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LEGAL COMPLIANCE AND KOREA’S FINANCIAL SERVICES MARKET: A STRATEGIC APPROACH

Young-Cheol Jeong†

Abstract: The purpose of this paper is to improve the compliance level in the Korean financial services market by proposing a more systematic approach to economic crimes. As one of the most important capital markets in Asia, the Korean financial services market has weathered well both the hardship of the Asian financial crisis and the challenges of the Great Recession. Thus, its policy directions and experience are valuable to other burgeoning capital markets around the world. This paper contributes to a better understanding of the compliance system in the Korean financial services market. Based on a literature review, this paper analyzes the three groups of counter-measures—criminal sanctions, administrative sanctions, and civil remedies. Currently, criminal sanctions on individuals are overly relied upon; administrative sanctions on corporate entities have become increasingly important; civil remedies by the damaged are not effective; and preventive efforts have been disregarded. The ultimate goal of regulations is to let regulated entities comply with legal requirements. With respect to crimes in the financial services market, educational and compliance programs should be implemented as important built-in enforcement tools. Enforcement mechanisms should encompass preventive and educational efforts. Further, redesigning new compliance structures based on education will free market players from fastidious regulatory policies and discretionary criminal indictment, and improve the trust in the financial system with minimal social costs.

I. INTRODUCTION

On September 1, 2010, the International Monetary Fund Executive Board, in its Article IV Consultation-Staff Report, observed that the South Korean (“Korean”) economy has had impressive success over the past year. The real GDP for 2009 was KRW 1,063 trillion, equalling about U.S. $1 trillion. The Board also projected 6.1% growth in 2010. Korea’s trade volume is expected to reach $1 trillion in 2011, after reaching an expected

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2 Id. at 24.  

3 Id. at 7.  

4 Korea’s exports are expected to increase by an estimated 10.3% in 2011, reaching $513 billion, while imports are expected to surge by 15.1% to $488 billion. KOREAN MINISTRY OF KNOWLEDGE ECONOMY, 2011 BUSINESS PLAN, available at http://www.mke.go.kr/news/bodo/bodoView.jsp?seq=65436&pageNo=3&srchType=1&srchWord=&pCtx=1.
$891.59 billion in 2010. Within the financial services market, the market capitalization at Korea Exchange (“KRX”) in 2009 was $834.5 billion. The amount of listed bonds as of 2009 was KRW 1,013 trillion. The total of bank loans to corporate customers and individuals was KRW 719 trillion and KRW 595 trillion, respectively, as of the end of 2010. Considering the global recession that started in 2007 is still lingering in Europe and the United States, the Korean economy’s recovery is “impressive.” Table 1 shows the market capitalization of major exchanges in the world.

<table>
<thead>
<tr>
<th>Exchanges</th>
<th>Unit: U.S. $1,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>NYSE Euronext</td>
<td>11,837,793</td>
</tr>
<tr>
<td>NASDAQ OMX</td>
<td>3,239,492</td>
</tr>
<tr>
<td>Shanghai SE + Shenzhen SE</td>
<td>2,704,778 + 868,374 = 3,573,152</td>
</tr>
<tr>
<td>Singapore</td>
<td>481,267</td>
</tr>
<tr>
<td>KRX</td>
<td>834,596</td>
</tr>
<tr>
<td>HK</td>
<td>2,305,142</td>
</tr>
<tr>
<td>Bombay SE</td>
<td>1,306,520</td>
</tr>
</tbody>
</table>

Note: KRX had exceeded $1 trillion by the end of 2010, due to the sound economy, qualitative easing, and KRW appreciation.

Source: World Federation of Exchanges

In contrast to the successful economic performance, the Korean business community has been in a vicious cycle of ad hoc criminal and administrative investigations, sanctions, and pardons. In 2010, several

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6 The term “financial services market” includes the insurance industry in most cases. However, it sometimes refers to only banking and capital market industries, depending on the context.
8 Id. Public and private bonds were KRW 759 trillion and KRW 254 trillion, respectively. Id.
10 IMF, supra note 1, at 3; see also Jong-Goo Yi, Commissioner, Fin. Service Comm’n (“FSC”), Presentation at Korea-FSB Reform Conference: Korea’s Experience and Policy Responses to Global Financial Crisis, (Sept. 3, 2010).
11 The amount of market capitalization was KRW 1.239 trillion. Review of 2010 Statistics, KOREA EXCHANGE (“KRX”), http://eng.krx.co.kr/m8/m8_5/m8_5_1/BHPENG08005_01_01.jsp (last visited Apr. 27, 2011).
12 This vicious cycle, however, is not limited to Korea. Raaj K. Sah, Social Osmosis and Patterns of Crime, 99 J. POL. ECON. 1272, 1280 (1991) (“An individual has a higher current propensity for crime if fewer resources were spent on the criminal apprehension system during a past period of his active life. Fewer resources dilute the resources spent on apprehending each criminal.”). See generally MARTIN T. BIEGELMAN & JOEL T. BARTOW, PREVENTION AND INTERNAL CONTROL (2006).
conglomerates came under investigation for the crimes of embezzlement or breach of fiduciary duty, leading to the prosecution of several executives from major Korean corporations. On August 13, 2010, a group of business leaders were pardoned, including those whose sentences were finalized less than a year before. These cases demonstrate prevalent financial misconduct in Korea, as well as a disregard for legal compliance by top management. The rule of law in Korea, as far as the business world is concerned, has a long way to catch up to be on par with the economic performance. The gap between the economic performance and the legal quagmire demonstrates the urgent need to develop a more effective enforcement mechanism. It is indeed one of many challenges that Korean lawyers, along with other parts of Korean society, should seek to overcome.

Korea relies heavily on criminal sanctions in regulating financial markets. The Public Prosecutor’s Office has long been one of the business

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14 See, e.g., Policy News, KOREAN MINISTRY OF JUSTICE, Aug. 13, 2010. Five Samsung executives were sentenced in 2009 for managing slush funds and avoiding tax. Id. The chairman was pardoned at the 2009 year-end pardon exercise. Id. Operators of more than KRW 4.5 trillion slush funds were cleared within three years from the date of investigation by special prosecutors. Id. Samsung Securities, which was a conduit of operating the funds, was just warned. Id. Samsung Life Ins. executives who destroyed evidence were released. Id. This might be a necessity to balance the need to maintain the rule of law against the wider public interest, such as that of the national economy.

15 See infra Table 4. Over-criminalization in the United States has also been the subject of criticism. See, e.g., John C. Coffee, Jr., Does “Unlawful” Mean “Criminal”?: Reflections on the Disappearing Tort/Crime Distinction in American Law, 71 B.U.L. REV. 193 (1991) (“[B]lurring of the border between tort and crime predictably will result in injustice.”); Steven Williams, The More Law, the Less Rule of Law, 2 GREEN BAG 2D 403, 405 (1999) (“As the commands of the state multiply, there is a corresponding decline in the fraction of those commands that people can be expected to comply with.”); William J. Stuntz, The Pathological Politics of Criminal Law, 100 MICH. L. REV. 505, (2001) (“Criminal law does not drive criminal punishment . . . . [T]he role [the definition of crimes and defenses] plays is to empower prosecutors, who are the criminal justice system’s real lawmakers.”); Paul H. Robinson & John M. Darley, Does Criminal Law Deter? A Behavioral Science Investigation, 24 OX. J. LEGAL STUD. 173, 175-917 (2004) (arguing deterrence does not work because of the legal knowledge hurdle, the rational choice hurdle, and the perceived net cost hurdle). Sentence severity may have a limited effect on compliance. See generally Anthony N. Doob & Cheryl Maire Webster, Sentence Severity and Crime: Accepting the Null Hypothesis, 30 CRIME & JUST. 143, 145 (2003) (“[T]he deterrent impact of penalty size has been seriously challenged by modern criminology.”) (internal quotation marks omitted); Cass R. Sunstein, Book Review: The Laws of Fear, 115 HARV. L. REV. 1119, 1123 (2002) (“[P]eople often neglect probabilities [and] focus on worst case outcomes.”).
sector’s most feared agencies (along with the National Tax Administration and the Board of Audit and Inspection), although now to a lesser degree than in the past. Almost every instance of misconduct in the financial market automatically leads to criminal sanctions, at least according to statute.\(^\text{16}\) The basic regulatory theory and principle in Korea appears to be that more severe penalties will naturally reduce crimes.\(^\text{17}\) Criminal sanctions, traditionally regarded as the most forceful sanctions an individual can face, are an attempt to ensure compliance founded on fear;\(^\text{18}\) individuals fear going to prison when they violate the law. Administrative sanctions, especially civil fines, are another method grounded on fear. Corporate entities are loath to part with their hard-earned economic gains when they breach legal requirements.\(^\text{19}\) Sanctions, however, are more effective for retributive justice rather than for preventive justice.\(^\text{20}\) Additionally, sanctions are not effective in handling all crimes, and their use likely leads to under-enforcement.\(^\text{21}\) As the Korean financial services sector expands in size and geography and becomes more complicated and specialized, criminal and administrative sanctions tend to be less effective at curbing misconduct in the market. As the number of cases and complaints increases,\(^\text{22}\) the current Korean regulation system is at risk of severe under-enforcement. In turn, this could erode civic norms of obedience.\(^\text{23}\)

This article argues that in order to avoid such an undesirable situation, Korea should strengthen its preventive regulatory system. To combat


\(^{17}\) Responses to the recent savings bank crisis exhibit the same severe penalties. See Press Release, Financial Services Board, Stricter Supervision of Savings Bank (Mar. 17, 2011); Se Young Lee, South Korea fights fire among its savings bank, WALL ST. J., Feb. 18-20, 2011, at 20; Se Young Lee, South Korea suspends 4 more savings banks, WALL ST. J., Feb. 21, 2011, at 20; Se Young Lee, Korea will stiffen bank supervision, WALL ST. J., Mar. 21, 2011, at 21.

\(^{18}\) JEREMY BENTHAM, PRINCIPLES OF MORALS AND LEGISLATION, Ch. I (1789).


\(^{20}\) See supra note 15 (discussing the inefficacy of criminal punishment as a deterrent).


\(^{23}\) See Cheng, supra note 21, at 659-61. Additional problems associated with retributive sanctions include a substantial risk of arbitrary and discriminatory enforcement, harm to the authority of the law, and degradation of law enforcement into a sporting chance. Id.
economic crimes, future enforcement efforts should focus on a forward-looking perspective—systematic and strategic preventive mechanisms and incentivized rewards, accompanied by reasonably certain and severe penalties. Sanctions and preventive measures are not sequential, however. Instead, they should co-exist. They are not a matter of choice or replacement, but a matter of focus and perspective.

This article is an attempt to improve compliance by introducing preventive mechanisms to the enforcement structure of financial services market crimes in Korea, thereby re-establishing the authority of the law. This is an essential and necessary step before Korea is truly ruled by law and thus establishes itself as a financially advanced country. Part II reviews the regulatory structure of the financial services market in Korea. Part III explores the status of ex post facto counter-measures for economic crimes. It will show that criminal sanctions are the traditional answer to crimes in Korea. Administrative sanctions, including civil fines, are the second most popular response, and civil actions for compensation of damages are just emerging. Part IV provides an overview of ex ante mechanisms under current Korean laws. Although they appear ineffective and even perfunctory, some preventive control mechanisms are in place in several statutes. Finally, Part V presents proposals to make these existing mechanisms more effective. First, preventive measures should become the favored means of improving these mechanisms. Courts should consider a company’s preventive efforts as mitigating factors when a breach occurs. Education, which has driven economic development in Korea for the past several decades, should also be a major part of prevention-based enforcement. Second, the rules themselves must be clear and limit discretionary enforcement. Various sanctions should be coordinated to the effect that law enforcement is not left to chance. Finally, in striking a

24 The term “economic crime” in Korea is broader than white-collar crime or corporate crime in other jurisdictions. See JUDICIAL RESEARCH TRAINING AND INSTITUTE, DISCUSSION ON ECONOMIC CRIMES 3-10 (2009). According to most public prosecutors, “economic crime” also covers customs duty violations and intellectual property rights infringement crimes. Id. It is characterized as profit-motivated, imitative, and corrupt. Id. Some use the term “financial crimes” and they are classified into four groups: corruption, fraud, theft, and manipulation. See Petter Gottschalk, Categories of Financial Crime, 17 J. FIN. CRIME 441, 443 (2010). Each category has subsets of crimes. Id. Corruption, for example, includes kickbacks, bribery, extortion, and embezzlement. Id. This article uses the terms “financial crime,” “economic crime,” and “crime in the financial market” interchangeably.

balance between public and private and between criminal and administrative, enforcement mechanisms should move towards the latter in both cases.

