

CASE STUDY: SEOUL

Building a government lead financial hub

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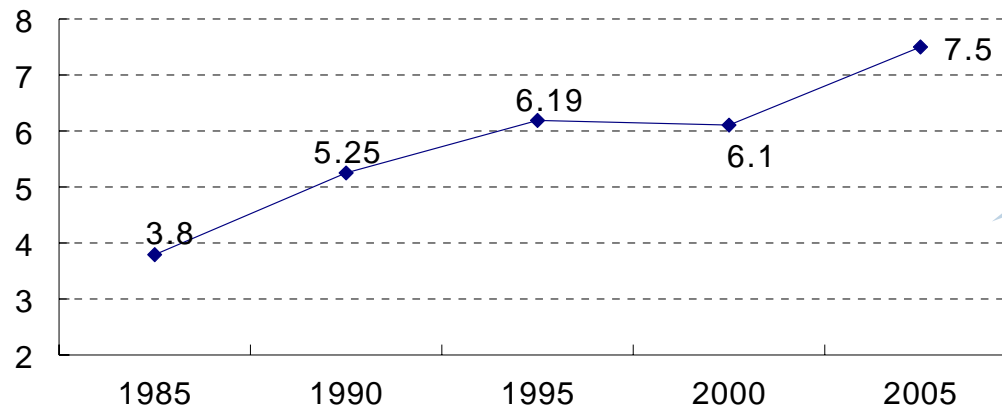
- Financial Market
- Strategy
- Implications

Financial market – Overall

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□ One of the fastest growing sectors

Financial Industry contribution to the GDP



On average, the Financial sector has grown 5.3% for the last 10 years (average GDP growth during the same period was 3.6%)

The size of financial market in Korea

(USD bn)

| | 2003 | 2004 | 2005 | 2006 |
|--|-------|-------|-------|-------|
| Market capitalization on stock market ¹ | 329.3 | 428.7 | 727.2 | 834.4 |
| Daily trade volume of foreign exchange market ² | 12.0 | 18.6 | 22.3 | 30.2 |
| Asset under management ³ | 121.1 | 179.2 | 203.4 | 252.6 |

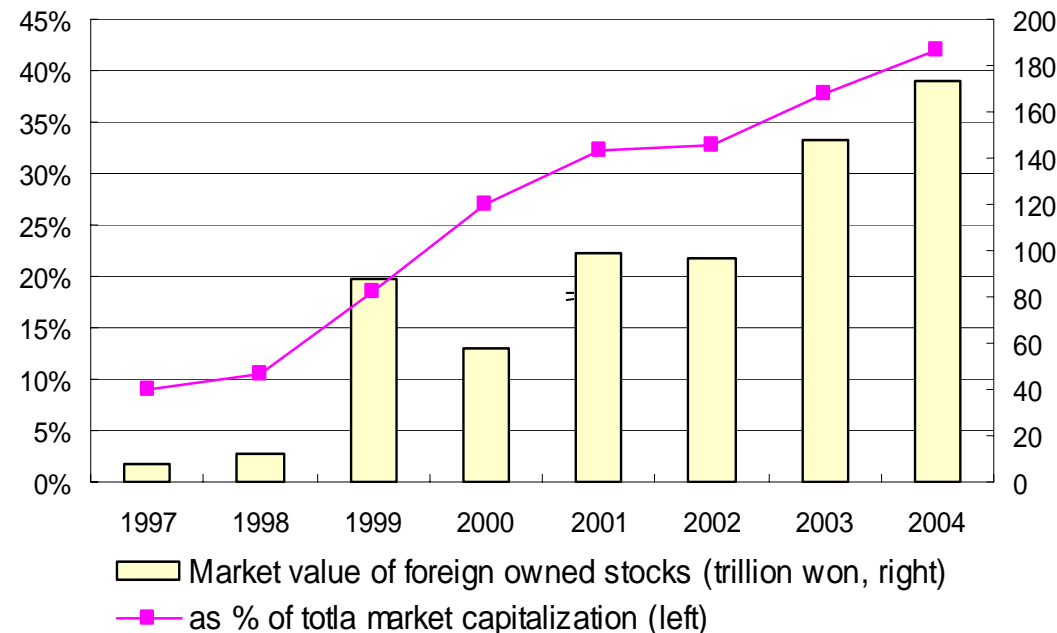
1. Figures refer to the total combined value of KOSPI & KOSDAQ
2. Includes conventional foreign exchange transaction (i.e. spot exchange, forward and future exchange, foreign currency swap) and foreign exchange derivatives transactions arising from currency or interest rates.
3. Figures represent both domestic and overseas funds

