KOREA

SECURITIES

SUMMARY

The Korean securities market is in the process of fundamental change. Korea is currently implementing a reform and restructuring program in cooperation with the International Monetary Fund (IMF) and other international financial institutions. This program involves significant capital market liberalization. Foreign participation in the equity and bond markets has been substantially liberalized.

Government interference with, and manipulation of, equity market prices has been virtually eliminated. Supervisory authority for the securities industry has been delegated from the Ministry of Finance and the Economy (MOFE) to the newly formed Financial Supervisory Commission (FSC), which reports to the Prime Minister.

The number of branches of foreign securities firms has increased since 1994, as more firms converted their representative offices into branches. Foreign firms can now form subsidiaries in Korea. There are five U.S. branches and seven representative offices at present.

Stock market trading continues to be dominated by individual investors, with foreign investors playing a growing role. The over-the-counter (OTC) market is now open to foreigners and a separate OTC market dealing in foreign-owned securities which had reached government-imposed foreign share limits is now virtually defunct in the aftermath of the government's removal of most such limits. The bond market is now open to foreign investors for both corporate and government bonds, although as yet there is little foreign participation.

Many of the regulatory and legal barriers for foreign securities firms and foreign investors have been removed. Limitations still remain on the operations of representative offices. Branch offices have to meet certain minimal capital requirements depending on their business activities. Consultation with affected foreign firms about regulatory changes has improved and the government has adopted a number of reform proposals made by foreign firms. Current issues of major concern to foreign firms are primarily ones of the need for increasing market liquidity and transparency.

DESCRIPTION OF THE MARKET

The Korean securities market has felt the effects of the Asian Economic Crisis which hit Korea in November 1997. Korea is currently in the process of implementing a reform and restructuring program in cooperation with the IMF, the World Bank and the Asia Development Bank. This program involves significant capital market liberalization and the introduction of greater openness and transparency in financial markets. Participation of foreigners in equity markets has been significantly liberalized, with complete liberalization (with few exceptions) scheduled for the end of 1998.

Earlier in 1998, foreign portfolio investors were limited to 55 percent aggregate and 50 percent individual ownership of most companies. These restrictions have now been eliminated. In the case of state-owned companies, the limits are 30 percent and 3 percent respectively, though these limits are scheduled to increase (though not be completely abolished). There are no limits on foreign ownership of listed bonds or commercial paper. Later in 1998, restrictions on foreign ownership of any security traded in the local securities market are scheduled to be lifted.

The Korean government has stopped efforts to artificially maintain and manipulate equities prices and the Stock Market Stabilization Fund was abolished formally on May 4, 1996, though it had been dormant for some time. The deposit requirement ratio which required that stock purchase orders be accompanied by a cash deposit was abolished on April 1, 1998. Limits on a stock's daily price movements are set at 12 percent. Government interference in the operations of the market has declined considerably. The capitalization of the Korean Stock Exchange (KSE) stood at 75 trillion won (US$46 billion) at the end of 1997. The value of bonds outstanding was 224 trillion won (US$132 billion) at the end of 1997. The number of listed companies on the KSE was 776 at the end of 1997, up from 693 companies listed in 1993. Bankruptcies and mergers and acquisitions are expected to lower that number over the course of 1998.

Trading averaged 41.2 million shares a day in 1997. The Korea Composite Stock Price Index, which measures aggregate price performance, closed 1997 at 376.3, a sharp decline from its 1996 close at 651.2. The first six months of 1998 saw further declines in stock prices as economic recession took hold.

The major law governing the securities market is the Securities and Exchange Act (SEA). The SEA was enacted in 1962, but has been revised several times since then, most significantly in 1998. The SEA separates the banking and securities industries. Article 29 of the SEA requires banks and other financial institutions to obtain government approval to engage in the securities business. Article 51 prohibits securities companies from engaging in a business other than the securities business without government approval.

Regulation of the securities industry had been performed by the Securities and Exchange Commission and the Securities Supervisory Board (SSB), formerly under the control of the MOFE. On April 1, 1998, as a result of financial reform legislation passed by the National Assembly, the Securities and Exchange Commission was abolished and replaced by the Securities and Futures Commission (SFC). The SFC was placed under the newly formed Financial Supervisory Commission (FSC), which was established to serve as Korea's integrated financial institutions' regulator. Additionally, the SSB reports to the FSC until January 1, 1999, when the SSB is scheduled to be merged with three other financial institution regulators. The four merged bodies will form the Financial Supervisory Board, which is the executive arm of the FSC.

There are currently 35 domestic Korean securities companies with operating licenses, an increase of three since 1994, though some face possible suspension of their licenses due to financial problems. There are 21 foreign securities firm branches (five U.S.) authorized, an increase from 10 in 1994. There are also eight representative offices (seven U.S.). This is a decline from the 26 authorized in 1993, generally reflecting a conversion from representative offices into branches. Foreign securities firms may now establish subsidiaries in Korea. There are three joint venture foreign securities companies established with Korean partners (two U.S. and one from Hong Kong). Merchant banks are also allowed to undertake selected underwriting opportunities.