II. REGULATORY STRUCTURE OF FINANCIAL SERVICES MARKETS

Part II provides an overview of the Korean laws applicable to financial sectors. While financial services are in the process of convergence, the regulatory legal scheme is still compartmentalized because three different statutes regulate banking, capital markets, and insurance. On the regulatory agency level, the Financial Services Commission covers financial services in general and establishes regulatory policies. The Financial Supervisory Services then implements the policies across the board.

A. Applicable Laws

The Banking Act, the Financial Investment Services and Capital Markets Act ("Capital Markets Act"), and the Insurance Business Act (collectively, "the tripartite statutes") are three pillars that support the financial services market. Aside from the tripartite statutes, separate statutes govern special banks, such as the Korea Development Bank, Industrial Bank of Korea, and Korea EXIM Bank. Mutual savings banks and capital companies for both consumers and small-to-medium enterprises are governed by the Mutual Savings Banks Act and the Special Credit Financial Business Act.

For the past decade, the Banking Act and the Insurance Business Act have undergone frequent amendments—five times for the Banking Act and

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26 Banking Act, supra note 16.
six times for the Insurance Business Act.\(^{32}\) Most changes were not motivated by a concern for specific financial crimes or misconduct. Instead, two other factors drove the amendments. First, they were the result of a general industry trend from government-dominated, implicit, bureaucratic regulations toward privatized, lucid regulations for investors. Second, they were driven by an aim to protect the interest of investors and creditors by reducing the possibility of major shareholders privatizing controlling interests. For example, the most recent amendment to the Banking Act liberalized the scope of the banking business sector and improved the corporate governance structure.\(^{33}\) The most recent change to the Insurance Business Act increased protection of insurance consumers by imposing a duty to explain and by making corporate governance more transparent.\(^{34}\)

The enforcement of the Capital Markets Act in 2009 resulted in sweeping changes because it consolidated six investment banking business-related laws: the Securities and Exchanges Act, Futures Trading Act, Asset Management Business Act, Trust Business Act, Merchant Banking Business Law, and Korea Securities and Futures Exchange Act. Before the Capital Markets Act, the six laws regulated different segments of the financial industry with the same function—overseeing business licenses.\(^{35}\) Thus, the Capital Markets Act was a game changer, moving Korea’s institutional regulatory framework to a functional regulatory framework.\(^{36}\)

The Capital Markets Act also delegated much of its rule-making and enforcement functions to self-regulating organizations such as the Korean Exchange (“KRX”) and the Korean Financial Investment Association (“KOFIA”). For example, KRX has the authority to establish listing/disclosure standards and trading/settlement rules at the KRX exchange,\(^{37}\) while KOFIA approves over-the-counter derivative products.\(^{38}\) Accordingly, KRX and KOFIA have established many regulations on capital markets.


\(^{33}\) Banking Act, \textit{supra} note 16.

\(^{34}\) Insurance Business Act, \textit{supra} note 28.

\(^{35}\) Consolidation is still on its way in the sense that banking and insurance are still separately regulated by different statutes.


\(^{38}\) \textit{Id.} arts. 283-93.
B. Regulatory Agencies

The legal structure employs three different statutes to govern financial intermediaries such as the merchant banking, investment banking, and insurance industries. In contrast, all financial services are regulated by one centralized agency. In other words, although institutional fragmentation still exists among these financial intermediaries, the regulatory organizations governing them were completely unified immediately after the 1997 financial crisis into one agency—the Financial Services Commission.

The Financial Services Commission was launched as the policy development agency, taking over the role of the Ministry of Finance. Based on authorization from the Banking Act, the Capital Markets Act, and the Insurance Business Act, the Financial Services Commission establishes policies regarding financial markets in general. Meanwhile, Financial Supervisory Services, a private entity, became the implementation arm under the Financial Services Commission. It primarily handles enforcement functions, although not exclusively. The Securities and Futures Commission, under the Financial Services Commission, maintains the primary authority to make decisions on administrative sanctions for certain breaches under the Capital Markets Act. KRX and KOFIA, as self-regulating organizations, have the authority to monitor and sanction their members.

C. Investigation

When violations of the tripartite statutes occur, a prosecutor may initiate an investigation if he or she reasonably believes that such investigation would lead to successful criminal prosecution under the

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40 KOREA MINISTRY OF GOVERNMENT LEGISLATION, supra note 36.

41 The rules and procedures of the Financial Services Commission are available at http://www.fsc.go.kr/eng/.

42 Financial Services Commission Act, supra note 39, arts. 24-50.

43 Id.

44 Capital Markets Act, supra note 16, art. 439. The Securities and Futures Commission (“SFC”) regulates unfair trading activities, which include insider trading, the 5% rule, major shareholder reporting, short-term windfall profits, failure to file periodic disclosure documents, the filing of false registration statements, and price manipulation. Id. arts. 172-74, 176, 178, 180, 427.

Korean Criminal Procedural Act. In practice, however, market regulators have the responsibility and power to monitor the market. Thus, in instances of abnormalities in trading, the KRX has the primary authority to request that the financial investment licensee produce relevant materials, or to audit the status of the assets, books, and other materials of its members. The Financial Services Commission may also request that KRX or the Financial Supervisory Services use the audit process and file a report. For banks and insurance companies, the Financial Services Commission can ask the Financial Supervisory Services to audit the questionable practices.

An agency may only initiate an investigation after establishing that it possesses the proper authority to do so. The Financial Services Commission may launch its own investigation procedure by requesting that a relevant party submit an affidavit, take the witness stand, or produce documents. If the Securities and Futures Commission wishes to investigate unfair trade practices, it may secure a search warrant from the court for such exercise. In the case of the most serious violations, the Financial Services Commission files a criminal complaint with the Public Prosecutor’s Office for indictment. The Public Prosecutor’s Office can also investigate the KRX, the Financial Supervisory Services, and other self-regulating organizations with the assistance of experts from these organizations.

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50 Capital Markets Act, supra note 16, art. 410.
51 See id. art. 426(1).
52 See id. art. 426(2).
53 See id. arts. 172-74, 176, 178, 180.
54 See id. art. 427.
55 See, e.g. Se Young Lee & Alison Tudor, South Korea Sanctions Deutsche Unit for Market Manipulation, WALL ST. J.; see also Press Release, Financial Services Commission, Price Drop on Option Expiration Date (Feb. 23, 2011).
56 According to the Financial Supervisory Service (“FSS”), predominant cases were transferred to the public prosecutor’s office. See FSS, 2009 YEARBOOK, Table 2-18 (2010). In the case of unfair trading, more than 80% of cases ended up with a criminal indictment. Id. at 69.
57 Judicial Research and Training Institute, supra note 24, at 216-17.
III. **EX POST FACTO MEASURES**

Part III explores the types and scopes of legal sanctions imposed when violations occur. Depending on the legal nature of the initiating entity, legal sanctions may be public or private. Public sanctions comprise two types of sanctions: criminal and administrative. Criminal sanctions commence when the prosecutory organization issues a criminal indictment and end when the court imposes a sentence. By contrast, administrative sanctions commence and end at the initiative of administrative agencies, such as the Financial Services Commission. If the violator wants to challenge the administrative sanctions, he or she can file a complaint with the court and seek revocation of such administrative measures. Alternatively, private individuals may sue in court for damages in accordance with the court’s procedural rules.

A. **Criminal Sanctions**

Criminal sanctions are the most severe form of legal sanctions. What conduct constitutes a crime and who is punishable are important policy issues. The process of criminalization is particularly significant.

1. **Strata of Criminal Conduct**

The tripartite statutes—the Banking Act, the Capital Markets Act, and the Insurance Business Act—take the typical structure of a statute in Korea; the last chapter of each statute is about penalties. In the case of the Banking Act, criminal conduct is subject to four tiers of sanctions: group one for up to ten years imprisonment or a fine of KRW 500 million;\(^\text{58}\) group two for up to five years of imprisonment or a fine of KRW 200 million;\(^\text{59}\) group three for up to three years of imprisonment or a fine of KRW 100 million;\(^\text{60}\) and group four for up to one year of imprisonment or a fine of KRW 30 million.\(^\text{61}\) The Capital Markets Act adopts the same four-tiered system: imprisonment of ten, five, three and one year(s); and a fine of KRW 500, 200, 100, and 30 million, respectively (see Table 2).\(^\text{62}\) The Insurance Business Act mandates a five-tier system: imprisonment of ten, seven, five, three and one years.\(^\text{63}\) The corresponding fines are lower than under the Banking Act and the Capital Markets Act: KRW 50, 40, 30, 20, and 10

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\(^{58}\) Banking Act, *supra* note 16, art. 66(1).

\(^{59}\) *Id.* art. 66(2).

\(^{60}\) *Id.* art. 67.

\(^{61}\) *Id.* art. 68(1).


\(^{63}\) Insurance Business Act, *supra* note 28, arts. 197-204.
million, respectively (see Table 3). It is not clear why the fines under the Insurance Business Act are lower than those under the Banking Act or the Capital Markets Act. It may be because the Banking Act and Capital Markets Act were revised recently, increasing the amount of fines, while the Insurance Business Act’s fines simply have not been correspondingly revised. The Banking Act and the Capital Markets Act are often subject to discussions for revisions, while the Insurance Business Act has received less criticism.

**[Table 2] Criminal Conduct and Sanctions Under the Banking Act & Capital Markets Act**

<table>
<thead>
<tr>
<th>Tier</th>
<th>Sanctions (in years/KRW million)</th>
<th>Statutory Provisions (Number of categories of criminal conduct)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Banking Act</td>
</tr>
<tr>
<td>Tier 1</td>
<td>10 years/KRW 500</td>
<td>Art. 66(1) (four)</td>
</tr>
<tr>
<td>Tier 2</td>
<td>5 years/KRW 200</td>
<td>Art. 66(2) (one)</td>
</tr>
<tr>
<td>Tier 3</td>
<td>3 years/KRW 100</td>
<td>Art. 67 (two)</td>
</tr>
<tr>
<td>Tier 4</td>
<td>1 year/KRW 30</td>
<td>Art. 68(1) (eight)</td>
</tr>
</tbody>
</table>

a) If the amount of damages arising out of criminal conduct exceeds KRW 500 million, the maximum sentence ranges from 3 years to life. Capital Markets Act, Art. 443(2).

Source: Banking Act & Capital Markets Act

**[Table 3] Criminal Conduct and Sanctions Under the Insurance Business Act**

<table>
<thead>
<tr>
<th>Tier</th>
<th>Sanctions (in years/KRW million)</th>
<th>Statutory Provisions</th>
<th>Number of Categories of Criminal Conduct</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 1</td>
<td>10 years/KRW 50</td>
<td>Art. 197</td>
<td>One</td>
</tr>
<tr>
<td>Tier 2</td>
<td>7 years/KRW 40</td>
<td>Arts. 198 &amp; 199</td>
<td>Five</td>
</tr>
<tr>
<td>Tier 3</td>
<td>5 years/KRW 30</td>
<td>Arts 200 &amp; 201</td>
<td>Six</td>
</tr>
<tr>
<td>Tier 4</td>
<td>3 years/KRW 20</td>
<td>Art. 202</td>
<td>Six</td>
</tr>
<tr>
<td>Tier 5</td>
<td>1 year/KRW 10</td>
<td>Art.203</td>
<td>Thirteen</td>
</tr>
</tbody>
</table>

Source: Insurance Business Act

The current criminal sanctions are quite mechanical, at least in terms of statutory provisions. Minor failures to report a quarterly report, for example, go to the catch-all administrative fine section. Except for those minor infractions, almost every violation of statutory prohibitions or other

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64 See *supra* notes 31-32 (citing revisions of the Banking Act and Insurance Business Act).