Financial Market – Overall

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Quick Globalization

- To overcome the East Asian Financial Crisis in 1997, the government implemented policies to attract foreign investment, thereby dramatically increasing foreign investor market share in the Korean financial market



Number of financial institutions in Korea (Dec 2006)

| | Banks | Securities Companies | Asset management Companies | Insurance | | Merchant banks | Total |
|----------|-------|----------------------|----------------------------|-----------|----------|----------------|-------|
| | | | | Life | Non-life | | |
| Domestic | 16 | 32 | 35 | 14 | 16 | 2 | 115 |
| Foreign | 38 | 22 | 14 | 8 | 13 | 0 | 95 |
| Total | 54 | 54 | 49 | 22 | 29 | 2 | 210 |

Financial market – *Equity*

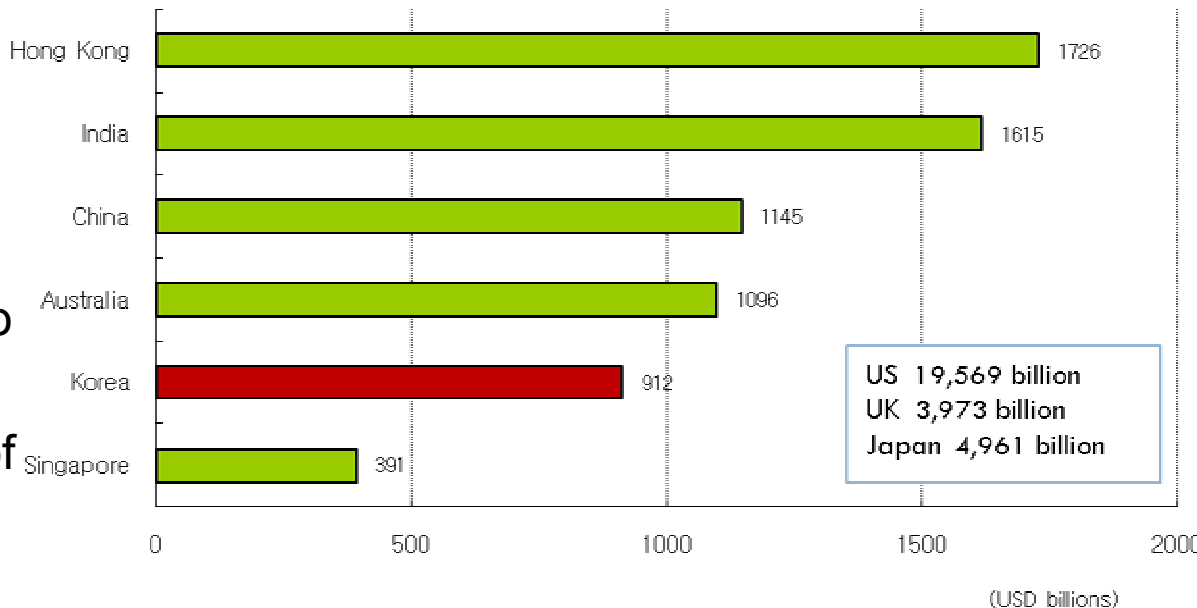
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- Korea's stock market is one of the largest in the region
 - ▣ In terms of market capitalization, the size of Korea's stock market is comparable to the that of Australia and China

- Korea's market has high growth potential

- ▣ Low PER(14.1) compare to Asian average of 16.5
- ▣ Relatively low market capitalization relative to GDP (87.3%)
- ▣ Portfolio Contribution of CIS on stock market is very low (only 20%)

