X

Recent Developments and Future Direction

A. Recent Major Developments

Recent major developments are considered those that occurred in the Korean bond market since the publication of the *ASEAN+3 Bond Market Guide Republic of Korea* in May 2018. For easy reference, the developments are reflected in reverse chronological order.

1. Introduction of 30-Year Korea Treasury Bond Futures (2024) [New]

In October 2022, the MOEF announced that it was working with Korea Exchange and market participants toward the introduction of 30-year KTB futures, likely in 2024. At the time of the announcement, the longest-dated hedging instruments traded on KRX were 10-year KTB futures introduced in February 2008.

The planned introduction was in response to a shift toward longer-tenored government bonds being in demand, particularly from insurance companies. In fact, the MOEF stated that 30-year KTB issuance had increased from KRW20.1 trillion to KRW47.8 trillion over the 5-year period to 2021, with KTBs representing 26.5% of total issuance for 2021.[40]

Trading of 30-year KTB futures contracts commenced on 19 February 2024. During the listing ceremony, the MOEF reiterated its commitment to maintaining liquidity in the underlying long-tenored government bonds, including through off-the-run and on-the-run issuance.[41]

2. Introduction of Indirect Market Access for Foreign Investors via an International Central Securities Depository Omnibus Account for Korea Treasury Bond Holdings (2024) [New]

The package of measures to make the Korean capital market more attractive to foreign investors, announced by the MOEF, contained the proposal to make available to foreign investors the option to obtain indirect market access to the Korean bond market through an omnibus account for KTB investments maintained by eligible ICSDs. To make such a proposal feasible, the set of measures also contained the exemption of foreign investors from withholding tax on sovereign debt securities (see subsection 7 in this section).

This account option will require the use of an intermediary who can give foreign investors access to the Korean market and maintain such omnibus accounts on behalf of the investors. Such an intermediary would need to be recognized as a tax processing entity (or QFI) by the NTS and fulfill certain reporting requirements (see also Chapter VI.H).

[40] As reported by *Yonhap News Agency*. 2022. S. Korea Seeks to List 30-Year Treasury Futures by 2024. 18 October. https://en.yna.co.kr/view/AEN20221018009800320.

[41] The full MOEF press release on the date of initial listing can be found at https://english.moef.go.kr/pc/selectTbPressCenterDtl.do?boardCd=N0001&seq=5781.

As far back as a 2016 press release, the FSC had acknowledged the challenges stemming from the need for domestic custodians and brokers to maintain segregated accounts for each foreign investor.[42] A subsequent trial of an omnibus account for equities investments in 2017 was not taken up by the market due to the heavy burden of reporting rules, according to an FSC press release on 13 December 2023. However, with the IRC system recently abolished, the market can make another attempt to establish an account structure considered best practice in many other capital markets.

The new account option would allow foreign investors to access Korean sovereign bonds without entering into a proxy agreement with a custodian in the Korean market and needing to maintain securities and cash accounts in the domestic market. In effect, the omnibus account of ICSDs becomes an indirect market entry option for foreign investors.

The first parties to avail themselves of the new omnibus account option were ICSDs Clearstream and Euroclear. Both parties signed memoranda of understanding with KSD at the end of 2022 and have since been working out contractual and operational details. KSD will maintain the intermediaries' omnibus account in addition to segregated accounts. The service is expected to be available from the first half of 2024 and the FSS was in the progress of determining the form and contents of transaction reporting by ICSDs.

Since this option is applicable only to foreign investors, a comprehensive description of the new account option, related process(es), as well as procedural challenges can be found in Chapter II.M.

3. Mandatory English Disclosure (2024) [New]

In April 2023, the FSC announced the introduction of mandatory disclosure of material information in the English language for issuers that are stock-listed on KRX, as part of its efforts to make the Korean capital market more attractive for nonresident investors.[43]

The FSC, together with the FSS and KRX as executing agencies of this policy measure, are pursuing a phased approach, starting with large, listed companies from 2024 and expanding the requirement to all remaining listed companies from 2026. In a first for the bond market, issuers stock-listed on KRX with bonds outstanding (regardless of the market of issuance) will have to include company information in English in any disclosure related to these bonds. The disclosure obligations continue to follow the existing prescriptions in the FSCMA as well as the disclosure rules issued by KRX.

Details of the disclosure provisions and the proposed timetable can be found in Chapter II.G.

