

RULE CHANGES PROPOSED TO BRING ABOUT IMPROVEMENTS TO THE CONVERTIBLE BOND MARKET

- Proposed rule changes include (a) strengthening information disclosure on the issuance and circulation of convertible bonds (CBs) to boost market transparency and (b) upgrading rules and procedure on refixing convertible prices of CBs to make them more reasonable.
 - After a revision process, the rule changes will go into effect in the third quarter of this year.
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The Financial Services Commission issued a preliminary notice of proposed rule changes regarding the issuance and disclosure of securities, which will be open for public comment from May 28 until June 11, 2024. The proposed rule changes deal with strengthening disclosure requirements on the issuance and circulation of convertible bonds (CBs), including bonds with warrants and (redeemable) convertible preference shares, and upgrading the rules and procedure on refixing convertible prices of CBs to make them more reasonable.

First, the revised regulation will strengthen disclosure requirements on the issuance and circulation of CBs. Under the current regulation, when issuing CBs, companies are required to disclose information about the entity who shall exercise the call option. However, in most cases, companies provide only a vague statement of “company or company-designated entity” in their disclosure filing, which makes it difficult for investors to clearly understand about the entity exercising the call option. To improve upon this situation and to help increase predictability for investors, the proposed rule change will require companies to file material information disclosures when designating an entity for exercising the call option or if the right to exercise the call option has been transferred to a third-party.

In addition, the practice of converting CBs into stocks after acquiring CBs close to their maturities and reselling them to the largest shareholder has been identified as a concern for unfair trading activities in capital markets. Although the practice of reselling CBs prior to their maturities is in essence similar to issuing new CBs, there has been lack of sufficient information being provided in the market thus far. Therefore, to address this problem, the proposed rule change will require companies to file material information disclosures when acquiring CBs close to their maturities with detailed information, such as reason for acquisition, plans for writing off or reselling, and so on.

Second, the revised regulation will upgrade the rules and procedure on refixing convertible prices of CBs to make them more reasonable. Current rules set the minimum level of refixing at 70 percent of the initial convertible price and allow companies to refix convertible prices below the minimum level only in exceptional cases via securing a special resolution at a general shareholders’ meeting or through changes in their articles of incorporation. However, there have been cases where companies often resort to their articles of incorporation to refix convertible prices below the minimum required level even for non-exceptional purposes. Therefore, the

proposed rule change will allow companies to refix convertible prices below 70 percent of the initial convertible price only by securing a special resolution at a general shareholders' meeting.

Moreover, there have been cases of excessive downward adjustment of convertible prices following a capital increase or stock dividend, since under these circumstances, companies are allowed to more easily decide to adjust convertible prices only through board decisions. To address this problem, the proposed rule change will make it clear that a downward adjustment of a convertible price following any change in capital status, such as a capital increase or stock dividend, will only be allowed above the value reflecting such event.

In addition, for privately offered CBs, the proposed rule change makes it clear that the reference date for calculating convertible prices will be based on the date when payments are actually made to ensure that their convertible prices sufficiently and fairly reflect market prices right before their issuance.

The proposed rule changes have been prepared after having a series of meetings with academia, market experts, industry groups, and related authorities. With these changes in place, the FSC expects that investor confidence will be boosted in the convertible bond market and companies will be able to raise funds using convertible bonds in a more prudent manner.

The revision proposal will be open for public comment between May 28 and June 11, 2024. After a regulatory review process and an approval from the FSC, the revised rules will take effect in the third quarter of this year.

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