

EX-ANTE DISCLOSURE RULE TO BE INTRODUCED FOR INSIDER TRANSACTIONS

The FSC announced a plan to introduce an ex-ante disclosure for stock transactions by company insiders (board members or principal shareholders) which have been subject to only the ex-post disclosure rule thus far. Insiders of listed companies who plan to sell or purchase shares issued by his/her own company within a given year will need to disclose the purpose, price and volume of trading as well as expected trading period at least 30 days before the expected trading date. For nondisclosure, disclosure of false information or failure to comply with the trading plan, authorities will prepare effective compliance measures depending on the severity of violation such as a criminal penalty, fine, administrative action, etc. Introducing ex-ante disclosure is expected to enhance information transparency and market predictability regarding insider stock trading, thereby helping to ease market volatility. Since this measure is a closely anticipated policy task of the new administration, the financial authorities will make efforts to promptly prepare and submit a revision proposal of the Capital Markets Act to the National Assembly.

BACKGROUND

Large-scale stock offloading by insiders such as board members of listed firms, etc. causing abrupt fall in stock prices has continued to present a source of discontent for investors and a concern for the society.¹ Some ordinary investors suspect that company insiders—who have the ease of access to undisclosed company information—have been using that information to pocket personal profits while ordinary investors are burdened with losses. Faced with this problem, the FSC has strengthened safeguards for ordinary investors by improving the rule in March this year to restrict stock sales for six months (a lock-up period) from the time of company being listed even for shares that have been acquired by exercising stock option. However, this measure alone cannot regulate sales of stocks by insiders after the lock-up period (six months) and that it is limited in its capacity to make available sufficient information about insider stock transactions—which can have a significant impact on stock prices—to ordinary investors. In the meantime, the U.S. has had a system in place that requires a submission of stock trading plan prior to insider trading in order to prevent unfair transactions using undisclosed company information and protect investors. Recently, there has been an expanded policy effort to bolster this system in order to improve transparency in insider transactions.

¹ e.g. Immediate sales of stocks—which have been acquired via exercising stock option—causing a fall in stock prices.

(AS OF NOW) U.S. Securities and Exchange Commission grants an exemption for sanctions on the use of undisclosed material information when company insiders have prepared and submitted stock trading plan in advance. (← Used as a ground for defense by company insiders)

(KEY POINT OF REGULATORY IMPROVEMENT SOUGHT AFTER) Policy effort being made to prevent abuse of the system by requiring a considerable period (120 days or more) between the time of submitting a stock trading plan and the actual trading date in order for the plan to be recognized as valid.

The government has included the introduction of an ex-ante disclosure rule as one of the key policy tasks of the new administration for restoring fairness and trust in the capital markets, and as such, the authorities have prepared a detailed plan after commissioning a study, engaging in policy seminar and meeting with experts.²

CURRENT SITUATION AND PROBLEM

I. UNFAIR TRANSACTIONS BASED ON THE USE OF UNDISCLOSED MATERIAL INFORMATION

An analysis of 274 cases of unfair transactions handled by the Securities and Futures Commission (SFC) over a five-year period (2017-2021) revealed that the use of undisclosed material information was most prevalent (43.4%) with 119 cases.

<SFC's Handling of Unfair Transaction Cases (2017-2021)>

Type of violation	3 most prevalent types of violation			Disturbing market order	Total
	Use of undisclosed information	Price manipulation	Fraudulent and illegal transaction		
# of cases	119	64	81	10	274
Prevalence	43.4%	23.4%	29.6%	3.6%	100.0%

※ When multiple types of violation were found in a single case, they were counted in the order of fraudulent and illegal transaction, price manipulation, use of undisclosed information and disturbing market order.

II. REGULATION ON INSIDER TRADING

In order to prevent the use of undisclosed material information by insiders such as board members and principal shareholders of listed companies, the Capital Markets Act stipulates (a) direct regulation (ban on the use of undisclosed material information) and (b) ex-post regulation simultaneously. In essence, the ban on the use of undisclosed material information prohibits the act of using inside information for stock sales or purchase or for use by other persons. Aside from this measure, the rule on returning short-term trading profit and the ex-post disclosure rule regulate the use of undisclosed information by company insiders.³

However, currently there exist no rules to preemptively or preventively regulate or oversee insider trading by company board members or principal shareholders. With only the ex-post disclosure requirement and sanctions, there are limits to effectively

² A research on regulatory measures on insider transactions commissioned to Seoul National University (May-Jul 2022), a policy seminar on strengthening investor protections in stock markets attended by FSC Vice Chairman (Jun 17, 2022) and a meeting with capital market experts chaired by FSC Vice Chairman (Jul 26, 2022)

³ (a) Rule on returning short term trading profit: A trading profit made within 6 months by an employee or principal shareholder should be returned to the company.
(b) Ex-post disclosure rule: A disclosure is required within 5 business days when a change in shareholding status occurs with a board member or principal shareholder.

preventing illegitimate acts committed by company insiders such as the use of undisclosed material information. Moreover, there continues to be a problem of critical information about changes in insider shareholding status—which can have a significant impact on stock prices—not being made available to ordinary investors in a timely manner.

