

KEIO UNIVERSITY
MARKET QUALITY RESEARCH PROJECT
(A 21st Century Center of Excellence Project)

KUMQRP DISCUSSION PAPER SERIES

DP2006-001

Asian Bond Market and Cross-Border Securities Settlement
-Toward the Cooperation between Japan and Korea-

Hyun Suk *

Inukai Shigehito **

Abstract

The purpose of this paper is to review briefly the needs and the rationale of the Asian bond market and to investigate some practical impediments to fostering the Asian regional bond market from the legal and regulatory frameworks in Korea and Japan.

The cross-border securities settlement in the region is one of the essential elements to foster the Asian bond market through the linkages and cooperation of regional financial markets. To develop and foster the Asian bond market, legal and institutional impediments need to be cleared or each country's law and regulations need to be adjusted to international standards or "Asian Bond Standards".

This is the revised paper presented at NIRA-ADB Joint Forum on 27 March 2006. We are very grateful to Mr. Huh (Korea Securities Depository) for his helpful comments.

* A 21st Century Center of Excellence Project Postdoctoral Fellow , Keio University

** Senior Fellow, NIRA

Korean Perspectives on Fostering the Asian Bond Market

Hyun Suk, Keio University
Inukai Shigehito, NIRA

1. Introduction

The 1997 financial crisis in Asia greatly impressed upon us the needs for regional cooperation in capital transactions as well as in the trade of goods with Asian countries. Since the crisis, there have been many attempts for cooperative economic activities in the region; the Free Trade Agreement (FTA) and Economic Partnership Agreement (EPA) furthered the trade in goods and services and investment facilities. The Chiang Mai Initiative (CMI) prevents the recurrence of the currency crisis and provides liquidity through the bilateral swap agreement (BSA) between two countries and the Asian Bond Market Initiative (ABMI) promotes the Asian regional bond market to channel the highly accumulated savings in Asia into the investment opportunities in this region. The Executives' Meeting of East Asia Pacific Central Banks (EMEAP) is a forum of central banks and monetary authorities in the East Asia and Pacific region set up for strengthening cooperation among its members. EMEAP already established the Asian Bond Fund (ABF1, ABF2) to purchase the bonds issued in the region in order to promote the development of regional bond markets and to circulate the accumulated funds. However, the capital transactions in the region are not so active while the size of the trade of goods is very large and GDP growth is also brisk compared with that of the US and EU area

ASEAN+3 countries are currently endeavoring to develop and foster the Asian bond market in a way to utilize the funds accumulated. Since the crisis, local currency bond markets in each country have been steadily growing in size. However, the lack of investors and dealers makes the bond market fragmented and we are also facing difficulties such as different legal and institutional systems of each Asian country. Therefore, the infrastructure construction of cross-border securities settlement in the region is very meaningful and important in developing and fostering the Asian bond market through the linkages and cooperation of regional financial markets¹ because we can't get the trust from the international investors and can't develop the Asian bond market without the efficient and safe settlement system in the region.

The purpose of this paper is to review briefly the needs and the rationale of the Asian bond market and then to investigate comparatively some regulatory impediments to fostering the Asian regional bond market from the legal and regulatory frameworks in Japan and Korea. Lastly the feasibility of "Dual Core Approach" and the alternative way of cross-border securities settlement will be reviewed.

¹ Oh (2004) and Huh (2005) pointed out major reasons for a new international CSD in the region as 1) low coverage of Asia by the existing international CSD and 2) the third time zone problem

2. Rationales to Develop a Well-functioning Asian Bond Market

Economies that depend heavily on bank financing bear critical costs when facing the economic or financial crisis owing to the absence and under-development of the bond markets. As seen in the Japanese banking crisis and financial crisis, Asian countries, especially bank-dependent economies suffered from so-called “double mismatch” in currency and maturity that is to borrow the short-term money in foreign currency and to invest funds domestically for the long-term. Also there is a lack of information for the interest rates determined in the bond markets, which consequently impedes the development of derivatives markets. However, the diversification of the financial market by developing the regional bond market makes both savers and enterprises better-off. For example, savers can have more portfolio options to invest in well-functioning bond markets. As a result, more savings can be mobilized in the medium and long term to fund the investments and in that small & medium sized enterprises (SME) that rely on only bank loans also can easily access to the bond market if they can issue the Asian bond in the region.

By developing the Asian regional bond market we can have more opportunities to develop Asian financial institutions and financial markets. And Excessive dependence on US dollar can cause the exposure to sudden reversal of foreign capital flows and the currency crisis. It also has the possibility that we can face the loss from the weakening of dollar because Most Asian countries hold their foreign exchange reserve in the form of dollar. Therefore we need the regional infrastructure to circulate the regionally accumulated funds to get more opportunities to earn higher returns on the rapid economic growth in the region. There are enough needs to develop and foster well-functioning regional bond markets complementary to bank-centered markets and necessary infrastructures to minimize the market risk and to circulate and utilize the accumulated funds in the region.

2.1 Foreign Exchange Holdings in Asia after the Financial Crisis

In 2005, Japan held 579.8 billion US dollars in foreign currency reserves, the US held 264.7 billion dollars, Euro Area (including European Central Bank) held 117 billion dollars and Asian countries held 1301.4 billion dollars. The share of foreign exchange holdings in Asian countries has been increasing up to about 45% of the world’s total foreign exchange reserves in 2005.

In recent years, a high percentage of the US current account deficit has been supplemented by the investments into US government bonds and foreign exchanges holdings of Asian countries. The funds accumulated in Asia flow into the US and European countries and a large proportion of these funds return to Asia in the form of US investment or hedge funds. Additionally this intermediation of funds is largely handled by financial institutions and settlement systems outside the Asian region.

-- Figure 1)--

2.2 Hedge Funds in Asia

According to HedgeFund Intelligence, the amount of hedge funds in Asia has doubled to 114.57 billion dollars by December 2005 from 59.11 billion dollar in December 2004. The number of funds managed in Asia has also increased to about 700. One of these growing factors is that hedge funds are seeking profitability in Asian countries such as India, Japan, Hong Kong, and Korea that have been in a phase of recovery and growth. Asian countries hold about 45% of US currency as a foreign exchange reserve and most of these accumulated funds are used to purchase US treasury bills² and then return to Asia as hedge funds.

--Figure 2)--

--Figure 3)--

2.3 Hollowing-out of Financial Intermediation Functions in Asia

The issuances of international bonds in Euro bond markets by Asian companies are mostly handled by foreign financial institutions and settlement systems outside the region. American and European investment banks have a monopolistic position in international bond markets. (Table 1) There are only few Asian companies and Japanese financial institutions that deal with Samurai bonds in the international bond market. This situation might lead to a hollowing-out of financial intermediation functions in Asia.

