

## MEASURES TO STRENGTHEN CAPACITY TO RESPOND TO UNFAIR TRADE PRACTICES IN CAPITAL MARKETS

The FSC proposed new measures to improve the effectiveness of penalties on unfair trade practices in capital markets. The measures include (a) a ban on new transaction and account opening for investment products and (b) disbarment from serving as a board member of listed companies up to 10 years. These measures will help prevent flagrant and repeated unfair trade practices and establish a sound capital market order. Authorities will propose a revision bill of the Financial Investment Services and Capital Markets Act (FSCMA) and propel its passage at the National Assembly.

In addition, the FSC will make efforts to pass another FSCMA revision bill to provide calculating method for unfair profits acquired by unlawful trades and to introduce penalty surcharges.

### **BACKGROUND**

In capital markets, unfair trade practices increasingly take diverse and complex forms. However, the measures to punish, block and prevent them remain somewhat ineffective. In particular, unfair trades on material nonpublic information by board members of listed companies (who in fact should have a high degree of integrity) happen frequently and recidivism by those who previously committed unfair trades proliferates. The majority of ordinary investors suffer financial losses and trust in our capital markets is damaged.

In May 2022, the new administration announced “improving the effectiveness of penalties on unfair trade practices” as one of 120 national policy tasks to restore fairness and trust in capital markets. Then, the government has prepared detailed plans through policy seminars and expert meetings.

### **CURRENT SITUATION AND PROBLEMS**

**(OVERVIEW OF UNFAIR TRADE PRACTICE CASES)** In recent five years (2017-2021), the number of unfair trade practice cases handled by the Securities and Futures Commission (SFC) was 274 in total, which translates into 54.8 cases annually.

In terms of violation type, use of material nonpublic information was most prevalent (43.4%), followed by unfair trading (29.6%), market price manipulation (23.4%) and

market disturbance (3.6%).

<Unfair Trade Practice Cases Handled by SFC in 5 Years (2017-2021) >

Type of violation	3 most prevalent types			Market disturbance	Total
	Use of material nonpublic info	Market price manipulation	Unfair trading		
# of cases (%)	119 (43.4%)	64 (23.4%)	81 (29.6%)	10 (3.6%)	274 (100%)

※ When multiple types of violation were found in a single case, the types of violation was recorded in the order of unfair trading, market price manipulation, use of material nonpublic information and market disturbance.

For the types of action taken by the SFC, the most prevalent (93.6%) was reporting and notifying to the investigative authority without any administrative measure. This is mainly due to the current penalty framework where three types of unfair trade practices (use of material nonpublic information, market price manipulation and unfair trading) make up most cases and they are mainly punished with criminal penalties (imprisonment, fine, etc.).

<Unfair Trade Practice Cases Handled by SFC in 5 Years (2017-2021) and Actions Taken by SFC>

Type of violation	3 most prevalent types (use of material nonpublic info, market price manipulation and unfair trading)		Market disturbance	Total
Action	Report and notify to investigative authority	Report and notify to investigative authority + administrative action*	Administrative action (imposing penalty surcharge)	
# of violators	1,006	22	47	1,075
Proportion (%)	93.6%	2.0%	4.4%	100.0%

\* Sanctions on financial investment business (suspension of duty, request for dismissal from position, warning, etc.), imposition of penalty surcharge, etc.

**(PROBLEM WITH PENALTIES)** The lack of expeditious and flexible penalty mechanism for unfair trade practice cases makes it difficult to penalize violators effectively and collect unfairly gained profits. Getting a court decision usually takes a long time (average 2-3 years), and until then, violators can trade freely in capital markets. Thus, there is a problem of losing timeliness of penalties. In addition, due to strict burden of proof required for criminal penalties, the rate of indictment and severity of penalties remain low. And the lack of diverse administrative penalties that may help constrain violations fuels the problem of recidivism.<sup>1</sup>

※ Most major economies such as the U.S., U.K., Hong Kong and Canada actively utilize various administrative penalties such as trade restrictions in capital markets, prohibition on listed company's board appointment, etc.

Lastly, as illegal activities like unfair trade practices are motivated by economic gain, penalties to deprive unfairly gained profits can be effective regulatory measures. However, the absence of legal ground for penalty surcharge on three most prevalent types of unfair trade practices and calculating method to assess unfairly gained profits makes it difficult for authorities to collect unfairly gained profits.

<sup>1</sup> # of recidivists for 3 most prevalent violation types (based on actions taken by the SFC): 17 out of 110 (15.4%) in 2019, 28 out of 98 (28.5%) in 2020, 21 out of 99 (21.2%) in 2021

## **KEY RESPONSE MEASURES**

### **I. POLICY DIRECTION**

The kinds of penalties will be diversified to significantly improve response capacity to root out unfair trade practices that may harm many investors and damage market credibility (→ through revision of the FSCMA). To be specific, authorities will introduce a ban for a certain period (up to 10 years) on (a) new transactions and account opening for investment products and (b) debarment from serving as a board member of listed companies for entities engaged in unfair trade practices. Moreover, authorities will continue to make efforts to pass the revision bills that provide a legal ground for the method of calculating unfairly gained profits on illegal transactions and introduce a penalty surcharge rule currently pending at the National Assembly.

