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LAW AND POLICY OF SECURITIES REGULATION IN KOREA

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Abstract: This Article describes the regulation of securities in Korea, exploring in detail the Securities Exchange Act of 1962. The current system of registration, disclosure, and enforcement is explained, with special attention given to the regulation of market professionals and of international securities offerings. This Article identifies areas in which the current Korean securities laws need improvement, and concludes that laws governing disclosure and international securities transactions must be improved if the Korean stock market is to continue to grow apace with the Korean economy.

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I. INTRODUCTION

In conjunction with the remarkable growth of the Korean economy, the Korean securities market has undergone rapid growth over the past ten years. At the same time, the securities market is becoming more internationalized as increasing numbers of corporations engage in cross-border securities transactions.

The growth and internationalization of the Korean securities market raise a number of issues that are not adequately addressed by the Korean securities laws. This article briefly examines the Korean securities laws and discusses those areas of law that need to be clarified, improved, or amended.

II. SECURITIES REGULATION IN KOREA

A. *Securities Laws*

In 1962, in recognition of the importance of effectively governing the securities markets, the Korean government enacted the Korean Securities and Exchange Law ("SEA").¹ The SEA, the Enforcement Decree,² and the regulations from the Ministry of Finance and Economy ("MOFE")³ promulgated under the SEA, are the principal sources of Korean securities law. The SEA regulates both the primary and the secondary markets, and the Enforcement Decree and the MOFE Regulations supplement the SEA with more detailed regulations.

Many other statutes also govern the securities markets of Korea. They include the Capital Market Promotion Act of 1968 ("CMPA"),⁴ which is designed to promote a sound capital market, the Securities Investment Trust Business Law of 1969,⁵ which regulates investment trust companies, and the Foreign Exchange Management Act ("FEMA")⁶ and its implementing regulations ("FEMR"),⁷ which govern cross-border transactions involving foreign exchange. The Commercial Code of Korea,⁸ the basic law on commercial and corporate matters, also governs securities transactions because under the Commercial Code, securities transactions are deemed to be commercial transactions.⁹

B. *Regulatory Authorities*

The Ministry of Finance and Economy of Korea¹⁰ is the highest governing body regulating the securities market and supervising the securities-related institutions. Under the MOFE, the following regulatory

¹ Securities and Exchange Act of Jan. 15, 1962, Law No. 972 (as amended Jan. 5, 1994) [hereinafter SEA].

² Presidential Decree No. 618, Mar. 30, 1962 [hereinafter Enforcement Decree].

³ Ministry of Finance Regulation No. 257, May 30, 1962 [hereinafter MOFE Regulations].

⁴ Capital Market Promotion Act, Law No. 2046, Nov. 22, 1968 [hereinafter CMPA].

⁵ Securities Investment Trust Business Act, Law No. 2129 of August 4, 1969, as amended.

⁶ Foreign Exchange Management Act, Law No. 933, Dec. 31, 1961 (as amended Dec. 27, 1991).

⁷ Foreign Exchange Management Regulations, Ministry of Finance Regulation No. 361, Nov. 27, 1964 [hereinafter FEMR].

⁸ Commercial Code, Law No. 1000, Jan. 20, 1962.

⁹ *Id.* art. 46, items 1-2.

¹⁰ In December, 1994, the Ministry of Finance and the Economic Planning Board were combined to form The Ministry of Finance and Economy.

bodies exist: (1) Securities and Exchange Commission ("SEC"); (2) Securities Supervisory Board ("SSB"); and (3) the Korea Stock Exchange ("KSE").

Unlike the U.S. Securities and Exchange Commission, the Korean SEC is not an independent agency. All resolutions adopted by the SEC must be reported to the MOFE. If the MOFE finds a resolution of the SEC illegal or highly inappropriate, it may cancel or suspend part or all of the resolution.¹¹ Further, to protect investors, the MOFE may order the SEC to take certain necessary measures.¹² Besides not being an independent agency, the SEC also has no quasi-judicial powers. The SSB, the executive body of the SEC, implements and enforces policies established by the SEC, regulates the primary and secondary markets, and supervises securities-related institutions.

The KSE is a juridical entity established by the SEA¹³ and is the only stock exchange in Korea. As a non-profit organization, the KSE engages in the following businesses: (1) opening of securities markets (including futures markets); (2) auctioning of securities; (3) other businesses incidental to the opening of securities markets; and (4) businesses approved by the MOFE.

III. WHAT IS A SECURITY?

A. *Definition*

Under the SEA, the following are "securities" and thus subject to the SEA:

- (1) national government bonds;
- (2) local government bonds;
- (3) bonds issued by a corporation incorporated under special legislation;
- (4) corporate bonds or debentures;
- (5) certificates of capital contribution issued by a corporation incorporated under special legislation;

¹¹ SEA, *supra* note 1, art. 126(1)-(2)

¹² *Id.* art. 126(3).

¹³ *Id.* art. 71(2).

- (6) stock certificates or instruments representing a preemptive right to subscribe to new shares;
- (7) certificates or instruments issued by a foreign country or corporation which are of the same nature as those referred to in items (1) through (6) above and are designated by the MOFE; and
- (8) other certificates or instruments which are similar or related to those referred to in items (1) through (7) above and are designated by the Enforcement Decree.¹⁴

Beneficial certificates issued pursuant to the Trust Business Law or the Securities Investment Trust Business Law are considered to fall under item (8) above and thus are deemed to be "securities."¹⁵ Also, under the SEA, rights to be represented by any of the securities are themselves securities even when the certificates thereof have not been issued.¹⁶

B. Problems

Unlike the U.S. securities laws, the SEA does not provide a broad definition of "securities."¹⁷ The SEA's definition of "securities" is limited to a concrete number of categories and does not include a catch-all definition such as "investment contracts" as exists in the U.S. statutes.¹⁸ Although this inflexible concept of "securities" may make interpretation of the term "securities" easier, it does not leave room to allow the SEA to cover newly created investment vehicles in the scope of its regulations.