--Table 1)--

Even in the Korea-related international bond business, there are only three Korean companies: Korea Development Bank, Deawoo Securities, and Woori Securities and Investment. The top five European and American companies occupy more than 50% of the market share. This low market share of Korean financial institutions is due to less development of domestic financial markets, low credibility of domestic securities companies, lack of risk management ability and networks overseas. Recently the financial market has been restructured to market-based system and demands of firms' direct financing have been increasing since the crisis, but the structure of the domestic financial market is so weak and the market also has been eroded severely by foreign capital.

--Table 2)--

² The current account deficit of the U.S. has increased sharply since 2000, reaching 666 billion dollars in 2004. More than half of the figure of over one trillion dollars in US government bonds held overseas is held in Japan, China and other East Asian nations. See details in Inukai (2005).

3. Legal and Regulatory Impediments to Building Asian Bond Market

3.1 Withholding Tax

A Korean resident is defined as an individual who has a domicile or has been residing in the country for at least 12 months. Both residents and non-residents do not pay capital gains tax on securities transactions however securities transaction tax is levied on the stock transactions not the bonds transactions. Tax rates are often reduced or completely exempted under applicable double taxation treaties, or agreements between Korea and the investors' countries.

	Withholding tax on interest income	Capital gains tax
Japan	No withholding tax for JGBs, if a number of requirements are satisfied	No capital gains tax
Korea	25% of income earned for all bond types	No capital gains tax

Source) AsianBondOnline, Asian Development Bank, Updated by the authors

--Figure 4)--

The participation of foreign investors in the Korean bond market is so low compared with that of other countries. One of the reasons for the low participation is withholding tax on the interest income of bond and cumbersome tax-reclaim procedures. In Korea, withholding tax on the interest income is levied on non-residents. So, the Korea bond market is not as attractive to foreign investors. Also the REPO market is under-developed so foreign investors can not hedge the risk of the volatility and face difficulties. The inactivity of REPO market is due to a short history of Korean REPO market and a wide scope of market participants. So most institutional investors prefer the call market to the REPO market. Therefore withholding tax should be relaxed or lifted in order to attract foreign investments and activate domestic bond markets as well as to develop the Asian bond market.

3.2 Regulations on Securities Issuance

Won-denominated bonds issued in Korea by non-residents are called "Arirang bonds" The Korean regulatory authority has been promoting this market by reducing the documentation burden in Korean language. But securities issued by non-residents in Korea are required to obtain the grading by local credit rating agencies.

Issuance of Local Bonds by Non-residents

	Japan	Korea
Bond issuance by non-residents	allowed	Allowed (prior to MOFE or permission from MOFE if necessary)
Local rating ³ / Local listing	Not required/Not required	Required/ Not required
Governing Law	Japanese law	Korean law
Documentation	Japanese	Korean
Time required to obtain approval	1-2 weeks	n.a.
Typical duration of issuance process	2-3 months	2 weeks

Source) Takeuchi (2005)

3.3 Capital Control

Non-resident investors in Korea need to obtain the “Investment Registration Certificate (IRC)” from the Financial Supervisory Service (FSS). Additionally, non-resident investors are not allowed to trade on the over-the-counter (OTC) market directly.

Credit and loans of more than 1,000 million Won a borrower denominated in local currency and granted by institutional investor require Bank of Korea approval. Furthermore, Won purchases by foreign investors must be associated with the securities transactions.

Capital Controls

	Local Currency		Foreign Currency	
	Outward	Inward	Outward	Inward
Japan	No restrictions		No restrictions	
Korea	No restrictions		Not to exceed amount imported and declared	Reporting Required

Source) AsianBondOnline, Asian Development Bank

3.4 Risks in Cross-border Links

Links may provide the provision of depository, credit, securities lending, custodian and settlement services, and the choice functions determine the design of the links, as do the structure of the central securities depository (CSD) and the legal framework applicable in each country jurisdiction. Links can also reduce costs to participants of meeting various collateral requirements, and reduce the number of intermediaries engaged in cross-border settlements. However, CSDs need to design links carefully to make sure that risks can be

³ There are three local credit rating agencies, Korea Investor Service (KIS), Korea Ratings, and National Information and Credit Evaluation).

reduced because linked CSDs are located under the different jurisdictions, they must address legal and operational complexities that are more challenging than those confronted in their domestic operations.

Clearing and Settlement of Bonds

	Japan	Korea
International Linkage	EuroClear (ICSD)	EuroClear, ClearStream ⁴ CMU (Hong Kong) JSSC (Japan) ⁵
RTGS/DVP	Yes	Yes
Settlement Cycle	T+3	T+1
Settlement Organization for Government Bonds	Bank of Japan-NET JGB Services owned by the Bank of Japan	Korea Securities Depository (KSD) operated by the Korea Stock Exchange (KRX)
Settlement Organization for Unlisted Corporate Bonds	Counterparties settle transactions at registrar banks using Japan Bond Settlement Network (JB Net). A book entry system will be set up in January 2006.	KSD operated by KRX.
Settlement Organization for Bonds Traded on a Stock Exchange (Government and Corporate)	Bank of Japan-NET JGB Services for listed JGBs; Delivery of physical certificates for listed corporate bonds.	KSD operated by KRX.

Source) AsianBondsOnline (<http://asianbondsonline.adb.org>), Updated by the authors

4. On the Feasibility of a “Dual Core Approach”

Regarding the issuing securities by the governing law of its own countries and selling securities overseas, for example Japanese firms issue securities based on the Japanese law and selling to Korean and Japanese, or Korean firms issue securities based on the Korean law and sell to Japanese and Korean investors, foreign investors’ transactions and deposits of securities have no problem except some matters with linkages with both countries’ central securities depositories (CSD).

First of all, issuing securities by Japanese law and selling to Korean investors have no problem. Under the current system, foreign currency-denominated securities held by

⁴ KSD opens accounts to deposit international bonds owned by Korean investors (one way linkage)

⁵ When Korean firms are listed on the stock exchange in both Korea and Japan, JSSC opens the consolidated accounts at KSD to deposit the listed stocks (one way linkage especially for depositing stocks)

Korean investors are deposited at EuroClear or other international CSDs that KSD has appointed. So, Japanese securities undertaken by Korean investors can be deposited at JASDEC.

However there are some problems in the regulations when the securities issued by Korean firms are sold to Japanese and Korean investors. Foreign investors who purchase Korean securities should observe the chapter two articles 7-5 and 7-19 of “Securities Business Supervision Regulation”. Therefore, Japanese investors should register at Korea FSS by themselves or standing proxy appointed by them. Foreign investors should open accounts at the authorized foreign exchange banks but omnibus accounts are not permitted for the sake of monitoring. So, the revision or abolition of the above regulations is needed for a “Dual Core Approach” to operate smoothly (JASDEC should register under its name or can be excluded from the above regulations)

And based on the 7-28 article of “Foreign Exchange Transaction Regulation”, those who sell the securities overseas can deposit at the international settlement organizations or foreign CSD. Therefore, the securities issued by Korean firms can be deposited at JASDEC. But the issuance should be reported to the Minister of MOFE and additionally Korean securities can not be cleared with Korean currency (Won) overseas because Korea Won is not an internationalized currency.

