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Recent Developments and Future Direction

A. Recent Major Developments

Recent major developments are considered those that occurred or have been announced in the Korean market since the first publication of the Bond Market Guide in April 2012.

1. Implementation and Improvement of Qualified Institutional Buyer Concept and Private Placement Market

In a first step toward a defined professional market segment in the bond market in the Republic of Korea, the FSC introduced the QIB system in May 2012. The market was designed to give opportunities to SMEs to raise capital as an alternative to bank loans or going public.

With the Regulation on Issuance, Public Disclosure, etc. of Securities, the market segment was extended on 30 December 2014 to securities that are issued by foreign entities and or bonds denominated in a foreign currency. These regulations gave rise in the Korean market to the issuance of bonds denominated in offshore Chinese renminbi.

In its Measures to Boost Competitiveness of Financial Investment Business, the FSC announced a further deregulation of this market segment by shaping it as a QIB Market with the use of international standards. The relevant regulations for the operation of the revised concept were amended on 1 August 2016.

2. Establishment of the KOFIA QIB (Qualified Institutional Buyers) Debt Securities Market

Pursuant to the QIB Market measures introduced by the FSC, KOFIA launched a QIB Market debt securities registration and disclosure platform with effect from 1 August 2016. The key feature of the new disclosure platform is that foreign issuers may utilize their standard issuance documentation and disclosure information in English for the first time for an issuance in the Korean bond market.

Similar to the previous practice, issuers of debt securities—including foreign issuers—are required to register their instruments with KOFIA for them to be eligible for trading in the professional OTC market.

3. Introduction of Electronic Short-Term Bonds

Electronic short-term bonds, which are electronically issued bonds with a maturity of 1 year or less, were introduced on 15 January 2013, pursuant to the Act on Issuance and Trading of Electronic Short-Term Bonds. These instruments were intended to provide an easily tradable alternative to commercial paper (see also Chapter III.C for more details).

4. First Issuance of 30-Year Treasury Bonds (September 2012)

The Government of the Republic of Korea needed a means to finance prolonged demands for public expenditures on a long-term and stable basis. As a result, and to diversify its portfolio of bond maturities, the government issued 30-year Treasury bonds (in addition to existing 3-year, 5-year, 10-year, and 20-year bonds) for the first time in September 2012.

5. Introduction of Treasury Bond Pre-Issuance (March 2015)

To mitigate a liquidity reduction after the change of benchmark bonds, the government introduced the pre-issuance concept in March 2015, under which it issues a benchmark bond as well as a subsequent benchmark bond at the same time, 3 months before new issuance.

6. Introduction of When-Issued Trading (December 2015)

In December 2015, the government adopted “when-issued trading,” which allows trading of newly issued KTBs from 2 days before the bidding day to the bidding day, in order to improve the capability to explore interest rates before bidding and to create new demand. Now the government is able to identify demand for KTBs in advance and, hence, to more flexibly control the amount of bonds to be issued. Dealers are provided an opportunity to hedge against risks of interest rate fluctuation and holding bid orders.

7. Introduction of Request-For-Quote in the KRX Market (March 2016)

KRX introduced an RFQ function in the KRX bond market in March 2016, as an addition to the CLOB, in order to enhance trade convenience and market efficiency. RFQ facilitates the execution of block trades—since RFQ trading counterparties consult with each other on trading conditions, including prices and quantities, before trade execution..

8. Fragmentation of Tick Size in the KRX Market (June 2016)

Effective June 2016, KRX adopted three tiers of tick size, taking into consideration the remaining time to maturity of the listed bonds and notes, thereby abolishing the existing tick size of KRW1 regardless of the residual tenor of the bonds (Table 10.1). Thanks to the three-tiered tick size, more precise and fairer prices are calculated and the narrowing of quotation spreads can reduce the costs of trading for bond investors.

