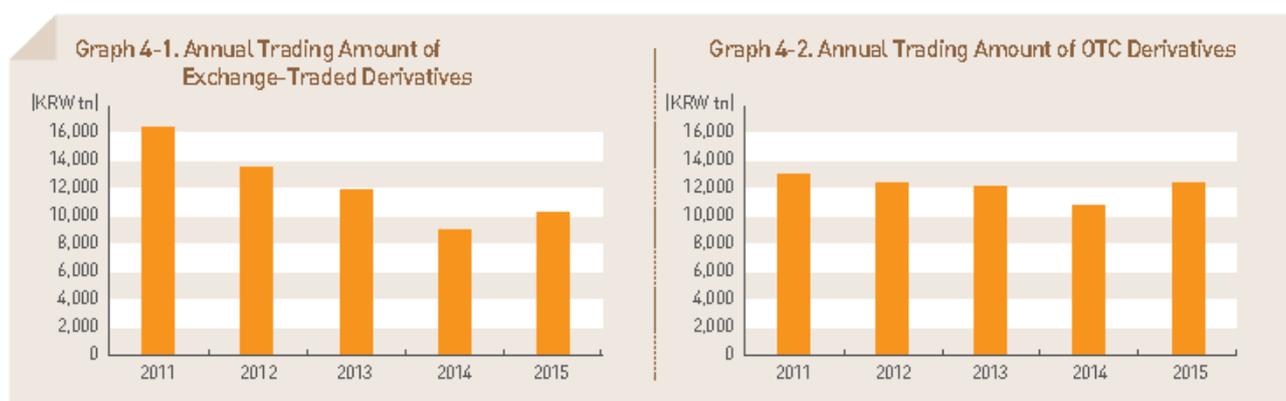
As part of its reform plan to expand foreign exchange liquidity, the Korean government started granting tax exemptions for foreigners in 2009 on interest income and capital gains for KTB and MSB investments. Although this tax exemption was repealed in 2011, net foreign buying of Korean bonds continued to climb due to global central banks' efforts to diversify foreign currency investment assets and prospects for a stronger Korean Won. As a result, the outstanding amount of foreign-held domestic bonds reached KRW 101.4tn at the end of 2015.

### 3. Derivatives Market

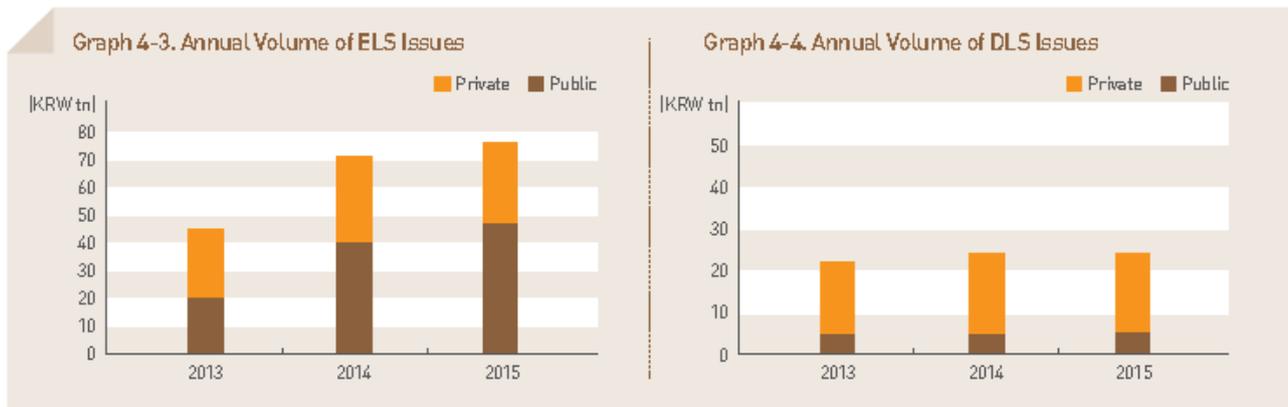
The Korean derivatives market has achieved spectacular growth since the establishment of the KOSPI 200 options market in 1996. To date, a total of 31 products have been listed, with six de-listed. Furthermore, the KRX has been the top global performer every year from 2001 to 2011, aside from 2 years, in terms of trading volume. In recent years, however, the market has suffered a sharp downturn due to heavier regulations and reduced volatility.