For a “Dual Core Approach” of International Asian CSD to settle the international Asian bonds smoothly as an international bond like Euro bonds, not as Samurai bonds or Arirang bonds, the regulations and institutional frameworks need to be revised or abolished. Whether international Asian bonds can be regarded as international bonds like Euro bonds is also linked to the problem that can be circulated overseas. To issue and circulate it overseas, the first way is to link each National CSD (NCSD) and deposit the securities undertaken. It requires each NCSD to deposit and circulate the issued securities.

For example, one Japanese firm tries to issue international Asian bonds in Hong Kong (or Singapore) and sell to Asian investors, Each Asian NCSD has to open an omnibus account with its own name, and then each investor can deposit his securities at CCASS (or DCSS)⁶. In this case, trading among domestic investors in each country doesn't affect the omnibus account at CCASS (or DCSS) in the name of relevant foreign CSD because they are traded among domestic investors.

For this mechanism to operate, first, the cooperation and linkages among Asian NCSDs are required. Second, each NCSD have to appoint International Asian bond as depositable securities. Third, the law of issuer country has to allow investors to open the consolidated accounts in the name of foreign CSD.

If the above mentioned conditions are satisfied and the trading at over-the-counter (OTC) market can be permitted, then it can be regarded as international Asian bond. However, linkages between NCSD for international Asian bond have some practical problems⁷;

⁶ CCASS stand for Central Clearing and Settlement System which is wholly owned by Hong Kong Exchanges (HKEx) and DCSS stands for Debt Securities Clearing and Settlement System operated by Stock Exchange of Singapore (SGX).

⁷ The bilateral linkage requires many accounts and it could only handle securities registered in both NCSDs . And Asian countries are facing different development stages of

complicated web-like linkages and strict regulation (for example, in Korea, investors have to be register their name with FSS and no securities transaction is allowed off-shore market). And second way is to establish a separate Asian CSD that can be settled, cleared and deposited in the region as already proposed in Korea (AsiaSettle, Oh et al (2004))

5. Summary

The cross-border securities settlement in the region is one of the essential elements to foster the Asian bond market through the linkages and cooperation of regional financial markets. To do so, legal and institutional impediments need to be cleared or each country's law and regulations need to be adjusted to international standards or "Asian Bond Standards" in order to foster the Asian bond market.

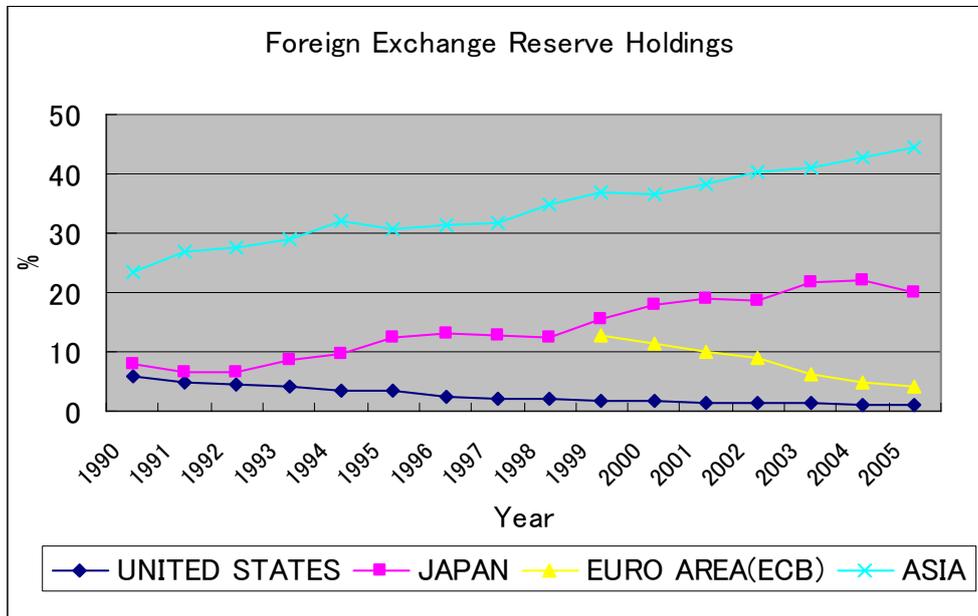
Under the current legal framework in Korea, when stock is issued overseas, it should follow the Korean Law, but the governing law of depository receipts of overseas securities is foreign country law. The problematic issue is that the overseas issuance of bonds depends on the law of the issuer country. The Korea securities-related law should be organized systematically in the near future to avoid excessive dependence upon English law and New York state law and to issue international Asian bond at the common off-shore markets in the region.

bond markets and different historical background, culture, and legal systems

Reference

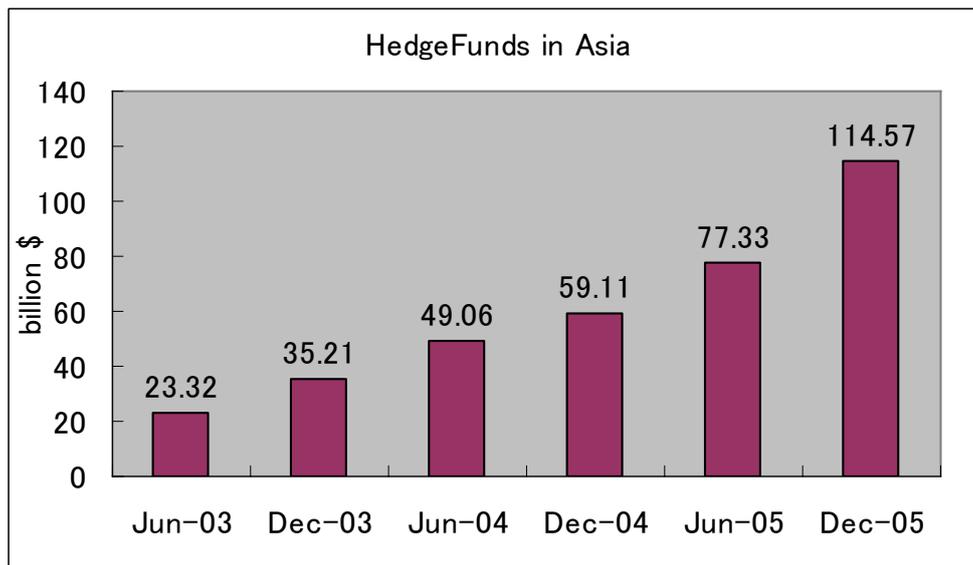
- Asian Development Bank, *Asian Economic Cooperation and Integration*, 2005
- Asian Development Bank, “Asian Bond Standards”
(http://asianbondsonline.adb.org/documents/Asian_Bonds_Standard_2005_May.pdf)
- Asian Development Bank, *Bond Market Settlement and Emerging Linkages in Selected ASEAN+3 Countries*, June 2005
- BIS, “Recommendations for Securities Settlement Systems,” November 2001
- Huh (2005), “Establishing and Operating a Regional ICSD (“AsiaSettle”) for Asian Bond Markets” Presented at NIRA seminar
- Inukai Shigehito (2005), “東アジア域内共通の金融資本市場構築への課題”
(中国北京市人民大会堂講演)
- Jeon, YongSuk (2005), “Perspectives and Main Businesses of Lead Manager Companies in Global Bond Issuance”, Korea Development Bank (in Korean)
- Oh, et al (2004), “Building a Settlement Infrastructure for the Asian Bond Markets:AsiaSettle”, KIF Financial Economics Series No. 2004-02
- Takeuchi Atsushi (2005), “Study of Impediments to Cross-border Bond Investment and Issuance in Asian Countries”, Asian Bonds Online Website
- Yoshida (2006), “Framework for Dual Core Asian International CSD” Presented at NIRA-ADB Joint Seminar, 27 March 2006.