65 Insurance Business Act, *supra* note 28, art. 449(1)-(13). Violations that are subject to administrative fines are perceived to be less egregious than those subject to criminal sanctions. However, such a distinction does not always make sense. For example, a failure to institute internal control systems is a serious violation, yet it is only subject to administrative fines. See *id.* art. 449(1)-(9).
requirement falls within one of four or five categories and each category corresponds with a certain combination of imprisonment and fines.\(^{66}\)

There is much room for improvement. First, it is undesirable to criminalize every violation of almost every section in the tripartite statutes.\(^ {67}\) This is the archetypal over-criminalization of government policies.\(^ {68}\) Criminal conduct should be limited to critical violations that would damage the system itself. Only price manipulation, insider trading, and false accounting should be conceptualized as securities crimes. Second, imprisonment for up to ten years should not merely be an alternative to a KRW 500 million fine.\(^ {69}\) Imprisonment, along with the confiscation of economic gains, would be a better option because violations could be more effectively deterred by making them costly.\(^ {70}\) Third, it should be considered whether ten years is an appropriate maximum term of imprisonment. For example, in the case of capital market fraud, the current maximum term of five years is disproportionate to the violations; a longer term would be more appropriate.\(^ {71}\) Finally, the scope of discretion permitted by the Capital Markets Act is too broad. The same violation could be subject to ten years imprisonment and/or a fine of KRW 500 million.\(^ {72}\) This wide discretion within the hands of the prosecutor’s office and the judicial branch should be controlled, or at least checked, to prevent any abuse of discretion.

2. Liability

The prohibitions and requirements under the tripartite statutes are addressed to individuals, corporate entities, or both. For example, individual CEOs not only must certify the accuracy of periodic filing statements of their investment banking houses, but must also file their own personal periodic reports with the Financial Services Commission. Regarding criminal sanctions, the complex relationship between an individual and the

\(^{66}\) See id. arts. 197-204.

\(^{67}\) In-Bong Jang, supra note 49, at 257-58.


\(^{69}\) See Banking Act, supra note 16, art. 66(1).

\(^{70}\) The Capital Markets Act provides for the possibility of dual sanctions: imprisonment and criminal fines. Capital Markets Act, supra note 16, art. 447. For tier one violations, fines equal treble damages—three times the amount of gains acquired or loss avoided. Id. This treble damage concept should be expanded to violations under tiers two through four, though it may not always be easy to calculate the amount of gains or loss, depending on the violation type.

\(^{71}\) Id. art. 444(13).

\(^{72}\) Id. art. 443.
corporate entity for which the individual is working presents a challenging legal issue.73

The tripartite statutes have one section in common—dual penalty clauses.74 Under the clause, if an individual violates the obligations or prohibitions under applicable statutes, the corporate entity shall also be held responsible for a fine.75 If the corporate entity breaches its obligation under the applicable statutes, the corporate entity as well as individuals shall be subject to criminal sanctions.76 This type of clause is common to almost every regulatory statute in Korea,77 but their desirability and scope remains controversial.78 Because a corporation is a hypothetical legal creation, corporate criminal liability due to individual misconduct creates a more mysterious concept; some scholars argue the individual must bear the blame, while others rely on respondeat superior to implicate the corporation.79

The dual penalty clauses under the tripartite statutes raise the question of whether a corporate entity could or should be subject to criminal sanctions, and if so, when and how.80 Despite many discussions about the desirability or theoretical possibility of corporate criminal liability, corporations are, in reality and by nature, only subject to a fine.81 The practical issue is under what conditions a corporate entity should be held responsible for an individual’s conduct. In general, corporations are liable

74 See Banking Act, supra note 16, art. 68(2); Capital Markets Act, supra note 16, art. 448; Insurance Business Act, supra note 28, art. 208.
75 Id.
76 Id.
78 See infra note 83.
81 The liquidation of a business or the temporary suspension of its license is, in effect, the same as a death sentence or imprisonment for an individual; such measures, however, are not penal sanctions, but administrative sanctions.
for the acts of employees if the employees are acting within the scope of their employment for the benefit of the corporation. The tricky question is whether the intent of the individual should be automatically imputed to the corporation, without the corporation’s own negligence being a factor. The dual penalty clauses in many administrative laws used to have no reference to this issue. After the Korean Constitutional Court rendered unlimited dual penalty clauses unconstitutional in several cases, however, new words were added to the effect that a corporate entity is responsible only if it fails to exercise due care over the supervision of the relevant matter. This new law compels corporate entities to use due diligence in order to avoid criminal sanctions.

In addition, the tripartite statutes are unclear as to whether an individual or a corporate entity should be held responsible for having aided or abetted other companies that violated legal prohibitions or demands. A traditional judicially-imposed theory is that criminal sanctions based on regulatory administrative statutes can be imposed on aiders and abettors to the same extent as principals; this is unlike the weaker liability for aiders and abettors found in the Criminal Act. Such exceptional treatment for regulatory administrative law violators, however, should be clearly grounded in statute, not judicial interpretation. Furthermore, it is doubtful that criminal sanctions based on regulatory administrative statutes should be distinguished from the crimes under the Criminal Act. If aiders and abettors are generally responsible under the Criminal Act, and corporate entities are also responsible for individuals under the dual penalty clause, 

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82 See Beale, supra note 80, at 1488 (noting that in the United States, the legal ground for civil corporate responsibility for a single employee’s actions is respondeat superior).

83 For example, art. 68(2) of the Banking Act was revised on May 17, 2010 to silence discussions about constitutionality of uniform dual penalty clauses.


85 See, e.g., Capital Markets Act, supra note 16, art. 448 (requiring failure of due care for corporate criminal liability); Banking Act, supra note 16, art. 68(2) (same); Insurance Business Act, supra note 28, art. 208 (same).


87 See Hyongbup [Criminal Act], Act No. 293, Sept. 18, 1953, amended by Act No. 7623, Jul. 29, 2005, art. 32 (hereinafter Criminal Act) (providing for reduced penalties for accomplices).


89 See Criminal Act, supra note 87, arts. 31-32.

90 See supra notes 74-76 and accompanying text.
then prosecutors may be able to argue for a higher degree of liability for corporate criminals than for individuals under the tripartite statutes. Because the Korean Constitution outlaws double jeopardy and ensures the right to a fair trial,91 these acts may push the limits of constitutionality.

3. **Investigative Procedure**

As discussed above, the Financial Services Commission, the Securities and Futures Commission, and the Financial Supervisory Services have the authority to investigate and determine market misconduct.92 For unfair transactions and certain other types of misbehavior in the capital market, the Securities and Futures Commission has the authority to determine the ultimate measures to be imposed on rule-violating investment banks.93 At the same time, banks and insurance companies are subject to the sanctions imposed by the Financial Services Commission. Thus, the relationship between the Financial Services Commission and the Securities and Futures Commission is not always clear.

Even if the violators are investigated and indicted by the Public Prosecutor’s Office, Financial Supervisory Services would perform the initial phase of the investigation as a matter of practice.94 Table 4 illustrates the volume and outcome of investigations performed by the Financial Supervisory Services for the past several years.

<table>
<thead>
<tr>
<th>Year</th>
<th>Notice to Prosecutor’s Office</th>
<th>Orders to return short windfall profits</th>
<th>Warnings, etc.</th>
<th>Total number of cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>186</td>
<td>56</td>
<td>17</td>
<td>259</td>
</tr>
<tr>
<td>2006</td>
<td>132</td>
<td>24</td>
<td>9</td>
<td>165</td>
</tr>
<tr>
<td>2007</td>
<td>138</td>
<td>50</td>
<td>14</td>
<td>202</td>
</tr>
<tr>
<td>2008</td>
<td>115</td>
<td>35</td>
<td>7</td>
<td>157</td>
</tr>
<tr>
<td>2009</td>
<td>142</td>
<td>16</td>
<td>18</td>
<td>176</td>
</tr>
</tbody>
</table>

Source: Financial Supervisory Services 2009 YEARBOOK

However, the Seoul Central District Court recently held that Financial Supervisory Services officials had no authority to prepare legally valid

91 Daehanminkuk Hunbeob [Constitution] arts. 12-13, 27.
92 Financial Services Commission Act, see supra note 39, art. 17(4); supra notes 42-43 and accompanying text.
94 A recent investigation of a corporation by the public prosecutor’s office is an exception to the general practice.
interrogatories at the request of the Securities and Futures Commission, because the officials cannot be regarded as special police. However, it seems legitimate and reasonable to support the investigatory authority of the Financial Supervisory Services, as it is the most important organization that has the necessary expertise on the capital market, and thus should be responsible for the initial phase of the investigation. One solution would be to designate the appropriate Financial Supervisory Services officials as special police. Another solution would be to add procedural safeguards to the Capital Markets Act relating to the Financial Supervisory Services’ investigative procedures.

B. Administrative Sanctions

For less serious violations, the Financial Services Commission, upon investigation, can issue administrative orders in addition to, or instead of criminal sanctions. Such orders can be addressed to the firms and/or the individuals. If revocation of a business license is comparable to a death sentence for an individual, suspension of license is equivalent to imprisonment. Furthermore, suspension of a business license can cause more substantial economic loss to the business entity than a fine. Accordingly, administrative sanctions can be more effective and less costly for enforcement than criminal sanctions.

1. Revocation or Suspension of Licenses

The Financial Services Commission can issue various orders to a financial investment business that has violated the Capital Markets Act. The most devastating order the agency may issue is the revocation of a business license. The Capital Markets Act lists eight specific grounds for imposing such a measure in order to prevent abuse of enforcement. If a business’ licenses are revoked, the business entity must be liquidated.

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99 Id. art. 420(1).
100 Id. Items include fraud, violation of conditions for a license, doing business during the suspension period, and failure to fulfill an FSC corrective or cease and desist order. Id.
101 Id. art. 420(2).
Foreign financial investment business entities are also subject to the same sanctions, but on different grounds.\textsuperscript{102}

Because revocation of licenses can be a death sentence to a corporation’s existence, the Financial Services Commission is required to have formal hearings before issuing this sentence.\textsuperscript{103} For less serious violations, the Financial Services Commission may: 1) suspend all or part of a business for up to six months; 2) transfer trust contracts; 3) correct or suspend business activities in violation; 4) make a public announcement of the sanctions; \textsuperscript{104} 5) issue a warning; 6) issue a reprimand; or 7) issue miscellaneous sanctions.\textsuperscript{105} Due to the Administrative Procedure Act, these measures also require notice and a hearing.\textsuperscript{106} As long as due process is secured, business license-related sanctions are desirable for efficiency and should be utilized more often than criminal sanctions. This would ultimately help financial institutions continue business with their customers. The issue is then how to ensure procedural protection for the customers.

