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FSS HANDBOOK 2015

About FSS HANDBOOK 2015

The FSS HANDBOOK 2015 is a general reference on Korea's financial regulation and supervision that the Financial Supervisory Service publishes in English as a public service. A PDF version of this publication is freely available online at the FSS English homepage (www.english.fss.or.kr). Please email your inquiry concerning this publication to intlsupport@fss.or.kr.

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ABBREVIATIONS

AEFSC	Act on the Establishment of the Financial Services Commission
CAEL	Capital, Asset quality, Earnings, and Liquidity
CAMEL-R	Capital, Asset quality, Management, Earnings, Liquidity, and Risk management
CAMELS	Capital, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk
CET 1	Common Equity Tier 1
CIS	Collective Investment Scheme
FCPB	Financial Consumer Protection Bureau
FDSC	Financial Dispute Settlement Committee
FHC	Financial Holding Company
FISIS	Financial Statistical Information System
FISP	Financial Investment Services Provider
FSC	Financial Services Commission
FSCMA	Financial Investment Services and Capital Markets Act
FSS	Financial Supervisory Service
IFRS	International Financial Reporting Standards
IT	Information Technology
KOSDAQ	Korea Securities Dealers Automated Quotations
KOSPI	Korea Composite Stock Price Index
LCR	Liquidity Coverage Ratio
MDG	Main Debtor Group
MID	Management Improvement Demand
MIO	Management Improvement Order
MIR	Management Improvement Recommendation
NCR	Net Capital Ratio
NFE	Non-Financial Entity
NOCR	Net Operating Capital Ratio
PEF	Private Equity Fund
RAAS	Risk Assessment Application System
RBC	Risk-Based Capital
ROA	Return on Assets
ROE	Return on Equity
SBL	Substandard or Below Loan
SFC	Securities and Futures Commission
SPC	Special-Purpose Company

1. Financial Supervisory Service

Integrated Financial Supervisory Authority

The Financial Supervisory Service (FSS) is Korea’s integrated financial supervisory authority responsible for the safety and soundness of financial institutions across the financial sectors. It examines and supervises financial institutions to ensure they operate in a safe and sound manner, serve consumers and investors, and comply with rules and regulations. The FSS also performs capital market supervision to protect investors and undertakes wide-ranging initiatives to protect consumers from malpractices of financial firms.

The FSS was officially established on January 2, 1999, pursuant to the Act on the Establishment of Financial Supervisory Organizations (the “Establishment Act”) that the National Assembly approved on December 29, 1997. The Establishment Act created the FSS as a specially legislated quasi-government supervisory authority and charged it with financial supervision across the entire financial sector.

Prior to the creation of the FSS, financial supervision was carried out by four separate sector-based authorities with the finance ministry exercising significant overarching oversight powers. For banking sector supervision, the Office of Banking Supervision under the Bank of Korea conducted examination of commercial banks and foreign bank branches, while the finance ministry assumed the primary responsibility for the oversight of government-affiliated policy banks known as specialized banks and nonbank credit institutions. Similarly, securities sector supervision was shared by the Securities Supervisory Board and the finance ministry, and insurance sector supervision by the Insurance Supervisory Board and the finance ministry. Supervision of other nonbank financial companies was generally divided between the finance ministry and the Bank of Korea’s Office of Banking Supervision. Although institutional and systemic shortcomings that came to light during the 1997 Asian financial crisis reinforced the need for reform of the regulatory and supervisory frameworks and structures, there was a broad recognition even before the crisis of changes needed to deal with the evolving financial market landscape. These ranged from the accelerating convergence of financial services to the blurring of the traditional boundaries between banking and nonbanking activities. The confluence of financial market liberalization, deregulation, and globalization that were gathering momentum across countries at the time also pointed to the need for bold systemic reform to drastically improve the effectiveness of Korea’s financial regulation and supervision.

Recognizing the exigency of reform, the government set up a presidential committee in January 1997 to explore new approaches that were needed in order to bring about more efficient and more robust financial regulation and supervision. The committee followed up with recommendations that culminated in the creation of the Financial Supervisory Commission—the predecessor to the Financial Services Commission—as the integrated regulatory authority on April 1, 1998, and later the creation of the FSS as the integrated supervisory authority on January 2, 1999.

As part of major government reorganization in 2008, the Financial Supervisory Commission consolidated the Financial Policy Bureau under the finance ministry and became the Financial Services Commission (FSC) on February 29, 2008. The name of the Establishment Act—formerly the Act on the Establishment of Financial Supervisory Organizations—was also changed to the Act on the Establishment of the Financial Services Commission (AEFSC).

As a result of the "two-tier system" that the AEFSC has created, the FSC assumes the primary responsibility for rulemaking and licensing, while the FSS principally conducts prudential supervision, capital market supervision, consumer protection, and other oversight and enforcement activities as delegated or charged by the FSC. The FSS also performs administrative functions in support of the rulemaking and licensing activities of the FSC. As the government regulatory authority, the FSC is staffed by civil servants, but the FSS as a specially legislated supervisory authority is staffed by private sector employees who are not part of the government civil service system.

1.1 ORGANIZATION

The FSS is organized into nine divisions comprising 44 departments and 15 offices (March 2016). Each department and office is charged with specific tasks and responsibilities ranging from examination and supervision to consumer protection. Each of the nine divisions is headed by a deputy governor and each of the 44 departments by a director general.
In addition to its headquarters in Seoul, the FSS maintains ten regional and district offices nationwide and eight representative offices overseas. The Office of the Chief Executive Auditor, which comprises an internal audit office and an inspection office, is responsible for internal audit, inspection, and compliance.

Fees collected from financial institutions and securities issuers and appropriation from the Bank of Korea make up most of the operating budget for the FSS. The relative share of fees to be contributed by the regulated financial institutions is determined annually by the FSC on the basis of the total amount of liabilities at the end of the previous fiscal year, subject to certain restrictions. The relative share to be collected from securities issuers is also determined by the FSC on the basis of the total amount of securities issued. When approving the budget for a fiscal year, the FSC takes into account the current funding level and other financial factors and conditions.

1.2 GOVERNANCE

The FSS is headed by the governor, the highest-ranking executive. Under the AEFSC, up to four senior deputy governors and nine deputy governors may be appointed under the governor. The chief executive auditor is the officer responsible for internal audit and compliance. The governor is appointed by the president with the recommendation of the chairman of the FSC. The governor, the senior deputy governors, and the deputy governors each serve a renewable three-year term. As of the end of March 2016, four senior deputy governors and nine deputy governors were serving under the governor.

Related Oversight Authorities

The FSS collaborates and coordinates its supervision activities with the FSC, the Bank of Korea, and the Korea Deposit Insurance Corporation in order to ensure timely and effective examination and supervision. The FSS also routinely shares supervisory information with other oversight authorities on a regular basis as part of its safety and soundness mandate.

1.3 FINANCIAL SERVICES COMMISSION

As the government regulatory authority, the FSC is vested with broad powers under the AEFSC to set the government's financial market policies, propose amendments to financial legislation to the National Assembly, make rules, grant regulatory licenses, and decide on major enforcement actions. Under the two-tier system created by the AEFSC, the FSS is subordinate to the FSC and subject to FSC oversight in respect of its inspection, examination, investigation, and enforcement activities.

The FSC is led by nine commissioners that include the chairman and the vice chairman. Each commissioner serves a three-year term. The chairman is appointed by the president with the recommendation of the prime minister. The vice chairman, who is appointed by the president with the recommendation of the FSC chairman, concurrently holds the position of the chairman of the Securities and Futures Commission (SFC).

Two standing commissioners are appointed with the recommendation of the chairman of the FSC. Of the five non-standing commissioners, four are ex-officio positions held by the vice minister of the Ministry of Strategy and Finance, the governor of the FSS, the deputy governor of the Bank of Korea, and the president of the Korea Deposit Insurance Corporation. The remaining non-standing commissioner is appointed with the recommendation of the chairman of the Korea Chamber of Commerce and Industry, who recommends an industry representative.

The FSC is a government agency whose officers are barred from holding any political position or engaging in any commercial activity during his/her tenure on the Commission. The nine commissioners are also barred from participating in the resolution of matters that may raise conflict of interest. Matters that come before the commissioners for resolutions are passed by the majority of the quorum.

As part of its regulatory mandate, the FSC deliberates and decides on policy matters directly pertaining to the supervision of financial institutions and the securities and futures markets. (Matters relating to the securities and futures markets are largely delegated to the SFC.) The FSC also has the authority to make rules and propose amendments to legislation on the financial sector to the National Assembly.

1.4 SECURITIES AND FUTURES COMMISSION

The SFC is a regulatory commission integrated within the FSC structure that performs the oversight of the securities and futures markets. It consists of five members who are appointed by the president for a renewable three-year term. The vice chairman of the FSC concurrently holds the position of the chairman of the SFC. The standing commissioner and three non-standing commissioners are appointed with the recommendation of the chairman of the FSC. The principal role of the SFC is to direct the investigation of market misconduct and abuse such as insider trading and market manipulation in the securities and futures markets and to establish accounting and audit standards. In addition, the SFC conducts advance review of matters relating to the securities and futures markets to be deliberated by the FSC.

1.5 BANK OF KOREA

The Bank of Korea, established in June 1950 pursuant to the Bank of Korea Act, is Korea's central bank. The Monetary Policy Committee, the highest decision-making body within the

central bank, sets monetary policies in pursuit of price stability and employment. Because of the Bank of Korea's long-standing interest in preserving a safe and sound banking system, the FSS maintains close cooperative institutional relationship and arrangements with the Bank of Korea.

In respect of banking supervision, the Bank of Korea may, when deemed necessary, request that the FSS conduct an examination of a specific financial institution or conduct a joint examination with the participation of specialists from the Bank of Korea. The Bank of Korea may also request that the FSS share the findings of examination conducted at the request of the Bank of Korea and take appropriate supervision actions. The information-sharing MOU that the FSS has signed with the Bank of Korea provides for, in principle, unrestricted information exchange for financial supervision and banking safety and soundness purposes unless specifically prohibited under the law for privacy and other applicable grounds.

1.6 KOREA DEPOSIT INSURANCE CORPORATION

The Korea Deposit Insurance Corporation was established on June 1, 1996, following the enactment of the Depositor Protection Act on December 29, 1995, to protect depositors and help maintain the stability of the banking system. When deemed necessary for the depositor protection mandate as provided under the Depositor Protection Act, the Korea Deposit Insurance Corporation may request that the FSS carry out an examination of an insured institution or provide for the participation of its specialists in the examination. The FSS and the Korea Deposit Insurance Corporation have signed an MOU to facilitate active information sharing on an ongoing basis.

2. Prudential Regulation and Supervision

Banks

Banking institutions that the FSS supervises are grouped into domestic banks and foreign bank branches for supervision purposes. Domestic banks comprise commercial banks and specialized banks, and commercial banks are further divided into national banks and regional banks, both of which are incorporated pursuant to the Banking Act.

2.1 TYPES OF BANKING INSTITUTION

National banks operate nationwide, but regional banks are subject to certain geographic restrictions in their business operations. Specialized banks refer to government-affiliated policy banks that have been established under individual legislation enacted by the National Assembly. The Banking Act in principle recognizes foreign bank branches as equivalent to domestic banks in respect of banking activities and for supervision purposes.

Table 1.
Types of Bank

Domestic banks	• Commercial banks	- National banks - Regional banks
	• Specialized banks	
Foreign bank branches		

Domestic Banks

Domestic banks comprise commercial banks and specialized banks, and commercial banks are further classified into national banks and regional banks.[1]

Commercial banks

National banks operate throughout the country without any regional restriction. The number of national banks grew from five at the end of 1979 to 16 by the end of 1997 on the back of financial market liberalization. Following the 1997 Asian financial crisis, which caused systemic stresses of unprecedented scale to the banking industry, the number of national banks fell to seven as a result of mergers and dissolutions. From January 1998 to September 2001, a total of five commercial banks (three national banks and two regional banks) were closed through purchase and acquisition, and a total of 11 banks (six national banks, two regional banks, and three specialized banks) were merged to form five banks (four national banks and one specialized bank).[2]

Regional banks were first established in 1967 in an effort to better balance regional economic development and provide greater access to financial services to the regional and rural areas. There were ten regional banks that were operating at the end of 1997, but the number fell to six as a result of closures and mergers in the wake of the 1997 financial crisis. Like national banks, regional banks maintain branch banking within their respective localities. The regional banks primarily serve small- and medium-sized enterprises, households, and individual borrowers in their respective regions.[3]

Specialized banks

Specialized banks were established during the 1960s primarily to supplement the commercial banks in areas where they could not supply

[1] In some publications by the Bank of Korea, banking institutions are divided into commercial banks and specialized banks with the commercial banks comprising national banks, regional banks, and foreign bank branches.

[2] As of January 1, 2016, six national banks—Shinhan, Woori, Standard Chartered Bank Korea, Hana (merged with Korea Exchange Bank in September 2015), Citibank Korea, and KB Kookmin Bank—were operating.

[3] As of January 1, 2016, a total of six regional banks—Daegu, Busan, Gwangju, Jeju, Jeonbuk, and Gyongnam—were operating.

sufficient funds due to limited capital and also to support specific industrial sectors that were given priority by the government in its economic development plans. As the banking landscape evolved, however, the specialized banks began to expand their businesses into commercial banking. Their share of capital allocation to the specific sectors they were originally intended to serve is still relatively high. In raising funds, specialized banks primarily rely on public funds and bonds, although they compete with commercial banks for deposits.[4]

Foreign Bank Branches

Foreign bank branches were first permitted to operate in Korea in 1967 as part of government initiatives to stimulate foreign capital investment and improve access to international capital markets. In 1984, the government began to remove restrictions on foreign branch operations in an effort to level the playing field for foreign banks, and in 1991 significantly eased regulations on foreign banks to promote greater competition among banking organizations operating in Korea. For instance, the government allowed foreign banks to open multiple branches under the same standards and procedures as those applied to domestic banks and to compete on equal footing with domestic banks. Traditionally, foreign bank branches in Korea specialized in wholesale banking. As a result of growing market liberalization and deregulation, however, foreign banks have recently been competing with domestic banks on wider-ranging banking businesses.

2.2 CLASSIFICATION OF BANK BUSINESSES

For supervision purposes, business activities that banks may engage in are broadly classified into primary business, secondary business, and concurrent business.

Primary Businesses

The primary business of a bank is banking services such as accepting deposits and making business and consumer loans and other credit services that are reserved exclusively for banking organizations as provided in the Banking Act. Foreign exchange services, certain types of securities-related activities such as issuance of debt for funding, and discounted commercial bill services are also classified as primary business services.

Secondary Businesses

Secondary businesses for bank include services such as credit guarantee, clearing of certain negotiable instruments, and factoring that are not directly related to banking services and secondary to a bank's primary businesses. A new secondary service business to be offered by a bank must be reported to the FSC/FSS at least seven days in advance.

Concurrent Businesses

Concurrent businesses are nonbanking businesses that a bank may engage in together with the primary and secondary businesses. They thus include activities connected with buying and selling of derivatives, treasuries, municipal bonds, investment advisory services, credit card services, bancassurance, and insurance agency services.

For classification purposes, concurrent businesses are further divided into three categories: Type 1 businesses requiring FSC/FSS authorization/approval or registration; Type 2 businesses open to banks under the existing rules and regulations; and Type 3 businesses posing little or no risk to a bank's safety and soundness such as custodian services for asset securitization and consumer credit information services.

2.3 RESTRICTED BUSINESS ACTIVITIES

The Banking Act provides restrictions on certain business practices of the banks. It also prohibits certain activities and limits the amount of credit that may be extended to a single counterparty for safety and soundness reasons.

[4] Five banking institutions operate as specialized banks under the law. They are (i) Korea Development Bank, (ii) Export-Import Bank of Korea, (iii) Industrial Bank of Korea, (iv) NongHyup Bank of the National Agricultural Cooperative Federation, and (v) Suhyup Bank of the National Federation of Fisheries Cooperatives.

Anti-Consumer Credit Practices

Banks must operate with Chinese walls and other internal controls that are designed to identify, evaluate, and prevent any conflict of interest that may arise with their customers. Such systems must be integrated into the organization's overall internal control systems. When making a loan, banks may not demand a tie-in from the borrower such as a compensating deposit. When acquiring a third-party collateral or debt guarantee for a loan, banks may not demand unjustified claim or security interest from the borrower or the guarantor.

Prohibited Business Activities

Banks are prohibited from engaging in certain investment activities for safety and soundness. In respect of securities investment, banks must limit their exposure to securities that are susceptible to extreme price volatility or liquidity risks. The exposure limit must also be proportionate to the level of capital available to readily meet any potential losses.

Ownership of land and other real properties that are intended for business operations is limited to 60 percent of the bank capital. The limitation is intended as a safeguard against excessive or prolonged exposure to illiquid assets. Ownership of real properties for purposes other than business operations is prohibited unless ownership stems from the acquisition of collateral from defaulted borrowers. The disposition of such property, however, must be completed within a year from the date of the acquisition.

Limits on Large Credit Extensions

Credit extension is regulated to minimize significant counterparty risks and prevent unsound bank lending practices. Credit extension is broadly understood to include not only loans made or renewed, but also any loan guarantees or lines of credit granted and other transactions that obligate a person to pay money or its equivalent to the bank.[5]

Credit extension to counterparty and group of counterparties

Credit extension to a single counterparty (borrower) may not exceed an amount equivalent to 20 percent of the creditor bank's capital (shareholders' equity). In addition, the limit on credit extension to a single counterparty and connected counterparties—collectively referred to as the "same counterparty"—is set at 25 percent of the creditor bank's capital.

Aggregate credit extensions

Credit extension to a same counterparty exceeding 10 percent of a bank's capital is deemed a large credit extension. The aggregate amount of large credit extensions must be less than five times the amount of capital.

Credit extension to large shareholders

Credit extension to a single shareholder may not exceed an amount equivalent to 25 percent of the bank's capital or an amount equivalent to the shareholder's equity in the bank, whichever is smaller. In addition, the aggregate amount of credit to be extended or extended to the bank's shareholders may not exceed 25 percent of the bank's capital.

Credit extension to subsidiaries

Credit extension to a single subsidiary of the bank may not exceed an amount equivalent to 10 percent of the bank's capital. In addition, the aggregate amount of credit extended or to be extended to the bank's subsidiaries may not exceed 20 percent of the bank's capital.

Parent-subsidiary credit extension

No credit may be extended by a subsidiary bank to the parent bank. Credit extension to a single subsidiary bank may not exceed 10 percent of the subsidiary bank's capital, and

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[5] Whereas the term "lending" generally refers to a loan lent to a borrower and a loan guaranty the borrower has made available to the lender for another party, the term "credit extension" refers to a broader range of lender-provided credits. Thus, credit extension includes not only a loan and a loan guaranty, but also other at-risk exposures to the borrower in the form of line of credit, commercial papers, bonds, and other such instruments. Lending was replaced with credit extension in the Banking Act in April 1999 in the wake of the Asian financial crisis as part of a broad banking sector reform aimed at instituting stricter rules and regulations on corporate lending.

the aggregate amount of credit extensions from the parent bank to the subsidiary banks may not exceed 20 percent of the subsidiary banks' capital.

Main Debtor Group Designation

Each year the FSS designates business groups with large debt obligations to banks and other major lending institutions as a main debtor group (MDG). When a business group is designated an MDG, the affiliates making up the group—companies belonging to the business group—become subject to additional credit restrictions and scrutiny from the creditor institutions. Depending on the level of credit risk identified or assessed, the creditor institutions may also coordinate their actions through the main creditor bank and demand that the MDG take debt reduction measures such as asset disposition and restructuring. The MDG designation is made each year on the basis of a fixed percentage of the aggregate credit extensions by regulated financial institutions.[6]

2.4 BANK SHARE OWNERSHIP

Restrictions on bank share ownership were first instituted in the Banking Act in December 1982 following a series of bank privatization initiatives as safeguards against large shareholders that may seek to profit from influencing the bank's credit decisions. The key safeguard provision in the Banking Act is article 15(1) that expressly prohibits a "same party" from holding more than 10 percent of the outstanding voting shares of a national bank. (The limit is 15 percent for a regional bank.) Shares held by a shareholder means shares that a person owns both legally and beneficially.

The Banking Act provides that the "same party" includes not only a shareholder of a bank, but also persons that are tied or connected to the shareholder by a special relationship ("related persons") such as the shareholder's family members or relatives. In addition, a company is deemed a related person to a shareholder of a bank if the shareholder's family members or relatives hold more than 30 percent of the total shares of the company or effectively controls the company as its largest shareholders.

Exceptions to the 10 Percent Limit

The Banking Act provides several exceptions to the 10 percent limit on bank share ownership. Shares that are held by a government authority or the Korea Deposit Insurance Corporation are not subject to any share ownership restriction. Similarly, bank holding companies are excluded from any bank share ownership restrictions. The maximum share ownership permitted for the same party of a regional bank is 15 percent.

Disposition of Excess Shares

Where the number of shares held by the same party exceeds the 10 percent limit, the voting rights of the excess shares (the above-10 percent shares) are suspended, and full disposition of the excess shares must take place promptly. When the shareholder fails to fully dispose of the excess shares, the FSC/FSS may issue a disposition order for any remaining excess shares within a period of less than six months. Failure to comply with a disposition order by the FSC/FSS may result in a daily fine equivalent to 0.03 percent of the book value of the remaining excess shares.

Approval for Excess Shares

A same party seeking to acquire shares in excess of 10 percent must satisfy the excess share acquisition criteria as set forth in the Banking Act and in the subordinate regulations and obtain approval from the FSC/FSS. Approval must be obtained each time the aggregate number of shares held by the same party exceeds 10 percent (15 percent for a regional bank), 25 percent, and 33 percent of the outstanding voting shares of a national bank. The FSC/FSS has the authority under the law to approve excess share acquisition with a specific limit on its own discretion; any

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[6] For 2014, the aggregate credit extension amount and the fixed percentage from 2012 were used; they were KRW1,633.4 trillion and 0.075 percent. The threshold amount for an MDG designation for 2014 was therefore KRW1.225 trillion, meaning business groups with debt obligations in excess of KRW1.225 trillion became subject to focused creditor scrutiny. Using the same rule, the threshold amount for 2015 was KRW1.273 trillion.

additional share acquisition thereafter must be approved again. The FSC conducts a review of bank shareholders' compliance with the excess share acquisition requirements on a semiannual basis and on an ad hoc basis as needed.