Market Capitalization of regional Markets, 2006



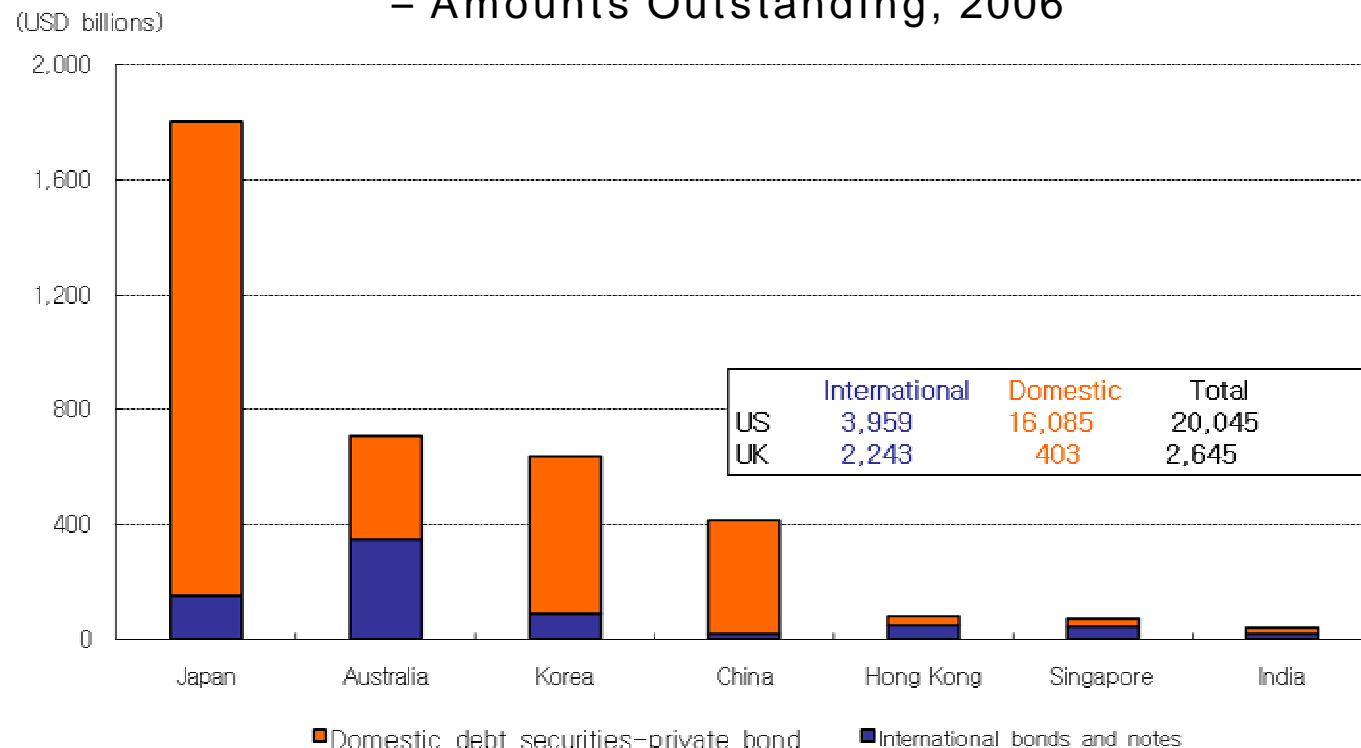
Data source: World Stock Exchange Federation

Financial market – *Fixed Income*

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- Korea's Bond Market is the third largest in the region
 - ▣ However, its size is only about one third of Japan's (Asia's largest)
 - ▣ Consists mostly of domestic bonds