IMPROVEMENT MEASURES

I. GENERAL DIRECTION

The current ex-post disclosure system will be expanded to ex-ante plus ex-post disclosures (requiring a revision to the Capital Markets Act). Company insiders (board members and principal shareholders) of exchange-listed firms will be required to disclose their company stock trading plan at least 30 days prior to the expected date of trade.

II. SPECIFIC MEASURES

- a) EX-ANTE DISCLOSURE:** An ex-ante disclosure duty will be imposed on insiders (board members and principal shareholders) of exchange-listed companies to allow opening up of their share trading plans to general investors.
- **(PERSONS SUBJECT TO DISCLOSURE)** Board members⁴ and principal shareholders⁵ of exchange-listed companies (same as the ex-post disclosure system)
 - **(DISCLOSURE OF STOCK TRADING PLAN)** A stock trading plan needs to be disclosed when a sales of 1% or more of stocks⁶ issued by the company in a given year is planned or when the sales volume amounts to KRW5 billion or more.
 - **(DISCLOSURE CONTENT)** The stock trading (sales or purchase) plan needs to be disclosed in specific terms with purpose of trading, expected trading price and volume, expected trading period, etc.⁷

<Ex-ante Disclosure Content (Example)>

(PRICE) Sales or purchase is possible at around market price (maximum $\pm 5\%$ from the closing price in the previous day) during the trading period.

(VOLUME) Disclosure of a targeted trade volume is needed, but sales or purchase within a certain level (maximum $\pm 30\%$) of the targeted trade volume is possible.

(EXPECTED TRADING PERIOD) Sales or purchase can be completed within 10 business days from the expected date of trade to help avoid heavy concentration of transactions on a particular day.

- **(DISCLOSURE DEADLINE)** Those subject to the ex-ante disclosure requirement will need to disclose their stock trading plan at least 30 days before the expected trading date. (It is expected to have the effect equivalent to banning trading for 30 days.)

⁴ Director, auditor and de facto director (someone who is actually accountable for business management, etc.)

⁵ Someone holding 10% or more of voting shares, or someone who can influence important management decisions such as appointment or dismissal of board members, etc.

⁶ Includes equity stocks (including preferred stocks), convertible bonds, bonds with warrants, relevant depository receipts, etc.

※ Total transaction amount is calculated from one year prior to the expected sales date to prevent evasion of regulation through stock splits, etc.

⁷ Grant some flexibility on the actual trading price and volume and the actual date of trade to allow flexibility in responding to market situations thereafter.

- b) EXEMPTIONS:** Stock trading that is deemed to have no potential linkage to the use of undisclosed material information or expected to cause no significant shock to the market will be exempted from the ex-ante disclosure duty.
- **(TRADING DUE TO EXTERNAL FACTORS)** Changes in shareholding status caused by outside factors and the types of stock trading⁸ for which an ex-ante disclosure can be difficult will be exempted from the ex-ante disclosure duty (but still subject to ex-post disclosures).
 - **(CHANGE OR WITHDRAWAL)** A change or withdrawal is prohibited in principle and will be recognized in limited cases only for unavoidable circumstances⁹ prescribed by the law.
- c) ENSURING EFFECTIVENESS:** Authorities will ensure strict compliance with the ex-ante disclosure obligation.
- **(OVERSIGHT)** Those subject to ex-ante disclosure will need to submit their stock trading plans to the Financial Supervisory Service, and the FSS will check compliance after trading has taken place through details of ex-post disclosures.
 - **(SANCTION)** For nondisclosure, disclosure of false information or failure to comply with the trading plan, authorities will prepare effective compliance measures depending on the severity of violation such as a criminal penalty, fine, administrative action, etc.

EXPECTATION

It is expected that the measures will prevent in advance company insiders from taking advantage of undisclosed material information while helping to ease market volatility. The enhanced level of information transparency regarding stock transactions by insiders can avert potential use of undisclosed material information by insiders. Providing a period of minimum 30 days prior to insider transactions taking place will grant more predictability which will help to cushion shock in the market caused by a temporary supply outflow.

FURTHER PLAN

Since this measure is a closely anticipated policy task of the new administration, the financial authorities will make efforts to promptly prepare and submit a revision proposal of the Capital Markets Act to the National Assembly within this year. Authorities are also closely reviewing detailed plans of other policy tasks regarding investor protection and prevention of unfair transactions and plan to announce them consecutively within this year—measures to diversify sanctions mechanisms on unfair transaction activities in capital markets (expected in Sep-Oct) and measures to protect retail investors when management change takes place following an M&A through stock acquisition (expected in Oct-Nov).

#

For press inquiry, please contact Foreign Media Relations at fsc_media@korea.kr.

⁸ Inheritance, stock dividend, M&A through stock acquisition, etc.

⁹ Death, dissolution, bankruptcy, insolvency, expecting excessive loss due to increased market volatility, etc. (Specific cases for exemption will be decided through revision to the subordinate regulation including the Enforcement Decree.)