Although the Banking Act and the subordinate regulations give exceptions to the 10 percent limit for the same party, they also require evaluation of the following considerations before additional share acquisition can be permitted:

(a) Risks the shareholder poses on the soundness of the bank;

(b) Shareholder's asset size and financial soundness;

(c) Amount of credit, if any, that the bank has extended to the shareholder; and

(d) Shareholder's capacity to contribute to the bank's safety and soundness.

2.5 BANK OWNERSHIP BY NON-FINANCIAL ENTITY

For a non-financial entity (NFE), the limit for share ownership in a national bank is 4 percent (15 percent in a regional bank).[7] The primary rationale for share ownership restrictions on an NFE is to prevent non-banking enterprises—mostly business groups that control companies engaging industrial enterprises—from unduly influencing the operation and management of a bank under the principle of the separation of banking and commerce.

Definition of Non-Financial Entity

An NFE is defined in the Banking Act as:

(a) A same party—a shareholder and any related persons—whose aggregate capital from non-financial business entities exceed 25 percent of the same party's aggregate capital, or whose aggregate assets from non-financial business entities exceed KRW2 trillion;

(b) An investment company where a person falling under subparagraph (a) above holds more than 9 percent of the investment company's outstanding shares;

(c) A private equity fund (PEF) where a person falling under either subparagraph (a) or (b) above is the PEF's limited partner who holds, together with any related persons, 18 percent or more of the PEF's paid-up capital;

(d) A PEF where a person falling under either subparagraph (a) or (b) above is the PEF's general partner;

(e) A PEF where the aggregate equity of the affiliated companies of a business group subject to interlocking share-holding restrictions constitutes 36 percent or more of the PEF's paid-up capital; or

(f) A special-purpose company (SPC) where a PEF falling under either subparagraph (c), or (d), or (e) holds more than 9 percent of the SPC's shares or equity and exercises de facto control over the management of the SPC.

Share Acquisition above 4 Percent

An NFE that seeks to acquire more than 4 percent of the outstanding voting shares of a national bank with the intent to become the bank's largest shareholder or participate in the management of the bank (by influencing the appointment of the bank's directors or officers) must obtain approval from the FSC/FSS.

Where an NFE must obtain an ex post approval for shares acquired in excess of 4 percent under exceptional circumstances—such as share disposition by other shareholders or a capital write-down—the NFE must report the acquisition to the FSC/FSS within 5 days from the date of the acquisition. The NFE must then either obtain approval from the FSC within six months from the date of the acquisition or dispose of the excess shares. Should the NFE

[7] The term "non-financial entity" has been translated as "non-financial business operator" in some publications.

fail to comply with the 4 percent limit within six months, the voting rights of the excess shares are suspended, and the FSC may issue a share disposition order for the excess shares.

9 Percent Share Acquisition Restriction

As a rule, no NFE may hold more than 9 percent of the voting shares of a national bank (15 percent for a regional bank). The restriction may be raised up to 10 percent with approval from the FSC, provided that the NFE relinquishes the voting rights of the above-9 percent shares and meets the applicable financial soundness criteria.

Share Acquisition above 9 Percent

An NFE may hold more than 9 percent of the voting shares of a national bank (and more than 10 percent with approval from the FSC) where:

(a) The NFE delivers to the FSC an intent to become a non-NFE within two years and obtains preliminary approval for the planned conversion to a non-NFE;

(b) The proportion of shares held by the NFE is not greater than the proportion of shares held by foreign investors as a group; this rule is applicable to a single bank only, and the voting rights become restricted, and the FSC may issue a share disposition order within one year for any excess holdings; or

(c) A fund created under article 5 of the National Finance Act or an entity managing such funds obtains approval from the FSC/FSS as an NFE.

Reporting of above-4 Percent Share Ownership

A report on share ownership must be filed with the FSC/FSS within 5 days as provided for under article 15-2 of the Banking Act when:

(a) A same party comes to hold more than 4 percent of the voting shares of a national bank;

(b) A same party falling under subparagraph a) above becomes the largest shareholder of the national bank;

(c) The aggregate equity of a same party falling under subparagraph a) above increases or decreases by more than 1 percent;

(d) A change of a partner (either the general partner or a limited partner) of a PEF that holds more than 4 percent of the voting shares of a national bank occurs; or

(e) A change of a shareholder or a partner (either the general partner or a limited partner) of a special-purpose company that holds more than 4 percent of the voting shares of a national bank occurs.

Restrictions on Large Shareholders

A shareholder of a bank classified as a large shareholder under the Banking Act is subject to certain share ownership restrictions. Article 2-1(10) of the Banking Act defines a large shareholder of a bank as:

(a) A shareholder that holds more than 10 percent of the voting shares of a national bank (15 percent for a regional bank); or

(b) A shareholder that holds more than 4 percent of the voting shares of a national bank and is either the largest shareholder of the bank or a shareholder that (i) effectively exerts influence on the bank's management decisions through such means as appointing the bank's directors or officers, or (ii) is an NFE that actively participates in the management of the bank through such means as appointing the bank's directors or officers.

The maximum amount of credit that may be extended to a single large shareholder is the lower of either (i) an amount equivalent to 25 percent of the bank's shareholders' equity, or (ii) an amount equivalent to the proportion of the shareholder's claim in the bank's shareholders' equity.

Where the amount of credit to be extended to a large shareholder exceeds the lower of either (i) 0.1 percent of the bank's shareholders' equity, or (ii) KRW5 billion, the bank must act to ensure that:

(a) A unanimous decision is reached from every member of the board of directors;

(b) The FSC/FSS is duly notified of the credit extension decision in advance; and

(c) Disclosure of the credit extension is made to the general public.

Credit extension to large shareholders is restricted to 25 percent of the bank's shareholders' equity. Cross-lending involving a borrower from another bank, which is intended to circumvent the existing credit extension restrictions on large shareholders, is not permitted. (In a cross-lending scheme, Borrower 1 obtains the maximum credit allowed from Bank A, and Borrower 2 does the same from Bank B. Borrower 1 then obtains additional credit from Bank B and Borrower 2 from Bank A. The secondary credit extensions are then switched between the two borrowers.)

Restrictions on Acquisition of Shares Issued by Large Shareholders

Bank acquisition of shares issued by a large shareholder is limited to 1 percent of the bank's shareholders' equity. For unlisted shares, the maximum is 0.5 percent. In addition, share acquisition above the lower of either (i) 0.1 percent of the bank's shareholders' equity, or (ii) KRW5 billion requires a unanimous consent of the board of directors of the bank, reporting to the FSC, and a public disclosure.

2.6 MINIMUM CAPITAL REQUIREMENTS

Basel III capital framework for domestic banks began on December 1, 2013. As a result of the implementation of the new capital standards since then, the minimum capital standards and the phase-in arrangements for domestic banks are virtually same as those put forth by the Basel Committee on Banking Supervision.

Table 2.
Basel III Capital Requirements and Phase-in Arrangement

	2016	2017	2018	2019
Common equity tier 1 ratio	4.5	4.5	4.5	4.5
Capital conservation buffer	0.625	1.25	1.875	2.50
Common equity tier 1 plus capital conservation buffer	5.125	5.75	6.375	7.00
Tier 1 capital	6.0	6.0	6.0	6.0
Total regulatory capital	8.0	8.0	8.0	8.0
Total regulatory capital plus capital conservation buffer	8.625	9.25	9.875	10.5
Liquidity coverage ratio	70	80	90	100

In full compliance with the Basel Committee's stricter capital standards, banking regulations provide that domestic banks' common equity tier 1 (CET 1) must be at least 4.5 percent of the risk-weighted assets and tier 1 capital 6.0 percent of the risk-weighted assets. Total regulatory capital, which consists of tier 1 capital and tier 2 capital, must be at least 8.0 percent of the risk-weighted assets at all times. Phase-in of conservation capital buffer above the 8 percent minimum has also been set to begin in 2016.

In addition to Basel III's enhanced capital standards, liquidity coverage ratio (LCR)—defined as a ratio of stock of high quality liquid assets to net cash outflows for a 30-day period—took effect at the beginning of 2015 requiring domestic commercial banks to meet a minimum ratio of 100 percent. For foreign bank branches, the minimum has been set at 20 percent for 2015 but will increase by

10 percentage points each year thereafter to become 60 percent by 2019. For the specialized banks excluding the Export-Import Bank of Korea, the minimum starts at 60 percent for 2015 but will increase by 10 percentage points each year thereafter to meet 100 percent in 2019.

2.7 PRUDENTIAL STANDARDS

Banking institutions must comply with certain safety and soundness standards in respect of their capital, assets, liquidity, and other critical aspect of their banking operations. Banks that fail to meet the expected safety and soundness standards are subject to supervisory actions that can range from recapitalization and dividend payout restrictions to prompt corrective action.

Liquidity Coverage Ratio

Liquidity is a measure of how well a bank is prepared to convert assets into cash with little or no loss of value in order to meet its liquidity needs in various liquidity scenarios. To help ensure effective bank liquidity supervision, the FSC/FSS has put into effect at the beginning of 2015 the Basel III LCR framework, which replaced the previous won-denominated liquidity ratio requirements that applied to banks.

As set by the Basel Committee on Banking Supervision, the LCR is intended to improve the resilience of a bank's liquidity capacity by requiring high-quality liquid assets sufficient to enable the bank to cope with a "significant stress scenario" lasting up to 30 days. The LCR is defined as a simple ratio of stock of high quality liquid assets to the total net cash outflows over the next 30 calendar days. Commercial banks and specialized banks must maintain a minimum LCR of 100 percent. For foreign bank branches, the minimum LCR is 60 percent. In addition, banks are subject to the net stable funding ratio requirement that supplements the LCR with a time horizon of one year.

Foreign Exchange Management and Requirements

Banks and other financial institutions that are authorized to engage in foreign exchange-related business activities pursuant to the Foreign Exchange Transactions Act ("foreign exchange-authorized institutions") are required to operate with safe and sound management of foreign exchange liquidity and foreign exchange risk.

- Open Foreign Exchange Position: Foreign exchange position refers to the difference between foreign currency-denominated assets and liabilities. For foreign-exchange authorized banks, the limit for aggregate foreign exchange positions (spot and forward positions) is set at 50 percent of the capital. The limit for the net forward position is 30 percent of the capital for foreign exchange-authorized banks and 150 percent for foreign bank branches.

- Foreign Exchange Liquidity Ratio: Banks are subject to three-month foreign exchange liquidity ratio requirement, which is defined as a ratio of foreign currency-denominated assets to foreign currency-denominated liabilities maturing within three months. They must also comply with seven-day and one-month maturity mismatch ratio (gap ratio) requirements. For foreign-exchange authorized banks, the minimum three-month foreign exchange liquidity ratio is 85 percent. The minimum seven-day and one-month mismatch ratios—defined as a ratio of net foreign currency-denominated assets (net of foreign currency-denominated liabilities) to aggregate foreign currency-denominated assets—are -3 percent and -10 percent, respectively.

- Stable Foreign Exchange Funding Ratio: Domestic banks are subject to foreign currency funding ratios relative to the outstanding foreign currency lending that are designed to prevent maturity mismatch between foreign currency borrowing and lending. The stable foreign exchange funding ratio—defined as a ratio of foreign

currency funding with maturity longer than a year to foreign currency lending with maturity longer than a year—must exceed 100 percent. Financial institutions with the outstanding amount of foreign currency lending less than USD50 million are exempt from the stable foreign exchange funding ratio requirement.

- Reserves Requirement for High-Quality Foreign Currency-Denominated Assets: Domestic banks excluding the Korea Development Bank and the Export-Import Bank of Korea must maintain certain levels of high-quality foreign currency-denominated assets that may be used during periods of major market distress. The minimum reserves requirement is either two percent of the bank's aggregate foreign currency-denominated assets or the retention of sovereign bonds and highly rated corporate bonds equivalent in amount to the maximum likely foreign exchange outflows during a two-month period.

- Loan-to-Deposit Ratio: Financial institutions are required to maintain their won-denominated loan-to-deposit ratio on a monthly average basis at or below 100 percent. For computation purposes, the amount of policy-directed loans is deducted from the numerator (loans), while the amount of covered bonds is added to the denominator (deposits).

Asset Classification

Bank assets are classified into five different classes: (1) normal; (2) precautionary; (3) substandard; (4) doubtful; and (5) presumed loss. Asset classification is made primarily on the basis of the borrower's debt-servicing ability. It is therefore not only backward-looking (e.g., duration of any nonpayment and the occurrence of any default in the past), but also forward-looking because the borrower's future debt-servicing ability is assessed and reflected in the classification. Loans classified as substandard, doubtful, or presumed loss are collectively referred to as "substandard or below loans" or SBLs for short.

The standard asset classification criteria give the due weight to the borrower's debt-servicing ability, the duration of any nonpayment from the borrower, and the occurrence of any default.

Borrower's Debt-Servicing Ability

Asset classification on the basis of the borrower's debt-servicing ability is made in consideration of the borrower's debt-paying ability and credit risk factors that include risks to the borrower's cash flows, business, industry, and financial stability. Nonpayment means interest or principal payment not made before the predetermined date with the lender. Asset classifications made on the basis of the duration of a borrower's nonpayment of interest or principle is presented in table 3.

Where the borrower's business is terminated, the borrower's default becomes final, or the borrower is in bankruptcy proceedings or in the process of business liquidation, the estimated collectible amount from the borrower collateral is classified as "substandard," and the excess amount not covered by the borrower collateral as "presumed loss."

Table 3.
Standard Asset Classification Criteria

	Duration of nonpayment of business and household loans	Duration of nonpayment of individual credit card receivables
Normal	Less than a month;	Less than a month;
Precautionary	More than a month, but shorter than 3 months;	More than a month, but shorter than 3 months;
Substandard	More than 3 months (for estimated collectible amount);	More than 3 months (for estimated collectible amount);
Doubtful	More than 3 months, but shorter than 12 months (in excess of the estimated collectible amount);	More than 3 months, but shorter than 6 months (in excess of the estimated collectible amount);
Presumed loss	More than 12 months (in excess of the estimated collectible amount);	More than 6 months (in excess of the estimated collectible amount);

Table 4.
Asset Classification Criteria

Category	Debt-servicing ability	Duration of nonpayment	Default criteria
Normal	Assets that are judged to pose little or no risk to full lender collection given the strength of the borrower's debt-servicing ability in consideration of its overall business soundness, financial conditions, and future cash flows;	--	--
Precautionary	Assets that are judged to pose no immediate risk to full lender collection given the borrower's overall business soundness, financial conditions, and future cash flows, but are susceptible to potential risks that may reduce the borrower's debt-servicing ability in the future;	Assets whose interest and principal payments from the borrower have been overdue longer than a month, but shorter than three months;	--
Substandard	Assets that are judged to pose significant risks to full lender collection because of the presence of risk factors that may undermine borrower's future debt-servicing ability;	Portions expected to be collected from assets whose interest and principal payments from the borrower have been overdue longer than three months;	Portions expected to be collected from assets that pose significant risks to full lender collection because of borrower default, bankruptcy, business liquidation, or business termination;
Doubtful	Portions of assets not expected to be collected given the borrower's sharply deteriorating debt-servicing ability that makes full lender collection unlikely;	Portions not expected to be collected from assets whose interest and principal payments from the borrower have been overdue longer than three months, but shorter than 12 months;	--
Presumed loss	Portions of assets not expected to be collected given the borrower's sharply deteriorating debt-servicing ability that makes recognition of loan losses unavoidable;	Portions not expected to be collected from assets whose interest and principle payments from the borrower have been overdue longer than 12 months;	Assets that pose significant risks to full lender collection because of borrower default, bankruptcy, business liquidation, or business termination;

Assets Subject to Classification and Allowance for Loan Losses

Asset classification and allowance for loan losses are applicable to all assets that are inherently vulnerable to credit risk and impairment. For banks, this rule applies to loans and credit guarantees under banking account. The same rule applies to assets subject to credit risk and impairment under the trust account.

Minimum Allowance for Credit Loss for Banks

The FSC/FSS requires banks to provide for estimated credit losses within their loan and other asset portfolios as allowances for loan losses, which are presented on the balance sheet as a contra-asset account. The minimum allowances for the five asset classes are presented in table 5. The FSC/FSS requires banks to make adjustment to loan loss provisions ("adjustment to loan loss provisions") based on International Financial Reporting Standards (IFRS) in order to ensure consistency with the regulatory minimum for loan loss allowances.

Table 5.
Minimum Allowances for Bank Credit Losses

(In percent)

	Business loans	Household loans	Credit cards
Normal	0.85	1.0	1.1
Precautionary	7	10	40
Substandard	20	20	60
Doubtful	50	55	75
Presumed loss	100	100	100

* The minimum allowance for restaurants, lodging, retail and wholesale businesses, construction, and real estate is 0.90 percent.

2.8 SUPERVISORY REVIEW OF FINANCIAL PRODUCTS AND SERVICES

Banks are required to file an advance report with the FSC/FSS on the use of new contract provisions and alterations to existing provisions for financial products and services for supervisory review in respect of their appropriateness and fairness to consumers. Provisions that are determined by the FSC/FSS not to unfairly disadvantage or otherwise harm consumers may be reported ex post within ten days of the change. Supervisory actions may ensue for new provisions or alterations that fall short of the expected standards.

New contract provisions and alterations subject to reporting for supervisory review include the following:

- Contract provisions that are aimed at circumventing the bank's legal liabilities stemming from negligence;
- Contract provisions that arbitrarily limit the scope of damages to the counterparty or assign the bank's liabilities to the counterparty without justifiable cause;
- Contract provisions that impose excessive penalty for delayed payment or otherwise improperly demand damages from the counterparty;
- Contract provisions that arbitrarily exclude consumer claims or violate consumer rights that are protected under the law.

Banks must also comply with the duty to provide ex ante disclosures that are material to consumer benefits such as alterations affecting interest rates charged, termination of contracts in effect, and deposit protection.

Nonbank Financial Companies

Nonbank financial companies refer to a category of financial services firms that are not classified as a bank, a financial investment services provider, or an insurance company. For supervision purposes, nonbank financial companies are broadly divided into three groups: mutual savings banks, specialized credit finance companies, and mutual credit cooperatives.

2.9 TYPES OF NONBANK FINANCIAL COMPANY

As is the case for banks, financial service businesses that are open to nonbank financial companies are generally classified into primary, secondary, and concurrent businesses. In addition to the authorized/approved or registered primary businesses, specialized credit finance companies may engage in secondary businesses including making loans, factoring, purchase of securitized assets, debt guarantee business, custodian business for asset securitization, consumer and borrower credit checks connected with loans and factoring. For credit card companies, secondary businesses include credit services, debit card services, and payment settlement and management services. Certain travel and insurance services are also open to credit card companies as secondary businesses.

Table 6.
Types of Nonbank Financial Company

Mutual savings banks	
Specialized credit finance companies	• Credit card companies • Leasing companies • Installment finance companies • New technology venture companies
Mutual credit cooperatives	• Credit unions • Agricultural/fishery/forestry cooperatives

Mutual Savings Banks

Mutual savings banks are regulated depositary institutions that provide retail and small business banking in limited scale. Although they are deposit-taking institutions and carry on commercial banking on a limited scale, they are not classified as banks for supervision purposes because they are incorporated and regulated under the Mutual Savings and Finance Company Act, not under the Banking Act as is the case for the commercial banks.

The primary businesses for mutual savings banks are largely limited to deposit and loan services, commercial bill services, intermediary services for government and public enterprises, and financial services firms, and debit card and payment settlement services. Mutual savings banks may also engage in broker/dealer services and trust services as provided under the Financial Investment Services and Capital Markets Act (FSCMA) with authorization/approval from the FSC/FSS. Consumer financing services are also open to certain qualified mutual savings banks. Mutual savings banks may engage in the sale of loans and act as agents for the sale of gift certificates and lottery tickets, and offer bancassurance services with authorization/approval from the FSC/FSS.

Specialized Credit Finance Companies

Specialized credit finance companies comprise credit card companies, leasing companies, installment finance companies, and new technology venture capital companies. All specialized credit finance companies are subject to FSS supervision. In addition to primary businesses that require registration with or approval from the FSC/FSS, specialized credit finance companies may carry on services secondary to the primary services.

Credit card companies

Credit card service is a business open to specialized credit finance companies with approval from the FSC/FSS. (Installment finance business, leasing business, and new technology venture capital business require registration with the FSC/FSS.) The primary services of credit card companies are

installment payment, cash advances, and card loan services, debit card services, and payment settlement services.

Leasing companies

Leasing companies engage in the business of providing facility leasing and deferred payment sales to business enterprises. As lessors, leasing companies generate rental income by granting the lessee a right to use for a period of time specific property that they own or have paid for. Deferred sale is a method used by leasing companies to deliver specific property to the lessee, which then uses the property with payments in periodic installments.

Installment finance companies

Installment finance companies are a type of consumer finance companies that conclude a sales/purchase agreement for a good or a service with a seller and a buyer, make payment to the seller for the good or the service purchased by the buyer, and receive regular principal and interest payments from the buyer.

New technology venture capital companies

New technology venture capital companies help raise capital to technology start-ups by underwriting debt and equity issues and offering financing to companies with the "venture" designation. They also provide consulting services to technology start-ups.

Mutual Credit Cooperatives

Credit unions and credit cooperatives, collectively referred to as mutual credit cooperatives, are not-for-profit financial cooperatives that are owned and controlled by members who share a common place of residence, workplace, organization, community or are tied by other associations. Most provide deposit and loan services and other member-specific financial services.

