

FSC PROPOSES RULE CHANGES TO UPGRADE REGULATIONS ON TREASURY STOCKS OF LISTED COMPANIES

- The proposed rule changes will (a) restrict allocation of new shares to treasury stocks when companies spin-off their business units, (b) strengthen disclosure duties on the acquisition, holding, and disposal of treasury stocks, and (c) close loopholes and remove regulatory arbitrage.
 - After a revision process, the proposed rule changes are expected to take effect in the third quarter of this year.
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The Financial Services Commission issued a preliminary notice of proposed rule changes concerning treasury stocks of listed companies on June 3. This proposal is a follow-up to the previously introduced plan to upgrade rules on treasury stocks of listed companies, which was unveiled on January 30 this year. The reform proposal will bring about changes to the Enforcement Decree of the Financial Investment Services and Capital Markets Act (FSCMA) and its subordinate regulations on the issuance and disclosure of securities, and it will be available for public comment from June 4 to July 16. The proposed rule changes are intended to (a) restrict allocation of new shares to treasury stocks when companies spin-off business units (also in mergers and acquisitions), (b) strengthen disclosure duties throughout the course of acquiring, holding, and disposing treasury stocks, and (c) close loopholes and remove regulatory arbitrage in the process of acquiring and disposing treasury stocks.

First, allocating new shares to treasury stocks will be prohibited when companies spin-off their business units, which will help to better protect the rights and interests of general shareholders. When it comes to treasury stocks, currently, almost all shareholders' rights, such as voting rights, dividend rights, and preemptive rights, are non-exercisable. However, due to the lack of clarity in statutory provision and court precedents, there have been cases where new shares were allocated in corporate spin-offs. This strategy was often used by companies to bolster control of largest shareholders, instead of making use of treasury stocks to boost shareholder value, which has been pointed out as a problem. Moreover, this has remained inconsistent from the perspective of global regulatory standards. Therefore, the Enforcement Decree of the FSCMA will be revised to restrict allocation of new shares to treasury stocks in corporate spin-offs of listed companies.

Second, disclosure duties on treasury stocks will be strengthened. Although the information on what companies plan to do with their treasury stocks after acquiring them can have significant effects on their stock price movements, there has been insufficient disclosure of information about this. To improve upon this situation, the Enforcement Decree of the FSCMA will be revised to require listed companies (when the proportion of their treasury stock holding is 5 percent or more of the total volume of stocks issued) to prepare reports on their treasury stock holding status, purpose of

holding, and future plan (additional acquisition or write-off) and get approval from their boards of directors. The subordinate regulation will be revised to require listed companies to attach this report when filing their business reports. In addition, the proposed revision to the subordinate regulation requires listed companies to disclose detailed information when disposing treasury stocks, such as the purpose of disposal, information about the counterparty, and expected effects on stock price. This will help to boost market function of surveillance and checks and balance on the practice of arbitrary disposal of treasury stocks.

Third, relevant upgrades will be made in regulations to close loopholes and remove regulatory arbitrage. Under the current system, less strict rules are applied when companies acquire treasury stocks via trust, instead of acquiring them directly. Thus, there exists the potential for companies to take advantage of this loophole. Moreover, when treasury stocks are acquired via trust, disposal of treasury stocks is not subject to the disclosure duty during the trust agreement period, which presents a loophole for investor protection. To improve upon this situation, the proposed revision to the subordinate regulation will apply the same standards when companies acquire treasury stocks via trust as in the case with direct acquisition. When the volume of treasury stocks being acquired is less than the initially planned or announced amount, companies will need to submit an explanatory statement, while entering into a new trust agreement will be prohibited until one month after the end of the scheduled treasury stock acquisition period. In addition, during the trust agreement period, even when disposal of treasury stocks is being carried out indirectly, companies will be required to submit reports detailing the purpose of disposal, information about the counterparty, and expected effects on stock price in their material information disclosures.

The proposed rule changes have been prepared after having a series of meetings and discussions with private sector experts, industry associations, and related authorities. With these measures in place, the FSC expects that companies will be encouraged to make use of treasury stocks for the purpose of increasing shareholder value.

The revision proposals for the Enforcement Decree of the FSCMA and the regulation on the issuance and disclosure of securities will be open for public comment from June 4 to July 16. After a legislative review process, the revised rules will take effect within this year.

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