2. \textit{Civil Fines}

Civil fines were introduced into the Korean legal system as part of the Monopoly Regulation and Fair Trade Act in 1980.\textsuperscript{107} Based on the Act, the Korea Fair Trade Commission has established a new financial model for developing additional revenue sources by imposing astronomically high civil fines for the past several years.\textsuperscript{108} Table 5 shows the enormity of civil fines perpetuated by the Fair Trade Commission.

\begin{itemize}
\item \textsuperscript{102} Id. art. 421.
\item \textsuperscript{103} Id. art. 423.
\item \textsuperscript{104} Regarding the constitutionality of mandatory public apology, see Const. Ct., 89HUNMA160, Apr. 1, 1991 (holding the public announcement of illegal conduct and a sanction of mandatory apology are not unconstitutional).
\item \textsuperscript{105} Capital Markets Act, supra note 16, art. 420(3). FSC may be able to sign with the applicable financial institutions a confirmation about the improvement of situations or a memorandum of understanding to rectify the wrongs. Reg. A&S, supra note 97, arts. 20-22. In the case of financial institutions in default, FSC also has the authority to take a variety of measures, including a petition for bankruptcy pursuant to the Law on Restructuring of Financial Institutions. Id.; see also S. Ct., 2004DOO13219, Jul. 28, 2006 (denying the administrative proceeding about the legality of such petition).
\item \textsuperscript{106} Haengjungjulcha beob [Administrative Procedure Act], art. 3. Further procedural protections generally apply for those facing administrative sanctions. See Reg. Inv., supra note 97, art. 36 (requiring FSC to provide notice and an opportunity to be heard).
\item \textsuperscript{107} Hae-Shik Park, \textit{The Legal Character of Civil Penalties on Unlawful Assistance under MRFTA}, 8 K. COMP. L. STUDY 225, 231-32 (2002). This article uses the term “civil fine” to mean a severe penalty, while reserving “administrative fine” to refer to a sanction for minor misbehavior. “Civil fines” are different from “enforcement penalties,” which are monetary sanctions issued when an agency’s specific order to a violator is not followed.
\item \textsuperscript{108} Korea Fair Trade Commission (“KFTC”), \textit{Status Report to National Assembly}, 28 (Oct. 5, 2010). The amount of civil fines tends to increase rapidly except for during election periods. Id. For January
\end{itemize}
[TABLE 5] KOREA FAIR TRADE COMMISSION CIVIL FINES RECORD

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Amount Collected Through Civil Fines Imposed (KRW Million)</th>
<th>Number of Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>36,308</td>
<td>91</td>
</tr>
<tr>
<td>2005</td>
<td>259,063</td>
<td>274</td>
</tr>
<tr>
<td>2006</td>
<td>175,261</td>
<td>157</td>
</tr>
<tr>
<td>2007</td>
<td>423,398</td>
<td>326</td>
</tr>
<tr>
<td>2008</td>
<td>272,869</td>
<td>141</td>
</tr>
<tr>
<td>2009</td>
<td>371,035</td>
<td>78</td>
</tr>
<tr>
<td>Jan.-Aug. 2010</td>
<td>458,762</td>
<td>39</td>
</tr>
<tr>
<td>Total</td>
<td>1,996,696</td>
<td>1,106</td>
</tr>
</tbody>
</table>

Source: KFTC, Status Report to National Assembly, 28 (Oct. 5, 2010)

Civil fines are imposed in the case of almost every violation of the Monopoly Regulation and Fair Trade Act.109 Other government agencies, such as the Financial Services Commission and the Korea Communications Commission, have followed suit.110 Civil fines are sometimes offered as an alternative to the revocation of a business license or as levies on pollution.111 Civil fines have become a favored sanction under all administrative statutes.112

Strong criticism of and legal challenges against excessive civil fines have been unsuccessful.113 In reality, the economic effect of civil fines is the same as criminal fines, and it was a thorny issue whether procedural safeguards under the Korean Criminal Procedural Act should apply for civil fines.114 Legal challenges based on double jeopardy, due process, through August 2010, though the number of cases was less than the annual average, the total amount of civil fines far exceeded the total in 2009. Id. 109 See Monopoly Regulation and Fair Trade Act, Act No. 3320, Dec. 31, 1980, amended by Act No. 8635, Aug. 3, 2007, arts. 6, 17, 24(2), 28, 31(2). 110 See Press Release, FSC, Study on Civil Fines on Unfair Trade Practices in Capital Markets (Mar. 4, 2010). In addition to FSC, Korea Communications Commission (“KCC”) has frequently levied civil fines to telecommunications companies. See, e.g., Press Release, KCC, Civil Fines on Three Wireless Data Service Telcos, (Dec. 2, 2010). The amount of fines in this case was KRW 8.4 billion, id., which is modest compared to the huge sales revenues of the three oligopolistic telecommunications companies. 111 See, e.g., Water Quality and Ecosystem Preservation Act, Act No. 7459, Mar. 31, 2005, amended by Act No. 10615, art. 41. 112 Ba Young-Kil Bae, A Study on the Administrative Money Penalty System, 3 K. PUB. L. STUDY 241, 246 (2002). In 2001, 51 statutes had civil penalty clauses; as of Apr. 2002, the number of statutes was 75. Id. 113 The initial purpose was to deprive the violators of the illegal profits, but later fines were introduced as punitive sanctions. Sang Kook Han, Money Penalties for Tax Crimes, 76 FIN. FORUM 6, 12 (2003). As to the constitutionality of civil fines, see Const. Ct., 99HUNGA18, May 31, 2001, in which the Constitutional Court rejected a challenge to the constitutionality of civil fines. 114 Byung-Duck Chung, A Study on the Legal Characterization of the Penalty Surcharges in Monopoly Regulation and Fair Trade Act, 15 K. MGMT. L. EV. 465, 484 (2005). Another form of fine is
presumption of innocence, uncontrolled discretion, or the proportionality principle have been futile.115 Alternatively, other milder procedural control methods have been discussed, such as providing explanations of the reasoning behind decisions;116 refining the relevant market and violation periods;117 and implementing a two-factor formula assessing impact and materiality.118 These have been proposed and partially implemented by the Korea Fair Trade Commission.119 For now, any further protections for alleged violators are not de lege lata [the law as it exists], but de lege ferenda [the law as it should be].

Civil fines became part of the enforcement mechanism relating to financial services market crimes when the Securities and Exchanges Act and the Banking Act were revised in 2001120 and 2002,121 respectively.122 Civil fines for financial market crimes are tightly regulated compared to regulation under the Monopoly Regulation and Fair Trade Act; the illegal conduct subject to civil fines is restricted. Regarding capital markets, only certain violations are subject to civil fines; violations regarding related party transactions,123 registration statements,124 tender offer filings,125 and periodic

the enforcement penalty, a monetary sanction issued when an agency’s specific order to a violator is not followed. Since 1991, when the Construction Act introduced this system, it has spread to 21 other statutes by 2008, including adoption by the Banking Act. See Kwan Hoon Kwak, supra note 88, at 87.


117 Taehi Hwang, A Legal Study on Setting the Basic Amount of Surcharges in Relation to the Cartel, 50 SEOUL L.J. 401, 402 (2009).


121 Capital Markets Act, supra note 16, arts. 428(1), 428(34). Here, a civil fine is an alternative to suspension of business activities under Capital Markets Act, supra note 16, art. 420(2).

122 Id. arts. 429(1)(119), 429(1)(122)-(123).

123 Id. art. 429(2)(142).
disclosure. Only in a case involving malice or gross negligence will the context, degree, period, frequency, and unlawful gains be weighed in determining the amount of a fine. Relevant parties shall have the opportunity to present their opinions or materials. One may object to such an order within 30 days to the Financial Services Commission, in which case the Commission has up to 90 days for reexamination. The Financial Services Commission follows a similar procedure when implementing the Banking Act and the Insurance Business Act.

The civil fine procedures for financial market crimes leave a lot of room for improvement in terms of substance and procedure. Table 6 shows the overall schematics of civil fines, showing the violations subject to civil fines are inconsistent among banks, financial investment firms, and insurance companies. The differences in the nature of banking, insurance, and investment banking do not justify such an inconsistency and thus the situation should be rectified. In addition, the size of the penalties are inadequate considering their impact on an investor’s trust in capital markets, especially when compared to the size of fines under the Monopoly Regulation and Fair Trade Act. The fines should be increased so violators are paying more when they are fined. Finally, the prior notice and hearing procedure should be more formally regulated to ensure procedural safeguards are in place.

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126 Id. arts. 429(3)(159), 429(3)(160)-(161).
127 Id. art. 430.
128 Id. art. 431.
129 Id. art. 432.
130 See Banking Act, supra note 16, art. 65(5)-(6); Insurance Business Act, supra note 28, art. 196(4).
131 The fines and their methods of calculation vary greatly across the various financial services fields. See Reg. A&S, supra note 97; Reg. Inv., supra note 97.
132 Yong-Chan Lee, Monetary Sanctions on Financial Institutions in Korea: Problems and Proposals for Improvement, 9 CHOONGANG L. REV. 537, 557-64 (2007). Lee argues that the number of minor violations subject to administrative fines should be expanded, while civil penalties could be more restrained. Id. However, the misdeeds subject to civil fines seem to be serious enough to warrant steep financial penalties. Id. The real regulatory policy goal seems to be consistency among three business lines. Id.
**[Table 6] Civil Fines Under the Banking Act, Capital Markets Act, & Insurance Business Act**

<table>
<thead>
<tr>
<th>Grounds</th>
<th>Basis</th>
<th>Rates</th>
<th>Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Banks</strong></td>
<td>Loan limit to one entity, limit on equity investment, limit to large shareholders, limit on investment in large shareholder’s equity, limit on investment in real estate, etc.; influence by large shareholders (18 items)</td>
<td>Excess over limit</td>
<td>7/10-7/160 (5 step)</td>
</tr>
<tr>
<td><strong>Insurance Companies</strong></td>
<td>Kickback, limit on asset management, transaction with large shareholders (5 items)</td>
<td>Excess, kickback</td>
<td>Same (except kickback)</td>
</tr>
<tr>
<td><strong>Financial Investment</strong></td>
<td>Transaction with or investment in large shareholders, shareholders, investment in large shareholders, misrepresentation in registration statement, tender offer report, periodic or continuous disclosure</td>
<td>Excess, offer amount, daily trade volume</td>
<td>3/100 10/100 (disclosure)</td>
</tr>
</tbody>
</table>

Source: Banking Act, Capital Markets Act, and Insurance Business Act

In practice, fines have not been prevalent. For the first half of 2010, the Securities and Futures Commission filed 89 cases based on disclosure violations, among which only eight cases resulted in civil fines (totaling KRW 471 million). As for banks and insurance companies, the Financial Services Commission issued eleven civil fines in 2010, which ranged from KRW 23 million to 4.5 billion. The trend seems to be moving towards imposing civil fines more frequently. Nevertheless, the fines themselves are meager compared to the amount of civil fines imposed by the KFTC, as shown in Table 5, above. The basis amount should be the amount involved in the illegal transaction rather than the fixed amount stipulated in the rules.

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134 Information on Regulatory Reform Resolutions, SFC, http://www.fsc.go.kr/info/con_stcc_list.jsp?menu=7220200&bbsid=BBS0025 (last visited Apr. 9, 2011). Of the remaining cases, three resulted in criminal indictments, one in a recommendation of management termination, nine in administrative fines (minor fines of lesser quantity than the more serious “civil fines”), and the remaining sixty-eight in warnings. Id.

135 Sanctions Information, FSC, http://www.fsc.go.kr/info/con_sanc_list.jsp?menu=7220300&bbsid=BBS0122 (last visited Apr. 9, 2011). In 2010, 86 banks were warned while in 35 cases executives were reprimanded. Id.

Furthermore, the rates of fines should go up in order for the civil fines to work effectively as sanctions and deterrents.  

3. **Censure of Executives**

In addition to corporate responsibility—or as an alternative to it—executives can be held responsible on an individual level. The Financial Services Commission has the authority to directly issue censures to executives, while employees are subject to similar sanctions at the request of the Financial Services Commission to the firm. The censures include termination, suspension for up to six months, warning, reprimand, notice, and other miscellaneous measures. One possible censure for employees is reduction of compensation. As in the revocation of a business license, termination or a request for termination requires a hearing. The Financial Services Commission must maintain records of such censure, and the individual may file an objection with the Financial Services Commission.

Under the regulatory scheme, while the Financial Services Commission does not have direct authority over the executives or other employees of financial institutions, it nonetheless may request financial institutions take disadvantageous measures to remedy managerial mistakes. Therefore, it seems more desirable to have the shareholders of financial institutions consider the future of the incumbent management.

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137 But see J. Karpoff, D. Lee & G. Martin, *The Cost to Firms of Cooking the Books*, 43 J. FIN. & QUAN. ANA. 581-611 (2008) (arguing in the context of the United States that market-level enforcements such as the loss of market value when news of misconduct is reported can be more effective than civil fines).

138 Capital Markets Act, supra note 16, art. 422; Banking Act, supra note 16, art. 54.

139 As to the effect of termination, see Banking Act, supra note 16, art. 18(1)(9). See also Capital Markets Act, supra note 16, art. 24; Capital Markets Act E.D. supra note 48, art. 27. For five years, they cannot be officers of other financial institutions.