Under the law, the following mutual credit cooperatives are recognized:

- Credit unions and their national federation (the National Credit Union Federation of Korea);
- Agricultural cooperatives and their national federation (the National Agricultural Cooperative Federation);
- Fishery cooperatives and their national federation (the National Federation of Fisheries Cooperatives);
- Forestry cooperatives and their national federation (the National Forestry Cooperative Federation); and
- Community credit cooperatives and their national federation (the Korean Federation of Community Credit Cooperatives).

Of the recognized mutual credit cooperatives, only community credit cooperatives and their national federation fall under the oversight of the Ministry of the Interior. By assets, credit unions are the largest.

2.10 GENERAL RESTRICTIONS AND PROHIBITIONS

Nonbank financial companies including mutual savings banks, specialized credit finance companies, and credit unions are subject to certain restrictions on credit extensions.

Mutual Savings Banks

Mutual savings banks are subject to credit extension limits that are similar in purpose to banks. For a single counterparty, credit extension may not exceed 20 percent of the mutual savings bank's capital. An additional limit of KRW10 billion is applicable where the counterparty is a corporate borrower (KRW5 billion for an individual business owner and KRW600 million for an individual borrower).

Moreover, the aggregate amount of credit extensions to a same counterparty—a counterparty and any group of connected counterparties—may not exceed 25 percent of the mutual savings bank's capital. Credit extension to a single counterparty exceeding 10 percent of the capital is deemed a large credit extension, and the aggregate amount of such large credit extensions must be less than five times the amount of capital.

Credit extension limits on mutual savings banks belonging to a business group

Credit extension limits for mutual savings banks that are affiliates of a business group were instituted in September 2010. For such mutual savings banks, the aggregate of credit extended to a single counterparty may not exceed 20 percent of the mutual savings bank's capital on a consolidated basis. Similarly, the aggregate of credit extended to a same counterparty—a counterparty and any group of connected counterparties—may not exceed 25 percent of the mutual savings bank's capital on a consolidated basis. Thus, mutual savings banks affiliated with companies in a business group are subject to credit extension limits applicable to not only a single counterparty and a same counterparty as a stand-alone mutual savings bank, but also credit extension limits applicable as affiliates in a business group.

Other limits on credit extension

Mutual savings banks must also comply with certain credit extension requirements to individual borrowers and small businesses. For mutual savings banks operating in major metropolitan areas, at least 50 percent of the aggregate credit extensions must be made to individual borrowers. Additionally, credit extension for real estate project finances may not exceed 20 percent of the total credit.

Securities investment

Some limits also apply to securities investments. The aggregate amount of securities investment may not exceed 100 percent of the mutual savings bank's capital. With respect to individual investment, stock investments may not exceed 20 percent of the capital, and the aggregate of stocks and bonds of a company (and others related to the company) may not exceed 20 percent of the capital.

Specialized Credit Finance Companies

Because specialized credit finance companies are not deposit-taking institutions and perform only limited credit intermediation functions, they are excluded from credit extension limits for a single counterparty, a same counterparty, and large credit extensions. In respect of credit extension to a major shareholder of a specialized credit finance company, however, credit extension limit is set at 100 percent of the company's capital.

Restrictions on real property acquisition

Specialized credit finance companies are prohibited from acquiring ownership of real properties for purposes other than business operations. In addition, ownership of real properties for business operation purposes is limited to 100 percent of the capital.

Restrictions on leverage ratio

Specialized credit finance companies are subject to leverage restrictions. Leverage ratio—defined as a ratio of aggregate assets to capital—may not exceed 6 (or 600 percent) for credit card companies; that is, aggregate assets may not exceed capital by a factor of 6. For other specialized credit finance companies, the leverage ratio must be less than 10.

Restrictions on secondary businesses of credit card companies

Credit card companies may offer cash advance and loan services to their card members as secondary businesses in addition to their primary business of credit card services. As a safeguard to prevent credit card companies from concentrating in cash advance and loan services, rules on the secondary businesses of credit card companies provide that the aggregate amount of receivables from cash advance and loan services may not exceed the aggregate of credit card receivables and debit card purchases.

Credit Unions

Credit extension to a borrower (and connected borrowers) may not exceed the larger of either 20 percent of the capital or 1 percent of the assets from the previous year's balance sheet. The maximum amount of credit extension permitted for credit unions whose capital was more than KRW25 billion won from the most recent accounting period is KRW5 billion. For credit unions with less than KRW25 billion in capital, the limit is KRW3 billion. In respect of asset-based credit extension limit, the maximum is KRW500 million. In addition,

credit unions must hold at least 10 percent of the member deposits as redemption reserve, and at least 50 percent of the reserve must be deposited at the national federation and the rest held in the form of cash or deposits in a financial services company or in qualified investment.

2.11 MINIMUM CAPITAL REQUIREMENTS

Minimum capital requirements became effective for mutual savings banks on December 31, 1998. The minimum capital rules have since been incorporated into the supervisory guidance standards and used for prompt corrective action evaluations. As part of enhanced prudential standards for mutual savings banks, the minimum capital requirement was set to be raised from 5 percent to 7 percent effective July 1, 2014, for mutual savings banks with KRW2 trillion or more in assets at the end the previous accounting period. For those with less than KRW2 trillion in assets, the minimum ratio has been set at 6 percent from July 1, 2014, to June 30, 2016, and to 7 percent effective July 1, 2016.

For prompt corrective action, a mutual savings bank with assets in excess of KRW2 trillion is issued a management improvement recommendation (MIR) for minimum capital ratio below 7 percent, a management improvement demand (MID) for minimum capital ratio below 5 percent, and a management improvement order (MIO) for minimum capital ratio below 2 percent. Similarly, a mutual savings bank with assets less than KRW2 trillion is issued MIR for minimum capital ratio below 6 percent (7 percent after July 1, 2016), MID for minimum capital ratio below 4 percent (5 percent after July 1, 2016), and MIO for minimum capital ratio below 1.5 percent (2 percent after July 1, 2016).

A uniform rate of 7 percent minimum capital requirement applies to specialized credit finance companies with the exception of credit card companies, to which an 8 percent minimum capital requirement applies. The minimum ratio for credit unions is 2 percent.

2.12 PRUDENTIAL STANDARDS

The safety and soundness standards for nonbank financial companies are similar to those that are applicable to banks. Some standards for nonbank financial companies are less stringent than those for banks in consideration of their unique service characteristics and business activities.

Asset Classification

Asset classification for nonbank financial companies is primarily made on the basis of the borrower's transaction history, credit rating, the duration of delinquent payment, and any occurrence of default with some adjustments available for the types of businesses of nonbank financial companies. Unlike the assets of banks, the assets of nonbank financial companies are not subject to forward-looking criteria. In addition, for project finance loans of mutual savings banks, asset classification must reflect an assessment of the project finance activity as a measure of the likelihood of future loan collection. (See table 7.)

Minimum Allowances for Credit Losses

Nonbank financial companies must comply with minimum allowance rules for credit losses by setting aside allowances for credit losses on the basis of asset classifications made. (See table 8.)

Credit Extension Limits

Nonbank financial companies are subject to credit extension limits on any single counterparty (borrower) and any connected or related counterparties as banks are. Credit extension in excess of 10 percent of the capital to a counterparty and any connected counterparties (a counterparty for the mutual savings bank) is deemed "large." (See table 9.)

Prudential Guidance Ratios

Nonbank financial companies must comply with safety and soundness guidance ratio requirements that the FSC/FSS has set for prudential regulation and supervision purposes. The ratios for nonbank financial companies are similar for those for banks. (See table 10.)

Table 7.
Asset Classification for Nonbank Financial Companies

	Mutual savings banks	Credit unions	Specialized credit finance companies	
Asset type	Loan assets	Loan assets	Loan assets (excluding household credit)	Credit card assets and household credit
Normal	Less than 2 months	Less than one month	Less than 2 months	Less than one month
Precautionary	2 to 4 months	Less than 3 months	2 to 4 months	1 to 3 months
Substandard	More than 4 months (estimated collection amount)	More than 3 months (estimated collection amount)	More than 4 months (estimated collection amount)	More than 3 months
Doubtful	More than 4 months (excess of estimated collection amount)	3 to 12 months (excess of estimated collection amount)	More than 4 months (excess of estimated collection amount)	3 to 6 months
Presumed loss	More than 4 months (no estimated collection)	More than 12 months (excess of estimated collection amount)	More than 4 months (no estimated collection)	More than 6 months

Table 8.
Minimum Allowance for Credit Losses for Nonbank Financial Companies

(In percent)

		Normal	Precautionary	Substandard	Doubtful	Presumed loss
Mutual banks		0.5	2.0	20.0	75.0	100.0
Credit unions		0.8	7.0	20.0	55.0	100.0
Specialized credit finance companies	Household loans	1.0	10.0	20.0	75.0	100.0
	Consumer installment finance receivables	1.0	10.0	20.0	75.0	100.0
	Credit card receivables	1.1	40.0	60.0	75.0	100.0
	Credit card loans	2.5	50.0	65.0	75.0	100.0
	Others (Businesses)	0.5	1.0	20.0	75.0	100.0

Table 9.
Credit Extension Limits for Nonbank Financial Companies

	Mutual savings banks	Credit unions	Specialized credit finance companies
Single counterparty	Less than 20% of capital; KRW10 billion for an entity, KRW5 billion for a sole proprietor, KRW600 million for an individual;	Greater of either 20% of capital or 1% of assets;	-
Counterparty and any connected counterparties	25% of capital;	-	-
Large credit extension	500% of capital;	-	-
Credit extension to a major shareholder and any specially related person	No credit extension permitted;	-	100% of capital;

Table 10.
Minimum Prudential Guidance Ratios

	Mutual savings banks	Credit unions	Specialized credit finance companies
Minimum capital ratio	7%	Net capital ratio of 2%;	Adjusted capital ratio of 7% (8% for credit card companies)
Won-denominated liquidity ratio	100%	-	100%;
Foreign currency-denominated liquidity ratio	-	-	-
Won-denominated loan-to-deposit ratio	-	-	-
Ratio of delinquent loans (more than a month)	-	-	Less than 10% (credit card companies only)
Ratio of loan loss provisions	100%	100%	-

2.13 SUPERVISORY REVIEW OF FINANCIAL PRODUCTS AND SERVICES

Specialized credit finance companies that set new standard contract provisions or make alterations to existing provisions for financial products and services must file an advance report with the FSC/FSS. Similar reporting is required for contract provision changes sought by the Korean Federation of Savings Banks and the Credit Finance Association of Korea. Supervisory actions may be taken for changes that are deemed contrary to consumer interest.

Financial Investment Services Providers

The FSCMA, which was initially enacted by the National Assembly in July 2007 and took effect on February 4, 2009, following a grace period of a year and half, provides for function-based supervision of securities and investment services collectively referred to as "financial investment services" by reclassifying previous service areas into six new categories of financial investment services. They are dealing, brokerage, collective investment schemes, investment advisory services, discretionary investment services, and trust services. Financial services firms may engage in one or more of any of the six financial investment services businesses with the appropriate regulatory authorization/approval from the FSC/FSS. Financial investment services provider (FISP) refers to a financial services firm that is licensed to engage in any one or more of the aforementioned six financial investment services.

2.14 CLASSIFICATION OF FINANCIAL INVESTMENT SERVICES

The businesses for which FISPs engage are divided into primary businesses, secondary business, and concurrent business.

Primary Businesses

The primary businesses for FISPs are dealing, brokerage, collective investment scheme, investment advisory services, discretionary investment services, and trust services.

Dealing

Dealing refers to proprietary buying and selling of an investment product (financial investment product) through the company's proprietary account. Dealing also covers underwriting securities on the behalf of an issuer and subscribing to the securities or making offers and accepting bids for the securities.

Brokerage

Brokerage refers to the business of non-proprietary buying and selling of financial investment products through customer accounts. Brokerage services cover subscribing to an investment product for a customer or making offers and accepting bids for an investment product.

Collective investment scheme

Collective investment schemes (CIS) pool funds from investors and invest in transferable securities and other financial instruments. CIS operators are entities that assume the primary responsibility for investing the pooled assets for the benefit of the investors.

The FSCMA replaced the concept of "indirect investment" in previous securities laws with the concept of "collective investment" and expanded the legal forms in which a CIS may be established. Under article 9 of the FSCMA, CIS may take on the following legal forms:

(a) A CIS in the form of a trust (an "investment trust"), in which a trust operator (a CIS operator) places assets under the management of a trust service provider;

(b) A CIS in the form of a company (an "investment company") incorporated pursuant to the Commercial Act;

(c) A CIS in the form of an investment company with limited liability (a "limited liability investment company") incorporated pursuant to the Commercial Act;

(d) A CIS in the form of a limited partnership company (a "limited partnership investment company") established pursuant to the Commercial Act;

(e) A CIS in the form of an association (an "investment association") established pursuant to the Commercial Act; and

(f) A CIS in the form of an undisclosed association (an "undisclosed investment association") established pursuant to the Commercial Act.

Investment advisory services

Companies offering investment advisory services engage in the business of providing advice on investment products and investment decisions in respect of such matters as investment to be bought and sold and the methods and the timing of the buying and selling. In addition to investment advisory service companies, securities companies and asset management companies may offer investment advisory services. Companies seeking to offer investment advisory services must register with the FSC/FSS.

Discretionary investment services

Companies providing discretionary investment services make partially or wholly discretionary investment decisions and manage the investments on behalf of customers. Discretionary investment service companies, securities companies, and asset management companies provide in discretionary investment services. Registration with the FSC/FSS is required for discretionary investment services.

Trust services

Trust services refer to the business of managing assets of a trust settlor for the benefit of the designated beneficiary. In addition to trust service companies, banks, securities companies, insurance companies, and asset management companies may engage in providing trust services.

Secondary Businesses

Because of the negative-list approach that the FSCMA takes for the regulation and supervision of financial investment services, there is no business activity specified as secondary. Financial services providers may engage in any businesses that are secondary to their primary business unless specifically provided otherwise under the law. To ensure an orderly process for secondary business, financial services firms must report to the FSC/FSS seven days in advance a secondary business to be started. The proposed secondary business may be delayed or denied in consideration of the safety and soundness of the company, investor protection, or risks posed to the market.

The range of services that may be offered by financial services companies as concurrent business together with the primary and secondary businesses vary widely from insurance agency to custodian services to payment settlement services. For services classified as Type 1 business, regulatory authorization/approval must be obtained. For services classified as Type 2, 3, or 4, the FSC/FSS must be notified of the new business seven days in advance before the start day for the concurrent business.

2.15 FINANCIAL INVESTMENT SERVICES-RELATED INSTITUTIONS

Certain securities industry associations and companies referred to as financial investment services-related institutions in the FSCM A also engage in limited activities that are closely related to financial investment services.

Korea financial investment association

Korea Financial Investment Association is the self-regulatory organization for Korea's securities industry. The association's main self-regulation activities include setting industry rules and regulations, inspecting member firms, and administering and registering various professional certifications. It also works to resolve disputes stemming from the business conduct of its member firms.

Korea securities depository

Korea Securities Depository is Korea's sole securities depository that provides centralized securities custody service, transfer services, and transaction settlement services.

Central counterparties

Central counterparties act as counterparties to securities transactions and provide confirmation services for transactions that are cleared.

Securities finance companies

Securities finance companies engage in the business of providing credit or lending securities to a broker or a dealer for the purchase or sale of financial investment products. They may also participate in securities underwriting and make securities available to facilitate transactions in the securities markets.

Merchant banks

The primary businesses of merchant banks include short-term financing activities such as buying and selling of short-term notes, facilitating financing for facilities and operating funds, foreign currency-denominated borrowings, debt issuance, and debt guarantee services. A number of secondary and concurrent businesses are also open to merchant banks. There was one merchant bank operating at the end of 2015.

Money brokerage companies

Money brokerage companies provide funding brokerage services for large financial institutions including banks, insurance companies, and securities companies through instruments such as money market products, repurchase agreements, and commercial banks. Money brokerage companies are specifically prohibited from engaging in a financial investment services business, but they may carry on businesses closely related to money brokerage services with FSC/FSS authorization/approval.

Short-term finance companies

Short-term finance companies carry on the business of issuing, discounting, trading, arranging, and underwriting corporate notes with maturity of up to one year. Companies that are licensed in broker/dealer businesses and engage in corporate note transactions not are short-term finance companies.

2.16 COMMON BUSINESS ACTIVITIES

The FSCMA set principles and mechanisms that are specifically designed to address conflict of interest for FISPs. Among them is the assumption and expectation of good faith effort from FISPs to conduct their business fairly and honestly and not to harm investors for their own or another party's benefit. To this end, FISPs must be able to identify and assess all potential conflict of interest on an ongoing basis and manage them appropriately in accordance with the internal control procedures.

Because of significant potential for conflict of interest that can arise from information exchanges or communications between different financial investment services businesses within a company, FISPs must take the due care to set up information barriers pertaining to the buying and selling of investment products, the ownership of such products, and other material undisclosed information. FISPs must also operate with appropriate Chinese walls to prevent their employees from assuming more than one position in multiple financial investment services businesses. They must also ensure appropriate walls for the use of office spaces and IT equipment and facilities.

2.17 SALES AND INVESTOR SOLICITATION

For investor protection purposes, financial investment services regulation divides investors into retail investors and institutional investors on the basis of their investment purpose, level of investment expertise, and risk appetite with a particular emphasis on protecting retail investors.

Know-your-customer rule

When soliciting a retail investor, the FISP must comply with the so-called "know-your-customer" rule by obtaining certain investor information—such as investment objectives, asset holdings, and previous investment experiences—and maintain records of investor signature and acknowledgement. Information verified by an investor must be immediately shared with the investor.

Principle of suitability

When soliciting a retail investor, the FISP must not offer any investment recommendation that is not suitable to the investor in consideration of the investor's investment objectives, asset holdings, or previous investment experience.

Principles of appropriateness

When soliciting a retail investor for the sale of derivatives or other complex investment products, the FISP must promptly inform the investor when it determines that the proposed product is not appropriate for the investor in consideration of the investor's investment objectives, asset holdings, and previous investment experience.

Duty to explain

When soliciting a retail investor, the FISP must take the due care to explain investment risk and other specific characteristics of the product it recommends. It must also retain records of investor acknowledgement of the product guidance from the provider. The duty to explain an investment product includes the duty not to make any deliberate omission or misrepresentation about the investment product.

Duty to disclose investor solicitation practices

FISPs must disclose to the general public the rules, standards, and procedures with which they must comply when soliciting an investor. In addition, differentiated information must be made available to the public when financial investment services companies solicit retail investors for derivatives and other complex investments.

Introducing broker

FISPs may employ introducing brokers who solicit investors or offer investment advices to investors on behalf of FISPs. Introducing brokers must register with the FSC/FSS.

2.18 GENERAL BROKER/DEALER REQUIREMENTS

FISPs acting as a broker/dealer for the purchase and sale of investment products must comply with certain restrictions that are designed to help protect investors.

Broker/dealer identification

When executing a customer order to buy or sell an investment product, the person handling the order must disclose to the customer whether he or she is a broker or a dealer.

Express customer order

Brokers and dealers must not engage in the buying and selling of investment products through a customer account without receiving an express order to buy or sell from the customer or an agent of the customer.

No abuse of information

Brokers and dealers must not exploit their superior investment and trading information to the detriment of their customers or engage in activities that undermine the integrity of the market.

Notification of settled transaction

When a customer order to buy or sell is executed and settled, brokers and dealers must provide the customer with detailed description of the transaction including the price at which the order was executed and the fees charged within the 20th day of the following month from the date of the settlement.

Segregation of proprietary and customer assets

FISPs are required to segregate their proprietary assets from customer assets at all times. All customer investment securities must be promptly deposited at the Korea Securities Depository.

2.19 MINIMUM CAPITAL REQUIREMENTS

Net operating capital ratio (NOCR), a variant of net capital ratio (NCR), was first introduced for securities companies in April 1997. After some modifications, NOCR was replaced by NCR in April 2014 in order to better reflect FISPs' loss-absorbing capacity and risk exposures on a consolidated basis. With the initial adoption of NCR, FISPs that were licensed as brokers and dealers (tier 1 group) became subject to the NCR requirement, but the others remained subject to the NOCR requirement. (Tier 2

group comprises collective investment services operators and tier 3 group companies providing investment advisory services, discretionary investment services, and trust services.) FISPs that opted for early NCR adoption may do so from January 2015. Others that did not opt for early NCR adoption will become subject to NCR beginning in January 2016.

Minimum NOCR and NCR for prompt corrective action

The minimum NCR for FISPs that are licensed as brokers and dealers (tier 1 group) is 100 percent. Tier 1 group companies whose NCR is in the 50-to-100 percent range are subject to MIR, those whose NCR is in the 0 to 50 percent range MID, and those whose NCR is below 0 percent MIO. The minimum NOCR for FISPs that are in tier 3 group is 150 percent. MIR is issued for NOCR in the 120 to 150 percent, MID for NOCR in the 100 to 120 percent range, and MIO for NOCR 100 percent.

2.20 PRUDENTIAL STANDARDS

Financial services firms that are licensed to offer financial investment services as a FISP must comply with prudential guidance standards set by the FSC/FSS in respect of capital adequacy, asset soundness, risk management, and foreign currency assets and liabilities. FISPs that fail to satisfy the required prudential guidance standards are subject to supervisory actions ranging from recapitalization to restrictions on dividend payouts.

Asset Classification

FISPs must classify assets exposed to credit risk and impairment into one of the five asset classifications: normal, precautionary, substandard, doubtful, and presumed loss and set aside allowances for credit losses accordingly on a quarterly basis.

Risk Management

FISPs must operate with risk management systems capable of identifying, evaluating, monitoring, and controlling risks inherent or associated with financial investment services. They must maintain integrated risk management for the business activities of their subsidiaries. The risk management practices and the company-wide risk management internal guidelines and risk management practices are subject to periodic supervision from the FSS.