As such, throughout 2014 and 2015, there has been an initiative to reinvigorate the exchange-traded derivatives market and reclaim its former glory. New product listings, such as the mini KOSPI 200 futures·options, volatility index·sector index products, and ETNs bore fruit, with market volume rebounding by 11.5% to record KRW 10,153tn.

For its part, the OTC derivatives market saw sluggish growth in 2014 owing to the low interest rate trend, but the size of the market expanded by 13.9% in 2015 compared to the previous year, posting KRW 12,273tn.



On top of this, structured products such as ELS and DLS have proven to be promising investment options for investors in the current economic environment. First introduced in Korea in 2003, the issuance volume of these mid-risk, mid-return products increased by a multiple of 30 in just over a decade, going from KRW 3.5tn to an impressive KRW 101tn in 2015.



After reaching a peak in 2011, activity in the Korean exchange-traded derivatives market has been losing vigor due to tightened derivatives market regulations, contraction of the spot market, and reduced volatility. The main cause behind the dampened exchange-traded derivatives market was an 86% drop in KOSPI 200 futures and options trading over the past five years. This trading accounted for 95% of total trading volume in 2011. The total trading volume of exchange-traded derivatives in 2015 was approximately 790 million contracts, a nearly 80% decrease from the 2011 figure of 3.93 billion contracts.

An analysis of the KOSPI 200 futures market shows that the daily average trading amount recorded KRW 18.9tn, down 58.3% compared to 2011, while the daily average trading amount for the KOSPI 200 options market fell 57.8% in the same period to KRW 74.3bn.

When compared with the global exchange-traded derivatives market, the Korean market has not performed at the same level. The global market has grown by 13.6% since 2011, backed by increasing derivatives trading in emerging economies and a bullish global stock market. However, the Korean market experienced a sharp decline, mainly due to a dramatic downturn in the number of retail investors brought on by stronger entrance barriers, such as the option multiplier increase from KRW 100,000 to KRW 500,000 and margin requirements imposed on call options.

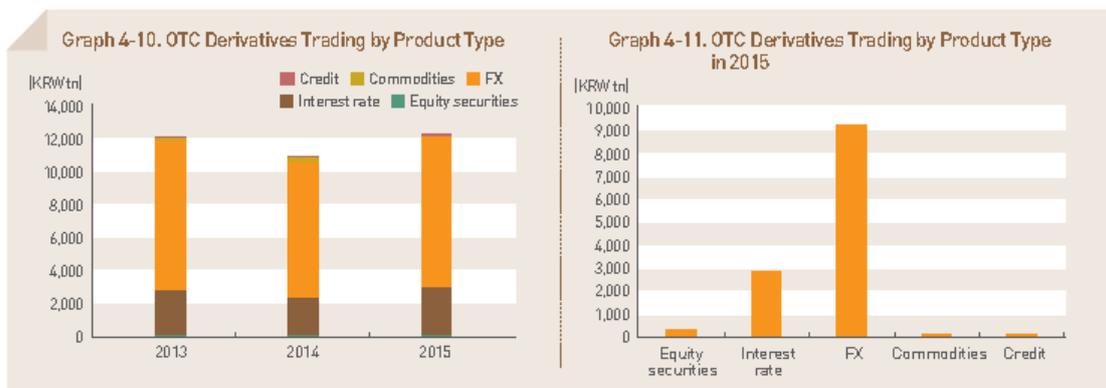


Foreign investors have taken the lead as retail & institutional investors have pulled back. Institutional investors in particular have left the market in response to a suspension of tax breaks on arbitrage trading, leading to a considerable drop in stock-related derivatives trading for hedging purposes.