International and Domestic Bonds
– Amounts Outstanding, 2006

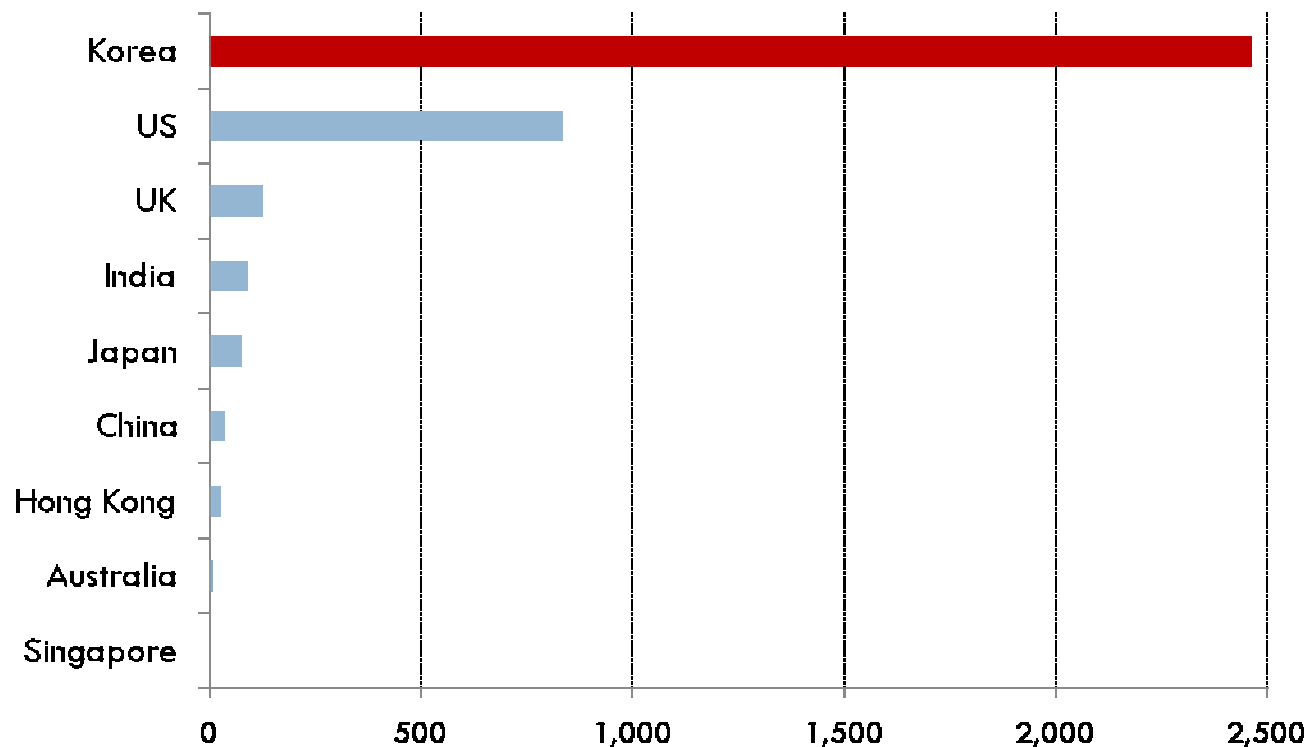


Financial market – *Derivatives*

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- Korea's stock index (KOSPI 200) options market is the world's biggest

Stock index derivatives (traded volume: millions of USD)