Soundness of Foreign Currency-Denominated Assets and Liabilities

FISPs that are authorized to conduct foreign currency transactions are subject to limits on their overall spot and forward foreign currency positions. In addition, they must also comply with foreign currency liquidity and maturity mismatch requirements.

Restrictions on Transactions with Large Shareholder

Unless permitted otherwise, FISPs may not engage in any of the following activities:

(a) Acquiring securities issued by a large shareholder;

(b) Acquiring equity and debt securities or notes issued by a subsidiary in excess of 8 percent of the FISP’s capital;

(c) Non-arm’s length transaction with a large shareholder or any related party;

(d) Any activity or arrangement designed to circumvent the three above-mentioned restrictions.

In addition, FISPs may not extend credit to a large shareholder—including any entities and individuals specially related to the shareholder—unless such credit extension poses no material risk to their safety and soundness.

2.21 SUPERVISORY REVIEW OF FINANCIAL PRODUCTS AND SERVICES

Financial services companies that engage in financial investment services must report any changes proposed to the standard contract provisions to the FSC/FSS and disclose them on their Internet homepages and through other appropriate means. Korea Financial Investment Association, the self-regulatory organization

for the securities and investment industries, may set the standard contract provisions for investment products for its member firms in order to ensure common investor protection practices with advance reporting to the FSC/FSS. The creation or alteration of contract provisions for use with qualified institutional investors must be reported ex post within seven days of the change. Supervisory actions may be taken for changes that are deemed contrary to investor interest.

Insurance Companies

Insurance companies are financial services companies that offer life, nonlife, and hybrid insurance products and services. The Insurance Business Act broadly classifies insurance into life insurance, nonlife insurance, and hybrid insurance. Whereas life insurance gives protection against death in the form of a payment to a beneficiary, nonlife insurance generally provides property and casualty coverage and includes reinsurance and guaranty insurance. Following a major overhaul of the Insurance Act in 2003, hybrid insurance was created as a separate business category in addition to life and nonlife insurance for products providing coverage for illness, injury, and long-term care.

2.22 CLASSIFICATION OF INSURANCE BUSINESSES

The range of business activities that insurance companies may carry on are divided into three broad types: primary business, secondary business, and concurrent business. In addition to the primary businesses, insurance companies may also engage in secondary businesses that are ancillary to insurance business and can be carried on by utilizing the company’s existing business assets and infrastructure. Insurance companies may also engage in concurrent businesses, which may not be related to insurance business but may be carried on concurrently with insurance businesses such as pension insurance and retirement, trust services, and investment advisory services.

Primary Businesses

The primary businesses for insurance companies are life insurance, nonlife insurance, and hybrid insurance. Whereas life insurance provides benefits to a designated beneficiary upon the death of the insured person (or a similar event) in exchange for regularly paid premium, nonlife insurance gives protection for property losses, personal injuries, and liabilities. Life insurance extends to pension insurance including retirement insurance, while

nonlife insurance covers fire insurance, marine insurance, auto insurance, guaranty insurance. Hybrid insurance covers insurance for injuries, illness, and long-term care.

The Insurance Business Act makes it illegal to carry on both life and nonlife insurance businesses because of differences in risks covered and the risk of losses in one insurance business spilling over to the other.

Secondary Businesses

Insurance companies may carry on businesses secondary to the primary businesses. The Insurance Business Act does not specify secondary businesses for insurance providers, but the FSC/FSS must be notified at least seven days in advance before an insurance company begins a secondary business.

Concurrent Businesses

Insurance companies may carry on certain noninsurance businesses concurrently with their insurance business, provided that the noninsurance businesses do not undermine the safety and soundness of the insurance companies or harm policyholders. The concurrent businesses for insurance companies include securitized asset custody services, electronic money transfer services, broker/dealer services for financial investment products, and retirement pension funds.

2.23 RESTRICTED BUSINESS ACTIVITIES

The Insurance Business Act provides for detailed rules for insurance companies' asset management in order to ensure safe and sound asset management to the benefit of policyholders. The general asset management restrictions and requirements for insurance companies are provided below:

(a) Real properties may not be acquired for non-operational purposes;

(b) Credit extension in the form of a loan is prohibited for speculative securities investment or for the acquisition of the shares of the insurance company extending the credit;

(c) Credit extension to an individual or an entity (and any connected parties) may not exceed 3 percent of the insurance company's assets;

(d) The aggregate ownership of equity and debt securities issued by an entity (and any connected parties) may not exceed 5 percent of the insurance company's assets;

(e) The aggregate amount of credit extended to an individual or an entity and the ownership of equity and debt securities issued by the same individual or entity may not exceed 12 percent of the insurance company's assets;

(f) Large credit extension—defined as any amount in excess of 1 percent of the company's assets—to an individual (and any connected parties), an entity (and any connected parties), or a large shareholder of the insurance company may not exceed 20 percent in aggregate;

(g) Credit extensions to a large shareholder (an entity) and its subsidiaries in aggregate may not exceed 40 percent of the insurance company's capital. If this amount is greater than the amount equivalent to 2 percent of the insurance company's assets, the latter is the maximum permitted;

(h) The aggregate amount of equity and debt securities issued by a large shareholder (an entity) and its subsidiaries may not exceed 60 percent of the insurance company's capital. If this amount is greater than the amount equivalent to 3 percent of the insurance company's assets, the latter is the maximum permitted;

(i) Credit extension to a subsidiary (and any connected parties) of the insurance company may not exceed 5 percent of the insurance company's capital.

Restrictions on Dealings with Subsidiaries and Large Shareholders

Insurance companies must comply with certain restrictions when acquiring a subsidiary or extending credit to the controlling shareholder. The Insurance Business Act also prohibits insurance companies from engaging in non-arm's length transactions with related parties.

Acquisition of subsidiary

A company of which an insurance company holds more than 15 percent of the company's outstanding issued shares is deemed a subsidiary of the insurance company. An insurance company that seeks to acquire a subsidiary must obtain approval from the FSC/FSS. The acquisition of consumer credit information providers and others performing support services to the insurance company must be reported to the FSC/FSS.

Credit extension to large shareholders

The Insurance Business Act also provides for restrictions on insurance company's credit extension to its controlling shareholder (an entity) to prevent shareholder abuses. For example, a vote by the board of directors of the insurance company and a public disclosure are required before credit extension in excess of 1/1,000 of the insurance company's capital or KRW1 billion—whichever is smaller—is made. The same is required for the acquisition of equity or debt securities issued by a large shareholder.

Non-arm's length transactions with related parties

The Insurance Business Act prohibits insurance companies from engaging in non-arm's length transactions with related individuals or entities to prevent risk transfers from their controlling shareholders or subsidiaries. Such transactions include (but are not limited to):

- Credit extension to the controlling shareholder or a subsidiary in support of recapitalization in another company;
- Asset transfers without consideration to the controlling shareholder or a subsidiary;
- Any non-arm's length transaction and credit extensions unequivocally disadvantageous to the insurance company.

Insurance Solicitation

Solicitation is the act of soliciting, negotiating, or procuring the purchase of an insurance product from consumers. For consumer protection, the Insurance Business Act limits individuals and entities that may engage in insurance solicitation to the following:

(a) Insurance company employees (excluding the company's chief executive officer, outside directors, auditor, and members of the board's audit committee);

(b) Insurance agents who are registered and employed by an insurance company; an insurance agent for a life insurance company may solicit a buyer for a nonlife insurance company (and vice versa);

(c) Independent insurance agents (also called insurance agencies) that sell insurance products from multiple insurance companies; and

(d) Insurance brokers who are FSS-registered independent intermediaries for insurance buyers and sellers; insurance brokers may conclude an insurance contract on behalf an insurance company.

Bancassurance

Bancassurance enabling banks, FISPs, and other authorized financial services companies to sell insurance products as independent insurance agents was introduced in May 2003. The authorized bancassurance sellers may solicit insurance buyers from their Internet homepage or face-to-face within designated spaces within their branches.

2.24 RISK-BASED CAPITAL

Risk-based capital (RBC) replaced solvency regime for insurance companies in April 2009 and took effect in April 2011 following a two-year grace period that had been given to

ensure a smooth transition to the new capital regime. The Insurance Business Act, the governing legislation for insurance business, has set the minimum RBC ratio of 100 percent. RBC functions as a minimum regulatory capital for insurance companies to be determined on the basis of the risks to which an insurance company is exposed. It is expressed as a ratio of available capital to required capital. For insurance supervision, the RBC ratio provides the basis for the supervisory rating of insurance companies and any follow-up prompt correction action needed.

Available Capital

Available capital—the numerator of the RBC ratio—is the risk buffer available to cover any unpredicted losses that insurance companies may sustain; it is similar to solvency margin under the solvency margin regime. Available capital is calculated by first aggregating an insurance company's core capital, which primarily consist of capital stock (paid-in capital and capital surplus), retained earnings, and accumulated other comprehensive income, and supplementary capital such as subordinated debt and loan loss reserves, then deducting from the aggregate capital items including prepaid expenses, deferred acquisition cost, and goodwill, and any capital shortfalls of the insurance company's subsidiaries.

Required Capital

Required capital—the denominator of the RBC ratio measuring the insurance company's total risk—is capital calculated from the insurance company's underlying exposures to insurance risk, interest rate risk, market risk, credit risk, and operational risk.

2.25 SUPERVISORY REVIEW OF INSURANCE PRODUCTS AND SERVICES

Insurance companies may offer certain types of insurance products without pre-supervisory review ("discretionary insurance products") if the product complies with the basic documentation and the contract provision requirements are met for an insurance product. If any of the documentation or contract provision requirements is subject to reporting for supervisory review, the product is deemed nondiscretionary ("nondiscretionary insurance product") and subject to reporting.

Supervisory review of an insurance product consists of an ex ante pre-sale review for nondiscretionary insurance products and an ex post after-sale review for discretionary insurance products. Documentation for the sale of a nondiscretionary insurance product must be submitted to the FSS for supervisory review at least 30 days prior to the expected date of the sale.

Discretionary insurance products may be offered to consumers without FSS supervisory review in principle. To mitigate the risk of consumer harm from discretionary insurance products, the FSS conducts ex post supervisory review to focus on defective discretionary insurance products each quarter. Under the intensive review regime, insurance companies submit a list of insurance products sold within ten days from the end of each quarter.

Financial Holding Companies

In addition to the four main types of financial services companies—banks, nonbank financial companies, FISPs, and insurance companies—financial holding companies (FHCs) that are duly incorporated pursuant to the Financial Holding Companies Act also fall under FSS supervision.

FHCs are regulated business entities that hold and exercise controlling interest in financial institutions and others with businesses closely related to those of financial institutions. A subsidiary is an entity controlled by an FHC, a second-tier subsidiary controlled by the subsidiary, and a third-tier subsidiary controlled by the second-tier subsidiary. A subsidiary of an FHC may hold a controlling interest in a second-tier subsidiary only if the second-tier subsidiary is either a financial institution whose business is closely related to that of the subsidiary or is a company that provides or facilitates financial services (such as an IT service provider).

FHCs were allowed for the first time in February 1999 with an amendment to the Monopoly Regulation and Fair Trade Act and were then placed under financial regulation and supervision with the passage of the Financial Holding Companies Act in October 23, 2000, and the approval of the subordinate supervisory regulations on December 29, 2000. Under the law, the scope of business activities for FHCs in is limited to (1) management of the subsidiary units, including establishing business objectives, evaluating business performance, determining corporate governance, inspection of the subsidiaries, and internal control; and (2) business activities facilitating the management of the subsidiary units, such as financing, joint development of financial products and services, and shared use of facilities. The supervisory framework for FHCs is essentially similar to that for banks. As a financial group, FHC is supervised on a consolidated basis.

Other Financial Services Providers

Postal savings and insurance, community credit cooperatives, and other similar enterprises managed or supervised by government or public agencies are exempted from FSS supervision.

Moneylenders engage in the business of providing short-term cash and loan services at higher interest rates than rates charged by the commercial banks and other regulated lenders. They fall under FSS supervision if they are registered with 2 or more municipal administrative authorities or if the aggregate amount of assets from the most recent accounting period exceeds KRW7 billion.

In addition to the institution-based supervision of financial services companies that are incorporated and recognized under the law, the FSS carries on function-based supervision of financial services activities whose business boundaries or risk characteristics are not well established. Such activities include foreign currency-related activities, derivatives trading, electronic financial services, and the sale of corporate, individual, and retirement pension products and pension asset management.

3. Supervisory Evaluation and Rating

Supervisory Evaluation

The FSS evaluates financial institutions' business operation and health and assigns an overall rating. Supervisory rating was first introduced for banks in October 1996 following Korea's membership in the OECD and the Bank for International Settlements. The rating regime was soon expanded to other types of financial institutions. It took effect for securities companies in January 1999, insurance companies and specialized credit finance companies in January 2000, mutual savings banks and specialized banks in July and August, respectively, of 2000, and FHCs in December 2000.

3.1 COMMERCIAL BANKS AND FOREIGN BANK BRANCHES

For the evaluation and rating of commercial banks and their operations in foreign countries, the FSS replaced CAMELS (Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk) with CAMEL-R for risk management beginning in the fourth quarter of 2012. (See table 13.) The evaluation of each of the six components is based on a combination of quantitative and non-quantitative factors. (Ratings for the management and risk management components are assigned using only non-quantitative metrics.) For the evaluation and rating of domestic banks' overseas banking operations and foreign bank branches, ROCA—short for Risk management, Operational control, Compliance, and Asset quality—is employed.

3.2 SPECIALIZED BANKS

The supervisory rating for each of the five specialized banks is assigned on the basis of the evaluation of six components: capital adequacy, asset quality, compliance, risk management, earnings, and liquidity or CACREL. For the evaluation of the earnings component of Korea Development Bank and the Industrial Bank of Korea, only non-quantitative metrics are used. Similarly, the earnings component is excluded for the rating of the Export-Import Bank of Korea; in respect of liquidity, the Export-Import Bank of Korea is also not subject to liquidity coverage ratio rules that are applicable to commercial banks. In addition, the foreign branch operations of the specialized banks are evaluated on the basis of asset quality, compliance, and risk management only.

3.3 NONBANK FINANCIAL COMPANIES

For the evaluation and rating of nonbank financial companies, the five components of CAMEL—Capital adequacy, Asset quality, Management, Earnings, and Liquidity—are used.

3.4 FINANCIAL INVESTMENT SERVICES PROVIDERS

A newly revised common supervisory rating system for FISPs took effect in April 2009 after the FSCMA took effect on February 4, 2009. The revised common rating system divides the evaluation criteria into common evaluation and business-specific evaluation. The common evaluation criteria comprise capital adequacy, earnings, and internal controls and account for 60 percent of the supervisory evaluation and rating. On the other hand, the business-specific criteria, which account for 40 percent of the supervisory evaluation and rating, comprise components that vary with the type of financial investment services business. Thus, for brokers and dealers, the evaluation components are liquidity and stability; for collective investment scheme operators, the two components are liquidity and appropriateness of asset management. Similarly, for real estate trust services providers, the other components are liquidity and asset soundness. For financial firms that engage in multiple financial investment services businesses, varying weights are assigned on the basis of the earnings from each business.

Table 11.
Rating Components and Evaluation Factors

Component	Quantitative evaluation factors	Non-quantitative evaluation factors	Assigned weight
1. Capital adequacy	• Total capital ratio; • Tier 1 capital ratio; • Common equity tier 1 ratio; • Leverage ratio;	• Compliance with supervisory guidelines; • Capital adequacy taking into account risk characteristics and magnitudes; • Adequacy of the composition of capital, the likelihood of future capital impairment; • Management's approach to preserving capital soundness;	20%
2. Asset quality	• Ratio of loans with increased risk of losses; • Ratio of loans classified as substandard or below (SBLs); • Ratio of loans with delinquent payment; • Loan loss provision ratio; • Seasonally adjusted delinquency rate;	• Appropriateness of credit risks management; • Identification, measurement, and assessment of credit risks; • Appropriateness of credit extension policy; • Appropriateness of asset classification practices; • Adequacy of allowances for loan and other credit loss; • Appropriateness of loan management; • Identification and management of problematic loans;	25%
3. Management	-	• Soundness of governance structure; • Appropriateness of management policy formulation and implementation; • Appropriateness of performance-based remuneration; • Assessment of business efficiency and improvement plans; • Assessment of internal controls and other operational aspects of business; • Compliance with laws and regulations and remedial measures recommended by supervisors following an examination; • Compliance with corporate social responsibility (CSR);	15%
4. Earnings	• Return on assets; • Cost-asset ratio; • Cost-income ratio; • Risk-adjusted return on equity;	• Risks to the size and components of earnings; • Appropriateness of earnings structure; • Appropriateness of expense structure; • Business effectiveness and capacity to generate future earnings;	10%
5. Liquidity	• Liquidity coverage ratio; • Foreign exchange liquidity ratio; • Won-denominated loan-to-deposit ratio; • Stable foreign exchange funding ratio;	• Appropriateness of liquidity risk management; • Volatility variables and factors for liquidity; • Appropriateness of funding structure and operation; • Stress test operation and management;	15%
6. Risk management	-	• Appropriateness of risk governance structure and policy management; • Status of risk management processes and controls; • Appropriateness of risk identification, measurement, and evaluation;	15%

3.5 INSURANCE COMPANIES

For prudential supervision of insurance companies, the FSC/FSS utilizes a range of approaches including credit extension and investment limits, asset classification, and allowance for credit losses to ensure asset safety and soundness. In addition, the FSC/FSS utilizes various solvency requirements, supervisory rating, and prompt corrective action to ensure effective prudential oversight of insurance companies.

The supervisory evaluation and rating regime was changed from CAMEL to RAAS—short for risk assessment and application system—in September 2012 for transition to risk-based supervisory evaluation and rating. Under RAAS, each insurance company receives from the FSS a composite rating on the basis of evaluation and rating of seven components of the insurance company's overall financial soundness and business operations. The seven components are: (1) management risk; (2) insurance risk; (3) interest rate risk; (4) investment risk; (5) liquidity risk; (6) capital adequacy; and (7) earnings. For each of the seven components, quantitative and non-quantitative factors comprising the component are analyzed for a component rating on a 1 to 5 numerical scale (1 the highest rating and 5 the lowest). The component ratings are then aggregated for the insurance company's composite rating on a 1 to 5 numerical scale with three levels (+, 0, or -) for each numerical scale, meaning a total of 15 possible level assignments.

Composite rating is used as the basis for prompt corrective action, which can vary from MIR and MID to MIO. MIR is the least adverse supervisory action and MIO the most adverse. MIR is issued when (1) the composite rating is 3, 2, or 1, and (2) the capital adequacy component rating is 4 or 5, or at least two of the ratings for insurance risk, interest rate risk, and investment risk are 4 or 5. MIO is made for insurance companies that are assigned a composite rating of 4 or 5.

The assets of insurance companies are classified into 5 classes: normal, precautionary, substandard, doubtful, and presumed loss. The specific asset classification rules for insurance companies are provided in the insurance supervision regulation. Assets subject to classification include loans, securities investments, notes, different types of insurance claims, and other assets held by insurance companies that are judged to merit specific asset classification on the basis of the obligor's ability to service debt and the nature of the business transactions. The classification of insurance companies' assets constitutes a major component for RAAS with a significant effect on the ability of insurance companies to meet its insurance and other obligations. For impaired assets, asset classification also forms the basis for allowance for various credit losses.

3.6 FINANCIAL HOLDING COMPANIES

In January 2008, LOPECM—short for Lead subsidiary, Other subsidiary, Parent company, consolidated Earnings, Capital adequacy, and Management—which had been used for FHCs, was replaced by RFI (Risk management, Financial condition, and Impact).

Component and Composite Ratings

Component rating is determined on the basis of the evaluation of quantitative and non-quantitative evaluation factors. The quantitative and non-quantitative evaluation factors are aggregated to generate the component rating. The component ratings are then aggregated using varying weights to determine a preliminary composite rating (5 possible ratings, 15 possible levels). The final composite rating is assigned following a full evaluation of the institution's overall business conditions and capability, supervision issues and concerns, assessment of results from off-site monitoring and ongoing supervision, market conditions, and other relevant factors not fully captured in the preliminary composite rating (5 possible ratings, 15 possible levels).

Supervisory rating is one of the factors that the FSS uses when determining the examination cycle for a financial institution. For an institution with a composite rating of 2 (satisfactory), the full-scope examination is planned at a 2-to-3 year cycle with minimum supervision for components with the highest ratings. The FSC/FSS subscribes to the confidentiality of financial institutions' supervisory rating and other nonpublic supervisory information.

As a general rule, supervisory evaluation and rating takes place when the FSS conducts a full-scope examination. In addition, the FSS conducts CAEL evaluation—capital adequacy, asset quality, earnings, and liquidity—of financial firms each quarter on the basis of Business Report that financial firms are required to file with the FSS.

3.7 ADJUSTMENT TO COMPOSITE RATING

The composite rating may be adjusted following the quarterly CAEL composite rating in accordance with the criteria established in the supervisory regulations. Under the rules, rating adjustment may be made when:

(a) The quarterly CAEL composite rating of quantitative factors drops by more than two or more ratings from the institution's most recent composite rating;

(b) The quarterly CAEL composite rating of quantitative factors deteriorates for two consecutive quarters from the institution's most recent composite rating;

(c) An institution is assigned a composite rating of 1, 2, or 3, but the capital adequacy or the asset quality component of the quarterly CAEL composite rating is assigned a rating of 4 or 5; or

(d) The FSS makes the judgment that rating adjustment is necessary because of the institution's worsening business conditions, heightened risk of asset deterioration, or other difficulties.