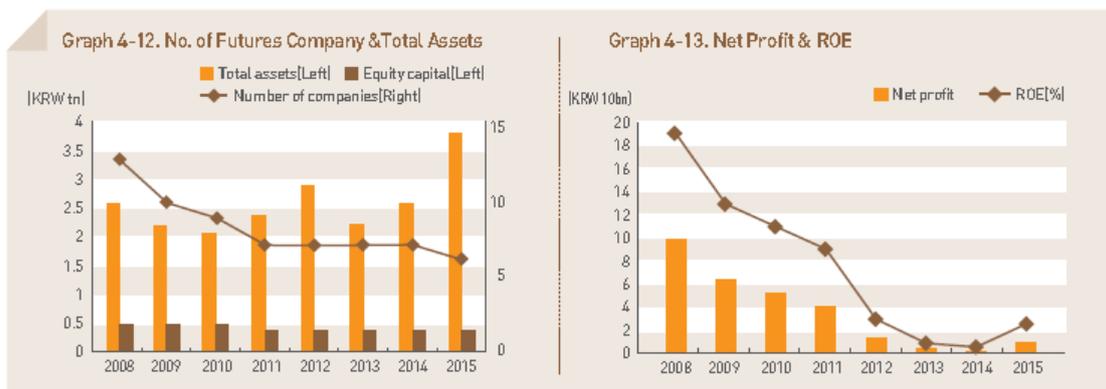
The drop in participation among domestic retail and institutional investors led to an increase in the proportion of foreign investment. These new investors were more involved in HFT with long-term strategic investment plans, wielding greater influence on the KOSPI 200 futures·options markets, KTB futures market, and USD futures market.



As for the OTC derivatives market, it was valued at KRW 12,273tn. OTC derivatives with an underlying currency account for the largest share, a staggering 74.8%, while those using interest rates came in second, at 23.29%.



The total number of futures companies in Korea as of late 2015 was six, down by one from the year before. Total assets for futures companies stood at KRW 3.8tn, a KRW 1.2tn (+47.5%) increase from the previous year. Equity capital was steady at KRW 0.41tn. Net profit for futures companies in 2015 was KRW 10.65bn, a five-fold gain from the previous year. ROE also added 2.1%p to reach 2.6%.



## 4. Fund Market

Korea's asset management industry continued to be in the spotlight in 2015, as pension assets have increased amidst the prolonged low interest rate environment and aging population.

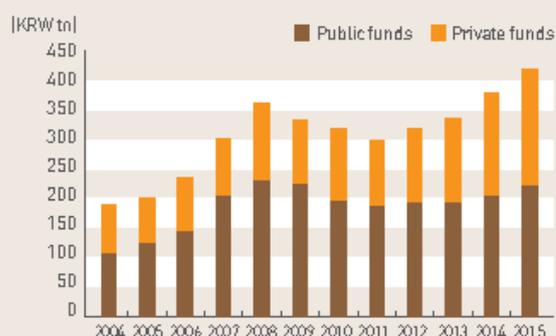
Over the year, both the government and industry players focused on facilitating and ensuring the steady growth of the asset management market. Notable developments in 2015 included the announced legislation on adopting the Individual Savings Account (ISA) system and private fund regulatory reforms, with about 100 new asset managers expected to join the market. Other forms of deregulation and systematic reforms were also seen in areas such as the fund taxation system. Owing to these efforts, total fund AUM in Korea surpassed pre-crisis levels.

As shown in the charts, total fund AUM reached KRW 421tn for 12,721 funds in late 2015. Low global interest rates and the Chinese economic slowdown prompted passive investor sentiment with a stronger preference for safe assets. As such, the most substantial net asset growth was seen in money market funds (MMFs) and bond funds, which increased by nearly KRW 11tn and KRW 14tn, respectively. Persistent low rates also boosted demand for alternative investments, with investors seeking to diversify their investments in the search for higher returns.

Total fund market NAV as of late 2015 was KRW 413tn, a 9.8% rise from the previous year. This growth enhanced profitability for asset management companies, despite new competition entering the market, and they continued the rebound that began in 2011.

With the drop in NAV for equity funds having

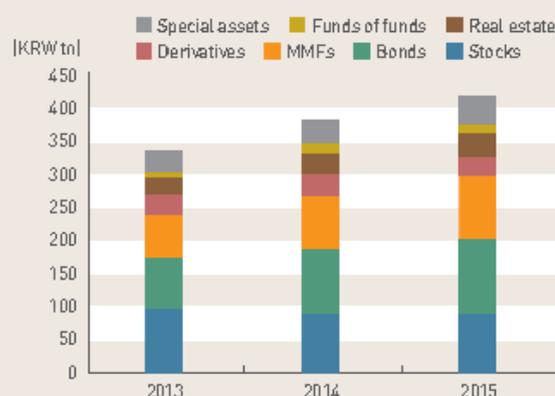
Graph 5-1. Fund AUM



Graph 5-2. Total Number of Funds



Graph 5-4. Investment by Fund Type



tapered off, aggregate NAV has grown significantly. In particular, a stronger preference for safe assets led to greater investment in bonds funds and MMFs, while at the same time, special asset funds and other forms of alternative investment also attracted investors.