4. Liberalization of the Onshore Foreign Exchange Market (2023) [New]

The MOEF, together with the BOK, announced in February 2023 that the trading hours of the onshore interbank FX market will be significantly extended. Consequently, the onshore interbank foreign exchange market has been operating from 9 a.m. to 2 a.m. the following day, effective 4 October 2023, instead of closing at 3:30 p.m., which had been in line with KRX trading hours. The new trading hours effectively align with the closing of the London interbank market and will also allow the inclusion of transactions executed after 3:30 p.m. in market benchmark rates.

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[42] For details on the FSC's review of the challenges for the Republic of Korea's market at the time, please refer to the 2016 press release at https://www.fsc.go.kr/eng/pr010101/22123.

[43] Information in this update note in part based on an FSC press release, which is available at https://www.fsc.go.kr/eng/pr010101/79726?srchCtgry=&curPage=&srchKey=sj&srchText=&srchBeginDt=2023-04-01&srchEndDt=2023-04-30.

The policy measure by the MOEF was part of the larger strategy to improve the attractiveness of the Korean capital market (see also other sections in this chapter) and followed much industry feedback on the challenges stemming from an early closing time for investors and intermediaries situated in other time zones. These challenges included market access generally as well as incurring trading premiums in after-hours trading.[44]

More information on these liberalization measures can be found in Chapter II.M. Please also see the proposed future changes to FX market participation, as detailed in section B of this chapter.

5. Replacement of Investor Registration Certificate with Legal Entity Identifier (2023) [New]

On 25 January 2023, the FSC announced that the IRC, the investor access concept for the Korean capital market, would be abolished. The announcement represented a key cornerstone of the government's efforts to further open and liberalize the Korean capital market, and came in response to much investor and industry feedback in recent years. At the same time, the IRC's abolition is part of a set of measures to make the capital market more attractive to foreign investors (see also other topics in this section).

Foreign institutional investors wishing to access the Korean market for the first time no longer require approval from the FSS but would need to provide to intermediaries in the Korean market their LEI to serve as investor identification, in addition to market-typical account opening documentation; an individual investor would use her or his passport details accordingly. The use of LEI is practical since most institutional investors are increasingly required to provide their LEI as counterparty identification when participating in major financial markets or market segments globally.[45]

The policy change was approved at a cabinet meeting on 5 June 2023 and took effect on 14 December 2023. A detailed review of this development and its implications can be found in Chapter II.K and Chapter II.M.

6. Exemption of Foreign Institutional Investors from Withholding Tax (2023) [New]

As part of its policy measures to make the Korean market more accessible and attractive for foreign investors, the Government of the Republic of Korea announced in December 2022 that foreign investors would be exempted from withholding tax on income and capital gains from their investment in KTBs and MSBs. A withholding tax exemption is also possible for other public debt instruments, and additional documentation may apply for certain amount thresholds; specific application forms, documentation requirements, and application practices apply.

In a positive sign of streamlining the exemption process, the necessary application form and relevant supporting documents will only need to be submitted once and may be shared among market intermediaries (brokers and custodians) that service a foreign investor. This practical solution was achieved by continuous discussions between the NTS and securities industry participants. The exemption of withholding tax became effective on 1 January 2023, in line with a new fiscal year in the Republic of Korea.

[44] Compiled from market authorities' press releases, other public domain sources, and legal commentary, including Kim & Chang. 2023. *Insights Newsletter*. 13 February. https://www.kimchang.com/en/insights/detail.kc?sch_section=4&idx=26745.

[45] For more information on the LEI and how it is used in other markets, please see https://www.gleif.org/en.

Details on the exemption, relevant forms, application process and documentation requirements, and relevant procedural descriptions can be found in Chapter VI.H.9.

7. Review and Enactment of Digital Assets Legal Framework (2022–2023) [New]

On 17 August 2022, the FSC announced the formation of a private–public joint task force to review existing laws and regulations, and to propose the necessary components of a legal framework suitable for digital assets. Part of the strategy to achieve this is the creation of the so-called Digital Asset Basic Act as fundamental legislation, while amending existing key legislation—such as the Financial Investment Services and Capital Markets Act—with references to that act or supplementary provisions. The framework is intended to cover crypto-assets, digital securities, as well as the tokenization of any assets.

Previously, the only law featuring any form of definition of digital assets had been the Act on Reporting and Using Specified Financial Transaction Information, commonly known as the AML Act, which became effective in March 2021. While the Electronic Securities Act, 2019 had been enacted prior to this initiative, it was found to be a valuable foundation for a digital assets framework as it already contained important key features of securities, such as the existence purely as an electronic (digital) record. Here, the formal definition of securities tokens is envisaged.