140 As to the challenge to the legality of warning, see S. Ct., 2003DOO14765, Feb. 17, 2005.


142 Capital Markets Act, supra note 16, art. 423.

143 Id. art. 424.

144 Id. art. 425.

145 Article 54 of the Banking Act, supra note 16, provides the following reasons for such an action: 1) officers fail to comply with Financial Services Commission orders; or 2) officers damage the sound management of banks. FSC may request the suspension of an officer, or recommend that dismissal be considered by shareholders. Id.
C. Private Enforcement

Although the regulatory agencies are primarily responsible for the protection of investors and efficient operation of the market system, they should be cautious not to be overly intrusive. With too much agency authority and responsibility, paternalistic protectionism could outgrow market-based management. Additionally, the regulatory agencies could not afford the financial cost of great supervisory responsibility. Consequently, private enforcement should be a pivotal component of the enforcement mechanisms.

1. Pre-Litigation Mechanisms

In disputes involving financial transactions, alternative dispute resolution fits the situation best because the judicial branch lacks expertise. Furthermore, solutions might have to come from collective remedial measures such as an establishment of funds. Prospective measures, such as revision of general terms and conditions, might be desirable. Rituals in court on a case-by-case basis do not always provide the best solution. Thus, using pre-litigation mechanisms is usually preferable, though this may depend on the situation.

Mediation is one such solution.\footnote{Sangsoo Kim, Financial Dispute and ADR: The Comparison between Korea and Japan, 7 K. J. FIN. L. 145, 165-67 (2010).} Although mediation is not binding, and thus of limited effect, the Financial Supervisory Services has a standing Dispute Resolution Committee.\footnote{Financial Services Commission Act, supra note 39, arts. 51-57.} The most troublesome issue is whether mediation is appropriate for a dispute, in light of the mandatory nature of financial regulations. For example, if a consumer argues about suitability or misrepresentation, whether it would be subject to mediation is not clear.\footnote{See Financial Services Commission Act, supra note 39, art. 53(1)(2) (providing for the option of rejection by the FSC).} In addition, there is a potential conflict as a regulatory agency might be partially responsible for a dispute. Nonetheless, the Financial Supervisory Services has been extremely successful and active in addressing consumer
disputes involving financial intermediaries in Korea. Thus, the Financial Supervisory Services has a plan to make mediation mandatory prior to litigation, and mediation unilaterally binding on the financial institutions. In addition to the Financial Supervisory Services, KRX operates the Market Audit Committee, which has dispute resolution functions. KOFIA also runs a dispute resolution center for its members.

Arbitration can be more effective than mediation, as arbitration decisions are binding. Unlike in the United States, however, most Korean contracts do not contain arbitration clauses in standard financial transaction documents. This might be partly due to the lack of expertise in arbitration at KRX and KOFIA. Even if we assume the relevant institutions do have the capability to arbitrate disputes, it remains unclear to what extent these disputes can be resolved by arbitration. For example, whether churning,

<table>
<thead>
<tr>
<th>Filed, 2009</th>
<th>Banks &amp; Consumer Fin.</th>
<th>Financial Investment</th>
<th>Life Ins.</th>
<th>Damage Ins.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>6,976</td>
<td>2,225</td>
<td>10,661</td>
<td>10,212</td>
</tr>
<tr>
<td>Mediation Acc’d, 2009</td>
<td>50.2%</td>
<td>37.1%</td>
<td>43.7%</td>
<td></td>
</tr>
<tr>
<td>Filed, 2008</td>
<td>5,200</td>
<td>1,163</td>
<td>7,393</td>
<td>7,269</td>
</tr>
<tr>
<td>Filed, 2007</td>
<td>2,020</td>
<td>561</td>
<td>7,603</td>
<td>6,895</td>
</tr>
<tr>
<td>Filed, 2006</td>
<td>2,154</td>
<td>470</td>
<td>8,681</td>
<td>7,084</td>
</tr>
<tr>
<td>Filed, 2005</td>
<td>3,861</td>
<td>424</td>
<td>7,631</td>
<td>6,766</td>
</tr>
</tbody>
</table>


Out of 28,988 cases filed with the FSS, 1,656 suits were filed with courts. 1,435 litigations were filed by financial institutions, not by consumers. Out of 1,656 suits, 478 cases were settled.

<table>
<thead>
<tr>
<th>Court cases</th>
<th>Banks, etc.</th>
<th>Financial Investment</th>
<th>Life Ins.</th>
<th>Damage Ins.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plaintiff FIG</td>
<td>82</td>
<td>56</td>
<td>161</td>
<td>1,357</td>
</tr>
<tr>
<td></td>
<td>30.5%</td>
<td>44.6%</td>
<td>73.3%</td>
<td>93.4%</td>
</tr>
</tbody>
</table>


See also Bill 1809789 proposed by Cong. MHCho, et al., on Nov. 3, 2010 to amend the Financial Services Commission Act. Art. 56 of the bill would require mediation before a suit is filed.

See Capital Markets Act, supra note 16, art. 405. More information is available at Market Oversight Committee, KRX, http://www.krx.co.kr/m11/m11_1/m11_1_5/m11_1_5_5/UHPKOR11001_05_05.html (last visited May 13, 2011).


See Cheol Han, Securities Arbitration as a Means of Securities Disputes Resolution, 22 K. COMM. L. STUDY 393 (2003).


unauthorized trading, or misrepresentation issues in violation of the Capital Markets Act should be arbitrated or not is unclear. Nonetheless, arbitration is a dispute resolution process with the potential to be more widely adopted in Korea.

2. Litigation for Compensatory Damages

In disputes with banks or insurance companies, account holders or insurance buyers can recover damages from the institutions if a breach of contract occurs. Likewise, dealers and brokers can compensate capital market investors with damages. For overtrading and unauthorized trading, Korean courts tend to allow such litigation liberally, although the amount of damages awarded is usually limited.

In cases of misrepresentation, insider trading, and unfair trading, the Capital Markets Act stipulates a private cause of action. Misrepresentation or omission of representation on material items in a registration statement would lead the issuers, directors, and advisors (such as accountants and underwriters) to be jointly and severally liable for damages. They are also responsible for damages due to misrepresentation or failure to represent major items in periodic and continuous disclosure documents. Anyone charged with insider trading is also liable for damages to investors who experienced loss in connection with the crime.

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159 E.g., Seoul High Court [Seoul High Ct.], 90NA21577, Jan. 23, 1991.
160 See generally KSLA, STUDY ON SUBSTANTIVE ASPECTS OF SECURITIES-RELATED DAMAGE CLAIMS (2003).
162 Seoul C. Dist. Ct., 2003KAHAP77160, May 19, 2005 (regarding the CPA firm of POSNIK); S. Ct., 97DA26555, Oct. 22, 1999 (regarding the CPA firm of Korea Steel Pipe).
163 Seoul District Court, 2000NA32740, Nov. 23, 2000 (regarding the underwriter of Hanil Securities); Seoul High Ct., 2000NA10828/10835, Jan. 9, 2001 (regarding the underwriter of Yent).
165 Capital Markets Act, supra note 16, art. 162; Securities and Exchanges Act, supra note 120, art. 186(5); S. Ct., 2002DA38521, Oct. 11, 2002 (regarding Daewoo Electronics).
166 Capital Markets Act, supra note 16, art. 174; Securities and Exchanges Act, supra note 120, arts. 14, 188(3); see Seoul High Ct., 94NA21162, Jun. 14, 1995 (limiting plaintiffs to contemporaneous
Any unfair trader, including one who has manipulated the market price, is also liable for the damages arising out of such trading.\textsuperscript{167}

3. \textit{Class Action}

After plenty of debate over the pros and cons of class action lawsuits,\textsuperscript{168} the Securities-Related Class Action Act (“Securities Class Action Act”) passed the National Assembly in 2004, becoming effective January 1, 2005.\textsuperscript{169} As for the listed companies, whose assets are less than KRW 2 trillion, it applies to actions after Jan. 1, 2007.\textsuperscript{170} Large listed companies also had a two-year reconciliation period.\textsuperscript{171} Though the Securities Class Action Act became fully effective on January 1, 2007, not a single class action had been filed until recently. On April 13, 2009, the first Korean class action suit was filed against Jinsung TEC for its failure to disclose loss from derivative trading in the first half of the year until it filed its third quarter report; the parties subsequently settled.\textsuperscript{172} Due in part to a lack of compensation for the class representative’s time and efforts, many expect the Securities Class Action Act to become a dead letter. Excessive filing is a phantom horror, as there have been only two suits filed.
It is proposed that limits on causes of action and legal representation under the Securities Class Action Act be abolished. Current causes of action are limited to misrepresentations in registration statement, misrepresentations in periodic or continuous disclosure documents, insider trading, and outside auditors’ liability. The current list of causes of action for class actions should be expanded more broadly so that any massive disputes such as product liability and other types of investor loss could be resolved by class action. In addition, the Securities Class Action Act limits legal representation on three cases for three years. The restriction on representation of plaintiffs in class actions should be immediately abolished.

IV. EX ANTE MEASURES

Korea should limit ex post facto measures on violators and utilize more ex ante measures because they are always less costly and more effective. Like infectious diseases, it is best to prevent legal disputes from occurring through preventive means. Accordingly, Korean law calls on financial institutions to take seemingly vigorous ex ante measures.

A. Compliance Officer

A compliance officer within a corporate organization is directly linked to corporate governance issues. Within the basic structure of financial institutions in Korea, the board has a “duty of care” to monitor business operations. For large financial investment companies, the board is

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173 Bill No. 1803630, which would delimit the restrictions on causes of action, is pending at the National Assembly. Alternatively, another proposed bill would expand the causes of action available to include product defects liability and other claims. See Bill No. 1801701.

174 Securities Class Action Act, supra note 169, art. 3.

175 For example, server computer downtime or disclosure of personal information by financial institutions can be considered. Farmers Coop & Hyundai Capital Facing Collective Action, SEOUL NEWS, Apr. 18, 2011, http://www.Seoul.co.kr.

176 Securities Class Action Act, supra note 169, art. 11(3).

177 The compliance concept was initially introduced into Korean law through the audit committee concept. Sang beop [Amendment Law] Act No. 6086, Dec. 31, 1999, art. 415(2).

178 For the most recent discussions about duty of oversight in the United States, see MICHAEL D. GREENBERG, RAND CENTER FOR CORPORATE ETHICS AND GOVERNANCE CONFERENCE PROCEEDINGS, DIRECTORS AS GUARDIANS OF COMPLIANCE AND ETHICS WITHIN THE CORPORATE CITADEL (2010).

179 If the asset is KRW1 million or more, it is a large financial institution regardless of whether its shares are floated or not. Capital Markets Act, supra note 16, art. 25; Capital Markets Act E.D., supra note 48;
required to have one-half or a majority of independent directors; three or more non-standing, outsider directors set up the director nomination committee and the audit committee, which are independent of the board. For smaller financial investment companies, a standing independent auditor is required. They are all subject to outside audits for accounting matters. Corporate governance of banks and insurance companies is the same as for large investment companies. Notwithstanding this panoply of gatekeepers, which is confusingly diverse, the compliance officer system was introduced to financial institutions in 2000 in the midst of the Asian financial crisis.

The board of financial institutions is required to nominate a compliance officer. His or her qualifications, such as work or research experience, must be excellent. To ensure independence, compliance officers are prohibited from engaging in other business activities. Compliance officers have the authority to request that management produce

Insurance Business Act, supra note 28, art. 15. As such, many life insurance companies are treated large even before their demutualization.

Capital Markets Act, supra note 16, art. 25. As for the qualification of outside directors, see id. art. 25(5).

Capital Markets Act, supra note 16, art. 25(2). One-half of the nomination committee must be outside directors. Id.

Capital Markets Act, supra note 16, art. 26. Two-thirds must be outside directors. Id. One member must have expertise in accounting. Id.

Capital Markets Act, supra note 16, art. 27. If the assets are less than KRW 100 billion, this requirement is waived. Id. art. 20. Thus, “smaller financial institutions” refers to companies with assets that are between KRW 100 billion and KRW 2 trillion. If the company has an audit committee, then a standing auditor is not required.