¹⁴ *Id.* art. 2(1).

¹⁵ Enforcement Decree, *supra* note 2, art. 2-2.

¹⁶ SEA, *supra* note 1, art. 2(2).

¹⁷ "Security" is defined under U.S. law to include, in part:

[A]ny note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call straddle, option or privilege on any security, certificate of deposit or group or index of securities, . . . or, in general, any interest or instrument commonly known as a "security"

Securities Act of 1933, 15 U.S.C. 77b(1); Securities and Exchange Act of 1934, 15 U.S.C. 78a(10).

¹⁸ *Id.*

IV. REGISTRATION AND DISCLOSURE REQUIREMENTS

A. *Company Registration*

For any public offering of securities, the SEA first requires the company concerned to register with the SEC. Those entities which are required to register with the SEC before offering securities to the public are:

- (1) corporations desiring to list their securities on the KSE;
- (2) non-listed corporations desiring to make a public offering of new issues or outstanding securities;
- (3) non-listed corporations desiring to merge into or consolidate with a listed corporation;
- (4) non-listed corporations desiring to have their securities traded on the over-the-counter markets;
- (5) corporations that are in the process of being incorporated and intend to make a public offering of securities; and
- (6) other corporations meeting the criteria set forth in the Enforcement Decree, as designated by the SEC.¹⁹

The central and local governments, statutory juridical entities established pursuant to special legislation, trust companies, and securities investment trust companies do not need to register with the SEC. These exempted entities need only file with the SEC certain documents such as the articles of incorporation and financial statements.

B. *Procedures for Public Offering of Securities*

Under the SEA, unless a registration statement has been filed with and accepted by the SEC, one may not publicly offer new issues or outstanding securities except in certain limited cases.²⁰ However, when making a series of public offerings of corporate bonds, other than convertible bonds, bonds with warrants and dividend participating bonds, a qualified issuer may file a shelf registration statement instead of filing a

¹⁹ SEA, *supra* note 1, art. 3.

²⁰ *Id.* art. 8(1). See *infra* part IV.E.

separate registration statement for each issue.²¹ In such case, the issuer need only file certain supplemental documents for each issue.²²

Under the Regulations on Filing Registration Statements of Public Offering of Securities ("Filing Regulations")²³ promulgated by the SEC, before a company makes an initial public offering of its shares which are not listed on the KSE, the company should submit a plan for the public offering to the SEC before filing a registration statement. Upon review of this plan, the SEC may recommend that certain changes be made.

Finally, under the Capital Market Promotion Act, when a company makes a public offering of shares (whether it be through a public offering or secondary distribution), the employees have the right to subscribe up to twenty percent of the offered shares.²⁴

1. Definition of Public Offering

The public offering of "new" issues of securities is defined as "a solicitation of an offer to acquire newly issued securities as against many unspecified persons under uniform terms and conditions."²⁵ The public offering of "outstanding" securities is defined as "an offer to sell, or a solicitation of an offer to buy outstanding securities as against many unspecified persons under uniform terms and conditions."²⁶ Under the Filing Regulations, a "public offering" is defined as one that is made to at least fifty persons.²⁷

²¹ SEA, *supra* note 1, art. 8(1). See also MOFE Regulations, *supra* note 3, art. 2-2.

²² SEA, *supra* note 1, art. 10(2).

²³ Regulations on Filing Registration Statements of Public Offering of Securities, promulgated by SEC, Apr. 6, 1982 [hereinafter Filing Regulations].

²⁴ CMPA, *supra* note 4, art. 17(1).

²⁵ SEA, *supra* note 1, art. 2(3).

²⁶ *Id.* art. 2(4).

²⁷ Filing Regulations, *supra* note 23, art. 2(1). When calculating the number of persons to whom an offer is made, the following persons, *inter alia*, are not included:

- (a) holder of the largest number of shares of the issuer;
- (b) all shareholders holding 5% or more of the shares of the issuer;
- (c) certain institutional investors designated under the Corporation Tax Law of Korea;
- (d) directors and auditors of the issuer;
- (e) any company in a special relationship with the issuer;
- (f) in case the issuer has not been incorporated, the promoters of the issuer; and
- (g) other persons designated by the SEC who are knowledgeable of the business of the issuer.

Id. art. 2(2).

2. *Registration Statement*

The SEA requires the issuer of the securities involved to file a registration statement when there is a public offering of securities.²⁸ "Issuer" means the corporation which will issue the securities or which has issued the securities involved.²⁹ Accordingly, even if a non-issuer wishes to make a public offering, the issuer must file a registration statement.

A registration statement is accepted on the date it is submitted unless the SEC issues a refusal notice.³⁰ A registration statement becomes effective after a prescribed time period from the date of acceptance of the statement.³¹ If an amendment to the registration statement has been filed, the amendment becomes effective after the prescribed time period from the date of acceptance of the amendment passes.³² However, if the amendment concerns the issue price or interest rate and is filed after the expiration of the prescribed time period, then the registration statement becomes effective three days after the filing of the amendment.³³ If such amendment is filed during the prescribed time period, then the registration still becomes effective on the expiration of the prescribed time period.³⁴ Finally, if the SEC determines that the information in the registration statement is public knowledge and is easily understandable, then the SEC may accelerate the effective date of the registration statement.³⁵

In general, before the registration statement has been accepted by the SEC, it is illegal to solicit offers to subscribe to or buy or to make an offer to sell new or outstanding securities.³⁶ Once the registration statement has been accepted, an offer to sell or a solicitation of an offer to buy may be made, although securities may not be sold until the registration statement has become effective.³⁷ Solicitation is defined as any activity promoting

²⁸ SEA, *supra* note 1, art. 8(1).

