

ASSOCIATION OF GLOBAL CUSTODIANS

Communication of the Association of Global Custodians Asia Focus Committee ¹

The Honourable Yoon Suk-heun
Governor, Korea Financial Supervisory Service,
38 Yeoui-Daero,
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Seoul 07321
Republic of Korea

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Dear Mr. Yoon,

1. Investment Registration Certificate (IRC) applications and documentation
2. Reconciliation by the FSS of IRC's positions

Member banks of the Association of Global Custodians (AGC) ² feel privileged to be able to provide custodial services to international investors through those of its member banks operating in the Republic of Korea. The majority of the 33.8% of total market capitalization owned by foreign investors in Korea at the end of January 2020 is under custody with these member banks.

Since the Korea stock and bond markets opened to foreign investment on 3 January 1992, foreign investment in the market has grown exponentially to date which has contributed considerably to capital expansion in Korea which has powered the economy: Korea is on track and predicted to become the 10th biggest economy in the world by 2027. This remarkable achievement has been underpinned by very efficiently operated and regulated stock and bond markets and by no small measure to the willingness of investors, their custodian banks, the FSS, the Bank of Korea (BoK) the KRX and the Korea Securities Depository (KSD) to always work with each other since 1992 to overcome challenges that arise in the market from time to time.

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² The Association of Global Custodians is an informal group of 12 financial institutions that provide securities safekeeping services and asset-servicing functions to primarily institutional cross-border investors worldwide. As a non-partisan advocacy organization, the Association represents members' common interests on regulatory and market structure matters through comment letters, white papers and interaction with legislative and regulatory authorities and financial industry organizations around the globe. The members of the Association of Global Custodians are: BNP Paribas; BNY Mellon; Brown Brothers Harriman & Co; Citibank, N.A.; Deutsche Bank; HSBC Securities Services; JP Morgan; Northern Trust; RBC Investor & Treasury Services; Skandinaviska Enskilda Banken; Standard Chartered Bank; and State Street Bank and Trust Company. For more information visit www.theagc.com

1. Investment Registration Certificate (IRC) applications and documentation:

Korea is a beneficial owner market which additionally requires every foreign investor (FI) to obtain an IRC before any broker in Korea can open an account for them. FI's are also required to have a custodial account to hold their assets in Korea. The vast majority of FI's are in account with our member banks providing custodial services in Korea, who also act as their Standing Proxy/Agent in applying for IRC's.

Until 1 June 2007 applications were undertaken and processed manually, but following significant, mutually beneficial cooperation and work between market participants and the FSS, the Financial Information Exchange System (FINES) introduced an automated process. With the introduction of electronic registration, the turnaround time for an IRC shortened from up to four days to up to just four hours for straight-forward applications, a significant time-saving for foreign investors.

The IRC application process is codified mainly in the Financial Investment Business Regulation, which delegates to the governor of the FSS, the technical rules applicable to IRC holders, including the application format and required supporting documentation. Technical rulings, therefore, are at the FSS' discretion. In regard to supporting documentation for legal entities, the requirements have been helpfully broad in nature: a certificate of incorporation or other similar documents issued by a foreign government agency or a regulatory authority stating the name of the entity, the date of its incorporation, the name of the issuing authority and the date of the issuance sufficing.

The types of entities applying for IRC's over the nearly 30 years since foreigners have been allowed to invest in Korean markets, have increased considerably, particularly types of common investment vehicles and non-government, corporate pension funds. The regulatory authorities that approve the registration of the many types of corporate investors within a country can vary considerably from country to country and accordingly incorporation documentation will vary considerably.

AGC member banks are all major international banks, incorporated in countries with very high regulatory requirements on a par with those enforced in the Republic of Korea. They have an obligation to undertake strict account opening due diligence, particularly in respect to incorporation detail, legal and beneficial ownership and would not perform standing agent duties for an IRC applicant in Korea for an existing account holder if they were not completely satisfied as to their standing.

However, notwithstanding the above, over the second half of last year and this year to date, member banks have experienced significant difficulties and delays hitherto not experienced in obtaining approval for all applications whether the application is straight-forward or not.

