

NEWSLETTER

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Banking & Capital Markets Group

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Guidelines on Foreign Exchange Business of Foreign Financial Institutions

On October 18, 2023, the Guidelines on Foreign Exchange Business of Foreign Financial Institutions (the **Guidelines**) were established and implemented to open the domestic foreign exchange market to the outside world. We will touch on the background behind the establishment of the Guidelines and main contents thereof below.

1. Background of Establishment of the Guidelines

It has been pointed out that the domestic foreign exchange market has been operated under an exclusive and limited structure. In order to tackle this and enhance the accessibility of the market at the global level, the Bank of Korea and other related organizations announced the 'Measures to Improve the Structure of the Foreign Exchange Market' on February 7, 2023, and presented the policy task of opening the domestic foreign exchange market to the offshore markets by allowing authorized foreign financial institutions to directly participate in the domestic foreign exchange market.

As a follow-up to the 'Measures to Improve the Structure of the Foreign Exchange Market', the Enforcement Decree of the Foreign Exchange Transactions Act was amended and enforced on October 4, 2023 - one of the notable amendments includes addition of 'an institution that meets the business categories and financial soundness standards determined and announced by the Minister of Economy and Finance among foreign financial institutions (referring to those established in accordance with foreign laws and operating in foreign countries)' to the definition of 'financial institutions' under the Foreign Exchange Transactions Act (the **FETA**).

Later on October 18, 2023, the Guidelines were established to stipulate matters necessary for foreign financial institutions to register as foreign exchange agencies and perform foreign exchange business.

2. Main Contents of the Guidelines

The Guidelines are applied first and foremost to the Foreign Exchange Transaction Regulations, and the main contents are as follows:

- **Establishment of business category and financial soundness standards for foreign financial institutions deemed as 'financial institutions' under the FETA**

The Guidelines stipulated the business category and financial soundness standards of foreign financial institutions deemed as 'financial institutions' under the FETA.

First of all, in regards to the industry standards, the Guidelines stipulated that the financial business equivalent to the banking business under Art. 8 of the Banking Act or the investment dealing business or investment brokerage business under Art. 12 of the Financial Investment Services and Capital Markets Act shall be deemed to meet the industry standards only if that business is conducted and operated abroad by those who fall under one of the following categories: (1) foreign financial institutions (including headquarters and branches); (2) overseas corporations or overseas branches of foreign exchange banks; or (3) overseas corporations or overseas branches of merchant banks, investment dealers, and investment brokers, which are foreign exchange agencies.

Besides the above, in regards to financial soundness standards, the stipulated requirement is that the Governor of the Bank of Korea recognizes that it meets internationally accepted levels such as international credit ratings.

- **Determination of the scope of overseas foreign exchange business**

The Guidelines define foreign exchange business performed by foreign financial institutions for non-residents and domestic financial institutions in the domestic interbank markets to the extent recognized by the Minister of Economy and Finance as 'foreign exchange business'. The specific scope of business is FX spot transactions and FX swap transactions ((1) trading between domestic currencies and foreign currencies according to Arts. 2-2 and 2-3 of the Foreign Exchange Transaction Regulations, and (2) trading different currencies according to the current exchange rate agreed in the contract and re-exchange according to the exchange rate set at the time of the initial contract after passage of a certain period of time).

However, the business scope involved with the transactions with those who are not overseas foreign exchange agencies or interbank market participants shall be limited to transactions with non-residents, and the types of currency for the transactions shall be limited to Korean Won (KRW) and United States Dollars (USD).

In addition, the Guidelines stipulated mandatory use of foreign exchange brokers and special cases for the Foreign Exchange Transaction Regulations.

- **Specification of registration requirements and procedures**

The Guidelines specified Art. 13 of the Enforcement Decree of the FETA, which stipulates the registration of foreign exchange businesses by foreign financial institutions deemed as financial institutions under the FETA, and further provided for the relevant requirements and procedures.

In particular, one of the registration requirements is that the overseas foreign exchange agencies shall execute credit extension agreements with 10 or more financial institutions, including four or more leading banks, among the institutions specified in the Guidelines. However, in principle, the provisions related to this requirement are expected to take effect from January 1, 2024.

In addition, the Guidelines provide for the details of the documents to be submitted for the registration, provisions on the change and revocation of registration matters, reasons for cancellation of registration and so forth.

■ **Regulations on obligations of overseas foreign exchange agencies**

The Guidelines separately set forth the verification and reporting obligations of overseas foreign exchange agencies.

According to the Guidelines, the overseas foreign exchange agency, when conducting transactions with customers subject to the FETA, is obliged to verify: (1) whether the customer is a non-resident; (2) whether the customer's transaction funds are deposited or disposed of between the foreign currency account and the KRW account under the same name through the overseas foreign exchange agency; and (3) whether the customer's transaction falls under the methods of payment or receipt or is subject to reporting of capital transactions under the FETA. It is obliged to submit transaction details related to overseas foreign exchange businesses and others to the Bank of Korea, and report the excess amount of FX forward purchase, excess amount of FX forward sale, and KRW borrowing details and balance with the agency to the Bank of Korea, each determined as of each business day. However, the verification obligation shall be applied from July 1, 2024.

Besides the above, the Guidelines stipulate the grounds for overseas foreign exchange agencies to entrust the fulfillment of the above obligations to domestic foreign exchange banks and/or others.

■ **Establishment of other regulations for soundness management and management supervision**

The Guidelines set forth provisions related to the FX forward position limit for the purposes of soundness management and sanctions against violations of such a limit. In addition, the Governor of the Bank of Korea is granted under the Guidelines the authority to: (1) supervise overseas foreign exchange agencies, (2) propose to the Minister of Economy and Finance cancellation of registration in case of material violations, and (3) take action against overseas foreign exchange agencies in case of their non-compliance with the inspection.

3. Implications

The 'Measures to Improve the Structure of the Foreign Exchange Market' are expected to bring about the effect of improving the foreign exchange market structure, such as promoting financial sector development, enhancing the convenience of foreign exchange transactions, easing market volatility, and enhancing external soundness. As part of this, the registration process of foreign financial institutions has commenced in accordance with the establishment of the Guidelines, and the foreign exchange authorities plan to extend the operating time and officially implement the same from the second half of 2024 after the pilot operation for the first half of 2024.

As a result of the preliminary demand survey, more than 30 institutions are willing to participate, and it is expected that direct participation of foreign financial institutions in the domestic foreign exchange market would be expanded following the establishment of the Guidelines. It is recommended for the foreign financial institutions that have interest in this regard to review the background and contents of this new system, the requirements and procedures for the registration of overseas

foreign exchange agencies under the Guidelines, and proceed with the registration if necessary. It may be also necessary to check matters to be attended to for compliance with the regulations such as fulfillment of various verification obligations and reporting obligations and soundness management as an overseas foreign exchange agency.

The Banking & Capital Markets Group of Lee & Ko has provided extensive advice on various legal matters and issues related to the FETA, and provides advisory services on the matters related to the registration of overseas foreign exchange agencies as noted above. Should you need any assistance from legal professionals regarding the above, please do not hesitate to reach out to the Banking & Capital Markets Group of Lee & Ko.

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