

## MEASURES TO IMPROVE STOCK TRADING SYSTEM

### **BACKGROUND**

The FSC announced measures to improve the safety of stock trading system, aiming to prevent a repeat of last month's 'fat finger' incident at Samsung Securities. The incident exposed systemic flaws in internal and external controls that had failed to detect and correct such an error at an earlier stage. It took 37 minutes for the securities firm to halt trading of the mistakenly issued stocks even after it recognized the error. It took almost an hour for the company to withdraw such stocks from trading accounts. Against this backdrop, the measures are intended to introduce multilayered verification systems covering the entire process of stock trading in order to minimize the likelihood of an incident from any error or mistake.

### **MEASURES TO BE TAKEN**

#### **1. CONTROLS IN STOCK TRADING SYSTEM**

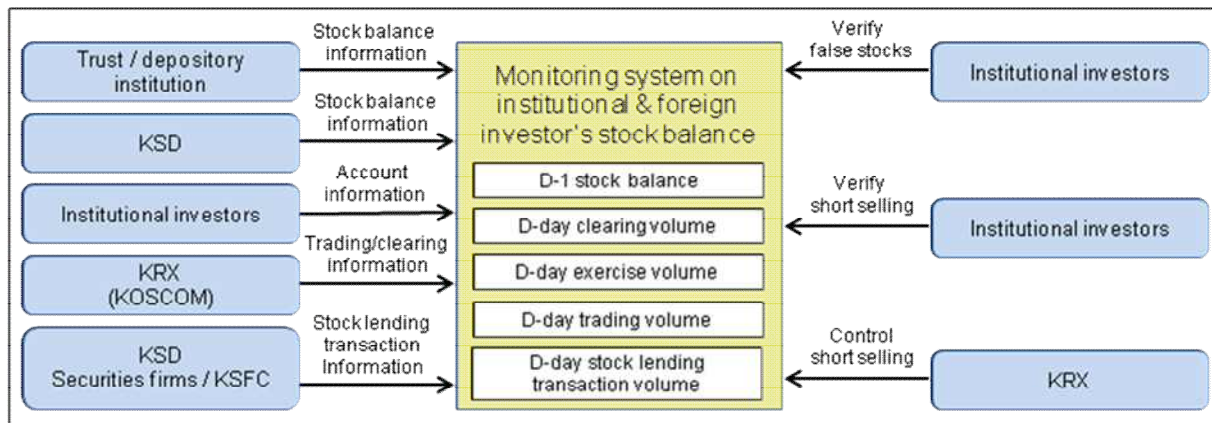
- Securities firms will tighten internal controls over stocks coming in and out of trading accounts and cross-check with the KSD. The value and volume of stocks per deposit or withdrawal will be capped – e.g. 5% of total outstanding shares, KRW 6 billion – to prevent any possible error if the process involves manual tasks.
- Before market opens for trade, securities firms will be required to verify on a daily basis whether its total balance of stocks equals the sum of stock holdings by investors. Currently, securities firms check on their total balance of stocks only, making it difficult to identify errors in each investor's stock holdings in a timely manner.



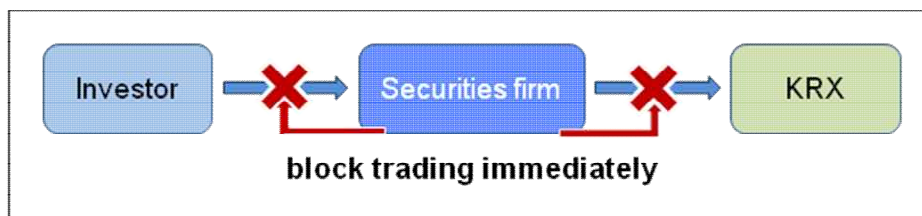
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Samsung Securities made a mistake of typing "shares" instead of "won" when paying dividends to its 2,018 employees on April 6 under a stock ownership plan, resulting in the issuance of 2.8 billion non-existing stocks.

- Securities firms, the KRX and the KSD will jointly establish a monitoring system that will enable real-time tracking of changes in balance of stocks and trading volume. The monitoring system will help them identify erroneous trades or naked short sales in real time.



- Securities firms will be required to introduce an “emergency button” system that would immediately halt erroneous trades by their employees, once an incident occurs.



- To prevent market shocks from massive trading orders, the KRX will lower the threshold for activating rejection of orders, currently triggered with an order exceeding 5% of listed stocks.

## 2. DIVIDEND PAYMENT PROCESS UNDER STOCK OWNERSHIP PLAN

- Securities firms will be required to divide their dividend payment process into two separate systems: one for cash dividend and the other for stock dividend
- Securities firms will be required to use banks' electronic system to pay cash dividend in order to avoid any possible confusion between 'cash' and 'stock' in the first place.

## 3. SHORT SELLING RULES

Although the incident of Samsung Securities itself was not directly related to short sales, it caused concerns about how the mistakenly issues stocks that did not actually exist could be traded on the market, prompting a public petition calling for a ban on short selling. Short selling is a commonly used trading strategy that allows an investor to sell borrowed shares. While such practice could be used for unfair trading

activities using insider information, it also has positive functions such as helping price discovery for stocks and mitigating market volatility. Against the backdrop, the FSC will toughen supervision and penalties on violations of short-selling rules, instead of a blanket ban on short sales.

- To provide more opportunities for retail investors, the FSC will expand the type and amount of stocks that retail investors can borrow for short selling.
- Using the new real-time monitoring system, the FSC will tighten monitoring on violations of short-selling rules. Irregular transactions such as massive “sell” orders exceeding outstanding stocks will be reported to the KRX in real time for inspection, if such trades are deemed to have violated short-selling rules.
- Penalties for breaches of short-selling rules, currently fines from KRW60 million to KRW100 million, will be toughened – e.g. criminal punishment and punitive fines on undue profits.

### **IMPLEMENTATION SCHEDULE**

<b><i>what</i></b>	<b><i>when</i></b>	<b><i>by whom</i></b>
<b>&lt;Internal and External Controls in Stock Trading System&gt;</b>		
- stricter internal controls by securities firms	3Q 2018	KOFIA, KSD
- verification system for stock holdings by investors	1Q 2019	KOFIA, KSD, KOSCOM
- real-time monitoring system	1H 2019	KOSCOM, KSD, KRX
- “emergency button” system	3Q 2018	KOFIA
- lowering threshold for triggering order limits	3Q 2018	KRX
<b>&lt;Dividend Payouts under Stock Ownership Plan&gt;</b>		
- overhauling dividend payment systems	3Q 2018	KOFIA, KSFC
<b>&lt; Short Selling Rules&gt;</b>		
- lowering barriers to retail investors	2H 2018	KSFC
- real-time monitoring	1H 2019	KOSCOM, KSD, KRX
- tougher penalties	2H 2018~ ※ FSC plans to propose a draft bill to revise the Financial Investment Services and Capital Markets Act by the end of 2018	FSC, KRX

\* KOFIA (Korea Financial Investment Association)

\* KSFC (Korea Securities Finance Corp.)

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