As a first step toward the envisaged legal framework, the Act on the Protection of Virtual Asset Users was passed into law on 18 June 2023; it will become effective on 1 July 2024, allowing market participants to adjust their activities or services according to new provisions.

The completion of the legislative work on the digital assets framework is expected for 2024, with laws typically becoming effective 1 year after promulgation.

For more details on the digital assets framework, particularly the definition of digital or virtual assets, please see Chapter III.A.

8. Introduction of the K-Taxonomy, K-Taxonomy Guidelines, and Green Bond Guidelines (2021–2023) [New]

The MOE announced the K-Taxonomy on 30 December 2021, as a policy framework that stipulates principles and standards for green economic activities and measures to encourage such activities. At that time, the MOE also publicized the K-Taxonomy Guidelines in an effort to pre-empt greenwashing and help accelerate capital flows into green activities. The MOE and the FSC, together with KRX, published in late 2020 the K-GBG, which was intended as the first official guidance to the market on green bonds, their definition, and related practices.

The K-Taxonomy and supporting policy measures took effect from 2023. The MOE initially conducted a pilot phase in the financial and other sectors from April to November 2022 to test market applicability. The pilot phase saw six companies issue green bonds for green energy generation and zero-emission vehicle infrastructure, in conjunction with the MOE, to the tune of KRW640 billion.

Since 2023, the MOE has been providing financial incentives for the issuance of green bonds. Incentives under the K-Taxonomy and K-GBG consist of support for interest coupon payments and extend from bonds to green asset-backed securities, but they do not cover support for issuance costs.[46]

For more detailed information on the K-Taxonomy, the K-Taxonomy Guidelines, the K-GBG, and sustainable finance instruments, please refer to Chapter III.B. The financial incentives offered to potential issuers of green bonds are further detailed in Chapter VI.C.

9. Development of Critical Benchmark Rates (2019–2023) [New]

With the discontinuation of the LIBOR as the benchmark interest rate for global markets, and the subsequent drive for regulatory authorities to determine an alternative benchmark rate for each market, the Government of the Republic of Korea legislated the need to develop multiple critical benchmark rates in the Act on the Management of Financial Benchmarks of the Republic of Korea, promulgated in November 2019 and effective on 27 November 2020. The act sets out standards for determining such critical benchmarks for the administrators and the administration of such benchmarks, as well as the obligations of the users of these critical benchmarks.[47] Consequently, two major reference rate candidates were developed by authorities.

Authorities had set up a Benchmark Rate Reform Task Force in June 2019 to determine a risk-free reference rate similar to the ones being established in major financial markets to replace LIBOR. The task force included representatives from the BOK, FSC, the Korea Capital Market Institute and Korea Federation of Banks, KOFIA, KRX, and KSD. The work of the task force, through its Working Group on Developing an Alternative Benchmark Rate, resulted in the formulation of the Korea Overnight Financing Repo Rate (KOFR) as a critical benchmark. KOFR is being calculated based on overnight repo transactions on sovereign debt instruments (KTBs and MSBs), a common practice also employed in other markets and, hence, considered a risk-free reference rate. KSD was designated to act as the KOFR-calculating agent in November 2021 since it facilitates the domestic repo market. The publication of KOFR officially commenced on 18 April 2022.[48]

In parallel, the FSC designated (in 2021) the domestic CD rate as one of the important critical benchmark rates for the Korean market. In local market terms, the rate is also referred to as “CD91,” reflecting the typical 91-day tenor of the underling products. In June 2023, the FSC appointed KOFIA as administrator of the CD rate, owing to its role as facilitator for the domestic OTC market. KOFIA commenced its role as CD rate calculator with effect from 2 October 2023.[49]

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[46] The K-Taxonomy and Green Bond Guidelines are available from the MOE website at https://www.me.go.kr/skin/doc.html?fn=20230831172157.pdf&rs=/upload_private/preview/. In addition to an official version in English, many law firms and other service providers offer English translations and interpretations of the provisions, typically on a sector or industry basis. The information in this note is partly based on an MOE press release available at https://www.korea.net/Government/Briefing-Room/Press-Releases/view?articleId=1568510&insttCode=A260112&type=N.

[47] Interested parties can view the full text of the act in English via the Korea Law Translation Center at https://elaw.klri.re.kr/eng_mobile/viewer.do?hseq=56616&type=part&key=23.