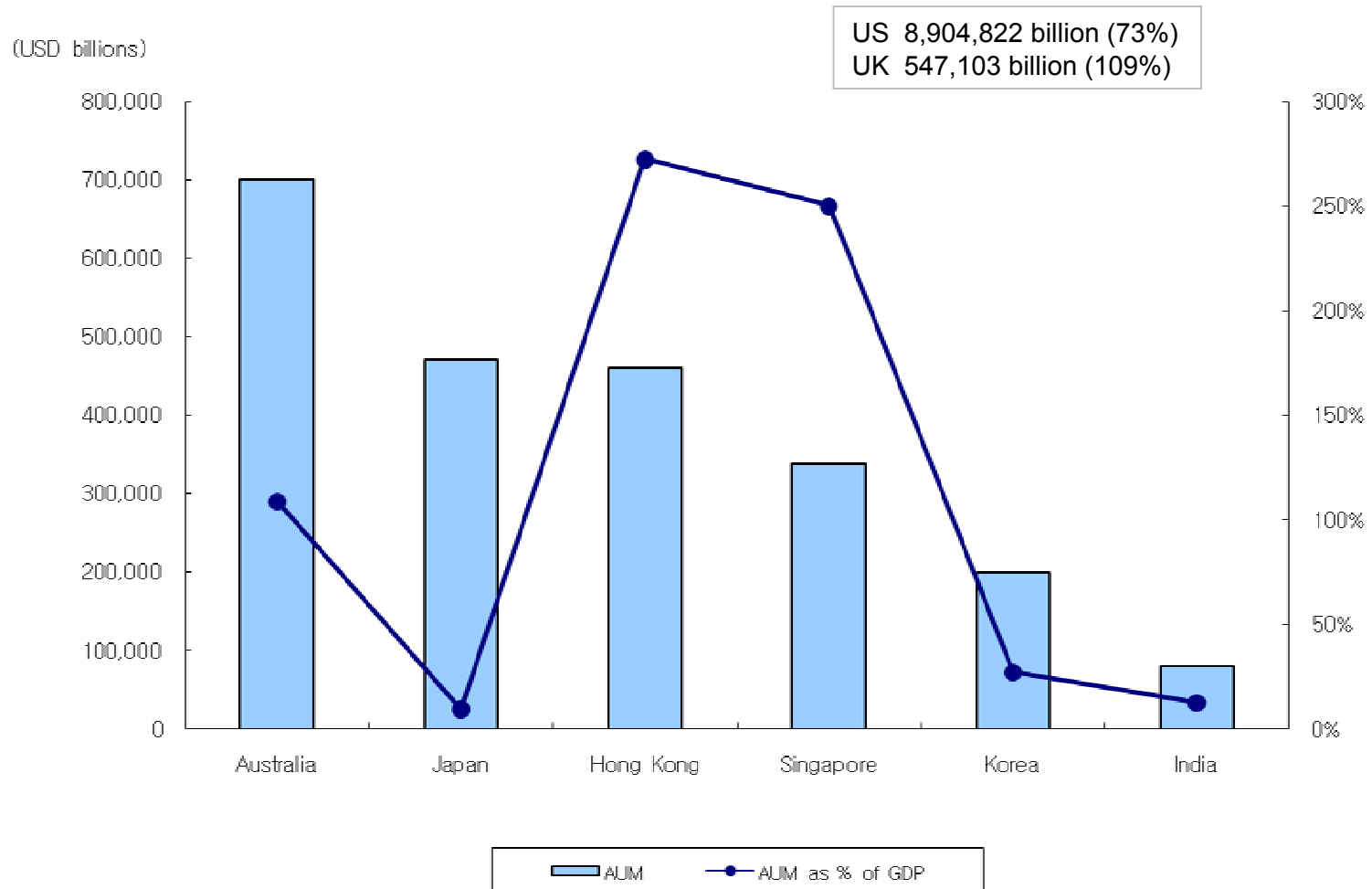


Data: World Federation of Exchanges

Financial Market – *Asset Management*

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- The size of the asset management market is the 5th largest in Asia



Financial Market – *summary*

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- The contribution of the financial market on GDP is significant.
- Growth of financial services sector accelerates.
- Korea has relative strength in the stock-index derivatives market.
- The asset management sector has great potential for growth.
- The equity market still has room for growth.

Government recognizes the strong potential in the financial market

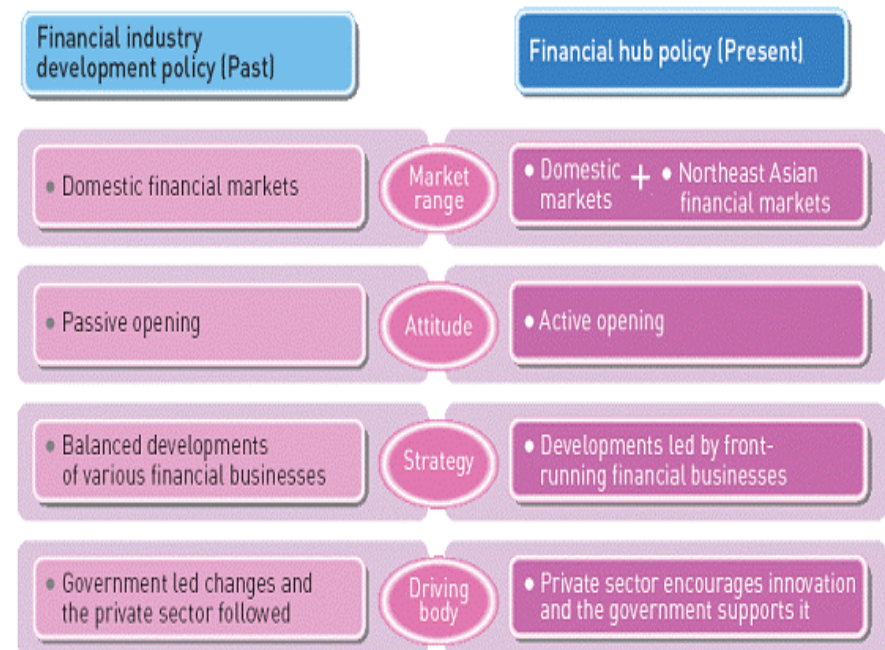
→ establish it as new engine for growth

Strategies – *Shifts in Government's Policy*

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- 1997 Shift in the Government's Priority
 - Financial Sector a low priority until the Asian Crisis
 - Reached a threshold to nurturing the manufacturing sector
 - The Asian Crisis demonstrated weakness of the financial system
 - Government shifts focus from manufacturing to reforming the financial system

- 2003 Paradigm Shift
 - Domestic → International Financial Hub
 - The government's goal since 1997 is to nurture financial markets
 - Realization that this requires foreign exposure and the growing internationalization of Korea's financial markets