3.8 PROMPT CORRECTIVE ACTION

Prompt corrective action is a remedial measure taken after the FSC/FSS makes the determination that a financial services firm demonstrates heightened risk of stress or failure primarily on the basis of the evaluation of its capital adequacy and the result of supervisory rating. The supervisory rating the FSS assigns to an institution becomes the basis for prompt corrective action, which may vary from MIR and MID to MIO. For a bank, MIR may be issued when (1) the composite rating is 3 or better, and (2) the rating for capital adequacy or asset quality is 4 or 5. For an insurance company, MIR may be issued when (1) the composite rating is 3 or better, and (2) either the rating for the capital adequacy component or the ratings for two of the insurance risk, interest rate risk, and investment risk components are 4 or worse. For securities companies, MIR may be made when the rating for the capital adequacy component is 4 or worse. MID is issued when a bank, a securities company, or an insurance company is assigned a composite rating of 4 or worse, while MIO is limited to a failing financial institution.

Table 12.
Bank Component and Composite Ratings

Ratings	1.Strong	2.Satisfactory	3.Less than satisfactory	4.Deficient	5.Critically deficient
Capital adequacy	• Capital level strong relative to risks, well above industry average;	• Capital level satisfactory relative to risks, worse than strong;	• Capital level insufficient relative to risks or asset risks, below industry average;	• Capital level deficient relative to risks; • Capital support from external sources needed;	• Capital level critically deficient relative to risks; • Viability uncertain; • Immediate capital support from external sources needed;
Asset quality	• Strong asset quality and credit practices; • Minimal risk; • Minimal supervisory concern;	• Satisfactory asset quality and credit practices; • Modest level of supervisory attention needed;	• Less-than-satisfactory asset quality; • Trends indicative of asset quality deterioration or risk exposures; • Improvement needed in credit practice and risk management; • Higher level of supervisory concern than before;	• Deficient asset quality; • Levels of risk and deteriorating assets significant and poorly controlled; • Institution's viability uncertain if left unchecked;	• Critically deficient asset quality; • Institution's viability questionable;
Management	• Strong performance by management and board of directors; • Management and the board amply capable of addressing existing and potential risks and problems;	• Satisfactory performance by management and the board of directors; • Management and the board effectively addressing weaknesses and risks;	• Less-than-satisfactory performance by management and the board of directors; • Improvement needed in risk management practices; • Insufficient response to the institution's problems, risks, and conditions;	• Deficient management and board performance; • Inadequate risk management; • Strengthening or replacing management or the board may be necessary;	• Critically deficient management and board performance; strengthening or replacing management or the board is necessary;

Earnings	• Strong earnings; • Earnings more than sufficient to support banking operations and maintain high capital and allowance levels;	• Satisfactory earnings; • Earnings above industry average and sufficient to support banking operations and maintain high capital and allowance levels; • Recent earnings experiencing slight decline;	• Less-than-satisfactory earnings; • Earnings fluctuating and unsustainable, insufficient to fully support banking operations and maintain high capital and allowance levels;	• Deficient earnings; • Earnings erratic, fluctuating, experiencing substantive drops, and insufficient to support banking operations and maintain high capital and allowance levels;	• Critically deficient earnings; • Losses and capital erosion a serious threat to the institution's viability;
Liquidity	• Strong liquidity levels and fund management practices; • Reliable access to fund sources to meet present and anticipated liquidity needs;	• Satisfactory liquidity levels and fund management practices; • Slight decline in liquidity, increased reliance on external funds; Modest weaknesses in fund management practices;	• Liquidity levels or fund management practices in need of improvement; • Insufficient liquid assets or increased reliance on interest rate-sensitive funds; • Unable to secure funds at competitive terms; • Evidence of material weaknesses in fund management practices;	• Deficient liquidity levels or inadequate fund management practices; • Unable to secure ample funds at competitive terms;	• Critically deficient liquidity levels and fund management practices; • Immediate external support needed to meet maturing obligations or other liquidity needs; • Viability of the institution threatened;
Risk management	• Strong risk management; • Minimal risk levels; • Effective risk management systems for identifying, measuring, monitoring, and controlling risk;	• Satisfactory risk management; • Risk levels under control; • Some weaknesses in risk management but well controlled by management;	• Material risk levels likely to adversely affect capital and earnings; • Deficiencies in risk management;	• Material risk levels threatening earnings and capital; • Significant default risk; • Risk management system too deficient to effectively identify, measure, monitor, and control risk;	• Significant risk levels threatening the institution's viability; • Wholly inadequate risk management practices;

Composite rating	• Institution sound in nearly all aspects; • No matters of supervisory concern; • Minor weaknesses but can be addressed in an ordinary, routine manner; • Not susceptible to vagaries of business conditions or financial markets; • Strong management performance and risk management;	• Institution fundamentally sound; • Moderate weaknesses present, but well within the capabilities of the management or minimal supervisory action; • Institution generally stable and capable of withstanding business fluctuations; • Broadly satisfactory risk management;	• Institution exhibiting a degree of supervisory concern in financial conditions, management performance, and compliance; • Institution in need of more than routine supervisory concern; • Institution less capable of withstanding business fluctuations and more vulnerable to external developments and conditions than institutions with composite rating of 1 or 2; • Failure unlikely in consideration of the institution's overall business and financial conditions;	• Institution exhibiting generally deteriorating financial conditions; Wide-ranging and serious financial and management deficiencies requiring close supervisory attention; • Institution not likely to withstand business fluctuations; • Failure a distinct possibility; • Unacceptable risk management practices;	• Institution exhibiting alarmingly deteriorating financial conditions, and failure highly probable; • Significant risk to deposits; • Immediate external support required to remain viable; • Greatest supervisory concern in need of immediate supervisory action; • Severity of risks and other problems beyond the ability or willingness of the management to address or control;

Table 13.
Capital Adequacy and Prompt Corrective Action

Capital adequacy		Prompt Corrective Action		
		MIR	MID	MIO
Banks and bank holding companies	Regulatory capital	< 8%	< 6%	< 2%
	Tier 1 capital	< 6%	< 4.5%	< 1.5%
	CET 1 capital	< 4.5%	< 3.5%	< 1.2%
Financial investment services providers	Net capital ratio	< 100%	< 50%	< 0%
	Net operating capital ratio	< 150%	< 120%	< 100%
Insurance companies	Risk-based capital	< 100%	< 50%	< 0%
Merchant banks	Capital ratio	< 8%	< 6%	< 2%
Mutual savings banks	Capital ratio	< 6%	< 4%	< 1.5%
Specialized credit finance companies	Adjusted capital ratio	< 7%	< 4%	< 1%
Credit card companies	Adjusted capital ratio	< 8%	< 6%	< 2%
Nonbank financial holding companies	Capital relative to required capital	< 100%	< 75%	< 25%

Table 14.
Supervisory Rating and Prompt Corrective Action

Supervisory rating	MIR	MID	MIO
Financial holding companies	Composite rating of 3 and component rating of 4 or 5 for either financial holding company or capital adequacy component;	Composite rating of 4 or 5;	
Specialized credit finance companies	Composite rating of 4 and component rating of 3 or better for either capital adequacy or asset quality component;	Composite rating of 4 and component rating of 4 or worse for capital adequacy or asset quality;	Composite rating of 5;
Credit card companies	Composite rating of 3 or better and component rating of 4 or 5 for either capital adequacy or asset quality component;	Composite rating of 4 or 5;	
Others	Composite rating of 3 and component rating of 4 or 5 for either capital adequacy or asset quality component;	Composite rating of 4 or 5;	

Table 15.
Remedial Actions Available under Prompt Corrective Action

	MIR	MID	MIO
Potential supervisory actions	• Operational improvement in organization and personnel; • Capital increase or write-off; • Restrictions on expansion into new businesses;	• Branch closings and restrictions on new branch openings; • Dismissal of company officers; • Partial suspension of business operations;	• Retirement of company stocks; • Appointment of outside administrator; • Merger;
Execution of business improvement plan	MID triggered if business improvement plan rejected or incompletely executed;	MIO triggered if business improvement plan rejected or incompletely executed;	Delicensing and business closure if business improvement plan rejected or incompletely executed;

4. Examination

The FSS examines financial institutions pursuant to authority conferred by article 37 of the AEFSC and other financial statutes. FSS examiners perform full-scope and targeted examinations of financial institutions to help ensure appropriate safety and soundness standards and enforce compliance with laws and regulations.

FSS examiners conduct full-scope examination to evaluate financial institutions' overall financial, management, operational, and compliance performance. The selection of financial institutions that are to undergo a full-scope examination is made in advance during the annual examination planning. The determination of the timing and duration of a full-scope examination and the number of examiners to be assigned is normally made with due consideration given to the size, the complexity, and the risk profiles of the subject institution, findings from the previous examination, and issues of supervisory concerns that have been raised from off-site monitoring.

A targeted examination is limited in scope and is intended to address a narrow range of supervision matters and concerns such as incidents of irregularity and unsound business activity.

Off-site monitoring also constitutes an important component of financial institution examination that complements on-site examination. For normal off-site monitoring, FSS examiners analyze financial and operational reporting from financial institutions, evaluates quantitative safety and soundness measures, and work to identify areas of weaknesses and risks in need of supervision action. If necessary, FSS examiners conduct an on-site inspection and meet with the subject institution's senior executives to address issues of supervisory concern.

4.1 OFF-SITE MONITORING

FSS examiners conduct off-site monitoring on an ongoing basis to help identify and address financial institutions' areas of weakness, deficiency, vulnerability, and risk. Off-site monitoring usually involves analyzing financial and operational reporting from financial institutions, evaluating quantitative safety and soundness measures, and addressing issues of supervisory concern. For data collection and analysis, FSS examiners make use of wide-ranging sources including Business Report that financial institutions file regularly with the FSS, internal reports, and meetings with senior executives and employees. Impact analysis of the subject institution's business strategy on its risk profiles is also carried out as routine part of off-site monitoring. Various IT support systems also facilitate off-site monitoring. When deemed necessary, FSS examiners also visit the subject institution in person to obtain additional information on unusual activities or areas of supervisory concern.

The findings of off-site monitoring often form the basis for on-site examination and other supervisory actions. The relationship manager assigned to each financial institution also participates in the off-site monitoring.

4.2 PRE-EXAMINATION PREPARATION

Planning for examination of financial institutions consists of quarterly and annual examination plans. The annual examination plan provides for the basic examination parameters and activities for the year with a particular emphasis on supervision policy objectives. It thus sets financial institutions (and branches) to be selected, the types of examination to be carried out (full-scope and targeted), the tentative dates, the number of examiners to be assigned, and the scope of the examination activities.

The selection of financial institutions to undergo a full-scope examination during the year is made with due consideration given to the size, the complexity, and the risk profile of the subject institutions, and the examination cycle. On the other hand, the selection for targeted examination is typically influenced by incidence of unsound or improper business practices and irregularities. After the annual examination planning is completed, a quarterly examination plan is set detailing the order of financial institutions to be examined, the dates and the duration of the examinations, the number of examiners to be allocated, and other details. The finalized quarterly examination plans are shared with the Bank of Korea and the Korea Deposit Insurance Corporation.

As part of the pre-examination planning, FSS examiners gather information on the subject institution from a number of sources including off-site monitoring and previous supervisory evaluation and ratings and apprehend the institution's overall financial and business status. A pre-examination team is also formed to lay the groundwork for the upcoming examination. The subject institution is given a prior notice providing examination and purpose and schedule at least ten days ahead of the commencement of the examination. Under an unusual circumstance in which giving a prior notice may compromise or jeopardize the intended performance of the examination, no advance notice may be given to the subject institution.

4.3 ON-SITE EXAMINATION

FSS examiners start off a full-scope on-site examination by meeting with the senior managers of the subject institution to give them appropriate guidance and expectations on the examination to be conducted. As part of the examination process, the examiner-in-charge may obtain statements and documentations from the subject institution's managers and employees and, if necessary, from other related parties. The scope of the examination may be expanded to include additional branches and other institutions if evidence of misconduct by the subject institution and other institutions exists, and the misconduct identified requires more extensive inspection.

Upon the completion of the full-scope on-site examination, the examiner-in-charge meets with the management and the board directors of the subject institution to communicate the supervision and examination policies of the FSS and areas of weakness and other supervisory concerns that came to light as a result of the examination.

4.4 POST-EXAMINATION ACTION

Upon the completion of a full-scope on-site examination, the examiner-in-charge prepares the examination report detailing the examination findings that include corrective actions to be taken to address unsatisfactory or deficient areas. For more serious violations of laws and regulations, enforcement actions are recommended.

The examination report and enforcement action recommendations are reviewed internally at the examination department and at the Enforcement Review Office to ensure proper, fair, and objective post-examination actions. When the internal review by the FSS is completed, the FSC may conduct additional review if the gravity of the matters raised in the examination findings merits it and decide on the adverse actions to be taken. The review process also provides for opportunities for the subject institution and individuals to be sanctioned to file objections to the adverse action decisions made by the Enforcement Review Committee or the FSC.

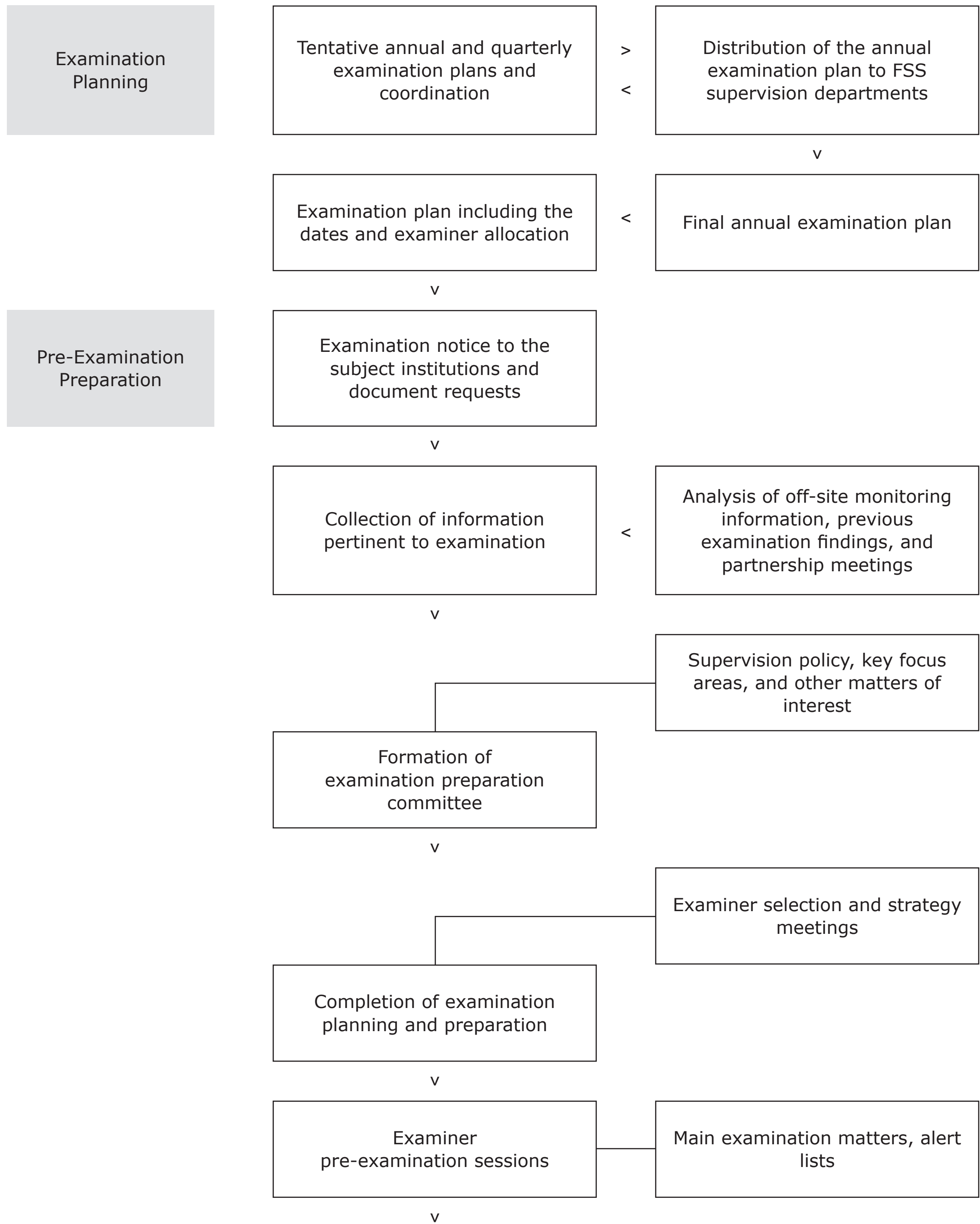
Enforcement Action

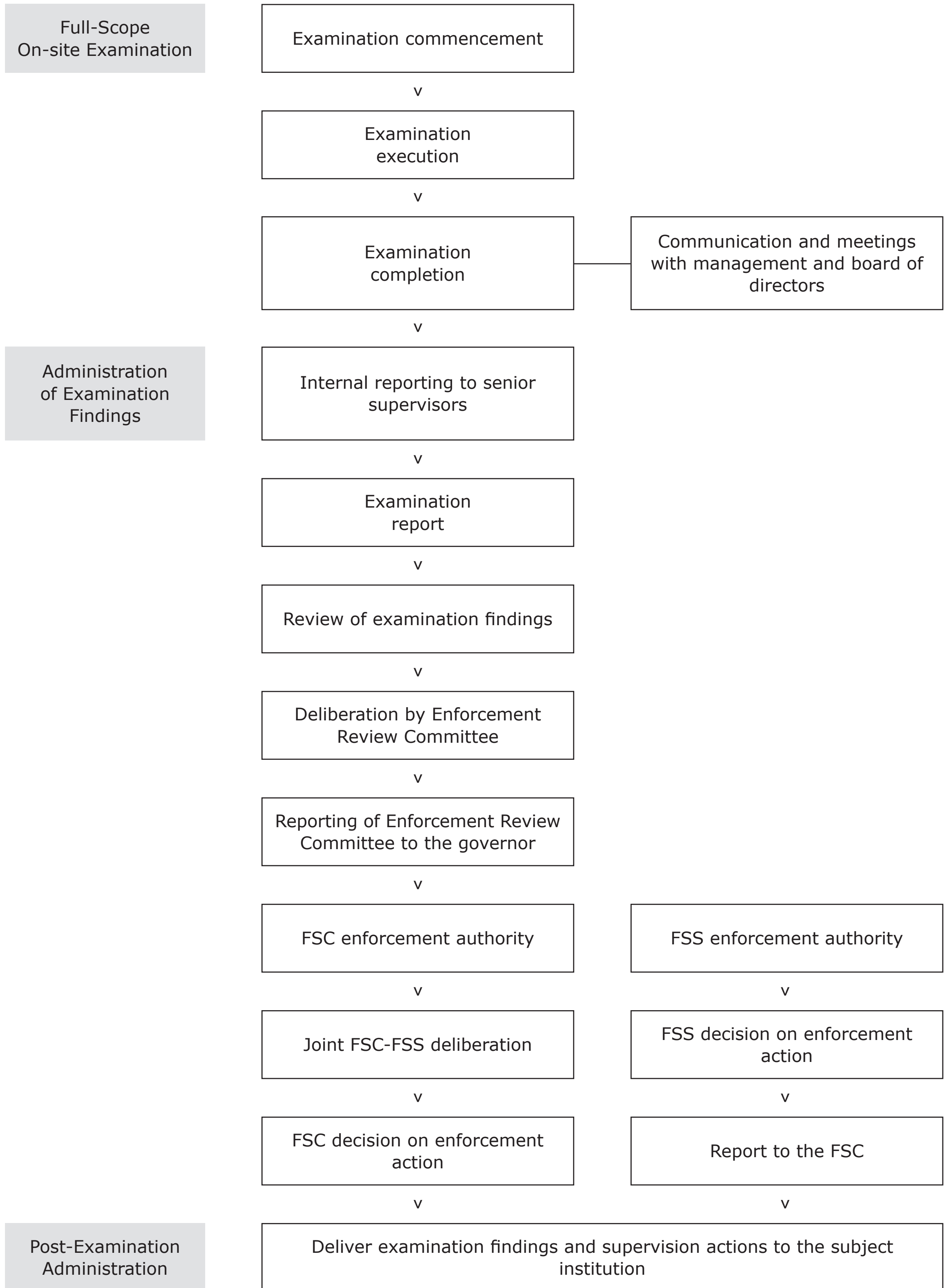
Enforcement typically takes the form of administrative sanctions against the subject institution and individuals involved in a rule violation. The types of sanctions that may be imposed on financial institutions and individuals are shown in table 16.

Table 16.
Post-Examination Actions

Financial institutions	• Revocation of business authorization, approval, or registration; • Whole or partial business suspension; • Branch closure, whole or partial suspension of branch operations; • Cease and desist order; • Transfer of business contracts to an unaffiliated party; • Order for public announcement or disclosure notice for wrongdoing; and • Institutional warning;
Senior executives	• Recommendation for dismissal; • Work suspension; • Disciplinary warning, admonition;
Employees	• Recommendation for dismissal; • Work suspension; • Pay reduction; • Reprimand, disciplinary warning;
Monetary penalty	• Civil fine; • Administrative fine;
Other sanctions	• Management caution; • Order for corrective measures, commitment letter; • Order for restitution; • Referral for criminal penalty;

Figure 1.
General Examination Process





Full-Scope On-site Examination
Examination commencement
Examination execution
Examination completion
Communication and meetings with management and board of directors
Administration of Examination Findings
Internal reporting to senior supervisors
Examination report
Review of examination findings
Deliberation by Enforcement Review Committee
Reporting of Enforcement Review Committee to the governor
FSC enforcement authority
FSS enforcement authority
Joint FSC-FSS deliberation
FSS decision on enforcement action
FSC decision on enforcement action
Report to the FSC
Post-Examination Administration
Deliver examination findings and supervision actions to the subject institution

5. Capital Market Supervision

Disclosure Rules

The FSCMA provides for fair and transparent corporate disclosure in order to protect investors and ensure an efficient and well-functioning securities market. The FSCMA provides for three general types of corporate disclosure: disclosure for new securities issuance, disclosure for listed companies, and disclosure for a significant event.

Disclosure for new securities offering pertains to information that an issuer must file with the FSC/FSS about an investment to be offered for sale to the public. The disclosure is made in the form of registration statement and prospectus. Registration statement is filed by a prospective securities issuer about to make a public offering, while prospectus is a document the issuer prepares with facts about the offering to help investors make an informed investment decision.