Table 10.1: Fragmentation of Tick Size on the Korea Exchange

Residual Tenor of Bonds and Notes	Tick Size
Less than 2 years	KRW0.1
2 years or longer to less than 10 years	KRW0.5
10 years or longer	KRW1.0

Note: For benchmark 10-year KTBs and 10-year inflation-linked bonds, the tick size remains KRW1, regardless of outstanding tenor.
Source: Korea Exchange.

9. First Issuance of 50-Year Treasury Bonds (October 2016)

In October 2016, the government issued 50-year KTBs worth KRW1.1 trillion for the first time. It is expected that the government's ability to finance long-term expenditure and its capacity to adequately control the issuance of KTBs will be enhanced after the successful issuance of the bonds. The issuance also allowed the government to have a longer-term fiscal outlook and develop ultra-long-term financial assets through the setting of an attractive interest rate for the bonds.

B. Future Direction

1. Participation of Nonresident Issuers and Investors

Underpinned by the growth of the bond market, foreign investor holdings of domestic bonds have steadily increased since the mid-2000s. Their bond investment was merely KRW1 trillion in the early 2000s but exceeded KRW100 trillion in 2015.

However, the volume of bonds and notes issued by nonresidents is still insignificant in the Republic of Korea. As of 2016, the volume of outstanding bonds issued by nonresidents through public and private placements stood at KRW320 billion and KRW440 billion, respectively, together representing only 0.04% of total outstanding bonds in the Republic of Korea.

In this situation, AMBIF, which represents a professional bond market, can provide op portunities for Korean investors to invest in bonds issued by foreign issuers and give K orean firms easier access to capital in the region. Moreover, the Republic of Korea can contribute to regional finance by participating in ASEAN+3 bond markets. In turn, it wo uld help strengthen regional cooperation and play a part in regional co-development.

The market for professional investors has gradually opened its doors to foreign issuers. Deregulation of the QIB Market, which came into force in 2016, for the first time allowed foreign issuers to raise capital in the private placement market, of which the QIB Market is a part.

This professional market concept was also applied to the exchange market. Cases in point are the KONEX, which was launched by KRX in 2013 and represents the SME stock market for professional investors, and the KSM, which opened in 2016 as the startup stock market for professional investors.

As such, infrastructure is in place for foreign entities to issue bonds in the Republic of Korea. However, foreign bond issuance remains insignificant. Considering the volume and share of foreign investment in domestic bonds and notes, bond issuance by nonresident issuers is very likely to grow. An increase in foreign bond and note issuance will not only enable foreign borrowers to raise capital in the domestic market, but also provide domestic investors with diverse investment opportunities to seek certain levels of expected returns.

To this end, the Republic of Korea should improve its capital market infrastructure as well as its bond market infrastructure. In addition, policy makers should evaluate a variety of options and their feasibility as the government continues its research into and preparations for participation in AMBIF. The implementation of AMBIF is expected to benefit the Korean bond market at large. A formal announcement on the Republic of Korea's participation in AMBIF is expected to be made by the relevant policy bodies or regulatory authorities soon.

2. Global Regulatory Trend for More Transparent Bond Trade

Since the global financial crisis, the regulatory framework of global financial markets has been evolving to pursue more transparency and greater access to information. New regulations seek to transform the existing method in which trading in the OTC market is conducted by voice into trading based on e-commerce principles and more transparent trading facilities (e.g., a regulated market or a multilateral trading facility). The International Organization of Securities Commissions also emphasized the importance of information in the secondary corporate bond market in its report released in August 2017. This consultation report recommends that supervisory institutions of member countries establish obligations of reporting corporate bond trades and requirements to bolster the transparency of trade information.

While authorities in the existing bond market segments in the Republic of Korea, both OTC and on-exchange, have put significant efforts toward transparency and information disclosure over many years, as described in this Bond Market Guide, the Korean bond market needs to take additional steps in response to global trends. Furthermore, these trends are very likely to affect the regulatory direction of other markets around the world, including the ones where issuers and investors with an interest in the Korean bond market are domiciled.