Chushikhoesae oebugamsae gwanhan beopyul [Act on External Audits of Stock Companies], Act No. 3297, Dec. 31, 1980, amended by Act No. 10303, May. 17, 2010, art. 2 [hereinafter External Audits Act]. Possessing assets of KRW 10 billion or more triggers an audit. Id. Outside audits must be done by certified accountants. Id.


Banking Act, supra note 16, art. 23-3; Capital Markets Act, supra note 16, art. 28; Insurance Business Act, supra note 28, art. 17. BYONG-JO MIN, ET AL., KOREA BANKING INSTITUTE, COMPLIANCE OFFICER, 207-225 (2009) (stating that internal education on compliance is conducted once or twice a year by most securities companies).

For example, qualifying factors for an insurance company’s compliance officer include: ten years of finance working experience; five years of finance working experience with a master’s degree; or five years of experience as a lawyer, certified public accountant, actuary or public official. Insurance Business Act, supra note 28, art. 17(4).

Id. art 17(5).
or submit information or documents, and are responsible for monitoring compliance in order to report to the audit committee or standing auditor.\textsuperscript{190}

Unfortunately, this inside gatekeeper does not appear to be functioning. The compliance officer system is still ineffective and perfunctory because the financial institutions are often managed by family members of the founder, not by professional managers.\textsuperscript{191} The only remaining option to rectify the situation is to have the nominating committee dominated by non-standing directors who are independent of the controlling shareholders.\textsuperscript{192} In the end, financial institutions should work for the benefit of the investors—the public.\textsuperscript{193}

B. Internal Control System

Another criterion for compliance is that financial institutions establish an internal control system as required. Along with the compliance officer, an internal control system was also introduced to financial institutions in 2000. Its coverage is extremely broad to include the following controls for investment banking businesses:\textsuperscript{194} i) division of business and organizational structure; ii) risk management guidelines for operation of proprietary and investor assets; iii) standard operation procedure manual; iv) establishment of efficient management information delivery system for decision making; v) verification procedure for compliance and counter-measure procedure on violations; vi) procedure and standards to prevent unfair trades, including transaction reports; vii) procedure setting up internal control standards; viii) appointment procedure of compliance officer; ix) cognizance and management of conflicts; x) compliance procedure on voting rights regarding collective assets or trust assets; and xi) selection of brokers and

\begin{footnotesize}
\begin{enumerate}
\item Id. art 17(6). Article 17(8) also provides incentives for businesses to have effective compliance programs, such as the waiver of audits, the shortening of audits, or the reduction of sanctions.
\item E.g., Jong-Mi Yoon, supra note 186.
\item Currently, the board has the authority to appoint the compliance officer. Insurance Business Act, supra note 28, art. 17(3).
\item If a company is operated by controlling shareholders, independent directors are desirable only for the protection of minority shareholders. Thus, one can argue that reliance on a director’s fiduciary duty (with breaches remedied through litigation) would be more effective. See HAL S. SCOTT, INTERNATIONAL FINANCE 88 (17th ed. 2010) (noting there is no systematic evidence that independent directors do a better job at protecting minority shareholder rights than non-independent directors).
\end{enumerate}
\end{footnotesize}
dealers for collective investment and trust assets. The Financial Supervisory Services, KOFIA, and Bank of Korea offer various standard forms and manuals.

In 2003, the Korean government expanded the mandatory internal accounting control system to the companies subject to outside auditing, which was modeled on Section 404 of the Sarbanes-Oxley Act of the United States. Such a system must include: 1) cognizance, measurement, classification, recording, and reports of accounting information; 2) control of errors in accounting information and a rectification method; 3) periodic checks and reconciliation of accounting information; 4) management of books and records, with controls against falsification, modification, or distortion; and 5) division of responsibility among management for the production and disclosure of accounting information. A company’s board is required to adopt the system, which is to be disclosed to the public investors. Under the system, the CEO shall designate one standing director as internal accounting system manager. The manager shall report to the audit committee or auditor annually on the company’s operational reality. The outside auditor for accounting matters is also required to report the status of the company to the board and attach its views to the annual audit report. The CEO and the officer for public disclosure matters are also required to certify that the company’s internal accounting control system complies with legal requirements. The Financial Supervisory Services provided guidelines for a standard practice of internal accounting

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199 See External Audits Act, supra note 184, art. 2(2). Companies with assets of less than KRW 100 billion are exempt.
201 Enforcement Decree of the Act on External Audits of Stock Companies, Presidential Decree No. 12939, Mar. 3, 1990, amended by Presidential Decree No. 2493, Nov. 15, 2010, art. 2(2) [hereinafter External Audits Act E.D.]. Article 2(2) lists additional items to be covered by such a system: establishment and amendment procedures; compliance procedures of management in producing and disclosing accounting information; counter measures in response to a CEO who orders the production or disclosure of false accounting information in violation of the system, and censure procedure for officers who violate the system.
202 Id. art. 2(3)(1).
203 Id. art. 2(3)(3).
204 External Audits Act, supra note 184, art. 2(3).
205 Id. art. 2(4).
206 Id. arts. 2-3.
control systems in 2005, and subsequently provided two commentaries in 2007.208

It is not clear whether this legal requirement of an internal control system has helped reduce the possibility of accounting fraud. As demonstrated by the fact that many accounting firms are still sanctioned by the Financial Services Commission for defective audits,209 this system does not appear to be airtight.210

C. Whistleblower Protection

The Capital Markets Act also has a special section for protection of whistleblowers. Anyone who has found unlawful conduct under the Capital Markets Act, including the unfair trades listed in Book 4,211 or who has been urged to violate the Capital Markets Act, may report such facts to the Financial Services Commission.212 The Financial Services Commission shall keep confidential the identity of the informer.213 The organization to which the informer belongs may not, directly or indirectly, discriminate against him or her.214 The informer, on the other hand, may be compensated by the Financial Services Commission up to KRW 100 million.215

In practice, however, compensation has never been paid out. Cases of unfair trading in capital markets involving inside informers seem to be extremely rare. The Financial Supervisory Services investigated 166 new cases during the third quarter of 2010, of which 48 cases were initiated by the Financial Supervisory Services and 157 cases were initiated by KRX. This is in stark contrast with the United States, where employees and the media report a substantial portion of instances of corporate fraud.216


209 FSC, REVIEW OF FY 2010 FINANCIAL STATEMENTS (Jan. 14, 2011). The sample review indicates more defective audits were noted in 2010 (38 of 217) than in 2009 (24 of 212). Id.


211 Capital Markets Act, supra note 16 (Book 4 addresses insider trading and unfair trading).

212 Capital Markets Act, supra note 16, art. 435; Capital Markets Act E.D., supra note 48, art. 384.

213 Id. art. 435(4).

214 Id. art. 435(5).


216 See I. J. Alexander Dyck, Adair Morse & Luigi Zingales, Who Blows the Whistle on Corporate Fraud, 38 (European Corporate Governance Institute, Working Paper 156/2007, 2007) (observing that in 216 reported fraud cases in large United States companies between 1996 and 2004, 34.3% of reports came
V. DISCUSSION

Discussion of theories of punishment, including expressivist—that is, the goal public condemnation—are beyond the scope of this article. However, it may be helpful to remember the unique characteristics of white-collar crime, including misconduct in the financial services market, as distinguished from non-financial crimes. As Darryl Brown has put it:

Corporate and white-collar crime prosecution differs from street crime prosecution because of its different mix of retributive and deterrence concerns, which leads corporate crime policy to take greater advantage of our knowledge of how social norms interact with law, of the social costs that accompany punishment, and of the alternatives to criminal law. . . . Our white-collar crime policy has a much better mix of regulatory strategies, civil remedies, and criminal sanctions.\textsuperscript{217}

The current financial services market in Korea is responsive to sanctions and deterrence. However, the focus of enforcement efforts should move toward civil and preventive aspects of the policy tools because, in part, the regulatory target is much more complicated than situations that may be reduced to guilty or not guilty verdicts.\textsuperscript{218} Furthermore, if criminal or administrative sanctions are imposed by less controlled, haphazard authorities, such sanctions become unpredictable. This has damaged and will continue to damage the legitimacy of the law.

A. Concern about Ineffective Sanctions and Due Process

The current Korean legal structure for regulating the financial services market has incorporated most of the major enforcement mechanisms adopted in both civil law and common law jurisdictions. It adopted criminal and administrative enforcement mechanisms administered by public authorities, which is a traditional approach in civil law jurisdictions. Private enforcement based on strict liability and class action, an approach utilized in

the United States, is also available. All the features of the Sarbanes-Oxley Act, including requirements for a board with outside independent directors, an independent audit committee, whistleblower protection, and certification of the CEO and disclosure officer, are also incorporated in Korean law.  

Although the current mechanism appears comprehensive and all-inclusive, the reality is far from the purported aim of such legislative moves. The current system is not entirely effective in addressing crimes in the financial services market. Violations of the laws seem significant across the board. The ongoing use of slush funds under borrowed names, stock price manipulation with corporate funds, and other unlawful behavior by business leaders demonstrates the disregard for the law among the top business executives. If top-notch business leaders behave this way, there is some indication that small and medium business managers can be much worse. The statistics illustrate the situation of continuously increasing cases and disputes.

More than a few corporations appear to have secret funds that are not recorded on their books, but instead concealed by false names; this practice is a violation of accounting rules. Most related party transactions between financial institutions and controlling shareholders or their affiliates are, for the purpose of managing the entrusted funds from their clients, subject to strict regulations—some are prohibited, some are to be approved of or reported. It seems that companies are not fully complying with these regulations. Loans in excess of legal limits have been made to affiliates, and entrusted funds are invested in-group affiliates. Requirements of initial and continuous public disclosure in a timely and accurate manner are not infrequently disregarded. Registration statements are not accurate and

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219 See supra Part IV. The one significant difference is that Korean law requires only one half of the board as independent for large listed or financial companies, while the Sarbanes-Oxley Act requires a majority of independent directors.
220 There seems to be no way to substantiate this observation with accurate statistical data. Refer to the continuous scandals involving the top business executives, supra notes 13-14.
221 See supra note 13 and accompanying text.
223 See, e.g., Press Release, FSC, Sanctions on Shinhan Bank for Violation of Real Name Financial Transactions System (Nov. 18, 2010).
224 See supra Table 6.
226 Reviewing the sanctions of the FSC, these violations appear to be most frequent.
periodic disclosure documents contain false or misleading information.\textsuperscript{228} Rumors are spread, and prices are manipulated.\textsuperscript{229}

Why do violations occur?\textsuperscript{230} It is true that some people will always commit crimes, as it is part of human nature. However, a truism is not a sufficient explanation for financial market crimes, as they are linked to the fundamentals of the economic system that allocates and mediates financial resources.\textsuperscript{231} There are many possible explanations for this phenomenon. Some argue that sanctions are not grave enough to deter potential violators. This is true of some violations,\textsuperscript{232} but not all.\textsuperscript{233} Others argue that violators easily avoid the loose network of investigations, and therefore the regulatory agencies should have broader investigatory authority.\textsuperscript{234}

This article argues that violations occur because the regulatory framework has not been accepted as establishing norms to be complied with by the players in the market. When regulatory powers are centralized in certain governmental agencies and their power is largely discretionary, one tends to believe that the rules can be made inapplicable if one has the power to influence the agencies. The public and the market players would not accept these kinds of rules as true norms that require observance. To enhance compliance, therefore, the rules of the game should be clear so that players can understand what is prohibited and what is allowed. Business people need to be educated about the rules to be observed, the odds of being caught, and the resulting severe hardship. In addition, incentives can be used to facilitate compliance when appropriate.\textsuperscript{235} Only when business

\textsuperscript{228} Press Releases, FSS, http://www.fss.or.kr/kr/nws/bodobbs_1.jsp?guben=01 (search for "disclosure violations"). One curious thing is why so few suits have been filed regarding Securities and Futures Commission sanctions.

\textsuperscript{229} E.g., Press Release, FSC, Sanctions on Unfair Trade Practices in Capital Market (Jan. 19, 2011) (announcing SFC resolutions on unfair trade practices from price manipulations to failure to report 5%). At least the number of violations discovered by the authorities has been increasing. See Securities and Unfair Trade Complaint Center, FSS, http://www.fss.or.kr/scop/main.jsp (last visited April 28, 2011) (providing statistics on unfair trade practices in the capital market).