Disclosure for listed companies refers to information about business operation and financial conditions that listed companies must file with the FSS periodically and as needed or appropriate. Disclosure for listed companies consists of Business Report—the quarterly, semiannual, and annual regulatory filings publicly companies are required submit to the FSS about their business operations, financial conditions, and other major aspects about their business—and material disclosure, which must be filed for any major business decision or external event that has a material effect on the company's ongoing business operation.

In addition to disclosures applicable to new securities offering and listed companies, disclosure for significant event must be filed when a major development or change to a company's business operations or financial conditions occurs. Excluding disclosures applicable to new securities offering and listed companies, disclosure for significant event includes large share ownership, disclosure for corporate insiders, tender offer, and short-swing profit.

5.1 DISCLOSURE FOR NEW SECURITIES OFFERING

Public offering of new securities generally starts with the issuer (or the issuer's board of directors) deciding on the final proposal for a public offering. The issuer then submits a registration statement and the accompanying prospectus for the offering to the FSC/FSS for review. Following a waiting period, the issuer may begin soliciting investors and receiving subscriptions. Upon the completion of the offering and settlement of payments for transactions with investors, the issuer submits a report on the completed offering to the FSC/FSS and starts to issue the securities to investors (or registers the securities with the Korea Securities Depository). The securities are then listed and traded publicly.

Primary and Secondary Solicitation

Under the FSCMA, specific standards apply to issuers that solicit investors for new securities offering and for seasoned securities offering. Whereas primary solicitation refers to the act of soliciting 50 or more investors to purchase newly issued securities, secondary solicitation refers to the act of soliciting 50 or more investors to purchase or sell securities that have already been issued.

Registration Statement

Registration statement must be filed with the FSC/FSS when the offering amount is more than KRW1 billion. No solicitation for investors is permitted until the issuer files a registration statement with the FSC/FSS and obtains a clearance to proceed with the securities offering.

Reporting person for registration statement

The reporting person or the person responsible for filing a registration statement for a securities offering is the issuer. Where a person other than the issuer engages in secondary solicitation, the reporting person is also the issuer.

Securities subject to reporting

Under the FSCMA, all securities offered through primary and secondary solicitations must in principle be registered. Securities exempted from registration are enumerated in the subordinate regulation; they include government treasuries, municipal bonds, and other special entities and enterprises that have been established by an act of the National Assembly.

Offering amount subject to reporting

Registration must be filed when the amount of a securities offering—through either primary solicitation or secondary solicitation—exceeds KRW1 billion. The amount of the securities offering is determined on the basis of the sum of the offering to be made for a year.

Waiting period and effective date of registration

Registration statement becomes effective after the FSC/FSS issues a clearance for the filing and a waiting period needed for review of the filing elapses. The issuer may not engage any solicitation prior to the filing of a registration statement, and registration statement that takes effect thereafter with an FSC/FSS clearance does not mean it is devoid of any misrepresentation or inaccuracy. (See table 17.)

Corrected registration statement

The issuer may submit a corrected registration statement for changes that need to be made to the initial registration statement. Changes to material disclosure items in the registration statement must be filed irrespective of the issuer's intent. The issuer must also submit a corrected registration statement upon a request or an order from the FSC/FSS.

Table 17.
Waiting Period for Registration Statement

<table>
<tr><th></th><th colspan="2">Stocks</th><th colspan="2">Bonds</th><th>Other securities</th></tr>
<tr><td></td><td>General offering, Shareholder priority offering</td><td>Shareholder allotment, third part allotment</td><td>Guarantee bonds, Collateral-backed bonds, ABS</td><td>Unguaranteed bonds</td><td></td></tr>
<tr><td>Listed companies</td><td>10 days</td><td rowspan="2">7 days</td><td rowspan="2">5 days</td><td rowspan="2">7 days</td><td rowspan="2">15 days</td></tr>
<tr><td>Others</td><td>15 days</td></tr>
</table>

Shelf Registration Statement

Shelf registration, which enables an issuer to register a public offering in advance and for multiple offerings using the same registration, is permitted for an issuer that meets the following criteria:

(a) The issuer is a FISP that has made a public offering during the most recent one-year period and has filed the regulatory semiannual and annual Business Report with the FSS during the most recent accounting year;

(b) The issuer has received an unqualified opinion for its financial statements from the issuer's external auditor for the most recent accounting year; and

(c) The issuer has not received any restriction or other adverse actions from the FSC/FSS on issuing securities during the previous one-year period.

Well-known seasoned issuers that meet all of the following conditions also qualify for shelf registration when issuing convertible bonds, bonds with warrants, participating bonds, and exchangeable bonds:

(a) More than 5 years have elapsed since the issuer became a listed company;

(b) The issuer's market capitalization on the last trading day of the issuer's most recent accounting period exceeded KRFW500 billion;

(c) The issuer has complied with the submission of the quarterly, semiannual, and annual Business Report to the FSS for the previous three years;

(d) The issuer has received an unqualified opinion from its auditor the most recent accounting year; and

(e) The issuer has not received a fine or a heavier sanction for accounting misconduct or violation of the FSCMA for the previous three years.

Effective duration for shelf registration

Shelf registration enables an issuer to comply with the registration requirements up to one year from two months after the effective date of the registration. An issuer that files a shelf registration must make a minimum of three securities offerings during the expected offering period. Well-known securities issuers are eligible for shelf registration up to two years with no minimum number of securities offering required during the offering period.

5.2 DISCLOSURE FOR LISTED COMPANIES

The FSCMA provides for two general types of disclosures of listed companies. One is the periodic disclosure that companies file with the FSC/FSS on a quarterly, semiannual, and annual basis during each accounting period. The other is material disclosure, which companies must file with the FSC/FSS for any event that has a material effect on investors or their investment decision. The Korea Exchange, a self-regulatory organization, also enforces its own disclosure rules—material business disclosure, inquired disclosure, and fair disclosure—to ensure smooth and orderly trading.

Periodic Disclosure

Periodic disclosure refers to Business Report that listed companies must file with the FSC/FSS on a quarterly, semiannual, and annual basis each year on their business operations, financial conditions, and management for public disclosure. The express aim of the periodic disclosure regime is to help investors make informed investment decisions, to contribute to fair and reliable price formation, and to help maintain fair and orderly markets. The annual Business Report is filed within 90 days after the end of the accounting period, while the quarterly and semiannual Business Reports are filed within 45 days following the end of the accounting period.

Companies that are subject to periodic disclosure include (1) those whose shares are listed and traded at the Korea Exchange, (2) those that have issued on the KOSPI Market or KOSDAQ Market or KONEX Market shares and other equity rights or claims, unsecured bonds, convertible bonds, bonds with warrants, participating bonds, exchangeable bonds, preemptive rights, depositary receipts, or structured derivatives, and (3) those subject to FSC/FSS designation of independent external auditor as provided for under article 2 of the Act on External Audit of Stock Companies.

Companies that are unable to file Business Report because of exceptional circumstances such as bankruptcy or dissolution or involuntary delisting from the stock exchange are exempt from filing Business Report.

Consolidated financial reporting

Companies that are subject to Business Report must present their financial statements on a stand-alone basis or a consolidated basis, whichever is applicable. Auditor's opinion must accompany financial statements submitted by the subject companies.

Disclosure items in the Business Report

Information to be disclosed in the quarterly and semiannual Business Reports is similar to information available in the Business Report. Consolidated financial reporting is applicable to companies that have opted for financial reporting under IFRS. Information to be disclosed in the Business Report includes the following:

- Company's business objectives;
- Trademark;
- Nature of business operations and activities (manufacturing, services, and financial services);
- Compensation for company officers;
- Status of board of directors, subsidiaries and affiliates, and other governance and organization matters;
- Shareholder composition and other shareholder information;
- Directors and Officers;
- Transactions with related parties;
- Financial statements and auditor's opinion;
- Management discussion and analysis (MD&A); and
- Other disclosures relevant to investor protection.

Material Disclosure

Companies that are subject to the quarterly, semiannual, and annual Business Reports must also comply with material disclosure that requires timely, up-to-date disclosure of any significant changes. Material disclosure must be filed within one day from the day of the occurrence. Activities, developments, and changes subject to material disclosure include the following:

- Nonpayment of notes, suspension of banking accounts;
- Partial or whole suspension of business operations;
- Submission of application for court receivership;
- Occurrence of a legally recognized caused for business dissolution;
- Decision by the board of directors to increase debt;
- Major business or asset disposition or transfer;
- Retirement of treasury stock; and
- Other major developments with significant effect on the company's management, business operations, and financial conditions.

5.3 DISCLOSURE OF SIGNIFICANT EVENT

Disclosure must be filed for a significant event such as the acquisition of a large number of shares of a publicly traded company, becoming a corporate insider for the first time, or a tender offer.

Reporting of Large Share Ownership

Under the regulation on the disclosure of large equity ownership in listed companies commonly referred to as the "five percent rule," a shareholder acquiring a class of equity securities of a listed company must file a report with the FSC/FSS and the Korea Exchange within five days after the acquisition when:

(a) The shareholder acquires five percent or more of the listed company's total equity securities issued (the "five percent shareholder");

(b) The five percent shareholder raises or reduces its equity ownership by one percentage point or more; or

(c) The five percent shareholder alters the purpose of its equity ownership or enters into or amends an agreement that can materially affect its equity ownership in the listed company.

The five percent rule is intended to ensure fair and orderly dissemination of information to investors and help them make informed

decisions. By facilitating effective disclosure of material information pertaining to large equity acquisitions and dispositions to all market participants, the five percent rule also contributes to more transparent and orderly market competition for the management control of publicly held companies.

Three types of five percent disclosure

The five percent rule provides for three types of disclosure in respect of the five percent rule: initial acquisition report, subsequent change report, and material change report.

(a) Initial Acquisition Report: When the equity ownership of a shareholder and persons specially related to the shareholder ("specially related persons") exceeds five percent for the first time, an initial acquisition report must be filed with the FSC/FSS and the Korea Exchange within five days after the date of the acquisition.

(b) Subsequent Change Report: When a five percent shareholder raises or reduces its equity ownership by one percentage point or more, a subsequent change report must be filed with the FSC/FSS and the Korea Exchange within five days immediately after the date of the change. A subsequent change report must also be filed when the shareholder's equity ownership falls by at least one percentage point from 5.5 percent to 4.5 percent or lower; no subsequent change report is necessary when equity ownership declines by 0.6 percentage points (less than one percentage point) to 4.9 percent. When a disclosure-triggering event occurs during the five-day disclosure period for an earlier disclosure-triggering event, both events must be reported together by the end of the earlier five-day disclosure period.

(c) Material Change Report: A material change report must be filed when:

- A five percent shareholder amends the purpose of its equity ownership from passive investment to influencing company management (or vice versa);

- A five percent shareholder whose purpose of equity ownership is to influence company management enters into or amends an agreement that can materially affect the shareholder's equity ownership in the listed company; such an agreement may include a contractual relationship or obligation to place the shareholder's equity securities under the management of a trust or to employ the equity securities for use as collateral or for securities lending or borrowing; the determination of whether an agreement or any change therein constitutes a disclosure-triggering event is to be made on the basis of the likelihood of a material change to the shareholder's equity ownership; and

- A five percent shareholder whose purpose of equity ownership is to influence company management amends the status of its equity ownership from legal ownership to beneficial ownership (or vice versa).

Securities covered under the five percent rule

The following classes of equity and equity-convertible securities are subject to disclosure under the five percent rule:

(a) Stocks including common voting stock, preferred voting stock, preferred nonvoting stock that becomes voting in the event of no dividend, and convertible preferred stock;

(b) Certificates representing rights/options to acquire new shares, including preemptive rights certificates and warrants;

(c) Convertible bonds;

(d) Bonds with warrants;

(e) Exchangeable bonds with equity conversion rights/options to any of the four above-mentioned (a-d) classes of securities;

(f) Structured derivatives with any of the five above-mentioned (a-e) classes of securities as the underlying assets.

When issued by an issuer other than the listed company, the following classes of securities are subject to disclosure under the five percent rule:

(g) Depositary receipts linked to any of the six above-mentioned (a-f) classes of securities;

(h) Exchangeable bonds with equity conversion rights/options to any of the seven above-mentioned (a-g) classes of securities; and

(i) Structured derivatives with any of the eight above-mentioned (a-h) classes of securities as the underlying assets.

Persons covered under the five percent rule

When the aggregate equity ownership of a shareholder and its specially related persons—defined as persons related to the shareholder ("related persons") and/or persons that jointly hold the issuer's equity securities with the shareholder ("joint holders")—exceeds five percent, both the shareholder and the specially related persons must file a disclosure under the five percent rule. Where both the shareholder and the specially related persons must file a report, the shareholder with the largest equity ownership may file a single joint report on behalf of the group.

The shareholder and the specially related persons filing a disclosure under the five percent rule must comply with additional disclosure requirements that are specifically applicable to corporate insiders such as directors, officers, and major shareholders.

1. Specially Related Person

Specially related person is a collective designation for the related person and the joint holder of a shareholder. Both related persons and joint holders are specially related persons of a shareholder.

2. Related Person

Where the shareholder is a natural person, the related person designation extends to the following persons:

(a) Spouse;

(b) Spouse's paternal relatives within two kinship degrees and the spouses of the paternal relatives;

(c) Father;

(d) Paternal relatives within six kinship degrees;

(e) Husbands of paternal relatives within three kinship degrees and the children of the paternal relatives;

(f) Wives of the paternal relatives within four kinship degrees;

(g) Mother;

(h) Maternal relatives within three kinship degrees and the spouses and children of the maternal relatives;

(i) Biological parents of an adopted person

(j) A direct biological descendant (of the shareholder) adopted by non-biological parents, and the descendant's spouse and children;

(k) Biological mother of a child born outside the shareholder's lawful marriage;

(l) Any person whose livelihood depends on the financial assistance of the shareholder or who cohabits with the shareholder in a dependent relationship;

(m) A company (and its directors and officers) at least 30 percent owned or effectively controlled by the shareholder—alone or together with any of the above-mentioned (a-l) persons; and

(n) A company or an entity (and its directors and officers) effectively controlled by the shareholder—alone or together with any of the above-mentioned (a-m) persons).

Where the shareholder is a legal entity, the related person designation extends to the following persons and entities:

(o) Shareholder's directors and officers;

(p) Shareholder's affiliate (as recognized under the Monopoly Regulation and Fair Trade Act) and the affiliate's directors and officers;

(q) A natural person (and any of the above-mentioned (a-k) related persons) that holds at least 30 percent of the shareholder or effectively controls it; and

(r) A company or a business group (and its directors and officers) that, alone or together with any of the above-mentioned (a-k) related persons, holds at least 30 percent of the shareholder or effectively controls it.

Where a related person is able to verify it holds less than 1,000 shares and it is not a joint holder, the related person's equity securities are excluded from the equity ownership calculation.

3. Joint Holder

A joint holder is a designation given to a shareholder that engages in any of the following activities under a mutual consent or under an agreement with another shareholder:

(a) Acquiring or disposing of equity securities jointly with another shareholder;

(b) Acquiring equity securities alone or jointly with another shareholder and transferring the acquired equity securities to another shareholder; or

(c) Exercising voting rights (including the right to dictate voting) jointly with another shareholder.

4. Legal and Beneficial Ownership

The five percent rule incorporates the concept of "securities held" to broadly encapsulate not only a shareholder's legally and beneficially owned equity securities, but also the shareholder's legally and beneficially owned equity conversion rights/options that may be exercised to acquire equity securities or wield voting powers as provided below:

(a) A person pays for and receives the issuer's equity securities using the name of another person to conduct the purchase; the duty to file a report under the five percent rule falls on the person that beneficially owns the equity securities irrespective of whether or not the purchase has been made under the name of another person;

(b) A person obtains a right to compel another person to deliver equity securities under the provisions of law involved or the terms and conditions of an agreement;

(c) A person obtains a right to acquire or dispose of equity securities or exercise voting rights under the provisions of law involved or under the terms and conditions of an agreement such as a contract to place assets under a trust, a collateral agreement, or a discretionary asset management contract;

(d) A person enters into a pre-agreement to acquire a listed company's equity securities, thus attaining the position of a potential shareholder of the listed company;

(e) A person acquires call options that may be exercised to acquire a listed company's equity securities, thus attaining the position of a potential shareholder of the listed company; and

(f) A person receives stock options that may be exercised to acquire a listed company's equity securities, thus attaining the position of a potential shareholder of the listed company.

Disclosure period

A five percent shareholder must file a report with the FSC/FSS and the Korea Exchange within five days following the date of a report-trigging event. When determining the number of days during which a disclosure must be filed, the day of the disclosure-triggering event, national holidays, Saturdays and Sundays, and the May 1 Labor Day are excluded.

Articles 154-3 and 4 of the Enforcement Decree of the FSCMA provide for a number of exceptions to the five-day disclosure period as follows:

(a) Where the purpose of the equity ownership is passive investment, the disclosure period for a subsequent change report extends to the tenth day after the end of the month during which the report-trigging event occurred; the disclosure period for an initial acquisition report is five days after the date of the acquisition;

(b) A five percent shareholder must file a report with the FSC/FSS and the Korea Exchange within five days following the date of a report-trigging event. When determining the number of days during which a disclosure must be filed, the day of the disclosure-triggering event, national holidays, Saturdays and Sundays, and the May 1 Labor Day are excluded.

(c) The following entities are qualified investors without the intent to influence company management:

- Korea Securities Finance Corporation (added Nov. 8, 2010);
- Korea Deposit Insurance Corporation and Korea Resolution & Collection (KR&C);
- Korea Asset Management Corporation;
- Korea Housing Finance Corporation;
- Korea Investment Corporation;
- Korea Finance Corporation;
- Korea Financial Investment Association;
- Korea Securities Depository;
- Korea Exchange;
- Financial Supervisory Service;
- Korea Credit Guarantee Fund;
- Korea Technology Finance Corporation;
- Funds and fund managing entities established under the law; and
- Joint enterprises established for member benefits under the law.

Filing a joint report

Where a shareholder and its specially related persons hold equity securities, the shareholder with the largest equity ownership may file a joint report as the group's reporting shareholder with the consent of each group member.

(a) For a joint report, each group member must deliver a power of attorney to the group's reporting shareholder for submission (duplicates of the letters) together with the joint report.

(b) The group's reporting shareholder must disclose any report-trigging event after a joint report has been filed. In the event the group designates a new reporting shareholder, the new reporting shareholder must file a joint report (together with letters of the power of attorney from the group members).

Cooling-off period for new share acquisition

The five percent rule provides a cooling-off period during which a five percent shareholder can neither acquire additional equity interests nor exercise the voting rights. The cooling-off period takes effect from the day after the date a disclosure-triggering event occurs to the fifth day after the date the five percent shareholder files a report.

(a) A five-day cooling-off period takes effect the day after a shareholder files an initial acquisition report for acquiring more than five percent for the purpose of influencing company management. Similarly, a five-day cooling-off period takes effect the day after a five percent shareholder files a material change report for changing the purpose of the equity ownership from passive investment to influencing company management.

(b) No cooling-off period takes effect for a shareholder that files a subsequent change report after filing an initial acquisition report with the intent to influence company management.

The cooling-off period commences the day after the date a disclosure-triggering event occurs and ends on the fifth day after the date a report is filed.

(a) The day the shareholder files a report is excluded from the cooling-off period. National holidays, Saturdays, Sundays, and the May 1 Labor Day are excluded from the cooling-off period.

(b) Failure to comply with the cooling-off period requirements may result in the suspension of the voting rights of the equity securities and an order for the disposition of the non-complying equity securities.

Disclosure for Corporate Insiders

A person who becomes a corporate insider—a director or an officer or a major shareholder of a listed company—for the first time must file a disclosure on its legal and beneficial equity ownership in the company (the issuer) within five days with the SFC and the Korea Exchange. Any change in the insider's equity ownership thereafter must also be reported to the SFC and the Korea Exchange within five days. Equity securities issued by the company and held by its corporate insiders are referred to as specific securities.

Corporate insiders are subject to strict equity ownership disclosure requirements because they are assumed to be privy to material nonpublic information about their company that may be abused for personal gains. The disclosure requirements are intended to ensure timely and fair disclosure of insiders' equity interests and any trade involving them to the market.

Specific securities

The term "specific securities" refers to any of the following classes of securities:

(a) Equity and equity-convertible securities such as voting stock, preferred nonvoting stock, convertible bonds, bonds with warrants, participating bonds, and investment contracts;

(b) Depositary receipts and exchangeable bonds linked to the equity securities listed in subparagraph (a);

(c) Derivatives and other investment products whose underlying assets consist of any of the securities listed in subparagraphs (a) and (b).

Persons subject to disclosure

The company's directors and officers and major shareholders are primarily subject to insider disclosure rules.

1. Directors and Officers

Directors and officers who are subject to insider disclosure requirements refer to:

(a) Directors (including outside directors) and the auditor elected by the company's shareholders at the general shareholders' meeting;

(b) Officers as provided under article 401-2(1) of the Commercial Act; they may include: (i) persons who effectively control the company and routinely order company directors to carry out specific activities; (ii) persons who can act on behalf of the company; and (iii) persons

who are not directors but perform executive duties and functions assuming such titles as honorary president, president, chief executive officer, executive director, director, or other titles indicative of decision-making position or authority.

The directors and officers of an affiliate of the listed company are not subject to insider disclosure irrespective of whether or not they are registered or unregistered directors.

The determination of whether a person is a company officer is to be made by the person in consideration of the following:

(a) A person carries out company duties assuming such job titles as honorary president, president, chief executive officer, executive director, and director;

(b) Where a person assumes an advisor title or a director-equivalent title, the determination is to be made with due consideration given to the following:

- Use of the title within the company;
- Areas of responsibility and decision-making authority;
- Amount of remuneration.