### **II. INTRODUCING TRADE RESTRICTION IN CAPITAL MARKETS**

**(ENTITIES SUBJECT TO TRADE RESTRICTION)** The SFC may designate violators of unfair trading rules specified in the FSCMA (e.g. three major violation types) as the entities subject to trade restriction.

**(SCOPE OF TRADE RESTRICTION)** The entities subject to trade restriction will be prohibited from engaging in new transactions and account opening for financial investment products (securities and derivatives). The term “transaction” in this regard means either direct or indirect trading of financial investment products knowingly engaged by an entity subject to trade restriction. However, transaction will be allowed in exceptional cases such as when a transaction unavoidably has to take place for fulfilling a previously signed contract, or when there is a low possibility of unfair trade practices or a transaction is carried out due to external factors.

**(TRADE RESTRICTION PERIOD)** Within maximum 10 years, the SFC decides the period of trade restriction for each case after considering the nature, severity, period, frequency of violations.

**(PROTECTING RIGHTS AND INTERESTS OF ENTITIES BARRED FROM TRADING)** Entities that are subject to trade restriction will get notified in advance and have an opportunity to present opinions at the SFC’s deliberation stage, and if dissatisfied with the SFC’s designation, they can file an objection. Moreover, if the SFC determines that its actions were illegitimate or unfair upon a court decision of not guilty or due to erroneous evidence, the SFC may reconsider the case and cancel or mitigate its actions (reconsideration process may commence upon motion by the entity or the SFC’s decision).

**(ENSURING EFFECTIVENESS)** Financial authorities may publicly announce the information of designated entities subject to trade restriction (personal information, type of violation, trade restriction period, etc.) on the website. Also, in a case that a designated entity continues to engage in transactions in spite of trade restriction

imposed, authorities will be able to impose a fine on both the entity and the financial institutions that allowed his or her transactions.

### **III. INTRODUCING RESTRICTION FOR BOARD APPOINTMENT AT LISTED COMPANIES**

**(ENTITIES SUBJECT TO BOARD APPOINTMENT RESTRICTION)** The SFC may designate perpetrators of unfair trade practices under the FSCMA as the entities subject to board appointment restriction.

**(SCOPE OF BOARD APPOINTMENT RESTRICTION)** The entities subject to board appointment restriction will be barred from being appointed as a board member of a listed company or a financial institution, and if already serving as a board member, he or she will lose the position. The term “board member” refers to a member of board of directors, an auditor and a virtual head of the company who is actually in charge of management.

**(PERIOD OF BOARD APPOINTMENT RESTRICTION)** Within maximum 10 years, the SFC may decide the period of board appointment restriction for each case as in trade restriction cases.

**(PROTECTING RIGHTS AND INTERESTS OF ENTITIES BARRED FROM BOARD APPOINTMENT)** As in trade restriction cases, the entities subject to board appointment restriction will get notified in advance, be entitled to submit comment and file an objection and reconsideration.

**(ENSURING EFFECTIVENESS)** Financial authorities may publicly announce the information of designated entities subject to board appointment restriction on the website as in trade restriction cases. Also, if a listed company appoints a designated entity as a board member, authorities will be able to impose a fine on both the designated entity and the listed company that hires the entity.

### **VI. INTRODUCING LEGAL GROUND FOR CALCULATING UNFAIRLY GAINED PROFITS AND IMPOSING PENALTY SURCHARGE**

Currently, there are revision bills of the FSCMA pending at the National Assembly which aim to introduce a legal ground for the method of calculating unfairly gained profits and allow imposition of penalty surcharge to enable more effective collection of unfairly gained profits from unfair trade practices. Authorities will actively support discussions at the National Assembly to pass these bills promptly.

#### **ANTICIPATED EFFECT**

With these measures in place, it is expected that the authorities will respond to increasingly diverse and complex nature of unfair trade practices in a more timely and flexible manner. Then, they can prevent unfair trade practice cases in advance and collect unfairly gained profits more effectively. Ultimately, the measures will help to establish a more credible environment for investment in capital markets.

## **FURTHER PLAN**

Authorities plan to propose a revision bill of the FSCMA within this year that contains measures to restrict trading in capital markets and serving as a board member at a listed company for those engaged in unfair trade practices. Moreover, authorities will continue to make efforts to pass the bill that provides a legal ground for the method of calculating unfairly gained profits from illegal trades and introduces penalty surcharges.

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