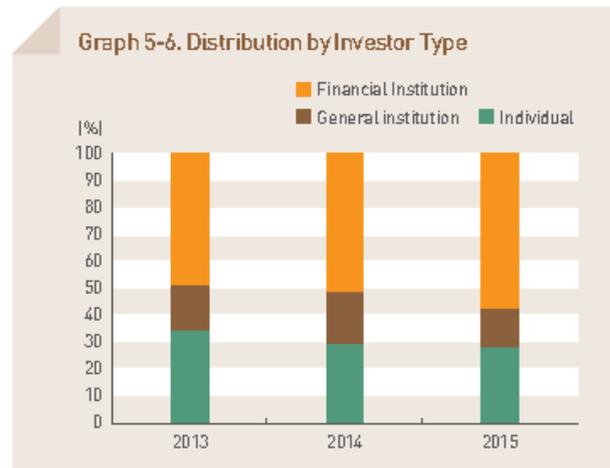
As of late 2015, financial institutions accounted for 57.3% of fund investments, which has been growing ever since the global financial crisis.

It is also worth noting that investments in overseas funds, which have been dropping since the crisis, enjoyed renewed interest recently due to prolonged stagnation in the domestic stock market.

Due to the persistent low interest rate environment, investor interest in mid-risk, mid-return investment products such as ETFs has been steadily growing.

At the end of 2015, the Financial Services Commission (FSC) announced its plan to develop the ETF market with support from the Korea Exchange. In the first half of 2016, various new ETF products, such as overseas ETFs with tax benefits, smart beta/strategic ETFs, and new growth industry ETFs, were launched. Active bond ETFs are set to launch in the second half of the year.

Bonds made up the largest share of fund investments as of late 2015, at 38.9%. Noticeably, investments in other assets accounted for a considerable 26.3%, which reflects the recent surge in demand for alternative investments and the consequent rise in NAV for real estate and special asset funds.



### **III. Regulatory Development**

#### **A. PLAN FOR NURTURING MEGA-INVESTMENT BANKS IN KOREA (AUG 2016)**

The FSC announced its plan to nurture mega-investment banks (IBs), meaning those with more than USD 10 billion in equity capital, in Korea by allowing a broader range of new businesses for securities firms with a larger amount of equity capital. The FSC introduced a scheme for “Comprehensive Financial Investment Business” in 2013, in which a securities firm with more than USD 3 billion in equity capital is permitted to engage in corporate lending. Since then, however, the securities industry has still been focused mainly on brokerage services and has fallen short when it comes to IB activities that channel risk capital to innovative companies. Against this backdrop, the FSC outlined a plan to strengthen securities firms’ IB functions to enable them to provide more comprehensive financial services for businesses and boost their global competitiveness.

##### **■ KEY POINTS**

- ✓ New financing channels will be permitted to aid securities firms with raising sufficient capital for corporate financing — e.g., issuance of promissory notes, introduction of an “Investment Management Account” (IMA) that utilizes a pool of customers’ deposits for investments.
- ✓ Regulatory amendments will be made to facilitate risk-underwriting activities by securities firms — e.g., separate NCR standards (NCR-II) to be applied to long-term corporate lending, securities firms to be allowed to lend companies up to 100% of their equity capital.
- ✓ Securities firms will be permitted an expanded business scope for corporate financing — e.g. internalization of order executions for unlisted company stock, foreign exchange operations, property-backed trust business, etc.
- ✓ Cooperation between securities firms and policy banks will be strengthened to support their global activities in overseas investments and M&As.

The FSC differentiated the scope of new business activities permitted for securities firms according to their equity capital size, in an attempt to incentivize them to further boost their capital to become a mega-IB with more than KRW10 trillion in the medium-to-long term.

1) **Securities firms with more than USD 4 billion in equity capital:** Those with equity capital exceeding USD 4 billion will be permitted to issue promissory notes and engage in foreign currency exchange business.

2) **Securities firms with USD 10 billion in equity capital:** The FSC will permit securities firms with equity capital close to USD 10 billion to establish Investment Management Accounts (IMAs) and engage in the property trust business as a means to raise sufficient capital for corporate financing.

