

## **RULES ON OVERHEATED SHORT SALE ISSUES TO BE AMENDED**

The FSC and Korea Exchange (KRX) announced a plan to amend regulations regarding overheated short sale issues, which came into force on March 27, 2017,<sup>1</sup> in a bid to better detect overheated short sales and toughen penalties on violations of short-selling rules.

For the past four months since the rules on designation of overheated short-selling stocks were introduced in March, KRX suspended trading of “overheated short-selling stocks” five times on the KOSPI market and six times on the KOSDAQ market.

However, it has been pointed out that the criteria for designation of overheated short-sale issues are too narrow to verify more short sales deemed overheated<sup>2</sup>; and penalties for violations of short sale rules are too lenient to be effective.

### **PROPOSED AMENDMENTS**

#### **I. AMENDING CRITERIA FOR DESIGNATING “OVERHEATED SHORT-SELLING ISSUES”**

##### **1. Key changes**

Currently, short-sale issues are designated as “overheated issues” when:

- (i) short-selling value of a trading day accounts for 20% or more(KOSPI) and 15% or more(KOSDAQ) of total trading value of the day;
- (ii) the proportion of short sales value of the day increases 100% or more, compared to the average of the 40 trading days; *and*
- (iii) the stock price falls 5% or more, compared to the closing price of the previous day.

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<sup>1</sup> Please refer to KRX's notice dated March 3, 2017 [Upcoming Changes] Amendments of Enforcement Rules of Stock Markets

<sup>2</sup> An “overheated short sale issue” was detected for every 13.8 trading days on the KOSDAQ market and 16.6 trading days on the KOSPI market, which fell short of expected frequency of detection: 6.6 trading days on the KOSPI and 8.2 days on the KOSDAQ.

The criteria will be amended to detect overheated short sale issues in a bull market and adjusted periodically depending on market situations.

- (i) The “proportion of short-selling” criterion<sup>3</sup> will be lowered from the current 20% to **18% (KOSPI)**; and from 15% to **12% (KOSDAQ)** out of total trading value of the day.

\* The criterion will not be applicable to issues whose price experiences a sharp drop of more than 10%; or KOSDAQ-listed issues whose proportion of short sales of a trading day accounts for more than 5% of the average of the preceding 40 days.

- (ii) The “*increase rate of short-selling value*” will replace the criterion of “increase rate of short selling proportion”

\* Short sale issues are designated as “overheated issues” if short-selling value increased more than six folds(KOSPI) and five folds(KOSDAQ), compared to the average of the preceding 40 trading days.

### <Proposed Amendments>

Criterion	As is	To be		
Price fall	more than 5%	5 – 10%	more than 10%	-
Proportion of short selling* <i>* short-selling value of a trading day/ total trading value of the day</i>	KOSPI: 20% KOSDAQ: 15%	KOSPI: 18% KOSDAQ: 12%	-	KOSDAQ-listed issues whose proportion of short sales accounts for more than 5% of the average of the preceding 40 days.
Increase rate	the proportion of short selling of a trading day increased more than two folds, compared to the average of the 40 trading days	Increase rate of short sale trading value compared to the average of the previous 40 trading days: - KOSPI: six folds - KOSDAQ: five folds		

## 2. Implementation schedule

Amended regulations on designating overheated short sale issues will go into force from *the end of September, 2017* after amending KRX rules.

<sup>3</sup> The criterion will be adjusted every quarter to be set to three folds the proportion of short sale during the preceding quarter. The upper limit will be capped at 20%.

## II. STRENGTHENING PENALTIES FOR VIOLATION OF SHORT SALE REGULATIONS

### 1. Key amendments

Currently, fines for violating short sale rules range from KRW 30 million to 50 million, depending on (i) whether **violation was committed intentionally or negligently**; and whether **a consequence of such violation is major, moderate or minor**. For example, those who committed a violation out of negligence face a penalty of KRW 7.5 million to 15 million depending on the gravity of consequence.

#### <Modifications to penalty rates>

<As is>

Conse- quence		Motivation	
		Intentional	Negligence
	Major	100%	75%
	Moderate	75%	50%
	Minor	50%	25%

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<To be>

	Motivation		
	Intentional	Major negligence	Minor negligence
	100%	90%	75%
	90%	75%	50%
	75%	50%	25%

Negligence will be subdivided into ‘minor’ and ‘major’ negligence, and penalty rates will be charged differentially according to the gravity of violation. If a trader committed a violation out of ‘major negligence’, he or she will be levied with heftier fines from KRW 45 million to 54 million, depending on the gravity of consequence. Continuous and repeated violation will be deemed as ‘major’ negligence and levied with heavier fines no matter it was intended or not.

If a violation of quotation rules is detected, the consequence of such act will be regarded as ‘moderate’ or ‘major’ even if the violation did not result in a price fall.

Penalties of multiple short sale violations will be charged separately even if the short-selling agent or reason for short-selling is the same. For example, if a fund manager mistakenly made naked short-selling of two issues, such act is regarded as **one ‘minor’ violation out of ‘negligence’**, subject to a fine of KRW 75 million under the current regulation. However, under the amended rules such act will be regarded as two separate violations out of ‘major negligence’ so that the person will face a heftier fine of KRW 60 million to KRW 108 million, depending on the severity of consequence.

Unfair trading activities using short-selling will be subject to an additional penalty. If a trader engages in short-selling using undisclosed information or for the purpose of price manipulation, the person will face an additional fine of up to 50% of the original penalty.

\* Such act of violation is punished concurrently with a criminal punishment for conducting unfair transactions (imprisonment of 10 years or less, or fine ranging from two to five folds the margin)

## **2. Implementation schedule**

Rule changes regarding stricter penalties will take effect in the fourth quarter of 2017 after FSC amends relevant regulations.

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