2. Major Shareholders

The term "major shareholder" denotes either of the following shareholders:

(a) A shareholder that holds at least 10 percent of the company's total voting equity securities issued, including depositary receipts that have been issued for such securities (irrespective of whether the voting equity securities are held in the name of the shareholder or not); or

(b) A shareholder that holds less than 10 percent of the total voting equity securities issued, but nevertheless effectively controls the company.

The ownership of specific securities such as convertible bonds and bonds with warrants that are not voting equity securities is not relevant to the determination of a major shareholder when the shareholder's voting equity securities in the company are less than 10 percent. Therefore, a shareholder that holds 7 percent of the voting equity securities and 3 percent of the convertible bonds issued by the company is not a major shareholder unless the shareholder effectively controls the company.

In calculating a shareholder's ownership of specific securities, equity securities held or traded under another person's name are included. Similarly, equity securities acquired and held under the employee stock ownership plan count toward equity ownership of a major shareholder.

A shareholder that effectively controls a company is a shareholder who:

(a) Has appointed, alone or together with other shareholders, the company's chief executive officer or the majority of the members of the company's board of directors;

(b) Holds the decision-making authority in respect of the company's business management, organization change, and other key decisions. The determination of whether a shareholder meets this criterion (and liability for the determination) is left to the shareholder.

Disclosure period

A person who becomes a director, an officer, or a major shareholder of a listed company for the first time must file a report on the ownership of specific securities issued by the company. An initial ownership report must be filed within five days after the person becomes a director, an officer, or a major shareholder. No initial ownership report is required if the person does not hold any legal or beneficial ownership of specific securities.

A change in ownership report must be filed within five days when a change in the

ownership of an insider's specific securities occurs. Where the number of specific securities changes by less than 1,000 and the acquisition or disposition amount is less than KRW10 million, a change in ownership report is not necessary. Where an insider ceases to be employed by or associated with the company, the departure must be disclosed even if there has been no change to the insider's ownership of specific securities.

1. Effective Date for Initial Ownership Report

   (a) Where a person is elected a director at the company's general shareholders' meeting for the first time, the effective date is the day of the election.

   (b) Where a person becomes an officer, the effective date is the day the person assumes the appointed position.

   (c) Where a person becomes a major shareholder after acquiring company shares, the effective date is the day of the share acquisition.

   (d) Where an unlisted company becomes listed for the first time, the effective date is the day the company becomes listed.

   (e) Where an unlisted company merges with a listed company, and an insider of the unlisted company becomes an insider of the listed company, the effective date is the day the shares of the merged company commences trading.

2. Effective Date for Change in Ownership Report

   (a) Where an insider either buys or sells specific securities on-exchange during regular trading hours, the effective date is the day of the transaction settlement (T+2).

   (b) Where an insider either buys or sells specific securities off-exchange, the effective day is the earlier of either the date the payment was made or the date the securities are delivered.

   (c) Where an insider acquires specific securities in a secondary stock offering, the effective date is the date immediately following the day the payment is delivered.

   (d) Where an insider lends or borrows specific securities, the effective date is the day the securities are lent or borrowed.

   (e) Where an insider receives specific securities as a gift, the effective date is the day the delivery of the securities is completed.

   (f) Where an insider inherits specific securities, the effective date is the day the inheritance is finalized. Where two or more persons inherit specific securities, the effective date is the day the division of the securities and any other share-related assets is completed.

   (g) Where an insider acquires specific securities through other means, the effective date is to be determined as provided under the applicable law:

      - Acquisition of scrip shares (capitalization shares): the date the scrip shares were allotted;

      - Acquisition of stock dividends: the date the stock dividend distribution was approved at the company's general shareholders' meeting;

      - Acquisition of shares from the exercise of equity conversion rights/options attached to convertible bonds: the date the conversion rights/options were exercised;

      - Acquisition of shares from the exercise of equity conversion rights/options attached to bonds with warrants and stock options: the date payment for the shares was made;

      - Acquisition of shares of a newly merged company: the date of the merger registration;

- Reverse stock split, stock split, and share redemption: applicable provisions of the Commercial Act.

3. Exemptions from Change in Ownership Report and Extension of Disclosure Deadline

Where the aggregate number of specific securities of an insider was less than 1,000 shares, or either the acquisition or the disposition amount was less than KRW10 million after the most recent filing, a change in ownership report is not necessary. The determination of disclosure exemption must be made on a cumulative basis.

4. Extension of Disclosure Deadline

For a change in share ownership due to stock dividend, stock split, reverse stock split, capital reduction, or other unavoidable causes, the disclosure deadline is extended to the tenth day of the following month. For certain qualified investors that pose little or no risk of abuse of inside information, the disclosure deadline is extended to the tenth day of the following quarter. The disclosure deadline for the initial ownership report remains unchanged at five business days.

The qualified investors exempted from the five-day disclosure period include the following:

- National and municipal governments;
- Bank of Korea;
- Korea Deposit Insurance Corporation;
- Korea Resolution & Collection;
- Korea Investment Corporation;
- Korea Finance Corporation; and
- Korea Credit Guarantee Fund.

Tender Offer

Disclosure for Significant Event applies to tender offer, which is made pursuant to the relevant provisions of the FSCMA. Under the law, a tender offer must be made and a tender offer statement filed when a person who together with any specially related parties seeks to purchase or otherwise acquire from at least ten shareholders of a listed company more than 5 percent of the company's shares. The period specified for the acquisition through a tender offer is six months.

Announcement of tender offer and tender offer statement

The prospective acquirer must announce the tender offer through widely circulated newspapers with specific information pertaining to the purpose of the offer, the number and the type of securities sought, the terms and conditions of the offer, and the methods to be used to acquire the desired shares. The prospective acquirer must submit a tender offer statement to the FSC/FSS on the day of the public announcement of the offer.

Corrected tender offer statement

The prospective acquirer may submit a corrected tender offer statement before the tender offer period expires to incorporate any changes to be made to the terms and conditions of a tender offer. Changes that are disadvantageous to the existing shareholders—such as a reduction in the purchase price or the number of shares to be acquired—are prohibited.

Short-Swing Profit Rule

Under the short-swing profit provisions of the FSCMA and the subordinate regulations (the "short-swing profit rule"), corporate insiders must return any profit they realize from the purchase and sale or the sale and purchase of certain classes of equity securities—referred to as specific securities in the FSCMA—within a six-month period. The disgorgement of short-swing profit is effective irrespective of whether or not any insider information was used to realize the profit.

The short-swing profit rule is intended to prevent corporate insiders from trading specific securities on the basis of material, nonpublic information. Such insider trading is illegal, and the short-swing profit rule imposes civil and criminal penalties on the violators in order to ensure no unauthorized disclosure or privileged inside information is used for personal gains.

Insiders who are subject to short-swing profit disclosure include:

(a) Directors, officers, and others covered under article 401-2(1) of the Commercial Act;

(b) Employees handling or given access to privileged nonpublic company information, including employees administering the company's regulatory filings as provided under article 161(1) of the FSCMA;

(c) Major shareholders (shareholders with equity ownership of ten percent or more in the company) or shareholders that effectively control the company.

Unfair Trading and Enforcement

Although unfair trading covers wide-ranging unlawful activities in the securities markets and is not specifically defined in the FSCMA, it comprises three general types: the use of material nonpublic information, market manipulation, and other illegal acts.

5.4 USE OF MATERIAL NONPUBLIC INFORMATION

The FSCMA strictly prohibits insider trading or the buying and selling of a publicly traded company's securities by insiders using material nonpublic information. Using undisclosed information to buy or sell the securities of a company set to become a publicly traded company within six months is also prohibited.

The prohibition on the use of material nonpublic information covers not only insiders, but also quasi-insiders and tippees who may become privy to material nonpublic information. Such persons include:

(a) Company's directors, officers, employees, and agents;

(b) Company's major shareholders and their agents and other related information users;

(c) Persons with legally granted regulatory or licensing authority over the company and their agents;

(d) Company's contractors and their agents and employees;

(e) Directors, officers, employees, and major shareholders of the company's affiliate or subsidiary; and

(f) Persons or insiders of a company currently in negotiation with the company.

Corporate Insiders Covered under Prohibition on Use of Material Nonpublic Information

The directors and officers and major shareholders of a listed company are corporate insiders who are specifically covered under the prohibition on the use of material nonpublic information.

Directors refer to directors (including outside directors) and the auditor elected by the company's shareholders at the general shareholders' meeting. As provided under article 401-2(1) of the Commercial Act, company offers include: (i) persons who effectively control the company and routinely order company directors to carry out specific activities; (ii) persons who can act on behalf of the company; and (iii) persons who are not directors but perform executive duties and functions assuming such titles as honorary president, president, chief executive officer, executive director, director, or other titles indicative of decision-making position or authority. A person is deemed a company officer if the person performs corporate duties assuming such job titles as honorary president, president, chief executive officer, executive director, or director.

A major shareholder is a person who holds at least 10 percent of the company's total voting equity securities issued, including depositary receipts that have been issued for such securities (irrespective of whether the voting equity securities are held in the name of the shareholder or not). A shareholder who holds less than 10 percent of the total voting equity securities issued, but nevertheless effectively controls the company, is also deemed a major shareholder.

Prohibition on Use of Information Pertaining to Large Share Purchase and Sale

The FSCMA prohibits the use of information stemming from or pertaining to a large share purchase or sale to buy or sell securities to protect investors. A share purchase or sale is deemed large if it is deemed sufficient to materially affect the company's management control. Persons subject to the prohibition on the use of information pertaining to large share purchase and sale include:

(a) A company (including its affiliates) that engages in the purchase or sale, and the company's officers, employees, agents, and others who come to possess knowledge of the transaction;

(b) Major shareholders of the company engaging in the purchase or sale and others who become privy to the transaction; and

(c) Persons who exercise legally granted regulatory or licensing authority over the company and who come to possess knowledge of the transaction.

5.5 MARKET MANIPULATION

Market manipulation, generally defined as a deliberate attempt to alter the prevailing share price and to profit from the artificially raised or reduced share price, is a violation of the securities law. Market manipulation includes orchestrated purchase and sale of securities in the spot and in the futures markets and covers trades involving listed and unlisted securities (including derivatives) through either the exchange or the OTC markets.

Market manipulation through disguised trading such as matched orders and wash sale that involve the purchase and sale of a company's shares by a person or an organized group of persons to create an impression of significant trading is a violation of the law. Specifically, it is a violation of the law to conspire with others to buy and sell a prearranged number of securities at a prearranged price with each other or to engage in fictitious buying or selling without transferring the legal ownership of the securities. Another common market manipulation is the creation of false trading impression. Manipulating a market price by creating a misleading or false trading impression on others is also a violation of the law. Such manipulation usually involves individuals who engage in prearranged buying and selling to create a false or misleading impression of significant trading.

5.6 OTHER ILLEGAL ACTS

In addition to use of material nonpublic information and market manipulation, the FSCMA broadly prohibits using illegal means, schemes, fraud, or making false or misleading statements or omitting material information when buying and selling securities. The FSCMA also make it unlawful to use deception, employ a false market price, disseminate a rumor, or make a threat when buying or selling securities.

5.7 INVESTIGATION AND ENFORCEMENT

As authorized under the FSCMA, the SFC is vested with the powers to investigate unfair trading and take appropriate enforcement actions. The powers specified for the SFC in the FSCMA include disgorgement of gains from short-swing profit by corporate insiders, reporting of share ownership by company officers and other insiders, prohibition on the use of material nonpublic information, prohibition on market manipulation, and prohibition on unlawful securities trading. The SFC is also granted the authority to investigate security offerings in the primary and secondary markets.

The FSCMA authorizes the SFC to delegate the power to investigate unfair trading to the FSS. As a result, it is the FSS that actually performs the investigation of unfair trading and other securities law violations under the authority of the SFC. (In addition to the SFC, the FSC delegates its broad investigation and enforcement powers to the FSS.)

The SFC may with a court-issued warrant conduct interviews, order document submission, and search the premises of individuals who are suspected of unfair trading connected with short-swing profit of a company insider, share ownership reporting, use of material nonpublic information, market manipulation, unlawful securities trading, or short-selling.

Investigation Methods

As provided under the FSCMA and the Act on Real Name Financial Transactions and Confidentiality, the FSS may perform investigation of unfair trading under the authority of the SFC in the following manner:

(a) Request records and other relevant documents;

(b) Request statements and affidavit from individuals who are involved in or connected with unfair trading;

(c) Summon for questioning individuals who are involved in or connected with unfair trading;

(d) Hold in custody documents and objects pertaining to unfair trading;

(e) Examine financial institution for unfair trading investigation; and

(f) Obtain information from government administrative agencies and from foreign supervisory authorities.

Corrective Measures and Enforcement Actions

When an investigation leads to the discovery of unfair trading, corrective measures and enforcement actions available to the FSS include:

(a) Refer the suspected individuals to the law enforcement authorities;

(b) Issue a warning or a corrective action;

(c) Impose an administrative fine, restrict new securities issuance, or refer to the law enforcement authorities for a disclosure violation; and

(d) Demand pay reduction and removal from the job for company officers and employees involved in unfair trading.

The SFC may refer some investigations to the prosecution authority as a priority under certain circumstances as follows:

(a) Action is needed because the SFC is unable to convene for an extended period as a result of unexpected developments and circumstances such as a natural calamity;

(b) Referral to the prosecution authority is needed because an unfair trading matter under FSS investigation is also being investigated by the prosecution authority;

(c) Violation of the securities law and regulation is recurring and threatening investors; or

(d) Action is needed to prevent a suspect from destroying evidence or fleeing.

Investigation and Enforcement Process

Investigation and enforcement of unfair trading is shared among the Korea Exchange, the FSS, and the prosecution authority. Whereas the Korea Exchange as a self-regulatory organization for the securities industry is charged with market monitoring and fact finding, the FSS conducts or takes charge of unfair trading investigations requiring highly technical or specialized expertise. The government prosecution authority works to impose criminal penalties for violation of the securities law. Thus, when the Korea Exchange detects a suspicious share price movement or an unusual trading activity, it forwards to the FSS information pertaining to the suspicious trading and individuals involved. The FSS then initiates additional fact finding and information collection and requests document submission and interviews from suspected individuals in order to determine whether any violation of law occurred. Where criminal penalty is warranted, the FSS refers the case to the prosecution authority on behalf or through the SFC.

The FSC may also investigate cases of unfair trading using its own broad investigation and enforcement powers on the basis of information received from the Korea Exchange and refer the cases to the prosecution authority for criminal action through the SFC.

Accounting Supervision

The legal framework for accounting supervision comprises the FSCMA, the Act on External Audit of Stock Companies (AEASC), and the Certified Public Accountant Act.

The FSCMA provides disclosure measures such as the periodic filing of Business Report to ensure the accuracy and reliability of financial reporting. It requires audited financial reporting from listed companies that are subject to Business Reports. The FSCMA also requires companies to continually operate internal controls, evaluate internal audit and the external auditors, and provide detailed assessment in their Business Report.

The AEASC provides for independent external audit of listed companies and others subject to independent external audit. Listed companies are required to appoint an auditor for a three-year term but may dismiss the auditor before the three-year term ends with the approval of the company’s audit committee and reporting to the SFC. The Certified Public Accountant Act governs the qualification, registration, services, rights, and duties of certified public accountants (CPAs) and accounting firms. CPAs and accounting firms must register with the FSC/FSS. Under the AEASC, any group of three or CPAs that operates as a non-business entity must register with the Korean Institute of Certified Public Accountants to carry on audit performance.

Companies subject to external audit are required to present financial statements in accordance with the established accounting standards. With accounting oversight authority delegated from the SFC, the FSS examines listed companies’ and unlisted financial services firms’ financial statements and the audit performed while it inspects the auditor’s report. Companies subject to external audit must also operate with an internal accounting management system for the preparation of accounting information. The auditor must also

prepare an evaluation of the actual status of the audited company's internal accounting management system and provide it in the Business Report.

Table 18.
Legal Framework for Accounting Supervision

	Financial investment services and capital markets act	Act on external audit of stock companies
Objective	• Efficient functioning of primary and secondary securities markets; • Protection of investors;	• Effective accounting supervision through independent external auditors; • Protection of market participants;
Regulated entities	• Listed companies and others subject to Business Report submission;	• Companies subject to independent external audit; • Auditors;
Regulatory reporting	• Registration statements; • Quarterly, semiannual, and annual Business Report;	• Financial statements; • Auditor's report;
Accounting supervision and procedure	• Mandatory audited financial statements of companies subject to Business Report;	• Mandatory audit of financial statements subject to independent external audit;
	• Affirmation of compliance with registration statement and Business Report requirements;	• Affirmation of compliance with accounting standards by company management;
	• Internal monitoring and controls;	• Internal accounting and audit management systems;
	• Review and inspection of companies subject to Business Report;	• Review of auditor's report (company and auditor); • Inspection of quality controls for auditing firms;
	• Adverse supervisory actions to companies including monetary fines, restrictions on new securities issuance, and other administrative actions; • Adverse supervisor actions to the auditor including monetary fines;	• Adverse supervisory actions to companies including recommendation for dismissal of officers, restrictions on new securities issuance, appointment of designated auditor, and other administrative actions; • Adverse supervisory actions to the auditor including restriction on audit of listed companies, audit suspension, and other administrative actions;

5.8 AUDIT REVIEW AND QUALITY CONTROL INSPECTION

The chief executive officer of a listed company is responsible for the preparation of the company's financial statements in accordance with the established accounting standards. The company's auditor then performs an independent audit of the accuracy and the reliability of the company's financial statements and delivers an audit opinion. The primary objective of accounting supervision is to review whether financial statements and the auditor's report are prepared according to the relevant standards. Reviewing the design and operation of auditors' quality control systems is another important accounting supervision objective.

5.9 COMPANIES SUBJECT TO AUDIT REVIEW

Under the authority delegated from or charged by the SFC, the FSS performs a review of audited financial statements from listed companies and unlisted financial services firms. The Korean Institute of Certified Public Accountants (KICPA) contributes to the audit review process by performing reviews of audited financial statements from companies not covered by the FSS.

Audit review broadly falls into either a targeted audit review or a sample audit review. The FSS conducts a targeted audit review when:

(a) The FSC requests a review;

(b) The FSC or the SFC suspects an accounting or audit violation;

(c) The SFC receives a request from a law enforcement authority with specific allegations about an accounting or audit violation; or

(d) The SFC receives a request from a corporate insider, an audit participant, or other sources with credible charges of accounting misconduct.

The FSS also conducts a sample audit review employing quantitative analysis methods utilizing financial analysis tools or random sampling methods.

5.10 AUDIT SUPERVISION

Under authorities delegated from or charged by the SFC, the FSS performs quality control inspection of auditors that:

(a) Perform audit of one percent or more of listed companies as of the end of April each year;

(b) Perform audit of listed companies with assets of KRW1 trillion or more as of the end of April each year;

(c) Employ 30 or more CPAs as of the end of April each year; or

(d) Become subject to FSS audit review upon the conclusion of a joint audit inspection with a foreign supervisory authority or other supervisory concerns.

The KICPA performs quality control inspections on auditors that do not fall under the above-mentioned categories.

5.11 ACCOUNTING AND AUDIT STANDARDS

Financial statements are prepared and presented in accordance with the accounting standards, while audits by external auditors are conducted in accordance with on audit standards. The FSC delegates the authority to set accounting standards to the Korea Accounting Institute (KAI) under the oversight of the SFC. Following the announcement of a roadmap for the full adoption of the IFRS in March 2007, the IFRS became mandatory for all listed companies, unlisted financial institutions, and companies set to go public beginning in 2011. Auditors are required to perform audit in accordance with the auditing standards set by the Korean Institute of Certified Public Accountants. The standards follow the IFAC's Clarified ISA.

6. Consumer Protection

Overview

The FSS works to protect consumers. Consumer protection activities that the FSS performs can be broadly divided into ex ante and ex post measures. Ex ante measures include such activities as enforcing standard contract provisions for financial products and services and disclosures and providing consumer counseling and financial literacy, while ex post measures refer to activities that are intended to rectify abuses and malpractices of financial services providers and help bring about remedy to consumers who are harmed by financial firms' misconduct.

In May 2012, the FSS consolidated its consumer protection functions and established the Financial Consumer Protection Bureau (FCPB) in order to provide more effective consumer protection. The FCPB's main responsibilities and functions are to administer consumer complaints, provide consumer counseling and dispute mediation services, and take supervisory actions on financial firms' misconduct. In addition, the FCPB conducts wide-ranging financial education programs to help improve consumer financial literacy and help consumers make more informed decisions.

As part of its consumer protection mandate, the FCPB also evaluates financial firms' consumer protection practices and consumer complaint administration systems. When deemed necessary, the FCPB may review complaints filed against financial firms and conduct on-site inspections. In respect of product and service disclosures, the FCPB works to improve financial firms' disclosure standards and practices to help consumers make informed decisions.
In addition, the FCPB also provides personal finance counseling services to help consumers exercise responsible and sound personal finance, management debt, and understand financial products.

Consumer Complaint Mediation

The Financial Dispute Settlement Committee (FDSC) is a committee that has been created under the FCPB to help mediate and resolve complaints consumers file against financial firms.[8] When a consumer files a complaint, the FCPB gathers and verifies the relevant facts and makes impartial recommendations to the parties involved to help them reach a mutually agreeable resolution without resorting to time-consuming and costly litigation through the court.

The FDSC is staffed by specialists that include independent outside experts. Each FDSC mediation meeting is attended by committee members who are selected by the FDSC chairperson on the basis of the specific areas of consumer complaints, which may vary from banking, nonbanking, and financial investments to insurance.

Consumer complaint is referred to the FDSC when the parties involved in a complaint are unable to reach an agreement within 30 days from the day the request for FDSC mediation has been submitted. The FDSC then deliberates on the case and proposes a resolution within 60 days with due consideration given to the applicable rules and regulations and information provided by the parties involved. The FDSC may dismiss a complaint if it does not merit a mediated resolution from the FDSC, or the facts and information provided by the parties cannot be substantiated. The FDSC decides on a resolution proposal with a majority vote. Once an FDSC resolution proposal is accepted

[8] Financial Dispute Settlement Committee has also been translated as Financial Disputes Mediation Committee in some publications.

by the parties involved, no further recourse is available. Unlike arbitration, the FDSC recommendation is not legally binding, and adjudication through the court is still available to consumers and financial firms.