3) **Securities firms with less than USD 4 billion in equity capital:** Securities firms with less than USD 4 billion in equity capital will also be subject to key reforms<sup>1</sup> to enable them to secure enough capital to engage in corporate financing.

In August, the FSC gathered feedback from the industry and experts regarding the plan. Based on the feedback, the plan will go into effect starting from 2017 after revising relevant laws.

## **B. TEST OPERATION OF OMNIBUS ACCOUNT (MAY 2016)**

The FSC/FSS and relevant agencies<sup>2</sup> will launch a test operation of the “omnibus account”<sup>3</sup> starting from May 25 with four standing proxies, two securities firms and one global financial investment company. The goals of the test run are (i) to have foreign investors engage in devising detailed procedures; and (ii) to prevent technical errors in the electronic and settlement system in advance of the omnibus account system going fully operational in 2017.

The test will be divided into two stages:

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<sup>1</sup> a) application of separate NCR-II, b) increased corporate lending limit up to 100% of equity capital, c) permitting internalization of order executions for unlisted company stock, d) cooperation with policy banks, sovereign funds, Growth Ladder Fund

<sup>2</sup> KRX, KSD, KOSCOM

<sup>3</sup> FSC Press Release (Feb. 1, 2016) 「“Omnibus Account” for Foreign Investors To Be Introduced」

**[Stage 1] Mock Trading** (May 25–Sept. 2016): Participants will process an entire trade, including procedure of order, settlement and ex-post reporting, through a mock trading system to test the detailed operation process and stability of the electronic system.

**[Stage 2] Real Trading** (Sept. 2016–prior to beginning of official operation in 2017): A limited number of participants, including global investors who participated in the mock trading stage, will conduct real trades through an “omnibus account”. The FSC/FSS will collect their suggestions during stage 2 and amend the system prior to it going fully operational in 2017.

The FSC/FSS will reflect the suggestions gathered from global investors in the process of the test operation to create detailed procedures of the omnibus account system, and assist global investors with participating in each stage of the test run.

### **C. PLAN TO STIMULATE FINANCIAL ADVISORY SERVICES (MAR 2016)**

The FSC outlined its plan to stimulate financial advisory services in response to growing demand from financial consumers for more accessible and tailored financial advisory services. The plan is mainly focused on: offering financial consumers comprehensive advisory services in a professional and independent manner; facilitating more innovative and affordable advisory services such as robo-advisors; and making financial advice more accessible and convenient for financial consumers.

**1) Lowering entry barriers for financial advisers:** Under the current Financial Investment Services and Capital Markets Act (FSCMA), the minimum capital requirement for registration as a financial adviser to provide advisory services for retail investors is USD 500,000. The FSC will propose amendments to the Enforcement Decree of the FSCMA in the first half of this year to create a new registration category for financial advisers who only offer advisory services within a narrow range of financial products, such as savings, funds and derivative-linked securities, and lower their capital requirement to USD 100,000.<sup>4</sup> Banks will be also allowed to offer financial advice within the newly-created category of advisory services; however, they will be prohibited from offering financial advice in equities, bonds and derivatives, due to a possible conflict of interest.

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<sup>4</sup> For financial advisory services for derivatives, equities and bonds, the current capital requirement of USD 500,000 will be maintained.

- 2) Introduction of Independent Financial Advisers (IFAs):** Independent Financial Advisers (IFAs) will be introduced to provide advice that is “independent” of product providers. The IFAs are required to meet strict standards for independence: 1) they must receive advisory service fees from their clients, not from product providers; 2) they cannot provide financial products concurrently (although discretionary investment business providers are exceptionally allowed to provide both advisory services and products); and 3) they are prohibited from providing advice for specific products, while they are allowed to offer advice for restricted types of products or restricted investment purposes on the condition that they should disclose such facts. Amendments to detail requirements for IFAs will be proposed to the Regulation on Financial Investment Business in the first half of this year.
- 3) Strengthening investor protection:** To ensure that financial advisers put their clients’ interests first, best practices guidelines for financial advisers will be established in the first half of 2017 to provide detailed rules for fiduciary duty. Financial advisers must receive fees from clients, and the fees must be charged independently, regardless of product providers. Non-IFA advisers are not forbidden from receiving commissions from product providers in addition to advisory fees from their clients; however, they must disclose such payments to their clients. Financial advisers are also required to disclose all factors that could affect their advice and provide sufficient explanation to their customers prior to signing a contract.
- 4) Facilitating Robo-Advisory (RA) services:** Robo-advisory services are classified into four categories, depending on whether human advisers are involved or not.