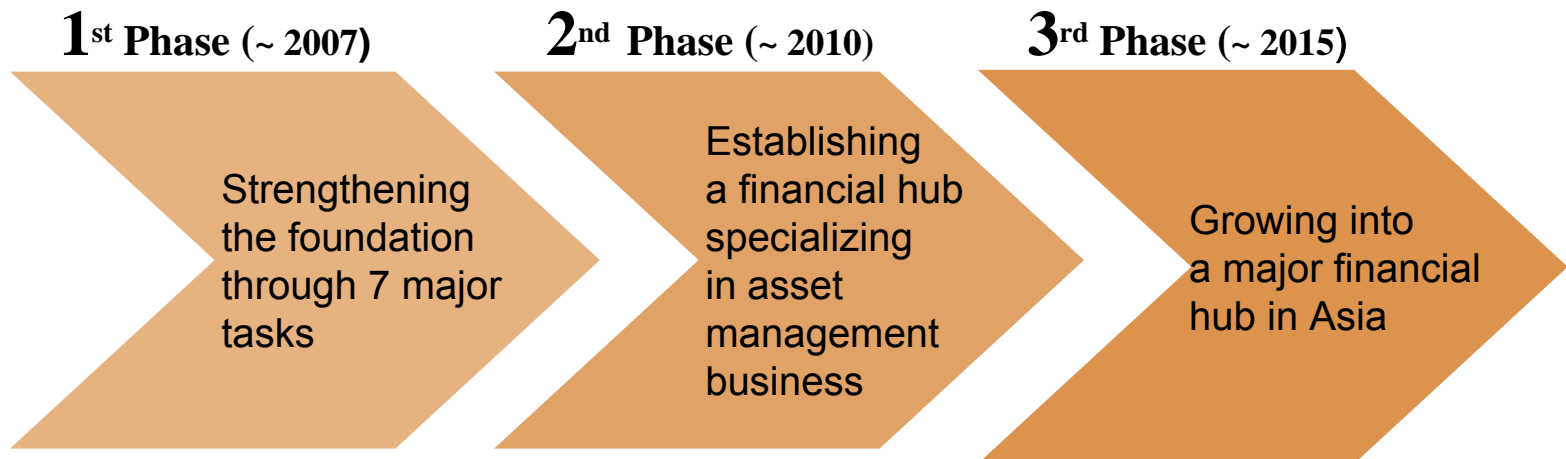
Strategies – Vision

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- Growing into a major financial hub in Asia
 - Korea set up its own financial project at the Presidential Committee on a Northeast Asian Business Hub in December, 2003.

Korea will eventually become a major financial hub in Asia by 2015 through three-stage strategies

3-stage 『Northeast Asian Financial Promotion Strategy』



Strategies – Tasks

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- Implementation of 7 tasks will establish the sound foundation for financial hub

Foster asset management business

Advance financial markets

Develop specialized financial services

Strengthen global financial network

Activate the Korean Investment Corporation

Innovate regulation and supervision system

Improve management and living conditions

Strategies – Achievements

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Foster asset management business

- Rise in the amount of assets to be managed
 - ✓ Employment Retirement Security Act (ERSA), effective as of December 2005, rise in corporate pension funds.
 - ✓ National Pension Funds– approved investment in stock (2005), expand outsourced management

Replaced existing Retirement Allowance System (Provides lump-sum termination indemnities)

World's 4th largest pension fund invests in equities only 11.2%

Will increase up to 30% by 2012

| | CaIPERS | CPPIB | ABP |
|----------------------------------|---------|-------|-------|
| Proportion on equity investments | 82% | 69.3% | 53.2% |

Strategies – *Achievements*

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- Permits for high risk/high return funds granted
 - ✓ PEF (lowered the minimum equity investment requirement)
 - ✓ Permission for investment in non-performing loans granted, decreased the mandatory investment ratio
- Foster a market for the management of household financial assets