²⁹ *Id.* art. 2(5).

³⁰ Filing Regulations, *supra* note 23, art. 17(2).

³¹ SEA, *supra* note 1, art. 9(1). The prescribed time period varies depending upon the type of issuance. For rights issue or issuance of shares due to an exercise of a subscription privilege, the prescribed time period is seven days; for public offering of shares by a listed company, ten days; for public offering of shares by a non-listed company, twenty days; for debentures, fifteen days for guaranteed, five days for secured; and for debentures issued under a shelf registration statement, seven days. MOFE Regulations, *supra* note 3, art. 3(1).

³² SEA, *supra* note 1, art. 11(5).

³³ MOFE Regulations, *supra* note 3, art. 3(2).

³⁴ *Id.*

³⁵ MOFE Regulations, *supra* note 3, art. 3(3).

³⁶ SEA, *supra* note 1, art. 8(1).

³⁷ *Id.* art. 10.

investors' subscription or purchase of the securities through: (1) dispatch of notices; (2) holding of investor presentation meetings; (3) distribution of printed materials; or (4) advertisements in mass media.³⁸

At the time of a public offering or of an issuance of new shares, a statutory prospectus³⁹ must be prepared and made available for public inspection at the issuer's head office, branch offices, SEC, KSE and office of securities companies dealing with the subscription.⁴⁰ Unlike in the United States, a prospectus need not be delivered to a potential investor unless such investor requests it.⁴¹ A prospectus must satisfy SEC requirements and only contain information that is consistent with that in the effective registration statement.⁴² Further, a prospectus must not omit any information contained in the effective registration statement.

3. *Amendments to the Registration Statement*

Once the registration statement has been filed, the SEC reviews it and the other documents submitted by the issuer. If the SEC determines that the registration statement is incomplete or inaccurate, then the SEC may issue an order to submit an amendment.⁴³ However, such order is rarely issued since the registration statement is only filed after an informal review by the SEC. In the case where such amendment order is issued by the SEC, the registration statement is deemed received on the date the amendment is accepted.⁴⁴

If any change occurs to any matter that is not material, the issuer may voluntarily file an amendment to the registration statement before the commencement of the offering period specified under the registration statement.⁴⁵ However, if the change relates to any matter that is material, as specified by the SEC, then the issuer must file an amendment. Failure to

³⁸ Filing Regulations, *supra* note 23, art. 3.

³⁹ A "preliminary prospectus" is used for public offerings or secondary distribution of securities when the registration statement has not yet become effective. A "main prospectus" is used after the registration statement has become effective. The "preliminary prospectus" and the "main prospectus" together are called "statutory prospectus." *Id.* art. 19.

⁴⁰ SEA, *supra* note 1, art. 12(1); MOFE Regulations, *supra* note 3, art. 4.

⁴¹ SEA, *supra* note 1, art. 13(1).

⁴² *Id.* art. 13(2).

⁴³ *Id.* art. 11(1).

⁴⁴ *Id.* art. 11(4).

⁴⁵ *Id.* art. 11(3).

file an amendment to the registration statement when required may result in criminal liability.⁴⁶

If the SEC deems it necessary for the protection of the public interest or investor protection, the SEC may order the issuer, underwriter, or other relevant persons to submit reports requested by the SEC and inspect books and records of the issuer.⁴⁷ Further, if the registration statement, prospectus, or the report of the actual distribution of the securities contains any false statement or omits material information, then the SEC may issue an amendment order or stop order.⁴⁸ If the SEC issues a stop order, then the effectiveness of the registration statement may be suspended.

C. *Contents of Disclosure*

When filing a registration statement, an issuer must complete a prescribed form.⁴⁹ This form consists of two parts and generally requires the following information. However, depending upon the type of securities offered, the information required may vary. Part I, description of public offering, requires the following:

- (1) brief description of public offering;
- (2) use of proceeds;
- (3) brief analysis by the underwriters of the securities to be offered;
- (4) brief analysis by the analyst institution of the securities to be offered; and
- (5) description of other matters for protection of investors.

Part II, description of the issuer, requires:

- (1) brief description of the issuer;
- (2) description of the business operation;
- (3) description of financial affairs;
- (4) opinion of an outside auditor (certified public accountant);
- (5) description of affiliated companies;
- (6) information on shares;

⁴⁶ *Id.* art. 210.

⁴⁷ *Id.* art. 19(1).

⁴⁸ *Id.* art. 20.

⁴⁹ *Id.* art. 8(2); see Filing Regulations, *supra* note 23.

- (7) information on officers and employees;
- (8) description of transactions with affiliated companies, shareholders, officers and employees;
- (9) detailed information on deposits, marketable securities, inventories, etc.; and
- (10) other necessary information.

If an issuer plans to issue shares at a price determined by the market, then the issuer may leave blank certain entries in the registration statement including the issue price.⁵⁰ Once the issue price is determined, however, the issuer must file an amendment to the registration statement.⁵¹

Although the registration statement requires a wide range of information, Korea's disclosure requirements are much less burdensome when compared to the disclosure requirements under the U.S. securities laws. For example, segment reporting, discussion of risk factors, management discussion and analysis of financial condition, results of operation and a detailed discussion of legal proceedings need not be included in a Korean registration statement. However, nonconsolidated and consolidated financial statements must be included in a Korean registration statement.