➤ **4 CATEGORIES OF ROBO-ADVISORY SERVICES**

	<b>Customers (advisory services)</b>	<b>Asset Managers (discretionary investment)</b>
<b>Back Office Service</b>	(phase 1) Human advisers provide advisory services to customers utilizing RA’s asset allocation	(phase 2) Human asset managers manage customers’ assets utilizing RA’s asset allocation
<b>Front Office Service</b>	(phase 3) RAs directly provide customers with advisory services based on their asset allocation results	(phase 4) RAs directly manage customers’ assets without the help of human advisers or managers

Korea’s robo-advisory services are in the early stages of development as asset managers recently launched the second phase of such services. Under the current regulatory system,

robo-advisors are not allowed to provide the fully-automated services in the third and fourth phases. The FSC will propose an amendment to the Enforcement Decree of the FSCMA in the first half of this year to enable robo-advisors that meet certain requirements to provide direct front-office services to customers. To this end, a pilot test of fully-automated RA services was launched in Sept. 2016.

#### **D. INTRODUCTION OF KOREAN ISAS (MAR 2016)**

Korea's Individual Savings Accounts (ISAs) were introduced on March 14, 2016. They enable individuals to invest in various financial products such as savings, funds and derivatives-linked securities. Previously, individuals had to open separate accounts for each financial product. The introduction of ISAs is expected to help individuals build an investment portfolio tailored to their risk appetite and investment purpose, and manage their wealth more efficiently with the aid of asset management experts. ISA products went on sale starting March 14, being offered through branches of 33 financial institutions – including banks, securities firms, and insurers.

There are two types of ISAs: a trust-type product, and a discretionary investment product.

- 1) **Trust-type ISAs:** The trust-type ISA is aimed at individuals who want to choose the financial products to be included in their accounts on their own. Financial institutions cannot change the composition of an investment portfolio without the guidance of the account holder.
- 2) **Discretionary ISAs:** The discretionary ISA is targeted at those who prefer to let asset managers manage their money for them. The financial institution provides the client with model portfolios, considering their risk appetite and investment purpose. The client then picks a model for the asset manager to follow on their behalf, with the asset manager choosing products to be included in the account. Financial institutions are allowed to rebalance assets within the account every quarter without the account holder's guidance, evaluating the profitability and safety of such assets.

Since only one ISA is allowed per person, individuals have to choose either a trust-type ISA or a discretionary ISA, considering which type of ISA is more suitable for themselves. Products that are allowed to be included in ISAs are as follows:

- 1) **Savings products** – savings and installment savings with banks and mutual savings banks; deposits with mutual financial institutions; and RPs
- 2) **Investment products** – public offering funds, ETFs, REITS, derivatives-linked securities (e.g. ELS, ETN, ELB, etc.)

Tax exemptions are granted for net earnings from ISAs. The account holder can receive tax exemptions ranging from USD 2,000 to 2,500, depending on their income level. Net earnings exceeding the tax exemption range will be taxed separately at a lower tax rate of 9.9%. Individuals with a financial income of less than USD 20,000 in the previous year can open an ISA. An ISA holder can invest up to USD 100,000 over five years, at a rate of USD 20,000 per year. To be granted tax benefits, ISA holders have to maintain their account for 3 to 5 years.

#### **E. DESIGNATION OF SME-SPECIALIZED BROKERS (FEB 2016)**

6 securities companies – Kiwoom, Yuanta, Eugene, KB, IBK and Korea Asset – were designated as SME-specialized brokers, with the aim being to expand market-based financing opportunities for SMEs and start-ups. These brokers will provide growth financing for SMEs through various government funding channels, with financing strategies tailored to the company’s current stage of growth.

<Financing by Stage>

- ① (Initial Stage) SME-specialized brokers (“Brokers”) serve as an intermediary for the start-up’s operating capital and execute direct investments.
- ② (Developing Stage) Brokers provide access to capital by managing incubator funds.
- ③ (Maturing Stage) Brokers can assist with the listing of mature SMEs by arranging IPOs, SPAC mergers, and so on.