# MONEY MARKET CHANGES AFTER THE INTRODUCTION OF MUTUAL FUNDS

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## *Introduction of Mutual Funds*

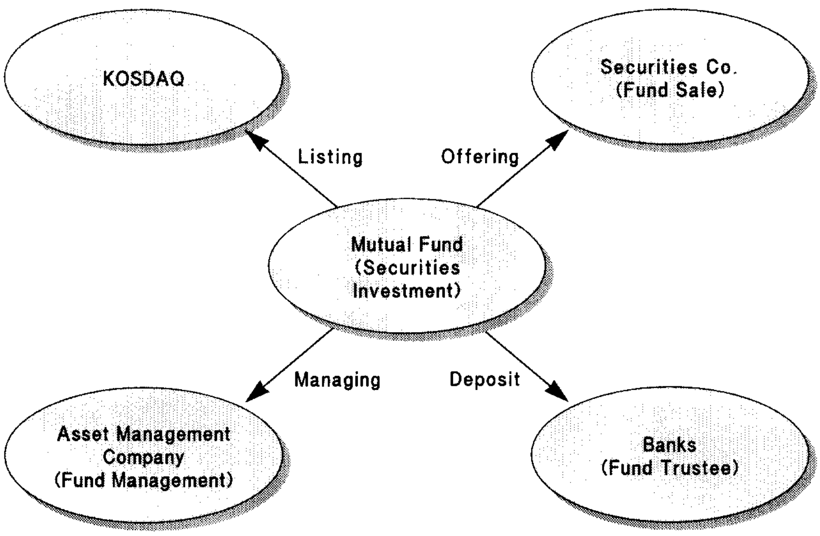
The Korean government finally decided to introduce mutual funds December in order to supplement the weaknesses of existing beneficiary certificates issued by investment trust companies (ITCs) and to boost Korean economy through the inflow of foreign capital.

A mutual fund attracts a pool of money from individuals and invests the money in stocks and bonds of listed companies, then pays dividends to the investors in the fund. Meanwhile, beneficiary certificates are a kind of financial product issued by ITCs. With the funds raised from the sale of the certificates, the ITCs make investments in stocks or bonds and return accrued profits to customers after a certain period of time. There are three income sources for both mutual funds and investment trust companies: interest received on bonds, dividend payments from stocks and capital gains from the sale of securities.

Mirae Asset Investment Management Co., a leader in mutual fund sales in Korea, made its successful debut in the market with the No. 1 "Park Hyun-joo" fund. The 50 billion won ($41.6 million) of No. 1 "Park Hyun-joo" fund, which seeks an annual profit rate of 20%~30%, was completely sold within the first four days of sale last December. Mirae Asset Investment Management Co. also sold its No. 2 and No. 3 mutual funds, totaling 150 billion won, successfully and will now put the No. 4 and No. 5 mutual funds, amounting to 200 billion won, on the domestic market for public sale.

In addition, funds launched by Samsung Investment Trust and LG Investment Trust, amounting to 30 billion won and 50 billion won

〈Figure 1〉 The Structure of Mutual Funds



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respectively, were also launched successfully. The total issuance of Korea's mutual funds reached 1.2 trillion won as of January 15th, and is expected to reach 2.5 trillion won by the end of January, as other investment trust management companies and securities companies as well as foreigners like the International Finance Corporation are planning to establish more funds. The Bank of Korea has estimated the size of mutual funds issued in 1999 will amount to 10 trillion won.

## Money Market Changes

Due to the government's continuing monetary expansion and low interest rate policies aimed at helping the domestic economy to recover, there is abundant liquidity in the money market. Therefore, the total value of the major financial institutions' savings and financial instruments has increased by 5.6 percent from 610.6 trillion won on December 7 to 644.9 trillion won in mid-January.

Despite the solid increase in the total money supply, the size of banks' savings and merchant banks' financial instruments has decreased, while ITC's certificate beneficiaries and customer deposits at the brokerage companies have significantly increased. The recent trend of the money market, therefore, is that money is flowing from savings accounts in commercial banks to securities funds in investment banks, thanks to the bullish mood in the Korean stock market. The introduction of mutual funds is likely to accelerate this trend.

The statistics on financial instruments confirm that money is moving from commercial banks and merchant banks to investment trusts and the stock market. As was mentioned above, it was mainly due to the bullish stock market. The Korea Composite Stock Price Index (KOSPI) which had stayed around the 500 point level before the introduction of mutual funds, jumped more than 100 points up to 622.52 points on January 18. Customer deposits, a barometer of the stock market sentiment, have reached 5.4 trillion won.