In addition to the registration statement, an issuer must submit, *inter alia*, the following documents:⁵²

- (1) articles of incorporation of the issuer;
- (2) a certified copy of the company registry regarding the issuer;
- (3) board of directors' resolution or similar document evidencing corporate actions taken with respect to the issuance of securities;
- (4) copies of all necessary government approvals in respect of the issuance;
- (5) a copy of any underwriting agreement;
- (6) an auditor's audit report; and
- (7) a securities analysis report prepared by the managing underwriters, if any.

⁵⁰ Filing Regulations, *supra* note 23, art. 9(1).

⁵¹ *Id.* art. 9(3).

⁵² *Id.* art. 10.

D. *Continuous Disclosure Requirement*

In addition to the information required by the registration statement, listed corporations and certain issuers who have filed registration statements must file annual reports with the SEC and the KSE.⁵³ Such annual report must include the following information: (1) the general condition of the corporation or issuer; (2) the corporation's or issuer's business operations and financial matters; and (3) a certified public accountant's audit opinion of the corporation or issuer.⁵⁴ Listed corporations which have a twelve months business year must file interim reports with the SEC and the KSE.⁵⁵

Further, listed corporations and certain issuers have an ongoing obligation to make full and prompt disclosures of all material corporate developments. To fulfill this ongoing obligation, all listed corporations and certain issuers are required to have at least two officers in charge of disclosing material corporate developments to the SEC and the KSE.⁵⁶ Finally, in cases where an event occurs which greatly affects the price or transaction volume of the relevant securities, the KSE may order the corporation or the issuer to make a public announcement of the reasons for such occurrence.⁵⁷

E. *Exempt Offerings*

Under the SEA, the public offering of the following categories of securities do not require the filing of a registration statement: (1) national government bonds; (2) local government bonds; (3) bonds issued by a corporation incorporated under special legislation; (4) certificates of capital contribution issued by a corporation incorporated under special legislation; and (5) other certificates or instruments designated by the Enforcement Decree. This means that among the eight categories of securities defined under the SEA, the public offering of only three types of securities will require the filing of a registration statement. They include (1) corporate bonds or debentures; (2) stock certificates or instruments representing a preemptive right to subscribe to new shares; and (3) certificates or instruments issued by a foreign country or corporation ("foreign securities") as desig-

⁵³ SEA, *supra* note 1, arts. 92(1), (3).

⁵⁴ *Id.* art. 92(2). *See also* MOFE Regulations, *supra* note 3, art. 15(1).

⁵⁵ SEA, *supra* note 1, art. 93.

⁵⁶ Regulation on Direct Disclosure by Listed Companies, art. 7(2), promulgated by the Korean Stock Exchange, July 8, 1988.

⁵⁷ SEA, *supra* note 1, art. 186(2).

nated by the MOFE.⁵⁸ So far, the MOFE has not designated any foreign securities as "securities" within the definition of the SEA. The MOFE, however, is expected to make such designation once foreign issuers are permitted to publicly offer their securities in Korea under the Foreign Exchange Management Law.⁵⁹

In addition to the exempted categories of securities, in the following cases a registration statement need not be filed:

- (1) small offerings not exceeding 100 million Won;⁶⁰
- (2) capitalization of reserves;⁶¹
- (3) stock dividends;
- (4) issuance of shares upon exercise of warrants or conversion rights;
- (5) issuance of shares due to mergers; and
- (6) stock splits or any other type of issuance of shares which does not require payment of consideration.⁶²

Finally, a registration statement need not be filed for a private offering of securities.⁶³

F. Problems

Although the Korean securities market is growing and becoming more internationalized, the Korean securities laws are not being clarified, amended or improved quickly enough to adequately accommodate the increasing number of international securities transactions. This is primarily because the Korean government was mainly interested in allowing Korean issuers to raise foreign capital but not in allowing foreign issuers to raise capital in Korea. However, as the global economy becomes increasingly interdependent and as most developed countries move towards open-door

⁵⁸ *Id.* art. 7.

⁵⁹ The MOFE announced that international financial organizations such as Asia Development Bank will be allowed to issue Won denominated bonds in Korea and that said bonds will be designated as securities under the SEA. Press release of the MOFE, Apr. 12, 1995.

⁶⁰ Interestingly, no provision prevents an issuer from splitting offerings into amounts less than the 100 million Won limit in order to evade the filing of a registration statement requirement.

⁶¹ Because there is no offering, issuance of shares in the above cases does not require filing of a registration statement.

⁶² *Id.*

⁶³ SEA, *supra* note 1, art. 8(1). See also Filing Regulations, *supra* note 23, art. 2.

economic policies, the Korean government will need to clarify, amend and improve many of its securities laws in order to keep pace and be able to effectively compete with other nations.

However, in order for these improvements to happen, other nations will also have to harmonize their securities laws. In particular, it is important that all nations try to move towards mutual recognition of each others' disclosure requirements. This is a critical step in the internationalization of the world's security markets.

V. ENFORCEMENT OF SECURITIES LAWS

A. *Criminal Liability*

A person may be subject to criminal liability if he fails to fully satisfy the disclosure requirements under the securities laws when making a public offering. For example, an issuer or an underwriter who makes an improper offer to a potential investor in the pre-filing period may be subject to a criminal sanction of up to two years imprisonment and a 10 million Won fine.⁶⁴ Also, an issuer or an underwriter who effects a distribution of securities by means of misleading statements or improper registration statements or prospectus may be subject to criminal sanctions of up to one year imprisonment and/or a 5 million Won fine.⁶⁵

B. *Civil Liability*

The SEA only has two provisions which create civil liabilities in connection with the distribution of securities: articles 14 and 197. Article 14 provides for civil liability for any untrue statement or omission of any material fact in a registration statement or prospectus.⁶⁶ Article 197

⁶⁴ SEA, *supra* note 1, arts. 8, 209.