Appendices

A. Incorporation of Financial Services Company

Financial services companies must be incorporated and licensed in accordance with the applicable laws and regulations. For supervision purposes, the FSS classifies financial institutions into four general types: bank, nonbank financial company, financial investment services provider, and insurance company.

A.1 REGISTRATION, AUTHORIZATION, AND APPROVAL

Unless specifically provided otherwise under the law, the incorporation of a financial services company requires FSC/FSS authorization, approval, or registration. Both authorization and approval are administrative actions that legally sanction a person (natural or legal) for a business activity. Although authorization and approval are similar in meaning and are often used interchangeably, authorization more narrowly means giving a person the permission to engage in a regulated business activity whereas approval more specifically means granting the full legal effect to a business activity. Some financial services businesses merely need to register with the FSC/FSS. Registration is approved without regulatory scrutiny when the applicant satisfies the established requirements.

A.2 REVIEW OF INCORPORATION APPLICATION

Authorization/approval for the incorporation of a financial services company is granted after a thorough review is performed of the incorporation application, especially in respect of the applicant's legal form, the feasibility and viability of the applicant's business plans, the availability of capital, the composition of the major shareholders, and the competence of the management.

Table 19.
Incorporation Requiring FSC/FSS Registration, Authorization, and Approval

Registration
Financial investment service provider
• Investment advisory company • Discretionary investment services company • Hedge fund
Insurance company
• Intermediaries including insurance sales agent, agency, and broker • Actuary, claims adjuster • Others providing product development or claims payout services
Nonbank financial company
• Leasing company • Installment finance company • New technology venture capital company
Authorization
Bank
• National bank, regional bank • Foreign bank branch
Financial investment service provider
• Dealing • Brokerage • Collective investment services • Trust services
Nonbank financial company
• Mutual savings bank • Credit union • Other deposit-taking institutions
Approval
Nonbank financial company
• Credit card company
Insurance company
• Life insurance • Nonlife insurance • Hybrid insurance

Type of Legal Form Proposed

As a rule, the incorporation of a financial service company is limited to a corporate form as recognized under the Commercial Act (the commercial code) with some exceptions provided for credit unions and several other smaller institutions.

Business Feasibility and Viability

For the assessment of the feasibility and viability of the application, extensive analysis and assessment of the financial soundness of the proposed business as a going concern are made. Assessments are also made on the prospect for the applicant's long-term business viability and its competitive effect on the industry.

Business Resources and Operational Capability

Human and business resources and operational capabilities that are available to effectively serve consumers and remain a going concern are another key review criterion. The appropriate levels of resources and operational capabilities may vary from industry to industry and the type of financial services to be offered. For services such as insurance requiring actuaries, claims adjusters and other specialists, the applicable laws and regulations provide for the required employee levels.

Minimum Incorporation Capital Requirements

Specific minimum capital requirements for the incorporation of a financial services company are set. (See table 20.) Note that authorization for financial investment service is granted for individual financial investment services businesses. Similarly, approval for insurance is granted for individual insurance business line.

Composition of Management and Shareholders

The composition of the management and the shareholders proposed is reviewed not only for prudential reasons, but also for potential abuses by company insiders. The review of the applicant's shareholders covers not only the individual organizers and major shareholders, but also persons specially related or connected to the shareholders and any other persons who may be able to exert undue influence on the management of the proposed company. The review extends to the shareholders' ability to contribute capital to the company, their financial conditions, their past irregularities and rule violations, and the sources of funding for the proposed incorporation.

Table 20.
Minimum Incorporation Capital Requirements

(KRW, billions)

Bank	
• National bank	100
• Regional bank	25
Nonbank financial company	
• Specialized credit finance company	- 20 for one or two business lines; - 40 for three or four businesses;
• Mutual savings bank	- 12 for a bank with the main office located in the Seoul Metropolitan City; - 8 for a bank with the main office located in one of the five metropolitan cities other than Seoul; - 4 for others;
• Credit unions	- 0.3 for region-specific credit union; - 0.1 for group-specific credit union; - 0.04 for workplace-specific credit union;
Financial investment services provider	
• Dealing	1–90
• Brokerage	0.5–10
• Collective investment scheme	2–8
• Trust services	5–25
Insurance company	
• Full insurance business	30
• Single insurance business	5
• Branch of foreign insurance company	3

In accordance with the principle of separation of banking and commerce, acquiring ownership in a financial services company—especially in a deposit-taking institution such as a

commercial bank or a mutual savings bank—is subject to enhanced regulatory review. The review is designed to prevent a few individuals, companies, and business groups from exercising undue influence on the credit decisions or the management of financial services companies and on market activities. The review of the proposed management also takes place with a particular emphasis on disqualifying causes and the ethical standards of the individual managers.

Preliminary Authorization/Approval

In order to ensure a smooth and cost-effective authorization/approval process for the incorporation applicant, the incorporation rules provide for a preliminary authorization/approval. Where it is determined that the applicant unequivocally meets all of the authorization/approval requirements or an accelerated authorization/approval is warranted, the preliminary authorization/approval may be waived. The law provides for a transparent and expeditious incorporation process by imposing a specific length of time within which the review must be completed for both the preliminary and the final authorization/approval.

An applicant that satisfies all of the incorporation requirements must be promptly granted the authorization/approval sought. Where the authorized or approved company fails to comply with any of the incorporation requirements after receiving the authorization/approval, the FSC/FSS may revoke the authorization/approval.

A.3 AUTHORIZATION FOR FOREIGN BANK BRANCHES

A foreign bank seeking to open or close a bank branch or a representative office in Korea must obtain an appropriate authorization from the FSC/FSS. The authorization of a foreign bank branch may be withdrawn where the branch's foreign-headquartered bank ceases to exist as a result of merger or other reasons, receives sanctions for improper or unlawful conduct, or suspends or terminates its banking business. Foreign bank branches must report all such occurrences to the FSC/FSS within seven days from the date of the occurrence. The banking license of a foreign bank branch is deemed to be revoked where the foreign-headquartered bank fails, loses its home banking license, terminates its banking business, or ceases to function as a going concern.

A.4 WITHDRAWAL OF REGULATORY AUTHORIZATION/APPROVAL

The FSC/FSS is vested with the authority to revoke the business license of a financial services company. A financial services company pursuing major reorganization or alteration of its existing business structure must obtain prior authorization/approval from the FSC/FSS. Such business reorganization or alteration includes a breakup of the company, a merger with another financial services company, a whole or partial acquisition (or assignment) of a financial services business, the termination of a financial services business, and the dissolution of the company.

Where it is determined that a financial services company is unable to continue safe and sound business operation as a going concern, the FSC/FSS may issue a prompt corrective action and order a merger or the dissolution of the company through the sale of the company's businesses.

The FSC/FSS may also revoke a business license where it is determined that a financial services company:

(a) Obtained a business license through misrepresentation, deception, or fraud;

(b) Failed to comply with legal and regulatory requirements;

(c) Carried on financial services business while under FSC/FSS-imposed business suspension;

(d) Failed to comply with supervisory orders for remedial actions;

(e) Acquired or disposed of assets (such as debt and equity securities) through illegal means;

(f) Defaulted on a credit obligation and significantly disrupted the normal and orderly functioning of the financial market; or

(g) Will likely cause substantial financial losses to depositors or investors due to a grave legal or regulatory failure.

The FSC/FSS may also revoke the registration of a financial services firm for any of the aforementioned causes.

A.5 FINANCIAL FIRM OWNERSHIP

Ownership of a financial services company is regulated under the principle of the separation of banking and commerce to prevent financial services companies from operating under the undue influence of a select few individuals, companies, or business groups. However, non-depository financial services companies such as specialized credit finance companies are not subject to stringent ownership restrictions. Small-scale depositary institutions such as mutual savings banks and credit unions that are not particularly susceptible to abuse by the controlling shareholders are also subject to less stringent ownership regulations.

A.6 GOVERNANCE

The board of directors of a financial services company comprises executive directors, non-executive directors (non-executive inside directors), and outside directors (non-executive outside directors). Non-executive directors and outside directors are mutually exclusive. Non-executive directors do not take part in the day-to-day management decisions. Outside directors are independent of the management. They are appointed at the general shareholders' meeting with the recommendation of the board's director selection committee; outside directors must make up the majority of the director selection committee.

Composition of Board of Directors

Outside directors must make up at least three of the board members and the majority of the board for commercial banks. Outside directors must also make up at least three and at least half of the board members for (1) financial investment services providers, insurance companies, and credit card companies with assets of KRW2 trillion or more, and (2) financial holding companies controlling a financial subsidiary that has assets of KRW100 billion or more or is required to appoint the majority of the board with outside directors.

At least a quarter (1/4) of the board members of listed companies with assets less than KRW2 trillion must consist of outside directors. For mutual savings banks with assets in excess of KRW1 trillion, at least three outside directors must be represented in the board and at least two for mutual savings banks with assets of at least KRW300 billion.

Persons Ineligible for Outside Director

The following persons are ineligible to serve as an outside director of a financial services company:

(a) A minor;

(b) A person who has been declared mentally incompetent by the court;

(c) A person in bankruptcy;

(d) A person with less than five years elapsed since the completion of a court-ordered prison sentence;

(e) A person with less than five years elapsed since being removed or discharged from employment for a breach of the Banking Act or any other financial laws and regulations;

(f) The largest shareholder and any persons specially related or connected to the shareholder;

(g) The spouse and children of a major shareholder;

(h) A current or former (during the previous two years) officer or employee (of either a financial services company or its subsidiary);

(i) The spouse and children of a current officer;

(j) A current or former (during the previous two years) officer or employee of a company with significant business relations with the financial services company; or

(k) A current officer or employee of a company where a current officer or employee of the financial services company serves as an outside director.

Outside Director Selection Committee

Outside directors are selected with the recommendation of director selection committee made up of outside directors who constitute the majority of the selection committee. The selected candidates are then approved at the general shareholders' meeting. (For listed companies, a person recommended by a shareholder who holds at least 1 percent of the company's outstanding voting shares must be included in the candidate list. This measure is intended to strengthen minority shareholder rights and provide a check on large shareholders.)

Audit Committee

An operating audit committee is mandatory for banks and financial services companies whose outside directors must constitute at least three and at least half of the board members. An audit committee requires a minimum of three directors, and a minimum of two-thirds (2/3) must consist of outside directors. For listed financial services companies whose assets at the most recent year-end financial reporting exceed KRW2 trillion, the audit committee must be headed by an outside director and include at least one director with accounting or financial expertise. For the commercial banks, a candidate selection committee made up entirely of outside directors must be formed for audit committee membership. The selected candidates may be presented to the general shareholders' meeting for appointment only with the consent of the two-thirds (2/3) of the outside directors. The eligibility requirements for audit committee members are same as those for outside directors.

Internal Controls and Compliance

Together with the outside director and audit committee regimes, internal controls and compliance constitute the core of corporate governance structure. Whereas outside directors and audit committee are particularly applicable to large financial institutions, internal control standards and compliance regimes apply to all financial services companies irrespective of the size, the types of business, and the listed status.

For compliance, at least one compliance officer must be appointed to monitor internal control compliance, investigate any cases of noncompliance, and report them to the audit committee. A vote by the board of directors is required to appoint or discharge a compliance officer. Foreign bank branches may appoint a compliance officer without satisfying the board approval requirement.

B. Legal and Regulatory Structures

Financial statutes and regulations consist of laws enacted by the National Assembly, enforcement decrees approved by the president's state council (cabinet), enforcement rules approved by the Office for Government Policy Coordination under the prime minister, and regulations written by the FSC/FSS. Although enforcement decrees, enforcement rules, and supervisory regulations differ in hierarchy, they are all intended to implement and support specific statutes enacted by the National Assembly.

B.1 LAWS

A law is enacted by the National Assembly. It supersedes enforcement decrees, enforcement rules, and regulations that are written and enforced by the administrative agencies of the executive branch.

B.2 ENFORCEMENT DECREES AND ENFORCEMENT RULES

An enforcement decree, also called presidential enforcement decree, is a regulation immediately subordinate to laws. It is approved by the president's state council (cabinet) to implement statutes enacted by the National Assembly. An enforcement rule is a regulation subordinate to enforcement decree and approved by the Office for Government Policy Coordination under the prime minister. Enforcement rules complement enforcement decrees with additional detailed rules in support of statutes enacted by the National Assembly. Laws passed by the National Assembly are not always accompanied by an enforcement decree and an enforcement rule.

B.3 REGULATIONS AND DETAILED REGULATIONS

In respect of financial regulation and supervision, regulations are written by the FSC, a regulatory agency of the executive branch, to complement enforcement decrees and enforcement rules and ensure full enforcement of statutes. Regulations are subordinate to both enforcement decrees and enforcement rules. The Regulation on Supervision of Banking Business is thus subordinate to the Enforcement Decree of the Banking Act. Because the FSC and the FSS share financial regulation and supervision, the FSC assigns or delegates most of the enforcement functions such as investigation of unlawful securities trading to the FSS. Detailed regulations are written by the FSS in support of FSC regulations to ensure effective performance of supervisory duties and functions.

B.4 LEGAL AND REGULATORY STRUCTURES AND RULEMAKING PROCESS

The legal and regulatory structure for banking business is typical of the legal and regulatory structures for nonbanking, securities, and insurance businesses. The statutes and regulations applicable to banking in descending hierarchy are:

1. Banking Act, legislated and amended by the National Assembly;
2. Enforcement Decree of the Banking Act, written and approved by the president's cabinet;
3. Regulation on Supervision of Banking Business, written and amended by the FSC; and
4. Detailed Regulation on Supervision of Banking Business, written and amended by the FSS.

The underlying rationale for the hierarchal structures is that the Banking Act provides the broad legal basis for regulating banking business, and the subordinate enforcement decrees and regulations set forth specific provisions needed to enforce the Banking Act. As an example, the provisions of the Banking Act and the subordinate enforcement decrees and regulations pertaining to bank capital requirements vary in specificity as follows:

- Article 34 of the Banking Act requires banking institutions to comply with supervision standards and grants the FSC the authority to set the supervision standards.

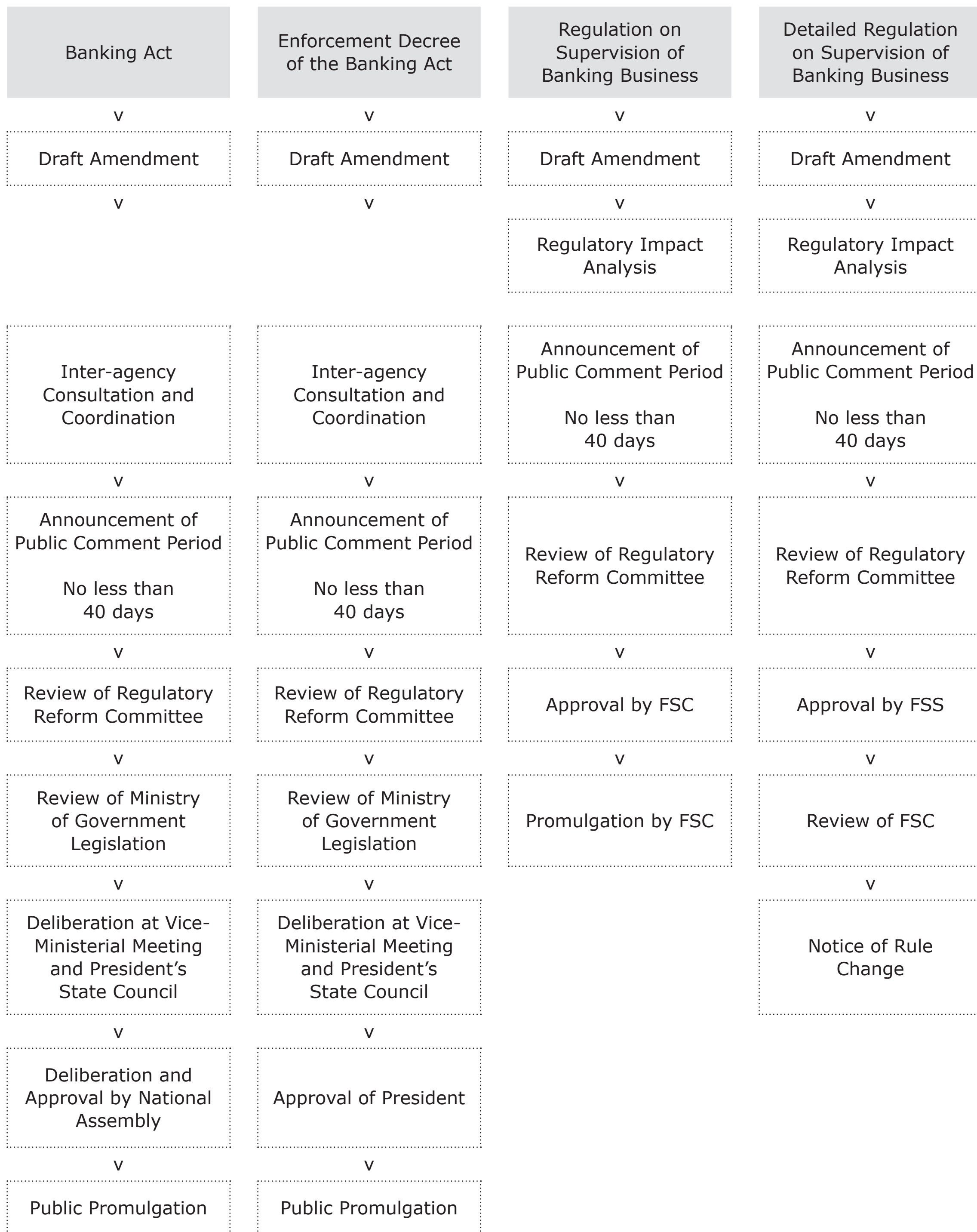
- Article 20 of the Enforcement Decree of the Banking Act sets forth specific provisions to be included in the determination of supervision standards; the specific provisions pertain to bank capital standards and asset classification rules.

- Article 26 of the Regulation on Supervision of Banking Business provides that banking institutions must comply with the minimum standards for common equity tier 1 capital, tier 1 capital, and total regulatory capital and that the authority to set the specific minimum capital standards may be delegated by the FSC to the FSS.

- Article 17 of the Detailed Regulation on Supervision of Banking Business specifies the numerical ratios to be complied with in respect of common equity tier 1, tier 1 capital, and the total regulatory capital.

The rulemaking process is similar for most regulations. In general, when a rule is newly written or amended, it is subject to a 40-day public comment period and an independent review. After the rulemaking agency decides on the final rule, the new rule is officially promulgated before it takes effect. (See figure 2.)

Figure 2.
General Rulemaking Process



C. FSS Financial Statistics

The FSS regularly releases extensive information on financial services firms, the financial services industry, and the capital markets through the Financial Statistical Information System (FISIS) at http://efisis.fss.or.kr. Information available on FISIS can be grouped into statistics for individual financial services firms and the Monthly Financial Statistics Bulletin.

C.1 STATISTICS FOR FINANCIAL SERVICES FIRMS

Information on individual financial services firms is culled from supervisory filings called Business Report that financial services firms are required to file periodically with the FSS. Information can be searched by each individual financial sector—i.e., banking, nonbanking, financial investment services, and insurance—or by each individual financial services firm. The Monthly Financial Statistics Bulletin is freely available on FISIS as an e-book in PDF.

Information available for financial services firms broadly covers the following four areas:

- General Information: Number of officers and employees, branches, and subsidiaries;
- Financial Statements: Summary financial statements, key funding and investment activities, and income and expenses;
- Soundness Indicators: Capital ratio, asset quality, ROA, ROE, and liquidity ratio; and
- Business Activities: Deposit and lending, insurance premium, securities trading and fees and commissions, and credit card purchases.

C.2 MONTHLY FINANCIAL STATISTICS BULLETIN

The FSS publishes the Monthly Financial Statistics Bulletin each month to cover wide-ranging financial industry and market statistics. The monthly bulletin covers the following four areas:

- Key Economic Indicators: Money supply, trade balances, foreign exchange reserves, interest rates, industrial activity indexes, stock indexes in major markets, and GDP;
- Financial Sector Comparison: Comparison of financial services providers (banks, securities companies, insurance companies, and others) by the number of companies, the number of employees, assets, capital, net income, deposits, and SBLs or loans classified as substandard or below;
- Financial Sector Statistics: Sector-by-sector financial conditions, income and expenses, key business indicators, and SBLs; and
- Capital Market Statistics: Funding activities, corporate bond issues, key KOSPI and KOSDAQ indexes, key derivatives indexes, and foreign investors' stock purchases.

D. FSS DART

DART—short for Data Analysis, Retrieval, and Transfer—is the online corporate disclosure filing system that the FSS operates to enable companies to electronically file documents and make other information disclosures. All DART filings are immediately made available to the public free of charge via the FSS DART Internet homepages at dart.fss.or.kr (Korean) and englishdart.fss.or.kr (English).

D.1 KEY DEVELOPMENTS

The development of DART began to take shape in early 1998. First launched in March 1999, DART became compulsory and replaced offline paper filings in January 2001; the English DART website opened in February 2007. DART continued to advance with the integration of XBRL-based reporting in 2007 and IFRS-based XBRL reporting in 2010. The FSS also started providing mobile DART service in 2012 and open API service in 2013.

D.2 FILINGS IN ENGLISH

Filings in English are not compulsory, but large publicly held companies often provide them on a voluntary basis for the benefit of their foreign shareholders and investors. Information available at the FSS English DART website include filings made to foreign exchanges by internationally active domestic companies, filings from the KRX (from the Stock Market Division and from the KOSDAQ Market Division), and corporate information provided by the Korea Listed Companies Association (KLCA) including company profile, major shareholder information, and financial information can also be accessed from DART.

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