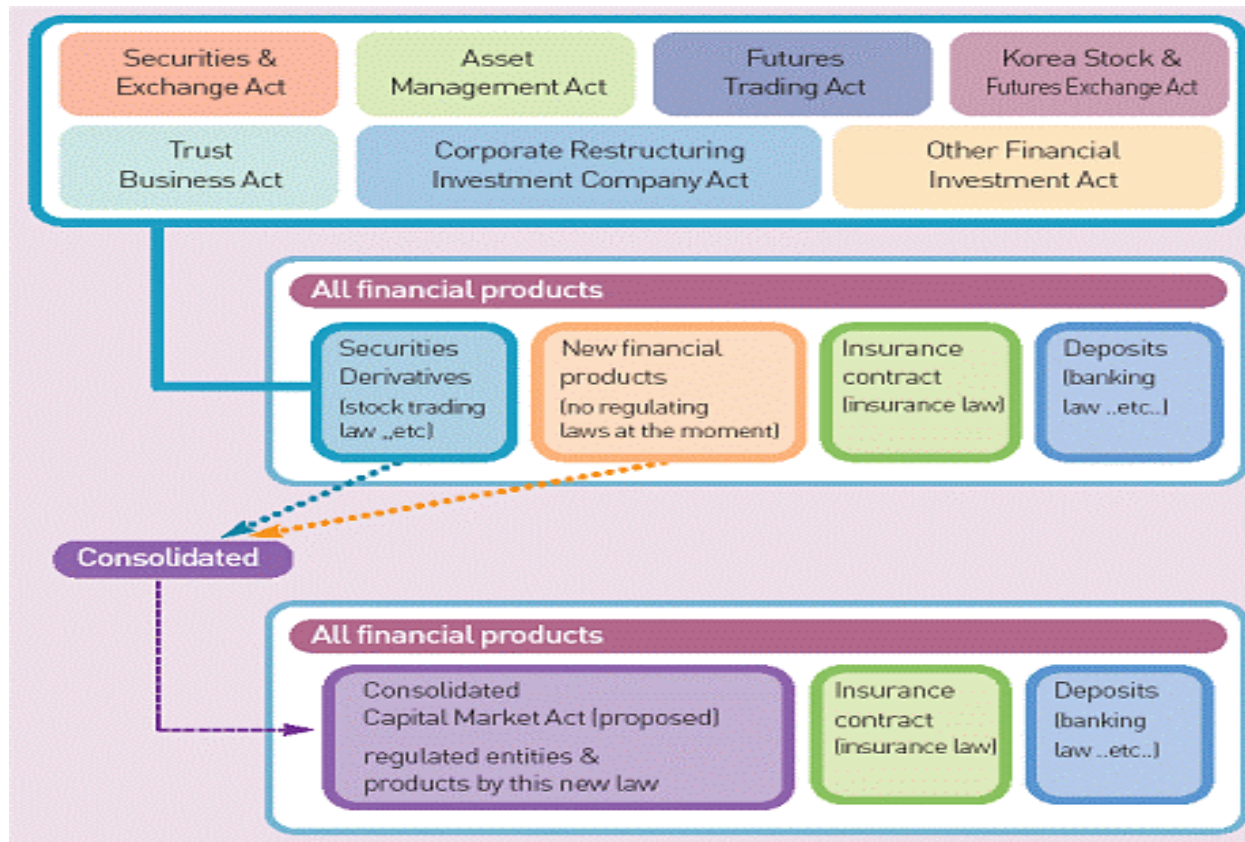
Rise in the AUM
145 trillion won in 2003
278 trillion won in 2007

Strategies – Achievements

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Advance Financial Markets

- Financial Investment Services and Capital Market Act (aka Capital Market Consolidation Act)



Strategies – *Achievements*

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- Bond Market Development
 - ✓ Separate Trading of Registered Interest and Principal of Securities (STRIPS)
 - ✓ Treasury Inflation-Protected Securities
 - ✓ Introduction of 20-yr Government Bonds
 - ✓ Issuance of foreign currency denominated corporate bonds by foreigners

- Liberalization of the foreign exchange market
 - ✓ From requiring authorization from the government for capital transactions to only requiring notification
 - ✓ Fully liberalize foreign real estate investment for residential purposes where previously it had a limit of USD 1 million
 - ✓ Korea Won futures and options were listed in CME

Strategies – Achievements

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Develop financial channels to enhance regional specialization

- Government sponsored banks will finance development projects
 - ✓ Korea Development Bank (KDB) – Cooperated on the Northeast Asia Development Financial Council (NADFC 2004) of regional financial firms such as the China Development Bank and Mizuho Bank to research and investigate development infrastructure needs
 - ✓ Export-Import Bank of Korea (EXIM) – Cooperated on the Northeast Asia Export Credit Agency Summit with the Export-Import bank of China and the Japan Bank for International Cooperation to jointly finance development projects in Northeast Asia.
 - ✓ KDB and EXIM also finance shipbuilding and other marine transport projects.