⁶⁵ *Id.* arts. 13, 210.

⁶⁶ Article 14 provides:

If a subscriber or purchaser of securities suffers damages caused by the issuer's submission of false information in the registration statement or in the prospectus referred to in article 12, or by the omission of material information required to be stated therein, a person who falls under any one of the following items shall be liable for such damages; provided, however, that this provision shall not apply to such cases where the person who may be liable for damages established that he could not have had knowledge of such matters despite his exercise of due care, or where the subscriber or purchaser of such securities was aware of the fact at the time that he offered to subscribe for or purchase the securities:

provides for civil liability for an auditor who has caused damages to third parties because of an omission of a material fact or false or misleading statements in auditing statements included in a registration statement or prospectus.⁶⁷

Under the SEA, only the following persons are subject to civil liability: (1) the registrant of the registration statement or any person who has prepared or delivered the prospectus; (2) the directors of the issuer at the time of filing of the registration statement or promoters if the registration statement was filed prior to the incorporation of the issuer; (3) a certified public accountant or appraiser who has prepared the audit report included in the registration statement; and (4) an underwriter or dealer who has entered into an underwriting agreement with the issuer.⁶⁸ The SEA does not impose civil liability on persons making a secondary distribution of securities, persons controlling the issuer, and aiders and abettors.

Any person subject to civil liability has two defenses available to him.⁶⁹ First, if such person can prove that he could not have known of any untrue statement or omission even upon exercise of due diligence, then he will not be held liable.⁷⁰ Second, such person will not be held liable if he can prove that the purchaser of the relevant securities knew of the untrue statement or omission at the time of his offer to purchase the securities.⁷¹

In a civil liability action under article 14 or article 197, the purchaser of the securities may recover damages that resulted from any untrue statement or omission of a material fact in a registration statement or a prospectus. Damages are calculated by subtracting the market price of the securities (or the price at which the securities were sold) from the price the purchaser paid.⁷² The purchaser has one year from the discovery of the

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- (1) The registrant of the relevant registration statement and the directors at the time the registration statement is filed (the promoters, where such registration statement has been filed prior to incorporation);
 - (2) A certified public accountant or appraiser who have signed or certified that the entries in the registration statement or the documents attached thereto are true and correct;
 - (3) A person who has entered into an underwriting agreement for the securities with the issuer; or
 - (4) Any person who has prepared or delivered the prospectus.

SEA, *supra* note 1, art. 14.

⁶⁷ *Id.* art. 197.

⁶⁸ *Id.* art. 14.

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.* art. 15.

untrue statement or omission, or three years from the effective date of the registration statement, whichever is earlier, to file a claim under article 14 or article 197 of the SEA.⁷³

C. *Investigative Powers of the SEC*

Under article 128 of the SEA, the SEC has the power to investigate anyone who is suspected of violating the securities laws or if the SEC deems it necessary for the protection of the public interest or investors.⁷⁴ For purposes of this investigation, the SEC may require the person under investigation to submit reports or documents and may demand any person to appear as a witness.⁷⁵

D. *Problems*

Under the current regulations, the SEC's investigative powers are too limited. The SEC does not have the power to compel a person to comply with its investigations nor does it have the power to invoke the assistance of the courts by requesting an injunction. As the Korean securities market further develops and thus increases the possibility of more sophisticated illegal activities, the Korean government should strengthen the investigative powers of the SEC. Specifically, the Korean government should give the SEC broader powers so that the SEC will be able to compel persons under investigation to comply with its investigations. In addition, the government should amend the SEA so that it will specifically provide for injunctive relief.

Further, as the Korean securities market becomes more liberalized and internationalized, the problems relating to the enforcement of Korean securities regulations and foreign securities regulations against transnational securities transactions will increase. In order to combat these problems, the Korean government should expand the territorial reach of its securities laws and pursue international cooperation with foreign countries with major securities markets.

⁷³ *Id.* art. 16.

⁷⁴ *Id.* art. 128(1).

⁷⁵ *Id.* art. 128(2).

VI. REGULATION OF MARKET PROFESSIONALS

A. *Securities Companies*

1. *Licensing*

Under the SEA, only a legal entity that is a stock corporation (“*chusik hoesa*”) and that has obtained the necessary license from the MOFE may engage in the securities business, which includes dealing, brokering and underwriting of securities.⁷⁶ A separate license is required to engage in each type of securities business. Foreign entities are permitted to participate in the equity of a securities company⁷⁷ so long as a Korean national or a corporation incorporated under Korean law holds at least fifty percent of the legal paid-in-capital or the voting power of such securities company.⁷⁸ Further, the SEA authorizes the MOFE to approve the establishment of a domestic branch of a foreign securities company to engage in one or more of the above mentioned securities businesses.⁷⁹

In determining whether to grant a license to a stock corporation to engage in the securities business, the MOFE will consider the applicant’s financial condition and profitability, the applicant’s personnel, and the economic circumstances in the region where the applicant proposes to operate.⁸⁰ With respect to a foreign securities company wishing to establish a branch in Korea, certain general conditions must be satisfied before a license will be granted:

- (1) The applicant must be domiciled in a country that permits Korean securities companies to establish business entities engaging in the securities business;
- (2) The applicant must have operated a representative office in Korea for at least two years before the date of its application to establish a branch in Korea;
- (3) The applicant must demonstrate that it is qualified to engage in the securities business in its country of domicile;

⁷⁶ *Id.* art. 28(1)-(2).

