

SFC IMPOSES PENALTY SURCHARGE ON VIOLATION OF SHORT SELLING REGULATION FOR FIRST TIME

The Securities and Futures Commission (SFC), a sub-commission of the FSC responsible for the oversight of the securities and futures market, reached a decision on March 8 to impose penalty surcharges of KRW3.87 billion and KRW2.18 billion on “company A” and “company B,” respectively, for their naked short selling activities, which violate the regulations on short sales prescribed in Article 180(1) of the Financial Investment Services and Capital Markets Act (FSCMA). Previously, illegal short selling activities were handled with administrative fine or caution. This is the first instance where authorities are imposing penalty surcharge on entities who committed those activities.

While closely cooperating with relevant institutions, authorities will continue to maintain effective market monitoring, detection and investigation system on violation of regulations against short sales, and continue to strictly penalize illegal activities.

<Key Details about Penalty Surcharge & Criminal Punishment on Illegal Short Sale Activities>¹

(Background) It was pointed out that imposing just an administrative fine of up to KRW100 million on an illegal short selling activity such as naked short selling is not effective as a sanction and that it remains weak in terms of preventive effect.

(Revision Details) The revised FSCMA created a penalty surcharge on short selling rule breakers, which retrieve their unfairly gained profits, and makes those rule breakers subject to criminal punishment such as imprisonment and monetary penalty (fine).

- Penalty surcharge: Within the amount of illegal short orders placed.
- Criminal punishment: Imprisonment of minimum one year or monetary penalty (fine) of at least three times and up to five times the amount of unfairly gained profits or avoided losses (which is the severest level of punishment available under the current FSCMA).

SUMMARY OF VIOLATION AND DETAILS OF DISCUSSION

- a) “Company A” had recorded on its internal system some amount of ◇◇◇ stocks that are expected to be issued through a capital increase without consideration before they are actually issued, in order to assess the value of its funds. Then, perceiving the stock as those can be sold, the company submitted sell orders on 210,744 ordinary shares (KRW25.14 billion) of ◇◇◇, which the fund had no ownership of, within a certain period in 2021. This was in violation of the regulation that prohibits naked short selling.

¹ Revised FSCMA went into effect in April 2021. Please click [here](#) to see the press release dated March 30, 2021.

b) “Company B” had erroneously entered the information of the borrowed △△▽ stocks, the name of which is similar to that of △△△ stocks, into its balance management system. Then, based on this overstated balance, the company submitted sell orders on 27,374 ordinary shares (KRW7.329 billion) of △△▽ stocks (which the company actually had no ownership of) on a certain day in 2021. This was in violation of the regulation that prohibits naked short selling.

As this is the first instance of issuing penalty surcharge on illegal short selling activities, authorities held in-depth discussions on the reasonable level of sanctions several times through the meetings of both the Committee for Deliberation of Investigations of Capital Markets (a consultative body of the SFC) and the SFC. After comprehensively considering various factors such as the details and motive of the violators and their impact on the market, authorities reached the decision on strict and effective sanctions that are in conformity of the purpose of the revised FSCMA.

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