\textsuperscript{230} See SECTION OF ANTITRUST LAW, ABA, ANTITRUST COMPLIANCE: PERSPECTIVES AND RESOURCES FOR CORPORATE COUNSELORS 29-36 (2005) (listing theories of criminal motivations: Genetics; Greed; Intent to Benefit the Employer; Ignorance; JanValjean Theory; Master of the Universe; Bad to the Bone; and Milgram Effect).

\textsuperscript{231} FSC thus recently adopted policy directions to liberalize regulations for small and medium growth companies and venture companies despite the possible insidious corruptions at KOSDAQ. See FSS, Development of KOSDAQ (Jan. 26, 2011).

\textsuperscript{232} See Criminal Act, supra note 87 and accompanying text.

\textsuperscript{233} Criminal sanctions for insider trading and price manipulation seem to be sometimes excessively harsh, especially the concept of price manipulation is not clear.


\textsuperscript{235} A lack of a feeling of guilt is one of the general characteristics of corporate crimes, LEE CHEON-HYUN, ET AL., K. INST. OF CRIMINOLOGY, ECONOMIC ACTIVITY AND CRIMINAL SANCTIONS OF CORPORATIONS 28-29 (2009), thus incentives may increase compliance.
people think they should play the game following the rules, can these rules become norms.

How can the Korean financial market become more advanced\textsuperscript{236} in the sense that all the players compete in accordance with the rules and any violators, if any, are found and punished? Modeling on every prevalent current foreign law is to chase a phantom. To improve the situation, the remedies should be coordinated and strategically focused, based on the particular business environment of Korea’s national economy. This article addresses two concerns about the current situation: 1) after-the-fact sanctions may not be workable anymore; and 2) procedural safeguards against less-controlled discretionary practices should be established. Solutions for these concerns are discussed in the following section.

\textbf{B. Proposed Strategic Approaches to Enhance Compliance}

This article proposes four strategic approaches to enhance compliance in the Korean financial service market. The first approach is to utilize incentives, including education. By offering incentives to implement preventive compliance programs, Korean regulatory agencies can improve the efficacy of the regulatory system. The preventive compliance programs should be intertwined with the enforcement mechanism. The other three approaches are to formulate clearer rules and to find the right balance among various enforcement tools—between private and public and between criminal and administrative. If too many different implementation measures and resources are devoted to stopping misconduct in the financial services market, this would lead to inefficient allocation of public capital. Specific enforcement structures should be designed for different types of financial crimes. Criminal sanctions should be limited to egregious violations and those in which damages are not easily calculated. Administrative sanctions are effective when immediate responses are desirable and criminal conviction is not easy. Private damage claims in the form of class action lawsuits should be more readily available to investors. In this way, government agencies and private players in the market will reach their own objectives and relative positions within specific timelines.

\textsuperscript{236} Many factors may be used to measure the financial market in a specific venue. The size of the market capitalization is an obvious choice. The number of IPOs by foreign corporations can be another tenet of competitive markets. Another measure is a review of market motivators, such as compliance costs and the resulting benefits of international financing, such as lower capital cost and bonding premium. Trustworthiness of the rules in the market is an important deciding factor. \textit{See} SCOTT, \textit{supra} note 193, at 48-55; COMMITTEE ON CAPITAL MARKET REGULATION, \textit{supra} note 80.
1. **Incentives of a Compliance Program**

As mentioned above, financial institutions are required to have a full-time compliance officer as well as internal control and accounting systems. However, failure to meet such requirements leads to sanctions while vigorous execution of the requirements leads to no rewards. Rewards, however, incentivize stricter compliance with *ex ante* measures and would ultimately lead to fewer violations. Such a compliance program should thus be considered in determining the legal liability of a company. If companies have implemented compliance programs, sanctions regarding a violation should be mitigated.

The Korean Court Organization Law was revised to require establishment of the Sentencing Commission on Apr. 27, 2007. The Sentencing Commission has vigorously built up the sentencing guidelines for several categories of crimes since then; by 2010, murder, bribery, sex crimes, embezzlement, and perjury were covered. In line with the Sentencing Commission’s efforts, the Korean Ministry of Justice has been discussing the standards for arrests. As the Sentencing Commission and the Ministry of Justice make progress in refining and expanding guidelines for arrest and sentencing, one factor to be considered is the compliance program of a corporate entity. As discussed above, a corporate entity cannot be held responsible for its employees or agents without a finding of negligence in its supervision and operation. Thus, compliance programs of a corporate entity must be reviewed in determining the existence of negligence on the corporate side. As civil fines on corporate entities also require a finding of negligence, the practice of a compliance program’s

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237 See *supra* Part IV.
238 For example, no dual liability has been recognized by courts because of the due diligence and care over management and supervision of its employees.
242 As of 2010, murder, bribery, sex crimes, burglary, embezzlement, perjury, and false accusations have been addressed.
244 See *supra* note 85 and accompanying text. It is not clear whether no negligence is a defense from the corporate side or whether negligence should be proved beyond reasonable doubt by the prosecutors. For an indication of similar options, see Kwan-Hoon Kwak, *The Study on the Prevention of Corporate Crime in Corporate Law*, 32 GANGWON L. REV. 163, 175-177 (2011).
requirements can operate as a defense.\textsuperscript{245} Depending on the level of in-house compliance programs, the prosecuting authority should consider deferring the prosecution.

Even once a corporate entity has been held responsible for the individual’s misconduct, compliance programs practice should be one of the factors the court considers when determining fines. The current regulations require the size of civil fines be determined in accordance with a formula that is more detailed than that which determines the size of criminal fines.\textsuperscript{246} The current regulations on unfair trading in the capital market provide for the possibility of a 20% reduction in fines if the financial institutions have operated consistent compliance programs.\textsuperscript{247} As such, as long as civil fines are concerned, compliance program practice offers a substantial incentive, although it is rarely applied. This incentive should be expanded to the effect that the sanction itself, or selection of a sanction, would be decided considering a company’s compliance program practice.\textsuperscript{248} Like the case for an anti-trust compliance program, the Financial Services Commission can consider grading the compliance program to grant appropriate benefits to the higher-level compliance programs.\textsuperscript{249}

In incentivizing compliance, education in corporate life should be credited and supported. Many contend that the driving force behind Korean economic development for the past several decades has been education.\textsuperscript{250} “Education” in Korea often means achieving higher individual scores on entrance exams at high schools and colleges. Education after graduation, however, is possible and desirable. Continuing education will contribute to

\textsuperscript{245} Some scholars argue that the prosecutor should have the burden of proof in such a case. See Andrew Weissmann, A New Approach to Corporate Criminal Liability, 44 AM. CRIM. L.REV. 1319, 1319-24 (2007).
\textsuperscript{246} Capital Markets Act, supra note 16, art. 430; Capital Markets Act E.D., supra note 48, art. 379; Reg. A&S, supra note 97.
\textsuperscript{247} Reg. A&S, supra note 97, schedule 2, item 5.C(4). Cooperation with the investigatory authorities also would be considered. Reg. A&S schedule 2, item 5.C(2) provides a 30% reduction for voluntary remedial measure while item 5.C(3) permits a 20% reduction in the case of voluntary reporting of violations. As to the leniency measures initiated from antitrust enforcement by the Korea Free Trade Commission (“KFTC”), see Leniency System Operation Announcement, KFTC Public Notice No. 2005-7, amended by KFTC Public No. 2009-46 (Aug. 20, 2009). However, not a single case has been found from FSC and SFC decisions on the amount of fines based on the compliance program. See supra notes 134-35.
\textsuperscript{248} See Regulations on Case Management, supra note 133 (providing that KFTC may waive ab initio investigation, depending on the level of compliance programs).
\textsuperscript{250} Yugui Guo, Asia’s Educational Edge: Current Achievements in Japan, Korea, Taiwan, China, and India 75-118 (2005).
higher collective achievements of social goals such as legal compliance. Education programs for compliance should be developed and utilized by corporations. It is true that KRX and KOFIA have been operating many seminars and education programs, and Korean law colleges and schools have done the same. However, not many compliance-related programs have been offered yet. By requiring corporate entities to run education programs about compliance, Korea should finally be able to become a respected member of the global corporate world.

2. **Clearer Rules**

Some argue that the principle-based regulation used in the United Kingdom provides a better alternative to the rules-based approach of the United States because the market always works better than regulations. Many believe the United Kingdom’s more principle-based system makes the financial market more competitive. The argument preferring one to the other is not convincing. Not only is the concept of principle-based regulation itself not clear, but law is always a combination of principles and rules. Without principles, the full meaning of rules is hard to grasp. Without detailed rules, the full significance of principles is difficult to enforce. They are not mutually exclusive; rather, they are complementary. Separating rules and principles would not help to frame the future regulatory framework for capital markets.

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251 For example, Yonsei Law School offers compliance seminars to its students.
253 As an *ex post facto* measure, the KFTC can request the firm get educated. See KFTC, Operating Manual on Corrective Measures, Nov. 1, 2005, amended on Aug. 12, 2009, art. VII.3(c).
254 For example, Professor Scott believes “[t]he United States clearly seems to be more enforcement-oriented, through the use of actions, than its capital market competitors, and this may be partially responsible for its loss of competitiveness.” *Scott*, supra note 193, at 156. He is also critical of the fact that the SEC as an agency is dominated by lawyers and that economists play a marginal role in the formulation of regulation or enforcement policy, suggesting the SEC use cost-benefit analysis in connection with its proposals. *Id.; see also* Edward Sherwin, *The Cost-Benefit Analysis of Financial Regulation: Lessons from the SEC’s Stalled Mutual Reform Effort*, 12 STAN. J. L. BUS. & FIN. 1 (2006); Luigi Zingales, *The Costs and Benefits of Financial Market Regulation* (European Corporate Governance Institute, Working Paper 21/2004, Apr. 2004) (supporting disclosure and whistleblower enforcement mechanisms as the least costly options).
In terms of relative weight, Korea needs more rules because too many rule-making functions have been delegated to the executive branch over the past several decades, in the name of efficiency. As Korea needs to make law based on political consensus and a more democratic process, the legislators need more training and time. Nonetheless, no policy or statute can be enforceable based on skeleton authorization from the legislative branch and enforcement from the executive branch. The statutes should be more focused on rules as a legitimate check to executive discretion. Unclear rules lead citizens to turn to political influence instead of trying to comply with rules, a dynamic that politicians and decision-makers seem to want to maintain. Korea needs rules that are more detailed, not more principles.257

One of the most persuasive arguments for broad executive authority in regards to the financial market is that the market is volatile and policy responses should be prompt. In terms of quantity, this might be true. However, there are many ways for regulatory agencies to respond to the market. Civil culture and legitimacy of law are the core values of compliance with law, and thus formulation of principles and rules should be reserved for the legislative branch. This is why the former Korean Ministry of Finance used to regulate the corporate finance of listed companies under the Securities and Exchanges Act before the Capital Markets Act entered into effect on February 4, 2009. After most sections were reassigned to the Korean Commercial Code,258 the Korean capital market functioned without any serious crises. The actual market situation over the past few years is a demonstration that rules can and should regulate the capital market.

Concerns over democratic legitimacy, however, are not necessarily of the utmost importance. More important is the inefficiency of the system stemming from the delegation of rulemaking to the executive branch. As Korean society is significantly diverse and complicated, unilateral rulemaking from the executive branch can no longer operate as a means of reaching consensus. It is true that legislative lawmaking competency could be improved. That, however, does not mean it is desirable that Korea statutes and rules should be formulated and processed interminably by the executive branch. As the National Assembly of Korea has been institutionalizing the Research Service and Budget Office259 to assist its legislative activities, it needs more work and responsibilities.