⁷⁷ Securities company is defined as “a person engaged in the securities business pursuant to the SEA.” *Id.* art. 2(9).

⁷⁸ *Id.* art. 28(4).

⁷⁹ *Id.* art. 28-2(1).

⁸⁰ *Id.* art. 32.

- (4) The applicant must not have been subject to any serious sanctions during the past two years; and
- (5) The applicant must meet the operating funds or capital requirements mandated by the number of securities business activities the applicant intends to perform.⁸¹

2. *Post-Entry Regulation*

The SEA primarily regulates securities companies' asset management by setting maximum debt-asset ratios and minimum reserve requirements.⁸² Further, the SEA requires securities companies to keep books and records of its business operations and to file business reports with the SEC periodically, including profit and loss statements, balance sheets and other financial documents.⁸³

The SEA also regulates other aspects of the operation of the securities companies. Under Article 35 of the SEA, a securities company must obtain MOFE authorization for a merger, acquisition or sale of all or any part of its securities business, and must obtain SEC authorization for certain events, such as, (1) establishment or closing of a branch office, or (2) disposing of capital or earned surplus.⁸⁴ Further, upon the occurrence of certain events, such as a change in the directors or statutory auditors or a change in the location of the head office or branch office, a securities company must report such event to the SEC.⁸⁵

Finally, directors and statutory auditors involved in the daily operation of a securities company are prohibited from engaging in the daily operation of other companies or engaging in any other business without

⁸¹ The following is the required minimum operating fund needed per number of securities business activities:

Number of Securities Business Activities	Minimum Operating Fund
one	10 billion Won
two	15 billion Won
three	20 billion Won

Press release of the Ministry of Finance, Nov. 29, 1990.

⁸² *Id.* arts. 39-40.

⁸³ *Id.* art. 47. See also Securities and Exchange Commission's Bookkeeping Rules For Securities Companies, art. 12.

⁸⁴ *Id.* art. 35(1)-(2).

⁸⁵ *Id.* art. 36.

SEC authorization.⁸⁶ Also, directors and statutory auditors are prohibited from trading securities for their own accounts except in limited circumstances.⁸⁷

3. *Reporting Requirements for Foreign Securities Companies' Branches in Korea*

Under the Regulation on Operation of Securities Business of Local Branches of Foreign Securities Companies (the "Regulation on Operation") of the SEC,⁸⁸ before commencing business a foreign securities company's branch must submit a report to the Governor of the SSB regarding the personnel and facilities of the branch office.⁸⁹ Further, article 14-24 of the FEMR requires that the branch office file a report with the Bank of Korea on the commencement of its operations after such commencement.⁹⁰

After commencing business, a foreign securities company's branch in Korea must submit to the SEC the following account settlement documents each year: (1) business reports; (2) financial statements and schedules thereto; and (3) current status of shareholders.⁹¹ Further, pursuant to the Regulation on Operation, in the event of a merger of the head office, or when there is a change of an officer of the head office or upon the occurrence of other important events,⁹² the head office must report details of such

⁸⁶ *Id.* art. 48.

⁸⁷ *Id.* art. 42.

⁸⁸ Regulation on Operation of Securities Business of Local Branches of Foreign Securities Companies, promulgated by the SEC, Oct. 11, 1991 [hereinafter Regulation on Operation].

⁸⁹ *Id.* art. 3.

⁹⁰ FEMR, *supra* note 7, art. 14-24.

⁹¹ Regulation on Operation, *supra* note 88, art. 5.

⁹² Other important events include the following:

- (a) When there is a change in the articles of incorporation, company name, capital or location of the head office;
- (b) In the event of merger, reorganization, or liquidation of the head office;
- (c) In the event of suspension, resumption, or discontinuance of the business of the head office or any business office other than the branch in Korea;
- (d) When there is a change involving a major shareholder of the head office or in the relevant law governing its incorporation;
- (e) When there is a change in the name or location of the head office or any business office other than the branch in Korea;
- (f) When there is a change of an officer (or director, auditor or other person in a similar position) of the head office;
- (g) When all or a part of the business of the head office has been transferred or acquired;
- (h) In the event of the head office's mishap involving securities or if the head office is named as a party to a material law suit;

event, change or occurrence without delay to the SEC directly or through its branch office in Korea.⁹³ The Regulation on Accounting of Securities Companies⁹⁴ and the Regulation on Trading of Securities by Foreigners (the "Trading Regulation")⁹⁵ also impose certain reporting requirements.

B. Investment Advisory Companies

The investment advisory business is defined as "the business of providing advice, orally, in written form or by some other communication, regarding the value of, and the investment decision on, securities."⁹⁶ Under the SEA, only those corporations which have registered with the MOFE may engage in the investment advisory business. Accordingly, individuals and partnerships are not permitted to engage in the investment advisory business.

Foreign investment advisory companies and investment trust companies are permitted to establish representative offices in Korea with the approval of the MOFE. However, foreign companies are not yet permitted to establish branch offices in Korea. In determining whether to grant an approval to a foreign investment advisory company or investment trust company to establish a representative office, the MOFE will consider factors similar to those that were considered in the securities companies case above. Although the Korean government is expected to permit the establishment of branches in the future, it is not entirely clear exactly when such liberalization will occur.

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- (i) When adverse actions have been taken by the relevant authorities of the resident country of the head office, such as the imposition of a fine, order for cessation of business, revocation of permit (including any permits related to the securities business and similar licenses and registrations) due to a violation of the laws and regulations of the resident country or decrees or directives issued pursuant to such laws and regulations; and
 - (j) When any other important event relating to the protection.