Figure 1) Foreign Exchange Reserve Holdings



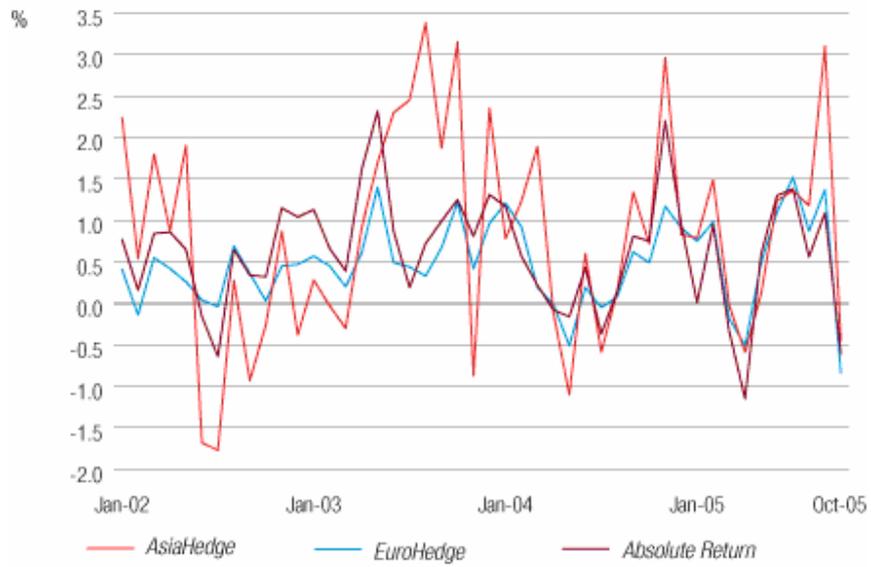
Source) IMF, International Financial Statistics (IFS) Online

Figure 2) Hedge Fund in Asia



Source) AsiaHedge

Figure 3) AsiaHedge/ EuroHedge Medians/ Absolute Return



Source) AsiaHedge

Table 1) Performance of Lead Manager Company in International Bond Markets
(As of Aug 2005)

Company	Rank	Share (%)	Amount	Fee (%)	Issue Number
Deutsche Bank AG	1	7.50	131,937	0.29	622
Citigroup	2	7.00	123,301	0.26	495
Barclays Capital	3	5.60	97,407	0.24	426
JP Morgan	4	5.60	97,366	0.33	435
HSBC	5	5.20	91,102	0.24	463
UBS	6	4.60	80,237	0.47	400
Morgan Stanley	7	4.20	73,159	0.30	233
BNP Paribas Group	8	4.10	71,995	0.23	303
Goldman Sachs & Co	9	4.00	69,891	0.21	174
Lehman Brothers	10	4.00	69,719	0.22	237
Credit Suisse First Boston	11	3.90	68,499	0.49	276
ABN AMRO Bank NV	12	3.40	59,421	0.29	289
Dresdner Kleinwort Wasserstein	13	3.30	57,055	0.23	316
Merrill Lynch & Co	14	3.20	55,339	0.24	243
Royal Bank of Scotland	15	2.60	45,288	0.39	224
Societe Generale	16	2.60	45,135	0.17	139
Hypovereinsbank	17	1.90	33,789	0.28	233
Nomura Holdings Inc	18	1.80	30,747	0.22	146
Bank of America	19	1.70	30,035	0.37	205
Landesbank Barden-Wuerttemberg	20	1.60	27,295	0.27	240

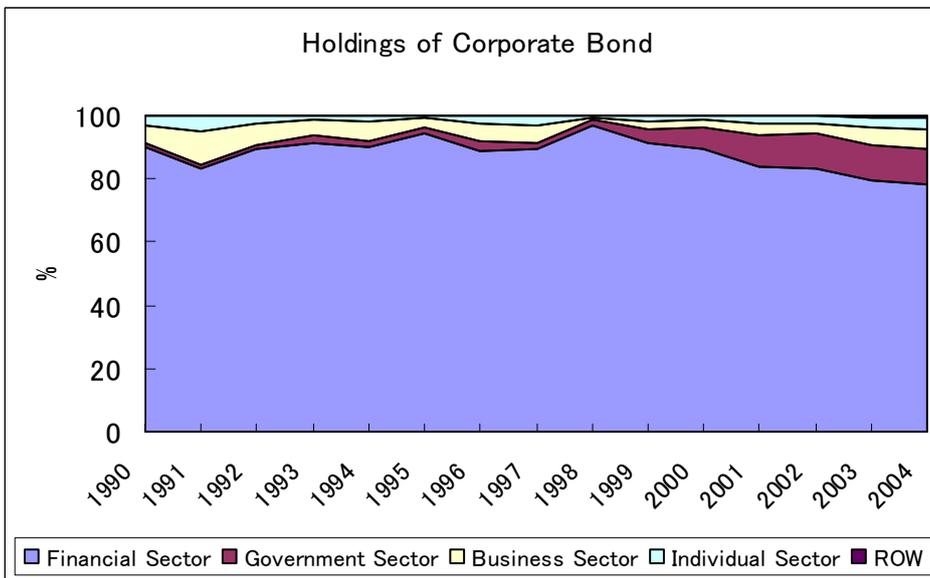
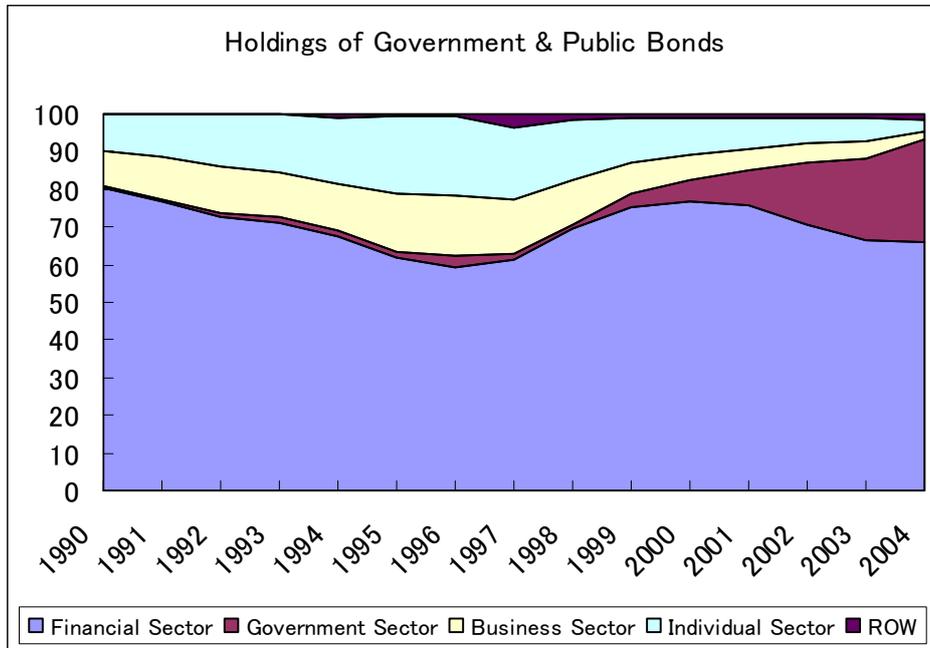
Source) Bloomberg, Jeon YongSuk (2005)