258 But see Capital Markets Act, supra note 16, arts. 165(2)-(18) (providing for listed companies).
3. **Balance between Public and Private Enforcement**

Public and private enforcement mechanisms have much room for improvement, and the right balance should be struck between the two enforcement avenues. The balance between *ex post facto* measures and *ex ante* programs should also be parsed. Under the Korean Constitution, public powers may intrude into private domains, including the self-sufficient market, for limited purposes and pursuant to specific processes and explicit authorization. Hence, public capital should be used according to the priorities of the model’s assumptions and maxims. Such expenditures, thus, are to be allocated depending on the severity of financial crimes and the efficacy of such spending, among other things. Such allocation is, in reality, the outcome of political process.

Figure 1, below, shows the overall enforcement mechanism and ensuing resource allocation depending on the severity of violations and efficacy of public spending. While the current flow of public resources in the diagram runs from left to right, this article argues the more desirable direction of the flow should be from right to left because the efficacy of diverse enforcement tools also runs from right to left.

![Diagram of Enforcement Mechanism and Resource Allocation](image)

The starting point for change is to provide opportunities for a remedy to private entities, except in cases of violations of moral principles.

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260 See supra Part III.

261 See infra Figure 1.

262 One may argue that all financial crimes are just from greed and thus not a violation of moral principles. However, certain crimes that are equivalent to fraud are related to moral principles, such as insider trading, addressed by the Capital Markets Act, supra note 16, art. 174.
Regardless of whether sanctions are from the court in response to the public prosecutor’s indictment, or from the Financial Services Commission as a result of its investigation, their basic aim is to impose hardship on the violators for their past misconduct, and thus to minimize future violations by the violator and others. Deterrence is one of the major reasons for sanctions. Even so, the deterrent effect has proved to be limited at best, and thus the basic approach to sanctions should be to minimize them. Misconduct in the financial market is not always frivolous, but in most cases it is technical (except fraud), making these kinds of violations more suitable for private entities to handle. On the other hand, criminal sanctions should be limited to the cases in which the social impact is enormous. In cases where the damages are not easily calculable, public sanctions should be taken more seriously.

One way to measure the balancing point between public and private enforcement mechanisms is cost-benefit analysis. The financial services industry in Korea accounted for 6.3% of the 2009 GDP. In terms of employment, it accounts for approximately 3.5% of the total employment. If official costs of enforcement are the sum of the Financial Services Commission and the Financial Supervisory Services budgets, they comprise 1.6% of the government spending. If official costs of enforcement, benchmarked to GDP, are calculated, about $47,000 per billion dollars of GDP were spent on regulatory costs for the financial services industry in 2010. If Korea Deposit Insurance Corporation’s budget and

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</table>

263 See supra note 15 and accompanying text.
264 See supra notes 67-68 and accompanying text; see also GAIL PEARSON, FINANCIAL SERVICES LAW AND COMPLIANCE IN AUSTRALIA 502 (2009) (“[C]riminal penalties are viewed by regulators as a matter of last resort, particularly as they take up significant resources and [the] criminal standard of culpability . . . is harder to prove.”).
266 The firms’ compliance costs also should be part of the total cost weighed against the benefits.
268 FSS is substantially financed by financial institutions’ contribution. See Financial Services Commission Act, supra note 39, art. 47. Official costs of enforcement, of course, can be expanded to include the budgets of both the Korea Deposit Insurance Corporation (“KDIC”), see infra note 269, and the
Korea Asset Management Corporation’s\textsuperscript{270} liabilities are counted as part of the enforcement costs, it would go up to almost $90,000 per billion dollars.\textsuperscript{271} Compared to the figures in the United Kingdom and the United States\textsuperscript{272} in terms of the ratio of the enforcement cost to the size of the financial market, Korea seems to be at high end. As such, private enforcement is the logical alternative to be encouraged.

This does not mean Korean public officials are corrupt, captured by the industry, or insufficiently trained. The argument for private enforcement does not stem from concerns about politically biased actions from public authorities. Korean bureaucracy seems to have been mostly competent and mostly apolitical. The argument also does not deny the possibility that private enforcement will be abused. It appears true in many cases that private enforcement actions are initiated on the back of factual records created by public authorities. Factual investigation and corresponding policy formation will remain largely with the public enforcement agencies. However, as the size and complexity of the Korean economy expands, the coverage of the bureaucracy should be decreased. Private enforcement mechanisms would be able to supplement public efforts proportionally as the financial services industry grows. Therefore, the right balancing point between public and private enforcement should move towards the private enforcement side.

More specifically, the current class action system would have to be liberalized to the effect that small investors may access legal representation in calling for compensatory damages.\textsuperscript{273} As discussed above, the Securities and Futures Commission ordered civil money penalties relating to ten cases of disclosure violations in the fiscal year of 2009-2010.\textsuperscript{274} Without the private enforcement possibility, however, the current scale of civil fines

\begin{footnotesize}
\begin{itemize}
\item For 2010, the annual budget of the KDIC was KRW 178 billion. Financial Status, KDIC, https://www.kdic.or.kr/introduce/estimate.jsp (last visited May 11, 2011). KDIC is similar to the Federal Deposit Insurance Corporation in the United States.
\item For 2009, the liability of KAMCO was KRW 2.45 trillion. Financial Statements, KAMCO, http://www.kamco.or.kr/home/man/04_03.jsp (last visited May 11, 2011). KAMCO handles all sorts of bad assets on behalf of diverse financial institutions.
\item One possibility is to expand the coverage of the Securities Class Action Act to breaches of the Capital Markets Act. Restrictions on legal representation also should be obviated.
\item FSS, Sanctions on Disclosure Violations, supra note 136 and accompanying text.
\end{itemize}
\end{footnotesize}
would not be a deterrent, considering the certainty of public enforcement. The most probable reason for the lack of private legal action seems to be limited access to legal remedies for small investors. Accessibility could also be improved by increasing the number of professional lawyers who are free from the captured interest of conglomerates, which dominate the economic scene in Korea. To reach critical mass for legal representation, especially for class action suits, attorneys should be readily available for all causes of action.

Many criticisms may be raised under the current mode of regulations in Korea. It may be true that some extra additional maneuvering by the government is possible. However, one cannot expect that government authorities can do everything. Furthermore, the government cannot be held responsible for everything. Except for certain types of misconduct in the financial services market where damages are not easily calculated, expansion of class actions appears to be the most realistic and least intrusive option to compensate mistreated investors.

4. **Balance between Criminal and Administrative Sanctions**

Based on the modern nation-state model, minimization of criminal conduct is the first principle. The second principle is that criminal penalties should be proportionate to the crimes. The third principle is that all powers should be institutionalized and systemized in order to be controllable. These are also the legal foundations of the mandate of government power, including prosecutorial authority. Even from a policy point of view, a prosecutor without principles has no legitimacy, and thus would quickly lose the confidence of the public. Without institutional trust from the public, no public agency could survive. If law enforcement institutions are ineffective, more crimes will occur.275 Fewer resources would then be available, which would in turn lead to more crimes.276 This is a typical vicious circle at institutional levels.

The financial services market plays a pivotal role of distributing limited financial resources within a society.277 It is a nerve center of the economic system. However, that does not mean violations in the financial

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275 See Raaj K. Sah, *Social Osmosis and Patterns of Crime*, 99 J. POL. ECON. 1272, 1280 (1991) (“An individual has a higher current propensity for crime if fewer resources were spent on the criminal apprehension system during a past period of his active life. Fewer resources dilute the resources spent on apprehending each criminal.”).

276 See id.

277 S. Ct., 2000DA9086, Mar. 15, 2002 (acknowledging special functions of banks, the Court directed that stricter fiduciary duty be imposed on management).
market should be penalized. Nor does it mean that corporate entities should be fined in addition to individuals. As explained above, though, the current situation is dreadful.\footnote{See supra Part III.A.} Every violation of the applicable laws involving the financial market is subject to severe criminal sanctions. Corporate entities are subject to dual penalties. Only the public prosecutor has the monopolistic power to file an indictment. No failed prosecution is checked by outsiders. Additionally, public prosecutors lack the investigatory expertise or instruments for financial market crimes. Thus, public prosecutors should narrow their jurisdiction over criminal conduct, which in turn would advance the efficiency of criminal sanctions.

The Ministry of Justice should revisit the scope of crimes under the foregoing tripartite statutes on financial markets. After narrowing the reach of criminal sanctions, the severity of the punishment should be increased so that it is measured proportionate to the crimes. Finally, the Ministry of Justice should develop a control mechanism to prevent illegitimate discretion. It should seriously consider developing guidelines and criteria to measure its discretionary power in writing.\footnote{See supra Part III.A.1.} Guidelines might have to be memorialized in writing as opposed to hierarchical approval procedures. The Internal Audit Committee and the Prosecution Citizens Committee should be more active.\footnote{See KOREA MINISTRY OF JUSTICE, 2011 BUSINESS PLAN 14, available at http://www.moj.go.kr.}

Compared to the Ministry of Justice, the Financial Services Commission has developed more detailed rules to calculate the amount of civil fines. To make them more effective, however, the amount of civil fines should increase substantially.\footnote{See supra note 104 and accompanying text.} The capital market cannot be developed by applying loose rules to the issuers of securities. Rather, the regulator’s policy goals should be to protect investors. In the case of price cartels, the fine is based on the gross sales revenue during the collusion. It is not limited to unusual gains from the collusion. Likewise, the size of a fine does not have to be capped at KRW 2 billion.\footnote{Capital Markets Act, supra note 16, art. 429 (lesser of sales or 2 billion for distribution in the primary market), 2 (lesser of 3/100 or 2 billion for tender offer) and 3 (lesser of 10/100 of daily trading or 2 billion); see also id. art. 428 (limiting 20/100 of the violated amounts).} To make administrative sanctions more certain, the Financial Services Commission should have extensive power to investigate the players in the market. The Financial Services Commission should develop formal procedures for hearings and other fact-gathering methods\footnote{Reg. Inv, supra note 97; Reg. A&S, supra note 97.} in order to fully develop due process. At the same
time, the procedural protection of individuals as well as firms should be clarified in writing. In sum, the balance between criminal and administrative sanctions should move towards administrative sanctions with due process safety mechanisms firmly in place.\textsuperscript{284}

VI. CONCLUSION

Phenomenally, Korea has built an industrial complex from green fields over the past several decades. The size of the financial market in Korea is already substantial,\textsuperscript{285} and it no longer stands alone, but is connected to international financial markets.\textsuperscript{286} The current enforcement system is full of gestures and postures, ultimately creating nothing but a facade. Enforcement mechanisms, however, should not only be part of the code, but also function within the system. Now Korea must develop the financial intermediaries and ensure the framework is efficiently constructed.

Korea’s regulatory framework should shift from backward-looking to forward-leaning. Threats of sanctions for past conduct are not a sufficient deterrent, and compliance should be considered to determine criminal and administrative liability. Education, which made Korean economic development possible, is a critical component to operate an effective compliance program. The magnitude of sanctions is not sufficient. The lack of certainty in sanctions cannot be ignored considering the size and interconnection of the financial services market in Korea. The rules must become clearer.

Discussion about the most desirable regulatory structures for the financial services market in Korea is important. Two increasingly important topics are how to establish an effective regulatory scheme and how to maximize efficacy and procedural and distributive justice within the system. By adopting the systemic and comprehensive approaches proposed in this article, Korea can formulate more enticing mechanisms to encourage market players to implement best practices as part of their business practices.

\textsuperscript{284} For the same line of arguments in the United States, see Geraldine Szott Moohr, \textit{The Balance Among Corporate Criminal Liability, Private Civil Suits, and Regulatory Enforcement}, 46 \textit{Am. Crim. L. Rev.} 1459 (2009).

\textsuperscript{285} See supra Table 1.

\textsuperscript{286} See \textit{Distribution of Shareholding by Owner}, KRX, http://www.krx.co.kr/m2/m2_5/m2_5_6/m2_5_6_2/JHPKOR02005_06_02.jsp (showing foreign investors’ ownership ratio for the past several years in terms of market price).

<table>
<thead>
<tr>
<th>Year</th>
<th>Ownership Ratio</th>
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<tbody>
<tr>
<td>2009</td>
<td>30.44%</td>
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<tr>
<td>2008</td>
<td>27.25%</td>
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<tr>
<td>2007</td>
<td>30.94%</td>
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<tr>
<td>2006</td>
<td>35.16%</td>
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