Regulation on Operation, *supra* note 88, art. 7.

⁹³ *Id.* art. 7.

⁹⁴ Regulation on Accounting of Securities Companies, promulgated by the SEC, Dec. 16, 1977.

⁹⁵ Regulation on Trading of Securities by Foreigners, promulgated by the SEC, Oct. 1, 1991 [hereinafter Trading Regulation].

⁹⁶ SEA, *supra* note 1, art. 2(10).

VII. REGULATION OF INTERNATIONAL SECURITIES TRANSACTIONS

A. *Applicable Laws and Regulations*

Generally, international securities transactions involving Korean securities or investors are regulated by the SEA, FEMA (the Foreign Exchange Management Act), and FEMR (the Foreign Exchange Management Act Regulations). The purpose of the SEA is to minimize the disruption of the Korean securities market that may arise from foreign investment in Korean securities while the purpose of the FEMA and the FEMR is to regulate the inflow and outflow of foreign exchange.

B. *Foreign Acquisition of Korean Securities*

1. *General Background and Prohibition*

Korea opened its securities markets to direct foreign investment in January, 1992. Under the Trading Regulation, foreign investors can directly purchase and sell equity shares listed on the KSE, subject to certain limits and restrictions.

Except in the case involving foreign financial institutions in Korea, foreigners are not permitted to invest in government or corporate debt securities denominated in Won currency, whether listed or unlisted.⁹⁷ Foreigners are similarly prohibited from investing in unlisted equity shares or in stock savings accounts. However, foreigners are permitted to invest in securities issued overseas by Korean companies in the forms of bonds, convertible bonds, bonds with warrants and depository receipts which are denominated in foreign currency (together, the "Overseas Securities").

2. *Aggregate and Individual Foreign Investment Limit*

For foreign investment in equity shares listed on the KSE, either a "general limit" or "exceptional limit" is imposed on foreign ownership of the shares of each class of a Korean company. Under the general limit, the aggregate foreign investment in each class of a company's outstanding

⁹⁷ Trading Regulation, *supra* note 95, art. 3.

equity shares may not exceed 12%.⁹⁸ Further, each foreign investor is subject to an individual ownership limit of 3% of the total outstanding equity shares of each class of a listed company.⁹⁹

In the case of the exceptional limit, the 12% aggregate limitation is subject to reduction to 8% for government-designated public corporations with shares listed on the KSE.¹⁰⁰ In addition, the SEA provides that such government-designated public corporations may restrict individual foreign ownership of their shares in their articles of incorporation.¹⁰¹ Currently, only the Korea Electric Power Corporation, Pohang Iron & Steel Co., Ltd. and The Citizens National Bank are such government-designated public corporations. The articles of incorporation of Korea Electric Power Corporation, Pohang Iron & Steel Co. currently provide for a 1% ceiling on the acquisition by a single foreign investor of their common shares. Further, no foreign investment is permitted in shares of Korean companies designated as "general telecommunications service providers" under the Telecommunications Business Law.¹⁰² Currently, only two companies, Korea Telecom and DACOM Corporation, are designated in this category and only DACOM Corporation is listed on the KSE.

The 12% aggregate limitation is also subject to increase up to 50%, as determined by the SEC, for foreign invested companies established pursuant to the Foreign Capital Inducement Act¹⁰³ or the FEMA. Foreign invested companies of which the foreign shareholding is 50% or more of the outstanding equity shares may adopt an aggregate investment ceiling in excess of 50%, subject to the SEC's approval.

In determining whether the above limits have been reached or exceeded, all foreign shareholdings are counted regardless of whether the shares were acquired outside Korea or through the KSE and whether they are newly issued or were previously outstanding.

⁹⁸ *Id.* art. 5(1). In October 1994, the Korean government announced that it intends to raise this limit to 15% during 1995.

⁹⁹ *Id.* art. 5(1).

¹⁰⁰ *Id.* art. 5(2).

¹⁰¹ SEA, *supra* note 1, art. 200(1)

¹⁰² Telecommunications Business Law, Law No. 4394, Aug. 10, 1991.

¹⁰³ Foreign Capital Inducement Act, Law No. 3691, Dec. 31, 1983.

3. *Foreign Investment Limit Exceptions*

Under the Trading Regulation, foreign financial institutions, which are defined as Korean branches and subsidiaries of foreign banks, securities companies and insurance companies, are generally extended national treatment.¹⁰⁴ In other words, these foreign financial institutions are accorded the same treatment as domestic financial institutions. Accordingly, the foreign financial institutions are not subject to the individual or aggregate foreign ownership limits, nor are their shareholdings included in the calculation of foreign ownership ratios.¹⁰⁵ Furthermore, the foreign financial institutions are permitted to acquire Won-denominated debt securities listed on the KSE.¹⁰⁶ Finally, under the Trading Regulation, the aggregate and individual limits on foreign ownership may be exceeded in certain cases including where a foreign investor acquires shares pursuant to the Foreign Capital Inducement Act or pursuant to an approval by the MOFE under the FEMA.¹⁰⁷

4. *Penalties and Sanctions*

A foreign investor that acquires shares in excess of any of the limits described above may not exercise its voting rights with respect to the shares acquired in excess of such limits, and the SEC may take certain corrective actions pursuant to the SEA, including ordering disposal of such shares, imposing trading restrictions, and canceling the investment registration of such foreign investor.

5. *Foreign Investment Reporting Obligations*

In order to effectively monitor foreign investments, each foreign investor is required to register with the SSB (Securities Supervisory Board) and to obtain an investment registration card before making the initial investment. Foreign investors must register and subsequently trade shares under their real names. Further, when opening a transaction account with a securities company, the foreign investor must establish the account in its

¹⁰⁴ Trading Regulation, *supra* note 95, art. 18-2.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.* art. 3(2).