Table 2) Performance of Lead Manager Company in Korea-related International Bond Markets
(As of Aug, 2005)

Company	Rank	Share (%)	Amount	Fee (%)	Issue Number
JP Morgan	1	14.00	1,238	0.50	6
Citigroup	2	12.30	1,088	0.46	9
Barclays Capital	3	8.60	762	0.29	7
ABN AMRO Bank NV	4	8.40	743	0.16	6
UBS	5	7.20	642	0.99	5
BNP Paribas Group	6	6.60	580	0.60	11
Credit Suisse First Boston	7	5.50	483	0.15	3
Deutsche Bank AG	8	5.10	451	0.61	3
HSBC	9	3.90	348	0.28	6
Korea Development Bank	10	3.80	340	0.30	4
Daiwa Securities SMBC Co Ltd	11	3.70	326	0.30	5
Merrill Lynch & Co	12	3.70	325	1.38	4
Bank of America	13	3.20	282	n/a	6
Standard Chartered PLC	14	3.20	280	n/a	16
Mizuho	15	1.90	168	0.35	1
Nomura Holdings Inc	16	1.90	168	0.00	5
Lehman Brothers	17	1.70	150	n/a	1
Goldman Sachs & Co	18	1.10	100	n/a	1
Daewoo Securities Co Ltd	19	1.10	100	0.30	2
Woori Investment & Securities Co Ltd	20	1.00	92	0.30	1

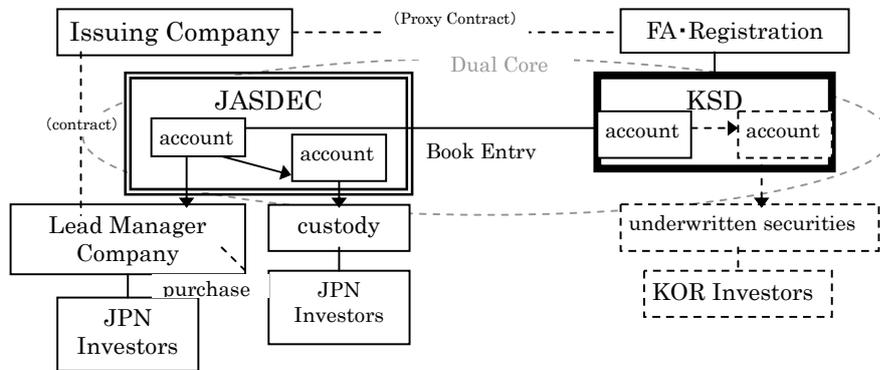
Source) Bloomberg, Jeon YongSuk (2005)

Figure 4) Holdings of Government Bonds & Corporate Bonds



Source) Bank of Korea, Flow of Funds Table

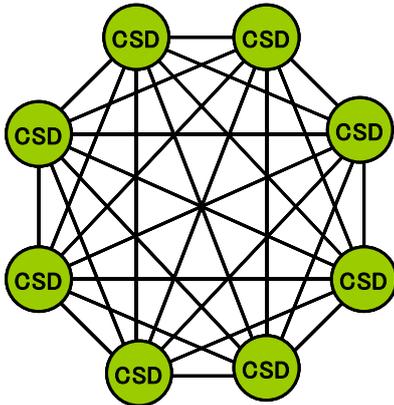
Figure 5) Japanese Firm Issuing Asian Bond



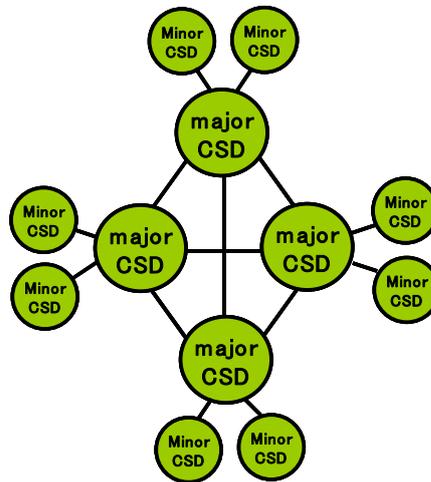
Source) Yoshida (2006)

Figure 6) Bilateral Linkages between NCSDs

(1) Eurolinks Real-Time Network
(Spaghetti Model)



(2) European Financial Superhighway
(Canneloni Model)



Source) Huh (2005)

Appendix I

INTERNATIONAL TAXES ADJUSTMENT ACT

CHAPTER VII INTERNATIONAL COOPERATION IN TAX AFFAIRS

Article 29 (Special Application of Withholding Tax Rate on Interest, Dividend and Royalty)

(1) With respect to the interest, dividend or royalty on intellectual properties, etc. from among the domestic source income by nonresidents or foreign corporations under a tax treaty, whichever lesser shall be applied between the limited tax rate under the tax treaty and the tax rate listed in any of the following subparagraphs:

1. Where the inhabitant's tax is not contained in the taxes subject to the tax treaty, the tax rate as provided in Article 156 (1) 3 of the Income Tax Act or Article 98 (1) 3 of the Corporate Tax Act; or
2. Where the inhabitant's tax is contained in the taxes subject to the tax treaty, the tax rate as provided in Article 156 (1) 3 of the Income Tax Act or Article 98 (1) 3 of the Corporate Tax Act, where to reflected the tax rate as provided in Article 176 (2) of the Local Tax Act.

(2) The tax authorities may, where the Contracting State requests the residents or domestic corporations to furnish the resident certificate with regard to an application of the reduced tax rate, issue the relevant certificate under the conditions as prescribed by the Presidential Decree.