There are currently seven regular foreign members of the KSE and two special members. Regular members pay annual membership fees of 12.7 billion won (US$9.2 million) and special members pay an annual membership fee of 2 billion won (US$1.5 million).

On the main exchange of the KSE, stocks continue to be traded in two sections. Newly listed stocks are assigned to the second trading section for at least one year before being eligible to be assigned to the first trading section where margin trading is possible. Stocks showing poor performance can be transferred back to the second section from the first section.

Individuals continued to dominate daily trading on the Exchange, accounting for 75 percent of the trades in 1997. Institutions accounted for 18 percent and foreign investors accounted for 7 percent. The KSE established the stock index futures and options markets in May 1996 and July 1997 respectively, using the Korea Stock Price Index (KOSPI) 200, a capitalization-weighted index composed of 200 representative stocks selected from a broad range of industries.

There is an OTC market operated by the Korea Securities Dealers Association which is now open to foreigners. A separate OTC market for foreigners trading in stocks which had reached their foreign share purchase limits is now virtually defunct with the removal of aggregate and individual foreign purchase limits for most stocks.

The Korean bond market is divided between government/public and corporate bonds. Bonds trade on both the main exchange and the OTC markets, with 95 percent of corporate and convertible bonds trading in the OTC market. About 62 percent of Korea's outstanding bonds are government/public, mainly Monetary Stabilization Bonds. Seventy percent of corporate bonds are straight discount or coupon bonds with warrants, both guaranteed and non-guaranteed. As of the end of 1997, corporate bonds worth 90 trillion won (US$53 billion) were outstanding. Corporate bonds amounting to 34 trillion won (US$20 billion) were issued in 1997. The slow liberalization of the bond market, which began in 1994, when foreigners were first permitted to buy very limited types of corporate bonds, was accelerated after the November 1997 financial crisis and the bond market is now fully open to foreign investors.

Several restrictions limit foreign financial institutions' ability to manage mutual funds. Under the Securities Investment and Trust Business Act, only investment trusts and merchant banks may manage mutual funds. However, effective July 1, 1998, the Foreign Capital Inducement Act's regulations were amended to repeal previous restrictions on foreign equity participation in investment trust companies and investment advisory companies.

As of July 1998, 32 domestic and ten foreign securities firms have received licenses to purchase offshore securities for Korean residents.

U.S. PRESENCE IN THE MARKET

There are presently five branches and seven representative offices of American securities firms operating in Korea. Foreign securities companies may now establish subsidiaries, though to date no American firm has established a subsidiary in Korea. One American firm has established an investment trust operation in Korea, and also has a branch office for its international mutual funds.

TREATMENT OF U.S. FINANCIAL INSTITUTIONS

Restrictions on foreign purchase of Korean securities firms have been removed. Subsidiaries are now permitted. In licensing foreign representative offices, the MOFE authorizes only liaison activities, i.e., offices that exchange information with the home office. Representative offices may not engage directly in domestic securities-related business in Korea, including purchases in the stock market. They cannot generate income, including commissions for any of their activities. Representative offices conduct research and perform services, acting as marketing agents for their parent companies. They identify clients for their parent companies and facilitate business with offshore entities in the area of corporate finance and sales of foreign securities.

As noted earlier, branches are permitted. The minimal capital requirements for branches and joint ventures vary by the number of activities in which the firm wishes to participate. The paid-in capital requirement for brokerage services is only 10 billion won (US$7 million), for brokering and dealing services is 30 billion won (US$22 million) and for full services, i.e., brokering, dealing and underwriting, is 50 billion won (US$36 million).

As part of the financial reform process, which began even before the economic crisis hit Korea in November 1997, the government is considering a wide range of liberalization and deregulation proposals. Consultation with affected foreign companies about regulation in the securities industry has improved considerably. The government, initially through the Financial Reform Commission and later, through the Financial Supervisory Commission, has actively sought the views of foreign securities firms.

Foreign investors may now sell stocks short and the requirements for borrowing stock have been relaxed. Both of these regulatory changes, implemented on May 22, 1998, were proposed by foreign securities firms. Regulatory changes are now posted simultaneously in Korean and English on the Internet. The KSE no longer calculates commissions and commission levels have been liberalized.

Foreign securities firms in Korea have made additional proposals for regulatory and market reform, some of which are under consideration by the government. These proposals deal not so much with national treatment issues as with improving market liquidity and transparency.

As in the banking sector, changes made in the past year in the securities sector go beyond the commitments contained in Korea's GATS offer. OECD financial market opening commitments will be bound in the WTO. Foreign participation in the band and OTC market is now allowed. Limits on foreign portfolio investment have been liberalized well in advance of government timetables. Limits on foreign equity participation in investment trust companies and investment advisory companies have been lifted. Foreign securities firms may now establish subsidiaries in Korea and may purchase Korean securities firms.

Exchange Rates Used:

1997 end-of-period	1,695 won/US$
June 1998 (for fees charged)	1,373 won/US$