¹⁰⁷ *Id.* art. 8(1).

registered name and present its investment registration card. The securities company in turn must verify the identity of the investor and report to the SSB the details of the account and the initial order.

Thereafter, the Trading Regulation and the FEMR require that the foreign investors report to the SSB whenever shares are acquired or transferred outside the KSE.¹⁰⁸ Foreigners currently may not effect share transactions outside the KSE except in limited circumstances or when approved.

C. *Offerings and Sale of Foreign Securities in Korea*

1. *Current Regulations*

Offerings and sale of foreign securities are not regulated by the SEA because foreign securities are not "securities" within the definition of the SEA. Under the SEA, only those foreign securities specifically designated as "securities" by the MOFE are regulated thereby. However, so far, the MOFE has not designated any foreign securities as "securities" for the purposes of the SEA.

Offerings and sale of foreign securities, however, are regulated by the FEMA and the FEMR. Under the FEMA, a foreign issuer may not offer or issue any securities in Korea without an approval from the MOFE.¹⁰⁹ To date, such approval has never been given.¹¹⁰ However, under the FEMR, qualified Korean investors may invest in eligible foreign securities up to a certain amount as described below.¹¹¹

2. *Qualified Investors*

Under the FEMR, all foreign exchange banks are permitted to purchase foreign currency denominated securities as portfolio investments.¹¹² Except for a general ceiling on the total amount of investment in securities under the Banking Act,¹¹³ there are no limits to the amount of

¹⁰⁸ *Id.* art. 29.

¹⁰⁹ FEMA, *supra* note 6, art. 20(4).

¹¹⁰ However, in line with the internationalization of the Korean securities market, the MOFE announced that the listing of foreign equity securities on the KSE will be permitted from 1995.

¹¹¹ See *infra* notes 113-25 and accompanying text.

¹¹² FEMR, *supra* note 7, art. 2-1.

¹¹³ Bank Act. Law No. 139 of May 5, 1950, as amended.

foreign currency denominated securities a foreign exchange bank may purchase as portfolio investments. All Korean commercial banks, foreign bank branches, and certain financial institutions are eligible to become foreign exchange banks.

The following institutional investors are also permitted to purchase eligible foreign currency denominated securities as portfolio investments: (1) securities companies; (2) securities investment trust companies; (3) insurance companies; (4) short-term finance companies; (5) pension funds and other statutory funds; and (6) general trading and other companies which have export and import records of over US\$10 million for the previous year.¹¹⁴ Securities companies, securities investment trust companies, and insurance companies may invest in eligible foreign currency denominated securities without any limitation.¹¹⁵ However, short-term finance companies, pension funds, and other statutory funds may only invest in eligible securities up to US\$100 million.¹¹⁶ As for general trading and other companies which have export and import records of over US\$10 million for the previous year, the investment ceiling is the lesser of 30% of the export and import record for the previous year or US\$300 million.¹¹⁷

In addition to the foreign exchange banks and qualified institutional investors, as of July 1, 1994, individuals and corporations may invest in eligible foreign currency denominated securities as portfolio investments. Under the FEMR, the investment ceiling for individuals is 500 million Won (approximately US\$675,000)¹¹⁸ and the investment ceiling for corporations is 1 billion Won (approximately US\$1,250,000).¹¹⁹

3. *Eligible Securities*

Foreign exchange banks are permitted to invest in any type of foreign securities regardless of whether they are listed or unlisted.¹²⁰ Institutional investors are permitted to invest in certain qualified types of foreign currency denominated securities.¹²¹ Finally, corporations and individuals are only permitted to invest in the following foreign securities: (1) share

114 FEMR, *supra* note 7, arts. 10-49, 10-14.

115 *Id.* art. 10-51.

116 *Id.* art. 10-51.

117 *Id.* art. 10-51, 10-15.

118 FEMR, *supra* note 7, art. 10-53-4.

119 *Id.*

120 *Id.* art. 2-1.

121 *Id.* art. 10-50.

certificates, bonds and beneficial certificates listed on any one of thirteen reputable foreign stock exchanges designated by the Governor of the SSB;¹²² (2) securities issued by domestic corporations; and (3) beneficial certificates issued by domestic securities investment trust companies exclusively for foreigners.¹²³ In addition, corporations and individuals are permitted to invest in eligible securities only through securities companies permitted to engage in international securities business and designated by the MOFE.

VIII. CONCLUSION

The Korean economy and the Korean securities market have achieved remarkable growth in the past ten years. Along with this growth, the number of cross-border securities transactions significantly increased and the Korean securities market became more internationalized.

In line with this growth and internationalization of the securities market, the Korean government needs to improve and internationalize its securities laws in order to truly become a member of the international community and effectively compete with other nations. In particular, the Korean securities laws need to be clarified, improved and amended in order to adequately accommodate the increasing number of international securities transactions. However, at the same time, to protect the Korean investors, the disclosure requirements under the Korean securities laws must be strengthened and the regulatory agencies must be given broader powers so that they can effectively enforce the securities laws.

¹²² The thirteen foreign stock exchanges designated by the Governor of the SSB are the New York, London, Paris, Frankfurt, Zurich, Tokyo, Luxembourg, Amsterdam, Brussels, Hong Kong, Singapore, Kuala Lumpur and Thailand stock exchanges.

¹²³ FEMR, *supra* note 7, art. 10-53-3. See also Regulation on Trading of Foreign Currency Securities, art. 6, promulgated by the SEC, June 24, 1994.