None of the regulations mentioned above can understandably stipulate all the technical rules that can cover so many different types of IRC applications. Ultimately for the more complex applications, as it has always been, it will come down to the judgment and discretion of the officer in charge.

Furthermore, classification of types of investors on the IRC application form to which documentation is required to match is proving a major new challenge. With regard to pension funds, Section "3", the selection of 'Pension Fund' business classification is permitted only for pension funds that are managed by state institutions. In such a case supplementary documentary evidence that the foreign investor is indeed a pension fund of a state-run institution is required. The form does not recognize regular corporate pension funds as a "Pension Fund" and applicants have to select "Fund/Foundation/Association" and "Collective Investment Vehicle (Contractual Type)" supported by registration documentation which in the majority of cases will not match this classification.

Significant delays in processing applications – up to fifteen days – are now unfortunately becoming the norm. This is a far cry from the very excellent turnaround time of four hours achieved in June 2007 following the introduction of FINES and even the four days under the old manual process. However, even when new guidelines are issued if they enforce the current approach to assessment, the unsatisfactory situation will prevail and become more hard-coded. This could have an adverse effect on investment in the market. Korea has been viewed by investors very much as a developed market and many of our member banks have advocated to MSCI that it most definitely should be classified as one. The current IRC application challenge, however, is a setback and we would like very much to get back to working as a partner with the FSS in ensuring access to the Korea markets for foreign investors in good standing does not become unnecessarily difficult and time-consuming.

2. Reconciliation by the FSS of IRC's positions:

Following approval of an IRC application, FINES automatically sends registration information to the Foreign Investment Management System (FIMS). FIMS monitors stocks that have an aggregate foreign ownership limit and also provides statistical data related to foreign investors' stake in listed stocks. In the required situation an IRC's holdings in a certain listed stock will always reconcile with FIMS's record, the record held by the investor, its Global Custodian and the Global Custodian's sub-custodian in Seoul. The sub-custodian's total holdings of a line of stock in its omnibus account with the KSD, must reconcile with the total holdings for that line of stock held in the individual IRC accounts every day.

However, there have been a number of cases where the FIMS record of holdings in a certain line of stock for a particular IRC holder, does not match the investor's record, even if the investor's record reconciles with that of the Global Custodian and the Global Custodian's record reconciles with that of its sub-custodian and the Sub-custodian with the KSD. These differences have resulted in the investors being unable to sell part or all their holdings in the

non-reconciled lines of stock and some currently face considerable losses at current prices from the prices that prevailed on the date of attempted sale.

In such cases member sub-custodian banks, on behalf of affected IRC holders, have submitted clear records of holdings and proof of reconciled positions with the investors, the Global Custodians and those sub-custodians to the FSS, but investigations have either not been undertaken, or if ongoing, are taking far too long.

As on-exchange trades are automatically updated to FIMS, it is likely that the FIMS records are not complete or in error due to either off-exchange trades having been reported in error, or data input for such trades has been incorrect.

This is a matter of grave concern. If the FSS is in practice adopting FIMS as the determinant system of proof of ownership before an IRC can sell a line of stock, then it is of utmost importance that daily reconciliation of FIMS takes place and all participants' positions are reconciled. However, FIMS does not determine legal ownership as market understanding is that FIMS is just a system run by the FSS for the purpose of monitoring foreign ownership limits. As matters stand this confusion and non-reconciled positions has been the case for some considerable time and quite understandably the affected IRC holders are considering their options.

Again this is a situation where our member banks are willing to cooperate and work closely with the relevant FSS section to resolve, but to date, as with the IRC application process involving the same section, this is proving very challenging. We feel sure that with goodwill and readiness to take action, these setbacks will be temporary and the excellent relationships that exist between the FSS, foreign investors, Global Custodians and sub-custodians will continue.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Robert Edwards', written over a horizontal line.

Robert Edwards, (as attorney in fact)
For and on behalf of Karin Quek,
Chairman, Asia Focus Committee,
The Association of Global Custodians

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