[48] For more information on KOFR's and KSD's role as calculating agent, please see https://www.kofr.kr/main.jsp.

[49] For more information, please see FSC. 2023. CD Rate as Critical Benchmark Rate to Take Effect from October 2. Press Release. 25 September. https://www.fsc.go.kr/eng/pr010101/80823?srchCtgry=&curPage=&srchKey=&srchText=&srchBeginDt=&srchEndDt=#:~:text=In%20March%202021%2C%20the%20FSC,benchmark%20rate%20in%20June%202023. The CD rate itself is published on the Korean version of the KOFIA OTC market website at https://www.kofiabond.or.kr/.

10. Introduction of Non-Competitive Bids Option for Government Bonds (2019–2021) [New]

Announced by the MOEF as part of measures to revitalize the government bond market in 2019, the introduction of non-competitive bids for government bonds was intended to ensure stability in the primary market and comes with incentives for primary dealers to regularly underwrite new issues.

A corresponding revision of the Regulations on KTB Issuance and Primary Dealer Operation for this so-called "non-competitive underwriting system" placed more weight on underwriting obligations of primary dealers than their market-making obligations by giving additional points for underwriting toward the quarterly evaluation of primary market participants. In addition, a fourth non-competitive bid option was introduced in 2021.

Please also see Chapter III.E. for an explanation of the additional non-competitive bid option.

11. Issuance of Green Bonds and Other Sustainable Finance Bonds (2013–2022) [New]

The first domestic green bond was issued by the Korea Development Bank in 2018, which also issued the first domestic social bond in the same year. Also, in 2018, the Export–Import Bank of Korea issued the first sustainability bond in the local market.[50]

The term used in the Korean market for such instruments is socially responsible investment bonds, typically referred to as SRI bonds and also tracked on KRX by this designation. SRI bonds comprise green, social, sustainability, and sustainability-linked instruments, and are understood to be synonymous with thematic bonds.

In the international market, the Export–Import Bank of Korea issued the first green bond in 2013. The first Climate Bonds Initiative-certified green bond was issued in April 2022 by Shinhan Bank.

Details of SRI bonds and their typical features in the Korean market can be found in Chapter III.B, while Chapter IV.F contains further details on SRI bond information services provided by KRX.

B. Future Direction

This section summarizes developments that are envisaged in the next 12–18 months, either based on existing announcements or market feedback. For practicality, these future developments are organized in chronological order.

[50] Text is based in part of information about SRI bonds on the KRX website, which acts as the key information resource for such instruments in the Korean market, available at https://sribond.krx.co.kr/en/01/01010000/SRI01010000.jsp.

1. Further Measures to Liberalize the Onshore Foreign Exchange Market (2024) [New]

As an additional policy measure under what the MOEF termed "Improvement Measures for Foreign Exchange Market Structure" in its February 2023 announcement, foreign financial institutions would in the future be able to participate directly in the domestic FX market—without having to establish a local entity in the Republic of Korea or having to use a domestic FX bank of broker to transact on their behalf. The measure refers to RFIs; details and conditions are further explained in Chapter II.M.[51]

The foreign exchange market reform measures will be officially implemented during the second half of 2024 after 6 months of pilot operation.

2. Inclusion of Korean Government Bonds into Global Bond Indexes (2024) [New]

The Government of the Republic of Korea is anticipating the inclusion of Korean sovereign bonds in the FTSE Russell World Global Bond Index in the near future. Index provider FTSE Russell had added the Republic of Korea to its watch list in September 2022, following announcements by the government that it would address some of the structural issues in the Korean bond market that had been highlighted by the industry.

An inclusion in the World Global Bond Index would result in significant extra investment in KTB and MSB by domestic and foreign investors in an effort to balance global bond portfolios that are tracking the index.

According to media reports, it may take up to 2 years for designated markets to move from the watch list to an actual inclusion in the index. The next update to the World Global Bond Index is scheduled for March 2024.[52]

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[51] Adapted from MOEF. 2023. Improvement Measures for Foreign Exchange Market Structure. Press Release. 6 March. https://english.moef.go.kr/pc/selectTbPressCenterDtl.do?boardCd=N0001&seq=5509.

[52] An example is *Korea Times*. 2023. Korea Fails To Be Included on FTSE Russell's Global Bond Index. 30 September. https://www.koreatimes.co.kr/www/biz/2023/10/602_360222.html.