Securities and Exchange Act

CHAPTER V SECURITIES BUSINESS

Article 28-2 (Securities Business by Foreign Securities Company)

(1) If a foreign securities company (this refers to a person engaged in the securities business in a foreign country pursuant to the relevant statutes of such country; hereinafter the same shall apply) intends to establish a branch office or any other business office in order to operate a securities business in the Republic of Korea, it shall obtain a license from the Financial Supervisory Commission by the type of business in accordance with the provisions of any subparagraph of Article 28 (2).

(2) The operating fund for the branch office or the business office under the provisions of paragraph (1) shall be not less than one billion won and according to the scope of its business shall exceed an amount prescribed by the Presidential Decree

(3) A foreign securities company that has not obtained a license for the establishment of branch office, etc. pursuant to paragraph (1) shall not conduct securities business with domestic residents.

(4) The branch office or any other business office licensed pursuant to paragraph (1) shall be regarded as a securities company organized under this Act except for the provisions of Article 28 (3).

(5) If a domestic branch office or other business office of a foreign securities company goes into liquidation or becomes bankrupt, its domestic holding assets shall be appropriated preferentially (for a performance of) to fulfill the obligations to persons who are the (counterparts to of securities transactions and have a domicile or residence in Korea at the time of the transaction. In this case, the scope of the domestic holding assets shall be determined by the Presidential Decree.

(6) If it is deemed inappropriate to perform the securities business because a domestic branch office or other business office of a foreign securities company violate(d)s this Act, an order or disposition made under this Act, or foreign statutes or subordinate statutes, the Financial Supervisory Commission may revoke the license, suspend the business, or take other necessary measures for the purpose of protecting the public interest or investors. The same shall apply in case it is deemed appropriate to perform securities business of a domestic branch office or other business office of the foreign securities company because the foreign securities company violates foreign statutes or subordinate statutes, etc.

(7) The Financial Supervisory Commission may set the conditions needed to obtain a license as referred to in paragraph (1).

(8) Necessary matters relating to the operation of a securities company by a foreign securities company shall be prescribed by the Presidential Decree.

Securities Business Supervision Regulation

Chapter 2.

Securities Trading by Foreigners

Article 7-5. Purpose

(1) The purpose of the provisions of this Chapter is to prescribe the matters necessary for the securities trading by foreigners pursuant to Article 203 of the Act and Article 87-2 of the Decree .

(2) The terms used in this Chapter shall have the same meanings given to them in the following :

1. The term "foreigner" refers to an individual who holds foreign nationality, having neither his address nor place of abode for more than six months in Korea, and a foreign corporation pursuant to Article 2 paragraph (16) of the Act.

2. The term "foreigner under national treatment" refers to any foreigner in the following. However, non-residents falling under Article 10 paragraph (2) subparagraphs 1, 2 and 6 of the Enforcement Decree of the Foreign Exchange Transaction Act shall be excluded :

a. Any person who works in domestic business office or other representative office or who engages in business activities in Korea; and

b. Any foreign corporation whose main office is located in Korea; or domestic branch, liaison office, sub branch or any form of office of a foreign corporation.

3. The term "direct investment" means that any foreigner owns stocks pursuant to Article 2 paragraph (1) subparagraph 4 item a of the Act on Promotion of Foreigners' Investment.

4. The term "stock investment" refers to the acquisition of any stock by the method other than the direct investment by foreigners.

5. The term "DR" refers to a receipt for the new stocks and treasury stocks of a domestic corporation held in Korea as underlying securities, which is issued by an overseas depository institution in a foreign country

6. The term "DR of trading stock" refers to a receipt for the stocks in trading issued by a domestic corporation held in Korea as underlying securities, which is issued by an overseas depository institution in a foreign country.

7. The term "overseas securities" refers to convertible bonds, bonds with warrant, exchangeable bonds, DRs, DRs of trading stock, and other documents or certificates similar thereto.

8. The term "financial institution" refers to any institution as prescribed in Article 38 of the Act on Establishment of Financial Supervisory Organizations.

9. "Investment group" means foreigners (limited to foreign juridical persons) who manage multiple investments for foreigners in accordance with statutes or contracts.

10. Other terms used herein this Chapter shall be governed by the stipulations of the Act, the Decree, and the Enforcement Rules.

Article 7-19. Exceptions to Application

(1) Article 7-6, Article 7-8, Article 7-10, Article 7-12 to Article 7-16 shall not apply to foreigners under national treatment.

(2) The provisions of the Act on Promotion of Foreigners' Investment shall apply to direct

investments, except those prescribed in this Chapter,

(3) Article 7-10, Article 7-12 and Article 7-15 shall not apply to the crises where a foreigner intends to acquire domestic currency bonds which are issued in Korea by a foreign corporation, and sold in overseas markets (including the case where domestic currency bonds sold in the domestic market are acquired for retirement by such foreign corporation).

(4) Article 7-8, Article 7-10, Article 7-12 and Article 7-15 shall not apply to the foreign exchange stabilization fund bonds in foreign currency issued in Korea by the Government.

Appendix II

1. Asian Bond Markets Initiative (ABMI)

Objective

The Asian Bond Markets Initiative aims to develop efficient and liquid bond markets in Asia, enabling better utilization of Asian savings for Asian investments. Activities of the ABMI focus on the following two areas: (1) facilitating access to the market through a wider variety of issuers and (2) enhancing market infrastructure to foster bond markets in Asia.

Background

Because of the underdevelopment of capital markets, Asian countries have depended on short-term foreign currency-denominated financing. This causes “maturity” and “currency” mismatches, making the region vulnerable to volatility in short-term capital movements. These risks were brought to the surface by the Asian financial crisis in 1997-98. Developing bond markets in the region is a very effective way to solve such problems and to significantly reduce “currency” and “maturity” mismatches in regional financing. At the ASEAN+3 Finance Ministers’ Meeting in August 2003 (Manila, the Philippines), finance ministers agreed to promote the Asian Bond Markets Initiative. Since then, ABMI Working Groups, which were established to address key issues in developing bond markets, have been actively promoting the ABMI.