The proportion of deposited money in investment trusts against total amount of the major financial instruments and savings (644.9 trillion won worth as of January 15th), has increased from 31.0 percent at the end of October to 34.6 percent, or 223 trillion won,

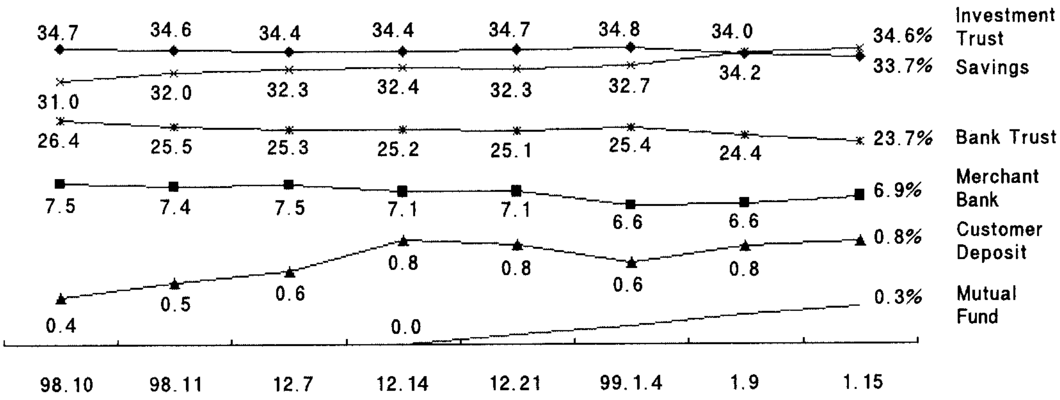
〈Table 1〉 Mutual Funds Listed and Amount

*(unit: billion won, as of Jan. 15.)*

| Management Co. | Fund list | Amount[1)] |
|---|---|---|
| Mirae Asset | 7 including 'Park Hyunjoo1' | 590 |
| Samsung Investment | 2 including 'Prime' | 300 |
| Samsung Insurance Investment | 3 including 'Emerald' | 200 |
| LG Investment Trust | 3 including 'Twins Vision' | 500 |
| Dongwon Investment Trust | Chang Pogo Fund | 50 |
| Seoul Investment Trust | 2-3 are preparing | 200 |
| Sangeun Investment Trust | 'Safety 1', 'Safety 2' | 200 |
| Asset Korea Investment Counsel | in preparation | 100 |
| Total | about 20 Funds | 2,140 |

Note: 1) includes funds which are being sold now and in preparation.

〈Figure 2〉 The Portions of Institutional Instruments in the Financial Market




Source: 「Daily Money Trend」, Bank of Korea.
Note: 1) Investment trust refers to the sum of beneficiaries of certificates and trust savings.
2) Customer deposits include only domestic investors' deposits.
3) The total amount of the major financial instruments and savings is 644.9 trillion won at Jan. 15.

Meanwhile, bank savings and bank trusts have decreased from 34.7 percent and 26.4 percent to 33.7 percent, or 217 trillion won, and 23.8 percent, or 159 trillion won. Merchant bank deposits are hovering at the 7 percent level, or 45.7 trillion won. Customer deposits proportion has increased greatly from 0.4 percent, or 2.1 trillion won, at the end of October to 0.8 percent, or 5.4 trillion won, thanks to bullish mood in the Korean stock market.

## Policy Measures To Be Implemented

In order to support the stable growth of the mutual fund market, the Korean government has decided that no taxes on profit margins on mutual funds will be imposed for 3 years. The government also allowed closed-end type mutual funds of over 80 billion won to be listed on the KOSDAQ.

Despite the Korean government's wishes for the stable growth of the mutual fund market, there are couple of measures which need to be implemented in order to expand the market and to protect investors. First, the liquidity of mutual funds should be extended. For example, the open-end type of mutual funds should be introduced shortly. In fact, in the U.S. the open-end type of mutual funds in much more popular. Moreover, even investors of closed-end funds should be able to "sell" all of or part of their shares in the funds more freely in the stock market. Currently, only a few funds can be traded on the bourse. Second, further regulations may be needed regarding "incentive compensation." The annual management fees currently charged to investors are at a normal level. But in addition to the annual management fee, most funds charge an "incentive compensation," a higher performance-based fee paid to the management company. For example, a fund's prospectus says, "the management company will withhold 20% of whatever rate of return above 15% as a performance fee." However, this kind of incentive is often found in private investment groups, not in public mutual funds. VIP

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