Strategies – *Achievements*

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Strengthen global financial network

- Launch 『fn Hub Korea』
A government sponsored organization that will support financial firms with difficulties they experience when doing business in Korea.
- 4 Banks, 1 Securities Firm, 2 Insurance Companies, and 5 Asset Management Companies opened branches or regional headquarters (Prudential) since 2004.

Strategies – Achievements

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Activate the Korea Investment Corporation

- Established in July 2005, this corporation manages Korea's foreign reserves.
- Made investment of 9 billion USD in 2006.



Korea Investment Corporation?

Korea Investment Corporation ("KIC") was established on July 1, 2005 under the Korea Investment Corporation Act. It was launched with a view to help stimulate the development of a stronger asset management industry in the country. KIC is mandated to manage part of Korea's foreign exchange reserves and other public funds by investing in a variety of financial assets in the international financial markets.

The Korean government expects KIC to attract foreign financial institutions to Korea, and accelerate the transfer of financial knowledge and global best practices to the local managers. In line with its mission, KIC will strive to contribute toward further developing the asset management industry in Korea.

Strategies – *Achievements*

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Innovate regulation and supervision system

- Zero based deregulation
 - ✓ Task Forces: Business operation, Corporate Finance, Consumer Protection and Finance Sanction
 - ✓ Through the first and second stage, 203 tasks identified, 154 reviewed, 52 deregulated
(e.g.) allowance of insurance companies' investment in PEFs
- Service oriented financial supervision system
 - ✓ Introduce No-action letter system
 - ✓ Disclose supervisory manual
 - ✓ Introduce Relationship manager
 - ✓ Launch taskforce for supporting foreign financial institutions

Strategies – *Achievements*

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Improve management and living conditions

- Establishment of more international schools
 - ✓ Local governments are actively engage in providing incentives for opening international schools
- Establish Graduate schools in Finance and related areas
 - ✓ KAIST opened Graduate school of finance in 2006
- Financial Skills Network Center (www.fnet.or.kr)
 - ✓ Database of financial experts
 - ✓ Creates network between financial institutions and universities/financial skills training centers
 - ✓ Perform regular survey of available financial skills
 - ✓ Publish financial skills demand/supply status report
 - ✓ Develop financial education system that meets needs of financial institutions

Implications

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- Improved regulatory environment
 - ▣ Consolidated Capital Market Act → taking the global standard in regulation system
 - ▣ Foreign Exchange Liberalization Act → ease with international financial transactions were improved
 - ▣ PEF's allowed → high risk/return strategies can boost the market
 - ▣ Zero-based Deregulation → continuously update regulations from the demand side
- But, there are still areas to be improved.
 - ▣ Inefficient practices in implementation, such as withholding licenses, need to be eliminated
 - ▣ Strengthen the role of SROs → set standards for implementation of regulation by self-regulating
 - ▣ Facilitate communication by publishing regulation in English

Implications

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- Asset Management Sector
 - ▣ Great potential for quick growth, led by expansion of outsourced management of public funds
 - ▣ Diversify invested asset classes
 - Hedge funds are not yet allowed → it is one of the fastest growing sectors of asset management and has reached 1.2 trillion USD in 2006 (about 10% is in Asia)
 - Currently PEF is allowed only for buyout funds
 - ▣ Focus on globalization of the sector
 - Less than 6% of AUM is invested in foreign funds
 - Most of AUM is domestically funded
 - 14 foreign asset management companies manage 16.9% of AUM

Implications

- Effective outward portfolio investment
 - ▣ More effective outward investment includes diversification. Government taking leadership in this with the KIC. Success will set an example and lead the market towards further globalization.
 - Expand to include other public funds
 - Lower restrictions to pursue effective portfolio management via investing in various asset classes
 - Enhance technology transfer in the asset management sector through on-the-job training and etc.
- Promote fair competition
 - ▣ Key to success in building a financial center is providing a basis for fair competition.
 - ▣ The fair competition standard has to be strictly enforced especially when outsourcing public funds.

Implications

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- Cohesive Leadership Team
 - ▣ MOFE, FSC, SMG, universities and leading financial institutions
 - ▣ Built from the top; possibly co-chaired by Minister of MOFE, mayor of SMG, FSC chairman, president of universities, chairmen of leading financial institutions
 - ▣ Supporting sub-committees focusing on specific areas
- Framework for growth in the financial sector intact
 - ▣ The government has created an environment that supports a financial center, especially in regulation changes
 - ▣ To fully mature, non-governmental institutions, private firms, society must follow the lead