Major Recent Progresses	
November 2002	The ASEAN+3 launched the Asian Bond Markets Initiative (ABMI)
May 2004.	Launch of the Asian Bonds Online Website (ABW)
June 2004	Provision of credit guarantees by JBIC for bond issued by an Asian multinational company in Thailand
December 2004	Issuance of cross-country primary collateralized bond obligations (CBOs) (named “Pan- Asia Bond”) by Korea and Japan
December 2004	Issuance of Ringgit-denominated bonds by the ADB and the IFC in Malaysia
May 2005	<p style="text-align: center;">ASEAN+3 Finance Ministers’ Meeting</p> (1) introduction of the ABMI Roadmap which proposes (i) a new framework to gather and share information in an integrated manner on bond market development, (ii) regular self-assessment by member countries on impediments in investment which are pointed out by market participants, and (iii) the launch of a study on Asian currency basket bond (2) commencement of a study of “Asian Bond Standards” to explore the development of international bond markets in Asia (3) embracing the voluntary “practical alternatives” for withholding tax treatment on bond holding

Source: Ministry of Finance, Regional Financial Cooperation among ASEAN+3

2. Executives' Meeting of East Asia Pacific (EMEAP) Central Banks

The Executives' Meeting of East Asia Pacific Central Banks (EMEAP) is a forum of central banks and monetary authorities in the East Asia and Pacific region set up for strengthening cooperation among its members. The eleven members of EMEAP include the Reserve Bank of Australia, People's Bank of China, Hong Kong Monetary Authority, Bank Indonesia, Bank of Japan, Bank of Korea, Bank Negara Malaysia, Reserve Bank of New Zealand, Bangko Sentral ng Pilipinas, Monetary Authority of Singapore, and Bank of Thailand. Three EMEAP working groups on payment and settlements system, financial markets, and banking supervision have been established.

The working group on financial markets studied the feasibility of establishing an Asian bond fund with the aim of (a) providing a catalyst, as a lead investor, for private investors to consider investment in Asian issues, particularly domestic currency bonds, and (b) to diversify investment of foreign currency denominated assets held at central banks and monetary authorities away from US and European securities into Asian bonds.

On 2 June 2003, the EMEAP announced the launch of the first Asian Bond Fund (ABF), which has an initial size of about USD1 billion. The ABF invests in a basket of US dollar denominated bonds issued by Asian sovereign and quasi-sovereign issuers in EMEAP economies (other than Japan, Australia, and New Zealand). The ABF is managed by the Bank for International Settlements in a passive style in accordance with a specific benchmark. An EMEAP Oversight Committee is to monitor the performance of the ABF.

EMEAP extended the ABF concept with the launching of the Asian Bond Fund 2 (ABF2) in December 2004. Implemented in April 2005, ABF2 invests in local currency bonds issued by sovereign and quasi-sovereign issuers in EMEAP economies (other than Japan, Australia, and New Zealand). It consists of two components, a Pan-Asian Bond Index Fund (PAIF) and a Fund of Bond Funds (FoBF). PAIF is a single bond fund index investing in sovereign and quasi-sovereign local currency bonds issued in eight EMEAP economies. FoBF is a two-tiered structure with a parent fund investing in eight Single-market Funds, each of which will invest in local currency sovereign and quasi-sovereign bonds issued in their respective markets.

PAIF and the eight Single-market Funds are passively managed by private fund managers against benchmark indexes called the [iBoxx ABF Index Family](#). PAIF, with an allocation of USD 1 billion, is managed by State Street Global Advisors. Another USD 1 billion is invested in the eight Single-market Funds investing in sovereign and quasi-sovereign local currency-denominated bonds in their respective markets. Management details of the eight market funds are shown in the table below.

Asian Bond Funds Manager

ABF2 Funds	Manager
ABF China Bond Index Fund	China Asset Management Corporation Limited
ABF Hong Kong Bond Index Fund	HSBC Investments (Hong Kong) Limited
ABF Indonesia Bond Index Fund	PT Bahana TCW Investment Management
ABF Korea Bond Index Fund	Samsung Investment Trust Management Company Limited
ABF Malaysia Bond Index Fund	AmInvestment Management Sdn. Bhd.
ABF Philippines Bond Index Fund	Bank of the Philippine Islands
ABF Singapore Bond Index Fund	DBS Asset Management Limited
ABF Thailand Bond Index Fund	Kasikorn Asset Management Company Limited
ABF Pan-Asia Bond Index Fund	State Street Global Advisors Singapore Limited

Source) AsianBondsOnline, <http://asianbondsonline.adb.org>

Asian Bond Indicator

Index Profile for 24 Apr 2006 (31 Dec 2004 = 100)

Market	Total Return Index			Market Value (LCY millions)	Annual Modified Duration	Annual Yield (percent)	LCY Index Return	
	LCY	Hedged	Unhedged				Daily Return	Month-to-date Return
CN	113.30	119.24	116.98	2,140,480	4.51	2.99	-0.00081	-0.00328
HK	98.26	98.89	98.53	61,764	3.36	4.74	0.00099	-0.00066
ID	110.05	107.17	116.10	206,833,986	3.64	11.97	0.00211	0.02683
KR	101.73	101.24	112.07	257,186,455	3.12	5.20	0.00114	0.00468
MY	105.75	106.85	110.10	149,291	4.07	4.24	-0.00037	-0.00815
P-A hedged	NA	105.05	NA	NA	3.95	4.94	0.00130	0.00444
P-A unhedged	NA	NA	109.39	NA	3.95	4.95	0.00534	0.01976
PH	140.17	134.43	152.52	633,763	3.92	7.42	0.00445	0.03349
SG	99.43	100.93	102.03	57,100	4.84	3.42	0.00199	0.00854
TH	100.90	99.65	104.33	1,061,277	4.56	5.78	0.00220	-0.00331

Index is rebalanced monthly.

Source: International Index Company Limited, <http://www.indexco.com>

3. Chiang Mai Initiative (CMI)

Objective

The Chiang Mai Initiative aims to create a network of bilateral swap arrangements (BSAs) among ASEAN+3 countries to address short-term liquidity difficulties in the region and to supplement the existing international financial arrangements.

Background

After the Asian financial crisis, East Asian countries shared the need to promote regional financial cooperation. At the ASEAN+3 Summit in November 1999, ASEAN+3 leaders agreed to enhance “self-help and support mechanisms in East Asia” through the ASEAN+3 framework. At the ASEAN+3 Finance Ministers’ Meeting in May 2000, finance ministers agreed to promote the Chiang Mai Initiative to establish a regional financial arrangement to supplement the existing international facilities.

Brief Chronology	
1997-1998	Asian financial crisis
November. 1999	ASEAN+3 Summit (Manila, the Philippines) – Leaders agreed to enhance “self-help and support mechanisms in East Asia.”
May. 2000	ASEAN+3 Finance Ministers’ Meeting (Chiang Mai, Thailand) – Finance Ministers agreed to promote the Chiang Mai Initiative.
May. 2004	ASEAN+3 Finance Ministers’ Meeting (Jeju, Korea) – Finance Ministers agreed to undertake further review of the CMI to explore ways of enhancing its effectiveness.

Japan’s Bilateral Swap Arrangements under the Chiang Mai Initiative (CMI)

Japan has concluded the Bilateral Swap Arrangements (BSAs) under the Chiang Mai Initiative (CMI) with the following countries:

(1) Korea

- Japan and Korea concluded a one-way BSA between US dollar and won up to US\$ 2 billion on July 4, 2001. Following the ASEAN+3 Finance Ministers agreement in May 2005 to enhance the CMI’s effectiveness (CMI Second Stage), Japan and Korea replaced the existing BSA with a new two-way BSA (a) between US dollar and Korean won up to US\$ 10 billion from Japan to Korea and (b) between US dollar and yen up to US\$ 5 billion from Korea to Japan, on February 24, 2006. In addition Japan and Korea concluded two-way BSA between yen and won up to the equivalent amount of US\$ 3 billion on May 27, 2005.

(2) Thailand

- Japan and Thailand concluded a one-way BSA between US dollar and baht up to US\$ 3 billion on July 30, 2001. Further to its expiry, Japan and Thailand concluded a new two-way BSA between (a) US dollar and baht and (b) US dollar and yen, up to US\$3 billion.

(3) The Philippines

- Japan and the Philippines concluded a one-way BSA between US dollar and peso up to US\$ 3 billion on August 27, 2001.

(4) Malaysia

- Japan and Malaysia concluded a one-way BSA between US dollar and ringgit up to US\$ 1 billion on October 5, 2001. (In addition, with Malaysia, Japan has a one-way BSA between US dollar and ringgit up to US\$ 2.5 billion under the New Miyazawa Initiative.)

(5) China

- Japan and China concluded a two-way BSA between yen and renminbi up to the equivalent amount of US\$ 3 billion on March 28, 2002.

(6) Indonesia

- Japan and Indonesia concluded a one-way BSA between US dollar and rupiah up to US\$ 3 billion on February 17, 2003. Following the ASEAN+3 Finance Ministers agreement in May 2005 to enhance the CMI's effectiveness (CMI Second Stage), Japan and Indonesia replaced the existing BSA with a new one-way BSA between US dollar-rupiah up to US\$ 6 billion on August 31, 2005.

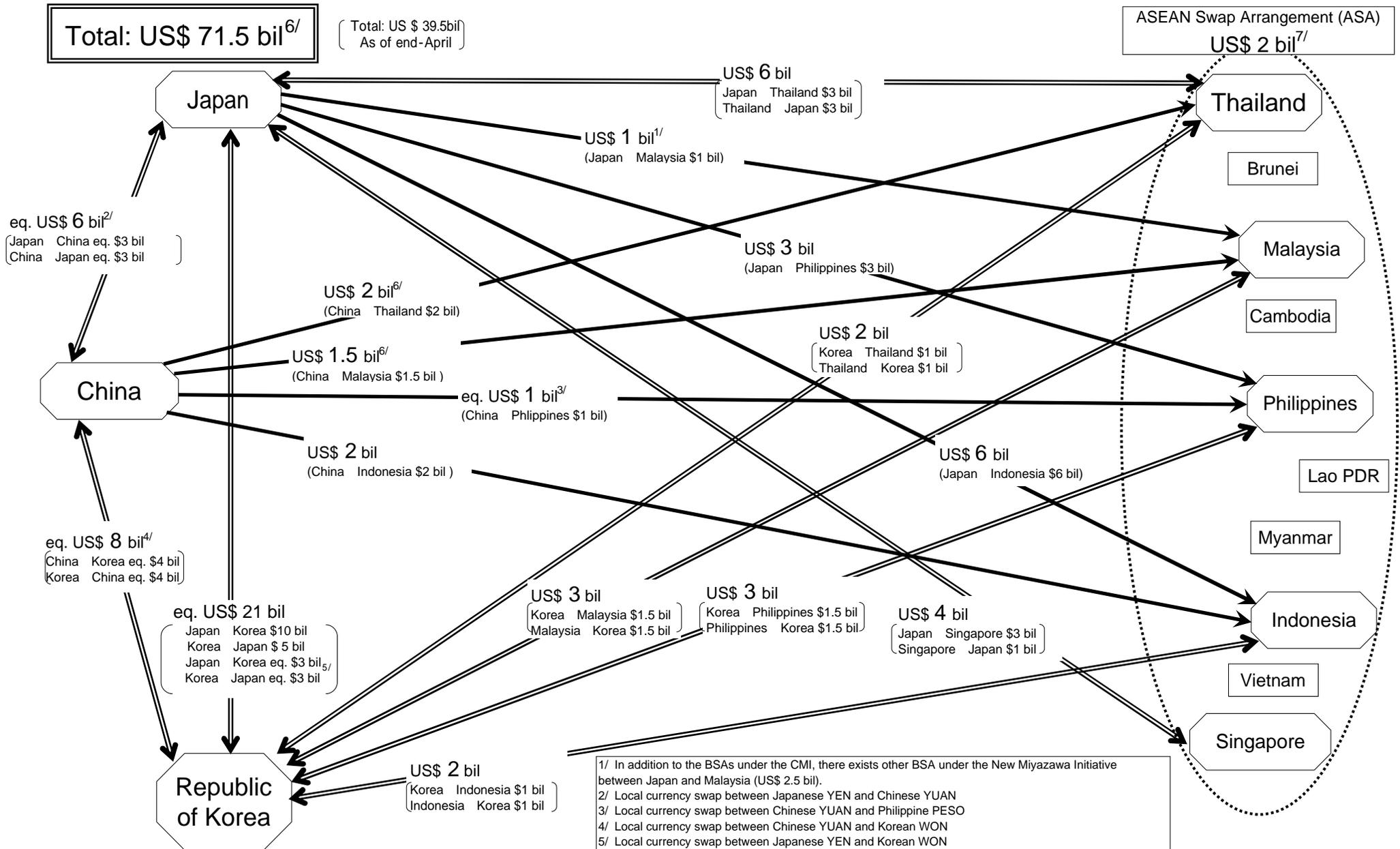
(7) Singapore

- Japan and Singapore concluded a one-way BSA between US dollar and Singapore dollar up to US\$ 1 billion on November 10, 2003. Following the ASEAN+3 Finance Ministers agreement in May 2005 to enhance the CMI's effectiveness (CMI Second Stage), Japan and Singapore replaced the existing BSA with a new two-way BSA (a) between US dollar and Singapore dollar up to US\$ 3 billion from Japan to Singapore and (b) between US dollar and yen up to US\$ 1 billion from Singapore to Japan, on November 8, 2005.

Source: Ministry of Finance, Regional Financial Cooperation among ASEAN+3

Network of Bilateral Swap Arrangements (BSAs) under the Chiang Mai Initiative (CMI)

Ministry of Finance, Japan
As of February 24, 2006



1/ In addition to the BSAs under the CMI, there exists other BSA under the New Miyazawa Initiative between Japan and Malaysia (US\$ 2.5 bil).
 2/ Local currency swap between Japanese YEN and Chinese YUAN
 3/ Local currency swap between Chinese YUAN and Philippine PESO
 4/ Local currency swap between Chinese YUAN and Korean WON
 5/ Local currency swap between Japanese YEN and Korean WON
 6/ The sum of US\$ 71.5bil includes the BSAs between (a) China and Thailand and (b) China and Malaysia, those of which are currently under negotiation for renewal, but does not include the BSA under New Miyazawa Initiative and the ASEAN Swap Arrangement (ASA).
 7/ It had been agreed in April 2005 that the ASA was expanded to US\$ 2 billion.